

A HUNDRED SMALL STEPS

Report of the Committee
on Financial Sector Reforms



Planning Commission
Government of India

A Hundred Small Steps

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Government of India
Planning Commission
New Delhi

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Contents

<i>Members' List and Terms of Reference</i>	vii
<i>Acknowledgements</i>	ix
<i>List of Abbreviations</i>	xi
1. Introduction, Executive Summary, and List of Main Proposals	1
2. The Macroeconomic Framework and Financial Sector Development	22
3. Broadening Access to Finance	49
4. Levelling the Playing Field	77
5. Creating More Efficient and Liquid Markets	103
6. A Growth-Friendly Regulatory Framework	124
7. Creating a Robust Infrastructure for Credit	151
8. Special Topics	181

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GOVERNMENT OF INDIA
PLANNING COMMISSION

Yojana Bhawan, Sansad Marg
New Delhi, 17th August 2007

ORDER

Subject: Constitution of a High Level Committee on Financial Sector Reforms

With a view to outlining a comprehensive agenda for the evolution of the financial sector indicating especially the priorities and sequencing decisions which the Govt. must keep in mind, it has been decided to set up a High Level Committee on Financial Sector Reforms with the following composition:

- (i) Shri Raghuram G. Rajan, Professor, Graduate School of Business, University of Chicago—Chairman.
- (ii) Suman Bery, Director General, NCAER.
- (iii) Uday Kotak, CEO, Kotak Mahindra Bank.
- (iv) Rajiv Lall, CEO, IDFC.
- (v) Vijay Mahajan, Chairman, Basix.
- (vi) Zia Mody, Senior Partner, AZB Partners.
- (vii) O.P. Bhatt, Chairman, State Bank of India.
- (viii) K.V. Kamath, MD & CEO, ICICI Bank.
- (ix) Chitra Ramakrishna, Deputy MD, NSE.
- (x) R. Ravimohan, MD & CEO, CRISIL.
- (xi) J.R. Varma, Professor, Indian Institute of Management, Ahmedabad.
- (xii) R. Sridharan, Adviser (FR), Planning Commission—Convenor.

02. The Terms of Reference of the Committee will be as follows:

- (i) To identify the emerging challenges in meeting the financing needs of the Indian economy in the coming decade and to identify real sector reforms that would allow those needs to be more easily met by the financial sector.
- (ii) To examine the performance of various segments of the financial sector and identify changes that will allow it to meet the needs of the real sector.
- (iii) To identify changes in the regulatory and the supervisory infrastructure that can better allow the financial sector to play its role, while ensuring that risks are contained; and
- (iv) To identify changes in other areas of the economy—including in the conduct of monetary and fiscal policy, and the operation of the legal system and the educational system—that could help the financial sector function more effectively.

03. The High Level Committee may invite such person(s) as it deems appropriate to participate in any of its meetings as special invitee(s).

Acknowledgements

When the Deputy Chairman of the Planning Commission, Shri Montek Singh Ahluwalia, asked me to put together a Committee to write a report on the next generation of financial sector reforms, I was intrigued but also puzzled. Why another report when so many reports had been commissioned in the recent past? He convinced me that there was merit in taking an overall view, highlighting the links between various needed reforms, and offering a generally consistent underlying approach. The purpose of the report would be to catalyze debate as well as action, some immediate and some over time as political will emerged.

With this in mind, I set about putting together a Committee of some of the finest financial and legal minds in the country. My first pleasant surprise was that no one I asked said no, despite their undoubtedly hectic schedules, and the fact that many of them were already on other Committees. Since then, I have been treated to a truly awesome display of true public-private partnership as people from the public sector, government, regulators, the private sector, academia, politicians, unions, NGOs, and the press have given freely of their valuable time to make this report possible. All constituencies had input into this process. We have also benefited from a large number of comments since a preliminary draft of the report was placed in the public domain for commentary.

I start my acknowledgements by thanking Mr. K.V. Kamath of ICICI Bank for kindly hosting many of the Committee's meetings, and creating a secretariat to take care of the logistical arrangements. It is clear that without the efficiency of the ICICI staff helping us, this report would certainly not have been completed on time. Dr. Nachiket Mor and Ms. Chanda Kochhar were free with their time, as well as their resources, including

their very able assistants, Persis Bharucha and Nita Colaco. I particularly thank ICICI for making available the services of Dr. Sona Varma and Mr. Vinay D'Costa. Dr. Varma was a great help throughout, and directed the Committee's work on financial inclusion. Vinay embodies for me the spirit of young India. He has been tireless throughout this Committee's tenure, working at all hours of the day and night, going well beyond the call of any reasonable concept of duty, to make this report come together. Thank you Vinay!

I also am very grateful to Mr. Om Bhatt of the State Bank of India, who hosted a number of the Committee's meetings and events. He also was instrumental in helping us reach a number of constituencies that we would otherwise not have been able to access. Ms. Brinda Jagirdar from SBI was of tremendous help, both at Committee meetings and in reaching out to various parts of SBI.

The Planning Commission has also been invaluable to the working of the Committee. Shri Ahluwalia, of course, has been very supportive throughout. The convenor, Mr. Sridharan, and his assistant, Mr. A.K. Chakrabarti, have been extremely helpful. Mr. Sridharan's knowledge of how government works have been especially important in clarifying my views, and the views of the Committee.

All the members of the Committee took on the additional burden of attending its Saturday meetings cheerfully. Committee discussions, while sometimes heated (and never short), were always focused on attempting to understand what in our opinion would be right for the nation. Many Committee members have written pieces of the report, and have drawn others from their organizations to help in the work. This has been truly a collective effort, and I

would like to express my sincere gratitude to Mr. Suman Bery, Mr. Uday Kotak, Mr. Rajiv Lall, Mr. Vijay Mahajan, Ms. Zia Mody, Ms. Chitra Ramakrishna, Mr. Ravimohan, and Prof. Jayanth Varma, in addition to the three members who have been acknowledged earlier.

The Committee is especially grateful to our 'virtual' members, Prof. Rajesh Chakrabarti, Prof. Eswar Prasad, Mr. Joydeep Sengupta, Dr. Ajay Shah, and Mr. Bahram Vakil, as well as Prof. Sankar De, Prof. Ashok Jhunjhunwala, Mr. Nirmal Mohanty, Mr. Ramesh Ramanathan, and Mr. Vidhu Shekhar. Each of them wrote, or helped in the writing of, significant portions of the report, and greatly enhanced the intellectual quality and practical content of the Committee's discussions. It also thanks Ms. Naga Annamalai, Mr. Anindya Bannerjee, Mr. Abhinav Chandrachud, Mr. Ashwin Ramanathan, Mr. Pramod Rao, and Mr. Mahesh Uttamchandani, who while not explicitly part of the Committee, helped guide important aspects of the Committee's work. Ritu Anand, Sugandha Garg, Leena Kinger Hans, Leena Pillai, Swati Ramanathan, Subrata Sarkar, and Priyanka Vasishtha were also very useful contributors to the work of the Committee. IIMS Dataworks and FINO helped us with data and in assessing practices.

We held nine formal Committee meetings and 11 informal ones. In addition, members of the Committee met with a number of relevant players in the financial sector arena. We obtained tremendous help from employees

from a variety of public, private, domestic, and foreign organizations, as well as some self-employed individuals. In each case, the individual shared their expertise with the Committee in their personal capacity. Among those that we would like to thank especially are: Anup Banerji, Priya Basu, Gautam Bhardwaj, Sanjay Bhargava, Tarun Bhatia, Saugata Bhattacharya, Christopher Butel, Nick Collier, M. Damodaran, Amaresh Dubey, Ajay Dwivedi, Tilman Ehrbeck, Joshua Felman, Neeraj Gambhir, Jim Hanson, Dharmakriti Joshi, Sachin Khandelwal, S. Khasnobis, Kalpana Kochhar, Charles Kramer, K.P. Krishnan, Roopa Kudva, P.J. Nayak, M. Mahapatra, Varsha Marathe, Mihir Nanavati, Sanjay Nayar, Robert Palacios, Aurobind Patel, V. Ramkumar, C.S. Rao, Renuka Sane, Naveen Tahilyani, Vijay Tata, Yashwant Thorat, Arun Thukral, Essaji Vahanvati, S. Venkataraman.

A number of reviewers (because some of them asked not to be named, we have decided to keep the entire list anonymous) read a first draft of this report and offered very useful comments. They have our gratitude.

After a preliminary draft was placed in the public domain for comment, we received a large number of comments, both directly, and in the press. While we have not accepted all suggestions, each one has been weighed for its consistency with our overall framework and alterations, where justified, have been made to the report.

Raghuram G. Rajan
12 September 2008

List of Abbreviations

AAIFR	Appellate Authority for Industrial and Financial Reconstruction
ABS	Asset-backed Securities
ACC	Appointments Committee of the Cabinet
AD	Authorized Dealer
ADB	Asian Development Bank
ADR	American Depository Receipts
AMC	Asset Management Company
AML	Anti-Money Laundering
AP	Andhra Pradesh
ARC	Asset Reconstruction Company
ATM	Automated Teller Machines
BANSEFI, Mexico	Banco de Ahorro Nacional y Servicios Financieros, Mexico
BC	Business Correspondents
BCD	Bond-Currency-Derivatives
BF	Business Facilitators
BIFR	Board for Industrial and Financial Reconstruction
BIS	Bank for International Settlements
BoE	Bill of Exchange
BOT	Bank of Thailand
BPL	Below Poverty Line
BRIC	Brazil, Russia, India, China
BSE	Bombay Stock Exchange
BSNL	Bharat Sanchar Nigam Limited
CAGR	Compounded Annual Growth Rate
CAL	Capital Account Liberalization
CBLO	Collateralized Borrowing and Lending Obligations
CBRC	China Banking Regulatory Commission
CCIL	Clearing Corporation of India Limited
CD Ratio	Credit-Deposit Ratio
CDFI	Community Development Financial Institutions
CDO	Collateralised Debt Obligations
CDR	Corporate Debt Restructuring
CDS	Credit Default Swaps
CDSL	Central Depository Services India Limited
CFT	Combating the Financing of Terrorism
CGAP	Consultative Group to Assist the Poorest
CIBIL	Credit Information Bureau (India) Limited
CICA	Credit Information Companies (Regulation) Act
CMIE	Centre for Monitoring Indian Economy
COSPI	CMIE Overall Share Price Index
CPC	Code of Civil Procedure
CPI	Consumer Price Index
CRA	Community Reinvestment Act

CRA ID	Central Record Keeping Agency identification
CRISIL	Credit Rating and Information Services of India
CRR	Cash Reserve Ratio
CVC	Central Vigilance Commission
DA	Direct Assignments
DCCBs	District Central Cooperative Banks
DICGC	Deposit Insurance and Credit Guarantee Corporation
DIP	Debtor-in-Possession
DRT	Debt Recovery Tribunal
ECB	External Commercial Borrowings
EPFO ID	Employees Provident Fund Organisation identification
EPIC	Elector's Photo Identity Card
FDI	Foreign Direct Investment
FI	Financial Institution
FII	Foreign Institutional Investor
FINO	Financial Information Network and Operations
FIPB	Foreign Investment Promotion Board
FIRA, Mexico	Fideicomisos Instituidos en Relación con la Agricultura
FMC	Forward Markets Commission
FRBM	Fiscal Responsibility and Budget Management
FSA	Financial Services Authority
FSC	Financial Supervisory Commission, Korea
FSDC	Financial Sector Development Council
FSM Act	Financial Services and Markets Act, 2000, UK
FSOA	Financial Sector Oversight Agency
GDP	Gross Domestic Product
GDR	Global Depository Receipts
GIC	General Insurance Corporation of India
HLCC	High Level Co-ordination Committee on Capital Markets
HPEC	High Powered Expert Committee
IBA	Indian Bankers Association
IBPC	Inter-bank Participation Certificates
ICA	Inter-Creditor Agreements
ICAI	Institute for Chartered Accountants of India
ICR	Insolvency and Creditor Rights
ICRA	Information and Credit Rating Agency
ID	Identification
IDBI	Industrial Development Bank of India
IDRBT	Institute for Development and Research in Banking Technology
IFCI	Industrial Finance Corporation of India
IIMS	Invest India Market Solutions
IISS	Invest India Incomes and Savings Survey
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IPDI	Innovative Perpetual Debt Instruments
IRDA	Insurance Regulatory and Development Authority
ISO	International Organization for Standardization
IT	Information Technology

KYC	Know Your Customer
LAB	Local Area Bank
LIBOR	London Inter-Bank Offered Rate
LIC	Life Insurance Corporation of India
LLP	Limited Liability Partnership
LSO	Loan Sell-Off
M&A	Mergers and Acquisitions
MBA	Master of Business Administration
MCA	Ministry of Corporate Affairs
MFI	Microfinance Institution
MGBBY	Mahatma Gandhi Bunkar Bhima Yojana
MNIC ID	Multi Purpose National Identity Card
MOF	Ministry of Finance
MOFE	Ministry of Finance and Economy, Korea
MPFI	Mobile Payment Forum of India
MTNL	Mahanagar Telecom Nigam Limited
NABARD	National Bank for Agriculture and Rural Development
NAFIN	Nacional Financiera, Mexico
NAIS	National Agricultural Insurance Scheme
NBFC	Non-Banking Financial Company
NCAER	National Council for Applied Economic Research
NCDEX	National Commodity & Derivatives Exchange Limited
NCLT	National Company Law Tribunal
NDS	Negotiated Dealing System
NEFIS	Nationwide Electronic Financial Inclusion System
NGO	Non-Governmental Organization
NHB	National Housing Bank
NPA	Non-Performing Assets
NPF	National Pension Fund, Korea
NPL	Non-Performing Loans
NPS	New Pension System
NREGS	National Rural Employment Guarantee Scheme
NRI	Non-Resident Indian
NSCC	National Securities Clearing Corporation
NSDL	National Securities Depository Limited
NSE	National Stock Exchange
NSEL	NCDEX Spot Exchange Ltd
NYMEX	New York Mercantile Exchange
OFO	Office of the Financial Ombudsman
OTC	Over the Counter
PAN	Permanent Account Number
PCAOB	Public Company Accounting Oversight Board
PCARDBs	Primary Cooperative Agriculture and Rural Development Bank
PIN	Personal Identification Number
PLR	Prime Lending Rate
POS	Point of Sale
PSB	Public Sector Bank
PSLC	Priority Sector Lending Certificates
PSU	Public Sector Undertaking

PTC	Pass-Through Certificates
QFII	Qualified Foreign Institutional Investor
RBI	Reserve Bank of India
REER	Real Effective Exchange Rate
RMBS	Residential Mortgage Backed Securities
RNBFC	Residuary Non-Banking Finance Company
ROE	Return on Equity
RRBs	Regional Rural Banks
RSBY	Rashtriya Swasthya Bima Yojana
RTGS	Real Time Gross Settlement
SAFE	State Administration of Foreign Exchange, China
SAT	Securities Appellate Tribunal
SBI	State Bank of India
SC(R)A	Securities Contract Regulation Act
SCARDBs	State Cooperative Agriculture and Rural Development Bank
SCBs	Scheduled Commercial Banks
SEBI	Securities and Exchange Board of India
SEC	Securities and Exchange Commission
SENSEX	Sensitive Index
SEWA	Self Employed Women's Association
SGL	Subsidiary General Ledger
SGSY	Sampoorna Gramin Rozgar Yojana
SHG	Self-Help Group
SIB	Securities and Investment Board, UK
SICA	Sick Industrial Companies Act
SIDBI	Small Industries Development Bank of India
SIP	Systematic Investment Plan
SLR	Statutory Liquidity Ratio
SME	Small to Medium Enterprises
SMS	Short Message Service
SNX	SAFAL National Exchange
SPV	Special Purpose Vehicles
SR	Security Receipts
SRFAESI	Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act
SRO	Self-Regulatory Organisation
SSI	Small Scale Industries
STCBs	State Cooperative Bank
TRAI	Telecom Regulatory Authority of India
UCBs	Urban Cooperative Banks
ULIP	Unit Linked Insurance Plan
UNCITRAL	United Nations Commission on International Trade Law
UP	Uttar Pradesh
US 64	Unit Scheme 64 of Unit Trust of India
UTI	Unit Trust of India
VAT	Value-added Tax
VSNL	Videsh Sanchar Nigam Limited
WPI	Wholesale Price Index
WTO	World Trade Organization