



## Reforming India's Financial Watchdogs

This editorial is based on [“Needed: A road map to regulate the regulators”](#) which was published in Hindustan Times on 04/11/2024. The article highlights the growing scrutiny of India's financial regulators, emphasizing the urgent need for a balance between regulatory autonomy and accountability. Strengthening oversight mechanisms is now essential.

**For Prelims:** [India's financial regulators](#), [Securities and Exchange Board of India](#), [Reserve Bank of India](#), [Insurance Regulatory and Development Authority of India](#), [Pension Fund Regulatory and Development Authority](#), [Gross non-performing assets](#), [National Pension System](#), [Paytm Payments Bank](#), [Digital lending](#), [Central bank digital currency](#), [SEBI's push for T+0 settlement cycle](#).

**For Mains:** Key Financial Regulatory Bodies in India, Current Accountability Concerns Raised at India's Financial Regulators.

[India's financial regulators](#) are facing unprecedented scrutiny, with [Securities and Exchange Board of India \(SEBI\)](#) **under spotlight for its handling of the Adani case** and [Reserve Bank of India \(RBI\)](#) **drawing criticism for its approach to fintech firms versus traditional banks**. As stakes rise in India's financial markets, the delicate balance between **regulatory autonomy and accountability** becomes increasingly crucial. History shows that effective regulation requires both **independence and oversight**. The time has come for India to strengthen its regulatory accountability mechanism,

### What are the Key Financial Regulatory Bodies in India?

- **Reserve Bank of India (RBI):** Primary banking and monetary authority established in 1934, serving as India's central bank with extensive regulatory powers.
  - The RBI majorly regulates **all scheduled commercial banks, NBFCs and foreign exchange markets**.
- **Securities and Exchange Board of India (SEBI):** Established in 1992 to regulate securities markets and protect investor interests.
  - Oversees **stock exchanges, mutual funds, and other market intermediaries**.
    - SEBI regulates two major stock exchanges (NSE and BSE).
- [Insurance Regulatory and Development Authority of India \(IRDAI\)](#): Created in 1999 to regulate and develop the insurance sector.
  - Supervises life insurance companies, general insurance companies, and specialized insurers.
  - India's insurance premium volume stands at **USD 131 billion as of 2022 (Life - 77%, Non-Life - 23%)**.
- [Pension Fund Regulatory and Development Authority \(PFRDA\)](#): Established in 2003 to regulate pension products and promote old-age income security.
  - Manages the [National Pension System \(NPS\)](#) with **over 6.62 crore subscribers**.

## What is the Role of RBI and SEBI in Ensuring Regulatory Oversight and Market Stability in India?

- **Preventing Systemic Risk:** The cornerstone of India's financial regulatory framework rests on the twin pillars of RBI and SEBI's coordinated efforts to **maintain market stability and prevent systemic risks**.
  - Through sophisticated surveillance systems, both regulators continuously monitor their respective domains - **RBI focusing on banking sector health through stress tests and capital adequacy norms**, while SEBI oversees market integrity through **circuit breakers and real-time monitoring**.
  - This was notably demonstrated in **SEBI's recent directive related to F&O** that requires option buyers to pay the premium upfront, rather than at the end of the trading day.
    - This change lowers default risks and strengthens market integrity by ensuring full payment commitment when orders are placed.
  - Also, RBI's tightened approach has maintained banking sector stability with [Gross non-performing assets \(GNPAs\)](#) for banks are forecasted to drop to a **decade-low of 2.5% in FY25**, while ensuring orderly markets despite global volatilities.
- **Consumer Protection and Transparency:** Consumer protection stands as a central mandate for both regulators, implemented through **comprehensive frameworks** that safeguard retail investors and banking customers.
  - For instance, **SEBI has prohibited online bond platforms from offering unlisted debt securities** and unregulated products via subsidiaries, under rule 51A.
    - This aims to **safeguard investors** by limiting exposure to unlisted and potentially high-risk products.
- Also, **RBI** introduced comprehensive guidelines in **September 2022** to regulate the rapidly growing [digital lending landscape](#)
- Also, the regulators' consumer-centric approach was particularly visible in high-profile cases - **RBI's decisive action against [Paytm Payments Bank](#) for compliance violations** and **SEBI's mutual fund Categorization and Rationalization to enhance investor clarity**.
- **Technology Adoption and Innovation:** The modernization of India's financial sector has been driven by both regulators' progressive approach toward technology adoption while maintaining security standards.
  - RBI's successful [Central bank digital currency](#) pilot reaching **1 million daily transactions** complements [SEBI's push for T+0 settlement cycle](#), putting India ahead of many developed markets.
- **Corporate Governance and Compliance:** Both regulators have established stringent oversight mechanisms that create a comprehensive governance framework for regulated entities.
  - [SEBI's LODR \(Listing Obligations and Disclosure Requirements\)](#) requirements work in tandem with [RBI's Prompt Corrective Action \(PCA\)](#) framework which is a key tool to monitor the financial health of banks
  - The implementation of enhanced **ESG reporting requirements across major listed entities** has positioned India at the forefront of sustainable finance.

## What are the Current Accountability Concerns Raised at India's Financial Regulators?

- **Transparency in Decision-making:** The lack of public disclosure **regarding regulatory consultations and decision-making processes** raises significant accountability concerns.
  - For instance, **RBI has repeatedly warned against cryptocurrency investments**, calling them a threat to financial stability, yet there has been **limited transparency on its long-term regulatory approach**.
  - SEBI has also faced criticism for insufficient stakeholder engagement particularly evident in the **recent [Adani-Hinderburg investigation](#)**.
- **Conflict of Interest Management:** The current framework for managing conflicts of interest within regulatory bodies shows concerning gaps.
  - **SEBI chairperson's recent conflict of interest allegations** highlight systemic weaknesses.
  - The **absence of a cooling-off period for senior regulatory officials** entering private

sector roles creates potential compromises.

- **Parliamentary Oversight Deficits:** The limited parliamentary supervision of regulatory bodies has created an accountability vacuum.
  - Despite the [Second Administrative Reforms Commission's 2009 recommendations](#), regular parliamentary committee reviews remain inconsistent and inadequate.
  - The [Public Accounts Committee](#) has recently decided to review the performance of regulatory bodies established by Parliamentary Acts.
    - However, significant gaps remain in continuous oversight and accountability.
- **Staff Accountability and Internal Governance:** Internal accountability mechanisms within regulatory bodies show significant weaknesses, **particularly in staff performance evaluation and decision-making processes.**
  - **September 2024's staff protests at SEBI HQ** and **October 2024's alleged dissent within RBI's Monetary Policy Committee** highlight governance challenges.
- **Delay in Enforcement Actions:** The significant time lag between violation detection and enforcement action compromises regulatory effectiveness.
  - The RBI's delayed introduction of specific regulations for **digital lending platforms** created a regulatory vacuum that led to exploitative practices by unregulated loan apps
  - Also, SEBI has been criticized for its delay in implementing **strict regulations around algorithmic trading**, which has led to several market volatility.
- **Political Interference:** In some instances, regulatory bodies may face pressure from the government to make decisions that align with political objectives rather than sound regulatory principles.
  - Political interference can undermine the independence of regulatory bodies and their ability to make impartial decisions.
  - **RBI** has, in recent years, been under pressure to increase its dividend payouts to the government, especially to meet budgetary targets and manage fiscal deficits.
    - The Reserve Bank of India has announced a [record dividend of ₹2.11 lakh crore to the Government of India](#) for the financial year 2023-24

## How does the Rise of Fintech Impact Traditional Regulatory Approaches in India?

- **Data Localization and Privacy Challenges:** India's data localization requirements have forced a complete restructuring of fintech operations, with the **RBI mandating that all financial data must be stored exclusively in India.**
  - This policy has created significant operational challenges for international fintech players while boosting domestic data center infrastructure development.
  - PhonePe alone has invested **over Rs 2,800 crore to expand infrastructure**, including data centers, across India in a data localisation push, **highlighting the massive scale of regulatory impact on infrastructure requirements.**
- **Digital Payment System Integration:** The UPI ecosystem has necessitated new regulatory frameworks for **interoperability and settlement systems**, pushing traditional banking regulations to evolve beyond **institution-centric approaches.**
  - The **UPI system now handles over 10 billion transactions monthly**, requiring real-time oversight mechanisms previously unnecessary in traditional banking.
- **Alternative Credit Models:** The rise of [Buy-Now-Pay-Later \(BNPL\)](#) and **micro-lending platforms** has challenged traditional credit regulations, forcing the creation of new frameworks for **short-term, small-ticket lending.**
  - The Indian BNPL market is experiencing explosive growth, projected to reach **\$100 billion by 2025**.

## What Measures can India Adopt to Enhance the Accountability of Financial Regulators?

- **Enhanced Parliamentary Oversight Framework:** Establish quarterly mandatory appearances of regulatory heads before **dedicated parliamentary committees for performance review.**
  - Create specialized **sub-committees within existing parliamentary panels** focusing exclusively on financial regulation oversight.

- Require **public disclosure of committee recommendations** and regulatory responses.
- **Standardized Public Consultation Process:** Mandate minimum public consultation period for all major regulatory changes, with structured feedback mechanisms.
  - **Create online portals for real-time tracking of consultation status** and stakeholder inputs.
  - Require regulators to publish **detailed rationale for accepting/rejecting stakeholder suggestions.**
  - **Similar systems in Singapore** achieved higher public participation in regulatory decisions.
- **Independent Regulatory Review Board:** Establish an autonomous board comprising financial experts, academia, and industry veterans to assess regulatory performance.
  - Implement quarterly performance audits based on **pre-defined metrics covering efficiency, transparency, and effectiveness.**
  - Require **regulatory impact assessments for all major decisions.**
- **Strengthened Internal Governance Structure:** Implement mandatory rotation of key positions within regulatory bodies every three years.
  - Create **internal ombudsman offices with direct reporting to parliamentary committees.**
  - Establish whistleblower protection mechanisms for regulatory staff. Require mandatory public disclosure of all senior-level appointments and their qualification criteria.
- **Technology-Enabled Transparency Platform:** Develop integrated digital platforms for **real-time disclosure of regulatory actions, decisions, and enforcement measures.**
  - Implement **blockchain-based recording of all regulatory decisions** for immutable audit trails.
  - Create public dashboards showing regulatory performance metrics updated monthly.
- **Professional Development and Accountability Framework:** Institute mandatory professional certification requirements for regulatory staff at all levels.
  - Create specialized training programs in emerging areas like **fintech, cyber security, and AI regulation.**
  - Establish clear performance metrics linked to regulatory effectiveness. Implement competitive compensation structures to attract top talent.
- **Coordinated Enforcement Mechanism:** Establish joint enforcement teams across regulators for overlapping jurisdictions.
  - Create a centralized database for enforcement actions accessible to all regulatory bodies.
  - Implement **standardized penalties and enforcement procedures across regulators.**

## Conclusion

India's financial regulators play a crucial role in **maintaining market stability and protecting investor interests.** However, to ensure their effectiveness, it is imperative to strengthen their accountability mechanisms. By enhancing transparency, conflict of interest management, parliamentary oversight, internal governance, and enforcement, **India can bolster the credibility of its financial regulatory framework.**

### **Drishti Mains Question:**

Examine the effectiveness of financial regulatory bodies in India in ensuring financial stability and protecting investor interests. What reforms are necessary to enhance their transparency and accountability?

## UPSC Civil Services Examination, Previous Year Questions (PYQs)

### **Prelims**

**Q.** Which of the following statements is/are correct regarding the Monetary Policy Committee (MPC)?  
(2017)

1. It decides the RBI's benchmark interest rates.
2. It is a 12-member body including the Governor of RBI and is reconstituted every year.
3. It functions under the chairmanship of the Union Finance Minister.

**Select the correct answer using the code given below:**

- (a) 1 only
- (b) 1 and 2 only
- (c) 3 only
- (d) 2 and 3 only

**Ans: A**

**Q. If the RBI decides to adopt an expansionist monetary policy, which of the following would it not do? (2020)**

1. Cut and optimize the Statutory Liquidity Ratio
2. Increase the Marginal Standing Facility Rate
3. Cut the Bank Rate and Repo Rate

**Select the correct answer using the code given below:**

- (a) 1 and 2 only
- (b) 2 only
- (c) 1 and 3 only
- (d) 1, 2 and 3

**Ans: B**

**Q. Which of the following is issued by registered foreign portfolio investors to overseas investors who want to be part of the Indian stock market without registering themselves directly? (2019)**

- (a) Certificate of Deposit
- (b) Commercial Paper
- (c) Promissory Note
- (d) Participatory Note

**Ans: (d)**

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### **Mains**

**Q. The product diversification of financial institutions and insurance companies, resulting in overlapping of products and services strengthens the case for the merger of the two regulatory agencies, namely SEBI and IRDA. Justify. (2013)**

