

India needs independent Financial Resolution Authority: RBI panel

India should have an independent Financial Resolution Authority (FRA) with sweeping powers over banks, insurers and brokerages — to prevent a contagion from sinking the financial markets, similar to what the US has evolved after the 2008 credit crisis, an experts' group has said.

Some of the tools to prevent any too-big-to-fail institution wrecking the system include liquidation, purchase and assumption, bridge institution, good-bank and bad-bank, bail-in and temporary public ownership, it said.

These are among the at least 38 major, and scores of minor, proposals floated by the group, headed by Finance Secretary Arvind Mayaram, and former deputy governor Anand Sinha, to prevent a meltdown similar to the one in US in September 2008 after the Lehman Brothers Holdings filed for the biggest-ever bankruptcy. The FRA should be independent of regulators and the shareholders must bear the losses in case of failure, the committee says.

"The aim of resolution is not to preserve the failing institution, but to ensure continuity of the functions that are critical for the financial system as a whole and limit any use of taxpayers' money," says the report submitted to the Reserve Bank of India Governor Raghuram Rajan.

India, which escaped the global financial crisis without much of a scar because of its closed market, is evolving systems and institutions to prevent calamities such as in the US where the government bailed out Wall Street banks with tax payers' money.

Although closed, India has seen instances of financial institutions such as Global Trust Bank going bust, but the RBI had arranged shotgun marriages to save depositors and let off those behind such failures without punishment. "What's common across all these tools is each of the resolution paths will typically impose losses on the shareholders," the report said. "FRA would be responsible for the resolution of all financial institutions, regardless of size or of sector. This FRA should be institutionally independent and an equal player with other safety net agencies."

The FRA will evolve a plan without moral hazard to ensure financial crisis at systemically important financial institutions does not spread and weaken others. It will be the sole empowered body to resolve a financial crisis, but without the ability to take an institution into temporary public ownership. That will be the prerogative of the government on the recommendations of the FRA, the report said.

"Situations where a financial institution, deemed to be systemically important, comes into financial distress and has the potential to trigger financial instability and cannot be resolved by sale to a third party because of its sheer size, can best be resolved as a last option by the government taking control of the financial institution," said the report.

"This tool, however, needs to be handled with due care. It should be ensured that this tool is operated only as an interim measure and the ultimate objective should be to arrange for a permanent solution such as sale or transfer or merger with a private sector purchaser."

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