Core Principles of Banking Supervision for Effective Financial Inclusion

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Here are the comments supplemental to those mentioned in my document dated 25^{th} March 2016 posted on BCBS site in response to the invitation on Draft Document on the subject.

Effective financial inclusion would mean that the intended objectives of financial inclusion would have been served well. Supervisory principles should therefore ensure such effectiveness. Second, the principles as mentioned in the document are directed to non-bank financial intermediaries: "The Guidance specific to nonbank financial institutions – which in many countries are the primary providers of financial services to un-served and underserved customers– is provided to reinforce the importance of the **proportionate** regulation and supervision of such institutions."(Emphasis is mine)

Regulatory requirements succeed and not precede the achievements of the financial inclusion agenda. There is broad recognition that multitude of institutions and multiple regulators with not necessarily complementary objectives exist on the map of financial inclusion. Therefore, there are supply side constraints in delivering the financial inclusion objectives to the intended target groups. It is not so much widening as deepening of the institutional delivery mechanisms that should concern the regulator in the financial sphere.

I have mentioned earlier that ten core principles in simple terms are adequate to take care of the supervisory concerns and suggestions have come that I should specify them in a tabular form that follows:

S.No.	Core Principle	Reasons
1	Responsibility, Objectives and Powers	Independence and accountability cannot be ensured without legal protection and therefore, these principles should be part of the responsibilities, Objectives of supervision shall include scrutiny and comment on the institution's commitment to the goals of financial inclusion that should necessarily find a place in its Memorandum and Articles of Association.
2.	Licensing and Permissible activities	The License shall contain the permissible activities and the boundaries of functioning. Therefore, these two need not be separate principles but clubbed as single objective.
3.	Cooperation and Collaboration	This is a critical principle that should actually have legal backing. Cooperation among institutions having competing objectives with each of the multiple regulators having its own sphere of authority and enforcement regulations, is difficult to achieve unless the objectives of financial inclusion dominate over that of individual regulatory objective of the involved institutions.
4.	The Core Principles relating to Supervision (8 to 12) can	Methods, tools, and instruments depend on what the regulator has to supervise. This should not be another

	all be under one single principle of 'Supervision Methods, Tools and Reporting'	audit or inspection but a few notches superior to it. One size fits all approach does not render supervision effective. SHGs, MFIs, MFOs, NBFCs, Producers' organisations within and outside the fold of cooperatives, financial cooperatives. Pension Funds, Micro Insurance, Reinsurance and Guarantee organisations should all be the focus of this supervision and Commercial Banks that are already covered comprehensively under Basel III core principles need not again form part of this supervisory agenda even if they are implementing schemes for financial inclusion. This would ab initio eliminates the need for third party concerns.
5	Corporate Governance	All the Directors or members of the Boards of Governance of the non=government organisations should be inducted with an individual statement specifying his personal objective for serving on the Board and the performance criteria he/she would like to set; the code of conduct that the Board specifies up front; periodical data and information that it seeks to review and the accountability and transparency rules among the most important areas. Supervisory Principles should review the Board of Governance from the bench marks it has set unto itself. Due diligence of the individual members of governance team shall include the track travelled in financial transactions individually and collectively prior to joining the Board to eliminate persons of doubtful financial integrity.
6	Risk Management Practices	Organisation's risk management permeates both products and processes. Each organisation shall clearly state its risk management objectives and measurement practices. Delegation of powers, discretionary roles, and accountability shall all be specified. Credit, market and operational risks are not necessarily of the same dimension or perimeters as of the commercial banks and therefore applying the same principles would not be in order.
7.	Capital Adequacy	Basel 1 and Basel II capital adequacy norms depending upon the size of the balance sheet of the firms in question are enough as these do not pose serious issues of funding either from the donors or from the owners of capital when sudden collapse occurs – could be manmade or natural disasters. Bankruptcy Law can also take adequate care in cases of company failures. Client protection here assumes supremacy over capital as the clients are of extremely small means

		and in that context guarantee mechanisms need proper surveillance.
8	Problem Assets, Provisions and Reserves	Prudential norms and provisions should sync with the lending practices. When most loans themselves are of very short duration and do not necessarily create durable assets the same prudential norm applicable for commercial banks would not be relevant. Most of the loans are for creating sustainable livelihood opportunities for the poor – the unserved and underserved customers. Therefore, the provisioning norms should also be equitable and have proportionality.
9.	Disclosure and Transparency	When data integrity is made part of disclosure, it will have greater import and would be capable of enforcing punitive measures for incorrect and malafide data. Boundaries of transparency need to be prescribed proportionate to the size of the balance sheet of the firms under supervision. Transparency should not border on nudity.
10	Abuse of financial services	Any abuse of financial services shall be viewed seriously and prompt action becomes imperative. If any organisation takes unduly long time either to fix the offence and take appropriate punitive action within reasonable time, it shall be subject to commensurating financial penalty and beyond three such penalties, license should be revoked.