"REVIVAL OF INDIAN INDUSTRY AND ECONOMY THROUGH REGULATORY MEASURES IN FINANCIAL SECTOR"

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Abstract

The Covid-19 has crisis raised both short- and long-term challenges for the insurance sector. Insurance companies were facing operational and procedural challenges, dips in revenue and depleting reserves as well as the mandate to meet the growing coverage requirements faced by the entire country. The immediate policy emphasis is on money market funds, open-ended funds, margining practices, liquidity, structure and resilience of core bond markets, and cross-border USD funding. COVID-19 created extraordinary challenges for Indian households, businesses, and the economy. Lockdowns triggered economic contractions vastly surpassing the initial trade shocks, travel restrictions, and other measures. Millions of people migrated from urban to rural areas. The downturn rapidly reduced working hours and raised unemployment. The consequences and survival tactics for households and businesses varied by sector and state, exacerbating existing disparities for low-income and rural households.

Key words: Financial Sectors, Reforms, Crisis, Remedies.

I. NTRODUCTION:

Regulatory reforms implemented in the years after the global financial crisis (GFC) enabled banks in many jurisdictions to enter the COVID-19 crisis with sizable capital and liquidity buffers. Concurrently, the swift and aggressive responses of central banks eased financial conditions and liquidity risks were allayed, compressing term spreads. Regulatory easing across jurisdictions facilitated the flow of financial resources to the economy and effectively prevented the amplification of the shock. As vaccination drives are being rolled out and the global economy re-charts an uneven upturn, this undertakes an overview of the policy responses that enabled this renewed tryst with recovery.

Global Regulatory Developments and Assessments

In its assessment of financial stability risks arising out of a potential large wave of insolvencies, the European Systemic Risk Board (ESRB) points out that public authorities have shielded the corporate sector so far from COVID-19 induced stress through a variety of measures, including loan guarantees and moratoria, thereby preventing the rise in insolvencies that typically follow in the wake of a contraction in economic activity[1]. As current support measures are withdrawn, these authorities should have strategies in place to evolve from addressing liquidity needs towards addressing solvency issues by differentiating between viable and non-viable firms and enabling fundamentally viable companies to thrive again in the post-pandemic period.

Regulatory Restrictions on Dividend Distribution - Calibrated Normalization

As the recovery begins to emerge in several parts of the world, a calibrated return to dividend distribution by banks is also taking place after the suspension of dividend payouts and buy-back of ordinary shares was necessitated by the pandemic. The European Central Bank (ECB) has recommended that banks should exercise extreme prudence on dividends and share buy-backs, limiting distributions to below 15 per cent of accumulated 2019-20 profits and not higher than 20 basis points of the common equity tier-1 (CET-1) ratio until September 30, 2021. The US Federal Reserve (Fed) has announced that temporary and additional restrictions on bank holding company dividends and share repurchases currently in place has ended for most firms after June 30, 2021, based on results from stress tests. The Prudential Regulatory Authority of UK has withdrawn its restrictions on dividend distribution and share buy-backs and left it to banks' boards to decide when to recommence distributions within an appropriately prudent framework.

Banking Sector Liquidity

The ECB has prolonged its support via targeted lending operations for banks upto June 2022 in order to smooth out any temporary funding issues for solvent banks. Additionally, it has provided for a liquidity backstop to support money market functioning during the extended pandemic period, by offering four additional pandemic emergency longer-term refinancing operations in 2021, each with a tenor of one year, allotted on a quarterly basis.

The US Fed had temporarily modified the provisions relating to the supplementary leverage ratio (SLR) by excluding central bank reserves and US Treasuries from the calculation of SLR so as to ease the strain on the US treasury market and enable banks to continue lending to households during the pandemic. While the accomodation was allowed to expire as scheduled on March 31, 2021 the Fed highlighted the need for recalibration of the SLR in view of the recent growth in central bank reserves and US Treasury reissuance.

Reform in Non-Bank Financial Intermediation

The Financial Stability Board (FSB), G-20 and IOSCO have set out a comprehensive programme for strengthening the resilience of Non-Bank Financial Intermediation (NBFI), which inter alia covers funding and credit intermediaries and markets, including money market funds (MMFs), investment funds, bond funds and the like. The immediate policy emphasis is on money market funds, open-ended funds, margining practices, liquidity, structure and resilience of core bond markets, and cross-border USD funding.

COVID-19-related Loan Loss Provisioning by Banks

In response to the pandemic, regulatory authorities granted banks greater leeway in implementing expected credit loss (ECL) provisioning. Provisioning practices by 70 internationally active banks show that relative to loans, the median of the annualised provisions rose from 35 basis points to 105 basis points between H2:2019 to H1:2020, with provisioning under the US Generally Accepted Auditing Principles (GAAP) being somewhat higher than under the International Financial Reporting Standards (IFRS)

Operational Risk in Banks

Operational resilience focuses on the ability of firms and the financial system to deliver key services and continue to serve the needs of customers through disruptions. The Basel Committee on Banking Supervision (BCBS) issued principles[5] for operational resilience and revised the principles for sound management of operational risk, aiming to strengthen banks' ability to withstand risk-related events including pandemics, cyber incidents, technology failures and natural disasters that could cause significant operational failures or wide-scale disruptions in financial markets..

Other International Regulatory Developments

In February 2021, the UK Treasury issued a consultation paper on its proposed central counter party (CCP) resolution framework, which would set out the powers that the Bank of England (BoE) would hold as a resolution authority in closing down a central counter party (CCP) after a fatal default or non-default event. The expanded CCP resolution regime would give the BoE additional powers to mitigate the risk and impact of a CCP failure and the subsequent risks to financial stability and public funds. These additional powers inter alia include the ability to write down CCP members' unsecured liabilities and to make cash calls on clearing members.

The European Banking Authority (EBA) has issued draft technical standards on implementing Pillar 3 disclosures on Environmental, Social and Governance (ESG) risks[7]. Acting on a mandate from the EU Capital Requirements Regulation, the EBA is proposing specific templates for quantitative and qualitative disclosures on climate-change-related transition and physical risks as well as financial institutions' mitigating actions and adaptation plans.

Insurance Sector

The International Association of Insurance Supervisors (IAIS) has identified the key challenges posed by cyber risk underwriting as: (a) measurement of risk exposure due to the evolving nature of cyber risk; and (b) issues related to the clarity of cyber insurance policies, which inter alia include overlapping coverage, the treatment of ransoms, fines, terrorism and war risk[8].

Central Bank Digital Currency

The third BIS Survey on Central Bank Digital Currency (CBDC)[9] notes that most central banks are exploring CBDCs, in both wholesale and retail form, progressing from conceptual research to practical experimentation. EMEs were driven by considerations of financial inclusion and payment system safety and efficiency in their approach to CBDCs. While most central banks have no plans to issue CBDCs in the foreseeable future, several are likely to launch retail CBDCs in the next three years.

Domestic Regulatory Developments

The Sub-Committee of the Financial Stability and Development Council (FSDC-SC), chaired by the Governor, Reserve Bank of India (RBI) met twice since December 2020 to review developments in the financial sector impinging on financial stability and to discuss matters involving inter-regulatory co-ordination. Among the issues taken up in its 26th meeting held on January 13, 2021 the Sub-Committee discussed the scope for improvements in "the corporate insolvency resolution process under the Insolvency and Bankruptcy Code, 2016 (IBC), utilisation of data with the Central KYC Records Registry and changes in the regulatory framework relating to Alternative Investment Funds (AIFs) set up in the International Financial Services Centre (IFSC)..

Initiatives from Regulators/Authorities

In order to mitigate pandemic induced stress, financial sector regulators and the government rolled out a number of measures, including extending existing relaxations to provide relief. Additionally, several significant regulatory initiatives were taken towards fortifying the resilience of the financial system Regulatory forbearances lapsed on the stipulated end dates.

Credit Related Measures

With the objective of alleviating the potential stress to individual borrowers and small businesses due to the COVID-19 pandemic, a limited window upto September 30, 2021 was opened by the Reserve Bank under Resolution Framework 2.0 permitting lending institutions to implement resolution plans in respect of their exposures to individuals, MSMEs and other small businesses with aggregate exposure upto ₹50 crore, while classifying the same as standard. Asset classification and provisioning norms are prudential guidelines that provide a baseline assessment of risks building up in financial intermediaries and a provision floor for expected losses. Any disturbance or pause in asset classification can have wider implications, particularly in respect of the assessment of the true financial position of banks and other lending institutions..

Development of the Credit Risk Market

In order to facilitate diversification of credit risk originating in the banking sector and to ensure market-based credit products for diversified set of investors having commensurate capacity and risk appetite, the Reserve Bank has been working on a revised securitisation framework, a comprehensive framework for transfer of loan exposures and on institutionalising a secondary market for corporate loans. As part of the latter, it has facilitated the establishment of a self-regulatory body viz., Secondary Loan Market Association (SLMA), comprising of market participants.

Pre-Packaged Insolvency for MSMEs

With the revocation of the suspension on fresh proceedings under the Insolvency and Bankruptcy Code, 2016 (IBC) on March 24, 2021, creditors can again leverage on the instrumentality of IBC for resolution of stressed assets. As regards MSMEs, the Central Government has promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance 2021 to allow the corporate debtor to initiate pre-packaged insolvency resolution processes in case of a default of ₹10 lakh and above. This hybrid mechanism (a blend of formal and informal mechanisms) is intended to facilitate resolution for MSMEs in an expeditious and cost-effective manner with minimum disruption in business continuity. In this scheme the resolution of a company's business is explored first with the debtor-in-possession even before the formal initiation of the process. After the process gets underway, in case there is no impairment of operational creditors' dues in the base resolution plan, the Committee of Creditors (CoC) has the option to call for resolution plans from third parties, while it is mandated to do so if impairment arises.

Bad Bank

In the Union Budget for 2021-22, the Government announced a proposal for setting up the National Asset Reconstruction Company Limited (NARCL), popularly termed as a "bad bank", to consolidate and take over stressed debt from banks, based on decided characteristics. The aggregation of assets is expected to assist in turning around the assets and eventually offloading them to potential investors for further value unlocking. Drawing from established market principles and global experience, the success of a bad bank initiative would eventually depend upon design aspects, viz., fair pricing; complete segregation of risk from selling banks; investment of external capital; independent and professional management of the new entity; minimising moral hazard; and adequate capitalisation of the banks post-sale of assets to invigorate fresh lending.

Customer Protection

Over the years, the Reserve Bank has taken several measures for improving customer service and grievance redress in banks. With increasing number of complaints received in the offices of the Banking Ombudsman, the need was felt to strengthen the existing mechanism. Accordingly, with effect from January 27, 2021[10] a comprehensive framework for dealing with customer grievances was implemented which comprises: (a) enhanced disclosures on customer complaints; (b) monetary disincentive in the form of recovery of cost of redress of complaints from banks when maintainable complaints are comparatively high; and (c) intensive review of the grievance redress mechanism and supervisory action against banks that fail to improve their redress mechanism in a time bound manner.

Summary:

Revealing from the effectiveness of measures, global standard setting agencies have been initiated processes to build new capabilities and refine the existing systems. As banks and other financial intermediaries strengthen capital positions and provisions to withstand the aftershocks from waves of the pandemic, these buffers will help in managing the rollback of regulatory measures without leaving stains in their wake. By and large these initiatives have been able to dampen and mitigate pandemic related losses and stresses, coushning the real activity and preserving the soundness of financial system globally. Undoubtedly it can be mentioned that covid 19 resulted in a noteworthy manner for the unprecedented and sustained policy support by governments, central banks and other regulators everywhere. In similar manner domestically too initiatives taken through several measures have been resulted in regulating economic and business space to strengthen financial sector entities, ease access to financial products, strengthen the grievance redressal mechanism and protect the interests of investors. As the economy is recovering from the pandemic the financial system will also be coupled in support of the revival of the further growth.