

Y V Reddy: Implementation of financial standards and codes: Indian perspective and approach

Speech by Dr YV Reddy, Deputy Governor of the Reserve Bank of India, at the Conference on International Standards and Codes organised by the IMF-World Bank, held in Washington DC, 7-8 March 2001. The appendix mentioned by Dr Reddy can be obtained from the Reserve Bank of India.

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In this paper it is proposed to describe the Indian perspective and approach in regard to the implementation of international financial standards and codes advocated by the Financial Stability Forum (FSF). The Indian efforts in this direction also seek to complement and support the ongoing initiatives of the G-20 aimed at encouraging implementation of standards and codes among member countries.

The paper is schematized as follows. Section I explains India's stand on global initiatives for implementation of standards and codes. While Section II narrates India's association with global efforts in evolving and promoting financial standards and codes, Section III describes the Indian approach to the implementation. Section IV mentions the institutional arrangements that have been put in place to guide the process of implementation. Section V provides an account of the work processes followed by Advisory Groups in the course of preparation of Reports. Section VI indicates the current status, while Section VII touches on the plans for following up on the submission of Reports. Section VIII brings out some highlights of Indian experience so far.

I. India's stand

1.1 **India is fully supportive of the need** to observe certain minimum universally accepted standards in areas relevant to the maintenance of stability in the international monetary system, including increased transparency in formulation and implementation of monetary and financial policies and improvements in dissemination of relevant data. **The establishment of a high-powered Standing Committee** on International Financial Standards and Codes (Standing Committee) **underscores India's commitment** to this international enterprise. At the same time, **India has been voicing, in the international fora, some of its concerns** regarding the manner of international financial institutions spearheading the implementation and assessment of codes and standards. India advocates a voluntary approach, fair, equitable, and continuous process taking duly into account the institutional and legal structure and stage of development in different countries.

1.2 Although the notion of a code of good practices is intuitively appealing, **the temptation to prescribe universally valid model** codes which do not allow for differences in institutional development, legislative framework and, more broadly, different stages of development must be avoided. Sometimes there is a tendency to recommend the practices of major industrial countries to developing country environments without adequate consideration being given to a country's stage of development and its ground realities.

1.3 Moreover, it stands to reason that the accent should be on **voluntary adoption and gradualism** rather than a big bang. In fact, the process may, in any case, be a medium term one and hence one should not look for instant compliance. Basle Core Principles of Banking Supervision offers an interesting example of how a standard attains a near universal acceptance based on **voluntary participation and country ownership**. It is also important that the manner in which these international standards are monitored does **not degenerate into categorizing countries as 'performers' and 'non-performers'**. In other words, the transformation of a best practice goal should not result in premature conditionality for countries that approach the Fund for balance of payments support.

1.4 The extent pace and sequencing should ideally be left to the country authorities. In keeping with this spirit, it has been held that the International Monetary Fund (Fund) may furnish the ROSCs (Reports on Observance of Standards and Codes) in respect of individual countries **only with the countries' specific permission**. The release of Article IV reports should also be left to the judgment

of individual governments. This is because the goal of transparency could best be served by a balanced and symmetric evaluation of data as between the authorities and the private sector.

1.5 It must also be added that the plethora of codes, standards and principles could be overwhelming and also highly demanding of manpower and financial resources. They also have a potential to become overly intrusive *vis-à-vis* national authorities. In any case some **prioritisation of Codes for considering implementation is inevitable** in respect of each country. There is a strong case for undertaking or fostering more intensified research on the relationship between implementation of standards and macroeconomic and financial stability.

1.6. Work on standards and codes is evolving in relevant international fora and priorities for implementing them would have to vary from country to country. In this regard, the potential for self-assessment on the part of individual countries needs to be explored. Besides being cost-effective, such an approach would also greatly facilitate country-ownership.

1.7. Some of the other serious concerns that deserve attention in this regard pertain to the specificity and the source of financial difficulties that might have to be adequately reckoned in individual cases. Since **financial crises can have multiple causes**, overemphasising financial standards could detract attention from other policy priorities. The relative importance of financial standards in crisis prevention must also be adjudged from the standpoint of the relative openness of the economy's capital account and in this sense the "one size fits all" approach may have to be eschewed.

1.8 Since the primary motive for having standards is to catalyze orderly capital flows, while ensuring financial stability, greater **consultation with the private sector** in evolving and prioritizing of core standards is of utmost necessity. All standards and codes are not equally relevant to all segments of private sector and further they do **tend to evolve over a period** reflecting concerns of both public policy and market participants.

1.9 It is gratifying to note that currently there is a **better appreciation of India's stand** in the international fora as compared with the past.

II. India's Association with the Global Efforts in Fostering International Standards and Codes

2.1 India has been closely associated with various standard setting bodies and has been **taking active part in the work of several key international fora devoted to the task** of developing and promoting implementation of financial standards and codes. Although India is not a member of the Financial Stability Forum(FSF)[®], it was one of the countries specially requested to help the Forum in **Task Force on the Implementation of Standards** and to participate in the Joint Committee Group meeting. The Task Force was set up to explore key issues relating to standards/codes/core principles and consider the strategy for fostering the implementation of international standards relevant for a sound financial system.

2.2 The Reserve Bank is also represented at the **Follow Up Group on Incentives for Implementation** of Standards instituted by the FSF following submission of the Task Force Report. The Group has been ascertaining how various elements of market and official incentives could best reinforce one another within the framework of the overall strategy to foster implementation of standards and, for this purpose, engages in a dialogue with a cross section of relevant market participants.

2.3 Reserve Bank of India officials **worked closely with the Basel Committee on Banking Supervision(BCBS)**. In 1997, in consultation with the supervisory authorities of a few non-G-10 countries including India, the BCBS drew up the 25 'Core Principles for Effective Banking Supervision' aimed at guiding supervisory authorities seeking to strengthen their current supervisory regime.

2.4 From its inception, India was also **represented on the Group on Joint Task Force on Securities Settlement Systems** constituted by the Committee on Payment and Settlement Systems (CPSS) and the International Organisation of Securities Commissions (IOSCO).

The CPSS and IOSCO have since released the report of the Task force in January 2001 for public consultation. Based on the comments received, the Task Force will develop the final recommendations.

2.5 As a member of the **Core Principles Liaison Group (CPLG) constituted by the Basel Committee on Banking Supervision(BCBS)**, the Reserve Bank has been attending the meetings of the Group and actively contributing to the discussions.

2.6 The Reserve Bank is also represented in the **Working Group on Capital (WGC) set up by the CPLG**. Recently, during February 6 to 9, 2001, the Reserve Bank of India hosted the meeting of the Group in Delhi to discuss the salient features of the second consultative paper issued by the Basel Committee. The meeting was attended by 26 representatives of supervisory agencies from several non G-10 countries as well as from international financial agencies.

2.7 India is one of the countries **that has sought participation in the joint IMF-World Bank Financial Sector Assessment Programme (FSAP)**. As part of the Reports on Observance of Standards and Codes (ROSCs), India's **compliance in respect of five standards and codes has already been assessed**, viz., Monetary and Financial Policy Transparency, Banking Supervision, Securities Market Regulation, Payment and Settlement system and Corporate governance.

2.8 Furthermore, the professional expertise **in the Reserve Bank of India has been made available** to IMF/World Bank in their FSAP exercises in other countries.

III. Indian approach

3.1 The Indian approach to implementation of financial standards and codes is based **on the efficiency-enhancing elements** of the standards and codes, and on the need to consider them as **part of process of institutional development** in the country, while not ignoring their **relevance to domestic as well as international financial stability**. Thus, they are viewed as an integral **part of the process of economic reform**, most appropriate to the country's needs. The emphasis is on **creating awareness** to promote adoption by the **relevant official agencies**, self regulating bodies and market participants **rather than prescribing compliance** at the instance of a central authority.

3.2 The Indian approach to the implementation of standards and codes is noteworthy in that **it follows a systematic process**. The process consists of the initial recognition, identification and taking on record of standards and codes in relevant areas. This is followed by **in-depth assessment by independent experts** of issues pertaining to the present status of applicability, relevance and the existing degree of compliance, the feasibility of compliance and the earmarking of the possible time frame for transition given the prevailing legal and institutional practices. It is also common to seek **comparison of the levels of adherence** in India, vis-à-vis industrialized and emerging economies, particularly to understand India's position and to **prioritize actions** on some of the more important codes and standards. The process seeks to **map out a comprehensive course of possible actions** for achieving the best practices. This approach is put in the **public domain** through publication of Reports on each of the selected standards and codes.

3.3 The next stage involves putting efforts for the **widest possible dissemination** of expert opinion on the subject in the form of the reports mentioned and by means of outreach programs like seminars and workshops. The objective is to obtain involvement and stimulation of interest among public-authorities and other stake holders in the debate and to garner a higher level of general awareness on the subject. This is to be followed by invitation of and consideration of inputs and feedback from relevant public and private sector organizations to enhance the sense of involvement and to build confidence. Such a participative and consultative approach is advocated to secure a convergence of viewpoints and, hence, **favorable public disposition towards the necessity of change**.

IV. Institutional Arrangements

Standing Committee

4.1 In order to facilitate positioning of international financial standards and codes in relevant areas of the financial system in India and to guide the overall process of implementation of appropriate changes in respect to various segments of the financial system, the Reserve Bank of India in consultation with Government of India, in December 1999, **constituted a 'Standing Committee on International Financial Standards and Codes'** under the Chairmanship of Deputy Governor, Reserve Bank of India and Secretary, Economic Affairs, Government of India as Alternate Chairman. The Committee could co-opt members depending on the subject under consideration.

4.2 The Committee has been enjoined with the **responsibility of identifying and monitoring developments in global standards and codes being evolved especially** in the context of the international developments and discussions as part of the efforts to create a sound international Financial Architecture, considering all aspects of these standards and codes to Indian financial system. The Committee has also been asked to consider **plotting a road map for aligning India's standards** and practices as necessary and desirable in the light of evolving international practices, periodically reviewing the status and progress in regard to the codes and practices; and **reaching out its reports** on the above to all concerned organizations in public or private sectors.

4.3 The Standing **Committee by itself will not take a view** on the Standards and Codes and it will disseminate views expressed on the subject mainly on the basis of the Advisory Groups constituted by it in different subject areas. The Standing Committee **will identify action** points that may arise out of the views expressed and also **make a mention of these to the concerned authorities** viz., Government, Reserve Bank of India, Securities and Exchange Board of India(SEBI) etc., thus acting as a catalyst in the whole process, while leaving it to the concerned institutions to consider appropriate measure. The Committee will no doubt make **arrangements to track the progress in implementation.**

Advisory Groups

4.4 **The Advisory Groups** constituted by the Standing Committee on International Financial Standards and Codes in **ten core subject areas** pertaining to the financial system are **entrusted with the task of studying**, in detail, the present status of applicability and relevance and compliance of relevant standards and codes, reviewing the feasibility of compliance and the time frame over which this could be achieved given the prevailing legal and institutional practices, comparing the levels of adherence in India, vis-à-vis in industrialized and also emerging economies particularly to understand India's position and prioritize actions on some of the more important codes and standards, and to chalk out a course of action for achieving the best practices.

4.5 Out of the set of twelve subjects (actually eleven as Accounting and Auditing are taken together) areas for which standards and codes that have been prescribed by international financial institutions and other standard setting bodies pertaining to the financial system, the Standing Committee has so far **identified ten core subjects for immediate** attention and assessment by Advisory Groups. These are, Transparency in Monetary and Financial Policies, Data Dissemination, Payments and Settlement System, Banking Supervision, Securities Market Regulation, Accounting and Auditing, Fiscal Transparency, Insurance Regulation, Bankruptcy Laws and Corporate Governance. The twelfth area namely 'Market Integrity' associated with the forty recommendations of the Financial Action Task Force(FATF) on money laundering is not being presently looked into by the Standing Committee.

4.6 It may need to be mentioned that all **Advisory Groups are chaired by eminent experts not generally holding official positions in Government or other regulatory bodies**. While the Chairmen of these Advisory Groups were identified and nominated by the Standing Committee, taking into account the experience and expertise, the **choice of members** of these Advisory Groups, was completely **left to the Chairmen of Advisory Groups**. The members are **generally non-official experts** in relevant subject areas. The Groups have, however, the option of **including officials from Government, Reserve Bank of India, SEBI, etc., as special invitees**. Such officials help in providing inputs on the understanding of extant position relating to the relevant standards and codes and also the steps under way towards improvements. This arrangement keeps the Advisory Groups outside the sphere of official influence and allows them to make critical assessment of relevance as well as state of compliance with standards and codes and give unbiased recommendations with regard to the feasibility of compliance and the necessity of achieving best practices in the areas covered by them.

4.7 In order to facilitate exchange of information and expertise on matters of mutual interest, the Advisory Groups have the **option of having interactions/consultations amongst themselves** and many did exercise the option. The Advisory Groups may also **jointly deliberate on overlapping issues** in certain subject areas to evolve a consistent approach. In finalizing its Report, the Standing Committee would, however, attempt to consolidate these overlapping areas. **The Reports of the Advisory Groups are made public, as soon as they are submitted** to the Standing Committee.

4.8 The Standing Committee also periodically reviews the progress of Advisory Group and is required to review its own status after the completion of one year and report to Government/RBI. **The Secretariat support to the Standing Committee is provided by the Reserve Bank of India.**

V. Work Processes

5.1 In view of the varied nature of the subject areas, each **Advisory Group decided to design its own methods and processes** of work. Thus, some Groups mounted special studies or technical papers, some divided the work of preparing basic technical papers among each of the members and most depended heavily on the background material collected and analysed by professionals in Reserve Bank of India. While an Advisory Group gave an interim report, the general preference turned out to be in favour of final reports, sometimes in parts submitted sequentially.

5.2 In some of the subject areas, concerned governmental or regulatory bodies had already constituted some study groups and hence it was argued on occasions that the Advisory Groups are duplicating such efforts. In such cases, it became necessary to clarify that the work of the Advisory Groups **is without prejudice to any other official and non-official initiatives, and that the work is not meant to be intrusive**. It also became necessary to encourage the Advisory Groups **to take account in their deliberations such parallel, though partial, efforts and provide appropriate inputs to such efforts whenever sought**. The process was made easier in several cases since one or more members of relevant Advisory Group happened to be so **eminent as to be involved in several of the initiatives**.

5.3 Some Advisory Groups had to reckon with the fact that their **perception of compliance with international standards differed from the official stance of concerned authorities** i.e. regulator or government body. The non-official status of the Advisory Groups has enabled them to consider the official stance but make its own independent assessment of degree of compliance.

5.4 In some of the Advisory Groups there has been a view in **favour of making recommendations on substantive policy-issues**, while the mandate was, say on, transparency. There have also been occasions when the Group **tended to comment** on functioning of official bodies in the context of standards.

5.5 In the preparation of their respective Reports, most Advisory Groups have also been studying and **reviewing international experience in various subject areas**. In particular, the Report of the Advisory Group on Monetary and Financial Policies took comprehensive account of extant institutional arrangements and practices in five countries namely, the UK, USA, Australia, New Zealand and South Africa. The Advisory Group on Bankruptcy Laws has examined the existing Acts on insolvency and bankruptcy in the US and selected countries in Europe and Asia. The Advisory Group on Accounting and Auditing has conducted in depth studies of the International Accounting Standards (IAS), the US Generally Accepted Accounting Principles (US GAAP) and the comparative structure of Accounting Standards in India and standards issued by the Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI).

5.6 In the course of their work, the Advisory Groups have also been **having the benefit of discussions with market participants, members from professional bodies as well as academics**. The Advisory Group on Insurance Regulation met the officials of Life Insurance Corporation of India and the Advisory Group on Fiscal Transparency had extensive discussions with all State Finance Secretaries and the Office of Comptroller and Auditor General of India. Advisory Groups have, in most cases, co-opted market participants and members from professional bodies as special invitees. For example, the Advisory Group on Payments and Settlement System has special invitees from the National Stock Exchange(NSE) and a member from academia. The Advisory Group on Accounting and Auditing has a member from the Institute of Chartered Accountants of India(ICAI) and other well known market participants and practicing professionals. Similarly, the Advisory Group on Securities Market Regulation and the Advisory Group on Banking Supervision has eminent experts from the Housing Development Finance Corporation(HDFC) and ICICI Bank. The Advisory Group on Bankruptcy Laws also includes practicing professionals and eminent academics, including the former Director of National Law School as the Chairman of the Group.

5.7 The Advisory Groups were **encouraged to prepare in tabular form the given international standard/code, current status in India and the corresponding recommendation of the Group as a supplement to the narrative to facilitate easy reference**.

5.8 As and when the Reports are received by the Standing Committee, they are **placed on the Reserve Bank of India's website for immediate wider public dissemination**.

VI. Current Status

6.1 As of now, the reports/part of reports in respect of the following subjects **have already been received by the Standing Committee** : Transparency of Monetary & Financial Policies (Final), Payment and Settlement System (Parts I and II), Insurance Regulation (Final- Parts I and II), Banking Supervision (Part I), Accounting and Auditing (Final), Bankruptcy Laws (Interim). All Reports have been placed on the RBI website <www.rbi.org.in> and are **in the process of being published** for wider dissemination and discussion.

6.2 **The ‘Foreword’ to the first in these** series of Reports on ‘Transparency in Monetary and Financial Policies’ is **presented as an Appendix to this paper**. As may be seen, the effort is to make the readers aware of what standards and codes are and their importance for national economies in the current milieu.

VII. Plans for follow up

7.1 The submission of the Reports by Advisory Groups would be followed up in accordance with the decisions of the Standing Committee meeting held on September 20, 2000.

7.2 The **Standing Committee** would consolidate the Reports of all Advisory Groups and **prepare its own report** containing executive summaries/highlights of all the reports, action points requiring attention by regulatory authorities/agencies concerned with the follow up. The Standing Committee report **also would be widely disseminated** to the public as the Advisory Group reports.

7.3 The Advisory Group would be requested to help **organise a seminar/workshop** for a day in an appropriate institution/centre for creating awareness and this would help the Standing Committee **to concretise the views on recommendations**.

7.4 For each Report, **a mailing list** covering both public sector and private sector organizations, international institutions and experts, both local and international, would be also be identified and finalised in consultation with the Chairman of each Advisory Group. The Standing Committee would request specific comments/feedback on the recommendations of the Advisory Group from these addressees.

7.5 The Standing Committee would prepare **an annual review of status and progress regarding compliance with**, and implementation of standards and codes and submit it to the Ministry of Finance.

VIII. Highlights

8.1 The Indian position which **recognises the significance, scope, limits and contextual degree** of relevance of international financial standard and codes has been considered by a broad spectrum of experts, intellectuals and market participants as reasonable.

8.2 Second, the need to **assess** Indian standards and codes with international **benchmarks** has **also elicited broad support**.

8.3 Third, the impact of the process could often **be indirect and not necessarily direct** and instant. For example, the Secretary Department of Company Affairs in a recent address to the Accountants and Auditors referred to the work of the Standing Committee and related it to the ongoing amendments to the Company Law.

8.4 Fourth, the participative processes also have **a multiplier effect** in terms of several means by which the codes and standards are disseminated. For example, the widely read Economic Survey 2000-01 of Government of India released as part of set of **Budget Documents** makes a detailed reference to the subject (vide Box 6.4 on International Financial Standards and Codes). There have also been extensive references to this in several **publications of Reserve Bank of India**.

8.5 Fifth, several prominent intellectuals, professionals, and market participants contributed to the process of benchmarking, and identifying gaps and they **participated in the exercise in a purely honorary capacity, as a national endeavor**.

8.6 Sixth, such a process **brought out the possible differing views** between official bodies or authorities and domestic independent opinion as regards the extent of compliance with such codes and standards. It is considered necessary **to recognise this and try to arrive at a consensus**.

8.7 Seventh, **some concern on the part of official authorities** to such an independent assessment is understandable **but could be significantly overcome** through their participation as special invitees and the efforts of advisory group which have members of national standing.

8.8 Eighth, many **areas of overlap** among the areas covered by different Advisory Groups were observed. Also, each Advisory Group **had to interact** with several regulatory and standard setting bodies. The process thus becomes **quite complex, especially when the jurisdictional issues** come up.

8.9 Ninth, several standard setting bodies including professional associations and self-regulatory bodies of market participants involved with current practices have, on occasions **had concerns about the Advisory Groups findings but special efforts by the Advisory Groups** helped assuage these concerns.

8.10 Tenth, the work of the Advisory Groups required **substantial technical and professional inputs** located in several agencies, public and private. These had to be pooled and collated.

8.11 Eleventh, the Advisory Groups have found **it difficult to focus entirely on compliance** issues since there is a preoccupation with immediate issues of operational significance to the market participants and such issues may be policy or procedural or may even be of short term relevance. The **main focus has not been, however, lost sight of**.

8.12 Twelfth, the enthusiasm for disclosure and transparency in public agencies **is not matched by eagerness to be transparent on the part of private sector**. The private sector's participation in the process helped a better appreciation of **the importance of disclosures**.

8.13 Finally, four lessons from the exercise appear to be relevant. The process of implementation demands significant resources and is time-consuming. Moreover, most of the follow-up activities require some legislative changes. In the ultimate analysis, adoption of the standards has to be driven by self-interest of the country and attempts should be toward harmony and ultimate convergence rather than mechanical compliance.
