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Legislative Department

विधि और न्याय मंत्रालय
Ministry of Law and Justice

**REPORT OF THE COMMITTEE
TO IDENTIFY THE CENTRAL ACTS WHICH
ARE NOT RELEVANT OR NO LONGER
NEEDED OR REQUIRE REPEAL/
RE-ENACTMENT IN THE PRESENT
SOCIO-ECONOMIC CONTEXT**

**VOLUME IV
(PART-III)**

**[COPIES OF REPORT OF FINANCIAL SECTOR
LEGISLATIVE REFORMS COMMISSION, REPORT OF
JOINT COMMITTEE TO EXAMINE THE
CONSTITUTIONAL AND LEGAL POSITION RELATING
TO OFFICE OF PROFIT, REPORT OF THE 13TH
FINANCE COMMISSION, GAZETTE NOTIFICATION
FOR CONSTITUTION OF 14TH FINANCE COMMISSION
AND THE COPY OF THE DRUGS (CONTROL) REPEAL
BILL, 2006 PERSUED AND CITED IN THIS REPORT]**

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FINANCIAL SECTOR LEGISLATIVE REFORMS COMMISSION

New Delhi
22 March, 2013

Shri P. Chidambaram
Finance Minister
Government of India
New Delhi 110001

Dear Finance Minister,

The FSLRC presents its Report to the Government of India. The Report is in two parts: Volume I – text of the findings and recommendations and Volume II – basic framework of a draft law.

The Commission did not release the Report in public domain since the mandate was to submit it to the Government. However, given the high level of stake-holder interest on the subject and the need for transparency, the Government may release the Report at the earliest.

Yours sincerely

B N Srikrishna
Chairman

Dhirendra Swarup
Member Convener

M Govinda Rao
Member

Jayanth Verma
Member

P J Nayak
Member

K J Ladeshi
Member

Yezdi H Malegam
Member

C K G Nair
Secretary

*Appointed Member of the 14th Finance Commission with effect from 04 February, 2013. Three Members of the FSLRC could not sign the Report. Shri C. Achuthan passed away on 19th September, 2011; Justice Deep Prasad Pal is seriously ill and Joint Secretary, Capital Markets (Nominee Member) could not attend the meetings due to other commitments.

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Acronyms

AAA	Aid, Accounts and Audits Division
ARC	Asset Reconstruction Company
ASIC	Australian Securities and Investment Commission
BOD	Board of Directors
BOM	Board of Management
BSM	Bank Subsidiary Model
CAG	Comptroller and Auditor General of India
CCI	Competition Commission of India
CCP	Central Counter Party
CEA	Chief Economic Advisor
CEO	Chief Executive Officer
CERC	Central Electricity Regulatory Commission
CERSAI	Central Registry of Securitisation Asset Reconstruction and Security Interest of India
CFSA	Committee on Financial Sector Assessment
CFTC	Commodities Futures Trading Commission
CFT	Combating the Financing of Terrorism
CPC	Code for Civil Procedure, 1908
CRR	Cash Reserve Ratio
DEA	Department of Economic Affairs
DICGC	Deposit Insurance and Credit Guarantee Corporation of India
DOP	Department of Post
DRT	Debt Recovery Appellate Tribunal
ORT	Debt Recovery Tribunal
EPFO	Employees' Provident Fund Organisation
EPF	Employees' Provident Fund
ESIC	Employees' State Insurance Corporation
FATF	Financial Action Task Force
FCA	Financial Conduct Authority
FDI	Foreign Direct Investment
FDMC	Financial Data Management Centre
FHC	Financial Holding Company
FI	Foreign Institutional Investor
FMC	Forward Markets Commission
FMI	Financial Market Intermediary
FRA	Financial Redress Agency

FSAT	Financial Sector Appellate Tribunal
FSA	Financial Services Authority
FSOC	Financial Stability and Development Council
FSLRC	Financial Sector Legislative Reforms Commission
FVCI	Foreign Venture Capital Investor
GDP	Gross Domestic Product
GIC	General Insurance Council
GOI	Government of India
HR	Human Resources
IBA	Indian Banks' Association
IMF	International Monetary Fund
IRA	Independent Regulatory Agency
IRA	Independent Regulatory Agency
IRDA	Insurance Regulatory and Development Authority
KYC	Know Your Customer
LIC	Life Insurance Corporation
MCA	Ministry of Company Affairs, Government of India
MD	Managing Director
MPC	Monetary Policy Committee
NABARD	National Bank for Agriculture and Rural Development
NBFC	Non-Banking Financial Company
NCDRC	National Consumer Disputes Redressal Commission
NHB	National Housing Bank
NCHC	Non-Operating Holding Company
NPA	Non-Performing Asset
NPS	New Pension System
NSSF	National Small Savings Fund
OTC	Over The Counter
PBMA	Public Debt Management Agency
PFRA	Pension Fund Regulatory and Development Authority
PPF	Public Provident Fund
PSB	Public Sector Bank
PSU	Public Sector Undertaking
QF	Qualified Foreign Investor
QIB	Qualified Institutional Buyer
RBI	Reserve Bank of India
RODRI	The Recovery of Debts Due to Banks and Financial Institutions Act, 1993
ROC	Registrar of Companies
RRB	Regional Rural Bank
RTI	Right to Information
SARFAESI	The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act
SAT	Securities Appellate Tribunal
SBI	State Bank of India
SEB	Securities and Exchange Board of India
SEC	US Securities and Exchange Commission
SIFI	Systemically Important Financial Institution
SLR	Statutory Liquidity Ratio
SOP	Standard Operating Procedure
TOR	Terms of Reference
UCB	Urban Cooperative Bank

UFA	Unified Financial Agency
UIDAI	Unique Identification Authority of India
UK FSMA 2000	UK Financial Services and Markets Act, 2000
UK	United Kingdom
ULIP	Unit-Linked Insurance Plan
UPSC	Union Public Service Commission
US	United States
WG	Working Group
WOS	Wholly Owned Subsidiary

Acknowledgement

When the Ministry of Finance approached me in early 2011 to chair a Commission on financial sector legislative reforms, I was somewhat daunted by the magnitude of the task. However, my hesitation disappeared when I saw the mandate of this body and the list of experts being proposed as its members. The remit of the Commission was on an extremely important national issue and the proposed members were renowned experts from an eclectic mix of relevant areas. That diminished my trepidation and imbued me with the confidence needed to take on the task.

Financial sector reforms affect everyone in the country and beyond, given the growing interface of our economy with the rest of the world. Dozens of legislations enacted from the 1870s were the foundations of this important catalytic sector. Many of them were enacted when financial economics was not born and the financial sector was at its infancy. In the last 100 years financial policies and practices have undergone many paradigm shifts. But its legal foundations, though amended in piecemeal fashion at times, remained more or less static with serious fractures visibly harming the system. These 'fault lines', once more or less hidden, are now evident openly in the form of lack of legal clarity on responsibility and powers of regulators, inter-regulatory disputes, regulator-regulated court battles, adventurism of market participants and the growing shadow banking and shadow financial sector. How do we address the new world of finance with the institutions and the equipment from a non-financial era? How do we transform the ossified institutional structures and outdated practices to suit contemporaneous needs? How do we address the transition? These were some of the questions confronting us. What complicated our task further was that the established global models were facing serious crises of confidence as the world economy was passing through one of the most turbulent periods in its economic-financial history. The revelations and lessons, particularly on regulatory models, emanating from the global financial crisis were intimidating even to high profile experts in the domain.

Given the nation as the stake-holder base of the Commission's mandate, it was felt imperative that we approach the issue with an open mind. Several expert committee reports were readily available to the Commission as a first step in helping our inquiry. We acknowledge our intellectual indebtedness to the reports of the committees chaired by M. Narasimham, R.H. Patil, Percy Mistry, Raghuram Rajan, J. Swarup, J.K. Sinha, among others. In addition, the Commission, after a few rounds of internal deliberations, sought the views of many more experts and major stake-holders. The Commission is grateful to all of them who gracefully accepted our invite and frankly shared their views without being coloured by their institutional affiliations. While the full list is annexed to this Report, I would particularly recall some of them. They include Dr. Shankar Acharya, Dr. Bimal Jalan, Mr. Deepak Parekh, Dr. Vijay Kelkar, Dr. Raghuram Rajan, Dr. Percy Mistry, Dr. Viral

Acharya, Dr. Avinash Persaud, the ESDC Sub-Committee (Dr. D. Subbarao, Prof. Kaushik Basu, Mr. U.K. Sinha, Mr. Hari Narayan and Mr. Yogesh Agarwal), Mr. Ashok Chawla, Mr. R. Gopalan, Mr. Rajiv Agarwal, Forward Markets Commission, among others. I also acknowledge the inputs provided by various industry associations such as FICCI, ASSOCHAM, and IBA.

The Working Groups which were set up by the Commission to delve deeper into sector-specific issues on banking, securities, public debt management, payments, insurance, pensions & small savings, carried the consultation/interaction process further. The inputs provided by these experts also were invaluable. Each working group report, chaired by a Member of the FSLRC with domain experts as Members, became a valuable addition to the resource base of this Report. We appreciate the efforts of all in these Working Groups.

I also acknowledge with great satisfaction the interactions we had with regulators, policy makers and other experts in select jurisdictions – Australia, Singapore, UK and Canada. I am also grateful to Mr. Bill Shorten, Minister for Superannuation and Financial Services, Australia, the Indo-US Business Council, City of London and the US Federal Reserve team who met with the Commission and shared their valuable thoughts. The support of Mr. Matt Crocke, Ms. Eva George, Mr. Gideon Lundholm and others who helped in organising these meetings is also appreciated.

Based on the broad contours of the framework emerging from our interactions, research and deliberations the Commission released an Approach Paper in October 2012. We received a number of suggestions which were further deliberated upon and some of them suitably incorporated in this final Report. The feedbacks were particularly helpful in strengthening the internal consistency of the recommendations. We are grateful to those who gave their views, particularly Dr. C. Rangarajan, the RBI, Department of Consumer Affairs and several other experts.

The Commission could embark on its task soon after its Notification in March, 2011, because of the timely logistical support provided by SEBI, National Institute of Public Finance and Policy (NIPFP), and National Institute of Securities Market (NISM). I value the support provided by these organisations which helped the Commission to focus its efforts on its main task from the early days.

The task of the Commission has been quite onerous, but in discharging it every Member of the Commission lived upto his/her name and contributed substantially in shaping this Report. I appreciate and acknowledge the contribution of each Member of the Commission and recall the insightful and animated deliberations in our meetings and through electronic communications. I appreciate the additional responsibility willingly discharged by Mr. Swarup as a mentor and advisor on organisational and critical technical issues. The role played by Dr. C.K.G. Nair, Secretary to the Commission, in designing and executing the structures and processes for the seamless functioning of the Commission and his effective interventions in the deliberations in resolving complex issues was exemplary and deserves particular commendation. The untimely demise of Mr. Achuthan was a great loss to all of us. We were handicapped by the poor health of Justice (Dr.) Debi Prasad Pal during the latter half of our work. Dr. M. Govinda Rao, who was with the FSLRC almost till finalising the Report joined the Fourteenth Finance Commission on 4th February 2013. Joint Secretary, Capital Markets (Nominee Member) could not attend the meetings due to other commitments.

The Commission had the benefit of dedicated research teams set up by the NIPFP and by the NISM. These teams worked as a single unit and Dr. Ajay Shah played the role of an inspirational leader to the research teams, synchronising the various young minds and their outputs into an organic whole and succinctly presenting issues before the Commission. I commend the efforts of Dr. Shah, Dr. Ila Fatnaik and every other member of this spirited group of young people who worked untiringly for about two years. I also

appreciate the efforts of the consultants of the Commission; Somasekhar Sundaresan, Bobby Parikh and Rajsekhar Rao in guiding the research team on many issues as well as contributing to the deliberations of the Commission.

A number of experts peer-reviewed the draft documents. K.P. Krishnan, Yesha Yacav, M.S. Sahoo, Bindu Anand and many others provided extensive support in reviewing the drafts. I appreciate their help and useful suggestions.


Financial sector being a catalyst for the real sector growth has to be dynamic enough to support the growth aspirations. The institutional framework – laws, policies and organisations – governing the financial sector should enable its orderly growth in tune with such aspirations. A status-quo framework of a low level, fragmented financial sector supporting the current modest economic size of our nation is incapable and insufficient to perform this aspirational role which our economic institutions should play for our future. Further, such a framework encourages the growth of twilight zones like shadow banking and other shadow financial entities leading to major issues of consumer protection and systemic risk. Given this, the Commission was fully convinced of the need for disbanding the sectoral thinking and incumbent organisational affiliations while designing a new institutional foundation for the aspiring, future Indian economy.

The findings and recommendations of the Commission are the result of distilled wisdom of dozens of high-calibre minds and extensive research on the financial sector laws, policies and practices in India and some of the major jurisdictions abroad, the latter mainly for focusing on post-crisis developments. Using these expert views, feedbacks, research material and the expertise in the Commission, we debated and deliberated on the most appropriate model for India taking the ground realities of the Indian system on board. After all the model we build should be country-specific, tailored to our milieu; laws cannot be formulated without a model, in the vacuum or in a fluid state. We were conscious of the fact that we were attempting something on a magnitude with perhaps no parallel in independent India and legislative changes on a holistic scale are not a regular activity we can undertake. As such, our effort has been futuristic and expected to be sustaining for decades, as institutional changes happen only in a matter of decades as famously stated by Nobel Laureate Oliver Williamson.

The suggested full-scale legislative reforms may look ambitious. The Commission debated this issue at length and, despite many organisation-affiliated views, was fully convinced that a full-scale revamp was needed as piecemeal amendments to the existing legislations were grossly inadequate for a rapidly growing and fast globalising Indian financial sector. It was also clear to us that the foundations of modern financial legal-regulatory structures should be erected during peaceful times rather than wait for a crisis to unfold and then embark on a fire-fighting mode of institution building, which would be muddled and fragile. The need for streamlining the laws and reducing the number of regulatory authorities and giving them clear mandate was a common train of thought of all the experts we consulted.

In brief, this Report is the result of enormous efforts put in by the Commission Members, Secretary, Consultants and Researchers and the intellectual inputs drawn from a large number of experts and stake-holders. I gratefully appreciate and acknowledge all these inputs and support, without which we would have had to settle for sub-optimal outcomes.

New Delhi
22 March, 2013


B.N. Srikrishna

Executive Summary

Mandate

The Financial Sector Legislative Reforms Commission was constituted by the Government of India, Ministry of Finance, in March, 2011. The setting up of the Commission was the result of a felt need that the legal and institutional structures of the financial sector in India need to be reviewed and recast in tune with the contemporary requirements of the sector.

The institutional framework governing the financial sector has been built up over a century. There are over 60 Acts and multiple rules and regulations that govern the financial sector. Many of the financial sector laws date back several decades, when the financial landscape was very different from that seen today. For example, the Reserve Bank of India (RBI) Act and the Insurance Act are of 1934 and 1938 vintage respectively. Financial economic governance has been modified in a piecemeal fashion from time to time, without substantial changes to the underlying foundations. Over the years, as the economy and the financial system have grown in size and sophistication, an increasing gap has come about between the requirements of the country and the present legal and regulatory arrangements.

Unintended consequences include regulatory gaps, overlaps, inconsistencies and regulatory arbitrage. The fragmented regulatory architecture has led to a loss of scale and scope that could be available from a seamless financial market with all its attendant benefits of minimising the intermediation cost. A number of expert committees have pointed out these discrepancies, and recommended the need for revisiting the financial sector legislations to rectify them. These reports help us understand the economic and financial policy transformation that is required. They have defined the policy framework within which reform of financial law can commence.

The remit of the Commission is to comprehensively review and redraft the legislations governing India's financial system, in order to evolve a common set of principles for governance of financial sector regulatory institutions. This is similar to the tradition of Law Commissions in India, which review legislation and propose modifications.

The main outcome of the Commission's work is a draft 'Indian Financial Code' which is non-sectoral in nature (referred to as the draft Code throughout), which is in Volume II of the report and replaces the bulk of the existing financial law.

Work process of the Commission

The Commission took a comprehensive, first principles approach to the task, rooting its analysis and decisions in a conceptual analysis of financial regulation and review of exper-

rience till date. Some elements of the work process that are used in India in Law Commissions were utilised. The Commission embarked upon an intense two year process, which started in April 2011. Three elements were emphasised in the work process. Commission has followed a *consultative approach*, reaching out into knowledge and perspective across all elements of Indian finance. Commission has cultivated a *multi-disciplinary approach*, drawing on the fields of public economics, law, finance, macroeconomics and public administration. Finally, Commission has drawn on *the experiences of emerging markets and developed jurisdictions* in understanding how financial law and agencies have been constructed worldwide.

The drafting of law in a democracy must necessarily give opportunities for all viewpoints to be heard. In addition, the crafting of law in finance involves considerable technical challenges. Over this two year period, more than 120 individuals participated in the process of the Commission in various capacities. This has helped ensure that diverse viewpoints fed into the debates of the Commission, and that the draft Code is characterised by technical soundness in terms of finance, economics, law, and public administration.

The tasks of financial law

The first set of questions that the Commission dealt with was about the purpose of the financial legal framework. Regulation is not an end in itself; it exists in order to address market failures. From this point of view, nine components were envisioned:

1. *Consumer protection* – The Commission found that a mere 'buyer beware' approach is not adequate in finance; regulators must place the burden upon financial firms of doing more in the pursuit of consumer protection. This perspective shapes interventions aimed at prevention (of inducing financial firms towards fair play) and cure (redress of grievances).
2. *Micro-prudential regulation* – When financial firms make promises to consumers, e.g. the repayment of a bank deposit, regulators are required to monitor the failure probability of the financial firm, and undertake interventions that reduce this failure probability.
3. *Resolution* – Micro-prudential regulation will diminish, but not eliminate, the failure of financial firms. A special, fast resolution capability is required, which swiftly and efficiently winds down stressed financial firms, and protects the interests of small customers.
4. *Capital controls* – These are restrictions on cross-border activity on the capital account. The Commission has no view on the sequencing and timing of capital account liberalisation. The work of the Commission in this field was focused on placing the formulation and implementation of capital controls on a sound footing in terms of public administration and law.
5. *Systemic risk* – Micro-prudential regulation thinks about the collapse of one financial firm at a time. A very different point of view is required when thinking of the collapse of the entire financial system. Micro-prudential regulation is about the trees, and systemic risk regulation is about the forest. It calls for measurement of systemic risk, and undertaking interventions at the scale of the entire financial system (and not just one sector) that diminish systemic risk.
6. *Development and redistribution* – Financial economic governance in India is charged with the development of market infrastructure and processes, and with redistribution. These objectives have to be achieved through sound principles of public administration and law.
7. *Monetary policy* – Objectives, powers and accountability mechanisms have to be setup for monetary policy.

8. *Public debt management* – A specialised framework on public debt management has to be setup that takes a comprehensive view of the liabilities of Government, and establishes the strategy for low-cost financing in the long run.
9. *Contracts, trading and market abuse* – Certain adaptations to the foundations of commercial law, surrounding contracts and property, are required to enable the financial system. Alongside this, the legal foundations for the securities markets are established.

The overall task of constructing financial law comprises the above nine elements, and of establishing sound foundations of regulatory governance.

This problem statement differs considerably from approach taken by existing laws in India, which are sector-specific. The existing laws deal with sectors such as banking, securities and payments. The Commission analysed this issue at length, and concluded that non-sectoral laws constitute a superior strategy.

As an example, a non-sectoral consumer protection law would lead to harmonisation of the consumer protection across multiple sectors. If this approach were not taken, there is the possibility of a certain sector having more lax standards of consumer protection than another. Profit-seeking financial firms would rush to exploit the profit opportunities, and distort the structure of the financial system.

In similar fashion, a non-sectoral micro-prudential law would ensure that similar reasoning about risk is applied all across the financial system. If micro-prudential regulation is done differently in different sectors, then profit-seeking financial firms will have an incentive to portray activities as belonging to sectors where capital requirements are weaker.

Non-sectoral laws are closely related to the idea of principles-based law. The draft Code is non-sectoral principles-based law. Regulators will issue regulations, that will often be sectoral and often be rules-based. The advantage of this arrangement is that specific details of technology and market process are not embedded in the law. Over the years, changes in technology and institutions would lead to modifications in regulations. Timeless principles would be re-interpreted in the future by courts and the tribunal, which would create case law. The Commission believes that the draft Code will, with no more than minor modifications, represent the essence of financial law for many decades to come. In this respect, the work of the Commission has taken Indian financial law closer to its roots in the common law tradition.

At present, financial law in India is fairly complex. The drafting style used in most current laws is relatively complex and thus unreadable to non-specialists. The Commission has tried to achieve a simple writing style for the draft Code. The unification of many laws into a single draft Code has greatly assisted simplification. A single set of definitions of terms is utilised across all 450 sections of the law. The entire draft Code is internally consistent, and has a simple and logical table of contents. This emphasis on simplicity would reduce the complexity faced by law-makers, bureaucrats, legal professionals and finance practitioners in understanding the law and working within it.

The first task of financial law is to establish a clear strategy for the nine areas listed above. The second task of financial law is to establish financial regulators.

In a liberal democracy, the 'separation of powers' doctrine encourages a separation between the legislative, executive and judicial functions. Financial regulators are unique in the extent to which all three functions are placed in a single agency. This concentration of power needs to go along with strong accountability mechanisms.

There is a strong case for independence of regulators. Independent regulators would yield greater legal certainty. The quest for independence of the regulator requires two planks of work. On one hand, independence needs to be enshrined in the law, by setting

out many processes in great detail in the law. On the other hand, alongside independence there is a requirement of accountability mechanisms.

The Commission has adopted five pathways to accountability. First, the processes that the regulator must adhere to have been written down in considerable detail in the draft Code. Second, the regulation-making process (where Parliament has delegated law-making power to regulators) has been established in the draft Code with great care, with elaborate checks and balances. Third, systems of supervision have been established in the draft Code with a great emphasis on the rule of law. Fourth, strong reporting mechanisms have been established in the draft Code so as to achieve accountability. Finally, a mechanism for judicial review has been established for all actions of regulators through a specialised Tribunal.

At present, laws and regulations in India often differentiate between different ownership or corporate structures of financial firms. The Commission has pursued a strategy of ownership-neutrality: the regulatory and supervisory treatment of a financial firm would be the same, regardless of whether it is private India, foreign, public sector and co-operative. This would yield a level playing field.

At present, many public sector financial firms (e.g. Life Insurance Corporation of India (LIC), State Bank of India (SBI)) are rooted in a specific law. The Commission recommends that they be converted into companies under the Companies Act, 1956. This would help enable ownership-neutrality in regulation and supervision. This recommendation is not embedded in the draft Code.

A related concern arises with co-operatives which fall within the purview of state Governments. The Commission recommends that State Governments should accept the authority of Parliament (under Article 252 of the Constitution) to legislate on matters relating to the regulation and supervision of co-operative societies carrying on financial services. This recommendation is also not included in the draft Code. The Commission proposes that regulators may impose restrictions on the carrying on of specified financial services by co-operative societies belonging to States which have not accepted the authority of Parliament to legislate on the regulation of co-operative societies carrying on financial services.

The footprint of regulation

As a first step in determining the appropriate form and extent of regulation for the Indian financial sector, the Commission began with an identification of the basic subject matter of regulation - financial products and services. In the view of the Commission, particular forms of dealings in financial products, such as securities, insurance contracts, deposits and credit arrangements, constitute the rendering of financial services. This includes services such as, sale of securities, acceptance of public deposits, operating investment schemes and providing credit facilities. The Commission however recognises that a principles-based approach to defining financial products and financial services comes with the risk of unintentionally casting the net of regulation too wide. Therefore, it was decided that financial regulation should apply to only those persons who are engaged in the business of carrying on financial services.

While proposing a list of financial products and services in the draft Code, the Commission is fully aware of the constant innovation in the field of finance. In order to ensure that the law can keep pace with these changes, the draft Code empowers the Government to expand the list of financial products and services, as required. At the same time, the draft Code also allows the regulators to exclude specific financial services carried out by specific categories of persons from the scope of financial services. Using this power the regulator will be able to specify exemptions, e.g. for hedge funds that do not access funds from more than a particular number of persons or investment firms that only advise their related persons. In going so, the regulator would of course be bound by the objectives and guided by the principles set out under the draft Code.

Structure of the regulator

Just as the draft Code does not differentiate between different sectors in the financial system, the draft Code establishes a single framework for regulatory governance across all agencies. This is rooted in the fact that the requirements of independence and accountability are the same across the financial system. With small adaptations, this standard framework is used in the draft Code for all agencies created therein.

The draft Code creates a series of obligations for the Government and for regulators. The draft Code covers all functions of regulators, and defines the behaviour that is required from the regulator.

All regulators will have an empowered board. The Commission has drafted a precise selection-and-search process for the appointment of all members. Four kinds of members are envisioned: the chairperson, executive members including an administrative law member, non-executive members and Government nominees. The role of each of these kinds of members has been defined. The appointment conditions for board members have been defined.

The draft Code establishes certain elements of the functioning of board meetings, so as to ensure adequate oversight of the board over the organisation, and an emphasis on transparency.

A general framework for establishing advisory councils, that will support the board, has been created. This is sometimes invoked in the draft Code in constructing statutory advisory councils. Apart from this, the board will be free to construct additional advisory councils based on its needs.

The Commission envisages that fees charged to the financial system will fund all regulatory agencies. Financial regulation will, therefore, generally impose no burden upon the exchequer. This will assist independence by giving regulators greater autonomy, and help the creation of a specialised workforce.

Functions and powers of the regulator

The actual functioning of the regulator lies in three areas: regulation-making, executive functions and administrative law functions. In each area, the draft Code defines the functioning of regulators with considerable specificity.

At present, in India, there is a confusing situation with regulators utilising many instruments such as regulations, guidelines, circulars, letters, notices and press releases. The draft Code requires all regulators to operate through a small number of well-defined instruments only.

The first task of a regulator is that of issuing regulations. If laws are poorly drafted, there is a possibility of excessive delegation by Parliament, where a regulatory agency is given sweeping powers to craft regulations. The Commission has consistently sought to define specific objectives, define specific powers and articulate principles that guide the use of powers. Through this, regulation-making at the regulator would not take place in a vacuum.

A structured process has been defined in the draft Code, through which regulation-making would take place. The regulator would be required to articulate the objective of the regulation, a statement of the problem or market failure that the regulation seeks to address, and analyse the costs and benefits associated with the proposed regulation. A systematic public consultation process is written into the draft Code. This structured regulation-making process would reduce arbitrariness and help improve the quality of regulations.

This structured regulation-making process requires a considerable expenditure of time and effort at the regulator. This is commensurate with the remarkable fact that Parliament has delegated law-making power to a regulator. In an emergency, the regulator

can issue regulations without going through the full regulation-making process. However, these regulations would lapse within six months.

Alongside regulations, the draft Code envisages a process through which regulators can issue 'guidelines'. Guidelines clarify the interpretation of regulations but do not, themselves, constitute regulations. Specifically, violation of guidelines alone would not constitute violation of the law.

At present, regulations are not subject to judicial review. The Commission envisages an important process of judicial review of regulations. It would be possible to challenge regulations either on process issues (i.e. the full regulation-making process was not followed) or substantive content (i.e. the regulation does not pursue the objectives, or exceeds the powers, or violates the principles, that are in the Act). The Commission believes that these checks and balances will yield considerable improvements in the quality of regulation-making in India.

Turning to executive functions, the draft Code has specifics about each element of the executive powers. The first stage is the processing of permissions. A systematic process has been laid down through which permissions would be given.

The second element is information gathering. Regulators require a substantial scale of regular information flow from financial firms. The Commission envisages a single 'Financial Data Management Centre'. All financial firms will submit regular information filings electronically to this single facility. This would reduce the cost of compliance, and help improve data management within regulators.

Turning to penalties, the draft Code has a systematic approach where certain standard categories are defined, and principles guide the application of penalties. This would help induce greater consistency, and help produce greater deterrence. A critical component of the framework for penalties is the mechanisms for compounding, which are laid on a sound foundation, and consistently applied across the entire financial system.

Once an investigation has taken place, and the supervisory team within a regulator believes there have been violations, the principles of public administration suggest that the actual order should be written by disinterested party. At the level of the board, an 'administrative law member' would have oversight of 'administrative law officers' who would not have any responsibilities within the organisation other than performing quasi-judicial functions. A systematic process would operate within the regulator, where administrative law officers and the administrative law member would be presented with evidence and write orders.

The working of the regulator ultimately results in regulations and orders. These would face judicial review at the Tribunal. The Commission envisages a unified Financial Sector Appellate Tribunal (FSAT) that would hear all appeals in finance. A considerable focus has been placed, in the draft Code, on the functioning of the registry of FSAT, so as to achieve high efficiency.

Consumer protection

The work of the Commission in the field of consumer protection marks a watershed compared with traditional approaches in Indian financial law. It marks a break with the tradition of *cooper emptor*, and moves towards a position where a significant burden of consumer protection is placed upon financial firms.

The draft Code first establishes certain basic rights for all financial consumers. In addition, the Code defines what is an unsophisticated consumer, and an additional set of protections are defined for these consumers. The basic protections are:

1. Financial service providers must act with professional diligence.
2. Protection against unfair contract terms;

3. Protection against unfair conduct;
4. Protection of personal information;
5. Requirement of fair disclosure;
6. Redress of complaints by financial service providers.

In addition, unsophisticated consumers have three additional protections:

1. The right to receive suitable advice;
2. Protection from conflicts of interest of advisors;
3. Access to the redress agency for redress of grievances.

The regulator has been given an enumerated set of powers through which it must implement these protections. Alongside these objectives and powers, the regulator has been given a set of principles that guide the use of the powers.

This framework of rights – powers – principles will shape the crafting of regulations. Once this has been done, regulators are obliged to undertake supervisory actions to verify that regulations are being complied with. This goes along with enforcement and disciplinary actions.

This regulatory and supervisory strategy will yield considerable gains in consumer protection, when compared with the present Indian practices. At the same time, there will be certain consumers who are aggrieved. The Commission envisages a single Unified Financial Redress Agency (FRA) which would serve any aggrieved consumer, across all sectors. This would feature a low-cost process through which the complaint of the consumer against the financial firm would be heard, and remedies awarded.

As with the FSAT, considerable effort has been made by the Commission to obtain an FRA that has high operational capabilities and thus imposes low transactions costs upon all participants.

The FRA is important as a mechanism for addressing the unfair treatment of one consumer. The FRA is also envisaged as a valuable measurement system, for the case database of the FRA is a map that shows where the problems of consumer protection lie. Hence, the Commission envisages a systematic process through which the analysis of this data would feed back into improvements in regulation and supervision.

The Commission recognises that competition is a powerful tool for the protection of consumers. The Competition Act enshrines a non-sectoral approach to competition policy. The Commission has envisaged a detailed mechanism for better co-operation between financial regulators and the Competition Commission through which there is greater harmony in the quest for greater competition.

Micro-prudential regulation

The pursuit of consumer protection logically requires micro-prudential regulation: the task of constraining the behaviour of financial firms so as to reduce the probability of failure. When a financial firm makes a promise to a consumer, it should be regulated so as to achieve a certain high probability that this promise is upheld.

The first component of the draft Code is a definition of the class of situations where micro-prudential regulation is required. This is done in a principles-based way, focusing on the ability of consumers to understand firm failure, to co-ordinate between themselves, and the consequences of firm failure for consumers.

Regulators have five powers through which they can pursue the micro-prudential goal: regulation of entry, regulation of risk-taking, regulation of loss absorption, regulation of governance and management, and monitoring/supervision. The draft Code specifies each of these powers in precise legal detail.

Alongside this, it specifies a set of principles that guide the use of these powers. Eleven principles have been identified that must be complied with. For example, principles require proportionality (greater restrictions for greater risk), equal treatment (equal treatment of equal risk), and so on.

It is envisaged that regulators will pursue the micro-prudential objective by writing regulations that utilise the five powers. At the same time, these regulations would have to satisfy the ten principles.

In this framework, there may be broadly three grounds for appeal against regulations. A regulation engages in micro-prudential regulation of an activity where micro-prudential regulation is not required. A regulation utilises powers which are not prescribed in the law. Finally, a regulation violates the principles which the regulator is required to follow.

Resolution

The Indian financial system has traditionally been dominated by public sector firms. When consumers deal with a Public Sector Undertaking (psu) bank or insurance company, for all practical purposes, they are dealing with the Government, and there is no perceived possibility of failure. Over the last 20 years, however, India has increasingly opened up entry into finance, and a new breed of private financial firms has arisen. These firms can fail, and when this happens, it can be highly disruptive for households who were customers of the failing firm, and for the economy as a whole.

Sound micro-prudential regulation will reduce the probability of firm failure. However, eliminating all failure is neither feasible nor desirable. Failures of financial firms is an integral part of the regenerative processes of the market economies: weak firms should fail and thus free up labour and capital that would then be utilised by better firms. However, it is important to ensure smooth functioning of the economy, and avoid disruptive firm failure.

This requires a specialised 'resolution mechanism'. A 'Resolution Corporation' would watch all financial firms which have made intense promises to households, and intervene when the net worth of the firm is near zero (but not yet negative). It would force the closure or sale of the financial firm, and protect small consumers either by transferring them to a solvent firm or by paying them.

At present, for all practical purposes, at present, an unceremonious failure by a large private financial firm in India is not politically feasible. Lacking a formal resolution corporation, in India, the problems of failing private financial firms are placed upon consumers, tax-payers, and the shareholders of public sector financial firms. This is an unfair arrangement.

Establishing a sophisticated resolution corporation is thus essential. Drawing on the best international practice, the draft Code envisages a unified resolution corporation that will deal with an array of financial firms such as banks and insurance companies. It will concern itself with all financial firms which make *highly intense* promises to consumers, such as banks, insurance companies, defined benefit pension funds, and payment systems. It will also take responsibility for the graceful resolution of systemically important financial firms, even if they have no direct links to consumers.

A key feature of the resolution corporation will be *speed of action*. It must stop a financial firm while the firm is not yet bankrupt. The international experience has shown that delays in resolution almost always lead to a situation where the net worth is negative, which would generally impose costs upon the tax-payer. The choice that we face is between a swift resolution corporation, which will stop financial firms when they are weak but solvent, and a slow resolution corporation which will make claims upon the tax-payer. Hence, a sophisticated legal apparatus is being designed, for a resolution corporation that will act swiftly to stop weak financial firms while they are still solvent. The

resolution corporation will choose between many tools through which the interests of consumers are protected, including sales, assisted sales and mergers.

It is important to make a clear distinction between micro-prudential regulation and resolution. Micro-prudential regulation and supervision is a continuous affair. Occasionally, when a firm approaches failure, resolution would come into action, and it would behave very differently from micro-prudential regulation. The resolution corporation would be analogous to a specialised disaster management agency, which is not involved in everyday matters of governance, but assumes primacy in a special situation. The resolution corporation will have close co-ordination with micro-prudential regulation. For strong firms, the resolution corporation will lie in the background. As the firm approaches default, the resolution corporation will assume primacy.

The resolution corporation will charge fees to all covered entities, who benefit from greater trust of unsophisticated consumers. This fee will vary based on the probability of failure, and on the financial consequences for the resolution corporation of the event of failure. This risk-based premium would help improve the pricing of risk in the economy, and generate incentives for financial firms to be more mindful of risk-taking.

The first three pillars of the work of Commission – consumer protection, micro-prudential regulation and resolution – are tightly interconnected. All three are motivated by the goal of consumer protection. Micro-prudential regulation aims to reduce, but not eliminate, the probability of the failure of financial firms. Resolution comes into the picture when, despite these efforts, financial firms do fail.

Capital controls

India has a fully open current account, but many restrictions on the capital account are in place. A major debate in the field of economic policy concerns the sequencing and timing towards capital account convertibility. The Commission has no view on this question. The focus of the Commission has been on establishing sound principles of public administration and law for capital account restrictions. A large array of the difficulties with the present arrangements would be addressed by emphasising the rule of law and by establishing sound principles of public administration.

In terms of creation of rules, it is envisaged that the Ministry of Finance would make 'rules' that control inbound capital flows (and their repatriation) and that RBI would make 'regulations' about outbound capital flows (and their repatriation). With RBI, the regulation-making process would be exactly the same as that used in all regulation-making in the Commission framework. With Ministry of Finance, the rule-making process would be substantially similar.

The implementation of all capital controls would vest with the RBI. The draft Code envisages the full operation of the rule of law in this implementation.

Systemic risk

The field of financial regulation was traditionally primarily focused on consumer protection, micro-prudential regulation and resolution. In recent years, a fresh focus on the third field of systemic risk has arisen. Systemic risk is about a collapse in functioning of the financial system, through which the real economy gets adversely affected. In the aftermath of the 2008 crisis, governments and lawmakers worldwide desire regulatory strategies that would avoid systemic crises and reduce the costs to society and to the exchequer of resolving systemic crises.

The problem of systemic risk requires a bird's eye perspective of the financial system: it requires seeing the woods and not the trees. This is a very different perspective when compared with the engagement of conventional financial regulation, which tends

to analyse one consumer, one financial product, one financial market or one financial firm at a time. The essence of the systemic risk perspective is to look at the financial system as a whole. This differs from the perspective of any one financial regulatory agency, and particularly divergent from the perspective of any one *sectoral* regulator which is likely to see that sector and not the overall financial system.

To some extent, systemic crises are the manifestation of failures on the core tasks of financial regulation, i.e. consumer protection, micro-prudential regulation and resolution. If the three pillars of financial regulation would work well, many of the crises of the past, and hypothetical crisis scenarios of the future, would be defused. Systemic risk in India will go down if institutional capacity is built for the problems of consumer protection, micro-prudential regulation and resolution. However, it will not be eliminated.

First, despite the best intentions, errors of constructing the institutional framework, and human errors, will take place. Second, even if all three pillars work perfectly, some systemic crises would not be forestalled. This calls for work in the field of systemic risk, as a fourth pillar of financial regulation.

While there is a clear case for establishing institutional capacity in these areas, it is also important to be specific in the drafting of law. Unless systemic risk regulation is envisioned as a precise set of steps that would be performed by Government agencies, there is the danger that systemic risk law degenerates into vaguely specified sweeping powers with lack of clarity of objectives.

The Commission deeply analysed the problem of reducing the probability of a breakdown of the financial system. This requires understanding the financial system as a whole, as opposed to individual sectors or firms, and undertaking actions which reduce the possibility of a collapse of the financial system. Each financial regulator tends to focus on regulating and supervising some components of the financial system. With sectoral regulation, financial regulators sometimes share the worldview of their regulated entities. What is of essence in the field of systemic risk is avoiding the worldview of any one sector, and understanding the overall financial system. In order to achieve this, Commission envisages a five-part process.

The first step is the construction and analysis of a system-wide database. This effort, which will be located at the Financial Stability and Development Council (Financial Stability and Development Council (FSDC)), will analyse the entire financial system and not a subset of it. The discussions at FSDC would communicate the results of this analysis to all regulators, who would co-operate in proposing and implementing solutions.

The second step is the identification of Systemically Important Financial Institutions (SIFIs). The analysis of the unified database, using rules which are agreed upon at FSDC, will be used to make a checklist of SIFIs. These will be subjected to heightened micro-prudential regulation by their respective supervisors.

The third step is the construction and application of system-wide tools for systemic risk regulation.

The fourth step is inter-regulatory co-ordination. Effective co-ordination across a wide array of policy questions is an essential tool for systemic risk reduction.

Finally, the fifth step is crisis management. The Commission envisages the Ministry of Finance as playing the leadership role in a crisis. Here, FSDC will only play a supporting role.

Four of the five elements of the systemic risk process involve a leadership role at FSDC. The Commission envisages that FSDC would be a new statutory agency, in contrast with its relatively informal existence at present.

Financial inclusion and market development

The development agenda in Indian financial economic policy comprises two elements: (i) The development of market infrastructure and processes, and (ii) Redistribution and financial inclusion initiatives, where certain sectors, income or occupational categories are the beneficiaries.

The framework proposed by the Commission involves placing the first objective with regulators and the second with the Government. The draft Code envisages regulators undertaking initiatives in the first area. For the second area, the Government would issue notifications in the Gazette, instructing regulators to impose certain requirements upon stated financial firms. The Government would be obliged to make payments to firms to reflect the costs borne by them.

The Commission felt that all initiatives of this nature – in the pursuit of inclusion or of development – should be subject to systematic evaluation after a period of three years. Decision making would be improved by a process of articulation of specific goals, followed by an evaluation of the extent to which these goals were met.

Monetary policy

The framework envisaged by the Commission features a strong combination of independence and accountability for RBI in its conduct of monetary policy.

The first stage lies in defining the objective of monetary policy. The Ministry of Finance would put out a Statement defining a quantitative monitorable ‘predominant’ target. Additional, subsidiary targets could also be specified, which would be pursued when there are no difficulties in meeting the predominant target.

The draft Code places an array of powers with RBI in the pursuit of this objective. Decisions on the use of these powers would be taken at an executive Monetary Policy Committee (MPC). The MPC would meet regularly, and vote on the exercise of these powers, based on forecasts about the economy and the extent to which the objectives are likely to be met.

The MPC would operate under conditions of high transparency, thus ensuring that the economy at large has a good sense about how the central bank responds to future events.

Alongside this core monetary policy function, RBI would operate a real time gross settlement system, that would be used by banks and clearing houses. It would also operate mechanisms for liquidity assistance through which certain financial firms would be able to obtain credit against collateral.

Public debt management agency

The management of public debt requires a specialised investment banking capability for two reasons:

1. Debt management requires an integrated picture of all onshore and offshore liabilities of the Government. At present, this information is fragmented across RBI and the Ministry of Finance. Unifying this information, and the related debt management functions, will yield better decisions and thus improved debt management.
2. A central bank that sells government bonds faces conflicting objectives. When RBI is given the objective of obtaining low cost financing for the Government, this may give RBI a bias in favour of low interest rates which could interfere with the goal of price stability.

In its entirety, the problem of debt management for the Government includes the tasks of cash management and an overall picture of the contingent liabilities of the Government. These functions are integrated into a single agency through the draft Code.

Contracts, trading and market abuse

The last component of financial law is the set of adaptations of conventional commercial law on questions of contracting and property rights that is required in fields such as securities and insurance. Statutes as well as case laws have shaped the rules regarding creation of financial contracts, transfer of rights, title or interest in such contracts and enforcement of such rights. These developments have largely been sector specific.

The framework of the securities markets requires legal foundations for the issuance and trading of securities. Issuance of securities requires three kinds of restrictions. At the time of the issue, adequate information must be available for an investor to make an informed decision about valuation. Once the trading commences, a continuous flow of information must be available through which the investor can make informed decisions. Finally, a set of rules must be in place through which all holders of a given class of securities obtain the identical payoffs. These three objectives would be achieved through regulations.

Financial markets feature a important role for infrastructure institution. The rules made by these organisations shape the design of financial markets to a substantial extent. The draft Code constrains the behaviour of Infrastructure Institutions in three respects:

1. Infrastructure institutions are required to issue bye-laws and abide by them;
2. The objectives that these bye-laws must pursue are defined in the law;
3. They are required to obtain approval from the regulator for bye-laws.

The information about prices and liquidity that is produced by financial markets has a public goods character. The draft Code has provisions that require dissemination of this information. In addition, the falsification of this information is termed 'market abuse'. The draft Code defines market abuse and establishes the framework for enforcement against it.

Financial regulatory architecture

We now turn to the financial regulatory architecture, or the division of the overall work of financial regulation across a set of regulatory agencies. Many alternative structures can be envisioned for the financial regulatory architecture. Parliament must evaluate alternative block diagrams through which a suitable group of statutory agencies is handed out the work associated with the laws. These decisions could conceivably change over the years.

At present, Indian law features tight connections between a particular agency (e.g. Securities and Exchange Board of India (SEBI) and the functions that it performs (e.g. securities regulation). The draft Code does not have such integration. Changes in the work allocation should not require changes to the underlying laws themselves. From the outset, and over coming decades, decisions about the legal framework governing finance would proceed separately from decisions about the financial regulatory architecture. This would yield greater legal certainty, while facilitating rational choices about financial regulatory architecture motivated by considerations in public administration and public economics.

At present, India has a legacy financial regulatory architecture. The present work allocation, between RBI, SEBI, Insurance Regulatory and Development Authority (IRDA), Pension Fund Regulatory and Development Authority (PFRDA) and Forward Markets Commission (FMC), was not designed. It evolved over the years, with a sequence of piecemeal decisions responding to immediate pressures from time to time.

The present arrangement has gaps where no regulator is in charge – such as the diverse kinds of ponzi schemes which periodically surface in India, which are regulated by

none of the existing agencies. It also contains overlaps where conflicts between laws has consumed the energy of top economic policy makers.

Over the years, these problems will be exacerbated through technological and financial innovation. Financial firms will harness innovation to place their activities into the gaps, so as to avoid regulation. When there are overlaps, financial firms will undertake forum-shopping, where the most lenient regulator is chosen, and portray their activities as belonging to that favoured jurisdiction.

An approach of multiple sectoral regulators that construct 'silos' induces economic inefficiency. At present, many activities that naturally sit together in one financial firm are forcibly spread across multiple financial firms, in order to suit the contours of the Indian financial regulatory architecture. Financial regulatory architecture should be conducive to greater economies of scale and scope in the financial system. In addition, when the true activities a financial firm are split up across many entities, each of which has oversight of a different supervisor, no one supervisor has a full picture of the risks that are present.

When a regulator focuses on one sector, there are certain unique problems of public administration which tend to arise. Assisted by lobbying of financial firms, the regulator tends to share the aspirations of the regulated financial firms. These objectives often conflict with the core economic goals of financial regulation such as consumer protection and swift resolution.

In order to analyse alternative proposals in financial regulatory architecture, Commission established the following principles:

Accountability Accountability is best achieved when an agency has a clear purpose. The traditional Indian notion, that a regulator has powers over a sector but lacks specific objectives and accountability mechanisms, is an unsatisfactory one.

Conflicts of interest In particular, direct conflicts of interest are harmful for accountability and must be avoided.

A complete picture of firms A financial regulatory architecture that enables a comprehensive view of complex multi-product firms, and thus a full understanding of the risks that they take, is desirable.

Avoiding sectoral regulators When a financial regulator works on a sector, there is a possibility of an alignment coming about between the goals of the sector (growth and profitability) and the goals of the regulator. The regulator then tends to advocate policy directions which are conducive for the growth of its sector. Such problems are less likely to arise when a regulatory agency works towards an economic purpose such as consumer protection across all or at least many sectors.

Economies of scale in Government agencies In India, there is a paucity of talent and domain expertise in Government, and constructing a large number of agencies is relatively difficult from a staffing perspective. It is efficient to place functions that require correlated skills into a single agency.

Transition issues It is useful to envision a full transition into a set of small and implementable measures.

The Commission proposes a financial regulatory architecture featuring seven agencies. This proposal features seven agencies and is hence not a 'unified financial regulator' proposal. It features a modest set of changes, which renders it implementable:

1. The existing RBI will continue to exist, though with modified functions.
2. The existing SEBI, FMC, IRDA and PFRDA will be merged into a new unified agency.
3. The existing Securities Appellate Tribunal (SAT) will be subsumed into the FSAT.
4. The existing Deposit Insurance and Credit Guarantee Corporation of India (DICGC) will be subsumed into the Resolution Corporation.

5. A new Financial Redressal Agency (FRA) will be created.
6. A new Debt Management Office will be created.
7. The existing Fsoc will continue to exist, though with modified functions and a statutory framework.

The functions of each of these seven proposed agencies are as follows:

Reserve Bank of India It is proposed that RBI will perform three functions: monetary policy, regulation and supervision of banking in enforcing the proposed consumer protection law and the proposed micro-prudential law, and regulation and supervision of payment systems in enforcing these two laws.

Unified Financial Agency The unified financial regulatory agency would implement the consumer protection law and micro-prudential law for all financial firms other than banking and payments. This would yield benefits in terms of economies of scope and scale in the financial system; it would reduce the identification of the regulatory agency with one sector; it would help address the difficulties of finding the appropriate talent in Government agencies.

This proposed unified financial regulatory agency would also take over the work on organised financial trading from RBI in the areas connected with the Bond-Currency-Derivatives Nexus, and from FMC for commodity futures, thus giving a unification of all organised financial trading including equities, government bonds, currencies, commodity futures and corporate bonds.

The unification of regulation and supervision of financial firms such as mutual funds, insurance companies, and a diverse array of firms which are not banks or payment providers, would yield consistent treatment in consumer protection and micro-prudential regulation across all of them.

Financial Sector Appellate Tribunal The present SAT will be subsumed in FSAI, which will hear appeals against RBI for its regulatory functions, the Unified financial agency, decisions of the FRA and some elements of the work of the resolution corporation.

Resolution Corporation The present IRCC will be subsumed into the Resolution Corporation which will work across the financial system.

Financial Redressal Agency The FRA is a new agency which will have to be created in implementing this financial regulatory architecture. It will setup a nationwide machinery to become a one stop shop where consumers can carry complaints against all financial firms.

Public Debt Management Agency An independent debt management office is envisioned.

Financial Stability and Development Council Finally, the existing Fsoc will become a statutory agency, and have modified functions in the fields of systemic risk and development.

The Commission believes that this proposed financial regulatory architecture is a modest step away from present practice, embeds important improvements, and will serve India well in coming years.

Over a horizon of five to ten years after the proposed laws come into effect, it would advocate a fresh look at these questions, with two possible solutions. One possibility is the construction of a single unified financial regulatory agency, which would combine all the activities of the proposed Unified Financial Authority and also the work on payments and banking. Another possibility is to shift to a two-agency structure, with one Consumer Protection Agency which enforces the proposed consumer protection law across the entire financial system and a second Prudential Regulation Agency which enforces the micro-prudential regulation law across the entire financial system. In either of these paths, RBI would then concentrate on monetary policy.

These changes in the financial regulatory architecture would be relatively conveniently achieved, given the strategy of emphasising separability between laws which define functions and the agencies that would enforce the laws. Over the years, based on a pragmatic assessment of what works and what does not work, the Government and Parliament can evolve the financial regulatory architecture so as to achieve the best possible enforcement of a stable set of laws.

The outputs of the Commission

The main result of the work of the Commission is the draft Indian Financial Code, a single unified and internally consistent draft law that replaces a large part of the existing Indian legal framework governing finance. As has been emphasised earlier, the use of simple English should help ensure that everyone connected with the field would be able to understand the draft Code. This relatively large draft law – which is comprised of 450 sections – constitutes Volume II of the report. Volume I expresses the arguments that led up to the key decisions embedded in the draft Code.

The Commission vigorously debated the ideas expressed in the draft Code over a period of two years, in twenty four full-day meetings. In any law of 450 sections, there are bound to be certain areas of disagreement. The five areas of disagreement within the Commission, which are expressed in four dissent notes, are as follows:

1. *Authorisation requirements:* Prof. Jayanth Varma expresses concerns about the authorisation requirements for financial service providers.
2. *Capital controls:* Mrs. K. J. Udeshi, Dr. P. J. Nayak and Mr. Y. H. Malegam disagree with allocation of responsibilities on capital controls between the Ministry of Finance and RBI.
3. *The role of the Ministry of Finance:* Dr. P. J. Nayak disagrees with the role envisaged for the Ministry of Finance in draft Code especially the role of the FSDC.
4. *Common-law tradition, principles-based law:* Dr. P. J. Nayak expresses concerns about the strategy of the Commission that has favoured a common law, principles-based approach.
5. *Regulation of Non-Banking Financial Company (NBFCs):* Mr. Y. H. Malegam disagrees with the allocation of regulatory responsibilities for NBFCs.

Conclusion

Financial economic policy is implemented by front-line agencies who are assigned functions by Parliament. The main purpose of financial law is to put these agencies on a sound footing, with the trio of objectives, powers and accountability mechanisms. Commission has focused itself upon this task, of establishing a sound regulatory process.

Most policy debates in the field of finance pertain to the subordinated legislation that is drafted by financial regulatory agencies. The work of Commission does not directly engage with these debates. As an example, Commission does not have a view on the timing and sequencing of capital account liberalisation. Similarly, a large number of the recommendations of the Working Groups which studied individual sectors fall in the domain of modifications to subordinated legislation. The work of Commission is focused on the incentives in public administration that shape the drafting and implementation of subordinated legislation. As a consequence, while the Commission has fully taken cognisance of the policy problems analysed by the expert committees of the last five years, and by its own Working Groups, it does not directly address them.

When the proposals of Commission are enacted by Parliament, they will set in motion a modified set of incentives in public administration. Clear objectives in law, and a sound regulation-making process, will improve the quality of subordinated legislation that is issued by regulatory agencies. The emphasis on legal process in the laws drafted by Commission will induce improved working of the supervisory process. A common consumer protection law will greatly benefit the users of financial services. These elements will yield a gradual process of change.

The Commission is mindful that over the coming 25 to 30 years, Indian GDP is likely to become eight times larger than the present level, and is likely to be bigger than the United

States as of today. Over these coming years, there will be substantial changes in the financial system. The technological change, and the financial products and processes which will come into play, cannot be envisaged today.

The aspiration of the Commission is to draft a body of law that will stand the test of time. The Commission has hence focused on establishing sound financial regulatory agencies, which will continually reinterpret principles-based laws in the light of contemporary change, and draft subordinated legislation that serves the needs of the Indian economy. This subordinated legislation, coupled with the jurisprudence built up at the PSAT and the Supreme Court, will continually reflect the changing needs of the Indian economy.

Introduction

1.1. FSLRC and its Mandate

The Ministry of Finance, Government of India, constituted the Commission¹ vide Resolution dated the 24th March, 2011, 'with a view to rewriting and cleaning up the financial sector laws to bring them in tune with the current requirements'. The Resolution, detailing the imposition and Terms of Reference (TOR) of the Commission, is in Annex 19.1.

The TOR are quite broad and cover a gamut of issues related to the financial sector in India. Broadly, the Commission has been tasked with examining and reviewing the legislative and regulatory systems; the inter-play of jurisdictions of various regulators; the issues relating to conflict of interest of regulators; the manner of drafting and implementation of subordinate legislation; the criteria and terms of appointment of senior officials in the regulatory authorities and appellate systems of financial sector; clarifying the principles of legislative intent; the issues relating to independence and autonomy of regulators; re-statement and/or repeal of legislations on the basis of liberalisation and other developments in the last two decades; the issues on data privacy and protection of consumers of financial services; the role of information technology and effectiveness of delivery of financial services; the recommendations made by expert committees in the past; the issues relating to inter-state aspect of financial services infrastructure and any other related issues; and evaluating the *raison d'être* of the several laws governing the financial sector, some of them as old as 140 years. Keeping them in context and fitting them to the broad framework of the economy's future requirements has been a daunting task. The Commission was given a time-frame of twenty four months to complete this effort.

The Commission was set up at a time when the global economy was recovering from the 2008 financial crisis. At the time, lessons from what went wrong and the possible options were being debated. These ideas and inputs were freshly available to the Commission. India escaped the crisis fairly unscathed; and therefore, the Commission did not have to work on regulatory structures and laws in a fire-fighting mode, which is not an appropriate way of building sustainable institutional structures. The Commission could, therefore, assimilate the lessons from the crisis, and at the same time, think and construct a model relevant to the Indian context in a calm and detached manner supported by quality research, extensive deliberations and detailed interaction with a host of experts and stakeholders.

¹The terms Commission and the Commission are used interchangeably in this report

1.2. Deliberations in the Commission

The Commission followed a multi-pronged approach in completing its task of preparing this report, as well as in drafting laws. This included: scanning expert committee recommendations; extensive research; deliberations by the Commission; deliberations, in its five Working Groups (wgs), on specific issues; interaction with several experts and stakeholders from the financial sector, as well as with financial policy makers, experts and regulators of select jurisdictions abroad. A team of consultants, researchers and other officials assisted the Commission in its task; the list is given in Annex 19.2.

The objective has been to assemble a solid information base relating to the current state of the economy and the financial sector, the institutional constraints, developments elsewhere and to make an assessment of what is needed to institutionalise the structure of the financial sector, in tune with the requirements of a fast growing economy. In its inquiry, the Commission also tried to understand the reasons for the 2008 financial crisis and the lessons that may be followed for the future India, as her institutions have to achieve the strength and maturity to withstand possible financial crises in the future.

The Commission had twenty four meetings over a span of two years. During the early days itself, an approach towards completing its task was designed. It was decided that the Commission would deliberate on the basic framework and the fundamental principles governing the financial sector and decide the same. Based on this framework and principles, the wgs would delve deep into select sector-specific issues that require detailed analysis. Based on the deliberations and decisions in the Commission and its wgs, draft documents would be prepared by the research team and debated further in subsequent meetings.

From the beginning, there had been a consensus that the Indian financial sector has been operating at a low-level equilibrium, although in this world of 'small finance', it may be doing reasonably well, according to established thinking. The Commission learned a lot from the various expert committee reports already available on the Indian financial sector. There was also unanimity that the trajectory had to be scaled up from this low-level equilibrium so that the financial sector effectively performs its catalytic role for a new aspiring India, which is expected to reach the size of the 2012 Gross Domestic Product (GDP) of the USA (us\$15 trillion) by 2025-30. While India wanted to avoid the path of runaway financial innovation and unmitigated risk-taking that led to the 2008 financial crisis, which continues to threaten the global economy, there was unanimity that the Indian financial structure needs to grow considerably. To enable this, the institutional structure needs to be revamped given that supporting laws are obsolete and organisational structures fragmented. In short, a consolidation of the financial sector laws and organisations was an essential prerequisite for unleashing the potential of the financial sector and in supporting the vaulting ambitions of the real sector.

1.3. Interaction with experts and stake-holders

Interactions with experts and stake-holders were held in parallel from the third meeting of the Commission. The list of experts and entities that the Commission invited for interaction is in Annex 19.3. A broad list of issues and questions was given to these experts; this list is in Annex 19.4. The Commission also interacted with policy makers, experts and regulatory authorities in select jurisdictions abroad; the list is in Annex 19.5. Ideas that emerged from these interactions have also been used in calibrating the position and drawing the broad contours of the stance that the Commission has adopted in its approach.

The broad themes emerging from these interactions are as follows:

1. The legislative foundation of India's financial sector is too complex and cumbersome. These legislations, of which many are outdated - with occasional, piecemeal amendment, do not provide a holistic framework for the harmonious development of the financial sector and its interplay with the needs of the economy. As such, there is an urgent need for an overhaul of the legislative-regulatory framework of the financial sector. However, there were different views with regard to the process of consolidating and harmonising this framework. Some suggested a complete overhaul, while a few suggested substantive surgery of the existing framework.
2. The regulatory architecture is too fragmented, leaving substantial scope for grey areas and overlaps, capture, and bargaining. While many experts were agnostic about the exact model to be adopted (from a single super-regulator to a dual structure of prudential regulation and conduct regulation to a limited number of functionally homogeneous regulators with a strong co-ordination mechanism), many expressed the need for greater consolidation. Further, the legal-institutional framework should provide clarity of purpose, powers and functions, as well as a statutory mechanism of accountability for the regulators. While many of the expert views were for total or greater consolidation, the existing regulatory authorities argued for status quo.
3. The current architecture is not conducive enough for addressing the issues emanating from the global context of financial development. Fragmented regulation and regulatory responsibilities and lack of clarity would hinder both domestic and global co-ordination efforts in addressing issues of contagion and global financial shocks. There is a need for strengthening the fundamental architecture in addressing such issues, as well as for evolving a framework for dealing with systemic risk and resolution. Though the tools for addressing these issues are still on the drawing board, some of the institutional structures available in select jurisdictions, such as resolution framework, have proved to be essential for preserving the stability of the financial system. A more streamlined structure is also needed for dealing with financial issues related to terrorism and other connected issues, which are a major global concern that national authorities have to address through international protocols.
4. There is a need for strengthening the consumer protection and grievance redress mechanism in the financial sector. This is particularly important given the low level of financial literacy, low penetration of financial services, absence of clear regulatory mandate on composite and complex products and on the roles of product distributors and financial advisers. Given the complexity of these issues, the main focus was on the necessity of placing consumer protection at the centre of the philosophy on financial regulation. This issue needs to be addressed both from the preventive and curative sides; by the regulators, as well as the redress agency, respectively.
5. The current architecture encourages turf battles and conflicts of interest. This is a result of the lack of clarity of functions of the various regulatory authorities, as well as of assigning conflicting functions to the same regulatory agency. Despite the explicit development objectives given to the sector-specific regulators, market development has been far from satisfactory as is evidenced in the time-frame on developing products and systems such as in the corporate bond markets. These need to be improved by clarifying the statutory provisions, streamlining regulatory architecture, and removing the conflicting functions from the mandate of some of the regulators.
6. There have been various arguments on the issue of adopting a principles-based approach to regulation, particularly as practised in some jurisdictions prior to the global crisis. At the same time, there has been strong support for adopting a principles-based approach to primary legislations so that these legislations do not go for

amendments frequently and, in the process, lead to regulatory uncertainties. It was also argued that the primary legislation should provide a template for expanding the basic principles into concrete regulations, which at times could be rules-based. It was also argued that the limited regulatory capabilities available should be harmonised and consolidated to promote the skills for administering the principles-based approach to regulation, rather than spreading such scarce skills across a large number of entities with fragmented mandate. These principles and regulations should address the incentive issues fundamentally, so as to minimise financial market adventures, rather than micro-manage product structures and market micro-structures.

7. While every regulator should encourage competition in their sector, the ultimate responsibility of managing economy-wide competition issues should be left to the Competition Commission. While this would help address many macro-level consumer issues, such micro-level issues should be addressed by the sector specific regulators and the grievance redress fora/forum. There should be greater, and institutionalised, interface between the Competition Commission and sectoral regulators in promoting competition and competition practices and culture.
8. While there has been a view that the redress mechanism under the Consumer Protection Act has been functioning satisfactorily, there were also arguments that this framework, as it exists today, is insufficient to deal with the growing complexities in the financial sector. While some of the respondents argued for strengthening consumer redress mechanism in each sector under the aegis of the existing regulators, there were also suggestions for consolidating the consumer redress mechanism by means of a single redress agency for the financial sector.
9. While some of the arguments for retaining sector specific regulators favoured retention of commodity market regulation as a separate area, there were also arguments that derivative markets are financial markets, there is growing financialisation of even physical commodities, players in the system are the same, irrespective of the underlying, and there is the need for consolidated regulation of organised trading to be effective.
10. There were also strong views on the need for strengthening the corporate governance process of regulators – the process of appointment, tenure, compensation and overall skill formation and development of domain expertise. Regulatory expertise, it was felt, is in short supply and should be made a thrust area of focus. Transplanting civil service structures to regulatory authorities is against the basic premise of setting up independent regulatory authorities and a new culture should be built alongside constructing new structures.
11. On issues related to transition arrangements, there were views which encouraged a gradual transition and those which argued for a sudden shift. The former was based on the premise that organisations and market entities take time to adjust to new laws and regulations, while the latter argued that greater flexibility would lead to bargaining for longer time-frame and in the process dilute the efforts towards institutional restructuring.

1.4. Working Group Process

As stated in an earlier section, the Commission decided to multi-task its approach by a parallel process of wgs. Five areas were identified for detailed analysis: (i) Banking, (ii) Securities, (iii) Public Debt Management, (iv) Payment Systems, and (v) Insurance, Pensions & Small Savings. Each Working Group was chaired by a Member of the Commission. Other Members were free to join any of the wgs as per their preference and attend any of

the meetings. Secretary to the Commission was part of all wgs and acted as a link between the Commission and the wgs, as well as between the various wgs in harmonising their approach and ideas in tune with the decisions of the Commission. The composition, terms of reference, and recommendations of these five wgs can be found in Annex 19.6, 19.7, 19.8, 19.9 and 19.10.

Apart from the Chair person, each wg comprised domain experts, who brought in considerable domain knowledge to the deliberations. All wgs were supported by the research team of the Commission; the team provided substantive inputs and drafted documents. Each wg had intensive deliberations and interacted with a number of stake-holders and experts from various institutions; a list of these institutions is in Annex 19.11.

After substantive deliberations and interactions, each wg came out with sector-specific aspects on consumer protection, micro-prudential regulation, legal process, and other aspects specific to the sector within the broad contours designed by the Commission. The Chairpersons of the wgs presented their reports before the Commission. Their recommendations were debated, analysed and finally accepted by the Commission, with appropriate modifications as deemed fit. The work of these wgs has been incorporated in the relevant parts of this report. Prior to the review by the Commission, many of the draft documents were peer reviewed by domain experts whose names are in Annex 19.12. The drafts were also intensively scrutinised by sub-groups of the Commission.

1.5. Analysis and assessment

The Commission has been tasked with the mandate of reviewing and rewriting financial sector legislations built up over a century. However, laws cannot be scripted in vacuum. Laws have to support a certain policy-organisational framework. In the context of financial sector laws, the laws should support India's financial sector structure and the delicate balance between the state policy and instruments and the market. The financial sector is a catalyst supporting that economic framework. Therefore, while designing the legislative framework for the financial sector, the contours of the financial sector, as well as the contours of the macro economy need to be clearly understood and the linkages harmonised for synergy.

After substantive deliberations and interactions, the Commission released an Approach Paper outlining the broad contours of the proposed financial sector institutional framework. The feedback on this Approach Paper, received from various stake-holders and the public, as well as, in general, through its website and correspondences (Annex 19.13), has also been analysed and incorporated into the analytical framework.

1.5.1. Long-term views on the Indian economy

Changes contemplated by the Commission are of high magnitude in terms of its impact on institutions. As such, the recommendations of the Commission cannot be viewed in a short-term framework, nor can the implementation and impact process be completed within a short horizon. Therefore, the Commission has envisioned a medium- to long-term view on the Indian economy and tried to structure the requirements of the financial sector in terms of laws and institutions to support this vision.

In 2012, the size of the Indian economy was about us\$2 trillion. The economy is expected to grow at a moderately high pace, despite periodic fluctuations on account of structural and cyclical reasons. Given the nominal growth rate in the vicinity of 15 per cent, the nominal GDP would double in about 5 years and would reach about us\$15 trillion by 2026. This was the size of the us economy in 2012. This implies that by around 2026, India's GDP will be the size of the present day US GDP. There will be changes in the

sectors, composition of GDP as well. Newer activities will enter the services and manufacturing sectors, making the primary sector smaller, implying a reduced share of agriculture in the overall GDP. All this means a greater role of the financial sector through the need for effective and qualitative financial intermediation. Even by keeping aside inclusion as an objective, the financial sector is expected to grow manifold in terms of size, strength, and efficiency to support the growing requirements of a fast growing economy. The small world of finance that exists in India today, however effective, will not be able to cater to the requirements of the huge economic opportunities that would be unleashed by the growth process. Therefore, even in static terms of assuming just normal growth as envisioned by the GDP growth rates, the financial sector needs to expand, innovate and experiment. The agenda of inclusion magnifies this need manifold.

1.5.2. Fragility of the current system

Through its own deliberations, research, and interactions with various experts, the Commission was convinced that the current regulatory financial structure of the Indian financial sector regulation is not only fragmented, but also fragile. This is evident from the fact that there is no uniform philosophy of regulation; different regulators approach similar issues in different ways. The financial sector lacks a uniform legal process, uniform appellate mechanism, and a uniform appointment process. This lack of coherence in the philosophy of regulation is a fundamental weakness of the regulatory architecture.

The Commission also noted several instances where the independent/statutory regulatory authorities were considered similar to the field agencies of the executive; instructions are passed on to regulators as if they are extensions of the executive. This blurred vision of agency structure needs to be corrected as statutory Independent Regulatory Agencies (IRAs) are quite different from the traditional field agencies of the Government. The IRAs are statutorily empowered to perform the three functions of the state – regulation-making (legislation), administration (executive), and adjudication (quasi-judicial) – even at the perceived cost of blurring the principle of separation of powers embedded in the Constitution. This is a conscious decision taken by the Parliament in empowering IRAs to help efficiently perform their task for which they were created. In order to prevent regulatory excesses, minimise ‘democratic deficit’, and make the IRAs restrict themselves to effectively performing their mandated responsibilities, an effective accountability framework is to be provided in the statute itself. Thus, statutory autonomy in performing their mandate and statutory accountability mechanisms are the balancing pillars of the principal-agent relationship while designing the IRAs.

Some of the developments in the regulatory sphere of financial markets in India in the last few years have raised doubts on the efficacy of the current model of delegation to regulatory authorities. Increasing tensions between the Government and the regulators, and between the regulators, has come to the fore during this period. These intermeddine steps were the result of an imperfect balancing of autonomy and accountability and a blurred picture on the type of principal-agent relationship. It dented the basic foundations of conditional delegation and the ability of the model to effectively regulate the financial system.

Instances of such mutually conflicting postures adopted by regulators are many. These include the oversight battle over unit-Linked Insurance Plans (ULIPs) between SEBI and IRDA, the conflicts between SEBI and FMC on commodity based exchange traded funds, the conflicts between FMC and Central Electricity Regulatory Commission (CERC) (even when the latter is a non-financial sector regulator) on electricity futures trading, the conflicts between Competition Commission of India (CCI) and sector-specific regulators, the frequency with which regulated entities challenge the regulators, all of which happened in the last few years, underlining the growing tensions and fissures in the regulatory-institutional framework of financial sector regulation.

The difficulty in addressing financial sector regulation on a holistic basis has given rise to a rapidly growing shadow financial sector. This includes shadow banking and other shadow financial service providers who collect huge amounts of money from the public, particularly the retail investors, leading to fundamental concerns on consumer protection and at times generating issues of financial stability and systemic risk. There have been increased incidences of such entities operating between the regulatory boundaries at their will, defrauding investors in the name of emus, plantations, and pyramid formations. Unless issues of regulatory grey areas and governance are addressed early in a systematic manner, all these issues are likely to aggravate in the future, given that innovations on products, practices and organisational structures very often happen outside regulatory boundaries.

The setting up of the FSOC and the formation of the Commission itself has been a clear recognition of the limitations of the existing statutory and organisational arrangements. While the FSOC, as an apex council for regulatory co-ordination and financial sector development, was an interim response, the Commission, mandated to rewrite and clear up the financial sector legislations and architecture, was to provide the long-term institutional answer to the problems haunting the current institutional ethos of the financial sector. This is what has been attempted in this report.

1.5.3. Financial inclusion and literacy

Financial inclusion is a major policy objective that India has been trying to achieve over the years. The Commission has noted that inclusion, even in terms of basic banking accounts, has reached only about half the population; in terms of financial instruments such as insurance and securities, inclusion is far limited. Though the level of inclusion should depend on the type of financial products, financial services, such as basic banking and pure insurance products, should reach almost all; other products, enabling risk management and income generation, should reach a sizeable population so that the benefits of modern finance are available to a large part of the population.

The Commission debated issues emanating from mandated development and financial inclusion as a regulatory responsibility. While expert opinion is divided on the subject, the underlying line of thinking has been that regulatory mandating has to be avoided because the regulatory approach should be to provide an enabling framework wherein service providers would be able to use innovative approaches, including usage of modern technologies, in achieving the desired macro objectives. Moreover, micro-level targeting and licensing approaches may do too slow in achieving this objective.

1.5.4. Financial globalisation and lessons from the crisis

No major economy in the world today can be viewed in isolation from the rest of the world. Given the size and the growing magnitude of interaction – in terms of trade, services, and capital flows – and the greater openness to globalisation, India is in a different economic milieu today than it was two decades ago. India is virtually part of the world of globalised finance and is learning to walk, negotiating the strong currents both positive and negative, generated by the forces of financial globalisation.

Negative aspects of financial globalisation and run away innovations in certain parts of the world resulted in the global financial crisis of 2008. The world has learnt a number of lessons from this crisis. The Commission, through its research, interactions with regulatory authorities and experts from different parts of the world, and through India's own experience during the crisis, has underscored the need for a carefully calibrated regulatory approach to address the limitations of the market, particularly its tendency to travel too fast and become too complex, both in terms of product and organisational innovations.

The Commission has understood that the world has learnt the lessons of financial instability and therefore provided for an effective and continuous mechanism for addressing issues of systemic risk, as well as, the need for addressing failures of individual entities through resolution. The messages coming clear and loud from the financial crisis on the need for more closely and effectively regulating the market, emphasis on systemic risk, and an effective resolution framework have been factored into the recommendations of the Commission.

1.5.5. Regulatory developments elsewhere

Following the financial crisis of 2008, there have been several efforts in some jurisdictions for strengthening, and in a few cases, recasting regulatory structures. These are particularly pronounced in the case of the US and the UK, while other jurisdictions are contemplating limited changes in strengthening the weaker links in their structures. The Commission had extensive interaction with the officials and experts on the changes being made in the UK, Canada, Australia, Singapore and limited dialogue with agencies such as the US Fed and Indo-US Business Council. The most radical changes are being contemplated in the UK, where the super regulator, Financial Services Authority (FSA), has been divided and the mandate relating to prudential regulation transferred to the Bank of England as its subsidiary and converting the FSA into a Financial Conduct Authority (FCA). Our understanding of the reasons for this change was that FSA's focus on the market conduct dimensions at the cost of relative neglect of the prudential dimension led to building up of risks for the banking sector, which was not observed in time. In the case of Australia, on the other hand, prudential regulation and conduct regulation had been divided and mandated to two distinct agencies (Australian Prudential Regulatory Authority and the Australian Securities Investment Commission) in their twin-peak mode which was adopted in the mid 90's. This model withstood the crisis relatively better. Similarly, in Canada, prudential regulation and conduct regulation has been placed in two different agencies, the Office of the Superintendent of Financial Institutions as well as the Financial Consumer Agency. While the importance of treating prudential and conduct regulation distinctly in those jurisdictions has been well understood, the Commission has not recommended a similar approach in the Indian context because of the reason that the required regulatory expertise is not yet available. Hence, the recommendation for the same regulator dealing with both prudential and market conduct aspects for the medium run, while in the long run this could be modified depending on the experiences gained within this country and elsewhere. The legal and statutory framework also tries to provide for easy changes in regulatory mandate so that changes in functions would involve only limited statutory changes.

1.5.6. Global co-ordination in the emerging context

Along with financial globalisation, complexities of financial regulation have also increased. This became more complex after the crisis and following the adoption of greater scrutiny of the concerns arising from terrorism-related financial activities. The new obligations under the Financial Action Task Force (FATF) and Combating the Financing of Terrorism (CFT) regimes have necessitated co-ordination between domestic financial regulators amongst all the jurisdictions and between the global co-ordinating institutions. Greater co-ordination has also become imperative in the context of concerns on financial stability. The Commission is fully aware of the onus that these additional tasks would bring upon domestic regulatory authorities as well as the enabling legal framework.

1.5.7. Harmonisation of laws

All the factors outlined in the previous sub-sections necessitate the need to redraft our legislations and harmonise them. Our laws have been built up over a century and have

been modified multiple times, creating newer and greater complexities. Sector-wise fragmentation and segmented approach to regulation further amplified these basic frictions. There is also a lack of coherence in terms of their underlying philosophy, since these laws had been enacted at different periods of time when financial sector needs were of a different type and nature. Many of these legislations are of pre-independence origin, where the objective functions were also different from what is desirable for a modern interdependent economy.

Given these underlying factors about the vintage, philosophy, structure, and constraints of the regulatory framework, the existing framework cannot be used effectively by a resurgent India, expecting to reach the size of current US economy in about two decades. It cannot also be used to address issues emanating from financial globalisation and for addressing the lessons learnt from the global crisis. It cannot address the requirements of a large, modern economy wherein the financial sector plays a significant role. It cannot address issues of effective global co-ordination, both as a requirement for global financial stability and supervisory requirement for combating terrorism and related financial issues. A fragmented approach, based on multiple laws and organisations, cannot effectively include the excluded population into the modern financial sector. Given these reasons, the Commission felt the need for a complete overhaul of the statutory framework. This involves repealing many of the statutes, substantially amending another set of legislations, and amending certain provisions in other related legislations.

1.5.8. Strengthening the regulatory framework

The existing regulatory environment in India is fragmented and complex. There are multiple regulators, each one tasked with a silo within the financial sector. Given the fluidity and the fungibility of financial markets, such a fragmented approach cannot possibly achieve the results desired in terms of providing an organic unity to the sector in addressing domestic and global co-ordination, addressing financial development and inclusion, and dealing with systemic stability and other concerns. In fact, the experience of regulatory co-operation in India has not been very encouraging and has witnessed escalation of conflicts in the recent past. The Commission, therefore, feels that the fragmented approach to financial sector regulation in India has failed on many grounds, which need to be corrected. But at the same time, learning from the global crisis and the consequential regulatory rethinking in multiple jurisdictions, and the need for aligning the regulatory requirements to our own milieu, the Commission deliberated the issue of appropriate regulatory structure in detail.

The tasks of financial law

The Commission has envisaged certain key components of the financial legal framework. Each of these components is guided by a clear understanding of market failures. Regulation is not an end in itself; it exists in order to address market failures. The Commission strongly feels that laws must be defined in terms of their economic purpose, rather than in terms of the powers conferred upon regulatory agencies or in terms of the entities who are affected by the law. This clarity on objectives is essential for obtaining accountability in regulation. If an agency is given the objective of 'regulation', then accountability is lost, because the agency will always be able to demonstrate that it has, indeed, regulated.

From this perspective, the tasks of financial law can be envisioned as the following nine components:

1. *Consumer protection:* A prime motivation of all financial regulation is to protect consumers. The relationship between financial firms and their customers is one where, many times, the outcomes may harm customers. These problems are not sporadic or accidental; but are often rooted in basic problems of information and incentives and will not be alleviated through financial literacy campaigns. The central purpose of financial regulation is to intervene in the relationship between financial firms and their customers, and address market failures. This requires a comprehensive consumer protection framework that covers both the problem of prevention (interventions that induce financial firms towards fair play) and cure (addressing consumer grievances).
2. *Micro-prudential regulation:* One element of protecting consumers is to constrain financial firms to take lower risk, so as to improve the extent to which promises by a financial firm to a consumer are upheld. This is the task of micro-prudential regulation. In addition to being motivated by consumer protection, high quality micro-prudential regulation also reduces systemic risk. This calls for a comprehensive micro-prudential framework.
3. *Resolution:* The best efforts of micro-prudential regulation will reduce, but not eliminate, the failure of financial firms. When such episodes arise, a specialised resolution capability is required to ensure graceful winding up of a financial firm that has become unviable, and transition the customers of the erstwhile firm. Under a formal arrangement such as this, a key difference that will be induced by a resolution corporation will be reduced burden on taxpayer resources by failing financial firms. When a financial firm is healthy, it would face micro-prudential regulation, while the resolution corporation would lie in the background. When the firm approaches failure, it would increasingly face the resolution corporation. This requires the legal framework to create a resolution corporation and set it in motion.
4. *Capital controls:* India now has an open current account, but many capital account restrictions remain. The Commission agreed that the timing and sequencing of capital account liberalisation should be chosen by policy makers in the future. The drafting of law needs to establish a sound legal foundation for capital controls, with a focus on objectives and accountability in regulation-making, and an emphasis on the rule of law. The regulations governing inward flows should

be framed by the Central Government, in consultation with the RBI. The regulations governing outward flows should be framed by the RBI, in consultation with the Central Government.

5. *Systemic risk:* Micro-prudential regulation focuses on one financial firm at a time. While this is important in its own right, there is a requirement for an additional, and different, perspective on risk of the financial system as a whole. This requires analysis of the entire financial system, understanding the build-up of risk across all elements of the financial system, and undertaking co-ordinated actions (through multiple regulatory agencies) to reduce the probability of a systemic crisis.

The terms *financial stability* and *macro-prudential regulation* are sometimes used in this discourse. The Commission has chosen to consistently use the phrases *systemic risk* and *systemic risk regulation* as they lend greater clarity in communicating the problem and the task.

6. *Development and redistribution:* In addition to the above components of financial law, financial economic governance in India is also charged with the objectives of development and redistribution. At the same time, these functions need to be placed on sound legal foundation.
7. *Monetary policy:* The conduct of monetary policy is covered by a law that establishes the central bank and defines the triad of objectives, powers and accountability mechanisms.
8. *Public debt management:* A specialised framework on public debt management is needed to cover the function of analysing the comprehensive structure of liabilities of the Government, and embarking on strategies for minimising the cost of raising and servicing public debt over the long-term within an acceptable level of risk.
9. *Foundations of contracts and property:* A specialised framework setting out the foundations of financial contracts, and making adaptations to general commercial laws, is required for the proper functioning of the financial system.

Each of these components is associated with a chapter in this report and a part in the accompanying draft Indian Financial Code ('draft Code').

2.1. Shifting away from a sectoral perspective

The discussion above has focused on nine areas of work:

- ▶ Consumer protection
- ▶ Micro-prudential regulation
- ▶ Resolution
- ▶ Capital controls
- ▶ Systemic risk
- ▶ Development
- ▶ Monetary policy
- ▶ Public debt management
- ▶ Foundations of contracts and property

The Commission has prepared a draft Code covering these nine areas. The draft Code also contains a specialised law to address governance processes associated with regulators and other financial agencies, addressing the problems of independence and accountability. Putting these ten elements together, the draft Code constitutes a fairly comprehensive and unified treatment of financial law.

This strategy differs from the current Indian law, which is sectoral in nature. Current laws are organised around sub-sectors of finance, such as securities or insurance or payments. The Commission debated this at length, and concluded that there was merit in shifting to a non-sectoral approach. Laws must be animated by an economic purpose and the market failures that they seek to address. Once this is done, the ideas apply consistently across all sectors of finance. As an example, a well-crafted micro-prudential law would apply to all components of finance. A well-crafted regulatory governance law would apply to all financial agencies.

This is a superior approach from many points of view. Shifting away from sectoral laws yields consistent treatment across sectors. It has become increasingly clear that the lines that separate banking or insurance or mutual funds or pension fund management are hard to define. Under this situation, if sectoral laws are applied, regulatory arbitrage becomes feasible, where the same activity is portrayed as belonging in the sector where the law is conducive to a higher profit rate. Non-sectoral laws that apply uniformly across the financial system eliminate such inconsistencies of treatment. They also eliminate the problems of gaps and overlaps.

While the draft Code proposed by the Commission is non-sectoral in nature, it is likely that regulators will draft sector-specific subordinated legislation. For example, the principles of consumer protection, embedded in the consumer protection part of the draft Code, will be translated by multiple regulatory bodies into detailed regulations that shape how consumers of banking or insurance are treated. The subordinated rules and regulations will, however, have to be consistent with the broad principles laid down in the primary law.

As an example, the term NBFC in India includes a wide array of activities. Rational and consistent treatment of a broad class of firms requires a clear conceptual framework. The approach taken by the Commission emphasises that regulation should flow from the economic and legal concern that the law seeks to address. It is useful to focus on the regulatory concerns associated with the main NBFC activities: deposit-taking, raising capital through securities issuance, and lending to consumers and investment. Under the framework proposed by the Commission, all these activities would be analysed through the objectives and powers contained in the draft Code under the parts on micro-prudential regulation, consumer protection and resolution. As an example, when a NBFC gives a loan to a consumer, the regulatory focus would be on consumer protection. If a NBFC does not take deposits, the nature of promises made to consumers changes, and the micro-prudential regulatory strategy would be correspondingly different.

In this fashion, conceptual clarity about the purpose of regulation would help regulators understand the diverse array of financial firms and activities, and apply the suitable regulatory instruments to each situation.

2.2. Adopting a principles-based approach

The Commission believes that there is value in harnessing India's common law tradition, where laws enacted by Parliament work at the level of high principles, and do not embed specific details. These relatively timeless principles are linked to the continuously evolving world of technology, institutional arrangements and financial sector processes through two methods: continuous revision of subordinated legislation that is drafted by the regulator, and interpretation by the judiciary. This approach, which may be termed an Occam's razor applied to the field of law, has worked well with components of Indian law such as the Evidence Act and the Contract Act, both of which were enacted in 1872, and have largely stood the test of time.

In the field of finance, this implies a 'principles-based' approach. Laws will articulate broad principles that do not vary with financial or technological innovation. Regulators will write subordinated legislation that could either be in the form of detailed prescriptive rules or be principles-based, depending on the situation and the judgment of the regulator. Subordinated legislation will be frequently modified by regulators, through a process defined by Parliament, and thus constantly adapt to financial and technological innovation. This combination of legislation and subordinated legislation yields a body of law that evolves smoothly over time. For a contrast, if detailed features of financial products

and processes were embedded in law, the requirement of frequent amendments to the law would hinder progress.

This approach also substantively improves the compliance culture. Under rules-based regulation, there is the risk that financial firms set up complex harmful structures that comply with the letter of the rules. The Commission recommends that laws should hold financial firms to a higher standard: that of complying with the *principles*.

Central to common law is the role of judges. When laws are written in terms of principles, there would be legitimate disagreements about the interpretation of principles. These are resolved by judges who build up the jurisprudence that clarifies what a principle means in the light of the continuous evolution of finance and technology. The workload of complex cases will go up, when we move towards a common law approach. The Commission has decided to build on India's success with the SAT, which will be subsumed in a FSAT that will serve as an appellate authority for the entire financial system and will also review validity of rules and regulations on the touchstone of principles-based law. Rulings of the FSAT, and the Supreme Court, would build a living body of jurisprudence alongside the principles-based laws recommended by the Commission.

2.3. Approach to drafting

In formulating the draft Code, the Commission surveyed drafting techniques adopted domestically and internationally. One option was to draft the provisions in the fashion that readers of Indian law have been familiar with for years, that uses compound and archaic words such as "shall", "notwithstanding" and "heretofore", or open-ended terms. Another option was to adopt the internationally accepted "plain and simple" drafting technique, which attempts to convey clear and precise meaning in simple English. It avoids usage of complex, archaic phrases and legal jargon and aims to ensure that ideas are presented in a logical and effective manner. It brings clarity to the reader and balances simplicity and precision.

A drafting technique must be consistent with the objective that the draft intends to convey. Sometimes, vague phrases might indeed convey the requisite meaning, while on other occasions, a precise formulation is necessary. The draft Code has attempted to balance these in the best possible manner, without compromising on the essence of the law.

After much deliberation, the commission decided to adopt the plain language technique, to the extent practical. The Commission believes that this is the best possible manner in which timeless principles can be articulated in the primary law and the intent can be communicated clearly to the regulators.

Adopting plain language technique would lead to avoiding usage of traditionally accepted, well understood and judicially recognised phrases, but in the interest of clarity and achieving international standards, this is a necessary bargain. It is expected that jurisprudence and interpretative meanings of new phrases would develop with time.

Plain language technique also advocates usage of gender neutral language. While the *General Clauses Act, 1897* provides that "words importing the masculine gender shall be taken to include females", the Commission has deliberately steered clear of referring to either, and sought to use language that is gender neutral, to the extent practical.

The following indicative list encapsulates the kind of standards that have been adopted in preparing the draft Code:

1. Active voice has been used to the extent possible.
2. Plain English words, and simple and short sentences have been used. For instance

- ▶ "in case" or "if" instead of "in the event of";
 - ▶ "if" or "when" instead of "provided that"; and
 - ▶ "within" instead of "with a period of", "before the end of".
3. Archaic phrases have been avoided, to the extent possible, for instance, "aforesaid", "thereof", "best of knowledge", "wherein", and "shall".
 4. Double negatives and complex sentences have been avoided to the extent possible.
 5. The use of explanations, exceptions, "non-obstante", "notwithstanding" and "subject to" clauses have been avoided to the extent possible.
 6. Words in pairs have been avoided, particularly if one of the words convey the full meaning, such as "null and void", "agreed and declared", "force and effect", "contravene and fail to comply", "freed and discharged".
 7. Vague words have been avoided, to the extent possible, for instance, "public interest", "as it may deem fit", "good faith".
 8. Latin and foreign words have been avoided, such as "*mutatis mutandis*", "*ultra vires*", "*ex parte*", and "*bona fide*".
 9. Use of un-numbered paragraphs have been avoided.

2.4. Financial regulatory governance

The bulk of the law that financial firms actually interact with is *regulations* and not the primary legislation. In order to cope with the specialised technical demands of the field, and the rapid pace of financial and technological innovation, the architecture that has been adopted the world over consists of Parliament drafting laws that establish financial regulators and set them in motion. The regulators then draft regulations, which embed intricate market knowledge, and evolve rapidly.

The central task of financial law, then, consists of setting up regulators and ensuring that they operate correctly. The Commission has made the sound structuring of financial regulators, and thus laying the foundation for a sound financial regulatory process, a prime objective. The work of the Commission revolves around four themes: (a) Clarity on objectives and avoiding conflicts of interest; (b) Precisely defined powers; (c) Operational and political independence; and (d) Accountability mechanisms.

2.4.1. Independence of regulators

In recent decades, independent regulators have become an important part of the policy landscape in India and worldwide. There are four arguments in favour of having the supervision and regulation of the financial sector done by regulatory agencies that are independent of the Government:

1. The regulator is able to setup a specialised workforce that has superior technical knowledge;
2. This is assisted by modified human resource and other processes, when compared with the functioning of mainstream Government departments;
3. With such knowledge, and close observation of the industry, an independent regulator is able to move rapidly in modifying regulations, thus giving *mobility* to laws; and
4. The presence of independent regulators improves legal certainty by ensuring that the regulatory approach does not fluctuate with political changes.

Merely physical separation of the regulator from the Government is however not sufficient to ensure its independence. This needs to be accompanied by legal and administrative processes that clearly delineate the functioning of the regulator from the rest of the Government.

In the normal functioning of Government, the three functions of regulation-making, enforcement and adjudication are kept separate under the 'separation of powers' doctrine. When the Parliament delegates those functions to the regulators, it places them in the unique position of being 'mini-states' with powers similar to the legislature, executive and judiciary all under a single entity. The Commission has strived to achieve greater separation of powers in the functioning of the regulator, particularly by separating out adjudication from other activities.

A well-structured, independent regulator needs to avoid two extremes. At one extreme is excessive delegation. As an example, if legislation sets up an independent regulator with the mandate of 'serving the public interest' or 'improving the welfare of the people of India', and arms it with sweeping powers, this would raise concerns about what such an agency could do. At the other extreme is the issue of micro-management in the legislation. If laws embed institutional details of markets, technology and financial sector activities, the key purpose of establishing independent regulators would be lost. To avoid both these extremes, the Commission recommends that independent regulators should be given precise objectives, and a specific toolkit of powers through which those objectives are to be pursued, with the independence to decide the manner in which the powers are to be used. Any action of the regulator will, however, remain subject to extensive mechanisms of accountability.

2.4.2. Accountability of regulators

As argued above, regulatory independence is essential to support the functioning of the regulator as an expert body, and to ensure that regulation-making and enforcement do not fluctuate with changes in political executives. But independence is not an unmixed blessing; when unelected officials are given strong powers, this needs to be accompanied by appropriate accountability mechanisms.

The Commission recommends that the substance of financial regulation is too minute and dynamic to be legislated upon by Parliament, however, the process through which financial regulation is to be effected should be clearly detailed in the law. Parliamentary legislation should therefore incorporate high standards of procedure that the regulator will be required to adhere to. Drawing on practical Indian experiences of the last twenty years and global best practices, the draft Code embeds an array of mechanisms through which independence of the regulator can be actually operationalised, and accountability achieved.

The Commission has adopted the following pathways to accountability:

1. Setting out of clear objective standards of governance that the regulator must adhere to;
2. A well-structured regulation-making process with appropriate checks and balances to ensure that all regulations are backed by thorough analysis of costs and benefits and are made through an open consultative process;
3. A formal and transparent system of regulation and supervision, rooted in the rule of law, which will include:
 - ▶ Duty of the regulator to explain its actions to regulated entities and the public at large; and
 - ▶ Requirements that regulatory actions and changes should be imposed with adequate prior information to persons likely to be affected (unless inappropriate for a particular situation) and should rarely be carried out without hearing the concerned parties;
4. Reporting requirements that mandate the regulator to disclose how it fared on pursuing its desired outcomes and at what cost; and
5. Fixing the judicial oversight of the regulator in FSAT which will ensure greater scrutiny over the actions of the regulator and with greater efficiency. Principles of efficiency and measurement of performance will also be applied to the FSAT.

2.5. Ownership neutrality and competition

The Indian financial system has an array of firms: co-operatives, private Indian firms, foreign firms and public sector firms. The Commission envisages a regulatory framework where governance standards for regulated entities will not depend on the form of organisation of the financial firm or its ownership structure. This will yield 'competitive neutrality'. In this framework, the regulatory treatment of companies, co-operatives and partnerships; public and private financial firms; and domestic and foreign firms, will be identical.

2.5.1. Treatment of foreign firms

Whether or not, or the extent to which, participation by foreign firms should be allowed in the financial sector is a policy matter to be determined by the Government. However, once a decision to allow foreign participation in a particular financial market has been made, there should be consistency in the regulatory treatment of foreign and domestic participants performing similar functions or undertaking similar risks in the market.

For example, if the foreign investment policy for a particular sector permits wholly owned foreign subsidiaries, the regulator must ensure that the net worth requirements, capital adequacy norms, investment limits and all other regulatory interventions should be the same for foreign subsidiaries and domestically owned firms.

Hence, the Commission recommends, under the capital controls framework of the draft Code, that subject to control restrictions as prescribed, there should be full national treatment for foreign firms.

2.5.2. Public sector financial institutions

The future of public sector financial firms is an important policy question which will shape the contours of Indian finance. In coming decades, public sector financial firms are likely to continue to be with us. The Commission has therefore identified three elements in the treatment of these firms:

1. Public sector financial firms require effective regulation and supervision. If there are problems with these firms, they impose costs upon the exchequer. Improvements in regulation and supervision will reduce the potential problems faced with public sector ownership.
2. At the same time, the draft Code emphasises the principles of equal treatment and a pro-competitive environment.
3. To the extent that competition concerns in the financial sector arise on account of existing laws

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2. At the same time, the draft Code emphasises the principles of equal treatment and a pro-competitive environment.
3. To the extent that competition concerns in the financial sector arise on account of existing laws that confer special privileges on state-owned enterprises, the Commission recommends amendments to the laws to create a level playing field between regulated entities, irrespective of the ownership structure.

The goal of achieving competitive neutrality in the financial sector necessarily involves a rethinking of laws such as the State Bank of India Act, 1955 and the Life Insurance Corporation Act, 1956, that were enacted to create specific financial institutions. Those laws contain provisions that vary or exclude the applicability of general corporate and financial laws to the institutions created under them. They also confer special privileges as seen in the case of the explicit Government guarantee under the Life Insurance Corporation Act, 1956, for all sums assured under LIC policies. The existence of such a provision in the law despite the entry of private insurers in the market induces an unfair competitive advantage in favour of LIC as many customers would tend to choose its policies over those offered by private insurers on account of the Government guarantee.

The Commission therefore recommends the repeal or large scale amendment of all special legislations that (a) establish statutory financial institutions; or (b) lay down specific provisions to govern any aspect of the operation or functioning of public sector financial institutions (see Table 2.1). The undertakings of all statutory institutions should

Table of Recommendations 2.1 List of statutory financial institutions

The following is a list of statutes that provide for the establishment of statutory financial institutions or contain special provisions to govern the operation and functioning of public sector financial institutions:

1. The State Financial Corporations Act, 1951.
Andhra Pradesh State Financial Corporation; Himachal Pradesh Financial Corporation; Madhya Pradesh Financial Corporation; North Eastern Development Finance Corporation; Rajasthan Financial Corporation; Tamil Nadu Industrial Investment Corporation Limited; Uttar Pradesh Financial Corporation; Delhi Financial Corporation; Gujarat State Financial Corporation; The Economic Development Corporation of Goa; Haryana Financial Corporation; Jammu & Kashmir State Financial Corporation; Karnataka State Financial Corporation; Kerala Financial Corporation; Maharashtra State Financial Corporation; Odisha State Financial Corporation; Punjab Financial Corporation; West Bengal Financial Corporation
 2. The State Bank of India Act, 1955
 3. The Life Insurance Corporation Act, 1956
 4. The State Bank of India (Subsidiary Banks) Act, 1959:
State Bank of Bikaner and Jaipur; State Bank of Indore; State Bank of Mysore; State Bank of Patiala; State Bank of Travancore and State Bank of Hyderabad established under the State Bank of Hyderabad Act, 1958
 5. The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970:
Central Bank of India; Bank of India; Punjab National Bank; Bank of Baroda; UCB Bank; Canara Bank; United Bank of India; Dena Bank; Syndicate Bank; Union Bank of India; All India Bank; Indian Bank; Bank of Maharashtra; and Indian Overseas Bank
 6. The General Insurance Business (Nationalisation) Act, 1972:
General Insurance Corporation of India; National Insurance Company Limited; New India Assurance Company Limited; Oriental Insurance Company Limited; and United India Insurance Company Limited
 7. The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980:
Andhra Bank; Corporation Bank; New Bank of India; Deccan Bank of Commerce, Punjab and Sind Bank; and Vijaya Bank
 8. The Export-Import Bank of India Act, 1981
 9. The National Bank for Agriculture and Rural Development Act, 1985
 10. The National Housing Bank Act, 1987
 11. The Small Industries Development Bank of India Act, 1989
-

be transferred to ordinary companies incorporated under the Companies Act, 1956 and their regulatory treatment should be identical as that applicable to all other financial companies. This has previously been done in case of the following institutions which were statutory corporations that were subsequently converted to companies under the Acts mentioned below:

1. IFCI Limited (previously called the Industrial Finance Corporation of India) through the Industrial Finance Corporation (Transfer of Undertaking and Repeal) Act, 1992;
2. Industrial Investment Bank of India Limited (previously called the Industrial Reconstruction Bank of India) through the Industrial Reconstruction Bank (Transfer of Undertakings and Repeal) Act, 1997;
3. Unit Trust of India through the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002; and
4. IDBI Bank Limited (previously called the Industrial Development Bank of India) through the Industrial Development Bank (Transfer of Undertaking and Repeal) Act, 2003.

The Commission recognises that the repeal or large scale amendments of the statutes identified in Table 2.1 is a long drawn process that may take some time for the Central Government to implement. However, there are certain specific provisions relating to winding up and liquidation of the concerned institutions under these laws that need to be amended immediately to give effect to the resolution framework envisaged by the Commission. This is being done in part or resolution in the draft Code.

It has also been observed that certain financial activities that are owned and managed by Government agencies tend to fall outside the sphere of financial regulation although they are functionally identical to regulated financial activities. This includes fund management services offered by the Employees' Provident Fund Organisation (EPFO), insurance services of postal life insurance and the Employees' State Insurance Corporation (ESIC) and the various small savings products issued by the Government. To the extent that these bodies are performing a social welfare function, it would not be practical or

desirable to apply all areas of financial regulation to them with the same rigour that is used for private enterprises. However, the Commission recommends that there is a need for proportional regulation of these activities, particularly in the field of consumer protection so that consumers are entitled to the same rights and protections irrespective of the ownership status of the service providers.

Hence, the Commission recommends that:

1. The Government should formulate a plan for the review of the following laws and schemes, which involve the provision of financial services directly by the Government or by agencies created by it:
 - ▶ The Government Savings Bank Act, 1873
 - ▶ The Employers' State Insurance Act, 1948
 - ▶ The Coal Mines Provident Fund Act, 1948
 - ▶ The Employees' Provident Funds and Miscellaneous Provisions Act, 1952
 - ▶ The Assam Tea Plantation Provident Fund Act, 1955
 - ▶ The Jammu & Kashmir Employees' Provident Fund Act, 1961
 - ▶ The Seamen's Provident Fund Act, 1966
 - ▶ The Public Provident Fund Act, 1968
 - ▶ Post Office Life Insurance Rules, 2011
2. The laws and schemes should be examined from the perspective of assessing the changes required in order to bring them within the purview of financial regulation and to ensure compatibility with the laws drafted by the Commission.

2.5.3. Treatment of co-operatives

In understanding the wide spectrum of the financial system in India, the Commission also focused on the role of co-operative societies. The subject of co-operative societies falls under Entry 32, List II of the Seventh Schedule of the Constitution of India, which provides that the incorporation, regulation and winding up of these bodies falls within the purview of the State Governments.

In addition, when co-operative societies engage in the business of financial services, they need to be regulated and supervised by financial regulators in a manner that is commensurate with the nature of their business and the risks undertaken by them. Since financial co-operatives often cater to the needs of small households, the Commission is of the view that such institutions should carry out their business under sound prudential regulation and resolution framework, with strong protections for their consumers and appropriate safeguards to ensure that in the eventuality of their failure, the burden does not fall upon tax payers. For this to be possible, the draft Code should apply in its entirety to co-operative societies providing financial services, to the same extent as it would apply to corporate entities.

Under the current laws, co-operative banks are subject to a system of dual regulation – by the Registrars of Co-operative Societies in State Governments and the RBI, as the banking regulator. This has resulted in operational and governance challenges in the regulation of co-operative banks that have been attempted to be addressed through memorandums of understanding entered into between the RBI and State Governments. The Commission recommends that financial regulators should have statutory control over the regulation and supervision of financial co-operatives, without having to rely on contractual arrangements with State Governments. This can be achieved under Article 252 of the Constitution which allows two or more State Legislatures to pass a resolution accepting the authority of the Parliament to make laws for the State on any matter on which the Parliament otherwise does not have the capacity to legislate. Using this provision, State Governments could pass resolutions to transfer the power to make laws on the regulation and supervision of co-operative societies carrying on financial services to the Parliament.

The grant of authorisation to carry on financial services is the prerogative of the financial regulator. The draft Code provides that while laying down the criteria for carrying on a financial service, the regulator may specify the permissible forms of organisation for a proposed financial service provider. The regulator may therefore decide that co-operative societies from States that have not allowed the Central Government to legislate on the regulation and supervision of co-operative societies carrying on financial services:

1. will not be granted the authorisation to carry out certain financial services, such as banking or insurance, which require intense micro-prudential regulation; or
2. will be granted authorisation to carry on specific financial services subject to certain limitations, such as, restrictions on access to the real-time gross settlement and discount window facilities provided by the central bank and exclusion from the protection of deposit insurance provided by the resolution corporation.

The Commission therefore makes the following recommendations with respect to co-operative societies:

1. In consonance with the recommendations on competitive neutrality, co-operative societies carrying on financial services should be subject to similar prudential regulation, consumer protection and resolution frameworks as other entities carrying on similar activities.
2. Using Article 252 of the Constitution of India, State Governments should accept the authority of the Parliament to legislate on matters relating to the regulation and supervision of co-operative societies carrying on financial services.
3. The regulator may impose restrictions on the carrying on of specified financial services by co-operative societies belonging to States whose Governments have not accepted the authority of the Parliament to legislate on the regulation of co-operative societies carrying on financial services.

Structure of the regulator

Government agencies are required to perform complex functions in eight areas in finance: consumer protection, micro-prudential regulation, resolution of failing financial firms, capital controls, systemic risk, development, monetary policy and debt management. For these functions to be appropriately performed, well structured Government agencies are required. This is sought to be achieved through a specialised and consolidated set of provisions on regulatory governance in the draft Code.

The Commission believes that the requirements of independence and accountability of financial regulators are the same across the financial system and hence it recommends a unified set of provisions on financial regulatory governance for all areas of finance. The objective of the proposed Code on regulatory governance is to create a series of obligations for the Government and for regulators. The Code will cover all functions of the regulator and lay down the principles and standards of behaviour expected from the regulator. It will also provide for a system of monitoring the functions of the regulator with a process to ensure that the regulator is fully transparent and they act in compliance with the best practices of public administration. Table 3.1 captures the recommendations of the Commission for the creation of an appropriate regulatory structure.

The Commission recommends that the structure of the regulator be standardised for all financial regulators. However, there may be exceptions required in respect of certain specific functions where the general regulatory processes may not apply. These exceptions to the general process law should be kept to the minimum and generally avoided.

3.1. Selection of the regulator's board

Regulators in India are statutory entities headed by a board. It is the responsibility of the Government to appoint the members on the board of the regulator. The Commission believes that it is necessary to create a statutory system for selecting board members in a fair and transparent manner. It is recommended that the Government should be aided in this process by a professional search and selection committee. This will help ensure that the selected members are competent persons with relevant knowledge and experience.

The Commission looked at various systems of selection committees present under Indian laws along with the practice in other common law jurisdictions. Based on this analysis, it recommends that the government should maintain a panel of experts who will serve as members of the selection committee at all times. Their expertise would be

Table of Recommendations 3.1 Basic structure of the regulator

1. The regulator will be set up as a corporate entity;
2. It will have the powers of a body corporate, including the power to enter into contracts, employ persons, acquire assets, hire agents and delegate certain functions to them; and
3. The regulatory organisation will be composed of three parts:
 - (a) *Board of the regulator:* responsible for oversight and governance of the regulator;
 - (b) *Chairperson:* will be the chief executive of the regulator and will chair its board; and
 - (c) *Office of the regulator:* comprising of the employees, agents and assets of the regulator.

Table of Recommendations 3.2 Selection of board members

1. The responsibility for appointing board members vests with the Government. While discharging this responsibility, the Government will be guided by the recommendations of a selection committee.
2. The selection committee will shortlist at least three candidates for every position and provide the list to the Government.
3. The structure of the selection committee will be as follows:
 - (a) The members will be appointed out of a list of experts maintained by the Government at all times, consisting of experts in the fields of finance, economics, law and public administration.
 - (b) It will consist of a representative of the Government (who will serve as the chairperson), the chairperson of the regulator (and in the case of selection of the chairperson, another Government representative), and three experts from the list maintained by the Government.
 - (c) The majority of the members must be persons who are not related to the Government. This is to ensure that the selection committee is not biased towards shortlisting only Government officials.
4. Merit will be the guiding principle for the appointment of board members. Therefore, if the pool of applicants in a selection process is weak, the selection committee will have the right (after recording the reasons) to suggest other names to be considered for selection. Nominations by any member of the selection committee should be in writing, accompanied by a statement of competence and experience of the person.
5. The regulator must, in advance, inform the search and selection committee of any foreseeable vacancies and it will be the duty of the selection committee to forward the names of short-listed candidates before the vacancy arises, and give the Government reasonable time to make a decision.

utilised by rotation as and when appointments to the board are to take place. The selection system will be governed by the process provided in Table 3.2.

The selection procedure should be designed in a manner that achieves a balance between the requirements of flexibility and transparency. Therefore, the draft Code does not lay down such level of detail that the selection committee is unable to shortlist deserving candidates or takes too long to do so. At the same time, the integrity of the selection procedure will be protected by requiring that all short-listing and decision making are done in a transparent manner - the committee should disclose all the relevant documents considered by it and prepare a report after the completion of the selection procedure. This will include the minutes of the discussion for nominating names, the criteria and process of selection and the reasons why specific persons were selected. The committee would however, not be required to disclose any discussion about candidates who were not short-listed.

3.2. Composition of the board of the regulator

The Commission suggests that the Board of a regulator should have four types of members:

1. *Chairperson* - There will be one chairperson of the board of a regulator. He/she will be responsible for the functioning of the board and the office of the regulator. He/she will also be responsible for and empowered with the day-to-day management of the regulator. In the event the chairperson is not available, the longest serving member of the board shall act as the chairperson.
2. *Executive members* - The chairperson will be accompanied by a set of executive members. Within

Table of Recommendations 3.3 Types of members on the board of the regulator

1. Chairperson of the board
2. Executive members, including a set of designated administrative law members
3. Non-executive members
4. Government nominees

In this category of members, some persons will be designated as administrative law members. *Administrative law members* will be responsible for:

- (a) Reviewing the performance and carrying out the oversight of a designated set of employees of the regulator, referred to as administrative law officers; and
- (b) Reviewing the decisions taken by the administrative law officers

The executive members will devote their entire time to the management of the regulator and will not be permitted to take up any other employment during their appointment. These members will be responsible for the oversight of the regulator's personnel, except for administrative law officers who will be monitored only by administrative law members.

3. *Non-executive members* - This category will consist of persons who are experts in the fields of finance, law, economics, etc., and are appointed to the board on a part-time basis. They will not be involved in the day-to-day functions of the regulator. Non-executive members may take up other engagements but will have to manage conflict of interest issues when participating in board meetings.
4. *Government nominees* - The Government will have the right to nominate ex-officio members on the board of the regulator. These members will represent the perspective of their departments/ministries or other regulators in the functioning of the regulator.

The Commission believes that it is crucial for the draft Code on regulatory governance to lay down the functions and powers of each type of member on the board of a regulator. Accordingly, the law will state that the chairperson and executive members are responsible for the day-to-day functioning of the regulator. The role of the administrative law members will be to focus on the regulator's adjudication and administrative law functions. Having a category of non-executive members is a continuation of the present system of appointing part-time members on the boards of financial regulators. Such non-executive members will provide two important benefits to the management of the regulator:

1. Since they will not be employees of the regulator, it is expected that they will be neutral observers in the functioning of the regulator and alert the Government of any violations of law by the regulator.
2. Such members should have expertise in finance and allied fields, and preferably also some experience in providing financial services. This will bring in expertise and information about the financial sector to the board of the regulator.

Unlike ordinary civil servants, board members are appointed for a limited time and do not have a guarantee of continued employment. Therefore, one of the crucial requirements of independence is that the members should be protected from pressure through change in their terms of appointment. For this reason, the Commission recommends that the draft code should provide the conditions of appointment of members - duration, entitlements, system of removal and conflicts of interests (see Table 3.4).

3.3. Functioning of the board

The functioning of the board of regulators should primarily be left to the rules and regulations formed by the regulator. However, in the interest of accountability, certain principles must be laid down to govern the actions of the board. The Commission is of the opinion that best practices of conducting the functions of deliberative bodies should be incorporated in the functioning of the regulator. The recommendations with regard to what should be contained in the draft Code to govern board meetings is provided in Table 3.5.

Table of Recommendations 3.4 Appointment conditions for board members

1. *Duration of employment:* All members of a board (including the chairperson) would have a fixed term of five years, subject to a retirement age for executive members. The age of retirement for executive members must be equivalent to the age of retirement for the equivalent senior-most Government positions.
 2. *Protection of entitlements:* The salaries and other entitlements of the members of the board should be fixed by the Government. However, once they are set, they should not be varied to the detriment of the incumbent members of the board, or require further approvals from the Government.
 3. *Terms of removal:* The draft Code provides for both, the reasons for which a member may be removed and the process by which removal will take place. This may be done for:
 - ▶ **Regular Reasons:** Completion of term, reaching the prescribed age limit, declaration of insolvency and conviction by a criminal court which involves imprisonment.
 - ▶ **Special Reasons:** Incapacity (physical and mental), behaviour unbecoming of the position held, conviction by a criminal court which does not involve imprisonment and dereliction of duty. For removal, under special reasons to take place the Government should establish a judicial committee (under the supervision of the Supreme Court), which will investigate whether removal is necessary on the suggested grounds and create a public report on the issue.
 4. *Re-appointment:* Members of the board can be reappointed for another term of five years as members. This provision will, however, not be available for the chairperson of the board who cannot be reappointed. There will be no automatic re-appointments - the incumbent member will be considered by the selection committee alongside other prospective candidates. If the selection committee finds the member suitable, he/she will be short-listed and the Government then may choose to reappoint such members. The Commission believes that this will ensure that the tenure of members is not extended as matter of course.
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Table of Recommendations 3.5 Law governing board meetings

The principles governing the following matters must be covered by the draft Code.

1. Frequency of meetings;
 2. Quorum;
 3. Method of taking and recording decisions;
 4. Decisions without meetings;
 5. Legitimacy of decisions; and
 6. Conflicts of interest.
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The Commission is of the view that very high regard should be given to the need for transparency in the board meetings of the regulator. While there may be some specific decisions or deliberations of the regulator which may have commercial implications and may not be released immediately, this should not be uncivily used as a reason to deviate from the general principle of transparency. The draft Code will therefore require the regulators to be transparent about meetings as far as possible and when any information is kept confidential, reasons for doing so must be recorded. For instance, pending investigations and queries about violations by a regulated entity should be kept outside the purview of publication as they have an impact on the reputation of the institution without a finding of violation of laws. However, the decisions of the regulator should be published to provide information to the regulated entities on the standards of conduct expected by the regulator.

There is also a need for a formal mechanism to evaluate the regulator's compliance systems. This will be achieved by setting up a *review committee* that will be comprised only of non-executive members of the board (see Table 3.6).

3.4. Advisory councils of the regulator

The regulators will be responsible for regulating a large and rapidly developing financial system in India consisting of a large number of stakeholders, including financial service providers, intermediaries, consumers and other users of the financial system. It is not possible to ensure that all these stakeholders are adequately represented at all times

Table of Recommendations 3.6 Role of the review committee

The Commission recommends that the non-executive members of the board of a regulator form a special committee called the review committee. This committee will discharge the following functions:

1. Oversight of compliance of the regulator with the governing laws;
2. Maintaining whistle-blower policies about violations of process within the office of the regulator;
3. Ensuring that all board meetings are held in compliance with the law and all meetings are instituted and votes are recorded by creating a report;
4. Creating a system to monitor compliance of the office of the regulator with the decisions of the board through reporting systems; and
5. Reviewing all risk management policies of the board of the regulator.

The review committee will make its observations in a report which will be annexed to the annual report of the regulator. The objective of this measure is to ensure greater transparency in the functioning of the board of the regulator.

at the level of the board of the regulator. In particular, it is extremely difficult to identify persons who can represent the interests of the common Indian household. Similarly, special fields of financial service may require the regulator to gain expertise in specific areas, such as, insurance, algorithmic trading, detailed analysis of data, etc. The Commission proposes that these issues should be addressed by creating advisory councils to advise the board of the regulator (see Table 3.7).

3.5. Resource allocation of the regulator

Financial sector regulation is a resource intensive function. The sophisticated character of financial markets coupled with rapid innovations in products and processes make it necessary for the regulator to have the capability and resources to keep pace with developments in the sector. The need for financial independence is one of the primary reasons for creating an independent regulator – it allows the regulator to have the required flexibility and human resources that are more difficult to achieve within a traditional government setup.

As the regulator is empowered to hold assets independently, it can create physical infrastructure dedicated to the enforcement of financial regulations. These resources can be scaled up and modified quickly. Being independent of the Government also allows the regulator to develop its own recruitment criteria and processes, which are necessary for mobilising required human resources. The Commission notes that the provisions governing financial independence of the regulators are wide and have worked till now. Therefore, the Commission is of the opinion that there is no need to substantially modify them.

The present financial laws allow regulators to charge fees from the regulated entities to cover their costs of functioning. In certain cases the Government has also provided

Table of Recommendations 3.7 Advisory councils

The Commission recommends creation of advisory councils to advise the board of the regulator. The councils will be created by the board of the regulator (unless specifically created by the law). The composition and functioning of the advisory councils will be as follows:

1. Composition:
 - (a) include experts in the field for which it has been created; and
 - (b) include persons with relevant experience in the area of finance.
 2. Functions:
 - (a) inform the board about issues in the specific areas for which they have been constituted; and
 - (b) Create a report on all draft regulations published by the regulator stating the council's views.
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Table of Recommendations 3.8 Principles governing regulator's resources

1. The regulator should be funded through fees levied on the financial firms.
2. The regulator should have the freedom to allocate the resources in the manner that it considers most appropriate to meet its regulatory objectives.
3. The Government may loan money to the regulator to offset initial setting up costs. However, apart from this the involvement of the Government in the financial matters of the regulator should be minimal.

initial grants or loans to regulators as a corpus to start their operations. Table 3.8 covers the recommendations of the Commission on the principles governing the finances of the regulator. It includes the recommendation that the regulator should be funded primarily through fees.

Allowing the regulator to fund itself from fees collected from regulated entities has the following advantages:

1. It ensures that financial stakeholders, who are the main beneficiaries of regulated markets, bear the cost of regulation instead of the cost being spread across the entire budget of the Government.
2. It creates operational efficiency for the regulator. As the financial market grows, the number of transactions and firms increase and that increases the resource flow into the regulator. In turn, the regulator can increase its spending on enforcement, inspections and other functions which help improve the confidence of users.
3. It helps achieve freedom from Government rules on pay and budgeting, and thus facilitates the hiring of experts.
4. It helps address issues of conflict of interests in a context, where, in addition to other dimensions of political economy, the Government is the owner of many regulated entities in the form of public sector financial firms.

The Commission recognises that the power to impose fees on regulated entities leads to cost on all consumers of financial services and therefore the draft Code provides certain guiding principles on the charging of fees instead of simply empowering the regulator to make the collection (see Table 3.9). It is particularly important to ensure that the imposition of fees should not impose an undue burden on regulated firms or transfer the cost of regulating one class of firms or transactions to others. To pursue this policy, the Commission recommends that regulators be empowered to charge three different types of fees.

1. **Flat fees for registration:** This fee should be as small as possible to ensure that it does not prevent entry of new financial firms.
2. **Fees dependant on the nature of the transaction:** This type of fee will vary depending on the nature of financial business being carried out. For example, if the cost of regulating an insurance firm is higher than the cost of regulating a brokerage firm, the fees levied on the insurance firm should be higher.
3. **Fees dependent on the number or value of transactions:** This type of fee will vary depending on the frequency and size of transactions. For example, a brokerage firm may have to pay fees depending upon the number of transactions it carries out. Similarly, an insurance firm would be charged depending on the number of insured contracts it executes.

As noted earlier, regulatory independence requires that the Government's right to intervene in the financial matters of the regulator is kept at a minimal. The Commission therefore recommends that the Government must only control the salary and perquisites of the members of the board of the regulator. The board should in turn be responsible for maintaining adequate staff and expertise to meet its statutory objectives within its financial capacity. The board should therefore be charged with the responsibility of designing a set of Human Resources (HR) practices that are conducive to the accomplishment of its regulatory objectives.

Table of Recommendations 3.9 Principles governing the charging of fees by the regulator

The legal provisions empowering the regulator to charge fees will incorporate the following aspects:

1. The regulator should charge fees only to cover expenses and keep adequate reserves;
 2. Fees should be charged only through regulations made after following the legislative processes specified in the draft Code;
 3. The regulator should clearly explain the fees it is charging and demonstrate that the fee is not disproportional to the cost for the regulator;
 4. Applying the principle of proportionality, the regulator should place higher financial burdens on firms that have more transactions, and thereby increase its work load and functions, etc.
 5. The regulator should break up the fees into different categories.
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Table of Recommendations 3.10 Performance measurement and reporting

The allocation of resources by the regulator is intrinsically tied to the performance of the regulator. Therefore the Commission recommends the following principles for the measurement of the regulator's performance and financial reporting:

1. The regulator should create two annual reports:
 - (a) Audited report which is comparable to traditional financial reporting; and
 - (b) Performance report which incorporates global best practice systems of measuring the efficiency of the regulatory system.
 2. The performance report should use modern systems of measuring each activity of the regulator as objectively as possible.
 3. Performance systems must require the regulator to create and publish performance targets.
 4. All performance measures must be published in the annual report.
 5. Performance measurement system should be reviewed every three years to incorporate global best practices.
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3.6. Performance assessment and reporting

The Commission noted that the present system of financial accounting of the regulator is focused primarily on the reporting of expenditures incurred by the regulator under various heads. This, according to the Commission, does not constitute a sufficient test of the fulfilment of *regulatory objectives* or the assessment of the regulator's *performance*. Therefore, there is need to require regulators to adhere to a more comprehensive system of measuring their performance.

Measurement systems for assessing the performance of regulators should include an assessment of the regulator's processes on metrics such as, the time taken for granting an approval, measurement of efficiency of internal administration systems, costs imposed on regulated entities and rates of successful prosecution for violation of laws. Adopting such an approach would constitute a departure from the present system where most financial regulators focus on measuring the activities of regulated entities and financial markets as a standard for their own performance. The Commission noted that while these measurements are important, measurement of various activities undertaken by the regulator will provide much greater transparency and accountability.

The measurement of activities of the regulator also needs to be tied with the financial resources spent by the regulator to carry out those activities. A system which merely measures the expenses of the regulator was therefore considered to be inadequate and the Commission recommends a move towards tying the measurement of regulatory activities and the expenditure incurred for it as a crucial link for improving regulatory governance. Accordingly, the Commission recommends the following measurement processes for the regulator (Table 3.10):

1. **Budgeting Process:** This process will measure the allocation of resources by the regulator for its different objectives and try to assess the regulator's performance in pursuing each objective in

the most comprehensive manner possible. Emulating the performance measure based auditing system used globally by financial regulators, this process will:

- ▶ relate the exercise of functions by the regulator with its expenses;
 - ▶ require the regulator to create performance metrics and targets which it will be required to achieve;
 - ▶ help in tracking the regulator's performance across financial years.
2. **Financial Accounting:** This will be the traditional accounting of expenses for the purposes of maintaining financial control and audit, which is currently being done by financial regulators. The financial accounts will be audited by the CAG.

Functions and powers of the regulator

The regulator acts like a mini-state in that it exercises legislative powers in the form of drafting regulations that are binding on regulated entities; it acts as the executive in its supervision and enforcement actions; and it performs a quasi-judicial function while assessing compliance with the law by regulated entities and compliance of processes by the regulator while imposing penalties on them.

While giving these wide ranging powers to the regulators, the draft Code on regulatory governance needs to put in place appropriate checks and balances to ensure that the powers are not misused and proper regulatory governance processes are followed in every action taken by the regulator.

The Commission has identified the following areas for which regulatory governance processes need to be clearly detailed in the draft Code:

1. Process for issuing regulations and guidelines;
2. Executive functions - granting permission to carry on financial activities, information gathering, investigation, imposition of penalties and compounding of offences; and
3. Administrative law functions.

4.1. Issuing regulations and guidelines

The primary function of a financial sector regulator is to set down standards of behaviour expected from regulated entities. This encompasses making regulations governing how the regulated entities should interact with the regulator, consumers, financial markets and other regulated entities. Regulations also guide the internal functions and actions of regulated entities in the conduct of financial activities.

In a system governed by the rule of law, no action should be judged against unknown standards. Therefore, before the regulator can carry out any supervision or adjudication functions it has the responsibility to lay down in clear and unambiguous terms, the behaviour that it expects from regulated entities. While doing so, the regulator needs to follow a structured process that allows all stakeholders to be fully informed of and participate in the regulation-making process.

Some existing regulators have already adopted the good practice of carrying out public consultations in the course of making regulations. However, the Commission

noted that since this is not mandated by legislation, the processes employed are not adequately rooted in a thorough analysis of the public administration problems faced in the regulation-making process. In addition, as with most other aspects of the legal process in Indian financial regulatory governance, the practices followed by different financial regulators differ in idiosyncratic ways.

The Commission has therefore identified detailed requirements to define the process that the regulators should follow while making regulations and the mechanisms for the judicial review of legislative powers exercised by regulators.

If laws do not define a fixed set of instruments that can be used by the regulator, the same regulatory agency might adopt multiple regulatory instruments – circulars, notices, letters, regulations, guidelines, master circulars, press notes – with similar outcomes but differing regulation-making processes. To avoid this situation, the Commission recommends that the draft Code should clearly define the legislative powers of the regulator and the instruments. The Commission recommends that the regulator should be empowered to issue only two types of instruments – regulations and guidelines.

4.1.1. Process for making regulations

The draft Code must determine the process to be followed for the formulation of regulations, starting with the manner in which the drafting of regulations is to be initiated. Given the wide impact of regulations, the Commission recommends that the regulation-making process should be directly overseen by the board of the regulator. This will ensure that the issues that require regulatory intervention are discussed and approved at the highest level within the regulator's organisation. Therefore, after the process of drafting regulations has been initiated within the regulator, it will have to be approved by the board of the regulator before being published to the public for comments.

The Commission believes that effective public participation in the regulation-making process is necessary to ensure that subsidiary legislations are responsive to the actual requirements of the economy. It will also help check and improve the information used and analysis done by the regulator. Therefore, the Commission recommends that the details of the process to be followed for carrying out consultations and receiving public comments should be laid down in the draft Code. Doing so will allow for the standardisation of best practices and hence lead to a more structured system for making subordinate legislations. The expected overall impact is that regulations will become more responsive to the needs of the financial system.

4.1.2. Emergency regulations

The Commission recognises that the regulator may sometimes be faced with an emergency situation that requires the rapid introduction of a new regulation. In such cases, it may not be feasible for the regulator to follow the detailed regulation-making process discussed above. Therefore, the draft Code envisages a separate emergency regulation-making process, as outlined in Table 4.3.

The Commission recommends that the draft Code will require the regulator to carry out the consultation process in two stages. The first stage will be the issuance of a set of introductory documents to inform the public of the proposed regulations and provide a system for giving comments (see Table 4.1). This will be followed by a requirement to respond to the comments received by the regulator and the issuance of final regulations (see Table 4.2).

4.1.3. Issuing guidelines

In a system of principles-based provisions that are to be interpreted and applied by the regulator, there is a genuine need for clarifications and explanations. This would require

Table of Recommendations 4.1 Issuance of documents for public consultation

The regulator will have to publish the following documents in the process of formulating new regulations:

1. The draft regulations;
2. The *jurisdiction clause* to identify the legal provision under which the proposed regulations are being made, and the manner in which the regulation is consistent with the principles in the concerned legislation(s). If the parent legislation does not specifically refer to the subject matter of regulations, the regulator will have to establish a logical connection between the subject matter and the empowering provision in the law. The document must contain explanation on how the regulation stands vis-a-vis each of the relevant principles in the part(s) of the draft Code from which the powers are being drawn;
3. A *statement of the problem or market failure* that the regulator seeks to address through the proposed regulations, which will be used to test the effectiveness with which the regulations address the stated problem. The statement must contain:
 - ▶ The principles governing the proposed regulations, and
 - ▶ The outcome the regulator seeks to achieve through the regulation, and;
4. An *analysis of the costs and benefits* of the proposed regulation. This is required because every regulatory intervention imposes certain costs on regulated entities and the system as a whole. The Commission recommends that regulations be drafted in a manner that minimises these compliance costs. In some cases where a pure numerical, value based cost-benefit analysis is not possible, the regulator should provide the best possible analysis and reasoning for its choice of intervention.

After publishing the above documents, the regulator will specify a designated time for receiving comments from the public on the regulations and the accompanying documents. The draft Code will ensure that the time period and the mode of participation specified by the regulator is appropriate to allow for widespread public participation.

Table of Recommendations 4.2 Process after receiving public comments

After the time specified for making comments has lapsed, it will be the responsibility of the regulator to:

1. Publish all comments received;
2. Provide reasonable general response to the comments received, and specific response to some comments if there is requirement stipulated in the draft Code for such response;
3. Publish the review of the draft regulations carried out by the regulator's advisory council;
4. Have the final regulations approved by the board of the regulator. In the interests of transparency, the Commission recommends that deliberations and voting by the board members should be available publicly; and
5. Publish the final regulations.

Table of Recommendations 4.3 Emergency regulation making

In emergency situations the regulator would be empowered to pass regulations without following the consultation process and without conducting a cost-benefit analysis, subject to the following conditions:

1. Regulations passed under this provision will lapse after a period of six months; and
2. The regulator must publish a reasoned order for using this power.

the regulator to have the power to issue guidelines explaining the interpretation of the regulator of laws and regulations. The Commission believes that allowing the regulator to issue guidelines of this nature will constitute an important step in reducing uncertainty about the approach that the regulator may take.

The mechanism of issuing guidelines should not be used to (in effect) make regulations without complying with the procedural requirements laid down for regulation-making. For this reason, the draft Code clarifies that guidelines are merely recommendatory in nature and the violations of guidelines alone will not empower the regulator to initiate enforcement action against regulated entities. Table 4.4 shows the recommendations of the Commission in relation to issuance of guidelines.

4.1.4. Accountability to the Parliament

Since the power to issue regulations is a legislative power delegated by the Parliament to the regulators, regulations formulated by the regulator should be placed before the Par-

Table of Recommendations 4.4 Issuance of guidelines

The law governing the issuance of guidelines should

1. Require the regulator to clearly explain the connection between the guidelines and the principles and provisions in the Parliamentary law that the regulator seeks to enforce;
2. Ensure that the guidelines are not used as a mechanism to create substantially new regulations;
3. Allow guidelines to be issued without a cost-benefit analysis but subject to the consultation process under which the draft guidelines will be issued for comments and responses of persons affected by the guidelines;
4. Clearly state that violation of guidelines alone would not constitute the violation of regulations or laws; and
5. If regulated entities ask for the interpretation or application of law for a specific transaction, the regulator should provide it for a reasonable fee.

Table of Recommendations 4.5 Judicial review of regulations

The Commission recommends that any challenge to a regulation framed by the regulator should be reviewed by the appellate tribunal on the following grounds:

1. The regulations should have been made within the bounds specified by the law. This would include ensuring compliance with the specific provision of law under which the regulation is made and the general objectives and principles of the regulator;
2. The regulations should have been made in compliance with the process laid down in the law; and
3. The documents published along with the regulations should not have any substantive material defects, which may be proved through expert evidence or facts.

ment. This allows the Parliament to review whether the regulator, acting in its capacity as an agent, has acted within its scope of authority while formulating the regulations.

The current system of review by the Parliament involves sending subordinate legislation (regulations made by the regulator in the present case) to a different committee than the one which reviews laws presented to the Parliament. The Commission recommends that it may be appropriate for those to be considered by the same committee.

4.1.5. Judicial review of regulations

At present, judicial review is largely limited to executive actions. However, the Commission recognises that it is equally important to have a mechanism that allows regulated entities and others to question the regulations made by the regulator in exercise of its legislative powers, if regulations exceed the mandate given to the regulator under the primary law or if the specified process for making regulations has not been duly followed. The Commission therefore recommends that the process to challenge subsidiary legislation made by regulators should also be provided in the draft Code.

The first point of challenge of regulations would be before the NSAT, a specialised tribunal that will be created for the financial sector as a whole. In addition to this, the power of the Constitutional courts to review legislation would of course continue.

The judicial review of the regulation-making process by the appellate tribunal should ideally provide a more detailed scrutiny than compliance with Constitutional provisions. In the course of this process, the regulations should be checked for compliance on the grounds mentioned in Table 4.5.

4.2. Executive functions

A major responsibility of any regulator involves the exercise of executive functions. This includes inspections, investigations, enforcement of orders and processing of complaints. The exercise of supervision and monitoring powers is fundamental to the effective enforcement of laws by the regulator. However, it is often seen that the manner of exercise

Table of Recommendations 4.6 General executive functions of a regulator

The Commission recognises that regulator must carry out certain general executive functions on a routine basis. These include:

1. Grant of approvals, including licensing or registration;
 2. Inspections, which may be routine or special;
 3. Proving violation of regulations to the judicial officers (by leading evidence);
 4. In the case of successful prosecution before the administrative law department, suggesting enforcement actions; and
 5. Compounding of offences with the involvement of the administrative law department.
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of executive function may place an undue burden on regulated entities and financial markets.

Long pending investigations create uncertainty for businesses. When news of ongoing investigations leaks, it may inflict damage to the reputation of any financial firm. Similarly, injunctions placed on businesses under investigation have strong economic implications and should be placed for the shortest possible period. These problems can be checked by putting in place legal measures that require investigations to be finished within specified time, and kept confidential from the public.

The Commission notes that the overall approach of the draft Code should be to provide for strong executive powers, balanced with greater transparency and accountability, to prevent abuse. Executive functions of regulator do not have standardised statutory checks under present legislations. Therefore, the Commission recommends that adequate transparency requirements, checks and judicial oversight be placed on the exercise of executive functions by regulator. This will also reduce allegations of possible bias and arbitrariness to the minimum.

It is also important to ensure that there is no overlap in the legislative and executive functions of the regulator. The executive should not be allowed to issue instructions of a general nature to all regulated entities or a class of regulated entities. Such instructions should only be possible after the full regulation-making process has been followed.

Table 4.6 sets out the areas in which the Commission has made specific recommendations regarding the exercise of executive powers.

4.2.1. Permission and approvals

Granting permissions to start a business is the core function of any regulator. This is also the first barrier to entry for new entrants to any business. Each new business permission also increases the burden on the regulator as it increases the number of entities it has to monitor. The draft Code must grant the regulator discretion to approve or reject applications. The Commission has decided that the power must be exercised in a manner guided by regulations. As far as possible the discretion of the regulator should be guided through an underlying duty to explain. The power of the regulator to reject applications should be balanced with the requirement for allowing legitimate parties getting approvals in a time bound manner for smoother functioning of the regulatory system. Table 4.7 summarises the recommendations of the Commission for governing the procedure for disposing applications.

4.2.2. Information gathering

Regulator requires information about the activities of their regulated entities. It may also require information from private sources and other government agencies. At present, a diverse array of mechanisms are used by firms to submit information to regulatory

Table of Recommendations 4.7 Giving permission to carry out a business

The system of giving permission to new entities must be strictly governed by regulations and finished within a time bound manner. The provisions must:

- ▶ Provide a system for persons to apply for authorisation to provide financial services;
- ▶ Ensure that all applications are accepted or rejected within a specified time;
- ▶ Ensure that whenever an application is rejected, reasons for the rejection are provided; and
- ▶ Provide that the regulator gives warning to the applicant before rejecting an application

Table of Recommendations 4.8 Information gathering

The draft Code contains the following provisions on information gathering:

1. The regulator should have the power to collect information from regulated entities;
2. The regulator should have power to collect information from other government agencies;
3. Information should be collected in electronic format as far as possible; and
4. The regulator should publish information it generates (orders, decision, list of regulated entities) in the public domain (about from confidential information).

agencies. Harmonisation into a single mechanism for electronic submission of information will reduce the cost of compliance for firms and also reduce the cost of information management for regulator. The Commission proposes to create a centralised database, through which all the information is collected by regulator and other agencies. A more detailed discussion on this centralised database can be found in the chapter on systemic risk. Maintaining and analysing this information is an important indicator of violation of provisions in many situations. Even at present, most regulators have the power to require regulated entities to produce documents and information in normal course of regulation. This power should be continued in the proposed legislation. Table 4.8 contains other details regarding information gathering powers.

The Commission also noted that the use of technology is crucial in the context of the information gathering function. Using electronic systems will affect stake-holders in the financial system in the following ways:

1. **Regulator:** Use of electronic data management will provide regulator with real-time information about financial entities. It will also provide regulator with modern analytical systems to track violations or risks. Toward this end, the Commission proposes to create a centralised database that will use state-of-the-art data management systems to route regulatory data.
2. **Regulated entities:** Use of electronic reporting systems may reduce compliance costs for regulated entities. It will also allow regulated entities to provide information to the regulator in a seamless manner.
3. **Consumers:** Access to records of the regulator about regulated entities in electronic format will allow consumers to gain information quickly. It will also help consumers to access their own records and check for financial frauds.

4.2.3. Investigations

It is important that the powers of investigation and enforcement are carried out in the least arbitrary and the most effective manner. The Commission has noted that executive functions in the financial market can have serious consequences. The information that a firm is under investigation may cause undue panic in the market and even if the result of investigation is a positive outcome for the firm, the intervening period may cause irreparable damage to the reputation and business of the firm. The system of investigations should therefore be such that it does not harm or unduly burden the entity under investigation (see Table 4.9).

The Commission is of the opinion that the executive investigation process should be carried out in:

Table of Recommendations 4.9 Investigations

The Commission recommends that investigations should be:

- ▶ Carried out according to the written terms of investigation;
- ▶ Carried out by an appointed investigator;
- ▶ Finished within a time bound manner, unless extended by an administrative law officer; and
- ▶ Carried out with least disruption to the function or reputation of a business.

The investigators empowered under the draft Code should have the power to:

1. Require production of documents;
 2. Require persons to answer questions;
 3. Require co-operation of non-regulated entities in investigation; and
 4. Require co-operation from other government agencies.
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Table of Recommendations 4.10 Information-sharing between regulators

1. The draft Code should require the regulator to create a framework for sharing of information.
 2. The electronic information framework of each regulator should be compatible with that of other regulator(s) and agencies with which it regularly shares information.
 3. The legal framework should have adequate checks and records to prevent misuse of informations.
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1. A confidential manner so as to prevent panic before any finding; and
2. A time bound manner so as not to unduly burden the entity under investigation.

4.2.4. Sharing of information

Investigations are greatly assisted by a strong database providing details of the regulated entities and the transactions they have undertaken. The Commission recognises that this information may not be available at a single source. Hence, the Commission suggests the creation of a single database, through which all information collected by regulator (and other agencies in the financial sector architecture), will be routed (see the chapter on systemic risk for a detailed discussion on this issue). Where regulator needs to obtain information from other regulator(s) or government agencies, the draft Code creates a framework for sharing information between the agencies. Table 4.10 provides the system suggested by the Commission for sharing of information.

4.2.5. Consequence of violations

The Commission found that different regulators have different consequences for violations of laws and regulations enforced by them. This creates detriment to the rule of law and increases uncertainty about violations.

The Commission recommends that:

1. The consequence of violations be standardised;
2. The way the consequence is determined be regulated by law;
3. Similar violations be treated with similar consequence; and
4. The consequence be proportional to the violation and the behaviour of the violator.

The Commission recommends that whenever a violation is detected the regulator must determine which of the following conditions led to the violation;

1. The violation was a result of an informed intent to commit the violation;
2. The violation was a result of serious negligence of maintaining standards expected of a reasonable person carrying out the activity; or
3. The violation was a result of a mistake or was of a technical nature.

The Commission recommends that depending on the cause of the violation the regulator must apply the following consequences in increasing order:

1. Issuing a private warning;
2. Issue a public notice;
3. Require a corrective action applicable to the violation;
4. Impose a monetary penalty;
5. Suspend the permission to carry out certain transactions;
6. Permanently revoke the permission to carry out regulated activities; and/or
7. Institute criminal proceedings in appropriate courts.

4.2.6. Imposition of monetary penalties

The Commission noted that the present system of specifying statutory limits on the amount of penalties that can be imposed for any violation has a critical flaw – it does not ensure that a violator pays a fine higher than the gain made through the violation. This is because it is impossible to predict the benefit a violator will gain by committing an offence. The maximum limit on penalties is sometimes lower than the benefit gained by the violator through violation. This leads to a situation where even if the violator is caught and required to pay the fine, he or she may still emerge monetarily better off.

The Commission notes that the level of penalties should be an effective deterrent to future violations and signal all other regulated entities that the potential of gain from violation will be outweighed by the penalty which will be applied in the case of detection of the violation. This principle also acknowledges that all violators of any law are never detected. Therefore, to act as a deterrence, the penalty should be a multiple of the illegitimate gain from the violation. The amount of penalty should also be dependent on whether the action was deliberately done or due to reckless behaviour or due to negligence of the person.

The system of imposing financial penalties should be guided by the following principles:

1. The penalty system should require the violator to pay a multiple of the illegitimate gain made from the violation;
2. Out of the penalty collected, the regulator should try to compensate any directly identifiable victims of the violations;
3. Any surplus at this point should be deposited with the Consolidated Fund of India;
4. In the event that there are no direct victims, the regulator must transfer all the penalty (after deducting administration costs) to the Consolidated Fund of India;
5. If there is no clearly identifiable illegal gain from the violation, the regulator must impose a penalty that is a proportion of the income of the violator from financial activities; and
6. All systems of monetary penalties must be regulated by regulations that consider the magnitude of the violations and the previous violations of the violator.

The doctrine of unjust enrichment allows the regulator to recover all the profit the violator made from the violation. Unjust enrichment should be recovered, in addition to the fine applied for violation of regulations. This should be recovered and then, if possible, distributed amongst persons who were adversely affected on account of the violation. Punitive damages create a deterrence for future violators who will know that in the event that they are successfully prosecuted the penalty they will face will surely outweigh the profits that they make. It requires the regulator to expressly impose fines which are higher than the benefit gained out of the violation. This is usually carried out by providing penalties as a multiple of the amount of gain by the violator. The Commission found that this principle has already been provided in some Indian legislations and should be extended to the financial sector as a whole.

Table 4.11 summarises the recommendations of the Commission for creating a legal system governing penalties.

Table of Recommendations 4.11 Requirement for proportional penalties

The regulator must ensure that the penalties deter potential violators in the future. It is impossible to ensure that all violators are caught. However, violators must pay fines proportional to the damage and the illegal gain. The following are the steps the regulator must follow:

- ▶ For each violation, the regulator must carry out an investigation on the illegitimate gain made by the violator;
 - ▶ The regulator must make an effort to determine the amount of illegitimate gains made by the violator;
 - ▶ The penalty will be a multiple of the illegitimate gain, but limited to a maximum of 3 times the illegitimate gain;
 - ▶ The regulator must compensate any direct victims of the violations if they can be ascertained; and
 - ▶ The regulator must have regulations and processes for calculating and enforcing the fines.
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Table of Recommendations 4.12 Compounding of offences

The system for compounding offences must:

- ▶ Be guided by a policy set out by the regulator;
 - ▶ Have adequate checks and balances to prevent interference from external parties;
 - ▶ Be transparent to prevent allegations of favouritism;
 - ▶ Consider previous behaviour of the party; and
 - ▶ Consider whether the party itself offered compounding before any investigation was started.
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4.2.7. Compounding of offences

The Commission believes that the system of compounding offences is important for reducing judicial burden and addressing minor violations, which are common in the financial sector. However, the system of compounding offences requires a standardised structure across all regulators which is not present as of date. The recommendations of the Commission are provided in Table 4.12.

4.3. Administrative law and role of tribunals

In exercise of their supervisory and enforcement powers, regulators need to assess whether or not regulated entities have adequately complied with the provisions of financial laws and in case of any detected breach, they have the power to impose appropriate penalties. These wide ranging executive powers given to regulators necessarily need to be balanced with proper systems governing the application of administrative law. Therefore, the Commission recommends that the exercise of quasi-judicial (administrative law) functions by regulators needs to be carried out within the bounds of a sound legal framework that ensures the separation of administrative law powers from other powers of the regulator.

In addition, there also needs to be a mechanism to review the actions taken by regulators in exercise of their quasi-judicial functions. Given the specialised character of financial markets and the complicated nature of issues involved, the Commission finds that there is a strong case for having a dedicated appellate tribunal.

The Commission therefore makes specific recommendations in respect of the processes governing these two areas:

1. *Administrative law functions carried out by the regulator:* How the regulator separates and carries out regulatory function within its organisation.
2. *Judicial review by appellate tribunals:* How the decisions of the regulator are reviewed through a dedicated financial sector appellate tribunal.

4.3.1. Administrative law functions of the regulator

At the level of the regulator's board, at least one executive member should be designated

Table of Recommendations 4.13 Requirement of administrative law officers

The system of administrative law functions requires:

- ▶ The board of the regulator will appoint one of its members as administrative law member;
 - ▶ The creation of a special class of officers called administrative law officers; and
 - ▶ While serving as administrative law officers, these persons shall not carry out other functions. This is necessary to maintain separation of their roles and responsibilities from the other staff members of the regulator.
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Table of Recommendations 4.14 Judicial review of executive actions

The Commission recommends the following principles for application of administrative law by the regulator:

1. All investigations and internal processes should strictly conform to procedures of fairness;
 2. Even minor non-compliance to procedure should be required to be adequately explained by the regulator;
 3. Administrative law officers should act as disinterested third parties in a dispute; and
 4. The decisions of administrative law officers will lead to the development of a body of cases similar to common law jurisprudence.
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Table of Recommendations 4.15 Procedure for administrative law functions

1. All decisions to impose penalty or decisions requiring any action against any regulated entity should be carried out by administrative law officers;
 2. Administrative law officers should place the proposed decision of the executive and the material on which the decision was arrived at, before the regulated entity through a notice called a *warning notice*;
 3. The regulated entity must be allowed to respond before a decision is taken;
 4. The decision of the administrative office must be a reasoned decision and should be provided to the regulated entity or other concerned person through a notice called the *decision notice*; and
 5. The regulated entity may ask the administrative law member of the board to review the decision taken by the administrative law officer.
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as an administrative law member. Under the member, the regulator will maintain a class of administrative law officers. The administrative law member will be responsible for oversight of the functioning of the administrative law officers. Consequently, such member will not take active part in executive functions of the regulator and not be involved in any investigation, inspection or similar other functions.

Like the administrative law members, the administrative law officers will also not be involved in any investigation proceedings. This would, however, be achieved without creating a wall of separation within the regulator – administrative law officers would be drawn from the general pool of employees of the regulator but as long as such persons are involved in judicial functions they would not be involved in any other regulatory functions (see Table 4.15).

4.3.2. Procedure for administrative law functions

The administrative law functions of the regulator are at two levels. The first level adjudication will be done by administrative law officers who will work inside the agency of the regulator but will not be involved in executive functions. While exercising their functions, the administrative law officers will examine the data and evidence collected by the regulator's executive officers and will assess the appropriateness of their executive orders (see Table 4.14).

Appeals from the orders of the administrative law officers will go to the administrative law members of the board. This process will act as a performance review of the administrative law officers and also reduce the number of appeals to the tribunal by weeding out flawed orders. Table 4.15 summarises the administrative law related processes of the regulator.

Table of Recommendations 4.16 Approach to judicial review of regulatory actions

1. All functions including the quasi-judicial function of regulator should be subject to judicial review;
2. This review should be done through an appellate mechanism;
3. There should be a single dedicated appellate tribunal for the entire financial sector that will cover all financial regulators;
4. The appellate tribunal will hear appeals against the decisions made by and the regulations framed by financial regulators;
5. The appellate tribunal will be funded by an appropriate fee from all regulated entities; and
6. The appellate tribunal's structure is clearly detailed out in the draft Code.

The Commission is of the opinion that while the entire Code for Civil Procedure, 1908 (CPC) need not be followed by the administrative law officers and members, the draft Code provides the basic rubric of the procedure of judicial determination and appeals. Therefore, it will be the responsibility of the board of the regulator to create appropriate subsidiary legislation to establish the procedures to be followed for the discharge of administrative law functions by the regulator.

4.3.3. Judicial review and appellate tribunals

The Commission recognises that actions taken by regulators can impose significant penalties and burden on regulated entities. Therefore, the *rule of law* requires that a clear judicial process be available to persons who seek to challenge regulatory actions. The needs of a modern financial system require us to move beyond a system where appeals against regulatory decisions can be made to an authority within the regulator or to the Government to the creation of a specialised FSAT. The appellate framework envisaged by the Commission is outlined in Table 4.16.

4.3.4. Structure of the appellate tribunal

As regards the structure and functioning of the FSAT, the Commission finds that there is need for clearly demarcating and concentrating on two important functions:

1. Judicial functions of the tribunal, which require persons with qualification and experience in law and finance; and
2. Administrative functions of the tribunal, which include service of documents, collecting evidence, accepting written submissions, managing dates for hearings and arguments.

The judicial functions of the tribunal requires expertise in various fields of law and finance. In order to satisfy the requirements of separation of powers envisaged in the Constitution, the Commission recommends that the tribunal must remain under the control of judicial officers. This is also consistent with the present structure of tribunals in India. Table 4.17 summarises the recommendations of the Commission in relation to the judicial functions of the appellate tribunal.

4.3.5. Functioning of the tribunal's registry

The present systems of management of courts and tribunals often involve mandating the chief judicial officer of the court or the senior-most judge to be responsible for the administration of the tribunal or court. This can interfere with the person's core appellate functions by causing him or her to divert attention to administrative matters. In some cases, this challenge has been addressed by appointing a separate *registrar* for the court or tribunal.

The Commission recommends that the appellate tribunal should be supported by an efficient registry which will be headed by a *registrar* having specialised management

Table of Recommendations 4.17 Judicial structure of tribunal

For creating a clear judicial structure for the appellate tribunal, the Commission recommends the following provisions:

1. The appellate tribunal will be headed by a presiding officer who is qualified to be a Judge of Supreme Court, Chief Justice of a High Court, or has served for at least seven years as a Judge of a High Court;
2. The tribunal will have at least two members; the specific number of members of a tribunal will be determined by the case load;
3. The members of the tribunal must have experience in the fields of finance, economics, accountancy and law;
4. The members may be formed into benches, in which case, each bench must have a person who is qualified in law; and
5. There will be a statutory appeal available against the decisions of the appellate tribunal to the Supreme Court.

Table of Recommendations 4.18 Rules of procedure for appellate tribunal

The appellate tribunal should devote attention to standardising the systems for:

1. Application of complaints and responses;
2. Implementation of temporary orders;
3. Introduction of evidence;
4. Hearing of arguments;
5. Determination of the case; and
6. Determination of the penalty.

skills who will be responsible for all the infrastructure and administrative functions of the appellate tribunal. To ensure that the separate registry does not undermine the independence of the tribunal, the registrar should be under the supervision of the chief judicial officer of the appellate tribunal.

The Commission recommends the following provisions relating to the registry of the appellate tribunal to ensure its efficient functioning:

1. *Developing details of procedure:* The draft Code requires the appellate tribunal to formulate its own regulations on procedure, and publish them so as to induce clarity amongst financial firms. These regulations, on the areas mentioned in Table 4.18, should be formed by the appellate tribunal itself.
2. *Using information technology:* The processes of the appellate tribunal should be geared towards using information technology to integrate its entire judicial functions into an electronic form. The objective of the use of technology would be to reduce the cost of approaching the tribunal, greater efficiency in the functioning of the tribunal and greater transparency in the performance of the tribunal. Information technology should be used to reduce requirements for physical travel, keeping paper records, and following up on compliance with orders.
3. *Resources and reporting:* The efficiency of the tribunal's procedures need to be continuously monitored and measured. The draft Code will help achieve this by specifying that the tribunal must comply with accountability requirements through the production of detailed performance statistics, annual reports and audit reports similar to that of regulators.

4.4. Conclusion

The functioning of regulatory agencies is a critical component of financial law. Regulatory agencies are remarkable in featuring a combination of regulation-making power that is delegated by Parliament, executive functions, and quasi-judicial functions. In addition, there are sound reasons for favouring significant political and operational independence in regulatory agencies. In order to obtain sound outcomes, the Commission has applied meticulous care in clearly establishing unconflicted objectives, processes governing legislative and executive functions, bringing in an element of separation of powers for per-

forming quasi-judicial functions, and establishing an effective specialised mechanism for substantive judicial review of regulations and orders.

The basic public administration challenge of establishing a regulatory agency does not vary from one agency to the next. Hence, the Commission proposes a single and consistent framework that is applied to all regulatory agencies.

Consumer protection

5.1. Strategic picture

A well functioning financial system should allow individuals, households and enterprises to efficiently allocate and manage their resources and protect themselves from risk, through the use of financial products and services. This involves complex interactions between consumers and financial service providers. At a first level, these interactions require the support of law to define and protect property rights and facilitate the enforcement of contracts.

However, the complexity of financial markets and the existence of *market failures* in the form of information asymmetries, market externalities and differences in the bargaining powers of consumers and service providers, create the need for a higher standard of protection for financial consumers. The need for financial consumers to be treated fairly makes it appropriate to adopt a more intrusive approach to financial regulation, when compared with most other fields.

Currently, the strategy in Indian finance is focused on the doctrine of *caveat emptor*: let the buyer beware. Beyond protection from fraud and provisions to ensure full disclosure, consumers are generally left to their own devices. After extensive analysis and debate on these questions, the Commission believes that to the extent that consumers of financial services are more vulnerable than consumers of ordinary goods and services, higher standards of protection ensured by special efforts of the State are justified.

The vulnerability of consumers reflects a major gap in Indian financial regulation, which needs to be addressed. As such, the Commission recommends the adoption of a consolidated, non-sector-specific, consumer protection framework for the entire financial system that will empower and require regulators to pursue consumer protection for the financial activities regulated by them. In this context, the draft Code approaches the problems of consumer protection on two fronts: prevention and cure.

Prevention requires regulation-making and enforcement across the entire financial system from the viewpoint of consumer interests. For example, looking at questions of remuneration and conflicts of interest, when a sales agent sells a financial product to a household, and gets paid a fee by the producer of this financial product, is there a problem with conflicts of interest? How do we evolve a structure where the provider acts in the best interest of the consumer? Regulators should be obliged to grapple with questions such as these.

The consumer protection part of the draft Code has three components: an enumerated set of rights and protections for consumers, an enumerated set of powers in the hands of the regulator, and principles that guide what power should be used under what circumstances. The details of consumer protection would, of course, lie in the subordinated legislation to be drafted by financial regulators. Whether or not, for example, loans and other conflicted remuneration structures should be banned is a question that would need to be addressed by the regulator. The regulator will use its authority to develop subordinate legislation which will adapt over the years to reflect financial innovation, technological change, and the evolving nature of the Indian economy. Alongside this regulation-making mandate, the regulator would also have supervisory roles to ensure compliance with the law.

In India, so far, the financial regulatory structure has been defined by sector, with multiple laws and often multiple agencies covering various sectors. This has led to inconsistent treatment, and regulatory arbitrage. Regulators have sometimes been lax in developing required protections out of notions of facilitating growth in the industry. These problems would be reduced by having a single principles-based law which would cover the entire financial system. The Commission believes that an overarching principles-based body of law would allow regulatory flexibility, consistent treatment of consumers across all aspects of their engagement with the financial system, fairness and ultimately a more stable financial system.

Turning from prevention to cure, the Commission proposes the creation of a unified financial redress agency. The redress agency is expected to have front-ends in every district of India, where consumers of all financial products will be able to submit complaints. Modern technology will be used to connect these front-ends into a centralised light-weight adjudication process. A well structured work-flow process will support speedy and fair handling of cases. Consumers will deal only with the redress agency when they have grievances in any financial activity; they will not have to deal with multiple agencies.

The complaints brought before the redress agency will shed light on where the problems of consumer protection are being found, and thus suggest areas for improvement in subordinated legislation. As such, a key feature of the redress agency will be the creation of a feedback loop through which the computerised case database of the redress agency will be utilised by the regulator to make better regulations on a systematic basis.

India needs a capable financial system, with sophisticated private financial firms. However, the emergence of this financial system should not become a *corte blanche* for clever financial firms who achieve undue influence with their regulators, to take unfair

Table of Recommendations 5.1 Framework on consumer protection

The draft Code contains a consolidated non-sector-specific financial consumer protection framework. It identifies consumer protection as a key regulatory objective and contains the following preventive and curative components:

1. Preventive tools

- ▶ Certain protections are provided to all financial consumers.
- ▶ An additional set of protections are provided to unconsolidated or retail consumers.
- ▶ The regulator is given a list of enumerated powers which it can use in order to implement these protections.
- ▶ The regulator will be guided by a list of principles that should inform the exercise of its powers.
- ▶ The regulator has been given the power to supervise financial service providers and initiate enforcement and disciplinary actions.

2. Curative tools

- ▶ Creation of an independent financial redress agency to redress complaints of retail consumers against all financial service providers.
 - ▶ A research program, applied to the data emanating from the redress agency, will feed back to the regulator and thus enable improvements in its work.
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Table of Recommendations 5.2 Meaning of "consumer" and "retail consumer"

The terms "consumer" and "retail consumer" are defined in the draft Code to mean:

1. *Consumer*: A person who has availed, avails, or intends to avail a financial service or has a right or interest in a financial product.
 2. *Retail consumer*: A consumer that is an individual or an eligible enterprise, if the value of the financial product or service does not exceed the limit specified by the regulator in relation to that product or service. The regulator may specify different limits for different categories of financial products and services.
 3. *Eligible enterprise*: An enterprise that has less than a specified level of net asset value or has less than a specified level of turnover. Each of these caps will be specified by the regulator.
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advantage of customers. The present financial laws in India are vulnerable to such a prospect. As such, the Commission believes that it is essential to place the function of consumer protection at the heart of financial regulation (see Table 5.1).

5.2. Scope of the law

In some jurisdictions, the protections under financial laws are available only to consumers who are individuals or households, and often only when they use financial services for personal or household purposes. This helps in limiting the coverage of the law to only the most vulnerable categories of users and avoiding regulatory intervention in markets involving sophisticated users. The Commission considered this position but found that in the present state of development of the Indian financial sector and the sophistication levels of consumers, adopting a limiting definition could lead to undue exclusions. It therefore opted for a wider definition of consumer, which includes any person who avails a financial product or service, without regard to the person's legal status or the purpose of use.

The draft Code empowers the regulator to classify consumers into different categories, based on their levels of sophistication, and issue subordinated legislations suited to the needs of particular categories. In addition to giving this discretion to the regulator, the Commission agreed that the law itself should contain additional safeguards for consumers who are identified as being most vulnerable and susceptible to abuse. This category of persons, referred to as *retail consumers*, will include individuals and small and medium enterprises, which are identified as eligible enterprises.

However, in order to exclude very high net worth individuals and enterprises undertaking large value transactions from its ambit, the category of retail consumers will be limited to persons who acquire financial services for a consideration that is below a specified limit (see Table 5.2).

5.3. Objectives and principles

The objectives of consumer protection are to guard consumer interests and to promote public awareness (see Table 5.3). While pursuing these objectives, the regulator will be empowered to make regulations to determine the manner and extent to which the protections under the law will apply to the users of different financial products and services.

Table of Recommendations 5.3 Objectives

The consumer protection part of the draft Code will direct the regulator to pursue the twin objectives of:

1. Protecting and furthering the interests of consumers of financial products and services; and
 2. Promoting public awareness in financial matters.
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Table of Recommendations 5.4 Principles to guide the regulators

The regulator must consider the following principles while carrying out any functions or exercising any powers relating to consumer protection.

1. The level of protection given to a consumer and the level of responsibility on the financial service provider should vary depending on:
 - ▶ the level of sophistication of the consumer;
 - ▶ the nature and degree of risk embodied in a financial product or service; and
 - ▶ the extent of dependence of the consumer on the financial service provider.
2. Consumers should take reasonable responsibility for their decisions.
3. Any obligation imposed on a financial service provider should be consistent with the benefits expected from such obligation.
4. Barriers to competition owing to adverse effects of regulatory actions should be minimised and there should be competitive neutrality in the treatment of financial service providers.
5. The need to promote, and not hamper, innovation and access to financial products and services.

Table of Recommendations 5.5 Protections available to consumers

- ▶ Basic protections for all consumers:
 1. Financial service providers must act with professional diligence;
 2. Protection against unfair contract terms;
 3. Protection against unfair conduct;
 4. Protection of personal information;
 5. Requirement of fair disclosure; and
 6. Redress of complaints by the financial service provider.
- ▶ Additional protections for retail consumers:
 7. Right to receive suitable advice;
 8. Protection from conflict of interest of advisors; and
 9. Access to the redress agency for redress of grievances.

The regulator will also be able to impose a range of requirements on financial service providers, spanning from disclosure, suitability and advice requirements, regulation of incentive structures, and more intrusive powers such as recommending modifications in the design of financial products and services.

The Commission believes that regulatory powers should be used where they are most required and in a least-distortionary manner. As such, guiding principles to inform the choice and application of powers should accompany the grant of any broad range of powers. These principles will require the regulator to pay special attention to diversity in consumer profiles and differences in the kind of risks that different financial products pose to consumers. Further, the principle of proportionality suggests that the intensity of any obligation imposed on a financial service provider should be consistent with the benefits that are expected to arise from imposing the obligation.

Currently, rapid expansion of financial access is a major policy goal of the Government. This requires significant leaps in innovations in financial products and processes, and business models. These innovations will be fostered by two elements: higher levels of competition and an appropriate regulatory climate that supports and enables innovation. Table E.1 summarises the principles that are being stated in the draft Code to guide the regulators on the subject of consumer protection.

5.4. Protections for all consumers

To be able to confidently participate in the financial markets, all consumers should be provided with certain basic protections. In addition, a wider set of protections need to be

Table of Recommendations 5.6 Unfair contract terms

- (a) An *unfair term* found in a financial contract that has not been negotiated between the parties will be void.
 - (b) *Non-negotiated contracts* include contracts in which the consumer has very little or no bargaining power compared to the financial service provider and standard form contracts.
 - (c) A term is *unfair* if it causes a significant imbalance in the rights and obligations of the parties, to the detriment of the consumer. However, this will not include a term that:
 - ▶ is reasonably required to protect the legitimate interests of the service provider;
 - ▶ sets the basic terms of the financial contract, such as the price, or
 - ▶ is required under any law or regulations.
 - (d) The court or redress agency may strike down a term for being unfair, while allowing the rest of the financial contract to continue.
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Table of Recommendations 5.7 Protection of personal information

Personal information means any information that relates to a person or permits the inference of a person's identity. This includes *demographic information* such as the person's name and contact information; *biometric information*, and *transactional information* about holdings and dealings in financial products and services. The draft Code provides for the following protections for personal information:

- (a) A prohibition on collection of personal information beyond what is required for providing the relevant financial service.
 - (b) A requirement to maintain confidentiality of personal information, unless the consumer has consented to the disclosure or it is otherwise permitted by law.
 - (c) An obligation to maintain accurate, up-to-date and complete personal information, and to allow consumers reasonable access to their personal information.
 - (d) Powers given to the regulator to specify additional requirements, exempt some financial service providers from application of this protection and establish mechanisms to ensure that consumers can access their personal information.
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available only to retail consumers. The Commission suggests six types of protections for all consumers and three additional protections for retail consumers (see Table 5.5).

1. *Right to professional diligence*

Consumers should be assured that any interaction that they have with a financial service provider will be carried out in good faith and in line with honest market practices. The level of diligence expected from a provider will vary depending on the honest practices followed in that line of business, the consumer's knowledge and expertise level and the nature of risk involved in the financial service.

2. *Protection against unfair contract terms*

Due to differences in the bargaining power of consumers and financial intermediaries, consumers are often forced to accept unreasonable contractual terms that are not in their best interests. To prevent this, the draft Code declares unfair terms in financial contracts that have not been explicitly negotiated between the parties to be void (see Table 5.6).

3. *Protection against unfair conduct*

A consumer's decision on whether or not to enter into a financial contract or the manner in which to exercise any rights under a contract should be taken in a fully informed environment, free of any undue influence. The draft Code therefore protects the consumer from any unfair conduct that is geared towards unfairly influencing the consumer's transactional decisions. This includes situations where a consumer's transactional decision is affected by:

- (a) *Misleading conduct*: Knowingly providing consumers with false information or information that is correct but is provided in a deceptive manner. Any failure to correct an evident and important misapprehension on the part of the consumer will also be covered under the law.
- (b) *Abusive conduct*: Use of coercion or undue influence to influence a consumer's transactional decisions.

4. *Protection of personal information*

Any information relating to an *identifiable person* belongs to that person and should be protected from unauthorised use. Financial service providers will therefore be restrained from collecting,

using or disclosing any personal information belonging to consumers, except to the extent required for the purposes of carrying out their business or expressly permitted under the draft Code. The draft Code also provides safeguards for consumers to be able to access their personal information held by service providers and ensure that the information is accurate and complete (see Table 5.7).

5. *Requirement of fair disclosure*

Information asymmetry between consumers and financial firms affects the quality of financial decisions made by consumers. This asymmetry needs to be addressed by imposing a positive obligation on financial service providers to provide consumers with all the information that is relevant for them to make informed decisions. This includes disclosures required to be made prior to entering a financial contract and continuing disclosures regarding material changes to previously provided information or the status or performance of a financial product.

Given the wide array of financial services being covered under the draft Code, the regulator may find it useful to specify different disclosure requirements for various financial products and services. With this objective, the draft Code empowers the regulator to make differing provisions regarding the types of information required to be disclosed, the manner in which disclosures must be made and the appropriate time-periods for making required disclosures.

6. *Redress of complaints*

The Commission envisages a two-tier approach for the redress of consumer complaints: first at the level of the financial service provider and subsequently at the level of the redress agency (for retail consumers).

If a consumer is dissatisfied with a financial product or service, the consumer should first take up the issue with the relevant financial service provider. For this purpose, the draft Code requires all financial service providers to have in place an effective mechanism to redress complaints from consumers. They will also be obliged to inform consumers about their right to seek redress and the process to be followed for it. The regulator may supplement these requirements by laying down specific details of the process to be followed by financial service providers to receive and redress complaints.

In certain cases the regulator may also envisage an additional layer of grievance assessment to take place after, or instead of, the service provider's own grievance redress mechanism and before the complaint goes to the redress agency. The stock exchange arbitration process would be an example of such an arrangement.

5.5. Additional protections for retail consumers

The Commission believes that the following rights and protections should be available to retail consumers over and above the protections available to consumers generally. These protections are needed due to the generally low levels of knowledge and experience of retail consumers.

1. *Assessment of suitability*

Retail consumers may often be in a situation where they are not able to fully appreciate the features or implications of a financial product, even with full disclosure of information to them. This makes a strong case for a thorough suitability assessment of the products being sold to them. The draft Code provides this protection by requiring that any person who advises a retail consumer in relation to the purchase of a financial product or service must obtain relevant information about the needs and circumstances of the consumer before making a recommendation to the consumer (see Table 5.8).

2. *Dealing with conflict of interests*

One of the best ways to ensure good consumer protection is to align the incentives of financial service providers with those of consumers and ensure that in case of a conflict, the interests of consumers take precedence. The draft Code incorporates this principle of prioritising the interests of retail consumers over those of the provider. It also requires advisors to inform retail consumers about any conflicted remuneration they stand to receive, which may influence the advice being given to the retail consumer. The regulator may, in addition, specify the nature, type and

Table of Recommendations 5.8 Suitability assessment process

1. A person making a recommendation to a retail consumer about the purchase of a financial product or service must make efforts to obtain correct and complete relevant information about the consumer's personal circumstances. Advice given to the retail consumer must be based on due consideration of the relevant personal circumstances.
2. If the advisor finds that the information is inaccurate or incomplete, the retail consumer must be warned about the consequences of using such information.
3. If a retail consumer plans to avail a financial product or service that the advisor does not deem suitable, it is the obligation of the advisor to clearly communicate the consequences to the retail consumer.
4. The regulator must specify the financial products or services that may be provided to retail consumers or a class of retail consumers only after proper advice has been given to them. Suitability assessment should be mandatory for these categories of products and services.
5. The regulator must take into account the following factors while making advice mandatory for any financial product or service:
 - the potential negative consequences to financial access due to the cost that will be imposed on financial service providers on account of suitability requirements; and
 - the extent to which fair disclosures required under the law may suffice to enable retail consumers to assess the suitability of the financial product or service for their purposes.

structure of benefits permitted to be received by an advisor for a particular financial product or service.

5.6. Functions and powers of the regulator

The Commission recommends the creation of a single consumer protection framework which will apply to all parts of the financial system. The consumer protection framework may be implemented by one or more regulators, depending on the views of lawmakers about financial regulatory architecture. While the financial regulatory architecture may change, it is expected that the consumer protection framework would not.

The general functions of a regulator include: making regulations to carry out the purposes of the law; issuing guidance to financial service providers; supervising the conduct of financial service providers to ensure compliance with the law; and taking appropriate enforcement actions to deal with any violations.

The regulator will also be responsible for the existence of financial awareness programmes in order to meet the objective of promoting public awareness in financial matters. This will involve spreading awareness about the benefits of financial planning, protections available to consumers, and features and functions of financial products and services. If required, the regulator may also choose to establish a separate financial awareness body to pursue this function.

In exercise of its supervisory functions, the regulator will need to put in place appropriate arrangements for seeking relevant information from financial service providers, imposing record-keeping requirements, conducting investigations, inspecting premises and holding meetings with the officers of financial service providers. If the regulator has reasonable grounds to suspect a violation of the law, it may initiate appropriate enforcement actions.

In addition to the general functions of rule-making, supervision and enforcement, the draft Code will contain the following specific provisions:

i. *Registration of individuals*

Proper training and qualification of front line staff can be an effective tool for ensuring that the protections envisaged by the law translate into actual practice. To achieve this, the draft Code will require registration of all individuals who deal with consumers in connection with provision of a financial product or service. This would include individuals who deal with consumers in their capacity as financial service providers or as employees or representatives of financial service

providers. The regulator will specify the requirements and process for the registration of such individuals as well as any code of conduct applicable to them.

2. *Information on new products*

The Commission believes that consumer protection regulation, as in other areas of law, should be guided by the principle of *allow-and-respond*, instead of following the *banned-until-permitted* approach. Accordingly, the draft Code does not require every financial product to be approved by the regulator.

Financial service providers will be able to provide any financial product to consumers subject to following a *fit and use* process. This will require the regulator to make regulations to specify the kind of information required by it on any new product that is proposed to be launched in the market. A financial service provider will be required to file the specified information with the regulator two months before the planned launch, so that the regulator may assess its risks and merits and, if required, make appropriate regulations. The regulator may seek additional information about the product during the two month period but will not have the power to block it from being launched after the expiry of that period.

3. *Power to specify modifications*

The regulator should be able to intervene in situations where certain features or aspects of a financial product or service are found to be harmful for consumers after it has been introduced in the market. The draft Code therefore allows the regulator to specify modifications in the terms and conditions of particular financial contracts or the process of delivering particular financial services. The Commission however recognises that this is a very strong power and its frequent use can cause undue hardships to financial service providers. Any such regulatory interventions must therefore be accompanied by a statement explaining the other interventions that were considered by the regulator to address the problem and the reasons why such interventions were found to be inadequate. This statement is in addition to the regular requirements of the regulation-making process.

5.7. Advisory council on consumer protection

In order to monitor and contribute towards the regulator's consumer protection objectives, the Commission recommends the creation of an advisory council on consumer protection (see Table 5.9). The advisory council will be responsible for:

1. Making representations, in the form of advice, comments or recommendations, on the regulator's policies and practices;
2. Reviewing, monitoring, and reporting to the regulator on the effectiveness of its policies and practices; and
3. Creating reports stating its views on all draft regulations published by the regulator.

The regulator must take into account any representations or reports received by it from the advisory council and provide a written response in cases where the regulator disagrees with the views or proposals made by the council.

5.8. Financial redress agency

The Commission recommends the creation of a new statutory body to redress complaints of retail consumers through a process of mediation and adjudication. The redress agency will function as a unified grievance redress system for all financial services. To ensure complete fairness and avoid any conflicts of interest, the redress agency will function independently from the regulators.

The financial redress mechanism proposed by the Commission will replace the existing financial sector-specific ombudsman systems such as the banking ombudsman and

Table of Recommendations 5.9 Composition of the advisory council on consumer protection

1. The advisory council will consist of persons who are consumers or persons representing the interests of consumers.
 2. The appointment of members of the council should also:
 - (a) give a fair degree of representation to experts in the fields of personal finance and consumer rights; and
 - (b) take into account the need to ensure proper geographical representation from across the country.
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Table of Recommendations 5.10 Composition of the redress agency's board

The general superintendence, direction and management of the affairs of the redress agency will rest in its board of Directors, which will be composed of:

1. A chairperson to be appointed by the regulators through a selection process, in consultation with the Central Government.
 2. One official to be nominated by each of the regulators.
 3. Four other members to be appointed by the regulators through a selection process.
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the insurance ombudsman although retail consumers will continue to have the option to approach other available forums, such as the consumer courts established under the Consumer Protection Act, 1986 and regular courts. In the future, if the Government is of the view that the redress agency has acquired sufficient scale and expertise to be able to efficiently address all complaints from retail consumers, it will have the power to exclude the applicability of the Consumer Protection Act, 1986 to retail consumers covered by the redress agency.

In any case, once a retail consumer opts for a remedy before the redress agency, it will not be permitted to institute fresh proceedings before another forum, either simultaneously or after a final order has been issued by the redress agency. Similarly, action initiated before any other forum will bar any action before the redress agency.

The redress agency will be managed by a board of directors (see Table 5.10 for the composition of the board). The agency will be funded through a combination of allocations from the Central Government, standard fees payable by all financial service providers and a complaint-based fee that will be collected as and when a complaint is brought against a financial service provider.

An effective dispute resolution body needs to be designed in a manner that ensures access, convenience, efficiency and speedy remedies. It needs to address two kinds of difficulties: a scenario where a genuine consumer is not able to obtain redress, and one where multiple cases are filed against a financial firm as a strategy of harassment. The Commission envisages the redress agency to function as a technologically modern organisation that will carry out video hearings, digital handling of documents, telephonic/online registration of complaints, maintenance of a high quality electronic database and online tracking of compensation payments. To ensure that the processes designed by the redress agency are in line with these requirements, the draft Code expressly requires the redress agency to put in place adequate systems, processes, technology and infrastructure to enable it to efficiently discharge its functions. The draft Code also empowers the regulators to impose service level requirements on the redress agency with measurable targets on matters such as the total cost to parties for proceedings before it, compliance cost for financial firms and time-periods for each step of the redress process. The redress agency will be accountable for meeting these targets with a requirement to explain any failure to do so. These measures will compel the redress agency to strive towards maximum efficiency in its processes and functioning.

The draft Code allows the redress agency the discretion to open offices anywhere in the country. The Commission intends that the redress agency will use this power to set up

Table of Recommendations 5.11 Outline of the redress agency's proceedings

The redress agency will follow the following steps while assessing complaints made to it by retail consumers:

1. **Receipt of complaint:** Complaints against financial service providers may either be submitted directly to the redress agency (at any of its offices) or be submitted to the regulator, which will then forward it to the redress agency.
2. **Screening of complaints:** The redress agency will screen all received complaints and may dismiss a complaint during the screening process if the consumer has not made a complaint to the financial service provider before approaching the redress agency; the complaint is frivolous, malicious or vexatious; or if the matter is pending before, or has been adjudicated upon by, another competent authority.
3. **Mediation:** A complaint that is not dismissed during screening will be referred to a mediator who will assist the parties to arrive at a voluntary settlement. If the mediation process fails, the complaint will proceed to the adjudication stage, unless it is withdrawn by the retail consumer.
4. **Adjudication:** The redress agency will appoint independent, skilled and qualified adjudicators, who will be responsible for investigating, considering and determining complaints. Unless an appeal is made, the decision of the adjudicator will be final and binding on the parties.
5. **Appeals:** Appeals from a decision of the redress agency's adjudicators will go to the FSAT and appeals from the appellate tribunal will go to the Supreme Court.

front-end offices throughout the country where retail consumers of all financial products and services will be able to submit their complaints. Modern technology would then be used to connect these front-ends into a centralised mediation and adjudication system (see Table 5.11).

The redress agency will endeavour to arrive at an amicable settlement in a majority of the complaints through its mediation process. In cases where a settlement is not achieved, the consumer may choose to withdraw the complaint from the redress agency, failing which, it will be referred for adjudication. The adjudicator will hear the parties, examine the claim and pass a final order on the complaint after taking into account:

- ▶ the provisions of the draft Code on consumer protection and regulations made under it;
- ▶ the terms of the financial contract between the parties;
- ▶ any code of conduct applicable to the financial service provider; and
- ▶ prior determinations made by the redress agency on similar matters.

An order made by the adjudicator may provide for an award of compensation to the retail consumer, subject to limits that will be specified by the regulators, or issue any other directions that the adjudicator considers just and appropriate. A party that is dissatisfied with the adjudicator's orders will have the right to bring an appeal before the FSAT and appeals from FSAT will lie before the Supreme Court.

The Commission sees strong complementarities in the roles of the redress agency (curing grievances) and the regulators (preventing grievances). The complaints received by the redress agency will shed light on areas where the problems of consumer protection are most prominent, and thus suggest areas for improvement in subordinated legislations. Hence, the draft Code seeks to ensure a feedback loop through which the redress agency will use the FOWC to share information on complaints with the regulators on an ongoing basis and the regulators will analyse the information received from the redress agency and utilise it for improved regulation-making and systemic improvement.

Specifically, the information technology systems within the redress agency must create a high quality database about all aspects of all complaints that are filed with it. This database must be analysed in order to shed light on the areas where there are difficulties and thus feed back into better regulation and supervision. The research program which studies this database should be a joint effort between the redress agency, regulators and academic scholars, with release of datasets and research into the public domain. Over the years, there should be a visible feedback loop where the hot spots of grievance that are identified lead to modifications of regulation and supervision.

Several provisions of the draft Code, specifically those relating to the creation and operation of the redress agency, require co-ordination and co-operation between multiple regulators. In the event that the regulators are unable to arrive at a consensus on such matters, within a reasonable period, the matter will be addressed through the Esoc.

5.9. Competition law and policy

The Commission recognises the major role of healthy competition in financial markets for ensuring the best interests of consumers. While perfect competition alone will not protect the interests of consumers, greater competition, in tandem with a sound and well-functioning consumer protection framework, is undoubtedly a powerful tool to enhance consumer welfare. The cci is the leading, non-sectoral authority responsible for competition policy issues in India. The cci has overlapping jurisdiction with many independent regulators as it is charged with the duty of fostering greater competition in all areas of the economy.

The Commission recommends a structured mechanism for interaction and co-operation between the cci and financial regulators in the following ways:

1. Consultation for draft regulations

The cci should review draft regulations issued by the regulator for public comments and provide its inputs on the potential competition implications, if any. The regulator must consider the representation made by cci before finalising the regulations. If the regulator disagrees with cci's views, it must provide written reasons.

2. Review of regulatory provisions

Cci must be empowered to monitor the effects on competition of any regulatory actions and practices on an ongoing basis. If it determines that a regulatory action is unduly detrimental to competition in a financial market, the cci must submit a report on the issue to the regulator. The regulator will be obliged to consider and respond to the report.

If the regulator and the cci disagree on the course of action to be taken, the cci will have the power to direct the regulator to take specified actions to address the negative effects on competition identified by the cci.

3. Reference by cci

The cci must make a reference to the regulator if it initiates any proceedings involving a financial service provider, and the regulator must respond with its views on the referred issue, within an agreed period. In such cases, if the regulator believes that an action taken by the cci may interfere with the regulator's objectives, the regulator may choose to nominate one non-voting member on to the cci's board to participate in proceedings relating to that matter.

4. Reference by the regulator

The regulator must report to the cci about any conduct of financial service providers that appears to it to be in violation of the Competition Act, 2002 so that appropriate proceedings may be initiated under that law.

5. Memorandum of understanding

The draft Code requires the cci and the regulator to enter into a memorandum of understanding to establish the procedures for co-operation between them, which may be modified by them from time to time.

There is also a need for organised interaction between the cci and the resolution corporation in the context of non-voluntary mergers and acquisitions. The mechanisms to address the likely effects of the resolution corporation's actions on competition in the relevant market is addressed in the draft Code under the part on resolution of financial service providers.

Micro-prudential regulation

Micro-prudential regulation refers to the regulation that governs safety and soundness of certain financial service providers. The rationale, scope and extent of micro-prudential regulation are primarily motivated by consumer protection concerns. Additionally, the possibility of large numbers of financial service providers failing at the same time, or a systemically important financial institution failing, can raise concerns about the stability and resilience of the financial system as a whole. Sound micro-prudential regulation then, plays a role in mitigating systemic risk as well.

6.1. Rationale for micro-prudential regulation

Financial service providers have a vested interest in their health. However, their financial health is not simply a matter of private concern, for a variety of reasons:

1. *Governance failures within firms:* Managers of a firm may not work in the best interests of shareholders - pursuant to the compensation structures of many organisations, managers may stand to make huge profits if the firm does well and walk away if the firm collapses. In particular, high-powered incentives created by share ownership, stock options, or profit-linked bonuses are likely to promote excessive risk-taking. Micro-prudential regulation is then a way of addressing the public good concerns raised by compensation structures and governance failures within a firm.
2. *Moral hazard:* Government rescue of failing financial service providers is inequitable because excessive risks taken by managers impose costs on tax payers at large. The possibility of such rescues induces moral hazard: managers have an incentive to increase risk knowing that taxpayers will bear the burden of any significant losses that arise. As such, micro-prudential regulation is justified to constrain excessive risk-taking by financial service providers.

Market discipline, understood here as the process by which informed consumers identify and avoid dealing with unacceptably risky financial service providers, can work to prevent some financial firms from managing their risks badly, but even such discipline is somewhat constrained by the following:

- ▶ *Information asymmetry:* It is often difficult for consumers to evaluate, before or after entering a contract, how well a financial service provider is performing. There is noise in the information available to consumers, and there are significant limitations to the ability of most consumers to process and react to market information. While markets generate signals of financial soundness in the prices of stocks and bonds, many consumers are not in a position to access and act on such information. This is particularly the case with unsophisticated consumers. Most households will not be involved in transactions of a size that would warrant large financial investments in monitoring.

Table of Recommendations 6.1 Objectives

The objectives of micro-prudential regulation are:

1. To promote the safety and soundness of regulated persons; and
2. To thereby contribute to the stability and resilience of the Indian financial system.

This problem is most prominent in institutions that make balance sheet-based obligations to consumers, and have opaque balance sheets, since the cost of information processing is highest. With banks, due to information asymmetries, depositors may not know a bank is failing until it is too late. Conversely, depositors may react to false alarms and trigger bank runs.

Weaknesses of market discipline exacerbate the governance problems of financial service providers. Managers are, then, more able to make decisions that yield short-term gains while reducing the health of the financial service provider in the long run.

- ▶ **Co-ordination problems:** Consumers with low-volume transactions could ostensibly join forces and develop mechanisms for monitoring while sharing costs. In practice, the likelihood of such mechanisms emerging is low to the extent that these monitoring financial service providers incur costs that all market participants benefit from. These public good problems create co-ordination problems for consumers which, in turn, lead to inadequate monitoring of financial service providers.
- ▶ **Market power:** Financial service providers usually enjoy significant market power compared to their consumers, and the latter's ability to enforce corrective actions on the former is limited.

Market discipline does play an important role in ensuring safety and soundness of many financial service providers, but it is often not enough. This inadequacy of self-regulation and market discipline becomes particularly problematic for financial service providers making certain kinds of obligations, and financial service providers of systemic importance.

The Commission notes that certain obligations are inherently more difficult to fulfil than other obligations. Debt repayment obligations - obligations that make specified payments at specified times - are inherently more difficult to fulfil than obligations linked to equity prices or firm profitability. Insurance obligations - which are contingent upon external events and which require payment, regardless of the financial health of the promising institution - also pose problems of fulfilment.

The Commission also notes that for certain kinds of financial service providers, if obligations are not fulfilled, there are adverse consequences for specific consumers. If bank deposits are lost due to a bank failure, the consequences for consumers, whose savings are deposited with the bank, will be quite adverse. If a large financial service provider fails, the entire financial system, and the larger economy, may be adversely affected.

This combination of harsh consequences of failure, problems limiting self-regulation and the ability of markets to ensure safety and soundness, and inherent difficulty of fulfilling certain obligations, creates a case for regulation organised around securing the safety and soundness of certain financial service providers.

Fragile financial service providers, whether those taking bank deposits, issuing insurance contracts or otherwise, limit participation of households in the financial system in line with the possibility of non-performance. This, in turn, diminishes the participation of households in the financial system.

These challenges motivate micro-prudential regulation. The State needs to establish regulatory and supervisory mechanisms that intervene in the behaviour of firms, and improve their safety and soundness. These mechanisms, if designed and implemented properly, would act on behalf of consumers and society to reduce, though not eliminate, the probability of firm failure. The objectives of micro-prudential regulation, as enunciated in the draft Code, are enumerated in Table 6.1.

The phrase *safety and soundness* needs to be interpreted in terms of the consequences of failure rather than failure itself. If it is efficient to let the regulated persons fail or become insolvent, while the obligations to consumers are protected, the regulator should

not that happen. For example, if consumers' funds are kept in a bankruptcy remote vehicle, it should be possible to let the regulated person fail, without significantly affecting the interests of consumers. In the stock market, the success of clearing arrangements has made possible a regulatory stance where many securities firms have failed with no adverse consequences to consumers. The construction of the resolution corporation thus greatly changes how regulators would view failure.

For systemically important financial institutions, *safety and soundness* should be taken to mean reducing the probability of *firm failure*, and for all other micro-prudentially regulated persons, it should mean reducing the probability of *the event of regulated person failing to meet the obligations made to consumers*. The Commission recognises that the acceptable probability of failure for regulated persons is not zero. However, if regulators are conferred with the objective of trying to *minimise* the probability of failure of regulated persons, they may adopt an excessively restrictive approach that could result in an adverse effect on competition or innovation in financial markets. This is not good, particularly given the resolution mechanism being enshrined in the draft Code. Therefore, the Commission recommends that the regulators should work with the objective of *reducing the probability of failure of regulated persons and maintaining it at below an acceptable level*. This *acceptable level* should be determined based on due consideration of the principles enunciated in the draft Code.

Micro-prudential regulation must be distinguished from 'systemic risk regulation', also called macro-prudential regulation (see Chapter 9). Sound micro-prudential regulation is, of course, an essential ingredient of reducing systemic risk. Yet micro-prudential regulation focuses on one firm at a time, while systemic risk regulation involves the financial system as a whole. Micro-prudential regulation sees the proverbial trees to the forest surveyed by systemic risk regulation.

6.2. A non-sector-specific micro-prudential framework

Micro-prudential regulation has often been a sector-wise concern. Some countries have sector-specific laws, focusing on issues and instruments in the respective sectors. For example, micro-prudential regulation in India is conducted by various financial regulators, operating in different sectors, through an array of relevant laws. In this context, the Commission recommends non-sector-specific micro-prudential provisions in the draft Code, for the following reasons:

1. There is underlying similarity in financial contracts—they are all built from a small number of contingent claims or obligations. There are common principles that underpin the micro-prudential regulation framework in different sectors, though specific risk-types to be addressed and the way instruments are to be used may differ. For example, there is significant convergence between the Basel II framework for banks and the European Union's Solvency II framework for insurance companies. Unification of the law will yield more consistent treatment across apparently diverse activities, which are actually constructed from a small set of core ideas.
2. As the financial system develops further, it will become increasingly difficult to draw sector-specific lines on financial products and services being offered. A common set of principles guiding the regulation of the entire financial system will help minimise the potential for regulatory gaps.
3. Once problems of competition policy are addressed, and competition in the financial system heats up, easy sources of profit will be competed away. This will give firms a strong incentive to pursue regulatory arbitrage. The use of a single set of principles, consistently applied across different kinds of activities, will reduce the extent to which regulatory arbitrage might arise.
4. Sector-specific regulators administering different sets of provisions create the possibility of a *race to the bottom*, where a sector regulator favours lax regulation in the interest of increasing the growth of the sector. The presence of non-sector-specific provisions will help curtail such destructive regulatory competition.

Table of Recommendations 6.2 Scope of micro-prudential regulation:

Micro-prudential regulation will apply to financial service providers that carry out specified activities or have been determined to be systemically important. Those financial service providers that are deemed to be micro-prudentially regulated are called *regulated persons* in the draft Code. The draft Code lays down the following tests for the regulator to determine which activities should be subject to micro-prudential regulation, and to what extent:

1. The nature of the relationship between the regulated person and its consumers, including:
 - (a) the detriment caused to consumers if obligations are not fulfilled by the regulated person;
 - (b) the ability of consumers to access and process information relating to the regulated person's safety and soundness; and
 - (c) the ability of consumers to co-ordinate among themselves to monitor the regulated person's safety and soundness.
2. Inherent difficulties in fulfilling the obligations owed by a regulated person to its consumers.

5. Conversely, multiple regulators interpreting a single set of non-sector-specific provisions, can generate healthy public debates. Such comparative discussions, across sectors, would not occur in a climate conditioned by separate regulatory ecosystems. If there were separate laws, then this comparative law discourse would not arise.

A unified set of non-sector-specific micro-prudential regulation provisions in the draft Code will help create a consistent framework across the financial system. This would, in turn, help in efficient allocation of capital owing to the substantial mitigation of regulatory gaps or arbitrage.

6.3. Scope of micro-prudential regulation

Since micro-prudential regulation is an expensive and intrusive form of regulation, the Commission considers it important to ensure that micro-prudential regulation applies only where it is required, and with intrusiveness that is proportional to the problem that is sought to be addressed. All persons providing financial services, termed as *financial service providers*, will require permission from the regulator to carry on the relevant financial activity. From this set of financial service providers, only a subset will be subjected to some or all micro-prudential provisions of the draft Code. This subset of micro-prudentially regulated financial service providers, referred to as *regulated persons*, will be determined by the regulator based on the tests given in the draft Code. The tests provided in the draft Code will also guide the regulator in deciding the extent to which micro-prudential regulation should apply to different regulated persons (see Table 6.2).

The Commission recommends that financial service providers deemed to be systemically important should be subject to micro-prudential regulation. Though identification of systemically important financial institutions will be made by the systemic risk regulator (FSOC), micro-prudential regulation of designated institutions will reside with their respective regulators.

Usually the obligations intermediated and backed by the provider's balance sheet, where the provider carries market risk, would be micro-prudentially regulated with high intensity, though not always. For example, for a provider with only a small number of consumers, balance sheet-based obligations may often not attract high intensity regulation, to the extent that the ability of individual clients to assess the credit-worthiness of that provider may be high. Providers making market-linked obligations, where the consumers are expected to hold the market risk, should typically not be micro-prudentially regulated with high intensity, because the inherent difficulty of fulfilling the obligations is low and the ability to assess credit-worthiness is high. Here also, retirement financing funds offering defined contribution schemes, may be an exception on the basis of the high level of adversity caused if the expectations are not met, and information asymmetries for investors at the time of purchase. Regulators will have to take positions on the

Table of Recommendations 6.3 Instruments of regulation

The powers of micro-prudential regulation are classified into the following functional categories:

1. Regulation of entry;
2. Regulation of risk-taking;
3. Regulation of loss absorption;
4. Regulation of governance, management and internal controls, and
5. Monitoring and supervision.

basis of comprehensive analysis of obligations made, relative levels of accountability to markets and institutional health.

Certain financial service providers are not likely to come under micro-prudential regulation:

- ▶ Investment funds with a small number of typically large value investors, such as hedge funds, venture capital funds, private equity funds, may not be subject to micro-prudential regulation, unless they are systemically important. Though the adversity caused by failure of some of these funds may be significant, information asymmetries and co-ordination failures are likely to be low given the small number of investors, who are likely to be sophisticated.
- ▶ Small, semi-formal arrangements at local level, such as mutual savings arrangements, may not be micro-prudentially regulated. Here, the local nature of the institutions should reduce information asymmetry and co-ordination failure, and make enforcement relatively easy for consumers, even though the adversity caused in case of failure to meet the obligation may be quite high, since many of these may be accepting members' deposits.

6.4. Powers of micro-prudential regulation

Micro-prudential regulation has evolved significantly in recent decades. Internationally accepted frameworks have undergone significant change over this period, and continue to evolve. The Commission recommends a set of principles-based provisions to allow regulation to adapt to changing circumstances and evolving scholarly and policy consensus on optimal structures of regulation.

The Commission has reviewed the range of micro-prudential powers used in India, along with prominent international comparators, and suggests a functional categorisation as suggested below (see Table 6.3). The Commission recommends that the precise mix of powers used, and that the manner of usage, evolve over time.

The regulator would only allow entry to those financial service providers that are likely to be prudently managed. The regulator would also work to ensure that regulated persons continue to be prudently governed and managed. Regulated persons would be regulated in terms of their risk-taking and risk avoiding practices, as well as the loss absorbing buffers they put in place. The regulator could also impose requirements to ensure business continuity and failure management in these persons. Regulated persons would be monitored and supervised to ensure compliance, and to respond to issues specific to any regulated person. Taken together, these components create the basis and framework of the Commission's approach to micro-prudential regulation.

6.4.1. Regulation of entry

The creation of micro-prudentially regulated persons should proceed on the basis of conditions consistent with the micro-prudential framework (see Table 6.4), so that on day one itself, an institution has low probability of failure. But there is a risk of excessive restrictions on entry that may impede competition and innovation.

Table of Recommendations 6.4 Regulation of entry

The regulator will have the following powers in connection with restricting entry:

1. Notifying pre-conditions for authorisation to carry on regulated activities;
 2. Authorising to carry on regulated activities, which may include a process of automatic authorisation; and
 3. Approving changes in the controlling interest of regulated persons
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If new firms can be created, existing firms can launch new products or services, and entirely new business models can come about, the environment will be competitive and dynamic. The pursuit of these objectives presents two puzzles: the legal framework should allow only reliable and competent persons to deal with financial consumers, and lack of existing regulations on a particular area should not hold back the emergence of new business models.

The Commission, therefore, recommends a balanced approach, which is enshrined in the draft Code.

1. *Requirement for authorisation:* Any person who seeks to carry out a financial service for the first time will need to be authorised by the regulator. This will not apply to a new product or service launched by existing financial service providers, if the person is already authorised for that line of business. All new products can be launched after following the *file and use process*.
2. *Exemption:* Representatives of authorised financial service providers need not seek authorisation for the services for their principal, as long as the representative is only carrying out the activity with regards to those services on behalf of the principal. Through regulations, the regulator will have the power to exempt, from the authorisation process, certain agencies of the government. The intent here is to exempt only those agencies that have a unique character, such as EPFO. This power should only be used as an exception, and does not mean that other regulations will not apply to an agency exempt from the authorisation process.
3. *Authorisation process:* The manner and process of obtaining authorisation for financial services will vary depending on the type of activity that is proposed to be carried out. A comprehensive authorisation process will apply to persons who want to carry out *regulated activities* which are to be micro-prudentially regulated with high intensity.

The need to promote innovation in the Indian financial system has been embedded thus: where a person proposes to carry out a financial service that is not a regulated activity, a simplified authorisation process will be applicable. Here, the regulator has the flexibility to specify that the authorisation requirement may be satisfied through an automatic process.

In either case, whether an activity is regulated or non-regulated, the authorisation process will not allow the regulator to refuse authorisation merely on grounds that the regulator does not have in place appropriate regulations to govern the proposed activity.

6.4.2. Regulation of risk-taking

This category of powers will empower the regulator to prescribe ways in which the regulated persons can avoid or reduce the risks they take (see Table 6.5). Regulator may impose restrictions on how the regulated persons invests the funds - their own funds and those of the consumers. In some cases, they may also impose restrictions on claims that may be placed from the regulated person's over business on consumers' funds. Regulator may also require adherence to certain business processes that reduce risks to the

Table of Recommendations 6.5 Regulation of risk-taking

The regulator will have the following powers in connection with reducing risks:

1. Regulating investments of own funds and consumers' funds;
2. Regulating claims on consumers' funds;
3. Regulating to foster business processes that reduce risks;
4. Regulating the valuation standards for assets and liabilities of regulated persons;
5. Regulating transactions with related persons; and
6. Regulating liquidity management.

Table of Recommendations 6.6 Regulation of loss absorption

The regulator will have the following powers in connection with absorbing losses:

1. Defining categories of capital resources, based on loss absorbing capacities;
2. Prescribing the amount of different types of capital resources required to be held, and the solvency requirements;
3. Defining criteria for assessing compliance with capital resource requirements;
4. Defining how regulated persons should manage the capital resources, including the requirement to notify the regulator while issuing certain capital instruments;
5. Regulating how the changes in values of assets and liabilities will be recognised; and
6. Mandating purchase of insurance from Resolution Corporation.

regulated persons. The draft Code also empowers the regulator to impose liquidity requirements on the regulated persons.

6.4.3. Regulation of loss absorption

These powers allow the regulator to require the regulated persons to keep capital resources and/or purchase insurance from resolution corporation for *absorbing* losses. Capital resources act as buffers that are typically used for covering unexpected losses arising from under-performing investments or under-valuation of liabilities.

In conventional thinking, equity capital is thought to play this role. Loss absorption functions can be provided by a variety of instruments not limited to equity capital. Different instruments have different loss absorption capacities, and these capacities may also vary with time. Contingent capital has debt-like features, but can become equity-like loss absorber depending on certain conditions. If there are instruments that require deep and liquid markets, during times of crisis, this loss absorption capacity may be constrained. The regulator will need to think about loss absorption capacities across different times, and ensure that there are adequate buffers in place for normal times as well as for times of crisis (see Table 6.5).

A mechanism of loss absorption being built in this framework recommended by the Commission is the resolution mechanism, which presently does not exist in India. For certain financial service providers, the regulator should mandate purchase of insurance from resolution corporation, as a pre-condition for undertaking the activities they propose to undertake. For example, for banking service providers, the regulator may impose a condition of getting their deposits insured upto a limit determined by the resolution corporation.

6.4.4. Regulation of governance, management and internal controls

These instruments empower the regulator to prescribe standards for good governance. Since the regulator shares the responsibility for achieving micro-prudential objectives with the board and management of the regulated person, it is important that these persons are prudently governed and managed (see Table 6.7).

Table of Recommendations 6.7 Regulation of governance, management and internal controls

The regulator will have the following powers in connection with improving governance and management:

1. Regulating norms of corporate governance;
 2. Regulating the structure of management incentives;
 3. Regulating risk management systems;
 4. Regulating internal controls and internal audit;
 5. Regulating appointment of qualified auditors and accountants; and
 6. Regulating outsourcing and appointment of agents.
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Table of Recommendations 6.8 Monitoring and supervision

The regulator will have the following powers in connection with monitoring and supervision:

1. Mandating disclosures to consumers and the market;
 2. Mandating reporting to the regulator;
 3. Conducting on-site supervision;
 4. Investigating powers; and
 5. Developing the capability to conduct analytics on their information received from regulated persons and other resources.
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6.4.5. Monitoring and supervision of regulated persons

These instruments can be used to improve monitoring and supervision by regulators, as well as, by market participants. The role of monitoring by market participants is complex. Since monitoring has a public good nature, the Commission proposes an approach that not only allows regulators to facilitate monitoring by market participants, but also empowers regulators to fulfil monitoring and supervisory functions on their own.

Monitoring and supervision can take many forms. Monitoring can involve disclosure of annual statements and other reporting. Regulated persons may also be required to obtain, maintain and disclose a current credit rating from an approved credit rating agency (see Table 6.8).

For regulated persons that are under the regulatory purview of more than one regulator, there should be a requirement for the regulators to co-operate to ensure optimal supervision. This may entail conglomerate supervision or supervision of a single regulated person undertaking multiple activities. The Commission does not prescribe any specific mode of co-operation, and the regulators will be expected to develop co-operation through mutual understanding and agreement.

6.5. Principles to guide the use of powers

Micro-prudential regulation, like all forms of regulation, imposes costs on the economy. Regulation is optimal when it achieves a desired objective while imposing the smallest possible distortion. As such, the draft Code enunciates principles that guide the use of powers instead of being a simple grant of powers. (see Table 6.9).

Distortions can take various forms. For example, regulations that focus excessively on products rather than underlying functions could encourage regulatory arbitrage between various products. Two different products that achieve similar payoffs between risks and rewards should be regulated in similar ways.

PRINCIPLE 1. Any obligation imposed on regulated persons should be proportionate to-

Table of Recommendations 6.9 Principles of micro-prudential regulation

The regulator must consider the following principles in discharging its functions and exercising its powers:

1. Any obligation imposed on regulated persons should be proportionate to:
 - ▶ the nature, scale and complexity of the risks in the regulated activity being carried out; and
 - ▶ the manner in which the regulated activity ranks on the factors stated in Table 6.2
2. Regulatory approach needs to take into account the feasibility of implementation by regulated persons and supervision by the Regulator;
3. The need to minimise inconsistencies in the regulatory approach towards regulated activities that are similar in nature or pose similar risks to the fulfilment of the Regulator's objectives under this Act;
4. Any obligation imposed on regulated persons should be consistent with the benefits, considered in general terms, which are expected to result from the imposition of that obligation;
5. The desirability of facilitating competition in the markets for financial products and financial services and minimising the adverse effects of regulatory actions on competition in the financial sector;
6. The desirability of facilitating access to financial products and financial services;
7. The desirability of facilitating innovation in financial products and financial services;
8. The need to ensure that regulatory actions are carried out in a manner that is least detrimental to competitiveness of India's financial system;
9. The need to take into account the long-term implications of regulatory actions, which will include a period of at least five years following a regulatory action;
10. The need to minimise the pro-cyclical effects of regulatory actions; and
11. The requirement that persons who control and manage the affairs of regulated persons must share the responsibility of ensuring the safety and soundness of the regulated persons.

- ▶ *the nature, scale and complexity of the risks in the regulated activity being carried out; and*
- ▶ *the manner in which the regulated activity ranks on the factors stated in Table 6.2*

This principle requires that regulatory instruments are used in a manner that is risk sensitive; the intensity of regulation should be proportional to risk held by the regulated person. For example, compare two banks with the same balance sheet size. One of them is investing only in low risk assets, while the other is investing in high risk assets. A regulatory approach that is sensitive to the risks will impose different micro-prudential requirements on these two regulated persons, because they have different levels of risks to their safety and soundness. Similarly, the factors listed in Table 6.2 translate the market failures providing the rationale for micro-prudential regulation into tangible tests. These tests can be used not just to determine where micro-prudential regulation will apply, but also to decide the extent to which such regulation are to be applied. Regulation ought to be proportional to the risks and market failures.

PRINCIPLE 2. *Regulatory approach needs to take into account the feasibility of implementation by regulated persons and supervision by the Regulator.*

The Commission notes that the regulatory approach should be modulated in light of questions of feasibility for regulated entities and the capacity of regulators to supervise.

For example, consider buffers to absorb losses. Risk-weighted capital based on internal models is potentially the most sensitive to risk though also the most opaque from the perspective of regulatory supervision. Simple leverage ratios are likely to be the least risk sensitive though easiest for regulators to monitor and enforce. While laws should not be constructed for regulatory convenience, the possibility of frustration of regulatory objectives should be kept in mind.

Alternatively, consider institutional capability, including questions of regulated persons manipulating regulatory frameworks to their advantage. A regulated person using the right internal models, and having access to sufficient data, could achieve fairly risk sensitive capital buffers. Conversely, a regulated person using poor models or insufficient data could fail to do so. Opacity raises the possibility of manipulation through regulation

cannot be designed with extreme examples in mind. Regulations framed from the perspective of malign institutions could lead to over-regulation just as the same framed with only the most benign institutions in mind could lead to under-regulation.

Regulators will also need to take into account the possibility of developing robust models, given data sufficiency constraints. Faulty modeling is a possible consequence of poor data, drawn from illiquid or opaque markets. As such, the draft Code authorises the regulator to consider alternative pathways and/or impose overall or risk-weighted capital requirements.

The micro-prudential provisions in the draft Code will ask regulators to confront the tradeoffs, and make wise decisions about the optimal regulation that is reasonably feasible for regulated persons to implement, and for the Regulator to monitor and supervise. Over the years, accumulation of datasets and academic research will give feedback about how certain initiatives have worked. Over the years, the financial system itself will evolve. The combination of these factors will give a healthy evolution of the appropriate tradeoffs.

PRINCIPLE 3. *The need to minimise inconsistencies in the regulatory approach towards regulated activities that are similar in nature or pose similar risks to the fulfilment of the Regulator's objectives under this Act.*

In the financial system, there are many ways of achieving the same objective. Products looking very different can be constructed that essentially fulfil the same function. The only difference would be the way these products look, and the specific contracts they comprise of. As an example, consider the number of ways of taking a levered position in shares of companies in the index, all of which fulfil the same function:

1. Buy each stock individually on margin in the cash stock market.
2. Invest in an index fund and borrow from a bank to finance it.
3. Go long a future contracts on the index futures.
4. Go long an over-the-counter forward contract on the index.
5. Enter into a swap contract to receive the total return on the index and pay a fixed interest rate.
6. Go long exchange-traded calls and short puts on the index.
7. Go long Over The Counter (otc) calls and short puts.
8. Purchase an equity-linked note that pays based on returns on the index, and finance it by a repo.
9. Purchase, from a bank, a certificate of deposit with its payments linked to returns on the index.
10. Borrow to buy a variable-rate annuity contract that has its return linked to the index.

Since these are functionally equivalent, each of these mechanisms would add the same risk to the regulated person. Regulators need not treat this diverse array of possibilities with a sense of alarm, neither should they be blind to these possibilities. The choice of a certain mechanism for fulfilling a function may depend on various factors, such as differences in financial systems, constraints imposed by institutional form, technological constraints, various types of transaction costs, and so on. An institution should be able to choose the best possible mechanism, given all the factors it chooses to consider. However, with a healthy financial regulatory structure, differences in micro-prudential regulation should not favour any one of these mechanisms over another.

If the regulators take a functional perspective towards risk, treating similar risks in a similar manner, it would help reduce regulatory inconsistencies across products and markets. This principle is likely to lead to efficient regulation, because it allows innovation and encourage competitive neutrality. It is also necessary because as system evolves and opportunities to earn supernormal returns become difficult to find, regulatory arbitrage could be used to destabilise the system. Capital will flow towards sectors with less expensive regulations and this can often involve inappropriate risk-taking.

PRINCIPLE 4. *Any obligation imposed on regulated persons should be consistent with the benefits, considered in general terms, which are expected to result from the imposition of that obligation.*

The incentives of regulators are usually asymmetric in favour of excessive caution; regulators may not get much credit for maintaining the safety and soundness, but are likely to be subjected to much criticism if the number of failures cross an acceptable level. Consequently, regulators may tend to be too cautious and impose excessive costs on regulated persons and the economy.

PRINCIPLE 5. *The desirability of promoting competition, access and innovation, and minimising the adverse effects of regulatory actions on competition, access and innovation.*

Competition in financial markets is likely to have a significant positive impact on growth. Competition and innovation often go hand in hand, since competition creates the incentive for innovation. The strength of competition is likely to influence the efficiency of financial intermediation and the quality of financial products.

Certain instruments of micro-prudential regulation, such as licensing, may have a direct impact on competition, innovation and access in the system. As an example, it is possible to use rules for entry in ways that close down entry altogether for years on end. Going beyond entry barriers, instruments such as capital requirements, if not properly used, could impede innovation and access.

The Commission believes that competition and high quality micro-prudential regulation can go hand in hand. Indeed, the Commission's reading of research of international contexts suggests that high quality supervision in banking enhances stability and competition. The Commission emphasises the pursuit of both goals: of high competition and high quality micro-prudential regulation. A sound approach to regulation and supervision is an integral part of a pro-competitive stance, through which there is no adverse impact on competition.

The Commission also asserts that safety and soundness can be pursued in a manner that minimises impact on access, innovation and competition. For example, hypothetical situations could be imagined where simple leverage limits and risk-based systems of capital adequacy achieve similar regulatory results though having a differential impact on innovation and competition. The Commission recommends that concerns of stability and impact on access, innovation and competition be considered in tandem.

PRINCIPLE 6. *The need to ensure that regulatory actions are carried out in a manner that is least detrimental to competitiveness of India's financial system.*

The Commission does not take a position on financial globalisation as such. The financial system provides the pathways through which foreign capital gets infused in the economy. The Commission simply notes that if policy makers continue to look to foreign capital for assistance in meeting the development and financing needs of the economy, micro-prudential regulation should be assessed in part by how such regulation affects the ability of the country to attract such capital.

Regulations enhancing safety and soundness of institutions should help the country attract financial capital, because investors are averse to losing capital due to instability in the financial system. But if micro-prudential regulation over-reaches, then this can negatively affect the return on capital. There is some evidence that global banks transfer resources away from markets with highly restrictive financial regulation.

The Commission also notes that the viability of an onshore financial system is an important measure of international competitiveness. Difficulties in regulation can lead to financial intermediation involving India to move offshore. The Commission recommends balancing two competing concerns. On the one hand, rules preventing the use

of offshore trading venues deny users of markets the lowest cost products and services. Conversely, a regulatory race to the bottom where economic stability is sacrificed to increase competitiveness is equally problematic.

PRINCIPLE 7. *The need to take into account the long term implications of regulatory actions, which will include a period of at least five years following a regulatory action.*

Numerous examples illustrate how micro-prudential regulation can be used in a manner that reduces failure over a short period of time, though with much worse consequences over a longer period of time. For example, regulations that allow conversion of a pool of illiquid, poorly rated assets into liquid tranches of differentially rated securities (some of them highly rated), may reduce the total capital obligations for the institutions originating these assets, while also seeming to maintain safety and soundness. Such regulation, if not conducted properly with sound alignment of incentives, requirement of buffers at different levels, and other checks and balances, may encourage creation of risks that may have consequences years later, perhaps going beyond the regulatory cycle in which the regulation was notified.

PRINCIPLE 8. *The need to minimise the pro-cyclical effects of regulatory actions.*

Micro-prudential regulation can often be pro-cyclical, that is, it can amplify business cycle fluctuations, and possibly cause or exacerbate financial instability. In a contraction, regulatory constraints may bite well before the bankruptcy law does, as financial institutions regard violating minimum capital requirements as extremely costly. Depending on how the instruments of micro-prudential regulation are used, the extent of pro-cyclicality may vary.

In the framework proposed by the Commission, the primary function of micro-prudential regulation is to think about one financial firm at a time. The task of thinking about overall systemic risk has been placed separately from micro-prudential regulation, precisely because micro-prudential regulation requires a different perspective. This principle requires micro-prudential regulators to be aware of the extent to which their rules are pro-cyclical and to seek alternative mechanisms which minimise this phenomenon.

PRINCIPLE 9. *The requirement that persons who control and manage the affairs of regulated persons must share the responsibility of ensuring the safety and soundness of the regulated persons*

Though the main objective of micro-prudential regulation is to maintain safety and soundness for regulated persons, the regulator is not the one ultimately responsible for the safety and soundness of the regulated persons. That responsibility should stay with the board and management of the regulated person. Once a financial service provider is identified for micro-prudential regulation, consumers, investors and other stake-holders should not perceive themselves to be absolved from responsibility for the safety and soundness of that institution. Regulation is only an additional set of measures that do not replace the efforts of the board and management of the regulated person. The regulator should lay out frameworks, which the board and management would be responsible for implementing.

In addition to those principles enshrined in the draft Code, the Commission also recommends that micro-prudential regulation be conducted in such a manner that there is *balance between a structured and a responsive regulatory approach*. A very structured, rules-based approach may bring clarity and certainty for regulated institutions, but may limit the ability of the regulator to see risks arising from areas they may not have thought about sufficiently in time. Also, if an institution is able to find a way to game the rules, the regulator may not be able to see the problems at all. Regulators could miss the big picture while being overly dependent on minutiae of the framework they have put in place. Or

the other hand, a principles-based, more discretionary approach may reduce certainty for the regulated institutions but give the regulator greater flexibility to pursue the micro-prudential objective. A balance needs to be struck between these two possibilities.

While there is merit in having primarily a structured approach to regulation, the nature of micro-prudential regulation is such that the regulator should not get overly dependent on a structured framework and specific rules, and should have capabilities to scope and monitor the risks being built, and through due process, respond to these risks pro-actively. This requires a mix of rules and judgement.

Resolution

7.1. The problem

The failure of large private financial firms can be highly disruptive for households that were customers of the failing firm, and for the economy as a whole. This might have been less important 20 years ago when the Indian financial system was dominated by PSUs that rely on implicit financial support from the tax payer. As India has increasingly opened up entry into finance, and several large private financial firms have arisen, it becomes important to create mechanisms to deal with failing firms.

Sound micro-prudential regulation will reduce the probability of firm failure. However, eliminating all failure is neither feasible nor desirable. Failure of financial firms is an integral part of the regenerative processes of the market economy: weak firms *should* fail and thus free up labour and capital that would then be utilised by better firms. However, it is important to ensure smooth functioning of the economy, and avoid disruptive firm failure.

This requires a specialised 'resolution' mechanism. A 'resolution corporation' would watch all financial firms that have made intense promises to households, and intervene when the net worth of the firm is near zero (but not yet negative). It would force the closure or sale of the financial firm, and protect small consumers either by transferring them to a solvent firm or by paying them. As an example, in India, customers of a failed bank are guaranteed the first Rs. 1 lakh of their deposits as 'deposit insurance'.

At present, India has a deposit insurance corporation, the DICGC. However, the DICGC is not a resolution corporation; it deals only with banks, and is otherwise unable to play a role in the late days of a financial firm. This is a serious gap in the Indian financial system. For all practical purposes, at present, an unceremonious failure by a large private financial firm is not politically feasible. Lacking a formal resolution corporation, in India, the problems of failing private financial firms will be placed upon customers, tax payers, and the shareholders of public sector financial firms. This is an unfair arrangement.

Establishing a sophisticated resolution corporation is thus essential to strong responses to the possible failure of a large financial firm and its consequences for the Indian economy. Drawing on international best practices, the Commission recommends a unified resolution corporation that will deal with an array of financial firms such as banks and insurance companies; it will not just be a bank deposit insurance corporation. The corporation will concern itself with all financial firms that make highly intense promises to consumers, such as banks, insurance companies, defined benefit pension funds, and

payment systems. The corporation will also take responsibility for the graceful resolution of systemically important financial firms, even if they have no direct link to consumers.

The defining feature of the resolution corporation will be its speed of action. It must stop a financial firm while the firm is not yet insolvent. International experience has shown that delays in resolution almost always lead to a situation where the net worth becomes negative; a situation where costs are likely to be placed on the tax payer. The choice that we face is between a swift resolution corporation, which will stop financial firms when they are weak but solvent, and a slow resolution corporation which will make claims on the tax payer. Hence, a sophisticated legal apparatus has been designed by the Commission, for a resolution corporation that will act swiftly to stop weak financial firms while they are still solvent. The resolution corporation will choose between many tools through which the interests of consumers are protected, such as sales, assisted sales, mergers and other arrangements.

It is important to make a clear distinction between micro-prudential regulation and resolution. Micro-prudential regulation and supervision is a continuous affair. Occasionally, when a firm approaches failure, the capabilities of the resolution corporation are required, and would proceed in a different manner than micro-prudential regulation. The resolution corporation is analogous to a specialised disaster management agency, which is not involved in everyday matters of governance, but assumes primacy in a special situation. The resolution corporation will have close co-ordination with the micro-prudential regulators. For strong firms, the resolution corporation will lie in the background. As the firm approaches failure, the resolution corporation will assume primacy. The provisions for both micro-prudential regulation and resolution have been drafted in an internally consistent fashion that design for this lockstep.

The first three pillars of the work of the Commission – consumer protection, micro-prudential regulation and resolution – are tightly interconnected. Consumer protection deals with the behaviour of financial firms towards their customers in periods of good health. Micro-prudential regulation aims to reduce, but not eliminate, the probability of the failure of financial firms. Resolution comes into the picture when, despite these efforts, financial firms fail.

7.2. An effective resolution framework

The analysis of the Commission in designing an effective resolution framework reflected a combination of:

1. India's experiences in managing a failing financial firm;
2. The emerging global consensus on the need to have an effective and wider resolution framework that is not limited to banks; and
3. The analysis of the tools of resolution that would protect the interests of the consumer and would incur least cost to the tax payer.

Table 7.1 enunciates the organisational structure of the resolution corporation. In thinking about the design and composition of the board of the resolution corporation, the Commission believes that a formal framework of information-sharing and timely co-ordination between the resolution corporation and the micro-prudential regulators can help achieve orderly and least disruptive resolution.

An effective resolution framework also requires appropriate arrangements for cross-border resolution. Since many SIFIs operate on a global level, an unco-ordinated approach by the home and host countries' authorities would create difficulties in the way of resolution of such institutions in a manner that would protect interests of consumers and prevent the risk of a contagion. Deliberations are underway at international policy forums to devise an optimal approach to cross-border resolution. India must participate in

Table of Recommendations 7.1 Organisation structure of the resolution corporation

The draft Code on resolution establishes a resolution corporation as a statutory body to carry out the resolution of covered service providers. Covered service providers include:

1. each financial service provider that makes 'covered obligations' as discussed in Table 7.2; and
2. each financial service provider designated by the Council as a firm.

The resolution corporation must have representation from across the financial regulatory architecture, including the central bank, financial regulators, and the Central Government, and must be headed by a chief executive. The resolution corporation must have representation of independent experts. The resolution corporation must also have an administrative law member on its board. The establishment of the resolution corporation will be carried out in alignment with the principles of legal process identified by the Commission.

Accordingly, the board of the resolution corporation will consist of executive, non-executive and nominee members, to be appointed by the Central Government:

1. the total number of members must not be more than nine (9);
2. the total number of non-executive members must be greater than the total number of executive members; and
3. three (3) members will be nominee members.

The executive members will include –

1. the Chair person of the corporation; and
2. an administrative law member.

The nominee members will consist of –

1. one nominee of the Reserve Bank;
2. one nominee of the Unified Financial Authority; and
3. one nominee of the Central Government.

The board will appoint a senior officer of the corporation to act as secretary to the board.

Table of Recommendations 7.2 Objectives

Resolution of covered service providers that are approaching failure should be carried out with the objectives of:

1. Protecting the stability and resilience of the financial system;
 2. Enhancing financial market efficiency through efficient pricing and allocation of risk;
 3. Protecting consumers of covered obligations up to a reasonable limit; and
 4. Protecting public funds.
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emerging global arrangements on cross-border resolution. Developments in this regard may well require amendments to the law in the future, such as to require the resolution corporation to co-ordinate with its counterparts in other jurisdictions. In this regard, the Commission recommends that, in five years from now, a committee be set up to review the emerging consensus in this field and suggest amendments in the legal framework on resolution accordingly.

7.3. Objectives of the resolution corporation

Designing an effective resolution mechanism requires clarity of objectives in performing resolution. Table 7.2 outlines the objectives of the resolution corporation that must guide its functioning.

The increasing size of deposit-taking institutions and the emergence of financial conglomerates have increased the risk to financial stability from firm failure. To address this concern, regulatory regimes have tried to redefine the scope of resolution. Internationally, regulators are now moving to broaden the mandate of resolution authorities to include any firm including banks, holding companies, non-bank financial corporations, and financial market infrastructure such as payment, settlement and clearing systems. The Code drafted by the Commission envisages a resolution corporation of similar scope.

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Commensurately, the corporation must have sufficient resources (financial, organisational and technical), and must have the legal powers for the rapid and orderly liquidation of a wide variety of covered firms – and firms – to avert risk to financial stability.

The resolution corporation regime must enhance financial market efficiency. It must not restrict market participants from innovation or taking calculated risks. Instead, it should facilitate the efficient pricing and allocation of risk, and the internalisation of the costs of firm failure. Market efficiency will be supported and enhanced in the following ways:

1. All covered service providers would pay fees that are proportional to the prospective costs that they may impose upon resolution, which reflects a combination of the probability of failure and the costs borne by the resolution corporation upon firm failure.
2. Allocation of losses to firm owners and unsecured and uninsured creditors will be in a manner that respects hierarchy of claims.

An important aspect of the resolution framework centres around the protection of consumers in proportion to the nature, scale and complexity of obligations owed by the regulated entity, and to prioritise claims according to the hierarchy determined by such obligations.

In determining the nature, scale and complexity of obligations the regulator, in consultation with the resolution corporation, must take into consideration the following factors:

1. the nature and extent of detriment that may be caused to consumers in case of non-fulfilment of obligations owed to them by the covered service provider;
2. the lack of ability of consumers to access and process information relating to the safety and soundness of the covered service provider; and
3. the inherent difficulties that may arise for financial service providers in fulfilling those obligations.

The obligations that score high on the above factors must always be protected by the resolution corporation. Such obligations will be referred to as "covered obligations". The objective of the resolution corporation will be to protect consumers of covered obligations up to a reasonable limit.

If there is no resolution framework, the Government will be pressured to capitalise distressed firms, leading to high fiscal costs, and losses to tax payers. This is especially true in the case of a SIFI, whose failure could threaten financial stability and the health of the real economy. The other alternative to taxpayer-funded bailout could be bankruptcy. However, as global experience in the aftermath of the financial crisis shows, regular bankruptcy proceedings may not be adequate to prevent financial market instability. Thus, a specialised resolution regime must offer a viable alternative to the financial instability resulting from bankruptcy proceedings, or the fiscal and political consequences of taxpayer-funded bailouts.

The global experience with financial firms that approach failure is that rapid and early action works smoothly, while delayed action places substantial costs upon the exchequer. Hence, the objective of protecting public funds is synonymous with building a capability that monitors covered financial firms, makes an early assessment about a firm that is approaching failure, and undertakes interventions early. This requires a sophisticated risk assessment system, one that works in partnership with micro-prudential regulation but ultimately reaches an independent decision.

7.4. Interaction between agencies

Micro-prudential regulation is closely linked with the resolution framework. They share a common objective, that is, to minimise costs to customers, the financial system at large,

and the tax payer arising from the risk of failure of a financial institution. However, there are important differences between the perspective of micro-prudential and resolution authorities in terms of timing and intensity of intervention. As long as a firm is healthy, the resolution authority does not intervene; and instead, relies on information from the micro-prudential regulator. At best, it conducts periodic reviews.

As the probability of failure increases, the degree of supervision by the resolution corporation will increase. At each stage of greater difficulty, there will be regular interaction between the micro-prudential regulators and the resolution corporation. Micro-prudential regulators and the resolution corporation have a well-defined protocol, embedded in the draft Code, for joint work covering:

1. Risk assessment of covered service providers;
2. Actions to be taken with respect to a covered service provider at different stages of risk to the covered service provider; and
3. Identification of emerging regulatory risks, their assessment, quantification and impact on the financial sector.

The task of resolving a failing covered service provider also involves interaction with the competition regulator, cci. One commonly used tool of resolution involves selling the firm to a healthy firm. In the routine business of selling or merging a firm, the effects on competition must be considered. The resolution corporation must consult the cci on the likely effects of its actions on the state of competition in the market. In addition, the resolution corporation must prepare a report detailing the effect that its proposed action is likely to have on competition in the relevant market. The interaction should involve sharing of any relevant information and data at the disposal of the resolution corporation.

However, in times of crisis, concerns of financial stability may outweigh competition concerns. An analysis of global experience shows that post-crisis, national competition authorities recognise that failing firm investigations are too lengthy, as firms in distress may deteriorate rapidly, and cause inefficient liquidations. Procedures need to be amended to facilitate speedy mergers of failing firms. In such an event, the obligation to consult the cci and examine the implications on competition must be exempted.

The resolution corporation must approach the fspc in two circumstances. Firstly, if there is a difference of opinion between the resolution corporation and the micro-prudential regulator, either entity may approach the fspc, which must resolve their dispute. Secondly, if the resolution corporation believes that it may be required to take action against a sfi, it must necessarily inform the fspc of the measures that it proposes to take thus, and seek permission for taking any such measures. The Commission is of the view that actions by the resolution corporation against a sfi are likely to have systemic implications. The one entity in the new financial architecture designed by the Commission with a view of the entire system is the fspc. Therefore, any actions against a sfi must necessarily be with the knowledge and permission of the fspc, to pre-empt any unforeseen systemic consequences from occurring.

Table 7.3 establishes the framework of co-ordinated action with other agencies.

7.5. Powers of the resolution corporation

The Commission believes that the resolution corporation needs to be equipped with wide powers to carry out its functions. To carry out its supervisory reviews, the resolution corporation needs to have a specialised staff of examiners. These examiners will conduct regular examination of covered service providers. When the covered service provider shows unfavourable trends in its risk profile, the resolution corporation can call for special examinations as a measure of enhanced supervision.

Table of Recommendations 7.3 Interaction with other agencies

The draft Code on resolution obliges the resolution corporation, the micro-prudential regulator, the competition regulator and the FSDC to consult and co-ordinate regularly and frequently, achieve regulatory harmonisation, and share information. Accordingly, the draft Code provides for:

1. An appropriate mechanism to address disputes in the event of disagreement between the regulators and the resolution corporation;
2. Where actions are likely to involve a firm, the resolution corporation must necessarily obtain the permission of the FSDC;
3. An obligation to consult on the likely effects of the resolution corporation's proposed actions on competition in the relevant market; and
4. Exemption from consultation with the FSDC in certain circumstances. Fine resolution corporation determines that those actions need to be taken immediately to prevent the probable failure of a covered service provider.

Proactive and timely intervention by the micro-prudential regulator and the resolution corporation is the key to ensure orderly resolution of covered service providers and to prevent losses to the insurance fund. To operationalise this, the Commission envisages a framework of "prompt corrective action" incorporating a series of intervention measures to be undertaken by the micro-prudential regulator and the resolution corporation to restore the financial health of the covered service provider. As a first step, the framework requires determination of certain measures of risk and identification of certain stages of the financial condition of covered service providers, based on the direction and magnitude of these risk measures. Once the stages are identified, the micro-prudential regulator and the resolution corporation will seek to address the concerns of firms through their supervisory and regulatory tools.

The Commission believes that the benefits of such a framework would be two-fold:

1. Enhanced regulatory intervention on deteriorating covered service providers would mitigate the risk-taking incentives by imposing more market discipline; and
2. Reduced regulatory forbearance such as "too big to fail", by linking regulatory response to a covered service provider's financial condition.

Table 7.4 outlines the Commission's recommendations.

7.5.1. Powers of the resolution corporation as receiver

The framework of "prompt corrective action" is designed to identify the risks to a covered service provider's viability at an early stage so that corrective actions can be taken by the covered service provider. However, if the covered service provider fails to implement the corrective actions prescribed by the micro-prudential regulator and the resolution corporation, and its financial condition continues to deteriorate, the covered service provider falls within the receivership domain of the resolution corporation.

Table 7.5 defines the powers of the resolution corporation as the receiver. In thinking about the corporation's role as a receiver, the Commission recommends that the corporation be given wide range of powers and accorded significant legal immunity.

7.6. Resolution tools

The choice and sequencing of the use of a resolution tool must be guided by the objective of minimising direct and financial costs to the system, proportional protection to cover small and less-sophisticated depositors and customers, and minimising contagion risk. The objectives should be prioritised as the resolution corporation determines to be appropriate in each case.

Global experience shows that the tools of resolution can broadly be categorised as:

Table of Recommendations 7.4 Examination and prompt corrective action

The resolution process requires the resolution corporation to undertake a series of activities including the regular monitoring, supervision and evaluation of covered service providers; prompt corrective action; and transferring and disposing assets of failing or failed covered service providers. To carry out these functions, the draft Code enables the resolution corporation to:

1. Conduct regular evaluations at periodic intervals;
2. Conduct 'special' evaluations of covered service providers that show unfavourable changes in their risk profiles;
3. Impose monetary penalty if a covered service provider fails to disclose relevant information or co-operate with the corporation.

The resolution corporation and the macro-prudential regulator must together establish a framework for prompt corrective action to identify risks to covered service providers at an early stage, and to ensure their timely resolution. Therefore, the law must provide for the determination of:

1. Indicators or measures of risk assessment by the macro-prudential regulator; and
2. Stages of identifying the risk to the viability of covered service providers based on these indicators or measures.

Five such stages – low, moderate, material, imminent, and critical risk to viability – must be identified. Each covered service provider, depending on its state of health, will be classified accordingly. In each of the stages, the resolution corporation will implement a series of measures as described below:

1. Low risk to viability: In this stage, the activity of the resolution corporation will be restricted to monitoring the covered service provider based on regulatory data, reports from examinations and inspections, and any other data that may be available to the corporation.
2. Moderate risk to viability: In this stage the resolution corporation will conduct a special examination of the affairs of the covered service provider to assess its health, and communicate its concerns to the covered service provider and may levy a premium surcharge.
3. Material risk to viability: In this stage, in addition to the actions mentioned above, the resolution corporation will require the covered service provider to prepare a resolution plan. The resolution plan will help the resolution corporation in devising optimal resolution strategies for the covered service provider. It will intensify engagement with the covered service provider on the resolution plan, including obtaining all the information related to the plan.
4. Imminent risk to viability: If the covered service provider has imminent risk to viability, within 90 days of such a determination, the corporation will apply for receivership of the covered service provider. The regulator must appoint the corporation as the receiver for such a covered service provider.
5. Critical risk to viability: If a covered service provider reaches this stage, the corporation will cancel or terminate all policies of insurance and apply for liquidation.

In each of these stages the regulator will apply its regulatory tools and will intensify engagement with the covered service provider. If it is placed in the receivership domain of the resolution corporation,

1. Sale to another institution: The most market-oriented tool of resolution involves selling all or part of the business of a covered service provider to a viable commercial purchaser. This tool is useful because it ensures continuity of services, and incurs minimal resolution cost. In the exercise of this tool, the resolution corporation must ensure that thorough diligence is followed in inviting bids, giving accurate information, maximising the number of potential purchasers and exploring multiple transaction structures.
2. Bridge institution: In some cases, it may not be possible to find a willing buyer for a failing covered service provider. In such cases, the resolution corporation can establish a wholly-owned subsidiary to bridge the time lag between the failure of such an institution and the satisfactory transfer to a third party. The management of the bridge institution will try to restore asset quality and arrange for finding a suitable buyer for the covered service provider. This is an interim solution which will culminate in either sale or liquidation or a combination of the two.
3. Temporary public ownership: If the other two tools fail to work, temporary public ownership is the last resort. The law will provide for specific conditions for its application.

Table 7.8 defines the three resolution tools and the conditions for their use.

The Commission recommends that the process of resolving a covered service provider, including the choice of a resolution tool, should not depend on the ownership structure of the service provider. This will result in 'ownership neutrality' in the approach of the corporation. In this framework, the treatment of public and private firm; and domestic

Table of Recommendations 7.5 Powers of the resolution corporation as receiver

If a covered service provider fails to implement the instructions of the micro-prudential regulator and the resolution corporation under the prompt corrective action framework, and reaches a stage of "imminent risk to viability," the regulator will appoint the resolution corporation as receiver of that covered service provider. As a consequence of being appointed as receiver of a covered service provider, the resolution corporation will have the following powers:

1. To act as successor to all rights, titles, powers, and privileges of the covered service provider;
2. To take over the management of the covered service provider;
3. To exercise any of the three major tools to resolve a covered service provider: sale to another financial service provider, the incorporation of a bridge institution, or temporary public ownership (nationalisation);
4. To manage and operate the covered service provider (including selling off its assets, arranging for the assumption of its liabilities, and conducting the business of the covered service provider); and
5. The resolution corporation as receiver shall terminate all rights and claims that the shareholders and creditors of the covered service provider may have against the assets of the company, except for the right to payment, resolution, or other satisfaction of their claims.

The resolution process must be allowed to proceed smoothly, with appropriate immunity from legal proceedings pending the completion of resolution. In law, this requires mandating the following:

1. The decision to resolve a covered service provider, as determined by the resolution corporation, is final, conclusive and may not be appealed;
2. A court will not have jurisdiction over any claim or any action seeking a determination of rights with respect to the assets of the covered service provider, including any assets which the resolution corporation may acquire as receiver; and
3. Throughout the exercise of its functions, the resolution corporation must be bound by a clearly defined legal process. If it strays from this process, it may be open to challenge before the tribunal.

Table of Recommendations 7.6 Tools of resolution

The draft Code on resolution enables the resolution corporation to exercise at least three types of resolution tool:

1. Resolution by purchase
 - ▶ The resolution corporation can merge a failing covered service provider with another financial service provider(s), or transfer some of its assets and liabilities to another financial service provider; and
 - ▶ The resolution corporation must ensure that there is thorough due diligence, and there is minimal disruption caused to the consumers of the service providers concerned.
2. Resolution by bridge service provider
 - ▶ The resolution corporation can create a wholly-owned bridge institution, to which all or some of the assets and liabilities of a failing covered service provider may be transferred;
 - ▶ This tool may be exercised if, given the size and complexity of the covered service provider, it is infeasible to sell it to another institution directly; and
 - ▶ This tool may also be exercised if the resolution corporation determines that the continued operation of the covered service provider is essential to provide financial services in the market.
3. Resolution by temporary public ownership
 - ▶ As a last resort, the resolution corporation may require temporary public ownership of a failing covered service provider in order to maintain financial stability;
 - ▶ This tool should be used only when all other options have been exhausted;
 - ▶ Temporary public ownership should typically be used for a SIFI, including banking service providers, where the risk of firm failure is a threat to the financial system;
 - ▶ The resolution corporation must consult and obtain the permission of the ESF in the exercise of this tool; and
 - ▶ Since the tool has large fiscal implications, the draft Code must limit the conditions when the tool can be exercised.

and a wholly owned subsidiary of a foreign firm will be identical from the viewpoint of resolvability.

In the existing legislative landscape, there are certain Acts such as the State Bank of India Act, 1955 and the Life Insurance Corporation Act, 1956, that were enacted to create specific financial institutions. These laws contain provisions that vary or exclude the applicability of general corporate and financial laws to the institutions created under them. For instance, the State Bank of India Act, 1955 exempts the State Bank of India from the

applicability of laws governing winding-up of companies and provides for its liquidation only by an order of the Government. These provisions create unfair competition as it creates a perception of safety in the minds of consumers and an expectation that they will be insulated from the failure of such firms. The Commission recommends that such provisions be amended immediately so that the resolution corporation can engage in orderly and least disruptive resolution of all covered service providers in accordance with its objectives envisaged in Table 7.2.

In an attempt towards enhancing the effectiveness of the resolution framework, the Commission also focussed on the regulatory framework of co-operative societies that carry out banking activities. In the current arrangement, such "co-operative banks" are governed by state legislations and are subject to a dual regulatory framework by the RBI and the Registrars of Co-operative Societies of the States in which the banks are located. This has created difficulties in the regulation of co-operative banks. These difficulties have been attempted to be addressed through memorandums of understanding entered into between the RBI and State Governments. Some States and Union Territories which have amended the local Co-operative Societies Act empowering the RBI to order the Registrar of Co-operative Societies of the State or Union Territory to wind up a co-operative bank or to supersede its committee of management and requiring the Registrar not to take any action regarding winding up, amalgamation or reconstruction of a co-operative bank without prior sanction in writing from the RBI are covered under the Deposit Insurance Scheme. These co-operative banks are designated as "eligible co-operative banks" for the purpose of deposit insurance under the DICGC Act, 1961. This has resulted in an uneven framework where some co-operative banks are eligible to avail the deposit insurance scheme by the DICGC while some others are not part of this arrangement.

The Commission is of the view that when co-operative societies engage in the business of providing financial services, they need to be regulated and supervised by financial regulators in a manner that is commensurate with the nature of their business and the risks undertaken by them and must be resolved in an orderly manner to cause least disruption to the consumers and the financial system. Since co-operatives often cater to the needs of small households, the Commission is of the view that in the event of a deterioration in their risk profile, they should be subject to the prompt resolution framework envisaged by the Commission.

This can be achieved under Article 252 of the Constitution which allows two or more State Legislatures to pass a resolution accepting the authority of the Parliament to make laws for the State on any matter on which it otherwise does not have the capacity to legislate. Using this provision, State Governments could pass resolutions to extend the power to make laws on the regulation, supervision and resolution of co-operative societies carrying on financial services to the Parliament.

The Commission therefore makes the following recommendations with respect to co-operative societies:

1. In consonance with the recommendations on competitive neutrality, co-operative societies carrying on financial services should be subject to similar regulatory and supervisory framework of resolution as other entities carrying on similar activities;
2. Using Article 252 of the Constitution of India, State Governments should accept the authority of the Parliament to legislate on matters relating to the failure resolution of co-operative societies carrying on financial services; and
3. The regulator may impose restrictions on the carrying on of financial services by co-operative societies from States whose Governments have not accepted the authority of the Parliament to legislate on the regulation of co-operatives. These restrictions would entail that co-operative societies in such states would not be covered under the resolution framework envisaged by the Commission.

Table of Recommendations 7.7 Funding of resolution and insurance coverage

Funding the costs of resolution and consequent payouts are incorporated in the draft Code. The resolution corporation must create a resolution fund. The draft Code enables the resolution corporation to:

1. Expand the coverage of traditional deposit insurance to include payment of compensation to specified consumers of covered service providers;
2. Collect premia from covered service providers to cover the likely costs of resolution; and
3. Terminate insurance in specific circumstances.

For the purpose of calculating premia, the draft Code provides for:

1. the manner of classification of covered service providers into different categories;
2. the manner and methodology of assessment of premia payable by different categories of covered service providers;
3. the process of collection of premia from covered service providers; and
4. the manner and mode of payment of premia by covered service providers to the Corporation.

The resolution corporation must be able to revise insurance limits, in accordance with the principle of proportionality to the risk to liability of covered service providers.

The draft Code on resolution allows for persons or institutions who have been reimbursed from the resolution fund to claim for compensation over and above what they have received. Alternatively, persons or institutions who are legitimate claimants, but whose claims have not been recognised by the resolution corporation, should also be able to seek such compensation.

In exceptional circumstances, there may be an access to a line of credit from the Central Government for a temporary period.

7.7. Fund for compensation and resolution

Since the scope of resolution runs beyond banks, the Code drafted by the Commission envisages the creation of a resolution fund, to which various premia received from covered service providers will be credited. The premia to be collected from the covered service providers would be proportional to their financial position as envisaged in the prompt corrective action framework.

In certain specified circumstances, the resolution corporation can terminate the policy of insurance issued by the resolution corporation. For example, the resolution corporation will be empowered to terminate the policy if the covered service provider fails to pay the premia for a specified period, or if the covered service provider is engaged in unsafe or unsound practices in conducting their business.

In the context of resolution, the Commission recommends the use of proceeds of the resolution fund for resolution related expenses including administrative expenses as well as for the payment of compensation to specified consumers. This reduces the burden on covered service providers to make separate contributions for different purposes.

The Commission recognises the fact that the resolution corporation may require monetary assistance if it is unable to meet its obligations in times of extreme financial distress in the markets. In such exceptional circumstances, the resolution corporation would be allowed to avail a line of credit from the Central Government for a specified period. The Central Government will determine and review the terms of the line of credit. Any extension, renewal or increase of credit under the line of credit sought by the resolution corporation must be accompanied by a detailed report stating the reasons for additional borrowing and its intended uses.

Table 7.7 summarises the recommendations of the Commission on insurance coverage and the scheme of funding resolution that must be embedded in the draft Code on resolution.

Table of Recommendations 7.8 Winding-up proceedings

If a covered service provider has failed and needs to be liquidated or wound up, the draft Code on resolution must allow for:

1. The process of liquidation to be carried out in accordance with the law of incorporation of the covered service provider;
 2. The resolution corporation to be appointed as the official liquidator by the court concerned; and
 3. The resolution corporation to be the creditor of the first priority if the resolution corporation has utilised proceeds from the fund towards meeting the expenses of liquidation.
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7.8. Consequences of resolution

A resolution action by the resolution corporation may include the following:

1. Transfer of shares, property, rights and obligations in contracts;
2. Change in the management of the firm, even resulting in removal of certain workforce;
3. Compensation; and
4. Liquidation of the covered service provider.

To provide for compensation, the resolution corporation must be empowered to carry out proceedings where persons or institutions to be compensated are identified and awarded monetary compensation.

Compensation proceedings would cover the following process:

1. Identification of the persons or institutions affected by the actions of the corporation who are to be compensated;
2. Evaluation of the amount of compensation to be carried out to each person or institution identified for compensation; and
3. Payment of the award.

As a last recourse, the law would allow dissenting claimants to file appeal to the appellate tribunal, beyond which the compensation proceedings would be final and conclusive. Appeals would be restricted to establishing whether due process was followed in the award of compensation.

An efficient resolution mechanism is one that ensures that those covered service providers that have become unviable are wound up. This ensures that deterioration of the financial health of a covered service provider does not affect other covered service providers in the financial system.

Since the resolution corporation closely monitors the viability of a covered service provider and works towards bringing the institution to a less riskier financial state, it is best suited to determine when a covered service provider should be liquidated. As such, if the resolution corporation determines that a covered service provider has failed, the covered service provider would proceed to liquidation.

The Commission has decided that liquidation of a covered service provider would only happen in accordance with the law under which the institution was incorporated. However, this law must stipulate that the resolution corporation would be appointed as the official liquidator of the firm. As mentioned earlier, there are certain special laws governing public sector financial institutions that contain provisions which would restrict the power of the resolution corporation to act as the official liquidator of those institutions. The Commission recommends that such provisions of existing laws be amended immediately to give effect to this power of the resolution corporation.

Table 7.8 states the position of the Commission regarding liquidation proceedings.

Capital controls

Capital controls are restrictions on the movement of capital across borders. The design of controls vary from country to country. Typically, capital controls include a range of measures from reserve requirements to quantitative limits, licensing requirements and outright bans. Controls may be imposed economy-wide or may apply only to specific sectors. In addition, restrictions may apply to all kinds of flows or may differentiate by type or duration of flows.

India's current account is fully liberalised. The Commission has no view on either the timing or the sequencing of capital account liberalisation. These are decisions which should be made by policy makers in the future. The focus of the Commission has been on establishing a sound framework of law and public administration through which capital controls will work.

8.1. Objectives of capital controls

While some nations have used capital controls as part of their policy response to sudden inflows, the International Monetary Fund (IMF) recommends that capital controls be implemented only on a temporary basis, when other macroeconomic policy responses have been exhausted. The Commission notes that empirical studies present mixed evidence on the effectiveness of capital controls in addressing macroeconomic imbalances and systemic risk. The Commission also acknowledges that, in the current Indian context, a distinction must be made between strategic and tactical capital controls. While the former involves defining a 'credible framework of rules of the game which can be used by foreign investors to decide their investment strategy', the latter would be 'situation specific - to be imposed when particular circumstances arise and withdrawn when they abate.' Consequently, the Commission recommends that capital controls be available for policy purposes as a temporary measure during macroeconomic crises.

Even in countries which have achieved full capital account convertibility, the legal framework provides for the imposition of controls for preventing foreign ownership of certain national assets for reasons of national security. The Commission recommends that in the Indian context too, the law should restrict foreign ownership of national assets. Accordingly, the draft Code provides for the pursuit of this objective with clarity on instruments and objectives.

The application of capital controls should be consistent with the principle of competitive neutrality. Controls should only be imposed at the entry level. Once an entry level

requirements are fulfilled, there should be full national treatment of foreign entities, i.e. full symmetry when compared with resident entities. For instance, net worth, capital adequacy norms or investment restrictions should not be different for a foreign entity when compared to a resident entity performing similar functions or investments in India.

8.2. Current framework

The Foreign Exchange Management Act, 1999, codifies the existing approach to capital controls. It differentiates between current account transactions and capital account transactions. The Central Government makes rules in consultation with RBI for current account transactions, and the RBI in consultation with the Central Government makes regulations in relation to capital account transactions. This approach has led to a complex web of rules and regulations on capital controls spread across laws. It has also led to the absence of a clear and consistent framework of policy and translation of policy into law. In studying the current framework, the Commission notes that the deficiencies can be broadly be classified into two categories:

1. **Difficulties of multiplicity:** These arise due to multiple laws, multiple regulators and multiple artificial investment vehicles created by the regulations; and
2. **Difficulties of absence:** These arise due to absence of legal process and judicial review, and absence of clear and consistent drafting.

8.2.1. Difficulties of multiplicity

The difficulties of multiplicity involve the following elements:

1. **Multiple laws:** The current framework of controls involves a myriad and complex web of regulations issued by multiple regulators regulating multiple market participants. Regulations are also organised by asset classes such as equity, quasi-equity instruments (such as convertible debentures) and debt instruments, issued by both listed and unlisted entities.
2. **Multiple regulators:** The institutional bodies regulating capital flows include the RBI, SEBI, FIC, IRDA, and the Interim FRPA. Within the Central Government, the Ministry of Finance houses the Department of Revenue, the Department of Economic Affairs, and the Department of Financial Services. The Department of Economic Affairs hosts the Foreign Investment Promotion Board which approves Foreign Direct Investment (FDI) into the country, on a case by case basis for those investments which require prior approval under the regulatory framework. The Ministry of Commerce and Industry hosts the Department of Industrial Policy and Promotion which is responsible for promulgating policy on FDI into the country.
3. **Multiple investment vehicles and unequal treatment:** Various artificial investment vehicles have been created in India to regulate capital inflows. These investment vehicles include the Foreign Institutional Investors (FIIs), the Foreign Venture Capital Investors (FVCIs) and the Qualified Foreign Investors (QFIs). Varied levels of controls are exercised on these vehicles, in accordance with policy considerations. In addition to the artificial vehicles, non-resident Indians and persons of Indian origin are treated differently from other foreign investors, effectively creating a separate 'investment vehicle'.

Additionally, there is also a problem of unequal treatment, as foreign investors are not treated at par with Indian investors.

8.2.2. Difficulties of absence

The difficulties of absence in the field of capital controls comprise the following:

1. **Absence of legal process:** The rule making process in relation to capital controls is devoid of any public consultation. In addition, policy pronouncements and regulations are rarely accompanied by statements of policy and purpose, making it difficult for stakeholders to deduce a regulator's intention.

2. **Absence of judicial review:** Currently, for violations of any regulations, direction or contraventions of conditions subject to which any authorisation is issued by the RBI, administrative hearings are conducted by first, 'adjudication officers' and second, by 'Special Directors (Appeals)'. Adjudication officers can begin inquiry only upon receipt of a complaint from an 'authorised person'. While contravention of conditions of approval of RBI can be a cause of action, 'failure to grant an approval' by the RBI or the Foreign Investment Promotion Board is conspicuous by its absence. Typically, the RBI regulation of capital flows has been seen purely as an act of monetary policy under the discretion of the central bank and not a regulatory action worthy of legal appeals. Appeals from decisions of Special Director (Appeals) go to a tribunal created by the Central Government. A person aggrieved by a decision or order of the appellate tribunal created by the Central Government must file an appeal to the appropriate High Court.
3. **Absence of clear and consistent drafting:** Capital controls regulations, as currently articulated, are ambiguous and inconsistent which increases the transaction costs for investors. At any given level of convertibility, an ad hoc administrative arrangement of sometimes overlapping, sometimes contradictory and sometimes non-existent rules for different categories of players has created problems of regulatory arbitrage and lack of transparency. These transactions costs increase the cost of capital faced by Indian recipients of foreign equity capital.

8.3. Proposed framework

India now has an open current account. Under the draft Code, there is a liberalised regime where foreign exchange for the purposes of current account transactions can be freely brought into the country or taken out of the country. This will be subject only to tax and money laundering considerations, as currently applicable.

The capital controls framework in India must address the difficulties in the present framework and seek to rationalise and unify rule making. The design of the draft Code on capital controls focuses on accountability and legal process, and leaves the questions of sequencing and timing of capital account liberalisation to policy makers in the future.

The Commission deliberated at length on the proposed framework on capital controls. One view was that the imposition of controls on capital flows are essentially based on political considerations. Hence the rule-making on capital controls must vest with the Central Government. Empowering the regulator to frame regulations on capital controls creates difficulties in articulating the objectives that should guide the regulator while framing regulations on capital controls. Another view was to give the regulator enhanced regulation making powers as it directly interact with market participants. The Commission, however recommends a mixed formulation. The rules governing capital controls on inward flows and consequent outflows i.e. repayment of the principal amount, should be framed by the Central Government, in consultation with the RBI. The regulations governing capital controls on outward flows should be framed by the RBI, in consultation with the Central Government.

Table 8.1 enunciates the design of the proposed framework on capital controls.

8.3.1. Rules and regulations on capital controls

The rules on inward flows will be made by the Central Government and the RBI will make regulations on outward flows. The rule making and regulation making will be a consultative process between the Central Government and the RBI. The consultations will be documented and may also be guided by national security considerations. Table 8.2 details the rule and the regulation making process recommended by the Commission. As is the case today, the oversight of reporting and supervisory powers over intermediaries in capital controls, the authorised dealers, will be placed with the RBI. Till such time capital account convertibility is not achieved. As is the case currently, the Financial Intelligence Unit would have a role in monitoring these flows for purposes of addressing money-laundering and related matters.

Table of Recommendations 8.1 Objectives

The draft Code addresses fundamental concerns in the framework of capital controls, and provides for the following:

1. The rules on capital account transactions (on all inbound flows including outflows that arise as a consequence of these inflows), will be made by the Central Government in consultation with the RBI. The regulations on capital account transactions (on all outbound flows) will be made by the RBI in consultation with the Central Government.
 2. A single investment vehicle for investment (i.e. qualified foreign investors) (these foreign investors who meet the customer due diligence criteria prescribed by the Central Government).
 3. A sound legal process while making rules for capital account transactions and while granting approvals.
 4. A framework for imposition of controls in emergency situations (such as war, natural calamity and balance of payment crisis).
 5. Review or restrictions on capital account transactions on national security considerations, by the Central Government or the RBI for inbound and outbound flows, respectively.
 6. Review of decisions of the Central Government and the RBI.
 7. The principle that once controls are imposed at the entry level there must be equal treatment for Indian investors and foreign investors.
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8.3.2. Single investment vehicle

The Commission believes that there must be an unified QFI framework to address unequal treatment of foreign investors. This recommendation is not new; the UK Sinha Report also recommended the removal of artificial, and multiple classification of foreign investors. In adopting those recommendations, regulators created an additional investor class of QFI without subsuming existing investor classes. This has unnecessarily increased complexity in regulation. The Commission therefore recommends combining regulation of all investment vehicles and individuals into a single, unified framework, the QFI regime. Any non-resident should be eligible to become a QFI provided it meets the customer due diligence norms prescribed by the Central Government. Creating a single investor class for foreign investments would offer a clear investment regime, and would considerably reduce uncertainty, compliance costs and the time taken to make investments without in any way altering the domestic investment framework. At the same time, this would ensure that India complies with the treaty obligations associated with the FATF.

8.3.3. Legal process

Legal process broadly refers to the processes, procedures, rights and institutions through which law is made and applied. Legal process includes principles of transparency and accountability, fairness in application, equality before the law and participation in decision making. The Commission proposes the deepening of legal process guarantees in the country's framework on capital controls. Legal process principles will be applicable at the levels of policy formulation, rule making, regulation making and implementation.

With rule/regulation making, the responsibilities are split between the Central Government and RBI. For regulations issued by RBI (for outbound flows), the usual regulation-making process detailed in the draft Code should be applied. For rules issued by the Central Government, the conventional regulation-making process cannot be applied as the Central Government is not a regulatory agency. The Commission recommends that a process that is similar in most respects should be utilised.

The grant of approvals presents unique problems. At the implementation level, denials of approvals and registrations must be done with transparency and must provide explicit reasoning. For instance, registrations must not be denied to meet broad policy objectives and policy decisions must not be implemented in an ad hoc manner or be targeted at individual participants. The Central Government and the RBI will be obliged to

Table of Recommendations 8.2 Rule and regulation making process

While making rules on inbound flows, the Central Government must first consult the RBI and then publish draft rules. The draft rules must be released for public consultation along with an analysis of the costs and benefits of the proposed rule. All other provisions of regulatory governance which apply to regulators while making draft regulations will apply to the Central Government as well.

For outbound flows, the RBI must first consult the Central Government and then utilize the usual regulation-making process.

In emergency circumstances, the Central Government or the RBI, as the case may be, need not follow the detailed rule-making process. However, consultation between the Central Government and the RBI must precede the rule-making. Additional controls on capital account transactions may be imposed in emergency circumstances.

The emergency rules and regulations will remain valid for only three months, and are required to be notified and placed before both the Houses of the Parliament.

The emergency rules and regulations will remain valid for only three months, and are required to be notified and placed before both the Houses of the Parliament.

Emergency situations include:

1. Outbreak of a natural calamity;
 2. Grave and sudden changes in domestic and foreign economic conditions;
 3. Serious difficulties or expectation of serious difficulties in international payments and international finance;
 4. Proclamation of national emergency under Article 352 of the Constitution of India; or
 5. Proclamation of financial emergency under Article 360 of the Constitution of India.
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Table of Recommendations 8.3 Grant of approval

The Central Government, in relation to inbound flows, and the RBI, in relation to outbound flows, will have the authority to grant approvals or dispose off applications by following a time-bound due process. Reasoned decision in this regard must be provided. If approval is granted, it must clearly specify its scope, effective period and any conditions subject to which it is granted.

While deciding on an application, the principles of proportionality between the costs imposed and the benefits expected to be achieved must be considered, and similarly situated persons must be treated in a similar manner. Equal treatment must be followed.

However, the Central Government and the RBI may impose conditions or reject applications on national security considerations such as:

1. Ownership of critical infrastructure by foreign investors;
 2. Ownership of critical technologies by foreign investors;
 3. Control or ownership of assets in India by foreign governments;
 4. Involvement of a non-resident or foreign government which presents a threat to peaceful coexistence of India with other nations;
 5. Involvement of a non-resident or foreign government which presents a threat or a major disruption to foreign relations of India; or
 6. Any other matter prescribed by the Central Government or specified by the RBI.
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provide decisions within specific and reasonable time limits. However, the Central Government and RBI may deny approvals or impose conditions where there are national security considerations.

Table 8.3 establishes the Commission's recommended framework regarding the granting of approvals that is embedded in the draft Code.

8.3.4. Review

The decisions of the Central Government and the RBI will be subject to a two-tier review. A senior officer in the Central Government will hear the matters relating to denial of approvals or imposition of unnecessary conditions by the Central Government. Appeals from orders of such senior officers would lie to the appellate tribunal. The administrative

Table of Recommendations 8.4 Review

The decision of the Central Government on granting or rejection of approvals on inbound flows will be subject to a review by a senior officer in the Central Government. The decision of the RBI on granting or rejection of approvals on outbound flows will be subject to a review by the administrative law member of the ABI. Matters relating to violations of the capital controls rules, regulations or conditions of any approval by any person will be subject to review of the administrative law officer in the RBI. The administrative law officer may initiate inquiry upon receipt of report by investigation officers. The administrative law officer must follow principles of natural justice, conduct an inquiry in a fair, transparent and time-bound manner and provide reasoned orders in writing. Appeals from the orders of the administrative law officer will lie to the administrative law member of the RBI. Appeals from the orders of the senior officer and the administrative law member will lie to the appellate tribunal.

Table of Recommendations 8.5 Reporting and Supervision

1. Supervision would be conducted by the RBI through its oversight of authorised dealers.
 2. The authorised dealers will conduct continuous monitoring of qualified foreign investors.
 3. The persons undertaking transactions and the authorised dealers will file reports with the RBI through FOMC.
 4. The Central Government will have access to the reports filed with the FOMC.
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law member of the RBI will hear the matters relating to denial of approvals or imposition of unnecessary conditions by RBI. Appeals from orders of such administrative law member will lie to the appellate tribunal.

Cases of violations of the provisions on capital controls under the draft Code, any rules or regulations on capital controls, or conditions subject to which approvals are granted, would be subject to review by an administrative law officer in the RBI. Appeals from the orders of the administrative law officer will lie to the administrative law member of the RBI. Appeals from the orders of such administrative law member will lie to the appellate tribunal.

Thus, this process would include first and second levels of administrative appeals, as well as the provision for awarding remedies. The Central Government, the RBI, and the appellate tribunal would be obliged to provide reasoned decisions involving interpretations of law. Such decisions would also be published. Appeals from the appellate tribunal would go directly to the Supreme Court, bypassing the High Courts, though writ jurisdiction of the High Courts would not be precluded.

Table 8.4 outlines the recommendations of the Commission that are embedded in the draft Code.

8.3.5. Reporting, supervision and enforcement

Ensuring compliance of provisions on capital controls in the draft Code, rules and regulations in relation to the capital controls is placed with the RBI in the draft Code. This would include oversight of reporting of foreign exchange transactions with the FOMC and ensuring compliance of the law, rules and regulations. Under conditions of full capital account convertibility, these functions will be placed with the Central Government.

The RBI will supervise authorised dealers (such as banking service providers) for the purpose of ensuring compliance with the law, rules and regulations. Certain supervisory activities would be delegated to these authorised dealers who will use their discretion on the basis of certain guiding principles (see Table 8.5 generally). All reports made to authorised dealers will be shared with RBI through the FOMC. FOMC will be able to share this information with the Central Government, as required.

8.3.6. Guidance and compounding

The transparent and easily accessible framework for guidance and compounding provided in the draft Code extends to the capital controls framework as well. The RBI will

Table of Recommendations 8.6 Compounding and guidance

1. Compounding of offences will be carried out by the RB.
 2. General and specific guidance will also be provided by the RB.
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provide guidance and compound matters in relation to capital controls under the draft Code.

Table 8.6 outlines the recommendations of the Commission on guidance and compounding.

Systemic risk

9.1. The problem of systemic risk

The field of financial regulation has traditionally focused on consumer protection, micro-prudential regulation and resolution. However, the 2008 financial crisis highlighted systemic risk as another important dimension of financial regulatory governance. Subsequently, governments and lawmakers worldwide have pursued regulatory strategies to avoid such systemic crises and reduce the costs to the exchequer, and ultimately society, of resolving the crises that do occur.

Systemic risk is the risk of a collapse in the functioning of the financial system, largely due to its interconnectedness to other parts of the economy, leading to an adverse impact on the real economy. Thinking about systemic risk oversight requires an integrated and comprehensive view of the entire financial system. In comparison, conventional financial regulation leans towards analysing consumers, financial products, financial firms or financial markets, one at a time.

The Commission recommends the IMF-FSB-BIS definition of systemic risk:

[a] risk of disruption to financial services that is caused by an impairment of all or parts of the financial system and has the potential to have serious negative consequences for the real economy

The primary regulatory mandate of regulators and agencies defines their perspective and information access, so an individual sectoral regulator is likely to focus its gaze or have a viewpoint on the operations of that sector alone, and not on the overall financial system of the country. For example, a resolution corporation tends to look at firms from the narrow perspective of how an individual firm would be resolved when in distress and this perspective informs its approach to the financial system. Systemic risk analysis, in contrast, requires a comprehensive system-wide perspective on the impact of the failure of an individual firm or sector.

The analysis of the Commission regarding systemic risk reflects a combination of:

1. India's experiences with severe systemic crises from 1992 onwards;
2. The emerging global consensus on methods for avoiding systemic crises that have come into focus after the 2008 financial crisis; and
3. The analysis of scenarios involving potential systemic crises in coming decades in India.

To some extent, systemic crises are the manifestation of failures in the core tasks of financial regulation – consumer protection, micro-prudential regulation and resolution.

Table of Recommendations 9.1 Objectives

The Commission notes that even if individual institutions appear sound and are well-monitored, system-wide risks may build up in the aggregate. Such risks need to be monitored, identified and addressed - with a system-wide perspective and not a sectoral perspective. Hence there is a need for an agency to:

1. Foster the stability and resilience of the financial system by identifying, monitoring and mitigating systemic risk; and
2. Improve co-ordination between multiple regulatory agencies (such as the micro-prudential regulators, the resolution corporation and other agencies within the financial system) by bringing diverse perspectives into the discussion, engaging with the regulatory stakeholders, identifying and reducing regulatory uncertainty (including regulatory arbitrage), and addressing unregulated areas. When a systemic crisis materialises, the agency must assist the Ministry of Finance and regulatory agencies in their efforts relating to resolving the crisis.

Many of the crises of the past, and hypothetical crisis scenarios of the future, are indications of the limits of such regulation, standing alone. Increasing institutional capacity to address the problems of consumer protection, micro-prudential regulation and resolution will certainly work to diminish systemic risk. However, such risk will not be eliminated.

The Commission notes that despite well-intentioned implementation, flaws in institutional design, and errors of operation in existing institutional arrangements are inevitable. Additionally, even if extant consumer protection, micro-prudential regulation and resolution regimes work perfectly, some systemic crises may not be prevented, and measures to contain such crises will need to be developed. These dimensions of concern call for urgent and thorough work in the field of systemic risk oversight, as a fourth pillar of financial regulation.

9.2. Objectives and principles

While there is a clear case for establishing institutional capacity in these areas, it is also important to be specific in the enunciation of its implementation. Unless systemic risk regulation is envisioned as a precise set of functions, demarcated by clear and concrete rules as specified by the draft Code, systemic risk law could easily devolve into a set of vaguely specified sweeping powers, and there could be a danger of sacrificing the goals of development and efficiency in favour of avoiding potential systemic risk. Therefore, the Commission has taken care to precisely articulate the strategy for systemic risk oversight, seeking to avoid any draconian control of regulatory powers and emphasising on inter-regulatory agency co-ordination. The Commission's recommendations also emphasise broad principles of regulatory governance so as to ensure that the operations of an agency charged with such functions are guided by an appropriate set of checks and balances.

Table 9.1 enunciates the objectives of systemic risk oversight.

Table 9.2 lists the principles that should guide the functioning of the agency designated to monitor and address systemic risk concerns.

9.3. Institutional arrangement

The monitoring of systemic risk across the world, in varying capacities, has resulted in countries adopting differing structural frameworks for this purpose. For example, the UK has envisaged a Financial Policy Committee, located within the Bank of England, that functions in a manner analogous to its Monetary Policy Committee. The US has established a statutory body called the Financial Stability Oversight Council which comprises the heads of various regulatory agencies and government representatives. Similarly, the

Table of Recommendations 9.2 Principles

The agency must be subject to regulatory governance norms, including the obligation to report on its activities at frequent intervals. The agency's decisions can significantly impact financial market participants, including by way of increasing costs of micro-prudential regulation. Such decisions can also have unintended consequences, causing regulatory arbitrage and otherwise generally affecting the competitive nature of financial markets. Therefore, the draft Code requires that the agency

1. Performs actions proportionate to the benefits expected from those actions;
 2. Ensures that its actions seek to reduce the potential for regulatory inconsistency;
 3. Does not cause a significant adverse effect on the competitiveness or growth of the financial sector;
 4. Acts in a transparent manner; and
 5. Be subject to the "duty to explain" principle: Whenever there is a conflict between principles, the agency must explain the rationale for acting in contravention of a principle, subject to the caveat that the agency's actions must always further its overall objective under the draft Code.
-

European Union has established a European Systemic Risk Board consisting of central bank representatives from member-states, as well as European Union financial regulators.

The regulatory architecture envisaged by the Commission consists of a resolution corporation tasked with managing the resolution of regulated entities, while regulators will pursue consumer protection and micro-prudential regulation within certain sectors of the financial system. None of these agencies will be able to monitor the financial system as a whole, on a constant basis. Hence, the Commission believes that monitoring and addressing of systemic risk concerns is best executed by a council of regulatory agencies, which allow it to combine the expertise of the multiple agencies involved in regulation, consumer protection and resolution. The board of the council will include the Minister of Finance, Central Government as the chairperson and would be served by an executive committee comprising the heads of the regulators and agencies of the financial sector. The Commission also envisages a secretariat to assist the executive committee with administrative matters. Except in circumstances of dispute resolution and implementation of system-wide measures, the managerial and administrative responsibilities of the council would vest in the executive committee. Where the executive committee is unable to reach consensus on a proposed decision or action of the council, the board will step in to resolve the issue, thus facilitating efficient functioning of the agency.

In the consultative processes of the Commission, the RBI expressed the view that it should be charged with the overall systemic risk oversight function. This view was debated extensively within the meetings of the Commission, however, there were several constraints in pursuing this institutional arrangement. In the architecture proposed by the Commission, the RBI would perform consumer protection and micro-prudential regulation only for the banking and payments sector. This implied that the RBI would be able to generate knowledge in these sectors alone - from the viewpoint of the safety and soundness of such financial firms and the protection of the consumer in relation to these firms. This is distinct from the nature of information and access that would be required from the entire financial system for the purpose of addressing systemic risk.

The Commission notes that its recommendation is in keeping with that of the Raghuram Rajan report (2008), which led to the establishment of the Financial Stability and Development Council (FSDC) by the Ministry of Finance. The proposals of the Commission aim to place the FSDC on a sound legal footing by sharply defining its powers and tasking it with achieving objectives in relation to monitoring and addressing systemic risk concerns.

Another key decision of the Commission involved the question of whether to structure the FSDC as a statutory body or as a unit within the Ministry of Finance. The analysis of the Commission emphasises the former for two reasons. First, the FSDC would require operational and financial autonomy in order to build a technically sophisticated staff to

Table of Recommendations 9.3 Establishment of the Agency

The following characteristics will apply to the FSOC:

1. It will be a statutory body;
 2. It will have operational and financial autonomy, and endeavour to build up a technically sophisticated staff;
 3. The chairperson of its board will be the Minister of Finance, Central Government;
 4. Other members of the board will be the head of the regulator for banking and payments, the head of the regulator for other financial sectors, the chief executive of the resolution corporation, the chief executive of the FSOC and an administrative law member to fulfil the requirements of regulatory governance, and
 5. It will be served by an executive committee chaired by the regulator for banking and payments. Managerial and administrative control will vest in the executive committee, which will refer decisions to the board when it is unable to reach consensus. There will also be a secretariat which will assist the board and the executive committee.
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Table of Recommendations 9.4 The systemic risk regulation process

Systemic risk regulation is envisioned as a five-element process. The first four would be performed by the FSOC exclusively and the fifth would be carried out under the supervision of the Ministry of Finance, Central Government.

1. Data, research and analysis;
 2. Identification and designation of SIFIs, including conglomerates;
 3. Formulation and implementation of system-wide measures for mitigation of systemic risk;
 4. Inter-regulatory agency co-ordination; and
 5. Crisis management.
-

undertake vigorous oversight. Second, where the FSOC's actions might adversely affect financial firms, enshrining the FSOC as a statutory body with adequate mechanisms for accountability will fulfil the requirements of regulatory governance.

The FSOC will have a compact membership of five persons, thus facilitating efficient discussions and decision making. The FSOC will be headed by a Chief Executive who will lead a high quality, full-time professional staff.

The Commission's recommendations are listed in Table 9.3.

9.4. The five elements of the systemic risk regulation process

Systemic risk regulation is a five-element process, as shown in Table 9.4. The first element is a data collection and research function. It involves constructing a measurement system through which the FSOC can study the entire financial system. The analysis of system-wide data collected by the FSOC on an ongoing basis will generate areas for discussion by the FSOC. The consensus of the FSOC executive committee and board will then be implemented by the respective agencies where areas of systemic risk concern have been identified. The FSOC will also be empowered to collect, warehouse and disseminate all financial sector data through a system-wide database.

The second element is that of utilising this system-wide database to identify SIFIs, including conglomerates. These will then be placed under enhanced supervision by the respective regulators and the resolution corporation. The FSOC will also be a forum for discussion about what this enhanced supervision will constitute, so as to ensure coherence in perspectives across the financial system.

The third element is that of taking the decision to impose system-wide measures on the financial system. The implementation of the system-wide measures chosen by the FSOC will be done by the regulatory agencies, in accordance with their primary legislative mandate. These measures can include capital buffers that work to diminish systemic risk, for example, by building up capital – across the financial system – in good times and drawing on that capital when the system is under stress. As with everything else in the

field of systemic risk, it is essential that system-wide measures are implemented on the scale of the financial system or a large part of the financial system. For example, raising capital requirements for the banking sector alone may lead to an increase in systemic risk relating to bank substitutes, or the non-banking sector, which may defeat the purpose of imposing the system-wide measure. For a system-wide measure such as capital requirements to matter on the scale of the entire financial system, the formulation and operation of such measures would have to take place in a co-ordinated fashion.

The fourth element requires promotion of inter-regulatory co-ordination amongst the members of the FSPC. Effective co-ordination across a wide range of policy areas is a key element of designing an appropriate institutional framework to monitor systemic risk. Since co-ordination is an inherent part of the FSPC's work, the performance of this function may not be visible as a stand-alone process with separate tangible goals. Nonetheless, the FSPC would focus on facilitating co-ordination which will aim to reduce regulatory uncertainty, thus promoting the overall coherence of the financial system.

Finally, the fifth element involves assisting the Central Government with crisis management. In the event that any systemic crisis occurs, the draft Code emphasises a more formal and cohesive approach to crisis management. The Ministry of Finance, Central Government will lead the crisis management function, with assistance from the FSPC. The FSPC will also provide assistance to members and other agencies in their efforts to resolve the crisis.

9.5. Constructing and analysing a system-wide database

The process of systemic risk oversight begins with the gathering of information from all sectors of the financial system, collating the same and analysing it from the viewpoint of identifying system-wide trends which may be areas of concern. This requires inter-regulatory agency co-ordination, through which the data gathering, as well as discussion leads to informed decision making. The Commission envisages the construction of a unified database, located at the FSPC which will hold all data relating to the entire financial system.

The FSPC will be a forum for the construction of a sophisticated database leading to the assimilation and transmission of system-wide financial data (Table 9.5). This database will serve to assist the FSPC in conducting research on systemic risk and system-wide trends, and facilitate a discussion about policy alternatives between the members of the FSPC. It will not have any power to give directions to financial regulatory agencies, which would be governed only by their respective legislation. The reporting requirements will be stipulated by the respective regulatory agency in relation to its respective financial entities. The latter will be required to route the data only through the FSPC's database. All regulatory agencies will have instantaneous and continuous access to the data of financial entities which they regulate.

Once this database is in place, and maintained regularly, the FSPC would conduct research, in co-operation with all regulatory institutions and with several academic institutions in order to analyse this data and identify potential systemic risks. These areas of concern would be brought up for discussion at the FSPC. Based on the consensus achieved at the FSPC, actions would be undertaken by all regulatory agencies in a co-ordinated fashion.

Towards this end, the FSPC will operate a data centre called the Financial Data Management Centre (FDMC) that will obtain data from regulated entities and other financial firms. All supervisory information supplied by a regulated entity to any regulator will be routed through and held by this database; there will be no other physical or electronic

filings by financial firms. It must be noted however that regulators and agencies will continue to collect any data that they require until the FDMC is fully functional. The FDMC will also contain public domain data from the economy at large, as appropriate.

Once the FDMC is operationalised each regulated entity will only submit all regulatory data through the database. Further, each regulatory agency will only be allowed to access the data it is authorised to collect from the entities that it regulates, to ensure that there is no widespread access by all regulatory agencies to a regulated entity's data. This access will be governed by memoranda of understanding that the members will enter into with the FSDC and the FDMC.

Table of Recommendations 9.5 The Financial Data Management Centre

- ▶ The FDMC will work within the FSDC as the sole electronic system for the collection of data from financial entities for regulatory reporting and supervision;
- ▶ All decisions on the nature of information to be collected will be entirely within the domain of individual regulatory agencies;
- ▶ The FDMC staff will merely aggregate the data and provide access to the regulators. All vetting and review of such data, and requests for additional information will continue to be done by the individual regulators; and
- ▶ The FSDC would be empowered to enter into memoranda of understanding with other regulators such as the CCI or other statutory agencies associated with the financial system for increasing the ambit of a centralised data collection, transmission and warehousing function.

To preserve data confidentiality, the FSDC's use of the data in the FDMC will be governed by the draft Code. It is envisaged that where the FSDC is required to obtain information from unregulated financial entities, it will be able to do so; however requests for data by the FSDC must necessarily be in consonance with its objectives. There will be legal procedures, grounded in principles of due process and regulatory governance that will guide the request for such data by the FSDC.

It is envisaged that anonymised data from the FDMC (which will not contravene confidentiality or privacy concerns or other law) may be made available for access to research bodies and members of the public to foster greater analysis and research relating to the financial system.

The FDMC would represent the first accretion of information on a financial system scale in India. With this data in hand, the FSDC would conduct a research programme on the problems of monitoring and mitigating systemic risk, through the identification of system-wide trends. In addition, the FDMC would also reduce the burden of multiple filings by financial firms, and promote a more efficient system of regulatory information gathering. Many benefits accrue from creating an FDMC, including de-duplication of regulatory filings, lower costs of compliance for firms, and standardisation of regulatory data standards. Members of the public and research bodies will also be able to access anonymised data to foster greater analysis and research of the financial system.

The operations of the FDMC are defined in Table 9.5.

It is evident that there will be considerable challenges that the FSDC would face while trying to conduct this research programme. The patterns of systemic risk in India are likely to differ considerably when compared with the experiences of more developed countries, which limits the portability of knowledge and ideas from those settings. Additionally, policy and scholarly understanding of systemic risk is relatively underdeveloped to the extent that actions to develop these databases have begun as recently as 2010 in countries such as the US. The FSDC would have to undertake special efforts in ensuring that the research programme has adequate capabilities and meets the desired end. The research programme must:

1. identify the interconnectedness of, and systemic risk concerns in, the financial system;

Table of Recommendations 9.6 Data, research and analysis

- ▶ Effective and informed analysis of systemic risk requires access to a high-quality, system-wide financial database containing data from all regulated and some unregulated entities;
- ▶ The draft Code will provide for a central agency or other mechanism that collects, warehouses and provides access to financial data. Such mechanism must be guided by certain basic principles – to standardise data collection; to reduce duplication of data; and to protect the confidentiality and privacy of data;
- ▶ There will be technological safeguards, as well as legal process to balance the gains from requests for data, and possession of information;
- ▶ The agency will also conduct analysis and research to develop indicators and instruments to monitor and mitigate risk, respectively. Each policy initiative in the field of systemic risk should be associated with data-capture and post-mortem analysis. This research must achieve state-of-the-art capability by world standards. It must recognise the unique features of the Indian financial system (and not mechanically transplant ideas from elsewhere) while featuring rigorous research methodologies that are respected worldwide; and
- ▶ Regular progress reports on the database, and results of the research programme, should be disseminated to the public. Anonymised data may also be released to foster better analysis and research.

2. Provide rapid response analysis when there is a significant financial event;
3. Develop systemic risk indicators;
4. Advise the Esoc on the formal functions of the Esoc (listed ahead) in the field of systemic risk;
5. Analyse the optimal uses of system-wide measures for influencing systemic risk that are embedded in the present law, and envision measures that merit consideration in future amendments to law;
6. Study the impact of regulatory policy on overall financial stability; and
7. Communicate the results of research to market participants and the public on a regular basis.

A summary of the research and analysis function as envisaged by the Commission is provided in Table 9.6.

9.6. Identification of systemically important firms

The draft Code in relation to micro-prudential regulation envisaged by the Commission imposes prudential requirements upon financial firms in accordance with the objectives and principles of the regulator. Some financial firms may present exceptional risks to the system by virtue of their sheer size, interconnectedness or infeasibility of resolution. Some financial firms can generate systemic risk concerns when seen as a conglomerate, though not taken individually. Some financial firms or conglomerates could be systemically important even if they make no promises to consumers, and are thus outside micro-prudential regulation.

The Esoc will analyse the data from the Fwdc to obtain information in relation to the overall financial system, and name the firms and conglomerates that are systemically important. The process used to identify such firms will benefit from international standards, but will be rooted in Indian realities. The methodology that will be used for this designation will be released into the public domain, go through a notice-and-comment process, and finally be approved by the Esoc.

This methodology will then be applied to the database within the Esoc to generate a checklist of systemically important firms and conglomerates, which will be released into the public domain. These firms will be brought under heightened supervision through micro-prudential supervision and the resolution corporation. The strategies for heightened supervision, that will be applied in micro-prudential supervision and by the resolution corporation, will be discussed at the Esoc so as to induce consistency in treatment across the financial system. This information will also be released into the public domain.

Table of Recommendations 9.7 Designation as Systemically Important Financial Institutions

- ▶ The FSDC will agree on the methodology for identifying SIFIs, which will embrace global standards to the extent possible for the Indian financial system. All the recommendations for the regulation-making process put forth by the Commission will be enforced on the construction of the methodology;
- ▶ Using this methodology, the FSDC will identify SIFIs. The list of such institutions will be released into the public domain annually;
- ▶ SIFIs will have the choice of appealing their designation at the appellate tribunal;
- ▶ This designation will be used by micro-prudential regulators, and by the resolution corporation, to exercise a higher standard of regulation and supervision; and
- ▶ The FSDC will monitor the higher standard of regulation and supervision by the regulatory agencies.

Financial firms can be adversely affected by being designated systemically important and being called upon to face higher regulatory standards and supervisory focus. The Commission therefore believes that financial firms must have an opportunity to appeal this designation to ensure that the FSDC's decisions comport with basic principles of regulatory governance.

The process followed in this field must, hence, follow a carefully structured set of steps, as detailed in Table 9.7.

9.7. System-wide measures

Financial regulators worldwide are gradually evolving measures for regulation which apply at a system scale. For example, measures that seek to resolve the problems caused by systemic cyclicality include the increase of capital requirements – across the financial system – in good times, and vice versa. This area also requires co-ordinated movement by all financial regulatory agencies. For example, capital requirements are raised in the banking sector alone, but not in other parts of the financial system, business will simply move away from banks, leading to regulatory arbitrage.

Therefore, there is considerable interest worldwide in identifying appropriate measures for counter-cyclical capital variation that are applicable to the entire financial system, or large parts of the financial system. At the same time, systemic risk as a body of professional, scholarly and policy knowledge is relatively underdeveloped. Therefore the Commission proposes laying the legal foundations for one measure – the counter-cyclical capital buffer.

The FSDC must conduct research and formulate a mechanism for the implementation of a counter-cyclical capital buffer such that it is applicable to the entire financial system, or large parts of the financial system – thus preventing concerns of regulatory arbitrage. Once such a measure has been formulated, the members of the FSDC will move in unison to increase or decrease capital requirements in counter-cyclical fashion. It must be noted that the counter-cyclical capital buffer is in addition to each regulator's power to specify capital requirements under its micro-prudential mandate.

Various types of system-wide measures which seek to resolve problems that are not solely cyclical in nature are also being debated internationally, such as sectoral capital requirements and leverage ratio requirements. In the coming decades, as the global consensus on such measures, as well as the experiences of countries in the use of such measures will increase, the FSDC may need to develop and authorise other system-wide measures.

When such a scenario arises, the systemic risk law should be amended to provide the legal foundations of additional measures. The Commission recommends that the FSDC should research the applicability of other system-wide measures to the Indian financial

Table of Recommendations 9.8 Counter-cyclical capital measures

- ▶ The Esoc must conduct research and formulate a mechanism for the implementation of a counter-cyclical capital buffer such that it is applicable to the entire financial system, or large parts of the financial system;
- ▶ The counter-cyclical capital buffer will be applied at the level of the entire financial system, or to large parts of the financial system, as appropriate;
- ▶ The Esoc will make the decision to increase capital requirements when systemic risk is building up, and decrease such requirements, and free capital when the system is under stress;
- ▶ Decisions of the Esoc will translate into action through co-ordinated regulations issued by the respective regulatory agencies with identical effective dates; and
- ▶ The Esoc will continue to conduct research on other measures. Once the Esoc is satisfied regarding the applicability of a measure, drawing on both international experience and original research in Indian settings, the Ministry of Finance will propose amendments to the appropriate sections of the draft Code pertaining to systemic risk, in Parliament.

Table of Recommendations 9.9 Aspects of inter-regulatory agency co-ordination

- ▶ Promoting formal co-ordination mechanisms amongst regulatory agencies;
- ▶ Coordinating the conduct of systemic-risk monitoring functions;
- ▶ Facilitating the adoption of common standards and practices in rule-making and enforcement;
- ▶ Coordinating with international organisations and multilateral bodies in conjunction with the Ministry of Finance; and
- ▶ Helping to resolve inter-regulatory agency disputes.

system and devise new measures (based on international best practices where appropriate). To this end, the Commission recommends that the Central Government should undertake a formal review of this issue in five years.

9.8. Inter-regulatory agency co-ordination

The institutional arrangement of the Esoc brings together multiple regulatory perspectives which are essential to identifying market trends that can result in systemic risk. The Commission believes that the Esoc can further promote co-ordination and consultation by initiating measures like the establishment of joint working groups, cross-staffing initiatives, designated points of contact for inter-regulatory communication, resolution of disputes and other such mechanisms between member-regulators.

The board of the Esoc will engage in resolving regulatory disputes amongst members of the Esoc and between members and other regulatory agencies, if required. The board of the Esoc will be empowered to determine its own procedure for resolution of the dispute, in line with the principles of natural justice.

The Esoc will also work with member-regulators to help in identifying and reducing regulatory uncertainty. In order to reduce regulatory uncertainty, the Esoc will promote consistency in the principles and practices adopted by its member-regulators in the areas of rule-making and enforcement. Such efforts will enable better resolution of conflicts between the policies of the members and promote cohesive oversight of the financial system.

The Commission wishes to emphasise that any action of the Esoc in this regard will not interfere with the functioning or the primary regulatory mandate of the regulators. Table 9.9 summarises the envisioned approach to inter-regulatory co-ordination.

9.9. Crisis management

Despite the best efforts at avoiding systemic crises, there is a possibility that some crises may occur. Crisis management requires extraordinary co-operation between the various

regulatory agencies. In such a situation, the FSDC will:

- ▶ Provide and conduct data analysis and research to seek to understand and resolve the crisis;
- ▶ Assist the regulators and members of the FSDC in their efforts to resolve the crisis;
- ▶ Implement any system-wide measures such as the release of the counter-cyclical capital buffer;
- ▶ Discuss and assist in the implementation of extraordinary methods of resolution for certain entities, such as SIFIs, if required; and
- ▶ Initiate an audit of all actions leading up to, and taken during, a crisis.

For efficient crisis management, the Central Government should have the ability to tap into the data and knowledge at FSDC and particularly, the FPMC. Second, crisis management will be improved by the presence of the resolution corporation and system-wide measures such as the release of the counter-cyclical buffer. Finally, the Ministry of Finance will be required to consult with the FSDC before making any decisions in relation to fiscal assistance, or other extraordinary assistance to financial service providers. The use of these powers should be restricted to emergency situations, and the actions of the FSDC should be subject to a post-crisis audit so as to ensure accountability.

CONTENTS

Financial inclusion and market development

In the framework proposed by the Commission, the focus is on regulatory functions, which are meant to address market failures that impede efficient functioning of the financial system. There are certain functions that are present in the existing legal and regulatory framework that are not strictly regulatory in nature, and therefore remain to be addressed. Specifically, these are functions that the state plays in (a) ensuring more equitable distribution of financial services, and (b) in fostering the development or improvement of market infrastructure and market processes. In this chapter, these problems are discussed in terms of the objectives, powers to pursue objectives, principles to guide use of powers, and institutional roles that should be enshrined in the *draft Code*.

10.1. Objectives

Development concerns within Indian financial markets broadly involve two aspects: (i) financial inclusion: initiatives where certain sectors, income or occupational categories are the beneficiaries of redistribution of financial services, and (ii) market development: fostering the development or improvement of market infrastructure or market process (see Table 10.1).

Financial inclusion comprises certain interventions that impose costs on society as a whole and yield gains to particular groups of citizens. Prominent and well-known initiatives of this nature include restrictions on branch licensing, to require banks to open branches in rural areas, and priority sector lending, to name some more widely known initiatives in banking. Similar initiatives are there in other sectors as well.

Table of Recommendations 10.1 Development functions

The Code should provide for the objective of fostering the development or improvement of market infrastructure or market process. This objective translates into the following:

1. Modernisation of market infrastructure or market process, particularly with regard to the adoption of new technology.
 2. Expanding consumer participation, and
 3. Aligning market infrastructure or market process with international best practices.
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Market development requires information gathering and analysis, which may be at the level of one sector, or on the scale of the full financial system. Inter-regulatory coordination is often called for. Market development may also require spending resources on market infrastructure that has public good characteristics. Such resources may be recovered from the financial service providers, and spent on market infrastructure based on a thorough understanding of costs and benefits. Market development may also require notifying regulations to bring market processes in line with international best practices.

Accordingly, the Commission, after much debate on the objectives of regulators in the pursuit of development, recommends that the regulatory objective of development should translate into the following:

1. *Modernisation:* The regulator should undertake measures that are necessary to modernise market infrastructure or market process, particularly measures with regard to the adoption of new technology.
2. *Emerging consumer participation:* The regulator should be able to pursue certain social goals which contribute to the welfare of the people more broadly. In particular, the regulator should be able to undertake measures that provide for the differentiation of financial products or financial services to specified categories of consumers, or that enlarge consumer participation in financial markets generally.
3. *Best practices:* The regulator may undertake measures to align market infrastructure or market process with international best practices.

Besides the measures that the regulator may undertake to pursue its objective of market development, the Commission recommends that the Central Government should be able to direct a specific regulator to ensure the provision of specified financial services by specified financial service providers or to any consumer or class of consumers. The provision of services in this regard must be with a view to ensure effective and affordable access of financial services to persons who would ordinarily not have such access.

The Commission acknowledges that there may be costs incurred by financial service providers in implementing such directions, and recommends that the Central Government reimburse the cost of granting such access to the financial service providers.

10.2. Institutional architecture

The Commission believes that these questions of development of markets and financial inclusion create certain problems for public administration. As an example, consider an attempt at subsidising credit for agriculture, or an attempt at increasing the flow of credit into certain states. If this is done by a financial regulator, three problems are encountered:

1. *Hidden costs:* When a regulation forces banks to give more loans to open a bank branch in a non-profitable location, this imposes a cost – a tax – upon other branches, and also depositors and shareholders. Questions of institutional design are raised when the power to impose such costs on certain parts in society is given to unelected officials. Therefore, the Commission recommends that where there is a cost incurred by financial service providers in granting effective and affordable access to financial services, such financial service providers should be reimbursed in some form (for example, cash, cash equivalents or tax benefits).
2. *Dilution of accountability:* There is considerable policy knowledge and experience worldwide about embedding principles of accountability into systems of consumer protection and micro-prudential regulation. There is less experience and information available with regard to accountability principles for market development or inclusion initiatives. For example, the number of households that participate in a given financial product may be increased quickly by reducing the burden of consumer protection. Similarly, the function of redistribution to exporters, by requiring banks to give loans to exporters, is in direct conflict with the function of protecting consumers who deposit money with banks. Competing objectives can hinder accountability.
3. *Inefficiency:* When a transfer is achieved by taxing some consumers in order to deliver gains to others, this is a form of taxation. The Commission believes such implicit and selective taxation of different categories of consumers is inefficient.

Table of Recommendations 10.2 Implementing market development

The implementation of the objectives of development should be as follows:

1. Regulators should pursue a developmental strategy that fosters the *development and improvement of market-wide infrastructure and processes*:
 - ▶ This should include measures to modernise market infrastructure or market process, including in particular, the adoption of new technology; measures to provide for product differentiation, or engaging consumer participation; or measures to align market infrastructure or market process with international best practices.
 - ▶ This goal should be subordinate to the goals of consumer protection and macro-prudential regulation, and should only be pursued where there is evidence of co-ordination failures in the market impeding the development of such infrastructure and processes.
 - ▶ A high-quality rule-making process should be applied and should involve features such as cost-benefit analysis and notice-and-comment periods.
 - ▶ There should be ex-post evaluation of the initiatives, to assess the costs of these initiatives and compare them with the benefits.
 2. In addition, the Central Government should be able to direct specific regulators to ensure certain practices in the financial markets:
 - ▶ These directions should be in the form of an order in writing issued by the Central Government and notified in the Official Gazette, to any specific Regulator to ensure the provision of any specific financial service by any specific category of financial service provider or to any consumer or classes of consumers on such conditions as may be prescribed, with a view to ensure effective and affordable access of financial services to any category of persons who would ordinarily not have such access; and
 - ▶ The Central Government should reimburse the cost of granting such access by providing either cash or cash equivalents, or tax benefits to the financial service provider.
 3. For initiatives involving multiple regulators, FSDC would play a think-tank role: in this instance, FSDC would perform a research and analytic role - measuring the state of play and the rate of progress of initiatives, undertaking post-facto analysis of past initiatives, formulating new ideas for reform and raising them before the Council.
 4. Where the issue is cross-sectoral and there is a need for co-ordination among regulators, this co-ordination should be done through FSDC.
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The Commission believes that there is a danger of reaching suboptimal outcomes when goals, powers and accountability are not clearly defined. Accordingly, the Commission recommends efforts to measure the efficacy of given development initiatives and evaluate alternative paths.

The Commission recommends:

1. Initiatives for development should be pursued by the regulators.

Table of Recommendations 10.2 Implementing market development

The implementation of the objectives of development should be as follows:

1. Regulators should pursue a developmental strategy that fosters the development and improvement of market wide infrastructure and processes:
 - ▶ This should include measures to modernise market infrastructure or market process, including in particular, the adoption of new technology; measures to provide for product differentiation, or encouraging consumer participation; or measures to align market infrastructure or market process with international best practices.
 - ▶ This goal should be subordinate to the goals of consumer protection and micro-prudential regulation, and should only be pursued where there is evidence of co-ordination failures in the market impeding the development of such infrastructure and processes.
 - ▶ A high-quality rule-making process should be applied and should involve features such as cost-benefit analysis and pro-fee-and-comment periods.
 - ▶ There should be ex-post evaluation of the initiatives, to assess the costs of these initiatives and compare them with the benefits.
 2. In addition, the Central Government should be able to direct specific regulators to ensure certain practices in the financial markets:
 - ▶ These directions should be in the form of an order in writing issued by the Central Government and notified in the Official Gazette, to any specific Regulator, to ensure the provision of any specific financial service by any specific category of financial service provider or to any consumer or classes of consumers on such conditions as may be prescribed, with a view to ensure effective and affordable access of financial services to any category of persons who would ordinarily not have such access; and
 - ▶ The Central Government should reimburse the cost of granting such access by providing either cash or cash equivalents, or tax benefits to the financial service provider.
 3. For initiatives involving multiple regulators, Esoc would play a think-tank role. In this instance, Esoc would perform a research and analytic role – measuring the state of play and the rate of progress of initiatives, undertaking post-facto analysis of past initiatives, formulating new ideas for reform and raising them before the Council.
 4. Where the issue is cross-sectoral and there is a need for co-ordination among regulators, this co-ordination should be done through Esoc.
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The Commission believes that there is a danger of reaching suboptimal outcomes when goals, powers and accountability are not clearly defined. Accordingly, the Commission recommends efforts to measure the efficacy of given development initiatives and evaluate alternative paths.

The Commission recommends:

1. Initiatives for development should be pursued by the regulators.
2. Additionally, the Central Government may direct a specific regulator to ensure the provision of specified financial services either by specified financial service providers or to any consumers or classes of consumers. The provision of such services must be with a view to ensure effective and affordable access to such services by persons who would ordinarily not have such access.
3. Where a financial service provider incurs costs in implementing such directions, the Central Government will reimburse the cost of granting such access by providing either cash or cash equivalents, or tax benefits to the financial service provider.
4. Whenever an initiative involves multiple regulators, the overall process of development should be analysed and measured by the Esoc. Similarly, if there is a need for co-ordination between regulators, it should be done through Esoc (see Table 10.2).

10.3. Principles that guide the use of measures

The Commission suggests a cluster of principles to guide the use of measures by the regulator and the government. In particular the Commission believes that the law must provide for the following balancing principles:

1. *Minimising any potential adverse impact on the ability of the financial system to achieve an efficient allocation of resources:* For a given improvement in financial

inclusion, the instruments should be used in a manner that is least distorting for capital allocation decisions of institutions.

2. *Minimising any potential adverse impact on the ability of a consumer to take responsibility for transactional decisions:* Consumers should take responsibility for their informed decisions. Instruments of development should be used in such a manner that lead to the least distortion of incentives for consumers.
3. *Minimising detriment to objectives of consumer protection, micro prudential regulation, and systemic risk regulation:* Instruments should be used in a manner least likely to cause detriment to achievement of objectives of the main financial regulation laws.
4. *Ensuring that any obligation imposed on a financial service provider is commensurate and consistent with the benefits expected to result from the imposition of obligations under such measures.*

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Monetary policy

In the long run, the prime determinant of price stability in a country is the conduct of monetary policy. While price fluctuations on a horizon of a few months may be influenced by other considerations, such as a monsoon failure, these considerations do not explain sustained inflation over multi-year horizons. Advanced and emerging economies have achieved price stability by establishing appropriate institutional arrangements for monetary policy.

Price stability is a desirable goal in its own right, particularly in India where inflation is known to hurt the poor. A focus on price stability is also associated with macroeconomic stabilisation. When an economy is overheating, inflation tends to rise; and a central bank that focuses on price stability tightens monetary policy. Similar effects would be found in a downturn, with a drop in inflation and monetary easing. Through this, a central bank that focuses on price stability tends to stabilise the economy.

In the 1970s, many countries experienced stagflation: a combination of low GDP growth and high inflation rate. To a large extent, these problems were related to the conduct of monetary policy. From the late 1970s onwards, the shift to a more rules-based monetary policy, and one that was more oriented towards price stability, has helped improve macroeconomic outcomes.

The Commission believes that the central bank must be given a quantitative monetary objective by the Central Government for its monetary policy function. Whereas the Commission recognises that there is broad consensus at an international scale on the need for a central bank to have a clear focus on price stability, after much discussions, it has decided to not specify such a requirement in the draft Code. Instead, the objective that the central bank must pursue would be defined by a Central Government and could potentially change over the years. If, in the future, the Government felt that the appropriate goal of monetary policy was a fixed exchange rate, or nominal GDP, then it would be able to specify these goals.

The problems of independence and accountability have unique features in the field of monetary policy. In the areas of consumer protection, micro-prudential regulation and resolution, independence and accountability are required in order to reduce the extent to which individual financial firms facing enforcement actions bring pressure on financial regulators. In contrast, in the field of monetary policy, there is no engagement with individual financial firms. The objectives are at the level of the economy; the instruments utilised are at the level of the economy. Monetary policy does not require conducting inspections of financial firms and writing orders at the level of one financial firm.

Table of Recommendations 11.1 Objective of monetary policy

1. The Central Government, in consultation with the central bank Chairperson, would release a Statement establishing the specifics of its predominant objective, as well as other secondary objectives (if any). In addition, if there are multiple secondary objectives, these would be prioritised in the Statement. These would be medium-term objectives.
2. The Statement would also define what constitutes a substantial failure in achieving the objectives.
3. The Statement would be released into the public domain.

At the same time, there is a strong case for independence in making this decision. If a central bank lacks independence, it comes under pressure to cut rates in the period preceding elections. This tends to kick off increased inflation after elections. The lack of independence at a central bank is thus associated with reduced fairness in elections and enhanced macroeconomic fluctuations.

Achieving independence of a central bank requires appropriate institutional design. One key element is a *mpc* that controls all instruments of monetary policy. Such an arrangement yields improved decisions by pooling the thinking and analysis of multiple members. In addition, it reduces the extent to which the head of a central bank can be pressured to cut rates in accommodating the government. The Ministry of Finance, as a representative of the Central Government, has the right to be heard in *mpc* meetings, but it should have no voting member in the *mpc*. This would remove political and electoral considerations from the conduct of monetary policy.

The strongest form of independence, among all the agencies for which bills have been drafted by the Commission, is found with the central bank. This requires a commensurately strong accountability mechanism. Strengthening accountability, alongside enhanced independence, is a core theme of the Commission.

11.1. Objective of monetary policy

The Central Government, in consultation with the head of the central bank (referred to as Chairperson in this chapter), would determine the predominant objective of monetary policy, as well as other secondary objectives (if any) through a formal process shown in Table 11.1. The specifics of the objectives would be articulated in a Statement, which would be released into the public domain. Each objective would be a quantifiable, numerical target. Secondary objectives would be prioritised and could be pursued subject to successful delivery of the predominant objective. These would be medium-term targets. The Statement would also quantitatively define what constitutes a substantial failure in achieving these objectives.

While the Statement would be issued every two years, it is expected that the substance of the Statement would be modified only occasionally, thus giving stability to monetary policy strategy.

11.2. Powers of the central bank

In order to perform its monetary policy functions and play its role as the lender of last resort, the central bank will have the following powers:

1. *Issuance of Legal Tender Currency*: The central bank would be the sole agency authorised to issue currency.
2. *Banker to Banks*: In order to facilitate smooth inter-bank transfer of funds, or to make payments and to receive funds on their behalf, banks need a common banker.

To facilitate smooth operation of this function of banks, an arrangement needs to be in place to transfer money from one bank to another. To fulfil this function, the central bank would act as custodian of specified reserves of commercial banks and as their settlement agent.

3. *Act as banker to the government.* As a banker to the Government, the central bank would perform the same functions for the Government as a commercial bank performs for its customers. It would maintain accounts of the Government; receive deposits from, and make advances to, the Government; provide foreign exchange resources to the Government for repaying external debt or purchasing foreign goods or making other payments. This would not include debt management for the Central Government, which would be undertaken by the debt management agency.
4. *Act as custodian and manager of foreign exchange reserves:* The central bank, as custodian of the country's foreign exchange reserves, would be responsible for managing such reserves. The basic parameters of the central bank's policies for foreign exchange reserves management would be safety, liquidity and returns.
5. *Powers to manage its balance sheet:* The central bank would have the power to undertake market operations, onshore and offshore, in managing its balance sheet. This may include, but would not be limited to, buying and selling of securities, foreign currencies, gold and other precious metals.

11.3. The monetary policy process

Once the Central Government has chosen the objective of monetary policy, the monetary policy process would comprise five elements:

1. Measurement and research foundations;
2. Decisions about the instruments of monetary policy;
3. Operating procedure of monetary policy;
4. Monetary policy transmission; and
5. Accountability mechanisms.

The central bank would establish an internal organisation structure to perform the first step – the economic measurement and economic research foundations that must guide monetary policy.

The Commission recommends the establishment of an executive MPC that would meet on a fixed schedule and vote to determine the course of monetary policy.

Once the MPC has determined the policy action, the central bank would establish an operating procedure through which the operating target would be achieved.

Monetary policy influences the economy through the monetary policy transmission – the array of channels through which monetary policy instruments influence households and firms in the economy.

Finally, there are accountability mechanisms through which the central bank would be held accountable for delivering on the objectives that have been established for it.

When all these five elements work well, the central bank would be able to deliver on the goals established for it. The draft Code has focused on the second ('Decisions about the instruments of monetary policy') and the fifth ('Accountability mechanisms'), which require to be enshrined in the law. The remaining three elements – measurement and research, operating procedure, and monetary policy transmission – would take place through the management process of the central bank, with oversight of the board.

Table of Recommendations 11.2 The monetary policy committee

1. The MPC will be chaired by the Chairperson of the central bank. It will have one executive member of the board of the central bank and five external members.
 2. External members will be independent experts in the field of monetary economics and finance. These members will be appointed by the Central Government, where in case of two of these members, the appointment will be in consultation with the Chairperson.
 3. The external members will extensively engage with the organisation and have access to data (except data on individual financial firms that is related to the supervisory process), research and other office facilities. However, they will have no management or operational role within the central bank. They will not be members of the board or any of the two advisory councils (described ahead). Their only function in the central bank is to be members of the MPC.
 4. The MPC will meet periodically and vote on all instruments of monetary policy. The main briefing report of the central bank's research department to the MPC will be released to the public one day before the MPC meeting.
 5. A representative of the Central Government would participate in the MPC meetings, but would not have a vote. The representative would express the views of the Ministry of Finance and these views would be released into the public domain.
 6. Decisions of the MPC would be made on a one-person one-vote basis.
 7. Each of the seven members will also submit a rationale statement about his/her vote. With a lag of three weeks, the voting record and all seven rationale statements would be released into the public domain.
 8. The central bank Chairperson would have the power to override the MPC in exceptional circumstances. However, he/she would be required to release a rationale statement in public, explaining the reasons for disagreeing with the MPC.
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11.4. The monetary policy committee

The Commission recommends the creation of an MPC that would determine the policy interest rate. In addition to the Chairperson and one executive member of the board, the MPC would have five external members. Of these five, two would be appointed by the Central Government, in consultation with the Chairperson, while the remaining three would be appointed solely by the Central Government. These members must not be employees of the Government or the central bank or be involved in political activity. They may be permitted to hold other offices or positions during their tenure as MPC members, subject to there being no conflict of interest. In order to avoid conflict of interest, external members should: (a) be restricted from certain activities or affiliations outside the central bank – these may include restrictions on involvement in financial institutions; and (b) not have allied commercial interests that may give them unfair advantage due to access to privileged information obtained in their capacity as members of the MPC.

MPC members would have access to relevant information within the central bank, other than information about individual financial firms that is related to the supervisory process. The members would interact with the research department on an ongoing basis. This would provide the members with a complete information base required to vote on monetary policy decisions.

This arrangement, which has been adopted in the monetary policy process worldwide, has many strengths. A formal voting structure, coupled with the release of the voting record and rationale statement, ensures that each member analyses the questions and arrives at his/her own judgement; and ensures that it diminishes the extent to which an individual can dominate the MPC meeting.

Monetary policy faces a challenge in terms of the dangers of political interference, particularly in the period prior to elections. The political leadership may often try to pressure the head of the central bank, asking for accommodative monetary policy. By placing the decision clearly in the hands of the MPC, there is no one person that can be pressured. A representative of the Central Government, would participate in MPC meetings but would not have a vote.

The staff of the central bank report to the head of the central bank and face obvious conflicts of interest in voting independently. Additionally, having multiple members from one organisation raises the possibility of group-think. These concerns are addressed by having five external members on the MPC. However, ultimately it is the head of the central bank who must be held responsible for delivering on the monetary policy objectives.

The accountability mechanisms (described ahead) would ultimately rest with the head of the central bank. Hence, under extreme circumstances, the head of the central bank has the power to override the MPC. However, this would have to be accompanied by a letter to the Central Government, which would be released into the public domain, explaining why he/she feels that the MPC is exceptionally incorrect in its assessment, thus justifying an exceptional bypassing of the MPC.

Under normal conditions, monetary policy can generally be conducted using only one instrument, the control of the short-term policy rate. Occasionally, there may be a need to use other instruments, such as 'quantitative easing', or trading on the currency market, or capital controls.¹ The framework envisaged by the Commission is unified in its approach: All powers of monetary policy should be wielded in the pursuit of well defined objectives established by the Central Government, and all exercise of these powers should be done by voting at the MPC.

The structure and functioning of the MPC is summarised in Table 11.2.

11.5. Accountability

Alongside the definition of the monetary policy objectives of the central bank, the Statement of the Central Government that establishes the objective of monetary policy would clearly define what constitutes a substantial failure to achieve monetary policy objectives. If such an event should arise, the head of the central bank would have to: (a) write a document explaining the reasons for these failures; (b) propose a programme of action; (c) demonstrate how this programme addresses the problems that have hindered the achievement of the target(s); and (d) specify a time horizon over which the MPC expects the target to be achieved.

A further check is envisaged in the form of a reserve power granted to the Central Government to issue directions to the central bank on issues of monetary policy under certain extreme circumstances. Given the drastic nature of this power, any direction under this power must be approved by both Houses of Parliament and can be in force only for a period of three months. Such direction may be issued in consultation with the head of the central bank.

11.6. Institutional structure

11.6.1. Board of the central bank

The board of the central bank would oversee the functioning of: (a) monetary policy; (b) micro-prudential and consumer protection functions for banking; and (c) micro-prudential and consumer protection functions for payments. The Chairperson and the board would ultimately be responsible for continually reforming the organisation so as to deliver on its objectives as defined in the draft Code. Decision-making about organisational and institutional arrangements would take place at the board.

¹The Commission envisages that the central bank will frame regulations on outbound capital flows, in consultation with the Government.

Table of Recommendations 11.3 Board of the central bank

1. The board of the central bank would have up to 12 members; the number of executive members should not exceed 50 percent.
 2. One of the executive members will be the Chairperson of the Bank (who would be the chair of the board).
 3. One executive member will function as the administrative law member.
 4. There would also be nominee members of the Central Government.
 5. In the exercise of micro-prudential and consumer protection functions, all regulations would be issued by the board.
 6. The board would oversee the functions of the central bank and have overall control of its organisation structure. It would continually work towards refashioning the organisation so as to best achieve its goals.
 7. The board would be assisted by two advisory councils, in the fields of banking and payments.
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Table of Recommendations 11.4 Functioning of the advisory councils for consumer protection and micro-prudential regulation in banking and payments

1. In the regulation-making process, all information associated with a proposed regulation would be placed before the advisory councils, which would draft a memo with its views on the proposed regulation. This memo would be presented to the board of the central bank.
 2. Each advisory council would submit a report every year, taking stock of progress in their respective fields and making specific recommendations for reform. The reports would be presented to the board of the central bank for decisions and be released to the public.
 3. Each council would periodically originate memos on current policy issues that would be presented to the central bank board for decisions and released to the public.
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While the board would not be involved in monetary policy decisions, it would, however, watch the extent to which the objectives of monetary policy (as formulated by the Central Government) are being achieved. The structure of the board, proposed by the Commission, reflects these three functions, and is shown in Table 11.3.

11.6.2. Advisory councils for banking and payments

The provisions on regulatory governance in the draft Code envisioned by the Commission involves a well-structured regulation-making process. When this process is completed, each proposed regulation would contain a draft regulation, the associated cost-benefit analysis, the comments received from the public, and the substantive response to each of them. Such information would be placed before the advisory councils and they would issue a statement containing their opinion on draft regulations. In addition, the two advisory councils would publish a report each year, highlighting new developments and areas of concern in their respective fields. The functioning of the two advisory councils for banking and payments is summarised in Table 11.4.

11.7. Temporary Liquidity Assistance

The central bank would operate mechanisms through which liquidity assistance is potentially available to financial service providers, against adequate collateral, to tide over temporary liquidity shortages, or technical payment problems that may hamper smooth functioning of the financial system. This would involve a distinction between 'standing facilities', which are oriented towards resolving problems in payments systems, and 'emergency lending assistance', which are somewhat longer term. These processes would involve mechanisms for co-ordination between the central bank and other regulatory agencies. The central bank would issue regulations to determine rules of collateral and the overall rules governing the lending.

Since this facility is intended to provide short-term liquidity support to financial service providers and not meant to be used as a replacement for funding day-to-day oper-

ations, the price structure should be such that the borrowing entity would prefer to first seek regular funding from the market.

The identity of the borrowing entity would be revealed to the public only after an appropriate lag, while the total amount lent through this facility should be part of the daily reporting requirements.

Public debt management

12.1. An independent public debt management agency

In India today, some functions of public debt management are divided between the Central Government and the RBI. The RBI manages the market borrowing programme of Central and State Governments. External debt is managed directly by the Central Government. However, some functions that are crucial to managing public debt are not carried out at present. For instance, no agency undertakes cash and investment management, and information relating to contingent and other liabilities is not consolidated. Most importantly, there is no comprehensive picture of the liabilities of the Central Government, which impedes informed decision making regarding both domestic and foreign borrowing.

For roughly two decades, the solution that has been proposed in order to address this problem has been a specialised agency that manages the liabilities of the Central Government in a holistic manner. Public debt is increasingly obtained from private lenders, including both domestic and foreign entities. Under these conditions, the management of Government liabilities can grow in infinitely complex ways that could only be tackled by a specialised agency.

A number of reports dealing with the issue of reform of public debt management, notably the REPORT OF THE INTERNAL WORKING GROUP ON DEBT MANAGEMENT (2008), have highlighted this gap in Indian financial sector regulation, and have argued for the creation of an independent public debt management office. The Commission also believes that there are other institutional benefits in avoiding conflicting roles for the RBI.

The Commission has considered the views of the RBI in this regard. The RBI believes that "to achieve public policy objectives of ensuring growth, price stability and financial stability, co-ordination between monetary policy, fiscal policy and sovereign debt management is critical". In the Commission's formulation, the management of public debt will not be carried out in isolation of an understanding between monetary policy and fiscal policy. This is addressed through the governance arrangements that the Commission recommends for the public debt management agency, where the RBI and the Central Government have a presence and a voice in the agency's deliberations (see Table 12.2).

Drawing on the consensus of expert committees of the last 20 years, the Commission recommends fast-tracking the setting up of an independent public debt management agency. In this regard, the RBI has put forth the view that "the expert committees that have recommended an independent public debt management agency have made

fiscal consolidation an essential pre-condition⁴ for creating such an agency. However, the Commission is of the view that such a pre-condition is not stated as a requisite in most of the expert committee reports that have recommended an independent public debt management agency, with the REPORT OF THE INTERNAL WORKING GROUP ON DEBT MANAGEMENT being a case in point.

The Commission believes that the main benefit of an independent public debt management agency will come through the integration of public debt management functions and various databases and information, which are currently dispersed. By unifying the public debt management function, and efficiently linking it with the cash and the investment management functions, there will be improved information, analysis and thus decision making. With specialised human resources at its disposal, the public debt management agency can contribute to a more effective interface with the market resulting in cost-efficient management of Government borrowings. A specialised, unified and independent agency will have significant comparative advantage over the existing structure of a fractured and unco-ordinated Government borrowing programme spread across various agencies.

The Commission's views on public debt management and the creation of the public debt management agency draws significantly from the deliberations of the Working Group on Public Debt Management (see Annex 19.9).

12.2. Structure of the public debt management agency

The governance and operations of the public debt management agency would be handled through a two-tiered arrangement. At the top, there would be an advisory council, comprising of experts in finance, law, and public debt management. The advisory council must advise and issue opinions on any matter related to the objectives and functions of the public debt management agency that is referred to it by the agency or the Central Government. It must also advise and provide its opinion on the financing plans submitted by the public debt management agency to the Central Government, as well as the agency's annual report, whenever such opinion is sought. The council must meet periodically to review and ratify the borrowing programme for the upcoming months.

The advisory council must issue its opinion by way of a consensus decision. Enforcing a consensus requirement is also a way of ensuring that there is co-ordination between the members of the council. Ideally, the chairperson of the council must be obliged to seek consensus from all members. When no consensus is possible, the council would resort to voting procedures. In such a scenario, opinions of individual dissenting members should be documented and placed on record. The functioning of the advisory council must follow standard governance practices as regards appointments, vacancies, meeting procedures, terms and conditions of appointment, resignation and future employment.

As its title suggests, the advisory council would have no executive control over the day to day management of the public debt management agency. The supervision and control over daily operations and management would vest in the hands of a management committee within the public debt management agency. The composition of the management committee would be similar to that of the advisory council, except that advisory council members would be senior in rank to those of the management committee.

This management committee must exercise general superintendence over, and manage the administration and business of, the public debt management agency. The roles and procedures followed by the committee must follow standard governance practices. The appointment of the chief executive of the public debt management agency should be open and transparent. The management committee should meet more frequently than the advisory council, and take operational decisions, which affect the daily affairs

of the public debt management agency. Table 12.1 and Table 12.2 establish the essential structure of the public debt management agency.

Table of Recommendations 12.1 An independent debt management agency

The draft Code creates a specialised statutory public debt management agency that is equipped to manage the liabilities of the Government, in a holistic manner. It will have a two-tiered arrangement as follows:

1. The public debt management agency will be guided by an advisory council and run by a management committee.
 2. The composition of the advisory council and management committee will be broadly similar, with representation from the RBI and the Central Government. The management committee should be headed by the chief executive of the agency, and the advisory council should be headed by an independent chairperson (see Table 12.2).
 3. The public debt management agency should function with independent goals and objectives. However, it remains an agent of the Central Government, to which it will be accountable for its actions and results.
 4. There should be regular and frequent consultation and co-ordination with the Central Government and the RBI, to ensure that all views are taken on record, and there is co-ordination between fiscal policy, monetary policy and public debt management. In part, this will also be achieved through the management committee and advisory council, where both the Central Government and the RBI have representation.
 5. The management committee will seek the opinion of the advisory council in matters of strategy and policy.
 6. The advisory council must provide opinions on any matters that are referred to it. It may also make recommendations, of its own accord, on any activities of the public debt management agency it finds relevant.
 7. The principles of governance, including transparency and accountability, will apply to all functions of the public debt management agency, its committee and council.
 8. The public debt management agency should be lean on staffing, and should have the power to decide staff salaries, and outsource a majority of its non-core activities.
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The public debt management agency should be a lean organisation, with limited staff on its rolls. A larger number of employees may be more challenging to handle, and may affect the organisation's performance. The public debt management agency must also have the authority to recruit staff with specialised skills on the sovereign bond market. Therefore, both selection processes and salary structures must be within the control of the agency itself. All non-core responsibilities should be outsourced to appropriate service providers, and the expertise and functions present within the agency should be limited and focused on the narrow mandate of the organisation.

Table of Recommendations 12.2 The composition of the advisory council and management committee

The composition of the management committee will be as follows:

1. the chief executive of the public debt management agency as its chairperson;
2. a nominee of the Central Government as member;
3. a nominee of the RBI as member;
4. a nominee of the State Governments, only if the agency borrows on behalf of any of them; and
5. experts as members.

In case the agency borrows on behalf of one State Government, such Government would nominate its officer as member. If the agency borrows on behalf of more than one State Government, one of such Governments would nominate that officer as member.

The composition of the advisory council will be as follows:

1. a chairperson;
2. a nominee of the Central Government higher than the rank of its nominee in the management committee;
3. a nominee of the RBI higher than the rank of its nominee in the management committee;
4. experts; and
5. the chief executive of the agency.

With the exception of the chief executive of the agency, the members of the advisory council cannot be the same as the members of the management committee.

Table of Recommendations 12.3 Operationalising agency role with independent objectives

The combination of being an agency with independent objectives and agent of Government has operational implications of the following nature:

1. While the public debt management agency will always act on instructions from the Central Government, the draft Code should allow it to have the discretion to decide on the details of how it implements these instructions in accordance with its objectives.
2. Throughout the process of implementing the instructions it receives, the public debt management agency must ensure that the objectives are met.
3. If, however, the instructions do not enable its objectives to be met, the public debt management agency must have the opportunity to place its objections to the instructions on record.
4. This should be done through mandating a regular consultation and feedback process between the agency and the Central Government, which should take place throughout the agency's exercise of its functions.
5. When issuing instructions, the Central Government must be obliged to consider the views of the public debt management agency, and would have full knowledge of the objectives of the agency as laid down in the draft Code.
6. If there is a disagreement between the two, the public debt management agency would be statutorily bound to meet the instructions, but through the consultation and feedback process, it would have placed on record its inability to meet its objective.
7. The accountability mechanism – routed through the Central Government and eventually to Parliament – would take into consideration all the efforts made by the public debt management agency with regard to achieving its objective, and the objections, if any, it would have already placed on record to this effect.

Table of Recommendations 12.4 Objectives of the public debt management agency

Table 12.1 states that the draft Code must create a public debt management agency that functions with independent goals and objectives, while remaining an agent of the Central Government. Accordingly, the draft Code charges the public debt management agency with the objective of *minimising the cost of raising and servicing public debt over the long-term within an acceptable level of risk at all times*. This will guide all of its key functions, which include managing the public debt, cash and contingent liabilities of Central Government, and related activities.

12.3. Objectives and functions of the public debt management agency

Table 12.4 sets out the objectives of the public debt management agency. It is important to recognise the tension between the short-term and the long-term. A public debt manager can always obtain gains in the short run through tactical decisions which appear to be expedient or immediately yield gains of a few basis points. But these tactics could well be damaging in the long run, if they reduce the confidence of market participants. Hence, the objective of the public debt management agency must be clearly defined in the draft Code as undertaking those actions which minimise the cost of borrowing of the Government in the long run. This should rule out an array of short-sighted tactical actions, such as exploiting informational asymmetry against market participants, exploiting regulatory constraints faced by market participants, and so on.

The key functions of the public debt management agency would be to undertake public debt and cash management for the Central Government. In addition to these, the various functions of the public debt management agency include the management of contingent liabilities, research and information, and the fostering of a liquid and efficient market for Government securities. These functions are summarised in Table 12.5.

12.3.1. Public debt management

The public debt management agency should advise the Central Government on the composition of debt instruments including the proportion of domestic to foreign debt instruments, alongside a thorough debt-sustainability analysis. Given the rising fiscal needs of

State Governments, the public debt management agency should co-ordinate the Central Government borrowing calendar with the borrowings of State Governments to ensure that the auctions of new issues are appropriately spaced.

The operations of the public debt management agency should also keep in mind investor preferences and the ultimate objective of public debt management, i.e., to meet the financial needs of the Central Government in an efficient manner over the long run. However, the final decision will rest with the Central Government. Once the Central Government has made decisions on the key questions, its remit would be executed by the public debt management agency.

Over the medium-term, the public debt management agency's focus is likely to shift towards building voluntary demand for Indian Government paper. It may consider a range of alternatives such as issuing inflation-indexed bonds or issuing in foreign currency, aiming to establish mechanisms that help address market concerns regarding inflation, exchange rate and credit risk, so as to minimise the interest cost paid by the Central Government in the long run.

As things stand today, external debt includes loans received from foreign Governments and multilateral institutions. The foreign currency borrowing of the Central Government takes place through multilateral and bilateral agencies. There is no direct borrowing from international capital markets. Further, State Governments cannot directly borrow from abroad and have to go through the Central Government as the sovereign risk is borne by the latter. Considering all these, both internal and external debt should fall under the scope of the public debt management agency.

Wherever feasible, the public debt management agency should establish limits for various categories of risk and overall risk. It must also seek to insure against these risks inherent in its portfolio. It should also develop a framework that helps identify the risks in the portfolio more efficiently, such as those associated with public debt management operations, refinancing, contingent liabilities, impact of sovereign credit ratings issued by credit rating agencies and global and domestic business cycle risks. It should also co-ordinate with the fiscal and monetary policy functions, and actively engage with credit rating agencies and the private sector and build relationships with market participants.

12.3.2. Cash management

The Central Government has been consistently running large fiscal deficit over the years. In this situation, cash surpluses do not arise except for very short periods of time, due to temporary mismatches between receipts and expenditures within a given financial year. However, the public debt management agency should be tasked with the function of managing and investing surplus cash of the Central Government whenever such a situation arises in future.

There is also a need for the efficient management of cash balances across various departments and ministries of the Central Government. Currently, a large part of the funds received by the various departments and ministries of the Central Government are held as surplus cash. This results in inefficient cash management for the Central Government as a whole. This is because the Central Government might be required to borrow in the market in a deficit situation even while some of its ministries hold on to surplus balances.

The cash balance position of the Central Government is also closely linked to the balances of State Governments, since the latter temporarily place surpluses with the Central Government. The frictional factors that contribute to the unintended liquidity crunch from time to time can be avoided if better cash management practices are introduced by both Central and State Governments in harmony with their public debt management practices.

Therefore, the public debt management agency should also carry out cash management, with a particular focus on its two main components – cash forecasting and cash balancing. Cash forecasting involves participating actively in the forecasting of expenditure and revenue, including long-term annual or half-yearly forecasts and the short-term monthly, fortnightly, weekly or even daily internal forecasts. It also means integrating forecasts of receipts and payments with other information on cash flows, notably those generated by financing decisions – bond issuance and servicing and by the cash manager's own transactions.

Cash balancing involves co-ordinating the matching of day-to-day expenses and revenues. This includes maintaining a regular channel of communication with the Central Government's banker (i.e., RB) to estimate end-of-day balances. It also requires implementing a remit from the Ministry of Finance regarding managing idle balances. In certain situations, this might also involve management of permanent or structural cash surpluses.

The public debt management agency should also maintain a database (or have access to the database created by the Ministry of Finance for this purpose) of the actual cash balances and the liquidity requirements of various departments and ministries of the Central Government, including forecasts of spending and revenue patterns that gets updated frequently.

12.3.3. Contingent liabilities

Contingent liabilities may be either explicit or implicit, and may be issued by either the Central or State Governments. There are close interconnections between contingent liabilities and debt issuance. The invoking of guarantees can have a substantial impact on the risk assessment of the public debt structure of the Central Government. The Commission is of the view that the public debt management agency must manage and execute implicit and explicit contingent liabilities. It must evaluate the potential risk of these contingent liabilities and advise the Central Government on charging appropriate fees. In addition, the Government should be required to seek the public debt management agency's advice before issuing any fresh guarantees since this has implications for the overall stability of the public debt portfolio.

The realisation of contingent liabilities is counter-cyclical, and adds to the financial burden of the Central Government especially at a time when it is in a crisis situation. Given this, the public debt management agency should advise the Central Government on making provisions for contingent credit lines with bilateral and multi-lateral agreements and establish similar credit lines with international agencies.

The management of contingent liabilities is a specialised function that involves undertaking the risk assessment of clients. Therefore, the public debt management agency should be allowed to contract out in part or in entirety the management of contingent liabilities to outside agencies if it so chooses.

12.3.4. Research and information

The public debt management agency must adopt a holistic approach that encompasses the entire liability structure of the Central Government. This includes not just marketable debt but also contractual liabilities from public accounts (such as small savings, provident fund receipts) and any other internal liabilities. While these liabilities are part of public accounts and not a part of consolidated funds, they influence the cost of raising debt and provide indirect support to the Governments.

It is also useful for the public debt management agency to maintain a comprehensive database of State Government debt, including information on Consolidated Funds

Table of Recommendations 12.5 Functions of the public debt management agency

1. *Managing public debt:*
 - ▶ The public debt management agency must design and recommend an annual calendar for the Central Government to manage its public debt;
 - ▶ The calendar will advise on all aspects of the composition of the borrowing and repayment of public debt;
 - ▶ This must be designed in consultation with Central Government and other key stake-holders;
 - ▶ The public debt management agency will eventually act on instructions received from the Central Government, but they must be empowered to make recommendations, even on a daily basis, if necessary; and
 - ▶ To ensure that there is an integrated approach to debt management, the public debt management agency must also manage the external debt for the Central Government.
2. *Cash management:*
 - ▶ The public debt management agency must co-ordinate with the departments, ministries and agencies of the Central Government and so, to estimate, monitor and manage daily cash balances. It must advise Government on measures to promote efficient cash management practices and to deal with surpluses and deficits.
3. *Contingent liabilities:*
 - ▶ The public debt management agency must manage and execute implicit and explicit contingent liabilities;
 - ▶ It must evaluate the potential risk of these contingent liabilities and advise the Central Government on changing appropriate fees; and
 - ▶ The Central Government must seek the public debt management agency's advice before issuing any fresh guarantees since this affects the overall stability of the public debt portfolio.
4. *Research and information:* The public debt management agency must have a view of the entire liability structure of the Central Government. Accordingly, it must develop, maintain and manage information systems, disseminate information and data; and conduct and foster research relating to its functions.
5. *Fostering the market for Government securities:* A liquid and efficient Government bond market enables low-cost financing in the long run. Hence, the public debt management agency must take steps to foster a liquid and efficient market for Government securities, including advising the regulators and the Central Government on the policy and design of the market. In this role, the public debt management agency must work towards:
 - ▶ Growth and diversification of investors and intermediaries;
 - ▶ Fair play;
 - ▶ Competition in intermediation;
 - ▶ Cost-minimising mechanisms for issuance and trading; and
 - ▶ Measurement of liquidity and market efficiency, and presentation of an annual report on the progress of the Government of India sovereign bond market.

of States, public accounts of States, Contingency Funds of States and any additional explicit or implicit guarantees and contingent liabilities not covered in these accounts.

The public debt management agency must, therefore, develop, maintain and manage information systems, disseminate information and data. It must release comprehensive transaction-level data, and actively foster academic research in the public domain. Beyond merely collating and disseminating data, the public debt management agency must identify gaps in existing sources of data and work with public and private institutions to fill them. Where necessary and relevant, it must synthesise data for market participants. The public debt management agency must also regularly collect and disseminate data and information on its own performance and operations.

12.3.5. Fostering the market for Government securities

Fostering a liquid and efficient market for Government securities should be an integral function of the public debt management agency given the importance of a well-functioning securities market in carrying out its primary functions of debt and cash management. This becomes all the more important as the market for Government securities has not as yet substantially developed in India.

The function of developing the Government securities market should not be con-

Table of Recommendations 12.6 Scope of the public debt management agency

There are limitations on the public debt management agency's functions, particularly in expanding it to States, as the management of State debt is a State subject under the Constitution of India. Accordingly, the draft Code must provide for the following:

1. While the public debt management agency acts as a Central Government agency obliged to manage only Central Government debt, it must undertake those functions related to State Government debt, which have implications for the Central Government's debt portfolio.
 2. This involves maintaining a comprehensive database of State Government debt and co-ordinating the Central Government's borrowing calendar with the market borrowings of State Governments.
 3. However, the public debt management agency may provide the option to the States of managing their public debt, subject to the State Governments entering into agreements with the agency to this effect.
 4. Additionally, the public debt management agency should be empowered to offer technical assistance to State Governments to set up their own debt management offices.
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fused with financial regulation. The functions of consumer protection and micro-prudential regulation, for the Government securities market, do not rest with the public debt management agency. However, as a specialised body that understands the market for Government securities, the public debt management agency should be an important voice on legal and institutional reforms that are necessary to achieve its objectives.

Going beyond this, public debt management agency must run a continuous effort of measuring market efficiency and liquidity, and asking how these can be improved, so as to cater to the goal of achieving low-cost financing for the Central Government in the long run. It must undertake initiatives to continually broaden access and participation in the market for bonds issued by the Indian Government, in terms of both investors and financial intermediaries, since this would yield improved market efficiency and liquidity.

12.4. Scope

Imposing the services of the public debt management agency on State Governments is not possible since the management of State debt is a State subject under the Constitution. The public debt management agency must be a Central Government agency obliged to manage only Central Government debt. It must, however, undertake functions related to State Government debt, which have implications for the Central Government's debt portfolio. This involves maintaining a comprehensive database of State Government debt and co-ordinating the Central Government's borrowing calendar with State Governments' market borrowings. However, at a later stage, the public debt management agency may provide the option to the States of managing their public debt (see Table 12.6), subject to the State Governments entering into agreements with the agency to this effect. This will not oblige State Governments to deal with the public debt management agency, as State Governments will also be able to enter into similar agreements with any entity offering such services for managing their public debt. Additionally, the Commission recommends that the public debt management agency should be empowered to offer technical assistance to State Governments to set up their own debt management offices.

Foundations of contracts and property

13.1. The interaction of financial laws with other laws

Financial laws do not operate in a vacuum. They interact with other laws in numerous ways. The Commission recognises that managing the interactions of the financial sector laws and regulations with other areas of law is of great significance. In this chapter the Commission addresses the following issues of interaction of financial laws and their operation in the financial markets:

1. **Interaction with other laws:** For the operation of financial markets and services, certain modification of the applicability of general laws of contracts, property and corporations are required. Some examples of these are the good faith principle in insurance, legal certainty of derivatives, requirement of corporations to make disclosures for publicly traded securities. Public policy concerns, and the regulatory stance, need to be unified for a broad array of traded securities in contrast with the present sectoral laws.
2. **Infrastructure Institutions:** Financial markets and services operate on a special set of institutions like exchanges, clearing houses, depositories, trade repositories, etc. Regulations governing these institutions, and the actions of these institutions, are integral to achieving objectives of consumer protection, micro-prudential regulation, systemic risk, and competition policy. In addition, a unique feature of some infrastructure institutions lies in the production of information that has a public goods character. This calls for transparency-enhancing measures and blocking market abuse.
3. **Special provisions for Infrastructure institutions:** Financial market institutions also require certain levels of protection from the operation of normal legal principles of areas of laws like evidence, property, bankruptcy, etc. These are mainly related to the certainty of the transactions carried out by financial parties on these institutions. For example, settlements carried out in a clearing house cannot be undone when a participant goes bankrupt.
4. **Public issue and trade of securities:** Issuing of securities to the larger public requires financial laws to govern entities outside the financial sector with respect to the securities they have issued. The objective of these regulations is not to regulate non-financial firms but to ensure that obligations incorporated in the securities created by them are fairly applied and the financial markets have adequate information about these non-financial entities which have issued the securities to make informed decisions about investments in such securities.
5. **Issues pertaining to the market abuse:** Financial markets operate based on the information generated by the issuers of securities and the integrity of transactions and information of infrastructure institutions. This requires the law to criminalise actions which undermine the integrity and fairness of trading of securities.

As they do not fit within the standard system of consumer protection and prudential regulation, the Commission has decided to consolidate its recommendations with respect to these issues in this chapter.

13.2. Principles relating to certain contracts

The financial sector requires modification of general principles of laws. These pertain mainly to:

1. Insurance laws where certain legal principles presently used are required to be legislated to provide greater clarity.
2. Securities laws where legal enforceability and contractual obligations are required to be protected.

13.2.1. Insurance

Insurance principles are governed by various principles of case law along with statute. The Commission examined these positions as a part of its comprehensive review of India's financial law. The Commission recommends legislative clarifications in the following areas to ensure the smooth functioning of insurance contracts.

1. The term 'contract of insurance' has been used in the Insurance Act, 1938 in the definitions of life insurance, general insurance, fire insurance, marine insurance and miscellaneous insurance businesses but the term 'contract of insurance' is not defined in any legislation.
2. Insurance contracts are governed by the principle of *uberrimae fidei*, where all parties to an insurance contract must deal in good faith, making a full declaration of all material facts in a given insurance proposal. In addition to the insurer's obligation to the insured consumer under the consumer protection laws, the Commission recommends that the law must require the insured to disclose all material facts to the insurer.
3. There is no specific statutory requirement to have an insurable interest to enforce insurance contracts (other than marine insurance contracts) though courts have always treated the presence of such an interest as a prerequisite for enforcing the same. The Commission recommends that primary law should not require an insurable interest at the time of entering into an insurance contract though the regulator should have the authority to require an insurable interest for certain types of insurance contracts through regulations.
4. Currently, Section 38 of the Insurance Act of 1938 does not allow insurers the option to refuse an assignment of life insurance policies. The Insurance (Amendment) Bill, 2009 proposes that an insurer may refuse an assignment if it finds that such an assignment is not *bona fide* and not in the interest of the policy holder or the public interest. The Commission recommends that the regulator should have the power to specify the types of permitted assignments and restricted assignments of insurance policies, though insurers should not have the discretion to refuse any assignment.
5. Currently, if an insurance policy matures the options available to a policyholder upon the lapse of a policy, no further notice needs to be given to the policyholder. The Commission recommends that insurers should serve notice to the policyholders in the event a policy lapses for non-payment of premium. Policyholders should be informed of the consequences of a lapse in the policy and the options available to them in the event of such lapse.
6. In indemnity insurance contracts, the law of subrogation, where an insurance company tries to recoup payments for claims made which another party should have been responsible for paying, is governed by case law. The Commission recommends that the law of subrogation be clearly defined in statute, drawing from directions provided by the Supreme Court in relevant case law.

Table 13.1 offers a brief summary of the specific recommendations of the Commission pertaining to the principles of insurance contracts.

Table of Recommendations 13.1 Insurance contracts

With respect to insurance law, the Commission recommends:

1. Consumers must have a duty of good faith obligation towards the insurer;
 2. The regulator should be able to make an insurable interest mandatory for only specified types of insurance contracts;
 3. The law should allow free assignment of insurance contracts subject to anti-fraud restrictions placed by the regulator;
 4. Adequate consumer protection regulation should be placed in the law requiring notice of impending default of insurance contracts due to non-payment of premium; and
 5. The duties of the insured and the insurer in the various events arising out of subrogation must be clearly stated in law, in accordance with relevant Supreme Court rulings.
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Table of Recommendations 13.2 Defining securities

To define securities, the Commission recommends:

1. Securities must be defined in two parts;
 2. The first part is the test of a freely transferable financial interest;
 3. The second part is an illustrative list of securities;
 4. The government should be allowed to add more securities to the illustrative list and financial markets develop and the innovation creates new securities.
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13.2.2. Securities

Defining what constitutes securities has been a challenge in many jurisdictions. The Commission found that the test depends on the free transferability of the instrument which leads to the creation of markets. Table 13.2 provides the recommendations of the Commission on defining securities.

Financial derivatives contracts are transactions, where parties agree that one party will pay the other a sum determined by the outcome of an underlying financial event such as an asset price, interest rate, currency exchange ratio or credit rating. Such contracts help in raising and allocating capital as well as in shifting and managing risks. Derivative contracts may be exchange traded or non-exchange traded, the latter being referred to as OTC. They may be standardised or non-standardised.

At the moment, there are certain complexities in enforcing derivative contracts. Section 30 of the Indian Contract Act, 1872 renders all wagering contracts void. Financial derivatives may be rendered unenforceable because of this provision. Exceptions to this rule have therefore been carved out through special legal provisions. Section 18A of the Securities Contracts (Regulations) Act, 1956 and Chapter III-D of the Reserve Bank of India Act, 1934 (introduced by the RBI Amendment Act, 2006) are examples of such special provisions. The Commission is of the view that for legal certainty in the enforceability of financial derivatives, an exception to the general application of section 30 of the Indian Contract Act, 1872 must be clearly specified in the law in a more general way.

The Commission has reviewed the question of requiring central clearing of OTC derivatives. Internationally, after the financial crisis in 2008, there has been a marked shift in favour of centrally cleared OTC derivative trading. In light of the positions taken by the G-20, both the European Union and the United States (US) have moved towards a regulatory framework for OTC derivatives trading that encourages central clearance. The Commission recommends that the regulator should have sufficient discretion to authorise such a position as and when required.

The Commission also reviewed the issue of inheritance of securities and other financial products. It found that the issues of inheritance should not create undue burdens on intermediaries who hold securities on behalf of the deceased. For example, property

Table of Recommendations 13.3 Exemption for derivative contracts

1. Notwithstanding section 30 of the Contract Act, 1872, a derivative contract is enforceable if it is exchange traded or entered into between sophisticated counterparties.
 2. If a financial service firm is able to prove that it transferred any security, deposit or obligation to a legally recognised nominee or to an executor or liquidator, it should be immune from being made a party to any dispute about the inheritance or bankruptcy of a person.
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disputes over securities should not involve the depository where a deceased person had kept securities. Similar issues are found in bank accounts and insurance contracts. This requires the laws to create a clear 'safe-harbour' for financial service firms as long as they transfer the securities to a nominee, or a court appointed executor/liquidator. The Commission states that this does not change any substantive provision in the inheritance laws of any person but merely clarifies the duties of financial firms in specified event.

The detailed recommendations of the Commission on securities are summarised in Table 13.3.

13.3. Infrastructure Institutions

There are certain activities associated with organised financial trading which are unique and different from the usual activities rendered by any other financial service provider in the financial market.

13.3.1. Different types of Infrastructure Institutions

Infrastructure institutions are a product of the historical development of the financial sector markets. As use of technology and complexity of the financial sector increases, new types of infrastructure institutions will develop within the financial sector. The Commission reviewed the requirement for designation as infrastructure institutions and listed the following activities in the financial sector at present:

1. *Multilateral Payment Clearing System*: which is a mechanism to transfer value between a payer and a beneficiary by which the payer discharges the payment obligations to the beneficiary. Payments enable two-way flows of payments in exchange for goods and services in the economy;
2. *Exchanges*: Exchanges are organisations which allow a number of parties to trade securities amongst themselves. They create rules for trading, monitor parties to prevent abuse, ensure declaration of relevant information, keep record of transactions and manage risks arising out of the transactions;
3. *Clearing and settlement*: Clearing is the calculation of the obligations of counterparties to make deliveries or make payments on the settlement date. The final transfer of securities (delivery) in exchange for the final transfer of funds (payment) in order to settle the obligations is referred to as settlement. Once delivery and payment are completed, the settlement is complete;
4. *Title storage*: Securities be kept in physical or dematerialised form. Securities accounts are maintained to reduce the costs and risks associated with the safekeeping and transfer of securities;
5. *Counter party default management*: The risk that the counter party to a financial transaction may default on its promise and thereby jeopardise the entire transaction is minimised by imposing a Central Counter Party (CCP). This CCP acts as a buyer to the seller and a seller to the buyer only for the purpose of settlement;

6. *Storage of transaction data:* The last financial crisis has highlighted the interconnected nature of finance. When a financial market player fails, the unmet obligations to other parties may spread risk across the financial system. While it is not possible to move all transactions to an exchange, trade repositories for OTC transactions have become an important infrastructure system to monitor risks during normal times and improve interventions in times of emergency.

The Commission recommends that the Government be provided with the power to add more services to the list of Infrastructure Institutions.

13.4. Regulatory issues of Infrastructure Institutions

The Commission found that the regulation of infrastructure Institutions requires the regulator to address the following six primary issues about their functioning.

1. An infrastructure institution must be governed in a manner which is compliant with the principles of prudential regulation;
2. An infrastructure institution must also protect the interests of the persons using its services in compliance with the principles of consumer protection;
3. Infrastructure institutions are usually systemically important as they connect other financial service providers and therefore systemic risk concerns require to be addressed;
4. Infrastructure institutions sometimes enjoy considerable market influence as they provide 'infrastructure' services to all players and this requires the regulator to ensure that this market influence is not used to discriminate between users;
5. Certain infrastructure institutions produce information which is used by the larger economy. The release and integrity of the information needs to be maintained;
6. Certain infrastructure institutions should be obliged to track market abuse and enforce against it, without diluting the requirement upon the regulator for this purpose.

The Commission recommends that infrastructure institutions be obliged to pursue these six objectives alongside the regulators. Regulators must have oversight over this rule-making process and ensure that rules are made by infrastructure institutions that are consonant with the above six objectives of regulators.

13.4.1. Prudential regulation

The general micro-prudential law mandates the regulator to monitor the promises made by financial firms in the securities sector. The Infrastructure Institutions make important promises to the consumers like delivering securities at an agreed price, keeping record of ownership, transferring money for financial and non-financial activities and extinguishing claims. The failure to keep these promises will have repercussions upon consumers and the financial system at large. Hence, regulators must enforce prudential regulation requirements upon infrastructure Institutions.

13.4.2. Consumer protection law

While infrastructure institutions may themselves not directly deal with consumers, financial service providers usually act as intermediaries between such institutions and retail consumers. This requires that regulators ensure that Infrastructure Institutions apply the principles of consumer protection law. These principles will operate in a number of ways to protect the interests of the consumer:

1. it will require the market design, that is embedded in the rules created by infrastructure institutions, to be fair to consumers;
2. it will require securities advisers to judge the appropriateness of the security to the needs of the retail consumer; and

- It will require sellers of securities to provide adequate information about the securities being sold and the terms and conditions of the security to retail consumers.

13.4.3. Systemic risk

Infrastructure institutions are usually systemically important financial institutions. Their failure has negative consequence on the entire financial system due to the connection services they provide between financial service providers. The rules made by infrastructure institutions must thus pursue high levels of safety, and regulators must monitor such institutions from this perspective.

13.4.4. Monopoly abuse

Contracting has taken place for millennia without the intervention of these infrastructure institutions. The economic purpose of such institutions may be classified into two parts. The first is that of *reduced cost in contracting*. The search cost for a counterparty goes down by going to an exchange. Standardisation of processes is essential for the use of electronics in securities trading, settlement, and payments.

The market power that infrastructure institutions enjoy are amenable to abuse. This may arise in areas like refusing to list securities, preventing access to connections or preventing access on neutral terms. Hence the regulator has to monitor the terms on which the infrastructure institution operates. An essential element of this is the requirement that all infrastructure institutions operate on predetermined rules which are approved by the regulator so that there is no arbitrary treatment of any party accessing the services.

13.4.5. Information as a public good

The information produced by infrastructure institutions has wide ramifications for the market economy. The prices of securities are utilised by the wider economy as a vital input for making decisions about resource allocation. Hence, infrastructure institutions should be required to release high quality information that will support such applications.

13.4.6. Market abuse supervision

Information produced by infrastructure institutions is vital to the functioning of the financial system. It is also an input into decision making across the economy. When this information is incorrect, it reduces the quality of decision-making across the economy, often involving persons who are not direct participants in the financial markets. Hence, regulators and infrastructure institutions must undertake initiatives that ensure the integrity of this information. This requires blocking market abuse.

Further, infrastructure institutions are at the front-line of supervision on the problems of market abuse. While the prime responsibility for enforcement against market abuse lies with regulators, the front-line tasks of watching markets and conducting the early stages of an investigation lie with infrastructure institutions. In the modern environment with high-speed computerised trading and complex trading strategies, infrastructure institutions are required to build sophisticated supervisory staff of a kind that is not easily assembled in governmental agencies.

Product development at infrastructure institutions will often lead to innovative new products being developed. While this is desirable, such institutions will also be required to build the commensurate supervisory capacity to understand and detect abuse in tracking billions of transactions in fast-paced information technology systems. The regulatory

Table of Recommendations 13.4 Depositories

The Commission recommends:

- ▶ Allowing depositories to store securities, including Government securities and records of other financial services in electronic format only;
 - ▶ Recognising the title of the consumer and the custody of the depository from such electronic records;
 - ▶ Allowing depositories to make records of pledge or hypothecation which are legally recognised; and
 - ▶ Allowing depositories to communicate with trading platforms and making changes to records accordingly.
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structure in this field consists of regulators focusing on the goal of market integrity and ensuring that infrastructure institutions are performing their functions in this regard adequately.

The requirements placed upon Infrastructure Institutions would have adverse implications for the costs of setting up new infrastructure Institutions and the costs incurred by users of such institutions. Hence, the draft Code envisages a review, conducted by the Regulator every five years, that examines the balance that has been obtained between the regulatory objectives and competitive dynamics.

13.5. Special provisions for Infrastructure Institutions

Infrastructure Institutions require special protection in the laws to ensure transactions to be final. This requires certain classes of such institutions to have certain privileges in law not available to private parties. The Commission found that the privileges should only be given to such institutions if they are regulated. These privileges are applicable in the areas of:

1. Acting as depositories,
2. Settlement;
3. Clearing

13.5.1. Depositories

Securities are intangible property. The only proof of the property is the contract (which is a written obligation). This creates unique challenges in relation to establishing ownership of such securities because:

1. Transfer of various types of financial products like shares or debentures can be easily forged (if they are paper based);
2. Paper based contracts are prone to destruction or loss; and
3. Modern financial systems operate on electronic systems.

The depository system for securities has been an efficient solution to the problems of securities and their title. Table 13.4 sets out the detailed recommendations of the Commission in relation to depositories.

13.5.2. Finality of settlements

A multitude of trades result in a multitude of obligations among the members. In an organised financial system, these are netted to result in consolidated obligations of each member to the CCP. The settlement so arrived at, must be final as against any claim by any creditor (including liquidator) of a member outside the closed system of the trading. In other words, legal certainty of transactions in organised financial trading is achieved only by making the netted obligations bankruptcy remote to the members of the organised financial system. Table 13.5 sets out the recommendation of the Commission to protect settlements on exchanges.

Table of Recommendations 13.5 Finality of settlements

The Commission recommends the creation of an exception to normal priority of claims in the following instance: when a trading member of a clearing house is declared as insolvent or bankrupt, the transactions and obligations of the member will be outside the jurisdiction of any liquidator or receiver. The claims of the clearing house over assets earmarked for settlement of claims will be the property of such clearing house till the claims are settled and cannot form part of the liquidation process.

Table of Recommendations 13.6 Finality of transactions

The Commission recommends:

1. An Infrastructure Institution which does netting and settlements should operate on rules which are approved by the regulator;
 2. The final set of transactions created by the Infrastructure Institution would be enforceable in law and would be recognized as a settlement for all the trades carried out;
 3. The Infrastructure Institution would be allowed to replace contractual obligations between trading parties with the obligations arising out of settlement system; and
 4. Even in the event of a bankruptcy of a person all the collateral of the person which have been deposited to the Infrastructure Institution must be outside the jurisdiction of a receiver or liquidator. The collateral should be used to complete the transactions already initiated on the Infrastructure Institution and then any surplus may be garnered by the liquidator.
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13.5.3. Finality of financial transactions

The Commission noted that transactions on an Infrastructure Institution cannot be easily undone. In netting and settling systems, if any individual transaction is undone, all dependant transactions will also have to be undone. This would create uncertainty for all persons using such institutions. Problems could also arise on exchanges where trades are executed at one point of time but the exchange of securities and money happens at a later point of time. If a person refuses to uphold the trade or goes bankrupt after making a trade but before completing it, a transaction may fail. Failure of a transaction in the exchange may have domino effect on other transactions.

The Commission is of the view that transactions on an Infrastructure Institution should be final and not undone under any circumstances. Recommendations of the Commission in relation to finality of transactions are given in Table 13.6.

13.6. Public issue and trade of securities

The Commission found that the public issue and trade of securities have three important regulatory objectives:

1. The public issue of securities should be done in a manner that adequate information about the issuer and the security is available (on a continuous basis) to the public to make informed decisions about investments.
2. The entity issuing the securities must have governance system which ensures that the issuer treats all purchasers of a specific class of securities in the same way and prevent illegitimate transfer of any funds from the issuer.
3. The trade of securities require that the rules governing the trading of different securities have common underlying principles which should apply to all trading of securities. These are required to prevent regulatory arbitrage between trading different securities and should be based on mitigating and managing the risk of transactions.

13.6.1. Public issue of securities

An incorporated or unincorporated entity may pool capital from an investor base by issuing securities. While doing so, the investor relies on the ability of the entity's manage-

Table of Recommendations 13.7 Issuance of securities

With respect to issuance of securities the Commission recommends:

1. Mandating the Government to publish a list of financial instruments which will be governed under securities law;
2. That once an instrument is included in the list of securities, the trading of such instruments should be carried out under general principles of organised financial trading;
3. Stipulating registration of the securities irrespective of the nature of the entity issuing them with specific requirements;
4. Creating statutory basis for disclosure obligations on the issuer (which must be done through regulations), instead of being completely reliant on the listing agreement;
5. Giving the regulator jurisdiction over issuers of securities when they approach a certain size or number of purchasers;
6. Creating exemptions from registration requirement for issues which are below a certain size:
 1. Empowering the regulator to regulate minimum corporate governance standards for issuers irrespective of their legal structure; and
 2. Empowering the regulator to frame regulations requiring disclosure of any change in ownership of the issuer entity (take over) and give investors a reasonable exit option in such event.

ment, which is in turn reliant on the disclosures made by the entity as well as the transparency of its governance processes.

The law must ensure that whenever any entity is raising capital from a fairly large pool of investors, it is properly managed and monitored. If such an entity is not managed and monitored, unscrupulous persons may use such entities to commit fraud. This, in turn, may detrimentally affect investor confidence and the smooth functioning of markets.

Accordingly, the Commission recommends that issuance of 'security' by any person must comply with certain registration requirements unless exempted by law. However, the Commission understands that such a broad definition may impose a prohibitive compliance cost on issuers. High compliance costs may limit the growth of small entrepreneurs. As such, broad exemptions need to be granted from the registration requirement for a limited number of issues to a limited number of people.

Presently, various continuous obligations and corporate governance norms are embedded in the Companies Act, 1956. These naturally apply only to companies issuing 'securities'. Various obligations applicable to issuers, such as corporate governance norms, arise from the listing agreement. The Commission is of the view that since 'securities' may be issued by entities other than companies, the disclosure and governance norms of the issuer should be independent of the legal structure of the issuer. The Commission believes that obligations imposed on issuers of securities must be codified in statute and elaborated by subordinate legislation or regulations.

13.6.2. Trading of securities

The Commission noted that while each type of securities may have specific legal issues related to creation, the organised trading of securities faces similar concerns about integrity. The Commission recommends that the law takes a unified approach to regulate the trading of securities. This would include exchanges, brokers, clearing houses and payment systems. This would require a generalised definition of securities. The Commission found that there is no fixed definition of securities. Therefore it recommends that the Central Government should create a list of securities based on the understanding of the financial sector.

Table 13.7 gives a detailed summary of the specific recommendations of the Commission pertaining to disclosure and governance obligations to be applied to issuers of securities.

Table of Recommendations 13.8 Listing of securities

With respect to listing of securities the Commission recommends:

1. Ensuring that exchanges do not arbitrarily refuse to list securities;
2. That persons in control of the issuer of securities do not discriminate against persons who have brought securities through the exchange;
3. That in the event the securities are delisted or cease to be traded, persons who have bought the securities from the exchange should be able to sell the securities at a fair price; and
4. That in the event the issuer changes fundamentally through a takeover, persons who do not agree to the change are able to sell the securities at a fair price.

Exchanges play a central role in the organised trading of securities. Table 13.8 provides the recommendations of the Commission with respect to the actions of exchanges in the course of listing and trading.

13.7. Market abuse

The Commission noted that the underlying principles of securities market requires integrity of the information produced by markets and fairness of the terms in trading in securities. These can be distorted through various ways which can be classified into the following categories:

1. **Market Manipulation:** Organised financial trading produces a stream of information, about prices, spreads or turnover. This information has important ramifications for the economy. Millions of individuals and firms make economic decisions as a consequence of the trading value of the securities. Any action which generates an artificial modification in these numerical values has an adverse impact on the market. Hence the law and regulatory processes that protect the integrity of information flow in the market. The regulator either on its own or through the infrastructure institution must establish rules, and exercise supervision, to identify and penalise attempts by market participants to induce artificial values of prices, spreads or turnover.
2. **Insider trading:** Concerns itself with trading based on non-public information that is availed through some special relationships and is considered an unfair advantage in such markets.

The Commission proposes that the law governing these concerns should be clubbed together under a general legal principle of market abuse. Market abuse can be classified into:

1. abuse of information;
2. abuse of securities; and
3. securities market abuse

Table of Recommendations 13.9 Types of market abuse

The law governing market abuse must cover the following circumstances:

1. **Abuse of information:** Occurs under three circumstances
 - ▶ When a person under a legal duty to disclose information does not do so or discloses false or deceptive information;
 - ▶ When any person uses information gained from sources which are not supposed to disclose information for purposes of trading; and
 - ▶ When any person circulates false or deceptive information with the objective of changing the price of a security and then trading such security for profit.
 Example: Insider trading, spreading false information.
2. **Insider trading:** Concerns itself with trading based on non-public information that is availed through some special relationships and is considered an unfair advantage in such markets.
3. **Securities market abuse:** Occurs when a person, with the intention of making a financial gain, artificially affects the price, liquidity, demand, supply or trading of securities or gives a false impression of the same. This may be done by dealing in securities through any manipulative, deceptive or artificial means.

Table of Recommendations 13.10 Market abuse

1. Market abuse means insider trading, abuse of information and securities market abuse.
 2. Dealing in securities through market infrastructure, with abusing the same, must be treated as an offence.
 3. Insider trading means dealing in securities or disclosing unpublished price sensitive information to any other person while in possession of unpublished price sensitive information, when such information was achieved through the breach of a fiduciary duty or other relationship of trust or confidence.
 4. The law must categorise attempting and abetting market abuse as an offence, albeit with lesser penalties.
 5. The law should prescribe a penalty on the offender, which would be capped at three times the legitimate gains made or losses caused. The maximum imprisonment as in the present law should be retained.
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The Commission recommends that the law governing market abuse cover the circumstances mentioned in Table 13.9.

Market abuse invites civil penalties as well as criminal sanctions in major jurisdictions across the world. The recommendations of the Commission in relation to market abuse are captured in Table 13.10.

Financial regulatory architecture

We now turn to the financial regulatory architecture, or the division of the overall work of financial regulation across a set of regulatory agencies. In the international experience, there are three main choices (Table 14.1): A single financial regulator; a 'twin peaks model', where one agency focuses on consumer protection and the other on micro-prudential regulation; and a fragmented approach, where there are multiple agencies.

14.1. Financial regulatory architecture as a distinct feature of financial law

Many alternative structures can be envisioned for the financial regulatory architecture. Parliament must evaluate alternative block diagrams through which a suitable group of statutory agencies is handed out the work associated with the law. These decisions could conceivably change over the years.

At present, Indian law features tight connections between a particular agency (e.g. SEBI) and the functions that it performs (e.g. securities regulation). The draft Code does not provide for such integration. This is to ensure that from the outset, and over coming decades, decisions about the legal framework governing finance can proceed separately from decisions about the financial regulatory architecture. Changes in the work allocation of agencies would not require changes to the underlying law itself. This will yield greater legal certainty, while facilitating rational choices about financial regulatory architecture motivated by considerations in public administration and public economics.

Table of Recommendations 14.1 Alternative structures

Single regulator
An financial regulation can be placed with one agency. In this case, this one agency will enforce micro-prudential and consumer protection provisions in the draft Code for all financial activities.
Twin peaks
Some countries have constructed two regulators: one focused on micro-prudential regulation and the other on consumer protection.
Complex structures
The us has a highly fragmented regulatory model. As an example, the Commodities Futures Trading Commission (CFTC) regulates derivatives trading, while the U.S. Securities and Exchange Commission (SEC) regulates the spot market. The us also has state level regulators in some areas.

14.2. Problems of the present arrangements

At present, India has a legacy financial regulatory architecture. The present work allocation – between RBI, SEBI, IRDA, PFRDA, and IBC – was not designed; it evolved over the years, with a sequence of piecemeal decisions responding to immediate pressures from time to time.

The present arrangement has gaps for which no regulator is in charge – such as the diverse kinds of ponzi schemes that periodically surface in India, which are not regulated by any of the existing agencies. It also contains overlaps where conflicts between regulators has consumed the energy of top economic policy makers and held back market development.

Over the years, these problems will be exacerbated through technological and financial innovation. Financial firms will harness innovation to place their activities into the gaps, so as to avoid regulation. When there are overlaps, financial firms will undertake forum-shopping, where the most lenient regulator is chosen, and portray their activities as belonging to that favoured jurisdiction.

An approach of multiple sectoral regulators that construct ‘silos’ induces economic inefficiency. At present, many activities that naturally sit together in one financial firm are forcibly spread across multiple financial firms, in order to suit the contours of the Indian financial regulatory architecture. Financial regulatory architecture should be conducive to greater economies of scale and scope in the financial system. In addition, when the true activities of a financial firm are split across many entities, each of which has oversight of a different supervisor, no single supervisor has a full picture of the risks that are present. Fragmentation of financial firms, which responds to fragmentation of financial regulation, leads to a reduced ability to understand risk.

When a regulator focuses on one sector, certain unique problems of public administration tend to arise. Assisted by lobbying of financial firms, the regulator tends to share the aspirations of the regulated financial firms, such as low competition, preventing financial innovation in other sectors, high profitability, and high growth. These objectives often conflict with the core economic goals of financial regulation such as consumer protection and swift resolution.

Reflecting these difficulties, the present Indian financial regulatory architecture has, over the years, been universally criticised by all expert committee reports. The Commission has analysed the recommendations for reform of financial regulatory architecture of all these expert committee reports and weighed the arguments presented by each of them.

14.3. Considerations that guide alternative architecture choices

In order to analyse alternative proposals in financial regulatory architecture, the Commission established the following principles:

Accountability: Accountability is best achieved when an agency has a clear purpose. The traditional Indian notion that a regulator has powers over a sector but lacks specific objectives and accountability mechanisms is unsatisfactory.

Conflicts of interest: In particular, direct conflicts of interest are harmful, for accountability and must be avoided.

A complete picture of firms: A financial regulatory architecture that enables a comprehensive view of complex multi-product firms, and thus a full understanding of the risks that they take, is desirable.

Table of Recommendations 14.2 Financial regulatory architecture envisaged by the Commission

Present	Proposed
(1) RBI	(1) RBI
(2) SCBI	
(3) FIC	
(4) IDBI	(7) Unified Financial Authority (UFA)
(5) PFRDA	
(6) SAI	(3) FSAT
(7) DICGC	(4) Resolution Corporation (5) FRA (6) Public Debt Management Agency (PDMA)
(8) FSOC	(7) FSOC

Avoiding sectoral regulators: When a financial regulator works on a sector, there is a possibility of an alignment coming about between the goals of the sector (growth and profitability) and the goals of the regulator. The regulator then tends to advocate policy directions that are conducive for the growth of its sector, which might be at the cost of overall consumer protection. Such problems are less likely to arise when a regulatory agency works towards an economic purpose such as consumer protection across all, or at least, many sectors.

Economies of scale in Government agencies: In India, there is a paucity of talent and domain expertise in Government, and constructing a large number of agencies is relatively difficult from a staffing perspective. It is efficient to place functions that require correlated skills into a single agency.

Transition issues: It is useful to envision a full transition into a set of small and implementable measures.

14.4. A financial regulatory architecture suited for Indian conditions

The Commission proposes the following structure, featuring seven agencies.

Agency #1: The RBI, which formulates and implements monetary policy, and enforces consumer protection and micro-prudential provisions of the draft Code in the fields of banking and payment systems.

Agency #2: The UFA, which enforces the consumer protection and micro-prudential provisions of the draft Code across the financial sector, other than in banking and payment systems.

Agency #3: A resolution corporation, which implements the provisions on resolution of financial firms in the draft Code.

Agency #4: The FSAT, which hears appeals against all financial regulatory agencies.

Agency #5: The FRA, which addresses consumer complaints across the entire financial system.

Agency #6: The FSOC, which will be responsible for systemic risk oversight.

Agency #7: The PDMA, an independent public debt management agency.

The table summarises the changes in the financial regulatory architecture that will be proposed. These changes will alter the Indian financial landscape from eight financial regulatory agencies to seven.

This proposal features seven agencies and is hence not a unified financial regulator proposal. It features a modest set of changes, which renders it implementable:

1. The RBI will continue to exist, although with modified functions;
2. The existing SEBI, FMC, IRDA, and PFRDA will be merged into a new UFA;
3. The existing SAT will be subsumed into the FSAT;
4. The existing BICGC will be subsumed into the Resolution Corporation;
5. A new FRN will be created;
6. A new PDMA will be created; and
7. The existing FSBC will become a full-fledged statutory agency, with modified functions.

14.4.1. Draft Indian Financial Code

The Commission has drafted a consolidated Indian Financial Code, which embeds the creation of the seven agencies and their responsibilities and functions. The draft Code consists of the following fifteen Parts:

1. Preliminary and definitions
2. Establishment of financial regulatory agencies
3. Regulatory governance
4. Financial consumer protection
5. Prudential regulation
6. Contracts, trading and market abuse
7. Resolution of financial service providers
8. Financial Stability and Development Council
9. Development
10. Reserve Bank of India
11. Capital controls
12. Public Debt Management Agency
13. Investigations, enforcement actions and offences
14. Functions, powers and duties of the Tribunal
15. Miscellaneous

The part on establishment of financial regulatory agencies provides for the creation of five new statutory bodies - UFA, Resolution Corporation, FRA, PDMA and FSAT. This part also provides for the allocation of regulatory responsibilities between the two financial sector regulators - UFA and RBI.

In case of RBI, the Commission recommends the continuance of the existing arrangement, with RBI as the country's monetary authority. The draft Code however revises the functions and powers of RBI, and sets out the manner in which it must be operated and governed. This includes provisions for the creation of an MPC and the powers of the committee in connection with the discharge of RBI's monetary policy functions. Similarly, in case of FSBC, the existing FSBC is to be recast as a statutory body.

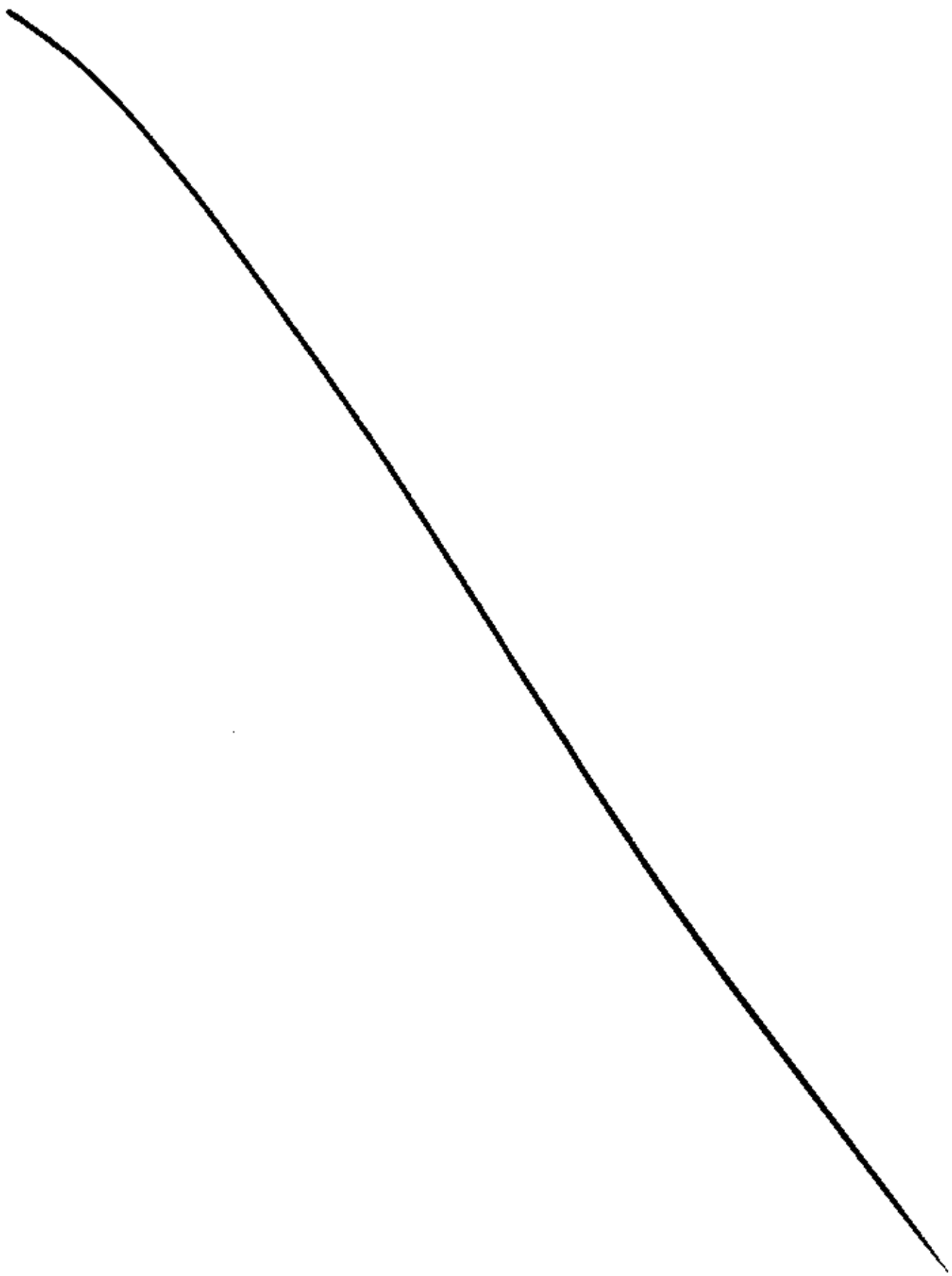
The remaining provisions of the draft Code lay down the powers and functions of these statutory bodies and the principles and processes to govern the exercise of their powers.

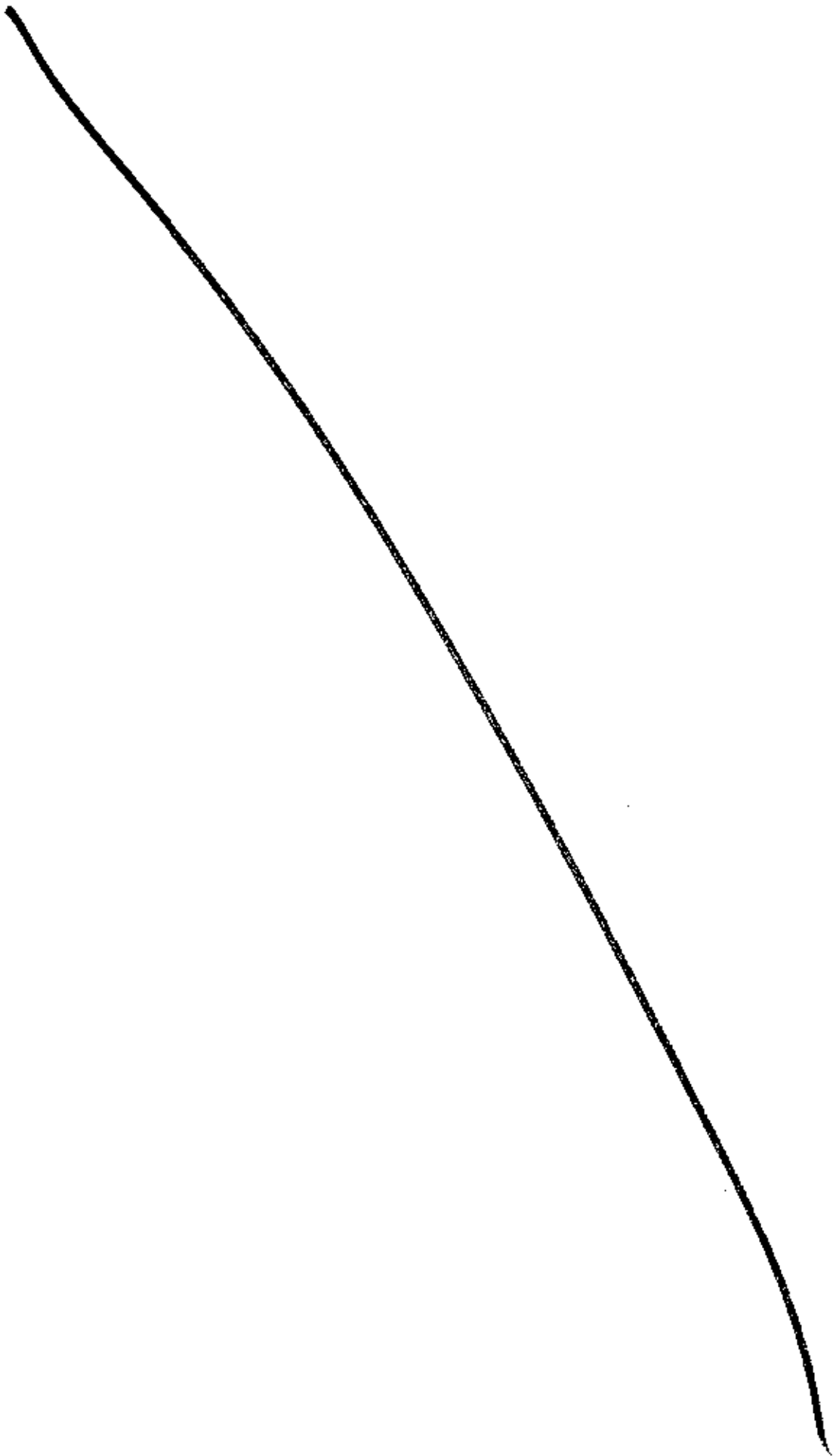
In the process of achieving the financial regulatory architecture proposed by the Commission, several amendments and repeals are also required to be made to the current financial sector laws that create the existing regulators and lay down their powers and functions.

14.4.2. Functions of the proposed agencies

We now review the functions of each of these seven proposed agencies:

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RB	It is proposed that RB will perform three functions: monetary policy; regulation and supervision of banking in enforcing the proposed consumer protection provisions and the proposed micro-prudential provisions; and regulation and supervision of payment systems.
UFA	<p>The unified financial authority will implement the consumer protection provisions and micro-prudential provisions for the entire financial system, apart from banking and payments. This would yield benefits in terms of economies of scope and scale in the financial system; it would reduce the identification of the regulatory agency with one sector; and it would help address the difficulties of finding the appropriate talent in Government agencies.</p> <p>This proposed unified financial authority would also take over the work on organised financial trading from RBI in the areas connected with the Bond-Currency-Derivatives nexus, and from FMC for commodity futures, thus giving a unification of all organised financial trading including equities, government securities, currencies, commodity futures, corporate bonds, and so on.</p> <p>The unification of regulation and supervision of financial firms such as mutual funds, insurance companies, and a diverse array of firms that are not banks or payment systems, would yield consistent treatment in consumer protection and micro-prudential regulation across all of them.</p>
FSAT	The present SAT will be subsumed in FSAT, which will hear appeals against RBI for its regulatory functions, the unified financial authority, decisions of the FRA, against the Central Government in its capital control functions and some elements of the work of the FSOC and the Resolution Corporation.
Resolution Corporation	The present ORCD will be subsumed into the Resolution Corporation, which will work across the financial system.
FRA	The FRA is a new agency which will have to be created in implementing this financial regulatory architecture. It will set up a nationwide machinery to become a one-stop shop, where consumers can carry complaints against all financial firms.
PDMM	An independent public debt management agency is envisioned.
FSOC	Finally, the existing FSOC will become a statutory agency and have modified functions.

The Commission believes that this proposed financial regulatory architecture is a modest step away from present practice, embeds important improvements, and will serve India well in coming years.

Over a horizon of five to ten years after the draft Code comes into effect, it would advocate a fresh look at these questions, with two possible solutions. One possibility is the construction of a single unified financial regulatory agency, which would combine all the activities of the proposed UFA and also the work on payments and banking. Another possibility is to shift to a two-agency structure, with one Consumer Protection Agency,

which enforces the proposed consumer protection provisions across the entire financial system and a second Prudential Regulation Agency, which enforces the micro-prudential provisions across the entire financial system. In either of these paths, RBI would focus on monetary policy.

These changes in the financial regulatory architecture would be relatively conveniently achieved, given the strategy of emphasising separability between laws that define functions, and the agencies that would enforce the laws. Over the years, based on a practical assessment of what works and what does not work, the Government and Parliament can evolve the financial regulatory architecture so as to achieve the best possible enforcement of a stable set of laws.

Transition issues

Once the government decides to move forward with the Indian Financial Code, transitioning from the existing setup to the framework proposed by the Commission will require planning and co-ordination. If not managed well, regulatory uncertainty could introduce considerable difficulties in the system. The Commission recommends that the Central Government should consider establishing a focused project team within the Ministry of Finance to facilitate the overall transition process. This team must be provided adequate staff and resources to enable effective discharge of its functions. The Commission suggests that the tasks of the project team would be to:

1. Create and implement an overall blueprint for the transition to the new legal framework;
2. Steer the draft Code through the entire legislative process;
3. Facilitate information flows and co-ordinate with relevant departments or agencies of the government, including existing regulators;
4. Determine the manner in which existing regulations will be phased out and the timing of the draft Code coming into effect; and
5. Identify the steps to be taken to ease the transition process for regulated entities, such as one-time exemptions from capital gains tax or stamp duty requirements.

To ensure that the transition is achieved in a timely and organised manner, the project team must devote significant efforts towards laying the groundwork for the actual creation and operation of new or modified agencies. In this context, the Commission suggests:

1. **Aligning ongoing work with project plan:** The project team must examine pending bills or draft regulations relevant to the financial sector in order to assess whether they are aligned with the key ideas of the proposed framework, as accepted by the Government. In the event of any material deviation, the project team may recommend that the Government consider the withdrawal of any bill that has been placed before Parliament.
2. **Introducing some elements into existing practice:** The Commission is of the view that many of its recommendations, particularly in the field of regulatory governance, build upon or formalise existing regulatory practices and procedures. Therefore, to the extent possible, the Commission's recommendations on regulatory governance can be implemented by the existing regulators with immediate effect. For example, many regulators already invite public comment on draft regulations. A requirement that all public comments received must be published can be enforced with immediate effect. Such steps will not only ease the transition process, but also allow the regulators more time to modify their internal processes.
3. **Preparation for creation of new agencies:** With FRA, POMA, FOMC and FSAT, there is a particularly important role for the development of information technology (IT) systems. The development of these systems can commence ahead of time. The second ingredient is the physical facilities to house the new group of agencies. This would also benefit from advance work.

On the functional side, certain preparatory steps can be taken. The Commission recommends the creation of an "Interim Co-ordination Council" of existing regulators, namely, SEBI, FMC, PFRDA and IRDA, that are to be merged to create the UFA.

The following are the recommendations of the Commission on how the implementation of each of the agency may take place:

1. UFA

- (a) **On acceptance:** An interim Board, without any powers, should be set up using an executive order. This Board will evaluate existing regulations and prepare for the eventual setting up of the UFA. Further, a co-ordination committee will be set up between all regulators that will be subsumed under UFA.
- (b) **On passage of draft Code:** The Board will be appointed as the official board under the law. All financial sector regulators other than RBI shall be subsumed under UFA. All the subsumed regulators will change letter heads and continue to function. Employees will be transferred. The Board will begin consultation on new regulations. Existing regulations will transition to new regulations over time.
- (c) **Law + 2 years:** Regulations existing before the passage of the draft Code will lapse. By this time, the Board must have replaced the entire subsidiary legislation and consolidated all subsumed agencies.

2. RBI

- (a) **On acceptance:** The RBI Board will evaluate existing regulations and prepare for the eventual transformation of the RBI. The Board will start taking steps to shift out functions of the PDMA and plan the establishment of the MPC process.
- (b) **On passage of draft Code:** The Board will need to be reconstituted reflecting the provisions of the law. The Board will begin consultation on new regulations. Existing regulations will transition to new regulations over time. PDMA and MPC will come into existence.
- (c) **Law + 2 years:** Regulations existing before the passage of draft Code will lapse. By this time, the Board must have replaced the entire subsidiary legislation.

3. Resolution Corporation

- (a) **On acceptance:** An interim Board, without any powers, should be set up using an executive order. This Board will evaluate existing rules and prepare for the eventual setting up of the Resolution Corporation.
- (b) **On passage of draft Code:** The Board will be appointed as the official board under the law. ORCC will cease to exist and its obligations will be subsumed by the Resolution Corporation till the new rules are put in place. Employees will be transferred or reverted. The Board will begin consultation on new regulations. Existing regulations will transition to the new regulations over time.
- (c) **Law + 2 years:** By this time, the Resolution Corporation will be fully functional and the new set of rules will be in place.

4. FRA

- (a) **On acceptance:** An interim Board, without any powers, should be set up using an executive order. This Board will evaluate existing rules and prepare for the eventual setting up of the FRA.
- (b) **On passage of draft Code:** The Board will be appointed as the official board under the law. Existing rules and ombudsmen will transition to new rules and agency over time.

- (c) **Law + 2 years:** By this time, the FRA will be fully functional and the new set of rules will be in place. Ombudsmen will cease to exist and all pending cases will be transferred to FRA.

5. FSAT

- (a) **On acceptance:** Preparation for expanding of physical and IT infrastructure, and benches. Drafting of new procedural laws should begin.
- (b) **On passage of draft Code:** SAT will be subsumed into the FSAT. The letter-head will change. New procedural laws will be passed and come into effect.

6. FSDC

- (a) **On acceptance:** The process of creating the financial system database will begin. Regulations specifying the technical specifications, as well as frequency of upgrading capabilities will be made. An interim Board and Sub-Committee will begin the process of preparing for the creation of research, analysis and process for SIFI designation.
- (b) **On passage of draft Code:** FSDC will come into existence as a statutory entity; and will implement all the existing research and continue capacity building.
- (c) **Law + 2 years:** FSDC will become operational.

7. PDMA

- (a) **On acceptance:** An interim Board, without any powers, should be set up using an executive order. This Board will prepare for the eventual setting up of the PDMA.
- (b) **On passage of draft Code:** PDMA will come into existence as a statutory entity; will implement all functions except cash management, contingent liabilities and services to others.
- (c) **Law + 2 years:** PDMA will become fully operational.

The draft Indian Financial Code is expected to replace a number of existing legislations, and necessitate amendments in most other such legislations. The legislations expected to be replaced will have to be repealed. Many issues addressed by provisions of these legislations are directly addressed in the draft Code, albeit in a principles-based manner. For some other issues, subordinate legislation is expected to be issued, but the draft Code provides the general power to the regulator and the corresponding principles to guide the regulators.

In this shift from a largely rules-based legal framework to a principles-based one, principles in the draft Code are expected to provide regulators with the independence to respond to problems within the financial system, using the enumerated powers given to them in the draft Code. The use of these powers is to be guided by principles in the draft Code, a requirement for benefits of a regulation to outweigh its costs, and a general requirement for consultations and research. For example, instruments such as the Statutory Liquidity Ratio (SLR) for banks and investment restrictions for insurance companies are not directly enshrined in the draft Code, but the draft Code empowers the regulators to make regulations on such requirements, guided by a set of principles, including one that requires them to be risk-based.

There are also issues on which shift to a new approach is recommended, which means that certain provisions in the existing legislations or certain legislations on the whole will not find corresponding provisions in the draft Code, nor are they expected to be addressed through subordinate legislation. On these issues, the Commission has taken a considered view to recommend a move to a different approach towards regulation. For example, in the interest of competitive neutrality and regulatory clarity, the Commission recommends repealing all legislations that give special status to certain financial

service providers that are functionally the same as other financial service providers created through regulatory authorisation. Such financial service providers will have to seek authorisation just like other financial service providers, and will be subjected to the same regulatory framework. For example, certain banks and insurance companies in India enjoy a statutory status, which should be replaced by a regulatory authorisation to do these businesses.

From existing legislations affecting India's financial system that are not to be repealed, most will require amendments. Some will have to be substantially amended, and others will require only minor amendments.

Following is a list of legislations to be repealed:

1. The Securities Contracts (Regulation) Act, 1956
2. The Securities and Exchange Board of India Act, 1992
3. The Depositories Act, 1996
4. The Public Debt Act, 1944
5. The Government Securities Act, 2006
6. The Reserve Bank of India Act, 1934
7. The Insurance Act, 1938
8. The Banking Regulation Act, 1949
9. The Forward Contracts (Regulation) Act, 1952
10. The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970
11. The Deposit Insurance and Credit Guarantee Corporation Act, 1961
12. The Foreign Exchange Management Act, 1999
13. The Insurance Regulatory and Development Authority Act, 1999
14. The Payment and Settlement Systems Act, 2007
15. The Acts establishing bodies corporate involved in the financial sector (e.g. The State Bank of India Act, 1955 and The Life Insurance Corporation Act, 1956)

Summary of recommendations not embedded in the draft Code

This chapter lists the recommendations from chapters in this report that have not been translated into specific provisions in the draft Code.

16.1. Ownership neutrality and competition

The Commission envisages a regulatory framework where governance standards for regulated entities will not depend on the form of organisation of the financial firm or its ownership structure. The Commission hence recommends the repeal of all special legislations listed in Table 2.1 that: (a) establish statutory financial institutions; or (b) lay down specific provisions to govern any aspect of the operation or functioning of public sector financial institutions. The undertakings of all such statutory institutions should be transferred to ordinary companies incorporated under the Companies Act, 1956 and their regulatory treatment should be identical as that applicable to all other financial companies.

The Commission also recommends proportional regulation of certain financial activities that are owned and managed by Government agencies and which presently fall outside the sphere of financial regulation. This includes fund management services offered by the EPFO and other statutory provident funds, insurance services of postal life insurance and the ESIC and the various small savings products issued by the Government. This requires examination of the legislative foundations of these programs and clarification of regulatory jurisdiction.

The principle that financial services should be regulated and supervised in a proportionate manner should apply equally to co-operatives created under laws made by State Governments. Since the subject of co-operative societies falls within the legislative domain of State Governments under the Constitution of India, the Commission recommends the following measures to ensure that regulators have adequate statutory control over the regulation and supervision of financial co-operatives:

1. Using Article 252 of the Constitution of India, State Governments should accept the authority of Parliament to legislate on matters relating to the regulation and supervision of co-operative societies carrying on financial services; and
2. The regulator may impose restrictions on the carrying on of specified financial services by co-operative societies belonging to States whose Governments have not accepted the authority of the Parliament to legislate on the regulation of co-operative societies carrying on financial services.

16.2. Parliamentary review of subordinate legislation

In order to strengthen the oversight of regulators who are empowered by Parliament to issue subordinated legislation, it is recommended that the subordinate legislations made by regulators should be reviewed by the same parliamentary committee which reviews primary legislation for the financial sector.

16.3. Recommendations of Working Groups

The Commission began by an in-depth examination of sectors within the financial system through the establishment of five wgs. Once this sector-level understanding was in hand, the non-sectoral draft Code was constructed by generalising from the recommendations produced by the five wgs. The legal effects of the non-sectoral draft Code have been evaluated in terms of implications for each of the recommendations of all the wgs.

The wgs reports embed a rich and contemporary knowledge of the policy problems faced in the five sectors. They add up to the largest-scale synchronised expert committee process in the history of Indian finance. Under the principles based and non-sectoral legal framework accepted by the Commission, several of the provisions that currently appear in the financial sector laws and have been discussed by wgs, and many of the recommendations of wgs, should feature in the subordinated legislations framed by the regulators. Therefore, the Commission recommends that the respective regulators should take into account the recommendations of the wgs while formulating subordinated legislation to implement the draft Code.

The recommendations of five wgs setup by the Commission can be found in Annex 19.6, 19.7, 19.8, 19.9 and 19.10. The full reports of all wgs are on the FSLRC website.

16.4. Cross-border resolution

An effective resolution framework requires appropriate arrangements for cross-border resolution. Since many SIFIs operate on a global level, an unco-ordinated approach by the home and host countries' authorities would create difficulties in the way of resolution of such institutions in a manner that would protect interests of consumers and prevent the risk of a contagion. Deliberations are underway at international policy forums to devise an optimal approach to cross-border resolution. India must participate in emerging global arrangements on cross-border resolution. The developments in this regard, in the coming years, may well require amendments to the draft Code on resolution - such as to require the resolution corporation to co-ordinate with its counterparts in other jurisdictions. The Commission recommends that in five years from now, a committee be setup to review the emerging consensus in the field of cross-border resolution and to suggest amendments in the legal framework on resolution accordingly.

The Commission recommends that the process of resolving a covered service provider including the choice of a resolution tool should not depend on the ownership structure of the service provider. This will result in 'ownership neutrality' in the approach of the corporation. In this framework, thus, the treatment of public and private firm; and domestic and a wholly owned subsidiary of a foreign firm will be identical, from the viewpoint of resolvability.

16.5. Systemic risk

The FSDC has been given the power to formulate and implement certain system-wide measures which seek to mitigate systemic risk in the financial system. Regardless of any independent action of the FSDC in relation to research on new system-wide measures, the Commission recommends that the Central Government should undertake a formal review in relation to this issue in five years.

16.6. Transition issues

The Commission recommends that the Central Government should consider establishing a focused project team within the Ministry of Finance to manage the overall transition process.

In the view of the Commission, the tasks of the project team would be to:

1. Create and implement an overall blueprint for the transition to the new legal framework;
2. Support the legislative process in the analysis and processing of the draft Code;
3. Undertake research and capacity building that is required prior to the new activities of regulatory agencies;
4. Undertake systems analysis, design and prototyping for the IT systems that would be required in establishing new functionality and new agencies;
5. Enable information flows and co-ordinate with all relevant departments or agencies of the government, including existing regulators;
6. Determine the manner in which pending bills and existing regulations will be phased out and the timing and sequencing of the draft Code coming into effect;
7. Incorporate, to the extent possible, the Commission's recommendations on regulatory governance within the existing regulators;
8. Create an "Interim Co-ordination Council" of the existing agencies that are to be merged to create the UFA; and
9. Identify the steps to be taken to ease the transition process for regulated entities, such as exemptions from capital gains tax or stamp duty requirements.

Conclusion

Financial economic policy is implemented by front-line agencies who are assigned functions by Parliament. The main purpose of financial law is to put these agencies on a sound footing, with the triad of objectives, powers and accountability mechanisms. The Commission has focused itself upon this task. The draft Code features substantial improvements upon present Indian practice in terms of clarity of objectives, precise statement of enumerated powers, and an array of accountability mechanisms.

The motivation for the establishment of the Commission was rooted in a series of expert committee reports which identified important difficulties in the prevailing Indian financial economic policy framework. The Commission has absorbed these areas of concern. Most of the shortcomings lie in the subordinated legislation, which is drafted by financial regulatory agencies. The work of the Commission, therefore, does not directly engage with these problems. The work of the Commission is focused on the incentives in public administration that shape the drafting and implementation of subordinated legislation. As a consequence, while the Commission has fully taken cognisance of the policy problems analysed by the expert committees of the last five years, it does not directly address them.

The Commission is mindful that over the coming 25 to 30 years, Indian GDP is likely to become eight times larger than the present level, and is likely to be bigger than the US GDP of 2012. Over these coming years, there will be substantial changes in the financial system. The technological change, and the financial products and processes which will come into play, cannot be envisaged today.

When the proposals of the Commission are enacted by Parliament, they will set in motion a modified set of incentives in public administration. Clear objectives in law, and a sound regulation-making process, will improve the quality of subordinated legislation that is issued by regulatory agencies. The emphasis on legal process in the new laws will induce improved working of the supervisory process. A common consumer protection law will clarify the objectives of financial regulatory agencies. These elements will yield a gradual process of change.

The Commission has unceavoured to draft a body of law that will stand the test of time. Hence, it has focused on establishing sound financial regulatory agencies, which will continually reinterpret principles-based laws in the light of contemporary change, and draft subordinated legislation that serves the needs of the Indian economy. This subordinated legislation, coupled with the jurisprudence built up at the RBI and the Supreme Court, will continually reflect the changing needs of the Indian economy, and serve the country well in coming decades.

Notes of dissent

18.1. Note of dissent by J.R. Varma

In my view, the authorization requirement (Section 142) for providing any financial service (which is defined very broadly in Section 2(75)) creates the risk of regulatory overreach. Many activities carried out by accountants, lawyers, actuaries, academics and other professionals as part of their normal profession could attract the registration requirement because these activities could be construed as provision of a financial service. Similarly, investors who rebalance their own portfolios regularly and day traders who routinely place limit orders on a stock exchange could also be deemed to require authorization. An expansive reading of Section 2(75)(k) could require even a messenger boy who delivers a mutual fund application form to obtain authorization. All this creates scope for needless harassment of innocent people without providing any worthwhile benefits.

The UK law by contrast requires authorization only for a narrow list of regulated activities and there is an explicit carve out for any activity which is carried on in the course of carrying on any profession or business which does not otherwise consist of regulated activities. Similarly, newspaper columns and a variety of information services are excluded from the definition of regulated activities under UK law.

The draft Indian Financial Code (Section 159(3)) does allow regulators to exclude any activities from the definition of financial service. However, this does not solve the problem of regulatory overreach because it relies entirely on regulatory self-restraint (which is often a scarce commodity). By contrast, under the UK law, the list of regulated activities is defined by the government and not by the regulator itself.

In my view, the authorization requirement under Section 142 should be restricted to a narrower subset of financial service providers.

18.2. Note of dissent by K.J. Udeshi

While I am in agreement with the recommendations of the Report, I have reservation on the recommendations relating to Capital Controls. The Commission recommends the following formulation:

"The regulations governing capital controls on inward flows should be framed by the Government, in consultation with the RBI. The regulations governing capital controls on outward flows should be framed by the RBI, in consultation with the Government." (See Chapter 8.3)

Consultation does not imply a consensus and when the RBI is in disagreement with the Government, the Government has the unquestionable powers to issue directions to the RBI. When the rule-making vests with the Government, the RBI may be consulted, but if there is a disagreement, the RBI would willy-nilly have to deal with a *fait accompli* and be accountable for the actions it would be required to take in the light of the Government's decisions.

In India, the forex reserves accretion is invariably on account of a capital account surplus and not due to a current account surplus and hence the composition of the inward flows assumes importance. Inward capital flows into India comprise FDI as also debt/portfolio equity flows and the latter are not only volatile but can undergo sharp directional shifts. There is widespread concern among several central banks in Emerging Market Economies about the added pressures on monetary management due to the prevailing extraordinarily strong and volatile cross-border capital flows. If the RBI has no say in initiating policy relating to these volatile flows, the RBI would be constrained to take monetary policy measures, both direct and indirect and administrative actions to deal with the consequences of such flows; such measures may not be what the Government or industry and the business community seek, leading to overall dissatisfaction.

If the RBI is to be accountable for the performance on its Balance Sheet, it has to be enabled to decide on the timing, quantity and quality of inward capital flows so that it can calibrate its forex interventions and sterilisation measures.

To the extent that inward capital flows impact liquidity conditions, it becomes necessary for the RBI to impose a burden on the banking system through imposition of reserve requirements and open market sales of securities. Such measures can impinge on the banking system and may not be in consonance with the medium/long-term policy object.

Both, financial markets and Governments have short time horizons and when initiating policy relating to debt/portfolio equity flows with the Government, it makes the task of the RBI as Monetary Authority and the Regulator much more difficult.

I am, therefore, not in agreement with the Commission's recommendation to place the policy and rule-making relating to all inward capital flows with the Government.

One of the top of the Commission is:

"V. Examine the interplay of exchange controls under FEMA and FDI Policy with other regulatory regimes within the financial sector."

The formulation of the FDI policy in many jurisdictions is statutorily the prerogative of the Central Governments, since the policy has implications for the macroeconomy, employment, security issues, social and political considerations etc. The Government's concerns in evolving FDI policies need to be recognised and therefore, my suggestion to the Commission has been that: (a) the Government may be entrusted with the policymaking relating to FDI, in consultation with the RBI, and the framing of the Rules relating thereto and (b) the RBI may be entrusted with the policymaking relating to all other transactions on the capital account, both inward and outward, in consultation with the Government and the framing of the regulations relating thereto.

Since the management of capital flows, excluding FDI is required to be with the RBI and the foreign exchange reserves management functions with the RBI, it is imperative that the policy on exchange rate management should remain with the RBI.

The handling of the foreign exchange crisis of the pre-liberalisation period (1990s) as also the handling of the exchange rate policy and cycles of ebb and flow of forex inflows has shown that such arrangements have worked well.

18.3. Note of dissent by P.J. Nayak

While the Commission's Report strives to break fresh ground in several directions, and particularly in respect of Consumer Protection and Resolution, there are two approaches adopted with which I disagree, while otherwise being supportive of the Commission's recommendations. As both approaches affect significantly the structure and conclusions of the Report, I believe their importance necessitates this Note of Dissent.

18.3.1. The Finance Ministry as a Financial Sector Regulator

The last 25 years of the evolution of financial sector regulation in India has seen a continual empowerment of regulatory agencies. This began with the transfer of powers for capital markets regulation from the Government to a new regulator, SEBI, followed subsequently to the establishment of other regulators for commodities, insurance and pension funds; and has coincided with the increasing empowerment of the two principal regulators, RBI and SEBI, through periodic amendments to Acts of Parliament under which they draw their powers. This directional thrust in the empowerment of regulators established outside of the Government has brought expertise into financial regulation. It is also now generally accepted that when the Government did regulate directly, as it did for the primary capital market through the Controller of Capital Issues, or the secondary capital market through the stock exchange division of the Finance Ministry, the consequences were sometimes unfortunate: new capital issues were continually grossly mis-priced, and malpractices in the functioning of brokerage firms were commonplace.

The Commission now arrests and partly reverses this directional movement, and it is with apprehension that one must view the very substantial statutory powers recommended to be moved from the regulators (primarily RBI) to the Finance Ministry and to a statutory FSDC, the latter being chaired by the Finance Minister. The Commission has recommended that direct statutory powers be vested in the Government in matters of (i) Capital Controls and (ii) Development. The statutory empowerment of the FSDC encompasses (iii) Inter-Regulatory Co-Ordination; (iv) Identification and Monitoring of SIFIs; and (v) Crisis Management.

This transfer of powers collectively constitutes a profound shift in the exercise of regulatory powers away from (primarily) RBI to the Finance Ministry. The Finance Ministry thereby becomes a new dominant regulator. To rearrange the regulatory architecture in this manner, requiring now institution-building while emasculating the existing tradition of regulators working independently of the Government, appears unwise. There is no convincing evidence which confirms that regulatory agencies have under performed on account of their very distance from the Government; indeed, many would argue that this distance is desirable and has helped to bring skills (and a fluctuating level of independence) into financial regulation.

The concept of a statutory FSDC, and the functions sought to be vested in it, are sensible provisions and will provide much needed co-ordination between regulators, as also the ability to steer the financial sector through periods of systemic risk. What is worrisome is that the chairmanship of FSDC is with the Finance Ministry, as this could lead to a government creep into the micro-prudential powers of other regulators. At present, without statutory powers, such a creep is difficult. As an uneasy compromise, the Commission has recommended (in Table 9.3) that an Executive Committee of the board of FSDC be constituted which will be chaired by the regulator for banking and payments (read Governor RBI), with managerial and administrative control, which will refer decisions to the board of FSDC when the Committee is unable to reach a consensus. It is unlikely that this would constitute an adequate bulwark against Government creep. A superior way of combining the needs of efficient co-ordination, the management of systemic risk

and regulatory independence, would be to have the Governor RBI (as the senior of the two micro-prudential regulators) chair the FSDC, with Finance Ministry officials also being represented on its board. The Chairmanship of FSDC is therefore critical. In any case, with the Commission proposing just two micro-prudential regulators, co-ordination becomes easier, and the case for the Finance Ministry exercising FSDC leadership weakens.

The Commission's recommendation (Chapter 8.3) of transferring from RBI to the Central Government rule-making powers on capital account transactions for all inward flows has even more alarming implications. Regulations influencing the quantity and structure of India's external liabilities, the management of the balance of payments, and the conduct of monetary policy have a close and intricate synergy. For the Commission to recommend regulatory scatter, wherein capital controls regulation is with the Government, monetary policy is conducted by RBI and the balance of payments is wedged in between the conduct of monetary policy and the impact of capital controls regulation is likely to prove damaging to the conduct of monetary policy and of fluent macroeconomic co-ordination.

The present law under FEMA vests powers of capital account regulation with RBI. It is true that since the economic reforms of 1991, RBI Policy governing inward equity investments has been authored by the Central Government, on the argument that it constitutes an adjunct of Industrial Policy. ECB policy has however evolved through consultation between the Finance Ministry and RBI, and has invariably required the assent of RBI, even where it may have been initiated by the Government. At best this *de facto* position could be formalised as *de jure*, with regulations on inward equity and equity-related investments being authored by the Central Government, and with external debt regulation vested in RBI. To move formal regulatory powers governing external debt policy away from RBI would be damaging to the maintenance of macroeconomic balances.

18.3.2. Principles as the Basis of Financial Sector Law

The Commission strives to choose an imaginative and bold approach in adopting a principles-based approach towards formulating law for the financial sector. It is necessary however to also put this approach to the test of pragmatism in the Indian context, particularly as most financial sector law has hitherto been rules-based.

Rules-based legislation brings greater certainty to financial sector participants in the understanding of whether a financial product or sales behaviour are legal, but this understanding is necessarily contextual. Rules therefore need to be elaborate in order to cover a plurality of situations which could arise in practice and, where there are gaps in these, participants could potentially exploit these to their advantage. Where rules-based law has achieved adequate comprehensiveness, it provides greater certainty to financial sector participants in understanding whether contracts and behaviour are lawful. Principles-based law does not provide such certainty, but by focusing on more generalised principles, covers the gaps by providing meaning to situations not presently contemplated but which could arise in future.

There are two difficulties which a principles-based approach could create. The first, recognised in the Commission's Report, is that participants are more reliant on courts in interpreting the law in a specific context. As the Commission's Report notes (See Chapter 2.2) "Central to common law is the role of judges. When laws are written in terms of principles, there would be legitimate disagreements about the interpretation of principles. These are resolved by judges who build up the jurisprudence that clarifies what a principle means in the light of the continuous evolution of finance and technology".

Such an approach works well when court processes are speedy and decisions of courts are dispersed quickly. In the Indian context, with an accumulating backlog of cases, the position is more problematic.

A second difficulty arises on account of the specific principles adopted for the legislative law. In the case of micro-prudential regulation, for instance, 11 principles are listed in Table 6.9 and constitute principles of administrative and economic rationality. The resulting law, applicable to the entire financial sector and embodying these 11 principles, is proposed in Section 141 of the draft Indian Financial Code. If the legislative basis of a micro-prudential law for banking (for instance) is to be restricted to these 11 principles, the burden on regulatory law to bring greater specificity in respect of banking increases very substantially. A mammoth superstructure of regulatory law will thus sit atop a slender base of legislative law. Aside from the issue of whether Parliament would be comfortable with this balance between legislative and regulatory law, such a legal structure imposes a high burden on the quality of regulation-writing. As each regulation can be challenged on grounds of being in violation of the principles, uncertainty about regulatory law will persist until the courts have ruled.

This double whammy of uncertainty will be detrimental to financial contracting, including new product design and sales behaviour across the financial sector. Financial sector contracts gain in strength when the interpretation of contracts is understood by general consensus *ex-ante*, before the contract is entered into, rather than *ex-post*, after interpretation by courts. While it may be true that a principles-based system will settle into its own equilibrium over a period of years, the likely travails associated with that until then appear disproportionate to the benefits. A more rules-based approach to the writing of financial sector law would have been preferable.

18.4. Note of dissent by Y.H. Malegam

I regret I am unable to agree with my colleagues on the following proposals in the Report:

18.4.1. Capital Controls

1. The Report recommends (Chapter 8.3) that: *"The rules on capital account transactions for all inward flows will be made by the Central Government in consultation with the regulators. The rules on capital account transactions for all outward flows will be made by the RBI in consultation with the Central Government."*
2. I believe that rules should be made by the Central Government only in respect of FDI inward flows and rules in respect of all other flows, both inward and outward should be made by RBI. My reasons for this belief are as under.
3. The distinction made in the Report between inward and outward flows is not as relevant as a distinction between inward FDI flows and other inward flows. The latter distinction is necessary for the following reasons:
 - ▶ Inward FDI flows result in the acquisition of assets by non-residents in India which can have policy implications e.g., retail, insurance etc.
 - ▶ While inward FDI flows do carry the right of repatriation of capital, in actual fact very little repatriation takes place and in the short-term FDI flows are largely stable.
 - ▶ On the other hand, non-FDI inward flows e.g., portfolio investment, external commercial borrowing, NRI deposits etc. are essentially short-term and volatile in nature.
 - ▶ Even non-FDI inward flows, on repayment result in outward flows.
4. The Report states (See Chapter 8.1) that IMF "recommends that capital controls be implemented only on a temporary basis where other macro-economic policy responses have been exhausted". While this is true, in a more recent Staff Paper (November 14, 2012) IMF has modified its stand and made the following statements:
 - ▶ "Capital flow liberalisation is generally more beneficial and less risky if countries have reached certain levels of "thresholds" of financial and institutional development"
 - ▶ "Rapid capital inflow surges or disruptive outflows can create policy challenges"
 - ▶ "In certain circumstances, capital flow management measures can be useful"
 These comments have to be viewed in the context of India's persistent current account deficit which is financed largely by net non-FDI inward flows.
5. As the Report mentions (section 11.2) RBI "in order to perform its monetary policy functions and play the role as lender of the last resort needs certain powers "which include the power to" Act as custodian and manager of foreign exchange reserves". There is strong linkage between capital controls and monetary policy. Capital flows have a natural tendency to affect monetary aggregates by increasing or decreasing the effective money supply and liquidity in the economy. Hence, in the Indian context, capital controls have been actively used as an additional monetary policy tool. To do this effectively, it is necessary that all capital flows, other than FDI inward flows should be monitored and controlled by RBI. Further as the IMF has pointed out, rapid capital inflow surges or disruptive outflows can destabilise the exchange and create volatility. For this reason also, capital controls need to be calibrated by RBI which has the responsibility for exchange rate management.

6. The present arrangement is that while the Central Government determines the policy for FDI, RBI, in consultation with the Central Government makes rules in relation to other capital flows. This arrangement has worked well and even the U.K. Sinha Working Group has not suggested any change to this basic arrangement. For the reasons enumerated above, this basic arrangement must be allowed to continue.

18.4.1. Financial Regulatory Architecture

1. The Report proposes (See Chapter 14.4) that: "the financial regulatory architecture suited for Indian conditions should consist of seven agencies" which will include:
 - ▶ "Agency #1: A central bank that does monetary policy and enforces the consumer protection and micro-prudential provisions of draft Code in the fields of banking and payments"
 - ▶ "Agency #2: CFA which enforces the consumer protection and micro-prudential provisions of the draft Code in all finance other than banking and payments"

The proposal therefore is that RBI will only regulate and supervise banks and payment system and that NBFCs and Housing Finance Companies (HFCs) will be regulated and supervised by CFA.

2. I believe that it is essential that NBFCs and HFCs should be regulated by the same regulator as regulates the banks i.e., RBI. My reasons are as under.
3. NBFCs are currently regulated and supervised by RBI. HFCs are currently regulated and supervised by National Housing Bank (NHB) which is a 100% subsidiary of RBI. Under the National Housing Bank (Amendment) Bill 2012 which is before the Standing Committee on Finance of the Parliament, it is proposed that the ownership of NHB will pass to Government and that regulation will pass to RBI with supervision remaining with NHB. The transfer of regulation is considered necessary since banks also do housing finance activity, the relative portfolio sizes being banks – 64% and HFCs – 36%. There are currently 54 HFCs with a total asset size of Rupees 335,000 crores which represents roughly 4.1% of the total asset size of all scheduled commercial banks.
4. NBFCs are also engaged in substantially the same activity as banks. They are asset finance companies, infrastructure finance companies, micro-finance companies and investment companies. They rely upon bank finance and are significant competitors of banks, particularly in the retail banking sector. Individually and collectively they are significant players in the financial system as shown below:
 - ▶ There are 12,348 NBFCs registered with RBI of which only 255 accept public deposits.
 - ▶ The total assets of NBFCs aggregate to Rupees 1,035,000 crores which represents roughly 12.7% of the total assets of all scheduled commercial banks.
 - ▶ There are 376 systemically important NBFCs with assets which aggregate to Rupees 923,000 crores, representing roughly 11.3% of the total assets of all scheduled commercial banks.
 - ▶ There are 42 NBFCs which have total assets in excess of the smallest scheduled commercial bank and 2 NBFCs which have total assets in excess of the smallest Public Sector bank.
5. As the Report points, (See Chapter 15.2) difficulties are created in addressing finance regulation on a holistic basis, when there is the rise of a rapidly growing shadow banking sector. As most knowledgeable commentators have pointed out,

one of the major causes of the 2008 financial crisis was the fact that credit intermediation activities were conducted by non-banks outside the regulatory environment. This has raised serious concerns of regulatory arbitrage, requirements for similar regulation of entities performing similar activities and issues of commonality of risks and synergies of unified regulation.

6. The concern for "shadow banking" has also resulted in a number of international initiatives as under:

- ▶ At the November 2010 Seoul Summit, the G-20 leaders highlighted the fact that Basel III is strengthening the regulation and supervision of shadow banking and requested the Financial Stability Board (FSB) to make recommendations in the matter.
- ▶ FSB identified "shadow banking" as non-banks carrying on bank-like activities such as credit intermediation, maturity transformation and credit facilitation.
- ▶ Even before the crisis IMF has prescribed that similar risks and functions should be supervised similarly to minimise the risk of regulatory arbitrage.
- ▶ In many countries, HFCs are regulated by bank regulators e.g., MAS in Singapore, HKMA in Hong Kong. In the U.S. the Dodd Frank Act provides for regulatory and supervisory oversight of both systemically important banks and non-banks by the Fed.

7. All the above considerations support the view that:

- ▶ NBFCs and HFCs are engaged in activities which can be termed shadow banking.
- ▶ They are of a size individually and collectively which can pose a serious challenge to the efficient regulation of banks.
- ▶ All the considerations mentioned in the Report to support the need for a single unified regulation support a single unified regulation of banks, NBFCs and HFCs.
- ▶ The Commission having decided that there would be two micro-prudential regulators with a separate regulator for banking must recognise that NBFCs and HFCs have greater synergy with banks than with the activities regulated by UFA.
- ▶ Consequently it is imperative that NBFCs and HFCs be regulated and supervised by RB.

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Annexes

Annexes

19.1. Formation of the FSLRC

**GOVERNMENT OF INDIA
MINISTRY OF FINANCE
DEPARTMENT OF ECONOMIC AFFAIRS
RESOLUTION**

No.18/1/2011-RE.

New Delhi, the 24 March, 2011

The Government in its budget 2010-11 had, inter alia, announced the setting up of a Financial Sector Legislative Reforms Commission (FSLRC) with a view to re-writing and cleaning up the financial sector laws to bring them in tune with current requirements. Accordingly, it has been decided to constitute the Financial Sector Legislative Reforms Commission comprising the following:

i)	Chairman	Justice (Retd.) B.N. Srikrishna
ii)	Member	Justice (Retd.) Debi Prasad Pal
iii)	Member	Dr. P.J. Nayak
iv)	Member	Smt. K.U. Udesi
v)	Member	Shri Yezdi H. Malegam
vi)	Member	Prof Jayanth R. Varma
vii)	Member	Prof. M. Govinda Rao
viii)	Member	Shri C. Achuthan
ix)	Member Convener	Shri Dharendra Swarup
x)	Member, Nominee	Joint Secretary (Capital Markets)
xi)	Secretary	Shri C.K.G. Nair

2. The Terms of Reference of the Commission will be as follows:

- i. Examining the architecture of the legislative and regulatory system governing the financial sector in India, including:
 - a. Review of existing legislation including the RBI Act, the SEBI Act, the IRDA Act, the PFRDA Act, FCRA, SCRA and FEMA, which govern the financial sector;
 - b. Review of administration of such legislation, including internal structures and external structures (departments and ministries of government), if required,

- c. Review of inter-play of jurisdictions occupied by various regulators;
 - d. Review of jurisdiction of departments within each regulator, and consider need for segregation / combination, and such other streamlining;
 - e. Review of issues relating to conflict of interest of regulators in the market;
 - f. Review of the manner in which subordinate legislation is drafted and implemented;
 - g. Review of eligibility criteria for senior officers in regulatory authorities and issues relating to tenure, continuity, and means of tapping and retaining lessons learnt by each authority;
 - h. Examine a combined appellate oversight over all issues concerning users of financial sector;
- I. Examine if legislation should mandate statement of principles of legislative intent behind every piece of subordinate legislation in order to make the purposive intent of the legislation clear and transparent to users of the law and to courts.
 - III. Examine if public feedback for draft subordinate legislation should be made mandatory, with exception for emergency measures.
 - IV. Examine prescription of parameters for invocation of emergency powers where regulatory action may be taken on an ex parte basis.
 - V. Examine the inter-play of exchange controls under FEMA and FDI Policy with other regulatory regimes within the financial sector.
 - VI. Examine the most appropriate means of oversight over regulators and their autonomy from government.
 - VI. Examine the need for re-statement of the law and immediate repeal of any out-dated legislation on the basis of judicial decisions and policy shifts in the last two decades of the financial sector post-liberalisation.
 - VII. Examination of issues of data privacy and protection of consumer of financial services in the Indian market.
 - IX. Examination of legislation relating to the role of information technology in the delivery of financial services in India, and their effectiveness.
 - X. Examination of all recommendations already made by various expert committees set up by the government and by regulators and to implement measures that can be easily accepted.
 - XI. Examine the role of state governments and legislatures in ensuring a smooth inter-state financial services infrastructure in India.
 - XII. Examination of any other related issues.
3. The Commission will devise its own procedure and may appoint consultants, advisors and experts and outsource research work to institutions of repute and expertise in the relevant area for the purpose for which the Commission has been set up. It may recall for such information and take such evidence as it may consider necessary. Ministries and Departments of the Government of India will furnish such information and documents and other assistance as may be required by the Commission. The Government of India trusts that State Governments and others concerned will extend to the Commission their fullest co-operation and assistance.
4. The Commission will have its headquarters in Delhi.
5. The Commission will make its recommendations within 24 months of the date of this Gazette Notification. It may consider, if necessary, sending reports on any of the matters as and when the recommendations are finalised.

Sd/-

(R. Gopalan)

Secretary to the Government of India

19.2. List of consultants, researchers and other officials who assisted the Commission

- ▶ Consultants
 1. Somasokhar Sundaresan
 2. Bobby Parikh
 3. Rajshekhar Rao
- ▶ Research team
 1. Prof. Ajay Shah
 2. Prof. Ila Patnaik
 3. Prof. Sunder Ram Korivi
 4. Amol Kulkarni
 5. Ankur Narain Saxena
 6. Apoorva Ankur Mishra
 7. Bhavna Laisingh
 8. K. Aishwarya
 9. Kaushalya Venkataraman
 10. Neena Jacob
 11. Pratik Datta
 12. Radhika Pandey
 13. Shubho Roy
 14. Smriti Parsheera
 15. Sowmya Rao
 16. Sumathi Chandrashekarani
 17. Suyash Rai
 18. Akriti Methur
 19. Aishwarya Kumar
 20. Axihi Dua
 21. Apoorva Gupta
 22. Karan Anand
 23. Kumar Anand
 24. Parikshit Kabra
 25. Shekhar Hari Kumar
 26. Shreya Kashyap
 27. Vikram Bahure
 28. Aphishek Gupte
 29. Alex Ctra
 30. Ambarish Moorthy
 31. Chirag Anand
 32. Darshika Singh
 33. Devika Das
 34. Madhavi Pundit
 35. Meeta Ganguly

36. Neeraj Singh
 37. Sudarshan Bhattacharjee
 38. Varsha Agrawal
 39. Vima, Balasubramaniam
 40. Dr. Poonam Mehra
 41. Shobana B
 42. Kavitha Ranganathan
- Other officials
1. A.K. Sinha
 2. Uday P. Apsingekar
 3. Vishvesh Bhagat
 4. Dipak Banerjee
 5. D.F. Pura
 6. Ram Rattan
 7. R.S. Tyagi

19.3. List of invitees for interaction with FSLRC

S.No	Name of Official/ Expert / Organisation
1	Mr. R. Gopalan
2	FICCI
3	Dr. C. Rangarajan
4 *	Dr. Montek Singh Ahluwalia
5	Dr. Shankar Acharya
6	Dr. Bimal Jalan
7 *	Confederation of India Industry
8 *	National Council of Applied Economic Research
9 *	Centre for Policy Research
10 *	ASSOCHAM
11	FHDCC
12	Dr. Vijay Kelkar
13	Dr. Percy S. Mistry
14	Dr. Raghuram G. Rajan
15	FSDC Sub-Committee
16	Forward Markets Commission
17	Indian Banks' Association
18	Prof. Viraj Acharya
19	Mr. Deepak S. Parekh
20	National Stock Exchange of India Ltd.
21	Multi Commodity Exchange of India Ltd.
22	National Commodity & Derivatives Exchange
23	BSE Limited
24 *	Dr. Y.V. Reddy
25	Mr. Ashok Chawla
26	Mr. Rajiv Agarwal
27	Dr. Avinash Persaud

* *Did not participate in the interaction*

External Agencies/Experts called on the Commission

1. City of London
2. Minister for Financial Services, Australia - Mr. Bill Shorten
3. Indo-us Business Council
4. us Federal Reserve Board Governor - Mr. Jerome H. Powell
5. Federal Reserve Bank of San Francisco - Mr. John C. Williams
6. Financial Services Authority, UK - Mr. Hector Sants

19.4. Issues for discussion with experts and stake-holders

General

- ▶ Strengths and limitations of the existing statutory framework of financial sector regulation and development
- ▶ Strengths and limitations of the current regulatory-organisational structures
- ▶ Capability of the Indian institutional architecture to address issues emerging from financial sector developments globally
- ▶ Adequacy of the consumer protection and investor grievances mechanisms embedded in the current framework
- ▶ Relevance of regulatory-architectural changes in advanced jurisdictions post-global crisis to India
- ▶ Mechanism for removing/reducing conflicts of interests in the current financial structure
- ▶ Any other suggestions

Additional questions/issues on the basis of domain expertise of the invitee

- ▶ Can regulation reduce the growing disenchantment with financial market adventures?
- ▶ Specific issues relating to the banking sector:
- ▶ Is a principle based approach (PBA) still a way forward? If so, is it possible to implement a PBA with limited regulatory capabilities? How to negotiate the transition phase in case of adopting a new institutional architecture?
- ▶ How does and how far the Competition Act address issues relating to customer grievances at the micro level? What are the institutional linkages available in the current customer/investor grievance redressal mechanism (including Consumer Protection Act) in promoting micro level customer satisfaction?
- ▶ What is the extent of institutionalised interface between the Competition Commission and the sectoral regulators? What mechanisms are in place or proposed to enhance the co-operation mechanism?
- ▶ How to balance the provisions in the Competition Act in respect of mergers vis a vis financial sector regulatory decisions based on expedient financial stability reasons?
- ▶ What is the experience with respect to implementation of Consumer Protection Act in achieving customer satisfaction? How far is it successful in resolving customer/investor grievances arising from the financial sector?
- ▶ What are the constraints for developing a national common market for commodities and spreading commodity derivatives throughout the country?
- ▶ How do you visualise the linkages between commodity derivatives market and other financial sector markets? Can they function independently in a completely integrated, globalised financial framework?

19.5. Interactions with authorities overseas

Australia

- | | |
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| Treasury | - Mr. Bill Shorten, Minister
Mr. Mike Callaghan, Executive Director
Mr. Rob Nicholl, CEO, Debt Management Office |
| Australian Prudential
Regulatory Authority (APRA) | - Dr. John Laker, Chairman
Dr. Jeff Carmichael, Wallis Inquiry Member and Inaugural Chairman of APRA |
| Financial Sector Advisory Council (FSAC) | - Mr. Paul Binsted, Chairman |
| Reserve Bank of Australia (RBA) | - Mr. Glenn Stevens, Governor |
| ASIC | - Mr. Greg Meccra, Chairman |

Singapore

- | | |
|---------------------------------|--|
| Monetary Authority of Singapore | - Mr. Ravi Menon, Managing Director and senior management team |
|---------------------------------|--|

United Kingdom

- | | |
|--|---|
| The Treasury | - Mr. Mark Hoban, Financial Secretary |
| Financial Services Authority (FSA) | - Mr. Hector Sants, CEO
Mr. Lyndon Nelson, Director |
| Prudential Regulatory Authority (PRA)
Transition Team | - Ms. Sarah Breeden, & Mr. Gregory Stevens |
| Financial Markets Law Committee (FMLC) | - Lord Hoffman, Chairman |
| British Bankers' Association (BBA) | - Ms. Saky Scutt, Deputy CEO |
| Prof. Charles Goodhart | - LSE Prof. and Director of Financial Regulation Research Programme |
| Financial Sector Practitioners' Panel | - Chairman Russell Collins |
| UK Debt Management Office | - Mr. Robert Sheehan, CEO and Mr. James Knight |
| International Centre for Financial Regulation | - Ms. Barbara Ridpath, CEO |
| City of London Roundtable | - Stuart Fraser, Mark Boleat and Representatives from financial markets |

Canada

- Department of Finance - Mr. Jeremy Rucin, Assistant Deputy Minister
- Financial Consumer Agency of Canada (FCAC) - Mr. Ursula Menke, Commissioner
Ms. Lucie Tedesco, Deputy Commissioner
- Canada Deposit Insurance Corporation (CDIC) - Ms. Michele Bourcua, President
- Bank of Canada - Mr. Tiff Macklem, Sr. Dy. Governor
Mr. Timothy Lane, Dy. Governor
- Office of the Superintendent of Financial Institutions (OSFI) - Mr. Mark Zelmer, Asstt. Supdt.
Ms. Patty Evanoff, Senior Director
- Ontario Securities Commission (OSC) - Prof. Mary Condon, Vice-Chair

19.6. Working Group on insurance, retirement financing, and small savings

19.6.1. Composition

Composition:

- Shri Dhirendra Swarup - Chairman
- Shri C.S. Rao - Senior Adviser
- Shri Tarun Bajaj - Member
- Ms. Anuradha Prasad - Member
- Shri Rajendra Chitale - Special Invitee

19.6.2. Terms of Reference:

1. Insurance

- (a) Review the consumer protection aspects of insurance and recommend principles for legal framework for the same. Some specific issues to be examined in this regard are:
 - i. Review distribution models and sales practices in the insurance industry.
 - ii. Review the present grievance redressal mechanisms.
 - iii. Review the manner in which special aspects of insurance contracts, such as, dealing with misstatements, insurance fraud, assignment of policy and appointment of nominees, should be addressed.
 - iv. Review the competition laws suitable for the insurance sector.
 - v. Review general market conduct laws suitable for the insurance sector.
- (b) Examine the role of the regulator in pursuing the goal of 'development' and the manner in which the development of products in various areas, including rural and social sector, micro insurance, agriculture insurance, health insurance, should be specified in laws and regulations.

- (c) Examine whether information should be treated as a public good that can be shared through appropriate data warehousing and data mining infrastructure, subject to customer privacy and confidentiality requirements.
- (d) Identify the prudential regulation and supervision aspects of insurance regulation and recommend a model legal framework for the same. This may include:
 - i. review of the ownership and capital structure of insurance companies.
 - ii. review of the laws governing investment norms for insurance companies - examining how the regulators can be empowered to adjust the regulatory framework with time.
 - iii. review of the prudent man principle approach versus prescription of investment guidelines.
- (e) Review the legal framework relating to re-insurance and examine the changes that might be required to promote more robust participation in the sector.
- (f) Review the systemic risks that can arise from the failure of insurance firms, and the legal framework for dealing with such risks.
- (g) Examine the appropriate resolution mechanisms that need to be adopted to deal with the failure of any insurance firm, keeping in view the interests of policyholders and financial stability. Also review whether this process should differ in any manner for life and non life insurance firms.
- (h) Review the design and implementation of the Employees' State Insurance Act, 1948 and examine the possibility of allowing employers covered by that legislation to opt for group medical insurance offered by the private insurance industry.
- (i) Review the regulation and structure of State owned insurers, in particular the special status of Life Insurance Corporation.
- (j) Examine the manner in which life insurance policies offered by the Department of Posts can be brought within the regulatory ambit in order to ensure the protection of consumers and provide a level playing field.
- (k) Review the role of self regulatory organisation and industry associations in the insurance sector and examine whether there is a need for a re-assessment of their functions.
- (l) Review the insurance related provisions contained in the Motor Vehicles Act, 1988 and identify any changes required to be made to the existing legal regime.
- (m) Examine the mechanisms that need to be put in place for resolution of disputes between market players-insurers and intermediaries.
- (n) In this context, review which powers should be given to regulators under law, how should the powers be used, how should the supervisory function be structured, and what punitive actions can be taken.

2. Pensions

- (a) The present retirement income framework in India consists of many components, such as, EPFO, New Pension System (NPS), Public Provident Fund (PPF), provident fund trusts and superannuation trusts, and is regulated in a very fragment manner. Examine the manner in which these components can be brought within the regulatory ambit of financial sector laws and the means for achieving coherence among the different components of the system?
- (b) Identify the consumer protection, prudential regulation and systemic risk aspects of pension regulation, which includes NPS, EPFO, provident fund trusts and superannuation trusts.

- (c) Review the 'development' role of EPFO and examine whether a developmental mandate is essential for ensuring widespread participation in voluntary NPS?
- (c) Review of NPS and examine if there are any changes required to its present features to promote the interests of consumers. This would include, reviewing the mandatory annuity requirement prescribed under NPS and examining the feasibility and desirability of providing minimum guaranteed returns to subscribers.
- (c) Review the laws governing investment norms for NPS, EPFO, provident fund trusts and superannuation trusts, and recommend a model legal framework that gives the requisite powers to the regulators.
- (f) Review the existing administered interest rate mechanism followed by EPFO and examine the problems that might arise on account of unfunded liabilities under the Employees Pension Scheme.
- (g) In this context, review which powers should be given to regulators under law, how should the powers be used, how should the supervisory function be structured, and what punitive actions can be taken.

3. Small Savings

- (a) Review the existing legal framework governing small savings schemes and identify any changes required to be made to it.
- (b) At present the Government acts as both the operator of small savings schemes as well as its regulator. Examine the issues that might arise on this account and whether there is a case for bringing these schemes under the same regulatory framework as the larger financial system.
- (c) Examine the legal framework required for the regulation of small savings distribution agents, including post offices and banks and review their incentive structures.
- (d) Review whether the financial activities of the Department of Posts may be brought within the regulatory ambit - can narrow banking, corporatisation be considered as options?
- (e) Examine the possibility of separating the investment function from the savings mobilisation function of small savings schemes and the potential implications of the same.
- (f) Identify the consumer protection and prudential regulation aspects of small savings schemes. The consumer protection aspects would include reviewing the need for preventive measures to deal with issues of excessive churning as well as the need for an appropriate grievance redressal mechanism. Issues to be considered in connection with the prudential regulation of National Small Savings Fund would include, capital requirements, liquidity regulations and norms on governance and internal controls.
- (g) In this context, review which powers should be given to regulators under law, how should the powers be used, how should the supervisory function be structured, and what punitive actions can be taken.

19.6.3. Recommendations on insurance

Development goals

1. The development of insurance markets should not be a regulatory objective. Market forces should ordinarily be able to achieve an adequate level of development in the sector. Towards this end, the law should specify that the need for pursuing competitive neutrality and fair competition should be basic principles to be followed by the regulator.

2. General development of markets has to be distinguished from specific measures that need to be taken to achieve the financial inclusion agenda. The mechanisms for achieving financial inclusion in the field of insurance should be aligned with the decisions that the Commission may take for promoting inclusion in the banking sector.

Prudential regulation

3. Capital regulation
 - (a) The capital resources maintained by insurance companies should be commensurate with the specific risks arising from their business activities. To achieve this, the primary law should provide that the prescribed capital requirements should be determined in a risk-based manner. Subject to this principle, the regulator will frame subordinate legislations to lay down the actual capital requirements and the process for computation of capital.
 - (b) The regulator should also be permitted to prescribe the minimum capital requirement for the setting up of an insurance company, instead of having the rupees 100 crores requirement laid down in the primary law. This will allow the entry conditions to be revised from time to time without requiring an amendment to the law.
4. The law should provide that insurance companies are permitted to hold different classes of capital. The classification of capital into different tiers will be done by the regulator through subordinate legislation. The regulator will also be empowered to restrict the extent to which insurers may rely on different tiers of capital for satisfying their capital requirements.
5. Insurance law should not specify foreign investment limits for investments in the sector. As in all other sectors, this power should be with the Central Government. In making its determination, the government may consider adopting different FDI limits for different types of insurance activities. In particular, a higher limit may be considered for the health insurance sector to promote more robust growth in the sector.
6. High-level principles relating to sound governance and management of insurance firms need to be enshrined in the law. The law should also mandate self-assessment of solvency and risk profile by insurers. The regulator should then use its supervisory powers to assess the adequacy and effectiveness of the measures adopted by the insurance company.
7. The law should specify that investments are to be made as per the prudent person principle and quantitative investment requirements and restrictions should be removed from the primary law. To the extent necessary, the regulator should be empowered to specify appropriate investment norms through subordinate legislation. This power would be subject to certain restrictions to be specified under the law. Specifically, the regulator will not be able to prescribe the composition of the investment portfolio or the minimum levels of investment for any given category of investment.
8. The law should not prohibit insurance companies from investing overseas. Insurers may choose to globally diversify their portfolio in accordance with the prudent person principle and risk-based capital requirements. The regulator may, however, choose to set out reasonable limits on the currency mismatch risks that may be held by an insurer.

Consumer Protection

9. The law should set out the principles of consumer protection to be observed by the insurance service providers and the framework within which these principles may be implemented by the regulator.

10. All individuals, who may be individual agents or employees of corporate agents, brokers, advisers, banks and insurance companies, who are involved in the sale of insurance services to consumers must be registered with the regulator. This registration process will be based on certain objective criteria, such as minimum qualifications, training and certification requirements, which will be prescribed by the regulator. The responsibility of verifying the individual's compliance with the specific requirements should be left to the insurance company, in respect of its employees and agents. In case of independent advisers and brokers, who are not aligned with any particular insurer, the relevant service provider would be responsible for the registration of its employees.
11. No minimum or maximum cap on commission or fee should be mentioned in the primary legislation. The law should allow the regulator to prescribe incentive structures for the sale of insurance services, keeping in view consumer interests.
12. In case a policy lapses due to the non payment of premium, there should be an obligation placed on the insurer to issue a notice to the policyholder. However, these details need not be specified in the primary law. The primary law should only provide that the regulator may frame specific regulations for dealing with the lapsation on insurance policies, with a view to protecting policyholders.
13. The scope of the present insurance ombudsman system needs to be expanded to allow complaints against insurance intermediaries, other than agents of the insurance company for whom the insurer will be directly liable. The ombudsman awards should be made enforceable against the complainant as well as the service provider, subject to the right to appeal before a specialised appellate forum.
14. The law should specify the duty of parties to an insurance contract to act in good faith. It should also set out the meaning and consequences of insurance fraud.
15. The collection and sharing of insurance information can help insurers make better pricing and underwriting decisions. It can also help insurers combat instances of insurance fraud. The law should enable the sharing of insurance information while specifically providing the data protection and confidentiality requirements applicable to any person, including the regulator, that holds information belonging to others.
16. The primary legislation must empower the regulator to act in a manner that promotes better access to micro insurance. This should be done by stating that "promoting innovation and access to insurance services" is one of the key principles to be followed by the regulator.
17. There is a need for reforms in the health care sector to provide for the codification of ailments, procedures and protocols followed by health providers. This will help in promoting better underwriting by insurance companies by reducing the more hazardous problems in the supply of health care services to insured persons.
18. Motor insurance:
 - (a) In order to minimise inconvenience and costs, the law should provide the accident victim, insurer and insured an opportunity to arrive at a voluntary settlement of the claim without having to go through the adjudication process. If the parties fail to arrive at a settlement, the compensation should be decided on a fast track basis by a specialised tribunal.
 - (b) The law should lay down the minimum amount of insurance coverage that must be obtained by every vehicle owner. This will ensure that accident victims are assured of receiving compensation of up to the insured amount. It will also provide insurers with more certainty on their potential liabilities. In order to achieve this, the regulator will have to discontinue the practice of fixing the premium for third party motor insurance policies.

19. Role of surveyors:

- (a) The Indian Institute of Insurance Surveyors and Loss Assessors should be given statutory recognition as a professional body responsible for the licensing and supervision of surveyors and loss assessors.
- (b) In order to protect the interests of consumers, the legal framework should allow them to appoint a surveyor in addition to the surveyor required to be appointed by the insurer. The insurer will be required to consider both reports before making a decision on the claim.

20. The law should empower the regulator to specify the types of permitted and restricted assignments of insurance policies. The insurer will not have the discretion to refuse to record an assignment that is made in accordance with the regulations.

Competition issues

- 21. The legal framework governing LIC should be at par with the laws applicable to all other life insurance companies. In particular, there should be no sovereign guarantee for the policies of LIC. The status of LIC should be changed from a statutory corporation to a Government company governed under standard company law provisions.
- 22. There is a need for encouraging competition in the reinsurance sector by adopting the following measures:
 - (a) do away with the mandatory requirement placed upon general insurance companies to reinsure a portion of their business with General Insurance Council (GIC);
 - (b) remove barriers which prevent Indian insurance companies from doing business with global reinsurers, subject only to prudential regulation requirements; and
 - (c) create an enabling framework for the entry of global reinsurance firms, including Lloyds, in the Indian reinsurance sector.
- 23. Competition policy should play an effective role in ensuring that government schemes do not create an uneven playing field between state-owned and private insurance companies.

Resolution and systemic relevance

- 24. The law should contain appropriate resolution mechanisms to deal with failing insurance firms, including provisions for enhanced supervision and the option of transferring the business of the failing insurer to a solvent insurer. These mechanisms should be applicable to both life and non-life insurers.
- 25. There is a need to create a compensation scheme to protect policyholders from the inability of an insurer to meet its financial obligations and to minimise the taxpayer's exposure to the failure of insurance firms. The design of the policyholder compensation scheme should be decided under the resolution framework being designed by the Commission.
- 26. It should be the regulator's responsibility to assess the systemic importance of individual insurance firms. Additional supervisory and resolution tools will need to be employed in respect of those insurance companies that are found to be systemically important.

Unregulated areas of insurance

- 27. Establishments covered by Esic should have the option to opt out of the medical benefit facilities provided under the scheme and obtain group health insurance coverage offered by an insurance company, if they are able to obtain similar benefits at a similar cost. In such cases, a proportionate amount of the total contribution payable to Esic that relates to the medical benefits provided under the scheme will be used as the premium for obtaining the insurance policy.

28. Being a social security scheme administered by the government, Esic should not be subjected to the entire gamut of insurance laws and regulations. However, the law should allow the insurance regulator to identify certain specific principles, such as those relating to corporate governance, investment management and consumer protection, that would have to be complied with by Esic.
29. In case of government-sponsored schemes that are administered through insurance companies, the general provisions of insurance laws would be applicable. However, the law should allow the regulator to vary the applicability of certain provisions of law, particularly in respect of the pre-sale obligations of insurers.
30. In case of schemes where the insurance coverage is contemplated to be provided directly by the government and the scheme is not funded through a complete or substantial fiscal transfer, the law will identify certain specific provisions, such as those relating to corporate governance, investment management and consumer protection, that would have to be complied with by the government body implementing the scheme. In order for these provisions to be effectively implemented, the law should mandate that any insurance business carried out by the government, which is eligible for limited regulation under insurance law, should be carried out through a separate corporate entity.
31. Life insurance schemes operated by the Department of Post (DOP) should be corporatised and brought within the purview of the insurance regulator to ensure effective prudential management, protect the interests of policyholders and create a level playing field.

19.6.4. Recommendations on retirement financing

Scope of retirement financing regulation

1. There should be common regulation and supervision for all retirement financing schemes, including various types of pension and provident fund schemes, but not including the unfunded, tax-financed schemes (such as Old Age Pension Schemes), or those that are largely tax-financed. This would mean that the mandates that are presently divided between PFRA and EPFO must be brought under one regulatory agency.
2. EPFO should only manage and not regulate retirement financing schemes. EPFO itself should be regulated in the same manner like any other retirement financing entity, and the entire range of regulations should apply to it. Similar approach should be taken towards PPF.
3. Smaller exempt and excluded funds should integrate with Employees' Provident Fund (EPF) or NPS. The tax treatment should continue if the fund chooses to integrate with either of the two. The law should not make reference to the possibility of exemption or exclusion, and it should mandate all existing funds that fall under these categories to opt for either NPS or EPFO.
4. The primary objective of retirement financing regulation should be to correct market failures in the retirement financing sector. Development of the sector or inclusion should not be mandates given to the regulator, though the regulator should have the flexibility to customise the regulation according to the profile of the consumers and the kind of the product being offered, based on cost-benefit analysis of the regulation.

Prudential regulation

5. Prudential regulation and supervision of retirement financing should be largely risk-based. Regulator should ensure that investigatory and enforcement requirements are proportional to the risks being mitigated.

6. The law must provide for licensing of retirement finance entities and retirement finance funds, but there should be no licensing of individual plans. The regulator may prescribe conditions to be fulfilled by each plan to be launched by the licensed fund. In addition to the entity's licensing, each of the trustees of the entity should be registered with the regulator.
 7. The law should define principles-based criteria for awarding licenses to retirement financing entities and funds. Licensing should be on the basis of demonstration by the trustees/promoters that they have the required legal, managerial and ownership structures, capability (human, technology and financial), risk management systems, investment policy, financial strength and capital to manage the entity and/or the fund. The process of awarding the licenses should be transparent, and the applicants should be given a detailed response in a reasonable amount of time. The regulator should also have the power to modify or withdraw the licenses after due process, and such decisions should be appealable in a court of law.
 8. The law should provide that the "prudent person standard" be followed for investment management by those managing the retirement financing funds, such as pension funds, EPFO, etc. The regulators should also have the powers to impose some broad portfolio restrictions to prevent excessive risk-taking by the funds. These restrictions should be imposed only as exceptions, and must not take the form of the regulators prescribing investment management strategies for the funds.
 9. All retirement financing funds must be required to set forth and actively pursue an overall "investment policy". The law should empower the regulator to define the minimum requirements for the policy.
 10. The law should empower the regulator to set standards for valuation of retirement financing assets in a transparent manner, informed by prevailing standards in other parts of the domestic financial system or in other jurisdictions. The regulator may, if it so chooses, delegate the task of setting standards to a standard setting body, but the regulator would continue to be responsible for the standards.
 11. For defined contribution schemes with administered interest rates, such as EPF and PPF, the regulators should have the power to regulate and supervise them for sound investment management practices.
 12. The law must empower the regulator to regulate and supervise the risk management systems of retirement finance entities and funds, to ensure the adequacy of risk management systems in place. These powers must cover all the key elements of risk management systems, and must always be used in a risk-based manner. The regulations must be principles-based, should focus on supervision rather than ex-ante rules, and the regulator should not impose any one risk management model on the entities and funds. For small funds with poor in-house capability, the regulator may mandate seeking external support in developing sound risk management practices.
 13. The regulators must be given the power to impose risk-based capital and liquidity requirements on retirement finance funds.
 14. The law should give the regulator the power to regulate and supervise all the key elements of corporate governance of retirement finance entities and funds, in a risk-based manner.
- Consumer Protection**
15. The law should provide protection to consumers from being misled or deceived, subjected to unfair terms of contract, or unduly penalised by the fund. Consumers should have access to a reasonable mechanism of grievance redressal. Consumers should also be given the right to get support to take the right decisions, and receive reasonable quality of service.

15. Consumer protection regulation must be proportional to the risk held by the consumer, and the extent to which the consumer is responsible for taking decisions about the plan on issues such as investment.
17. All individuals dealing with retirement financing must be registered with the regulator, who must stipulate significant training requirements on the individuals involved in the process of helping the consumers decide about retirement financing.
18. The structure of various types of charges on retirement financing schemes should be regulated by the regulator.
19. The regulator must be given the powers to ensure inter-operability, portability and exit options in retirement financing plans.
20. The regulator must have the power to mandate suitability analysis and advice to be given by the provider to the consumer regarding the asset allocation decision. The regulator must also have the power to recommend modifications to schemes and processes to ensure that consumers are given suitable solutions.

Failure of retirement finance funds

21. The law should provide for an efficient resolution mechanism for funds offering defined benefit retirement financing plans. This should be modelled on the resolution process for banking and insurance, but with more time for the funds to improve their financial position. There should be an agency responsible for the resolution function.
22. There should be a process to move the consumers' funds from one defined contribution fund to another smoothly, if the retirement finance entity sponsoring the defined contribution fund goes bankrupt.
23. The agency responsible for resolution should have access to comprehensive information about retirement finance entities and funds. The agency should have access to auditors' reports and the powers to ask for information on any fund and conduct on-site investigation of a fund.
24. The resolution process should start with a quantitative trigger.
25. The resolution process should start with giving the fund a notice to improve its financial position. If the fund fails to do so, the process should focus on transfer of the assets to another fund, or under the management of another fund. Liquidation of fund should be the last option in the resolution process. When resolution process starts, the fund should be prevented from collecting contributions.
26. Establishing a retirement finance protection fund, which would guarantee payouts from all defined benefit schemes, may be considered. The fund could also provide some guarantees to defined contribution schemes, to help them hedge certain investment risks.
27. If the retirement finance protection fund is established, it should charge risk-based levy from the participating funds; participation should be mandatory for funds offering defined benefit plans; and the fund could be managed by the agency that is responsible for resolution of failing funds.

Special topics

28. Only insurance companies that have proven capability in offering life insurance should be allowed to do the business of issuing annuities.
29. Compared to pension funds, for insurance firms issuing annuities, there should be greater flexibility given to the regulator in law to stipulate restrictions on investment choices. This should be in line with the regulations of life insurance companies.
30. The regulators should work to ensure that consumers take the optimal annuitisation decision, by mandating partial annuitisation and providing active support to consumers to take the right decision.

31. Resolution of insurance firms issuing annuities should be considered along the lines of resolution of any life insurance firm. This issue has been discussed in detail in this report's chapter on insurance firms.
32. Just as in the PFRDA Bill, NPS should be acknowledged as a unique object in the law, and its various components should be regulated at par with their respective categories.
33. The law should acknowledge the unique status of NPS as a government intervention to address market failures in the retirement financing market, and the market power is commands to meet its objectives. If NPS exerts anti-competitive pressures over and above its basic objectives, it should be regulated from a competition standpoint. NPS should be separated from the retirement financing regulator, because there is conflict of interest in managing such a system and regulating the retirement financing sector. This can be achieved by making the NPS Trust an independent entity. The retirement financing regulator should regulate and supervise the NPS Trust.
34. The law should give the regulator the powers to regulate infrastructure for retirement financing sector. Sections from PFRDA Bill on regulation of infrastructure for retirement financing can be considered for drafting these provisions in legislation. These sections provide for regulation and supervision of infrastructure services such as record keeping.

19.6.5. Recommendations on small savings

Legal framework

1. There is a need to consolidate and modernise the laws on small savings. Accordingly, the GSB Act, GSC Act and PPF Act should be replaced with a consolidated law that should, inter alia, contain provisions relating to manner of collection and investment of funds, consumer protection, grievance redressal and, to the extent relevant, prudential regulation.

Structure and regulatory framework

2. All functions related to the operation and management of small savings should be performed by an independent entity that should be brought within the limited purview of the financial regulator. However, prudential regulation of the proposed small savings entity should not extend to changing the manner in which the funds held by National Small Savings Fund (NSSF) are invested since that constitutes a fiscal decision.
3. To address concerns that corporatisation of the scheme would lead to loss of public confidence, it should be ensured that upon the transfer of the management of small savings to an independent entity, the law effecting such transfer should explicitly clarify that these schemes are guaranteed by the government.

Consumer protection

4. Requisite changes may be made in the laws governing small savings to include provisions on investor protection, compensation and grievance redressal.
5. To minimise operational risks on account of agent defaults and to protect the interests of investors, the law should lay down the framework for the licensing, qualifications and training of agents.

19.6.6. List of Acts to be reviewed

1. Insurance Act, 1938
2. Insurance Regulatory Development Authority Act, 1999

3. Insurance Laws Amendment Bill, 2008
4. Life Insurance Corporation Act, 1956
5. Life Insurance Corporation (Amendment) B'l., 2009
6. General Insurance Business (Nationalisation) Act, 1972
7. Marine Insurance Act, 1963
8. Motor Vehicles Act, 1988
9. The Actuaries Act, 2006
10. Employees' State Insurance Act, 1948
11. Companies Act, 1956 (to a limited extent)
12. Indian Contract Act, 1872 (to a limited extent)
13. The Pension Fund Regulatory and Development Authority Bill, 2011
14. Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (Employees' Provident Fund Scheme, 1952, Employees' Pension Scheme, 1995, Employees' Deposit-Linked Insurance Scheme, 1976)
15. Income Tax Act, 1961 (to the extent relevant for recognised provident and superannuation funds)
15. Public Provident Fund Act, 1968
17. Government Savings Bank Act, 1873
18. Government Savings Certificates Act, 1959

19.7. Working Group on payments

19.7.1. Composition:

Dr. P.J. Nayak	- Chairman
Shri Ranjit Tinsaker	- Member
Shri Uttam Nayak	- Member
Shri Bharat Poddar	- Member
Shri A.P. Singh	- Member
Shri Abhishek Sinha	- Member

19.7.2. Terms of reference

1. To identify what are the systemic risks to the financial system and to the real economy from payment systems. Payment systems can be systemically important, partly because shocks can originate within them, resulting in operational risks, but also because they can act as channels for propagating shocks originating outside their operations, through credit and liquidity markets. An understanding of the potential systemic credit, liquidity and operational risks in payment systems is thus required, so that criteria for identifying systemically important payment participants and systemically important payments systems can be formulated. Finally, to assess whether there are risks to financial stability arising from encouraging competition and innovation in payments.
2. To evaluate whether the regulatory system should cover all payment systems without exception, or instead merely those which are systemically important. Alternatively, to examine whether there should be a separate regulator for retail and small-value payment systems as compared to systemically important payment systems.

3. As shocks can spread through payment systems to other participants and lead to their bankruptcy, to examine the design of a uniform and quick process for handling payment-induced bankruptcy.
4. To review whether independent payment systems should be encouraged, not linked to payment participants, thereby minimising moral hazard through conflicts of interest, and encouraging technology infusion at a faster pace. This would in turn require a review of whether payments should be viewed as an offshoot of banking, or as a distinct industry in its own right. It would also require assessing whether "banks being special" militates against having independent payment systems. To assess whether existing legislation is adequately supportive of the absorption of fast-changing payments technologies.
5. To review whether RBI should remain the regulator of payment systems or whether instead a regulator independent of RBI should be set up. This involves identifying whether there are conflicts of interest and moral hazard, as also whether adequate domain knowledge gets continually upgraded, in the present regulatory structure.
6. To ensure compatibility with the recommendations of the FATF.
7. To suggest regulation to promote transparency, security, efficiency and certainty of payments; and to ensure that regulation is agnostic to ownership structures of the regulated, necessitating treating regulated entities in the public and private sectors on par. To also suggest constructive and creative ways of enforcement of regulations.
8. To develop a quick and clear appeals process when there is conflict, equally fair to both disputants, especially when one of them is the regulator. To frame dynamic laws for penalties and review the stringency of current laws.
9. To promote financial inclusion following the ideals proposed in various reports such as the 'Report of the Inter-Ministerial Group: Framework for delivery of Basic Financial Services Using Mobile Phones'; 'From Exclusion to Inclusion with Micro-payments'; and Unique Identification Authority of India (UIDAI).
10. Any other matter the Working Group may consider relevant.

19.7.3. Recommendations

1. The Payments Regulator should permit self-registration of payment system providers, including through online modalities.
2. The Payments Regulator should permit existing non-payment businesses to extend their business models to cover payments, in order that customer coverage could thereby expand.
3. Empower the payments regulator to ensure that access to infrastructure services is open and free of restrictive practices.
4. In order to foster financial inclusion within payments, the Payments Regulator should encourage the concept that certain categories of small-value payments could dispense with Know Your Customer (KYC) requirements for the entity making payments. Further, the categories of such payments should be clearly identified.
5. The Payments Regulator should permit, and indeed encourage, electronic KYC authentication as a full substitute for paper-based KYC authentication.
6. Regulation must maintain a level playing field within the payments industry between the public sector and the private sector, and between bank and non-bank players. It would need to be neutral to the ownership and category structures of the regulated entity, in the absence of which innovation within the payments industry is liable to be stifled.

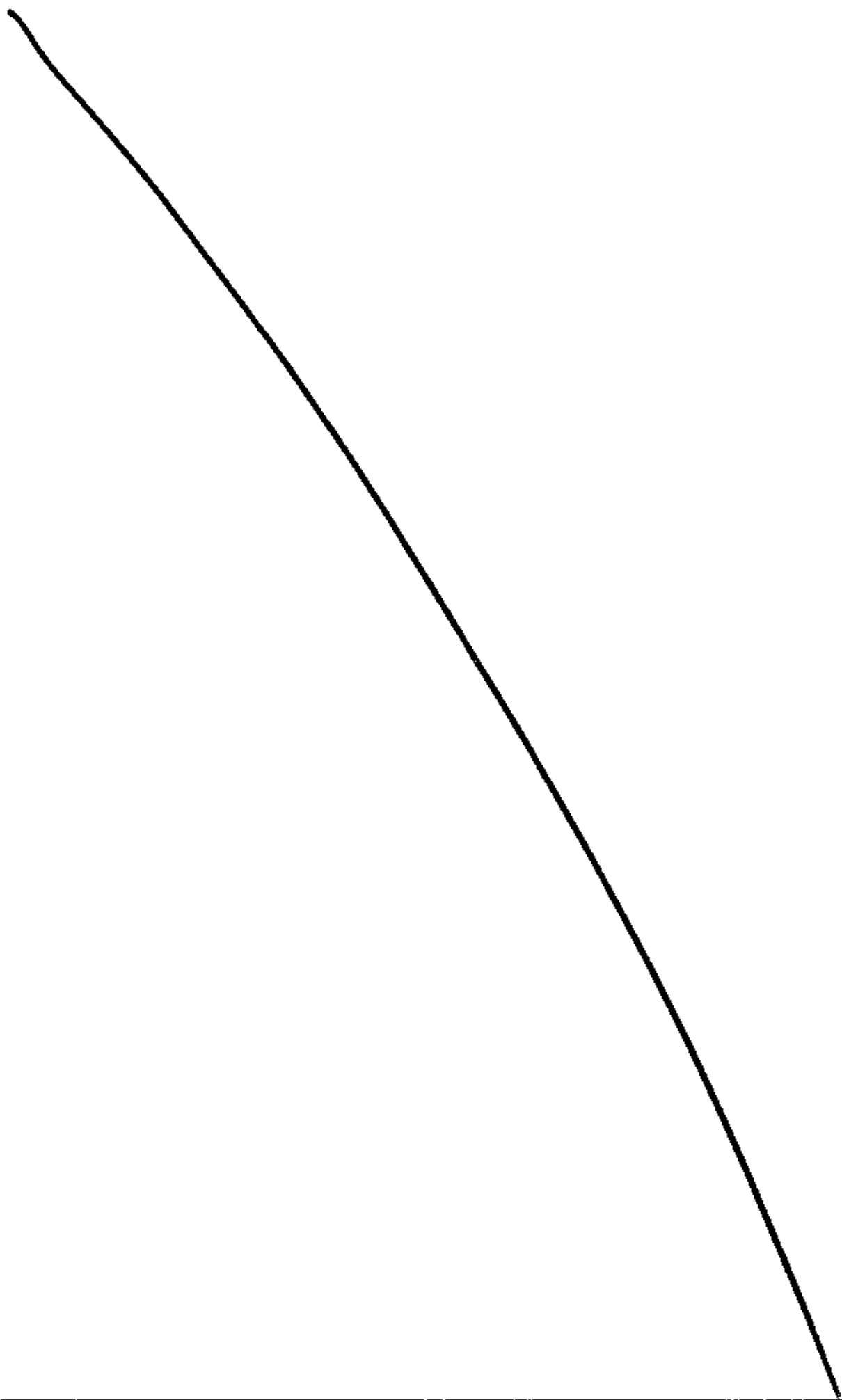
7. Regulation should encourage independent payment system providers, which are not linked to payment participants, thereby minimising moral hazard through conflict of interest.
8. Encourage innovation in payments regulation and supervision, by recognising that this is a fast-changing technology-enabled business. Bring in relevant expertise into the regulatory body in order to improve the regulation and supervision of this industry. Restrict representation from within RBI on the Board for Regulation and Supervision of Payment and Settlement Systems to the Governor (as Chairman) and the Deputy Governor in charge of Payments.
9. The Payments Regulator would need actively to sponsor the constitution of a Payments Council, a body which would be representative of payment system providers and users of payment systems. Regulations would be issued by the Payments Regulator which would define the role which the Council would play in advising the payments regulator on industry standards and other related matters. It would be mandatory for the payments regulator to consult with the Payments Council on such matters.
10. All payment system providers should be governed by one consistent legislative framework.
11. A system of 'proportionate regulation' would be helpful, allowing nascent businesses to adapt technology solutions without undue regulatory intervention, while requiring systemically important businesses to submit to stronger regulatory oversight.
12. It is important to infuse a transparent and fair rule of law into regulatory decisions. Legislation needs to provide for a quick appeals process, equally fair to both disputants, especially when one of them is the regulator. Further, all appellate powers presently vested in RBI and the Finance Ministry should be transferred to the appellate body.
13. All regulations made by RBI on payments would need to be consistent with the principles listed above as contained in Recommendations 1-12 above, which would be incorporated into a new enactment on payments. Regulations could thereby be challenged in the appellate body on grounds of violating the new legislative law.
14. Strong legal protection for payment system participants and other customers of payment systems would need to be incorporated in the new legislation. The constitution of a separate Customer Protection Agency to ensure this, backed by laws that require the enforcement of contracts by payment system providers, would facilitate this. Customer protection would no longer be the prime responsibility of RBI as the payments regulator.
15. Introduce a uniform and quick process for handling bankruptcy within the payments sector, with revenue payables of a payment system provider having priority in the context of bankruptcy.

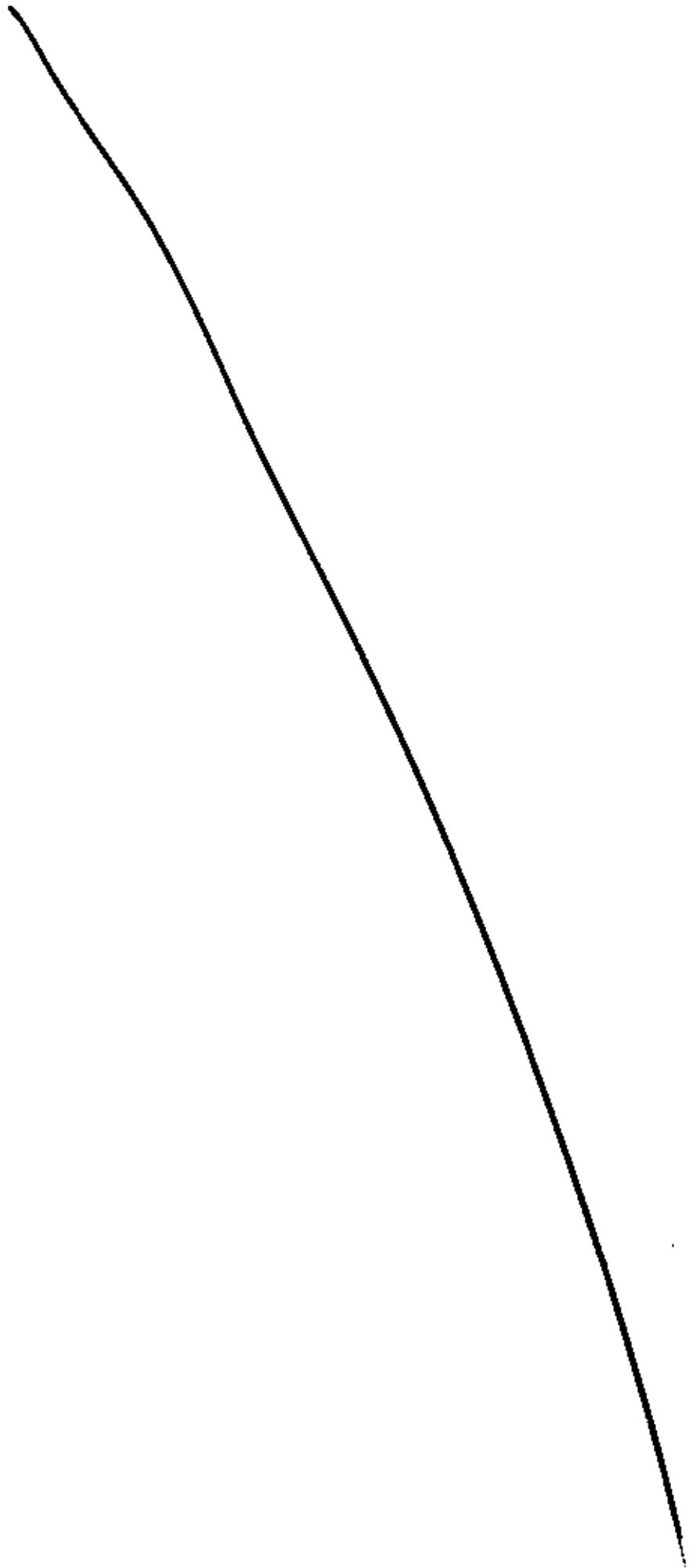
19.8. Working Group on securities

19.8.1. Composition

Prof. Jayanth R. Varma	-	Chairman
Shri Ravi Narain	-	Member
Shri Madhu Kannan	-	Member
Shri Neeraj Gambhir	-	Member
Shri Jayesh Mehta	-	Member
Shri S.A. Narayan	-	Member
Prof. K.G. Sahadevan	-	Member

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19.8.2. Terms of Reference

The work on securities will work on all dimensions of organised financial trading. The terms of reference shall be as follows:

1. Review the existing legal framework including SC(R)A, Securities Act, depositories legislation, RBI Amendment Act of 2005, FC(R)A, etc.
2. Review expert committee recommendations, and identify the legal changes which would implement existing recommendations.
3. Unification and harmonisation of the legal and regulatory treatment of all underlying and all traded products. How would we treat otc and exchange-traded derivatives in a unified framework? How should the word 'security' be defined, in a way that accommodates all dimensions of organised financial trading, and supports future innovations?
What should be done about commodity spot trading when delivery is done through dematerialised warehouse receipts? This may require examining the Warehouse Development and Regulation Act.
4. Should clearing corporations / clearinghouses be treated as a part of micro-prudential regulation or systemic stability? Are they systemically important components of the payments system?
5. What are the unique features of consumer protection in securities markets?
6. What are the unique features of micro-prudential regulation and systemic stability for securities markets?
7. What does financial law have to do, other than the main paths of consumer protection, micro-prudential regulation and systemic risk? What 'Aspects of Financial Contracts' require legislative attention, over and above these three pillars?
How do we obtain:
 - (a) Enforceability of derivative contracts in view of their similarity to wagering contracts
 - (b) Enforceability of netting, cross margining and closeout of positions by the clearing corporation especially in the event of bankruptcy of market participants.
 - (c) Bankruptcy remoteness of collateral in derivative margining and other contexts
 - (d) Securitisation especially of future cash flows
 - (e) Inter-linkage of CCPs with the payment system and their ability to settle in central bank money
 - (f) Legal protection of exchanges and clearing corporations in respect of actions taken by them after a participant default
 - (g) Resolution of clearing corporations and other systemically important securities market intermediaries
8. To review the legal framework through which the regulatory agency would write subordinate legislation on issues of ownership, governance, and compensation policy for critical infrastructure providers.
9. How should the issues of insider trading and fraud be dealt with, in a general way, which applies to all securities?
10. The field of corporate governance is a complex interplay of company law and securities law. What, if anything, should securities law be doing?
11. In the field of fund management, to review the structures used by mutual funds, private equity funds, etc., and examine the need for fundamentally different approaches.

19.8.3. Recommendations

1. The legal framework for securities must recognise the public good nature of financial markets and establish the principles of market integrity and transparency as key regulatory objectives.
2. The definition of securities should be entity neutral and should be broad enough to cover new instruments that emerge from the process of financial innovation. It must include a wide range of unlisted tradable instruments for the purpose of market abuse regulations, but must have broad exemptions for the purpose of registration requirements as explained in Recommendations 6 and 8.
3. The registration requirement must be entity neutral and should not therefore be restricted to companies.
4. There is a need to prevent redistribution of shares by the original recipient of shares. Otherwise, indirectly an offer may be made to a large number of persons.
5. There is need for an aggregation requirement whereby offers of the same class of securities by the same issuer over a period of say twelve months are aggregated. Concomitantly, the number of 50 may need to be increased to 100 or 150.
6. It is necessary to exempt offers to qualified institutional investors who do not need as much protection as retail investors.
7. There is a need to impose a registration requirement when the total number of holders of the securities exceeds a threshold (say 500 or 1000) even though only a small number of investors were approached in any given year.
8. It is desirable to have a "crowd funding exemption" for issues that are small in the aggregate even if they tap a large number of investors.
9. The statute must explicitly state that the purpose of the registration requirements is to ensure adequate disclosure and that the registration requirement is not to be used as a form of merit based regulation of public offers.
10. Commodity derivatives should be regulated in the same way as financial derivatives while taking care to exclude genuine commercial transactions in commodities.
11. The obligations to make adequate disclosures (prospectus, annual and quarterly reports and material event disclosures) must be laid down in statute and made applicable to all listed entities regardless of their legal form. The details regarding the content and format of these disclosures can be left to delegated legislation.
12. There must be a statutory provision allowing the regulator(s) to impose corporate governance obligations on listed entities in relation to (a) minimum proportion of independent directors in the Board of Directors (or similar governance organ) and its key committees (b) financial literacy requirements of members of key committees of the board.
13. The scope and objectives of takeover regulations must be laid down in statute. In particular:
 - (a) The regulations should cover all acquisitions of 25% of the voting rights as well as creeping acquisitions by controlling shareholders.
 - (b) Minority shareholders must be treated fairly by giving them an opportunity to sell at the higher of the highest price paid by the acquirers and the undisturbed market price by means of an open offer.
 - (c) While the long term goal is therefore a regime of 100% open offers, taking into account the development of takeover financing and other relevant factors, the regulator may specify a lower size of the open offer. The regulator(s) would be required to publish a report every five years justifying the size of the open offer.

- (d) The Board of the target company should be restricted from alienating material assets, incurring material borrowings, issuing new shares, buying back shares except with the approval of the shareholders by special resolution during the pendency of an open offer.
 - (e) The regulator should impose appropriate disclosure requirements on the acquirer to allow the shareholders of the target company to make an informed decision.
14. Legal certainty of enforceability of derivative transactions must be ensured for (a) exchange traded derivatives and (b) otc derivative transaction between sophisticated counter parties without reference to whether and by whom they are regulated.
 15. The regulator(s) should be mandated by law to balance the conflicting objectives of safety and efficiency in relation to for-profit Financial Market intermediaries (FMs). Moreover, the regulator(s) must be required to publish a report every five years on how it achieved this balance highlighting the emerging competitive landscape and technological developments.
 16. Every clearing house should be able to settle in central bank money. There should be mandatory settlement in central bank money for systemically important clearing houses, which should be stipulated in primary legislation.
 17. Clearing corporations of stock exchanges should be brought within the scope of the Payment Act (2007) to ensure finality of netting and settlement and to allow the clearing corporations to appropriate the collateral of insolvent members towards their settlement and other obligations.
 18. The definition of insider trading should be incorporated into the statute and should cover only cases where the trading was in breach of a fiduciary duty or other relationship of trust and confidence.
 19. The definition of other forms of market abuse like fraud, misrepresentation and the use of deceptive devices must also be part of the statute.
 20. In order to bring consistency in the scope of activities conducted by "market intermediaries", an activity based approach should be followed to define market intermediaries in primary securities legislation.
 21. A broad set of activities which are intended to be regulated by the securities regulator, whether or not such activities are primary or ancillary functions of the concerned entity must be specified.
 22. In order to ensure that the securities market regulator adequately enforces the provisions in relation to code of conduct of market intermediaries, the principal legislation in relation to securities market should lay down the broad principles of code of conduct of market intermediaries, specifically covering high standard of service, due diligence, disclosure of fees, prompt disbursement of payments, timely and adequate disclosures, confidentiality of client information, avoidance and management of conflicts of interest, sound corporate governance and compliance.
 23. Regulation regarding governance structure of funds should be neutral to the legal structure adopted by the fund. Regulations should not specifically prescribe the legal structure of the fund.
 24. To facilitate more flexible and modern legal forms of organisation, suitable amendments may be required in taxation and other laws.
 25. The primary statute must contain broad provisions on the governance of mutual funds including: the basic principle of unit holder approval for major decisions (or exit opportunity in lieu of such approval); requirements regarding offer documents and periodic disclosures; requirements regarding custodian and auditors. Details regarding these can be left to delegated legislation.

26. The primary statute must also lay down the broad principles of investment restrictions including matters like diversification requirements, borrowing restrictions, and liquidity of underlying investments. Details regarding these can be left to delegated legislation.

19.9. Debt Management Office

19.9.1. Composition

Dr. M. Govinda Rao	- Chairman
Shri Dhirendra Swarup	- Member
Shri Kanagasabapathy Kuppuswamy	- Member

19.9.2. Terms of Reference of the Working Group on Debt Management Office

1. Critically evaluate the case for separation of the PDMA from the RBI. In this context, focus on the conflicts of interest between the RBI's monetary policy, supervisory and regulatory objectives and the debt management objectives of minimising the borrowing cost and the development of a Government bond market. This analysis may be carried out in the light of new developments.
2. Determine how to setup the PDMA under the Commission, legal architecture, keeping in view Commission's work on independence, transparency and accountability.
3. Specify the work required in the PDMA on databases. This requires consolidation of all information on assets and liabilities along with contingent liabilities into a single centralised database.
4. Specify in greater detail the consolidation of the functions of several dispersed debt management departments within the RBI and Ministry of Finance into a single agency.
5. Issues related to placing the cash management function in the PDMA:
 - (a) Specify the cash management functions of the PDMA.
 - (b) Study international best practices on how PDMA and the Treasury cooperate on cash management.
 - (c) Draft law which places the cash management function in the PDMA.
6. Sub-national debt: As long as states are indebted to the Central Government, the states are required to seek the permission of the Central Government to borrow. The nature of assistance that the PDMA may offer to these sub-national governments in managing their debt needs to be explored.
7. Review the 2008 report and draft Bill on establishing a National Treasury Management Agency chaired by Dr. Jehangir Aziz, from the above perspectives.
8. Any other matter the working group may consider relevant.

19.9.3. Recommendations

1. The we recommends that implicit and explicit contingent liabilities should be managed and executed by the PDMA. The PDMA should evaluate the potential risk of these contingent liabilities and advise the Government on charging appropriate fees. In addition, the Government should be mandatorily required to seek advice of the PDMA before issuing any fresh guarantees since this has implications for the overall stability of the debt portfolio

2. The PDMA should adopt a holistic approach that encompasses the entire liability structure of the Central Government including not just marketable debt but also contractual liabilities from public accounts (such as small savings, provident fund receipts) and any other internal liabilities.
3. The wc believes that imposing the services of the PDMA on State Governments might not be advisable since the management of state debt is a state subject. It recommends that at the present juncture, the PDMA should be a Central Government agency obligated to manage only Central Government debt. The PDMA should, however, undertake functions related to State Government debt, which have implications for the Central Government's debt portfolio. This involves maintaining a comprehensive database of State Government debt and coordinating the Central Government's borrowing calendar with State Government's market borrowings. However, at a later stage, PDMA may provide the option to the states of managing their debt.
4. In regard to external debt, the wc is in favour of an integrated approach and recommends that the PDMA manages the external debt for the Central Government. The wc believes that the current set-up of external borrowings through external assistance needs to evolve over time into the Central Government developing a sovereign benchmark in the external market. This would benefit the corporates approaching international markets. In order to assist the PDMA in performing this role, the wc recommends that the Aid, Accounts and Audits Division (AAA), currently under the Department of Economic Affairs (DEA), Ministry of Finance should be merged with the PDMA once it comes into operation.
5. The Central Government has been consistently running large fiscal deficit over the years. In this situation, cash surpluses do not arise except for very short periods due to temporary mismatches between receipts and expenditures within a given financial year. However, PDMA should be tasked with the function of managing and investing surplus cash of the Government whenever such a situation arises in future.
6. On the structure of the proposed PDMA, the wc after considering various options recommends setting it up as a statutory corporation with representation from both the Central Government and the RBI. Further, the proposed PDMA should function with independent goals and objectives while being accountable to the Central Government for its actions and results. There should be a mechanism for constant consultation and coordination with both the Ministry of Finance and RBI.
7. The wc recommends a two tiered arrangement for the operations and management of the PDMA. It envisions a vertical relationship between the Policy Advisory Board and the Board of Management with the latter seeking opinion of the former in matters of strategy and policy. The Board of Management should have a direct line of communication with the Government. However, it should be required to consider any opinions or recommendations made by the Policy Advisory Board through a documented voting process. The duties of the Policy Advisory Board should be to provide opinions on any matters that may be referred to it by either the Board of Management or the Government. In addition, the Policy Advisory Board may also make recommendations suo motu on any activities of the PDMA it finds relevant.
8. The wc is of the opinion that transparency should be embedded into the organisational structure and the proceedings and other related documents of the meetings, including dissenting opinions, should be made statutorily public, and be open to the jurisdiction of the Right to Information (RTI). Based on the staff size and the activities of PDMA in various countries, the wc recommends that the Indian PDMA should be lean on staffing (approximately 70 staff), and should outsource a majority of its non-core activities.

19.10. Working Group on banking

19.10.1. Composition

Smt. K.J. Jdeshi	-	Chairperson
Smt. Y.H. Malegam	-	Member
Shri Janmajeya Sinha	-	Member
Shri Aditya Pur	-	Member
Ms. Naina Lal Kidwai	-	Member
Shri Rajiv Lal	-	Member
Shri Harsh Vardhan	-	Member
Shri M.G. Bhide	-	Member

19.10.2. Terms of Reference

The working group on banking will work on all entities which accept deposits for the purpose of lending or investments, of deposits of money from the public, repayable on demand or otherwise. The Terms of Reference of the Working Group shall be as follows:

1. To review the legal framework of the financial firms that are engaged in banking, such as commercial banks, public sector banks, cooperative banks, SA, and its subsidiaries and Regional Rural Bank (RRB) in India.
2. Unification and harmonisation of the legal and regulatory treatment of these entities.
3. To identify legal mechanisms for obtaining equal treatment, regardless of ownership and nationality on questions of competition policy, mergers, take overs, and governance.
4. The field of creditors rights and debt recovery should ideally be a feature of company law and debt in general. Yet, finance policy makers have embarked on initiatives such as The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI). What is the appropriate balance that Commission should adopt?
5. To review expert committee recommendations, and identify the legal changes which would implement existing recommendations.
6. To review the legal framework through which the regulatory agency would write subordinate legislation on issues of ownership, governance, and compensation of banks.
7. Addressing consumer protection, resolution, systemic risk and prudential regulation in banking.

19.10.3. Recommendations

1. The wg recommends that the definition of banking must be guided by the principle that all deposit taking activities (where the public places deposits with any entity, which are redeemable at par with assured rates of return) must be considered as banking. Consequently entities undertaking such activities must obtain a bank license and /or be subject to the regulatory purview of the banking regulator
2. On the definition of "banking" the wg recommends that any entity that accepts deposits, has access to clearing and to the RBI repo window is a bank. The primary activity of a bank is to accept deposits. Once an entity accepts deposits, it will have access to clearing and discount window of RBI.

3. On the issue of co-operatives which collect monies from members/ shareholders, this wg recommends that any co-operative society accepting deposits exceeding a specified value must fall within the regulatory purview of the banking regulator. Co-operative banks are currently regulated under Part V of the Banking Regulation Act, 1949 (BR Act), but many provisions in the BR Act are not applicable to them. This wg recommends that such exclusions be removed. Co-operative banks must be treated at par with banking companies. This wg also endorses the policy recommendations of the Malegam Report on Urban Co-operative Banks (2011). To deal with the problem of dual control, the Committee recommends the creation of a new organisation structure for Urban Cooperative Banks (UCBs) consisting of a board of management in addition to the board of directors. The board of directors would be elected in accordance with the provisions of the respective State Co-operative Societies Acts or the Multi-State Co-operative Act, 2002 and would be regulated and controlled by the Registrar of Co-operative Societies. The board of directors would establish a board of management, which shall be entrusted with the responsibility for the control and direction of the affairs of the Bank assisted by a CEO who shall have the responsibility for the management of the Bank. RBI would have powers to control and regulate the functioning of the Bank and of its board of management and of the Chief Executive Officer (CEO) in exactly the same way as it controls and regulates the functioning of the Board and the Chief Executive in the case of a commercial bank.
4. On the issue of companies accepting deposits, the members of the wg deliberated at length. It was pointed out to the wg that the RBI had, in its presentation before the Commission submitted that: "Only banks, statutory corporations, companies and co-operative societies regulated by the RBI should be allowed to accept deposits from public". While some members were of the opinion that the issue of companies accepting deposits is beyond the purview of this wg, other members expressed the opinion that deposit taking activities should be restricted only to banks. On the question of whether this issue falls within the ambit of this wg, the members deliberated that the Reserve Bank of India Act, 1934 (RBI Act) already prohibits partnership firms from accepting deposits. Hence some members of the wg recommended extending this prohibition to corporates accepting deposits as well. This requires amending Section 58A of the Companies Act, 1956. The proposed Companies Bill of 2011 is a step in this direction. It places restrictions on the acceptance of deposits by companies. It lays down the procedure for acceptance of deposits by members. A limited class of companies including banks and non-banking financial companies are allowed to accept deposits from public.
5. On the issue of NBFCs, this wg recommends that deposit taking NBFCs must obtain a license to operate as a bank and will fall within the regulatory purview of the banking regulator. The class of NBFCs that do not accept deposits from public will not be regulated by the banking regulator.
6. This wg also considered and debated the recommendations of Vickers Report (2011) and on the issue of ring fencing:
 - (a) This wg recognises the significant role played by NBFCs in providing finance. However, with a view to systemic risk oversight, this wg recognises that credit linkages between banking and non-bank finance should be subject to appropriate regulatory oversight from the viewpoints of both micro-prudential regulation and systemic risk regulation.
 - (b) Once transition to the Financial Holding Company (FHC) structure, as contained in the recommendation of this wg, is achieved subsidiaries of banks must only do such activities which banks themselves can undertake.

- (c) There must be ring-fencing of banks vis-a-vis other non-bank entities. Further, banks must not lend to intermediaries which are not regulated by a financial sector regulator. However, the operation of certain financial institutions such as mutual funds might require access to short-term funding. Such short-term funding must be within stringent prudential regulations.
7. This wg recommends that laws relating to banking should be ownership neutral and should provide a level playing field for all banks. As a necessary consequence this wg recommends corporatisation of all Public Sector Banks (psbs).
 8. In case of foreign banks having branches in India, this wg recommends that all such foreign banks set up a Wholly Owned Subsidiary (wos) in India. Transition issues will need to be addressed by the Government of India (goi) so that they do not incur taxation from capital gains, or stamp duty, when they convert from branch operations to wos.
 9. On the issue of deposit taking by co-operative societies this wg recommends that there should be some restriction on deposit taking by co-operative societies and that such activity should fall under the regulatory purview of the relevant legislation. The deliberation was on whether the restriction should be based on number of members or on the value of deposits. While some members expressed the view that restriction should be based on number of members i.e. a co-operative society accepting deposits from more than 50 members should fall within the regulatory ambit of the RBI, the opinion finally weighed in favour of value of deposits. The wg finally concluded by recommending that any co-operative credit society accepting deposits exceeding a specified value must follow the provisions of the relevant legislation.
 10. The wg recommends that there should be no exemption from the jurisdiction of the cci under the Competition Act, 2002 (Competition Act) for mergers of banks. The wg, however makes a distinction between voluntary and assisted mergers. All voluntary mergers will be subject to the review and approval by the competition regulator. One of the key recommendations of the Commission is the establishment of a resolution corporation to ensure prompt and orderly resolution of weak financial institutions. One of the tools of resolution involves sale or merger of weak firm with a healthy acquirer through appropriate mechanisms of due-diligence. To achieve this framework, the wg recommends that all assisted mergers involving sale of a failing bank to a healthy bank will be done under the supervisory review of the resolution corporation.
 11. This wg recommends corporatisation of all psbs, such as sei, its subsidiaries, corresponding new banks within the meaning of the Bank Nationalisation Acts and RBIs by converting them into companies under the Companies Act. This would level the playing field and will also rationalise the merger/ amalgamation provisions by bringing them with a single unified framework under the BR Act. In addition, this wg also endorses the policy approach that co-operative banks accepting "public deposits" must obtain a bank license from the regulator.
 12. Ownership in banks must be dispersed. The wg recommends that the current position of law in this regard be maintained.
 13. Bank supervisors must have powers to comprehensively look at human resource policy documents of a bank and recommend changes to the extent such policies impinge upon excessive risk-taking and soundness. The Board of Directors (bod) and shareholders of banks must have the power to claw back payments made to the top management in line with the global trend of curbing excessive risk taking by the top management.

¹¹In its submission to the Commission, the RBI has made a strong case for integrating the various statutes governing different segments of the banking industry and different dimensions of the banking business into a harmonised law to provide clarity and transparency.

14. Regulators must look at compensation policy and structure and its impact upon incentives and the ability of the bank to perform adequate risk management. The focus of supervisors should be upon the incentive implications of the compensation structure. There is a case for rules that require compensation to be spread over longer horizon, with provisions for claw back of payments in certain cases. While there is some thinking on framework for compensation in private and foreign banks, the same needs to be extended to PSBs. The legal and regulatory framework for compensation should give the BoD and shareholders the ability to push PSBs towards more rational compensation structures, given the deep links between the problems of risk management, operational controls of PSBs, and the flaws of compensation structure.
15. The notion of fit and proper for the boards of banks needs to be reviewed. The wg recommends removing the restriction on directors on Boards of banks also being directors of other enterprises. However, the Managing Director (MD) would not be allowed to occupy a board position in group companies/entities.
15. Further, this wg recommends that Section 20(i)(b) of the BR Act, which places restrictions on loans and advances by the BoD, must be confined to only loans and advances made to private limited companies or to entities where the director has substantial interest. For the purposes of this recommendation, the entities in which the director is deemed to be substantially interested must be in line with standards used for related party transactions under the Companies Act and accounting standards. This recommendation is broadly in line with the recommendations of the Committee on Financial Sector Assessment (CFSA) (2009). Referring to the definition of "substantial interest" in Section 5(he) of the BR Act, the CFSA was of the view that,

"this quantitative stipulation (Rs. 5 lakhs or 10% of the paid up capital of a company) has proved to be very low because of inflation and also growth in size of banking companies. It is felt that the quantitative ceiling of Rs. 5 lakhs should be removed and an appropriate percent of the paid-up capital be stipulated"

Hence the definition of substantial interest needs to be revised upwards.
17. With respect to PSBs, the BoD, must be given greater powers to nominate members of the appointment committee and the compensation committee of the BoD.
18. On governance arrangements, the wg recommends that uniform rule of law must be followed by banks irrespective of ownership. This includes:
 - (a) Separating the position of chairman and managing director in case of PSBs as well.
 - (b) BoDs of PSBs must play the same role as any other BoD, with the same stipulations as any other type of bank.
 - (c) Fully complying with the listing norms (see stock exchange rules) in case of listed entities.
19. This wg recommends that the current mode of operations of banks under Bank Subsidiary Mode (BSM) is inadequate and there should be a shift towards the FHC model as a preferred model for financial sector in India. The FHC model mitigates the risks spilling over to the bank from other entities in the group.
20. Subsidiaries of banks should only do business that could have been done purely within the bank. If insurance cannot be done by a bank, it should not be done by the subsidiary of a bank.
21. Further, capital of banks should not be allowed to take any risks apart from banking risks, and mechanisms must be put in place through which resources from the

bank does not flow up into the FHC or to sister subsidiaries in times of crisis, or otherwise. This is consistent with the ring-fencing approach, where micro-prudential regulation and resolution would face clearly defined bank risks, which are engaged in a well defined business of banking (public deposits that are redeemable at par with assured rates of return), with no other complexities of financial structure.

22. To achieve this transition the govt must provide a one time exemption to capital gains and stamp duty when such conversion happens.
23. With respect to the structure of the holding company, the Percy Ministry Report (2007) states that the holding company must pursue the business strategy of a unified financial conglomerate. In addition this we endorse the policy recommendations contained in the Percy Ministry Report (2007) which states that the holding company must be required to comply only with the Companies Act with exchange listing requirements, and should be subject only to systemic risk oversight by the appropriate regulator.
24. Considering the issues and gaps in the current legal framework and drawing on the recommendations of standard-setting bodies and international best practises, this we recommend that a sophisticated resolution corporation be set up that will deal with an array of financial firms including banks and insurance companies. The mandate of this corporation must not just be deposit insurance, it must concern itself with all financial firms which make intense promises to consumers, such as banks, insurance companies, defined benefit pension funds, and payment systems. A key feature of the resolution corporation must be its swift operation. It must also effectively supervise firms and intervene to resolve them when they show signs of financial fragility but are still solvent. The legal framework must be so designed to enable the resolution corporation to choose between many tools through which the interests of consumers are protected, including sales, assisted sales and mergers.
25. Prudential regulation should be ownership-neutral. The scope of regulation should be agnostic to the ownership structure of the banks.
26. Quantity and quality of capital should be the core part of prudential regulation of banks.
27. Prudential regulation should cover systemic interconnectedness in the context of the holding company model. As outlined above, one of the core mandates of prudential regulation is to limit the negative externalities arising out of the failure of a systemically important firm. The instruments of prudential regulation should be designed to deal with such kinds of firms.
28. In the proposed regulatory architecture the jurisdiction, approval and enforcement process of regulators is important and needs to be clearly defined in the prudential legislation.
29. There is a need for a comprehensive law on consumer protection and a redressal forum focussed on financial services, which cuts across different sectors such as banking, insurance and securities market.
30. In addition specific consumer protection issues also arise in case of electronic/not banking and lending. The rights and liabilities of parties entering into a net banking transaction is not clearly provided under any law and consumers are not protected by law against unauthorised electronic transfers. In addition liability of lenders towards fair disclosure and treating borrowers fairly is not governed by legislation but through guidelines of RBI. These specific issues are required to be addressed in laws to be written by Commission.

31. The wg recommends the move towards the FHC model as with appropriate accounting and reporting standards, it will help in identification of systemic risk build-up in large financial conglomerates.
- With appropriate accounting and reporting standards the move towards the FHC model will help in identification of systemic risk build-up in large financial conglomerates.
32. There are concerns which arise with insolvency proceedings of entities which are systemically important. In this regard the wg endorses the recommendation of CFSI to keep resolution of these entities separate from those relating to ordinary companies.
33. This wg endorses the recommendations of CFSI which recognises the need for a regulatory agency which would conduct periodic assessments of macro-economic risks and risk concentrations. This agency must also monitor functioning of large, systemically important, financial conglomerates anticipating potential risks.
34. While research and academic literature in systemic risk is relatively new, based on the existing experience of the countries and as endorsed by its inclusion in the Base III report, the wg recognises the need for countercyclical capital buffer as a policy tool for dealing with systemic risk.
35. In our view, the threshold limits for application of Recovery of The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDBFI) must not be stated in the act. The Central Government must have the power to determine the limit through rules. In addition, the capability and efficiency of Debt Recovery Tribunals (DRTs) must be measured on an ongoing basis and limitations must be addressed efficiently. The threshold limit after which cases may be filed before the DRT may be decreased only if the efficiency and capability permit.
36. This wg endorses the recommendations of Malegam Report on Urban Co-operative Banks (2011) and recommends a separation of the ownership of UCBS. In this way the banking business would be separated from the co-operative society. This would ensure that the regulatory treatment of the banking arm of the co-operative society is at par with banks. With the implementation of this recommendation the banking arm of co-operative banks must also be granted the same privileges available to banks under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) and RDBFI.
37. Section 14 of SARFAESI is silent on the time period within which petitions are required to be disposed off by the Chief Metropolitan Magistrate or District Magistrates. Since no time lines are prescribed, these petitions take longer than required to be disposed off leading to unnecessary delays. In *International Asset Reconstruction Company Private Limited through its Authorised Representative of Constituted Attorney Mr. Tushar B. Patil v. Union of India, through the District Magistrate and Others* noting the significant delay caused in enforcing security interests under Section 14 of SARFAESI petitions, the Bombay High Court has prescribed a time line of two months for all petitions filed under Section 14 of SARFAESI. This wg recommends that the law should prescribe a time period (perhaps 2 months) within which the District Magistrate or the Chief Metropolitan Magistrate, as the case may be, should dispose off Section 14 petitions. Those who fail to meet the time limit should be required to report the number of cases where they took longer than the prescribed time limit.
38. Neither Section 14 of SARFAESI nor the rules prescribed under SARFAESI, state what documents are required for filing a petition for enforcing a security. This leads to uncertainty in procedure with different courts requiring different documents leading to unnecessary delays. The Debt Laws Amendment Bill (2011), addresses this

issue by providing a list of documents to be filed with a Section 14 petition under SARFAESI. In our view, the proposal in the Debt Laws Amendment Bill (2011) would be sufficient for addressing this issue. This wc recommends the same list of documents to be filed with a Section 14 petition.

39. A petition for enforcing security interest under Section 14 SARFAESI can only be filed with a District Magistrate or a Chief Metropolitan Magistrate. In present day administrative services, the Deputy Commissioner of a particular district also acts as a District Magistrate. A Deputy Commissioner is an administrative officer principally responsible for overseeing revenue collection, such as collection of land revenue and other public dues. A Chief Metropolitan Magistrate on the other hand, does not exercise executive and judicial function but is the administrative head of metropolitan courts in India. Since both District Magistrates and Chief Metropolitan Magistrates are involved more in administrative functions than actual day to day judicial functions, there is considerable delay in addressing petitions under Section 14 of SARFAESI. The Debt Laws Amendment Bill (2011) addresses this issue by allowing the District Magistrate or the Chief Metropolitan Magistrate to authorise any officer subordinate to him to take actions for enforcing the security interest. On this issue, it is the view of this wc that the proposals in the Debt Laws Amendment Bill (2011) is sufficient to address the problem. If the District Magistrate or the Chief Metropolitan Magistrate is allowed to authorise any officer subordinate to him to take actions for enforcing the security interest it would help in reducing delays.
40. In India our laws give preference to crown debt in the form of taxes and statutory dues over the claims of secured creditors during insolvency and bankruptcy proceedings. Though reforms in certain tax laws now provide priority of secured creditors. Tax dues under Customs Act, 1962, Central Excise Act, 1944, and service tax under the Finance Act, 1994 are subject to the claims of secured lenders under ROBEI and SARFAESI. While these reforms have only partly addressed the issue, the general principle of priority of secured lenders over crown debts and debts under other welfare legislations such as labour laws is not specifically provided for in our laws. This wc endorses the recommendations of the Raghuram Rajan Committee Report (2009) on rationalising insolvency and bankruptcy proceedings:
- (a) While it is important to protect employee claims such as overdue wages, there must be a limit, say six months, to which such pay is protected. After the expiry of this period employees must also join the ranks of unsecured creditors.
 - (b) The government, which has substantial powers to recover arrears to it prior to bankruptcy, should not stand ahead of secured creditors.
 - (c) Statutory priorities of a firm should be well disclosed so that creditors can act well in time, before they get crowded out by other claims.
41. The purpose of setting up ORTs was to ensure speedy recovery of debts by setting up a special tribunal system which follows a summary procedure as opposed to a detailed procedure followed by the civil courts. ORTs in India are now plagued with the same problems that afflict civil courts: Huge backlog of cases and insufficient infrastructure. An efficient tribunal system has sufficient resources at its disposal and has well trained and competent staff. If the objective and purpose of setting up ORTs are to be given effect to, one cannot ignore the infrastructure issues that afflict the ORTs.
- To address the infrastructure issues that afflict ORTs in India, there is a need to rethink and overhaul the legal framework under ROBEI:
- (a) **Objective of ORT:** Amend ROBEI to clearly state the objective of ROBEI, as a special tribunal, for providing a mechanism for recovery of debt that is fair, just, economical and quick.

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- (b) **Efficiency of DRT:** Suitably amend RDBFI to place an obligation on the appropriate entity to ensure efficient and effective functioning of the system.
- (c) **Training of judicial and recovery officers:** Suitably amend RDBFI and SARFAESI to place a duty on the appropriate entity for training of judicial and recovery officers.
- (d) **Uniform procedures:** Amend RDBFI to reflect the principle that uniform procedures must be followed by all DRTs.
- (e) **Comprehensive rules on procedures:** Detailed rules of procedure under the Civil Procedure Code, 1908 and rules of evidence under the Indian Evidence Act, 1872 are not required to be followed. Keeping this in mind, the rules of procedure for DRTs under RDBFI, namely the Debt Recovery Tribunal Rules, 1993, were drafted. The rules of procedure were intended to be light touch by allowing significant liberty to the tribunals to devise their own methods and standards. This has led to inconsistent and differing approaches taken by different DRTs. There is a need to set out comprehensive if not detailed, set of rules of procedure applicable to hearings before DRT to increase certainty of procedure and provide guidance to practitioners.
- (f) **Quantitative measurements of performance:** Amend RDBFI and SARFAESI to ensure reporting requirements by appropriate authorities for preparing annual reports which detail revenues received through filing fees, resource allocation, steps taken towards efficient functioning of the tribunals, statistical analysis of cases and workload, time taken to dispose cases, and reasons for delay.
- (g) **Funding and resource allocation:** There is a need to rethink the funding and resource allocation for DRTs in India. Tribunals do not function efficiently if they are not well funded and do not have sufficient resources at their disposal. The recommendations are two fold:
- i. **Independence:** Currently, resource allocation for DRTs is done through the Ministry of Finance, through the budgetary process. Financial sector regulators in India, such as SEBI and IRDA, have the ability to charge fees from regulated entities to cover the cost of their functioning. Independence in funding and resource allocation is important for effective functioning as it allows the entity the operational flexibility. The recommendation is therefore to amend RDBFI recognising the principle of independent resource allocation.
 - ii. **Quantum of fees:** There is merit in empowering the DRTs to determine the filing fees by keeping in mind the overall costs for their effective functioning. The applicants who file petitions before DRTs are financial institutions which can afford to pay for speedy recovery of loans made by them.² Currently, only the Central Government has the power to make regulations prescribing the fees. Since the recommendation of this we is to grant more independence to DRTs for allocating resources, deciding the quantum of fees should be their prerogative and is a necessary outcome of such independence.
- (h) **Adopting information technology:** Indian courts have been slow in adopting information technology. While there has been some improvements in communication to the public through websites; there is no movement towards integrating the entire court process into an electronic form. Digitisation of court records and computerisation of registries would be beneficial.

²At present, the cost of filing an original application before the DRT is Rs. 12,000 when the amount of debt owed is Rs. 10 lakhs, subject to a maximum cap of Rs. 150 lakhs.

in handling the huge backlog of cases. As an example, digitising the registry of the Supreme Court of India has been beneficial in reducing arrears and in facilitating docket management. For efficient functioning of CRTs, adopting information technology would help in overall reduction of case backlog and would lead to greater efficiency.

42. Amend Section 5 of SARFAESI to allow sale of assets from one Asset Reconstruction Company (ARC) to another.
43. Amend Section 9 of SARFAESI to allow the issue of convertible debt by an ARC. The proposals contained in the Debt Laws Amendment Bill (2011) allows converting only a portion of the debt into equity. It does not allow the conversion of all of the debt into equity, and it does not allow issuing convertible debt which may or may not convert into equity.
44. Suitably amend SARFAESI to allow all secured creditors who are regulated entities under the purview of the Act.
45. Amend Section 12 of SARFAESI to list enumerated powers of Reg along with principles that reflect factors which will inform RBI of the choice of powers to be used.
46. While stamp duty laws are not within the purview of laws to be rationalised either under Commission or within the scope of the TOR of this Wg, this Wg is of the opinion that there must be rationalisation of stamp duty laws in India. A possible solution could be the levy of transaction tax as opposed to stamp duty. The power to levy transaction tax lies with the Parliament and a transaction tax similar to that of goods and services tax may be introduced by abolishing stamp duty.
47. The recommendations in this part are primarily clarifications and standardisation of the process of securitisation, and are not features of the primary law. Reforms in these areas would lead to smoother functioning and greater clarity in the process of securitisation. Some of these also act as a guide to the enumerated powers/principles to be reflected in the powers of the regulator under Section 12 of SARFAESI:
 - (a) **Clarity on sale/lease of business:** Although Section 9(b) of SARFAESI allows securitisation/reconstruction companies to sell or lease a part of the business of the borrower, the exercise of this power is subject to RBI guidelines, which have not been issued by RBI. This Wg recommends that since the primary legislation allows sale or lease of a business by an ARC, the regulator must not exercise discretion by not issuing guidelines on substantive rights.
 - (b) **Restructuring support finance:** Borrowers' debts turn into Non Performing Assets (NPAs) on account of their inability to finance the debt. The goal of restructuring is to turn around the profitability of such borrowers. Typically, ARCs fund the purchase of the bad assets by issuing securitisation receipts to Qualified Institutional Buyers (QIBs). ARCs are only allowed to deploy funds to restructure the loan account of the borrower. Deploying of funds by the ARC into the defaulting borrower is not permitted. Given that ARCs are in a better position to restructure and revive failing companies there may be merit in allowing ARCs to also deploy funds into the borrowing company. On the basis of the proposals contained in the Debt Laws Amendment Bill, 2011, which allows partial conversion of loan into equity, deploying funds into the borrower company should be allowed, as this will act as an incentive for the ARC to restructure the company in a holistic manner. This Wg is of the opinion that the regulator must prescribe guidelines, subject to prudential regulations, on when ARCs can deploy funds towards restructuring the borrower company along with the process to be followed.

- (c) **Pledged shares and exemptions from the Takeover Code:** When the underlying security, which has been acquired by an ARC, are shares held in dematerialised form, there are no statutory provisions or regulatory guidelines allowing substitution of the ARC in place of the original lender. This leads to complications and excessive procedural requirements. Further, while banks and financial institutions have been exempted from the Securities and Exchange Board of India Substantial Acquisition of Shares and Takeover, Regulations, 2011 (Takeover Code), for pledged shares held by them, similar exemptions have not been made applicable to ARCs. This WG recommends that substitution of ARCs in place of the original lender, and the exemption from the applicability of the Takeover Code must be allowed. This would however require appropriate amendments to subordinate legislation by SEBI and Ministry of Company Affairs, Government of India (MCA), as applicable.
- (d) **Modification of charges:** Companies which mortgage their assets are necessarily required to intimate the Registrar of Companies (RoC) to assist in case of insolvency/winding up. However, currently dormant companies (companies who have not complied with filing of annual returns among other things) are not allowed to change or modify their charge registers in light of recent notifications of the MCA.³ This leads to a situation where if the assets of the dormant company are securitised and transferred to ARCs, the names of ARCs cannot be substituted leading to difficulties in enforcement proceedings/insolvency and winding up cases. This WG is of the opinion that modification of charges and exemptions in case of ARCs acquiring NPAs of dormant companies must be allowed. This would however require appropriate clarifications by the MCA.
- (e) **Central Registry:** The Central Government has set up a central electronic registry under SARFAESI effective from March 31, 2011 to prevent frauds in loan cases involving multiple loans from different banks. The central registry is maintained by Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) under SARFAESI. The registration of charges can be done online and search of the records of the registry can be done by any person online. This WG is of the opinion that the scope of the registry must be expanded to include encumbrance over any property and not just those which are mortgaged to banks or financial institutions. In addition all existing registration systems such as land registry and filings with the registrar of companies, must be integrated with the central registry so that encumbrance on any property (movable or immovable or intangible) is recorded and can be verified by any person dealing with such property.

19.10.4. List of Acts governing the Indian banking sector

1. Banking Regulation Act, 1949
2. Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (applicable to banks nationalised in 1970)
3. Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (applicable to banks nationalised in 1980)
4. Companies Act, 1956 (to a limited extent)
5. Reserve Bank of India Act, 1934, rules, guidelines, master circulars, and regulations made thereunder

³The Ministry of Company Affairs through General Circular 33/2001 dated June 1, 2001 notified that unless a company files its updated balance sheet and profit and loss account it will not be able to file any event based compliance forms, including for modification of charges.

6. Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
7. Recovery of Debts Due to Banks and Financial Institutions Act, 1993
8. Foreign Exchange Management Act, 1999 (for foreign currency dealings), guidelines, rules, regulations and master circulars made thereunder
9. Banking Ombudsman Scheme, 2006 (not an Act, but governs resolution of consumer disputes)
10. Payment and Settlement Systems Act, 2007
11. Regional Rural Banks Act, 1976 (for rural banks)
12. Deposit Insurance and Credit Guarantee Corporation Act, 1961
13. Banking Laws (Amendment) Bi., 2011
14. State Co-operative Societies Acts (for each state)
15. Multi State Co-operative Societies Act, 2002
16. State Bank of India Act, 1955
17. State Bank of India (Subsidiary Banks) Act, 1959
18. Competition Act, 2002

19.10.5. List of Committee Reports on Indian banking sector

1. Narasimham Committee - and II
2. Percy Mistry Committee
3. Raghuram Rajan Committee
4. LeelaCher report: Consolidation of Banking Industry in India
5. Jmaji Report: Review of the Banking Regulation Act
6. A. Ghosh Committee: Frauds and Malpractices in Banks
7. Adhyarjuna Committee: Changes in NI Act and Stamp Act
8. B. Tradi Committee: Insolvency and winding up
9. Bhide committee: Coordination between commercial banks and SFCs
10. James Raj Committee: Functioning of psas
11. K. Madhav Das Committee: Urban Co-operative Banks
12. Marathe Committee: Licensing of New Banks
13. M.L. Dantwala Committee: Regional Rural Banks
14. Thirugalaya Committee: Restructuring of RRBS
15. S.S. Kadkarni Committee: Trading in psas
16. S.S. Kohli: Rationalising Staff Strength in Banks
17. S. Padmanabhan Committee: Inspection of Banks
18. S. Padmanabhan Committee: Onsite supervision function of Banks
19. R.N. Midga Committee: Cooperative societies
20. Rajamanar Committee: Changes in banking laws and bouncing of cheques
21. Raghavan Committee: Competition Law
22. R. Jiran: inspection system of banks
23. Pilla' Committee: Pay scales of bank officers
24. Pendarkar committee: Review of the system of inspection of commercial, RRB and urban co-operative banks

19.11. Interactions by the Working Groups

WG on Payments

- ▶ Reserve Bank of India
- ▶ National Payments Corporation of India
- ▶ PayPal
- ▶ Vodafone
- ▶ Bharti Airtel
- ▶ A Little World

WG on Insurance, Pensions & Small Savings

- ▶ General Insurance Council
- ▶ Life Insurance Council
- ▶ Lloyds
- ▶ Indian Institute of Insurance, Surveyors & Loss Assessors
- ▶ Ministry of Labour
- ▶ Insurance Regulatory and Development Authority

WG on Securities

- ▶ Association of Investment Bankers of India
- ▶ Association of National Exchanges Members of India
- ▶ BSE Ltd.
- ▶ Indian Clearing Corporation of India
- ▶ National Stock Exchange of India Ltd.
- ▶ National Securities Clearing Corporation Ltd.
- ▶ MCX-SX
- ▶ Central Depository Service (India) Ltd.
- ▶ The BSE Brokers' Forum

19.12. External Reviewers and Experts who worked with the Research Team

S.No.	Name	Designation	Organisation
1	Avnash Persaud	Senior Fellow	Caribbean Policy Research Institute
2	Badri Narayanan	Advisor	Third Eye Capital Advisors LLP
3	B'ku Kurwila	Legal Consultant	New York, USA
4	Bindu Anant	President	FMR Trust
5	Cnandrasekhar Bhaskar Bhawe	Former Chairman	Securities and Exchange Board of India
6	Jahangir Aziz	Chief Economist	J.P. Morgan Chase & Co
7	K.N. Vaidyanathan	Chief Risk Officer	Mahindra and Mahindra
8	K.P. Krishnar	Secretary	Economic Advisory Council to Prime Minister
9	Kate McKee	Senior Advisor	OSAP
10	M.S. Sahoo	Former Member	Securities and Exchange Board of India
11	Matt Crooke	Minister-Counselor	Australian High Commission, New Delhi
12	Molina Asthana	Principa. Solicitor (Commercial, Property & Technology)	Victorian Government Solicitor's Office, Melbourne, Australia
13	Monika Halar	Editor	Virtual Money
14	N.K. Nambodari	Special Secretary	Department of Legal Affairs, GOI
15	Nachiket Mor	Chair	Sugha Vazhu Health Care Private Ltd
16	O.N. Ravi	Corporate Development Officer	The Clearing Corporation of India Limited
17	Ritvik R. Pandey	Director (Budget)	Department of Economic Affairs, GOI
18	Renuka Sane	Research Economist	Indira Gandhi Institute of Development Research
19	Sanjay Banerji	Professor of Finance	University of Nottingham Business School
20	Sanjiv Shah	Executive Director	Goldman Sachs
21	Subrata Sarkar	Professor	Indira Gandhi Institute of Development Research
22	Sudhamoy Khasnoodis	Founder	-Care Life Pte. Ltd, Singapore
23	T. Koshiy	Executive Director, Advisory Services	Ernst & Young Private Ltd.
24	Tarun Ramadorai	Professor of Financial Economics	Saïd Business School & Oxford-Man Institute of Quantitative Finance University of Oxford
25	Wikramaditya Khanna	Professor	University of Michigan Law School
26	Viral V. Acharya	Professor of Economics	New York University Stern School of Business
27	Yesna Yadav	Assistant Professor of Law	Vanderbilt University Law School

19.13. Submissions to FSLRC

A. General Submissions

S.No.	From	Remarks
1.	Mr. Rajiv Ranjan, President & CEO, Reliance Asset Reconstruction Co. Ltd through CM Division of MoF	SAR-ACSI Act: Legal and Regulatory issues
2.	Mr. S.M. Roy	Funds for investor education - unclaimed moneys of investors dealing with companies
3.	CM Division, DEA, MoF	Draft National Competition Policy 2011
4.	Mr. B. Veeraswamy	Review of employees' Pension Scheme - 1995
5.	Mr. Dirk Kempthorne, President & CEO of ACLI / CM Division, DEA, MoF	White paper on Benefits of Life Insurance Sector Reforms prepared by American Council of Life Insurers (ACLI)
6.	PHD Chamber of Commerce and Industry	Written submission based on interaction
7.	FICC	Written submission based on interaction
8.	DFS, through CM Division, DEA, MoF	Suggestions for the consideration of Commission
9.	Indian Banks' Association	Written submission based on interaction
10.	Mr. Charan Lal Sahu, All India Sahu Mahasabha, through DEA, MoF	Amendments in a. Laws U/A 39(C) of the Constitution of India in Central Acts to root out corruption
11.	Mr. Sandeep Parekh, FINSEC, Mumbai	Written representation on policy issues to terms of reference of the Commission
12.	Mr. L. Rutton, MD & CEO, MCX, Mumbai	Written submission based on interaction
13.	Mr. Bill Shorten, Minister for Employment and Workplace Relations etc., Canberra ACT	Written submission based on interaction
14.	Mr. Rajiv Agarwal, Secretary, Consumer Affairs	Written submission based on interaction
15.	Mr. R. Gopalani, Secretary (Economic Affairs)	Copy of reply sent to Shri Rajiv Agarwal, Secretary, Mo Consumer Affairs Reg. on acceptance of their request to remove FCRA from the TOR of the Commission
16.	MoF (CM Division)	Withdrawal of Indian Trust Act (Amendment) Bill 2009 from the Lok Sabha seeking views/comments of Commission
17.	Mr. H. Jayesh, J.Jins Corp, Mumbai	
18.	Keith Noyes, Regional Director, Asia Pacific International Swaps and Derivatives Association, Inc., Singapore	
19.	CUTS International,	On the need for a dedicated consumer protection agency

B. Feedback on Approach Paper

S.No	Author/Publication
1.	Bureau Report – Economic Times (ET) 02.10.2012
2.	Ila Patnaik – Financial Express 02.10.2012
3.	Monika Jalan – MINT 02.10.2012
4.	Editorial – MINT 02.10.2012
5.	Bureau Report – Business Standard 02.10.2012
6.	Asit Ranjan Mishra – MINT 02.10.2012
7.	Editorial – Financial Express 02.10.2012
8.	Bureau Report – Financial Express 02.10.2012
9.	Editorial – ET 04.10.2012
10.	Shaji Vikraman – ET 04.10.2012
11.	Bureau Report – Hindustan Times 05.10.2012
12.	Dhirendra Kumar – ET 08.10.2012
13.	George Mathew – Indian Express 09.10.2012
14.	K.K. Srinivasan (Former Member, IRDA) – email dated 12.10.2012
15.	Bimal Jalan (Ex. RBI Governor) – Moneycontrol.com 13.10.2012
16.	Sucheta Dalal – Moneylife 15.10.2012
17.	Sameer Kochhar – inclusion.in 17.10.2012
18.	Dr. C. Rangarajan, Chairman, PMUAC – Moneycontrol.com 20.10.2012, MINT 28.10.2012 & Times of India 28.10.2012
19.	Dipankar Chaudhury – MINT 25.10.2012
20.	S.S. Tarapore – inclusion.in 29.10.2012
21.	Madhoo Pavaskar – e-mail 30.10.2012
22.	Venkat Chary, Chairman, MCX – e-mail/letter 30.10.2012
23.	Joseph Massey, MD, MCX-SX – 31.10.2012
24.	CLTS International – e-mail dated 02.11.2012
25.	Ministry of Corporate Affairs – 05.11.2012
26.	Forbes India – 08.11.2012
27.	Indian Centre for Islamic Banking – 12.11.2012
28.	Alternative Investments and Credits Limited – 15.11.2012
29.	Department of Consumer Affairs – 29.11.2012
30.	Reserve Bank of India – 07.12.2012

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Report of the
Financial Sector Legislative Reforms Commission

Volume II: Draft Law

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Indian Financial Code

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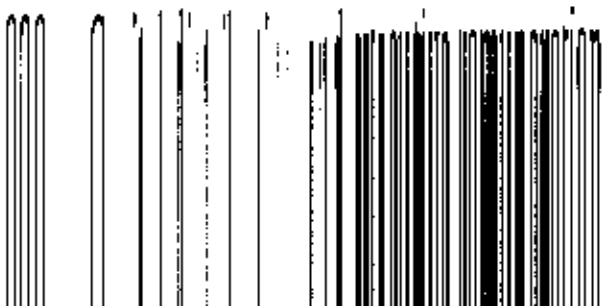
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Indian Financial Code

A

BILL

to consolidate and amend the law regulating the Indian financial sector and to set out principles for financial regulation, and to provide for the establishment, objectives, powers of, and framework for interaction among, financial regulatory agencies, and for matters connected therewith or incidental thereto, with a view to bring coherence and efficacy in the financial regulatory framework.

WHEREAS this Act lays down mechanisms of independence and accountability, and provides for judicial review and oversight over financial sector regulation;

AND WHEREAS this Act is intended to be a principles-based law, enabling its application to any segment of the financial sector, intending to focus on ownership-neutrality, and seeking to foster competition;

AND WHEREAS this Act is aimed at strengthening and formalising the governance of financial regulatory agencies, and to provide for a comprehensive framework for consumer protection, prudential regulation, regulation of certain types of financial contracts, market abuse, resolution of financial service providers, systemic risk oversight, effective and affordable access to financial services, market development, capital controls, and public debt management in India;

BE it enacted by Parliament in the Sixty-fourth Year of the Republic of India as follows:—

PART I

PRELIMINARY

CHAPTER 1

PRELIMINARY

Short title,
application and
commencement.

- 1. (1) This Act will be called the Indian Financial Code, 2013. 5
- (2) This Act extends to the whole of India.
- (3) This Act will come into force from such date as may be notified by the Central Government.
- (4) The Central Government will have the power to notify different dates for different Parts of this Act to be brought into force, with no such Part being made effective partially. 10

CHAPTER 2

DEFINITIONS

Definitions.

- 2. In this Act, unless the context requires otherwise –
 - (1) "actuary" means a person certified to practice as such by the Institute of Actuaries of India under section 9 of the Actuaries Act, 2006 (35 of 2006). 15
 - (2) "administrative law member" means an executive member of the board of a Financial Agency who is qualified in the field of law, and is designated as such under section 33.
 - (3) "advice" means a recommendation, opinion, statement or any other form of personal communication directed at a consumer that is intended, or could reasonably be regarded as being intended, to influence the consumer in making a transactional decision. 20
 - (4) "auditor" means a chartered accountant certified to practice as such by the Institute of Chartered Accountants of India under section 6 of the Chartered Accountants Act, 1949 (38 of 1949), and carrying out the task of audit. 25
 - (5) "authorised dealer" means a person authorised under Chapter 70, in relation to capital account transactions, to engage in the business of –
 - (a) dealing in foreign exchange; or
 - (b) receiving any payment by order or on behalf of any non-resident, in any manner. 30
 - (6) "banking" means the business of accepting deposits from the public with the promise of repaying such deposits at an assured rate of return.
 - (7) "banking service provider" means a financial service provider which carries on banking. 35
 - (8) "beneficial owner" means a person whose name is recorded as such with a depository and the term "beneficial ownership" will be construed accordingly.

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- (9) "bridge service provider" means a wholly owned subsidiary of the Corporation, established in accordance with section 255(1), to which the Corporation may transfer some or all of the assets or liabilities of one or more covered service providers.
- 5 (10) "bye-laws" means the bye-laws made under this Act.
- (11) "capital account transaction" means a transaction which alters the assets or liabilities, including contingent liabilities, outside India of residents, or in India of non-residents.
- 10 (12) "capital distribution" means a distribution of cash or other property by a financial service provider to its owners made on account of their ownership.
- (13) "central counterparty" means a person interposed between counterparties to contracts traded in one or more markets for securities, becoming the buyer to every seller and the seller to every buyer.
- (14) "Class A offence" means an offence described under section 415(1)(a).
- 15 (15) "Class B offence" means an offence described under section 415(1)(b).
- (16) "Class C offence" means an offence described under section 415(1)(c).
- (17) "clearing" means the process of transmitting, reconciling and wherever relevant, confirming payments or securities transfers, prior to settlement.
- 20 (18) "combination" has the meaning assigned to it under section 5 of the Competition Act.
- (19) "compensation" means the amount that may be given to persons identified under a compensation order.
- (20) "compensation notice" means a notice issued by the Corporation under section 276.
- 25 (21) "compensation order" means an order issued by the Corporation under section 278.
- (22) "Competition Act" means the Competition Act, 2002 (12 of 2002).
- (23) "Competition Commission" means the Competition Commission of India established under section 7 of the Competition Act.
- 30 (24) "complainant" means a retail consumer who has filed a complaint with the Redress Agency or whose complaint has been forwarded by the Regulator to the Redress Agency.
- 35 (25) "complaint" means an oral or written expression of dissatisfaction made by, or on behalf of, a consumer alleging that the consumer has suffered or is likely to suffer an inconvenience or loss on account of a financial product provided, or a financial service rendered, by a financial service provider or its financial representative.
- (26) "compounding order" means an order referred to in section 413.
- (27) "conduct" includes any act or omission.
- 40 (28) "consumer" means a person who has availed, avails, or intends to avail of a financial service or has a right or interest in a financial product.
- (29) "Consumer Advisory Council" means the advisory council on consumer protection established under section 129.

- (30) "contract of insurance" means a contract under which a financial service provider, for consideration, assumes the risk of one or more persons, and distributes it across a class of similarly situated persons, each of whose risks has been assumed in a similar transaction, and includes any instrument that may be prescribed by the Central Government to be a contract of insurance. 5
- (31) "control" means the right to control, individually or in concert with other persons, directly or indirectly, whether by virtue of ownership or management rights, by agreement or in any other manner, -
 - (a) the management or policy decisions of a person; or
 - (b) the appointment or removal of the majority of the members of the body responsible for the oversight of the affairs of a person. 10
- (32) "Corporation" means the Resolution Corporation established under section 16.
- (33) "Corporation Board" means the board of the Corporation.
- (34) "Corporation Chairperson" means the chairperson of the Corporation.
- (35) "Corporation insurance" means the contract of insurance issued by the Corporation to a covered service provider under section 262. 15
- (36) "Council" means the Financial Stability and Development Council established under section 20.
- (37) "Council Board" means the board of the Council.
- (38) "Council Chairperson" means the chairperson of the Council. 20
- (39) "Council Chief Executive" means the chief executive of the Council.
- (40) "counterparty" means a party to a trade in the market for securities.
- (41) "covered service provider" means a financial service provider that has obtained Corporation insurance under section 262.
- (42) "covered service provider under resolution" means a covered service provider that the Corporation resolves under a resolution order. 25
- (43) "credit arrangement" does not include an arrangement, irrespective of its form, which is a contract of insurance or credit extended by an insurer solely to maintain the payment of premiums on a contract of insurance, but means an arrangement that is - 30
 - (a) a credit facility;
 - (b) a credit transaction;
 - (c) a credit guarantee; or
 - (d) combination of any of the above.
- (44) "credit facility" means an arrangement, irrespective of its form but not including a credit transaction, in terms of which - 35
 - (a) a creditor undertakes to supply goods or services or to pay any amount, with or without collateral or guarantee, to the borrower or on behalf of, or at the direction of, the borrower; and
 - (b) any charge, fee or interest is payable by the borrower or on behalf of or at the direction of the borrower to the creditor in lieu of the arrangement referred to in clause (a). 40

- (45) "credit guarantee" means an arrangement, irrespective of its form but not including a credit facility, in terms of which a person undertakes or promises to satisfy upon demand any obligation of another consumer in respect of a credit facility or a credit transaction to which this Act applies.
- 5 (46) "credit transaction" means an arrangement, irrespective of its form, which is -
- (a) a lease;
 - (b) a mortgage agreement or secured loan;
 - (c) an instalment agreement; or
 - 10 (d) any other agreement other than a credit facility or credit guarantee, in terms of which payment of an amount owed by one person to another is deferred thereby attracting a liability to pay a charge, fee or interest to the credit provider in respect of -
 - (i) the agreement; or
 - (ii) the amount that has been deferred.
- 15 (47) "current account transaction" means a transaction that is not a capital account transaction, and includes -
- (a) payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business;
 - 20 (b) payments due as interest on loans and as net income from investments;
 - (c) remittances towards living expenses of relatives or dependents; or
 - (d) travel expenses, medical expenses, insurance, or education expenses of relatives or dependents.
- 25 (48) "Data Centre" means the Financial Data Management Centre established under section 294.
- (49) "Data Centre Director" means the director of the Data Centre.
- (50) "debenture" means any instrument evidencing debt, whether or not secured by a charge on assets.
- 30 (51) "Debt Agency" means the Public Debt Management Agency established under section 24.
- (52) "Debt Agency Advisory Council" means the advisory council of the Debt Agency established under section 378.
- (53) "Debt Agency Chief Executive" means the chief executive of the Debt Agency.
- 35 (54) "Debt Agency Management Committee" means the Management Committee of the Debt Agency.
- (55) "decision order" means an order as described in section 402.
- (56) "deposit" means a contribution of money, made other than for the purpose of acquiring a security, made by a person which may be repayable at the demand of that person.
- 40 (57) "depository" means a person engaged in the business of providing depository service.

- (58) "depository service" means the service provided by a person to another person where beneficial ownership in a financial product is held by such provider in trust for, or on behalf of, the beneficial owner or any other person nominated by the beneficial owner.
- (59) "derivative" means any transferable instrument - 5
- (a) giving the right but not the obligation to acquire any security;
 - (b) giving the right but not the obligation to sell any security;
 - (c) giving the right to exchange any security;
 - (d) providing for exchange of one or more payments based on value of one or more securities, currencies, interest rates, yields, other derivatives, financial indices, credit ratings, or financial measures; 10
 - (e) giving rise to a settlement determined by reference to value of securities, currencies, interest rates, yields, other derivatives, financial indices, credit ratings, or financial measures; or
 - (f) giving rise to a settlement determined by reference to commodities, other than when - 15
 - (i) such instrument is not traded on an exchange;
 - (ii) the transaction is in ordinary course of business;
 - (iii) the transaction is not subject to clearing and settlement through an Infrastructure Institution or subject to regular margin calls; and 20
 - (iv) neither of the parties to the transaction is a financial service provider or an authorised dealer.
- (60) "direct participant" means a financial service provider through which consumers use the services of an Infrastructure Institution.
- (61) "eligible enterprise" means a person, other than an individual, which at the relevant time has a net asset value of not more than a specified amount or has a turnover of not more than a specified amount, but excludes a financial service provider who is a consumer of a financial product or financial service that is identical to, or substantially similar to, the financial product or financial service that such person provides. 25
- (62) "examiner" means an examiner appointed under section 224(3). 30
- (63) "exchange" means any person that constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities.
- (64) "Executive Committee" means the Executive Committee of the Council established under section 292. 35
- (65) "executive member" means a member of the board of a Financial Agency, not being a nominee member, who is responsible for the day-to-day management and functioning of the Financial Agency.
- (66) "executive remuneration" means the remuneration paid or payable by a regulated person to - 40
- (a) persons exercising significant functions;
 - (b) persons who have a specified connection with the regulated person, which may include, persons providing specified services to the regulated person or their officers and employees; and
 - (c) officers and employees of a description specified by the Regulator. 45

- (67) "Financial Agency" means -
- (a) the Corporation;
 - (b) the Council;
 - (c) the Debt Agency;
 - (d) the Financial Authority;
 - (e) the Redress Agency; and
 - (f) the Reserve Bank.
- (68) "Financial Authority" means the Unified Financial Authority as established under section 3.
- (69) "Financial Authority Board" means the board of the Financial Authority.
- (70) "Financial Authority Chairperson" means the chairperson of the Financial Authority.
- (71) "financial contract" means a contract for the provision of a financial product or financial service.
- (72) "financial product" means -
- (a) securities;
 - (b) contracts of insurance;
 - (c) deposits;
 - (d) credit arrangements;
 - (e) retirement benefit plans;
 - (f) small savings instruments;
 - (g) foreign currency contracts other than contracts to exchange one currency (whether Indian or not) for another that are to be settled immediately; and
 - (h) any other instrument that may be prescribed under section 150(1).
- (73) "financial regulatory data" means all information that a financial service provider or an authorised dealer is obligated to submit to a Financial Agency under law.
- (74) "financial representative" means any person acting on behalf of a financial service provider, as an agent or otherwise, in connection with the provision of a financial product or financial service.
- (75) "financial service" means -
- (a) buying, selling, or subscribing to a financial product or agreeing to do so;
 - (b) safeguarding and administering assets consisting of financial products, belonging to another person, or agreeing to do so;
 - (c) effecting contracts of insurance;
 - (d) managing, or offering or agreeing to manage, assets consisting of financial products belonging to another person;
 - (e) rendering or agreeing to render advice on, for consideration, or soliciting for the purposes of -
 - (i) buying, selling, or subscribing to, a financial product;
 - (ii) availing a financial service; or
 - (iii) exercising any right associated with a financial product or financial service;

- (f) establishing or operating an investment scheme;
 - (g) maintaining or transferring records of ownership of a financial product;
 - (h) underwriting the issuance or subscription of a financial product;
 - (i) providing information about a person's financial standing or creditworthiness; 5
 - (j) selling, providing, or issuing stored value or payment instruments or providing payment services;
 - (k) making arrangements for the carrying on of any of the financial services in clauses (a) to (j);
 - (l) rendering or agreeing to render advice on, or soliciting for the purposes 10 of -
 - (i) buying, selling, or subscribing to, a financial product;
 - (ii) availing any of the financial services in clauses (a) to (j); or
 - (iii) exercising any right associated with a financial product or any of the financial services in clauses (a) to (j); 15
 - (m) any service carried out by an Infrastructure Institution; and
 - (n) any other service that may be prescribed under section 150(2).
- (76) "financial service provider" means a person engaged in the business of providing a financial service.
- (77) "financial system" means the aggregation of all financial service providers in 20 India, along with -
 - (a) the financial markets in which they operate;
 - (b) their financial products and financial services; and
 - (c) the financial contracts entered into by them.
- (78) "financial system crisis" means a state of the financial system where there is a 25 large-scale disruption to the provision of financial services due to an impairment of all or parts of the financial system that has the potential to have serious negative consequences for India.
- (79) "financial system database" means the database of financial regulatory data.
- (80) "fit and proper persons" means persons who - 30
 - (a) possess sufficient relevant professional qualifications, knowledge, skills, expertise and experience to carry out the functions required to be performed by them;
 - (b) are of good repute and integrity;
 - (c) have not been convicted of an offence under this Act; and 35
 - (d) for the purposes of Part V, satisfy such other requirements as may be specified by the Regulator.
- (81) "foreign currency" means any currency other than Indian currency.
- (82) "foreign currency contract" means a contract - 40
 - (a) to buy or sell any foreign currency; or
 - (b) to exchange any one currency for another.
- (83) "foreign exchange" means foreign currency and includes -

- (a) deposits, credits and balances payable in foreign currency;
- (b) drafts, travellers cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in foreign currency; or
- (c) drafts, travellers cheques, letter of credit or bills of exchange, expressed or drawn by persons outside India but payable in Indian currency.
- (84) "government security" means a security that is created and issued by the Central Government, a State Government or a public authority for the purpose of raising debt.
- (85) "group" means a person and any number of persons -
- (a) that control, are controlled by, or are under common control with that person;
- (b) that have the capacity to exercise a significant influence over the financial decisions of that person due to the existence of an arrangement or relationship between them; and
- (c) over whose financial decisions that person has the capacity to exercise a significant influence, due to the existence of an arrangement or relationship between them.
- (86) "Indian currency" means any currency which is legal tender in India.
- (87) "Infrastructure Institution" means an Infrastructure Institution referred to in section 183.
- (88) "insurer" means a financial service provider carrying on the business of effecting contracts of insurance in India.
- (89) "investment contract" means an investment in any person, other than an individual, with reasonable expectation of profit or return to be derived from entrepreneurial or managerial efforts.
- (90) "investment scheme" means any arrangement with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangement, whether by becoming owners of the property or any part of it or otherwise, to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income, where -
- (a) persons participating in such schemes do not have day-to-day control over the management of the property, whether or not they have the right to be consulted or to give directions; and
- (b) the arrangement has either or both of the following characteristics -
- (i) the contributions of the participants and the profits or income out of which payments are to be made to them are pooled; or
- (ii) the property is managed as a whole by or on behalf of the operator of the scheme.
- (91) "inward flow" means a capital account transaction which alters the assets in India of non-residents.
- (92) "Issue Department" means the department of the Reserve Bank referred to under section 351.
- (93) "issuer" means -
- (a) a body corporate that issues or proposes to issue any security; or

(b) any person, other than a body corporate under clause (a), performing the acts and assuming the duties of an issuer, depositor or manager pursuant to the relevant documentation or instrument.

(94) "Monetary Policy Committee" means the Monetary Policy Committee of the Reserve Bank established under section 333. 5

(95) "negotiable instrument" has the meaning assigned to it under Negotiable Instruments Act, 1881 (26 of 1881).

(96) "netting" means the process by which the obligations from and to a particular counterparty may be set-off, reducing the number and value of payments or deliveries needed to settle a set of transactions. 10

(97) "nominee member" means a member of the board of a Financial Agency, nominated by persons identified under Part II.

(98) "non-executive member" means a member of the board of a Financial Agency other than an executive member and a nominee member.

(99) "non-resident" means a person other than a resident. 15

(100) "notification" means a notification published in the Official Gazette, and the terms "notified" and "notify" will be construed accordingly.

(101) "outward flow" means a capital account transaction which alters assets outside India of residents.

(102) "payment instruction" means any instrument, authorisation or order in any form, including electronic means, to effect a payment - 20

- (a) by any person to a system participant; or
- (b) by a system participant to another system participant.

(103) "payment obligation" means an obligation of one system participant to pay another system participant such amounts that are due as a result of clearing or settlement of payment instructions relating to funds or financial products. 25

(104) "payment system" means a system that enables payment of funds to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them and includes -

- (a) money transfer mechanisms like debit cards, credit cards, electronic money; 30
- (b) systems to connect a payer and a beneficiary operated by a person who is neither the payer nor the beneficiary; or
- (c) creating substitutes for legal tender with the promise of converting them into legal tender freely.

(105) "person" includes - 35

- (a) an individual;
- (b) a Hindu undivided family;
- (c) a company;
- (d) a trust;
- (e) a partnership; 40
- (f) a limited partnership;
- (g) a sole proprietorship;

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PART I: 2. DEFINITIONS

- (h) an association of persons or body of individuals, whether incorporated or not;
- (i) every body corporate, artificial juridical person not falling within clauses (a) to (h); or
- 5 (j) any agency, office or branch owned or controlled by any of the persons mentioned in clauses (a) to (h).
- (106) "policy-holder" includes a person to whom the whole of the interest of the policy-holder in the contract of insurance is assigned once and for all, but does not include an assignee thereof whose interest in the policy is defeasible or is for the time being subject to any condition.
- 10 (107) "premium" means the premium payable by a covered service provider to the Corporation under Chapter 50.
- (108) "prescribed" means prescribed by rules made by Central Government under this Act, and the term "prescribe" will be construed accordingly.
- 15 (109) "Presiding Officer" means the presiding officer of the Tribunal.
- (110) "pro-cyclical effects" means the extent to which prudential requirements imposed under this Act are positively correlated with changes in overall economic conditions.
- (111) "professional diligence" has the meaning assigned to it in section 85(2).
- 20 (112) "public authority" means any authority or body or institution of self-government established or constituted, including any body owned, controlled or substantially financed, directly or indirectly with the funds provided by the Government, by or under –
- (a) the Constitution of India;
- 25 (b) any law made by the Parliament or the legislature of any State; or
- (c) any notification issued or order made by the Government.
- (113) "public debt" means the obligation arising from borrowings, whether internal or external, upon the Central Government.
- (114) "public servant" has the meaning assigned to it under section 2(21) of the Indian Penal Code, 1860 (45 of 1860).
- 30 (115) "publish" means publishing of information in a manner best suited to bring it to the attention of the persons which are affected by the information and to the public at large, including by way of electronic means, as soon as may be practicable, unless otherwise provided or specified.
- 35 (116) "qualified foreign investor" means a non-resident that fulfils the customer due diligence criteria prescribed by the Central Government.
- (117) "real time gross settlement" means the real time settlement of payments, transfer instructions, or other obligations individually on a transaction-by-transaction basis.
- 40 (118) "Redress Agency" means the Financial Redress Agency established under section 12.
- (119) "Redress Agency Board" means the board of the Redress Agency.
- (120) "Redress Agency Chairperson" means the chairperson of the Redress Agency.

- (121) "registered owner" means a depository whose name is entered as such in the register of members or equivalent register of the issuer.
- (122) "regulated activity" has the meaning assigned to it in section 151.
- (123) "regulated person" means a financial service provider that -
- (a) is engaged in the business of carrying on a regulated activity; or
 - (b) has been designated as a Systemically Important Financial Institution.
- (124) "regulations" means the regulations made under this Act.
- (125) "Regulator" means the Reserve Bank or the Financial Authority, as applicable, in accordance with the allocation of responsibilities under section 11 and "Regulators" means both the Regulators, as the context may require.
- (126) "regulatory inconsistency" means any inconsistency in the regulation of financial services that may be similar in nature, or pose similar risks to the fulfilment of the objectives of a Financial Agency.
- (127) "related persons" in relation to a person means -
- (a) persons belonging to the same group as that person; and
 - (b) persons responsible for the oversight and strategic management of that person; or
 - (c) relatives of the persons under clause (b), as may be specified by the Regulator.
- (128) "related person transaction" includes the following transactions between related persons -
- (a) any arrangement for the provision of a financial product or financial service;
 - (b) transfer of any assets or liabilities;
 - (c) making of any advances or loans;
 - (d) entrusting assets or money;
 - (e) any explicit or implicit guarantees;
 - (f) donations of any kind; and
 - (g) any other transaction specified by the Regulator.
- (129) "relevant personal circumstances" mean the objectives, financial situation and needs of a retail consumer, as would reasonably be considered to be relevant for the purpose of giving advice to the retail consumer.
- (130) "Reserve Bank" means the Reserve Bank of India established under section 7.
- (131) "Reserve Bank Board" means the board of the Reserve Bank.
- (132) "Reserve Bank Chairperson" means the chairperson of the Reserve Bank.
- (133) "resident" means -
- (a) an individual whose domicile or habitual abode is in India, and includes
 - (b) a citizen of India, other than when such citizen stays outside India for the purposes of employment, business, vocation, or in circumstances as would indicate intention of such individual to stay outside India for an uncertain period; or

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- 5 (ii) an individual, not being a citizen of India, when such individual stays in India for the purposes of employment, business, vocation, or stays with spouse of such individual, such spouse being a resident, or in circumstances as would indicate intention of such individual to stay in India for an uncertain period; or
- (b) a person, other than an individual, the control and management of whose affairs is substantially located in India.
- 10 (134) "resolution" means and includes any of the following measures, or a combination thereof, undertaken by the Corporation or the Regulator, as the case may be –
- (a) "prompt corrective action" under Chapter 45;
 - (b) "purchase" under Chapter 47;
 - (c) "bridge service provider" under Chapter 48; or
 - (d) "temporary public ownership" under Chapter 49.
- 15 (135) "Resolution Fund" means the Resolution Fund established under section 264.
- (136) "Resolution order" means an order of the Corporation issued under section 243.
- 20 (137) "resolution transferee" means a person identified by the Corporation to which the assets or liabilities of a covered service provider under resolution are transferred, in whole or in part.
- (138) "respondent" means a financial service provider against whom a complaint has been filed with the Redress Agency.
- (139) "retail advisor" means a financial service provider or financial representative that gives advice to a retail consumer.
- 25 (140) "retail consumer" means a consumer who is an individual or an eligible enterprise where the value of the financial product or of the financial service rendered, does not exceed such amount as may be specified.
- (141) "retirement benefit plan" means any arrangement or scheme that –
- 30 (a) is established or maintained for the purposes of providing benefits in old-age to the beneficiaries of the arrangement or scheme; and
 - (b) restricts withdrawals of contributions or accumulations until the maturity of the arrangement or scheme, in accordance with its terms.
- (142) "rules" means the rules made by the Central Government under this Act.
- 35 (143) "Secretariat" means the Secretariat of the Council established under section 293.
- (144) "security" means a transferable financial interest which is not a negotiable instrument but includes –
- 40 (a) shares and instruments equivalent to shares in the capital of any person other than an individual;
 - (b) debentures;
 - (c) any form of secured debt as defined under section 2(ze) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002);
 - (d) depository receipts in respect of securities;

- (e) derivatives;
 - (f) government securities;
 - (g) transferable warehouse receipts;
 - (h) rights or interest in securities;
 - (i) instruments admitted to trading on an exchange; 5
 - (j) any investment contract which is not a deposit or a contract of insurance, unless exempted by the Central Government; or
 - (k) such other instruments as may be prescribed by the Central Government to be securities.
- (145) "settlement" means the completion of delivery of funds or a financial product against payment of funds, in order to settle obligations. 10
- (146) "show cause notice" means a notice as described in section 400.
- (147) "significant function" means a function that enables or is likely to enable the person responsible for its performance to exercise a significant influence over the conduct of a financial service provider's affairs and includes the functions of oversight, strategic management and effective control over the financial service provider. 15
- (148) "small savings instruments" means -
- (a) a deposit as defined under section 3 of the Government Savings Bank Act, 1873 (5 of 1873); 20
 - (b) a savings certificate as defined under section 2(c) of the Government Savings Certificates Act, 1959 (46 of 1959); or
 - (c) any subscription to the public provident fund issued under section 4 of the Public Provident Fund Act, 1968 (23 of 1968).
- (149) "specified" means specified by regulations made under this Act and the term "specify" will be construed accordingly. 25
- (150) "system participant" means a banking service provider or any other person participating in a payment system and includes the system provider.
- (151) "system provider" means a person who is engaged in the business of operating a payment system. 30
- (152) "system-wide measure" means a measure that seeks to mitigate systemic risk in the financial system and may be applicable to the entire financial system or one or more parts of the financial system.
- (153) "systemic indicator" means an indicator so determined by the Council under section 299 to designate financial service providers as Systemically Important Financial Institutions. 35
- (154) "systemic risk" means a risk, arising either in India or elsewhere, of large-scale disruption to financial services due to an impairment of all or parts of the financial system, that has the potential to have serious negative consequences for India. 40
- (155) "Systemically Important Financial Institution" means a financial service provider so designated under section 300.
- (156) "trade repository" means a financial service provider that maintains a centralised electronic record or database of transaction data.

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- (157) "transactional decision" means a decision taken by a consumer concerning -
- (a) whether, how, and on what terms, to avail of a financial product or financial service; or
 - (b) whether, how, and on what terms, to exercise a right in relation to a financial product or financial service or to demand the discharge of a duty owed to the consumer in terms of such product or service.
- (158) "Tribunal" means the Financial Sector Appellate Tribunal established under section 28.
- (159) "unpublished price sensitive information" means information which is not publicly available and which would, if publicly available, be likely to have a significant effect on the price of securities.
- (160) "warehouse receipt" has the meaning assigned to it under section 2(u) of the Warehousing (Development and Regulation) Act, 2007 (37 of 2007).

PART II

ESTABLISHMENT OF FINANCIAL REGULATORY AGENCIES

CHAPTER 3

ESTABLISHMENT OF THE UNIFIED FINANCIAL AUTHORITY

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Establishment and incorporation of the Financial Authority

- 3. (1) A body by the name of the Unified Financial Authority is established under this Act to exercise the powers and carry out the functions designated to the Financial Authority under this Act.
- (2) The Financial Authority will be a body corporate having -
 - (a) perpetual succession;
 - (b) a common seal;
 - (c) the power to sue and be sued;
 - (d) the power to enter into and execute contracts;
 - (e) the power to acquire, hold and dispose of property, both movable and immovable; and
 - (f) the power to employ persons to discharge its duties.
- (3) The Financial Authority will have its head office at Mumbai, and it may establish offices at any other place in or outside India.

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Composition of the Financial Authority Board

- 4. (1) The Financial Authority Board will consist of executive, non-executive and nominee members, to be appointed by the Central Government, where at all times -
 - (a) the total number of members must not be more than twelve;
 - (b) the total number of executive members must not be greater than half of the total number of members; and
 - (c) up to two members will be nominee members.
- (2) The executive members will include -
 - (a) the Financial Authority Chairperson; and
 - (b) an administrative law member.
- (3) The nominee members under sub-section (1)(c) will be nominated by the Central Government.
- (4) The Financial Authority Board will appoint a senior officer of the Financial Authority to act as its secretary.

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Eligibility of members of Financial Authority Board

- 5. Members of the Financial Authority Board must be fit and proper persons having expertise in dealing with matters relating to finance, economics, law or public policy.

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Financial Authority Board

- 6. (1) The general superintendence, direction and management of the affairs and business of the Financial Authority will vest in the Financial Authority Board, which may exercise all powers that may be exercised and do all acts that may be done by the Financial Authority.

- (2) The Financial Authority Board must keep under constant review the performance of the Financial Authority in giving effect to its objects, carrying out its functions and utilising its resources.

CHAPTER 4

5

ESTABLISHMENT OF THE RESERVE BANK OF INDIA

7. (1) The body corporate by the name of "Reserve Bank of India" established under section 3 of the Reserve Bank of India Act, 1934 (2 of 1934), will continue as if it were established under this Act, and will exercise the powers and carry out the functions designated to the Reserve Bank under this Act. Establishment of the Reserve Bank.
- (2) The Reserve Bank will have -
- (a) perpetual succession;
 - (b) a common seal;
 - (c) the power to sue and be sued;
 - (d) the power to enter into and execute contracts;
 - (e) the power to acquire, hold and dispose of property, both movable and immovable; and
 - (f) the power to employ persons to discharge its duties.
- (3) The Reserve Bank will have its head office at Mumbai, and it may establish offices at any place in or outside India.
- 20 B. (1) The Reserve Bank Board will consist of executive, non-executive and nominee members, to be appointed by the Central Government, where at all times - Composition of the Reserve Bank Board.
- (a) the total number of members must not be more than twelve;
 - (b) the total number of executive members must not be greater than half of the total number of members; and
 - (c) up to two members will be nominee members.
- (2) The executive members will include -
- (a) the Reserve Bank Chairperson; and
 - (b) an administrative law member.
- (3) The nominee members under sub-section (1)(c) will be nominated by the Central Government. Eligibility of members of the Reserve Bank Board.
- (4) The Reserve Bank Board will appoint a senior officer of the Reserve Bank to act as its secretary.
9. (1) Members of the Reserve Bank Board must be fit and proper persons, having expertise in dealing with matters relating to banking, payments and monetary policy.
- (2) A person cannot be appointed as a member on the Reserve Bank Board if such -
- (a) is an employee of the Central Government, except in case of the nominee members;

- (b) is a member of Parliament or a state legislature;
- (c) is a director, employee or officer of any banking service provider;
- (d) is a director, employee or officer of any system provider;
- (e) is a member of an advisory council of the Reserve Bank; or
- (f) is a member of the Monetary Policy Committee, other than -
 - (i) the Reserve Bank Chairperson; or
 - (ii) the executive member designated by the Reserve Bank Board to serve on the Monetary Policy Committee.

Reserve Bank Board.

10. (1) The general superintendence, direction and management of the affairs and business of the Reserve Bank, other than the formulation of monetary policy, will vest in the Reserve Bank Board, which may exercise all powers that may be exercised and do all acts that may be done by the Reserve Bank.
- (2) The Reserve Bank Board must keep under constant review the performance of the Reserve Bank in giving effect to its objects, carrying out its functions and utilising its resources.

CHAPTER 5

ALLOCATION OF DUTIES

Allocation of duties between the Financial Authority and the Reserve Bank.

11. (1) The Reserve Bank will be the Regulator for banking and payment systems.
- (2) The Financial Authority will be the Regulator for all financial services other than banking and payment systems.
- (3) All references to the Regulator in this Act will mean the Regulator under subsection (1) or subsection (2), as the case may be.

CHAPTER 6

ESTABLISHMENT OF THE FINANCIAL REDRESS AGENCY

Establishment and incorporation of the Redress Agency

12. (1) A body by the name of the Financial Redress Agency is established under this Act to exercise the powers and carry out the functions designated to the Redress Agency under this Act.
- (2) The Redress Agency will be a body corporate having -
 - (a) perpetual succession;
 - (b) a common seal;
 - (c) the power to sue and be sued;
 - (d) the power to enter into and execute contracts;
 - (e) the power to acquire, hold and dispose of property, both movable and immovable; and
 - (f) the power to employ persons to discharge its duties.
- (3) The Redress Agency will have its head office at Mumbai and it may establish offices at any other place in or outside India.

Composition of the Redress Agency Board.

13. (1) The Redress Agency Board will consist of executive, non-executive and nominee members, to be appointed by the Regulators, where at all times -

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Part II: 7. ESTABLISHMENT OF THE RESOLUTION CORPORATION

- (a) the total number of members must not be more than seven;
 - (b) the total number of executive members must not be greater than half of the total number of members; and
 - (c) two members will be nominee members.
- 5 (2) The executive members will include the Redress Agency Chairperson, who will be appointed by the Regulators, in consultation with the Central Government.
- (3) The nominee members under sub-section (1)(c) will be nominated by the Regulators, and will consist of one official from each of the Regulators.
- 10 (4) The Redress Agency Board will appoint a senior officer of the Redress Agency to act as its secretary.

14. Members of the Redress Agency Board must be fit and proper persons having expertise in dealing with matters relating to consumer protection, including redress of consumer disputes.

Eligibility of members of the Redress Agency Board.

- 15 (1) The general superintendence, direction and management of the affairs and business of the Redress Agency will vest in the Redress Agency Board, which may exercise all powers that may be exercised and do all acts that may be done by the Redress Agency.
- (2) The Redress Agency Board must keep under constant review the performance of the Redress Agency in giving effect to its objects, carrying out its functions and utilising its resources.
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Redress Agency Board.

CHAPTER 7

ESTABLISHMENT OF THE RESOLUTION CORPORATION

- 25 16. (1) A body by the name of the Resolution Corporation is established under this Act to exercise the powers and carry out the functions designated to the Corporation under this Act.
- (2) The Corporation will be a body corporate having -
- (a) perpetual succession;
 - (b) a common seal;
 - (c) the power to sue and be sued;
 - 30 (d) the power to enter into and execute contracts;
 - (e) the power to acquire, hold and dispose of property, both movable and immovable; and
 - (f) the power to employ persons to discharge its duties.
- (3) The Corporation will have its head office at Mumbai and it may establish offices at any other place in or outside India.
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Establishment and incorporation of the Corporation.

17. (1) The Corporation Board will consist of the following executive, non-executive and nominee members, to be appointed by the Central Government, where at all times -
- (a) the total number of members must not be more than nine;

Composition of the Corporation Board.

Part II: 8. ESTABLISHMENT OF THE FINANCIAL STABILITY AND DEVELOPMENT COUNCIL 19

- (b) the total number of executive members must not be greater than half of the total number of members; and
- (c) three members will be nominee members.

(2) The executive members will include -

- (a) the Corporation Chairperson; and 5
- (b) an administrative law member.

(3) The nominee members under sub-section (1)(c) will consist of -

- (a) one nominee of the Reserve Bank;
- (b) one nominee of the Financial Authority; and
- (c) one nominee of the Central Government. 19

(4) The Corporation Board will appoint a senior officer of the Corporation to act as its secretary.

Eligibility of members of the Corporation Board.

1B. Members of the Corporation Board must be fit and proper persons having expertise in dealing with matters relating to the regulation, supervision, or resolution of financial service providers. 15

Corporation Board.

19. (1) The general superintendence, direction and management of the affairs and business of the Corporation will vest in the Corporation Board, which may exercise all powers that may be exercised and do all acts that may be done by the Corporation.

(2) The Corporation Board must keep under constant review the performance of the Corporation in giving effect to its objects, carrying out its functions and utilising its resources. 20

CHAPTER 8

ESTABLISHMENT OF THE FINANCIAL STABILITY AND DEVELOPMENT COUNCIL

Establishment and incorporation of the Council.

20. (1) A body by the name of the Financial Stability and Development Council is established under this Act to exercise the powers and carry out the functions designated to the Council under this Act. 25

(2) The Council will be a body corporate having -

- (a) perpetual succession;
- (b) a common seal; 30
- (c) the power to sue and be sued;
- (d) the power to enter into and execute contracts;
- (e) the power to acquire, hold and dispose of property, both movable and immovable; and
- (f) the power to employ persons to discharge its duties. 35

(3) The Council will have its head office at Mumbai and it may establish offices at any other place in or outside India.

Composition of the Council Board.

21. (1) The Council Board will consist of the following executive and nominee members -

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Part II: 9. ESTABLISHMENT OF THE PUBLIC DEBT MANAGEMENT AGENCY

- (a) two executive members; and
 - (b) four nominee members.
- (2) The executive members will consist of -
- (a) the Council Chief Executive; and
 - (b) an administrative law member.
- (3) The nominee members under sub-section (1)(b) will consist of -
- (a) the Minister of Finance, as a nominee of the Central Government;
 - (b) the Reserve Bank Chairperson, as a nominee of the Reserve Bank;
 - (c) the Financial Authority Chairperson, as a nominee of the Financial Authority; and
 - (d) the Corporation Chairperson, as a nominee of the Corporation.
- (4) The nominee of the Central Government under sub-section (3)(a) will be the Council Chairperson.
- (5) The Council Board will appoint a senior officer of the Council to act as its secretary.

22. (1) The general superintendence, direction and management of the affairs and business of the Council will vest in the Executive Committee of the Council, which may exercise all powers that may be exercised and do all acts that may be done by the Council.
- (2) All references in this Act to the Council Board, or the board of a Financial Agency, where relevant to the Council, will be read as references to the Executive Committee, except as provided under sub-section (3).
- (3) All references to the Council, or to the Council Board in sections 291, 301, 302, and 305 will be read as references to the Council Board.
- (4) Where there is any disagreement, or lack of consensus in the Executive Committee regarding any proposed decision or proposed action of the Executive Committee, the Executive Committee must request the Council Board to make a decision regarding such proposed decision or proposed action.
- (5) The Executive Committee must keep under constant review the performance of the Council in giving effect to its objects, carrying out its functions and utilising its resources.

Executive Committee of the Council.

23. The Council Chief Executive must be a fit and proper person, having expertise on matters relating to systemic risk.

Eligibility of Council Chief Executive.

CHAPTER 9
ESTABLISHMENT OF THE PUBLIC DEBT MANAGEMENT AGENCY

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24. (1) A body by the name of the Public Debt Management Agency is established under this Act to exercise the powers and carry out the functions designated to the Debt Agency under this Act.
- (2) The Debt Agency will be a body corporate having -

Establishment and incorporation of the Debt Agency.

- (a) perpetual succession;
- (b) a common seal;
- (c) the power to sue and be sued;
- (d) the power to enter into and execute contracts;
- (e) the power to acquire, hold and dispose of property, both movable and immovable; and
- (f) the power to employ persons to discharge its duties.

(3) The Debt Agency will have its head office at Mumbai and it may establish offices at any other place in or outside India.

Composition of the Debt Agency Management Committee.

25. (1) The board of the Debt Agency, referred to as the Debt Agency Management Committee will consist of executive, non-executive and nominee members, to be appointed by the Central Government, where at all times -

- (a) the total number of members must not be more than eight;
- (b) the total number of executive members must not be greater than half of the total number of members; and
- (c) at least two members will be nominee members, under sub-sections (3)(a) and (3)(b).

(2) The executive members will include the Debt Agency Chief Executive, who will also be the chairperson of the Debt Agency Management Committee.

(3) The nominee members under sub-section (1)(c) will consist of -

- (a) a nominee of the Central Government;
- (b) a nominee of the Reserve Bank; and
- (c) if the Debt Agency borrows on behalf of more than one State Governments, one nominee on behalf of all such State Governments.

(4) The nominee member under sub-section (3)(c) will, -

- (a) if the Debt Agency borrows on behalf of one State Government, be appointed in accordance with rules made by the Central Government; or
- (b) if the Debt Agency borrows on behalf of one or more State Governments, be appointed by rotation from such State Governments, and in accordance with rules made by the Central Government.

(5) The Debt Agency Management Committee will appoint a senior officer of the Debt Agency to act as its secretary.

Eligibility of members of Debt Agency Management Committee.

26. Members of the Debt Agency Management Committee must be fit and proper persons having expertise in dealing with matters relating to public debt, public finance or financial markets.

Debt Agency Management Committee.

27. (1) The general superintendence, direction and management of the affairs and business of the Debt Agency will vest in the Debt Agency Management Committee, which may exercise all powers that may be exercised and do all acts that may be done by the Debt Agency Management Committee.

22 Part II: 10. ESTABLISHMENT OF THE FINANCIAL SECTOR APPELLATE TRIBUNAL

- (2) The Debt Agency Management Committee must keep under constant review the performance of the Debt Agency in giving effect to its objects, carrying out its functions and utilising its resources.

CHAPTER 10

5 ESTABLISHMENT OF THE FINANCIAL SECTOR APPELLATE TRIBUNAL

28. (1) A tribunal by the name of the Financial Sector Appellate Tribunal is established under this Act to exercise the jurisdiction, powers and authority conferred upon the Tribunal under this Act. Establishment of the Tribunal.
- (2) The Tribunal will have its main bench at Mumbai and may establish benches at any other place in India.
29. (1) The Tribunal will consist of the Presiding Officer and at least two other members. Composition of the Tribunal.
- (2) The Central Government may notify a higher number of members of the Tribunal in consultation with the Presiding Officer.
- 15 (3) The Presiding Officer and all members of the Tribunal will be appointed by the Central Government in accordance with the provisions of Chapter 83.
- (4) In the event of a temporary vacancy in the office of the Presiding Officer, the Central Government may nominate one of the members of the Tribunal as an officiating Presiding Officer for a period not exceeding one hundred and eighty days, having regard to suitability for effective oversight and administration of the Tribunal's adjudicating functions.
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PART III

REGULATORY GOVERNANCE

CHAPTER 11

FINANCIAL AGENCIES

Selection of certain members of the board of a Financial Agency

- 30. (1) Except for nominee members, all members of the board of a Financial Agency must be appointed by the Central Government from a list of persons short-listed by a selection committee. 5
- (2) The selection committee must be constituted by the Central Government in accordance with the First Schedule and must follow the procedure laid down in that Schedule. 10
- (3) For any vacancy in the board of a Financial Agency, the selection committee must not consider any person -
 - (a) who has been appointed twice as a member of the board of that Financial Agency;
 - (b) who has served as the chairperson of any Financial Agency; 15
 - (c) whose age would not permit such person to serve a term of at least three years; or
 - (d) who is a non-executive member of any Financial Agency for the position of non-executive member.
- (4) The selection committee must consider the following principles when selecting persons - 20
 - (a) merit;
 - (b) independence;
 - (c) balance of the board; and
 - (d) conflict of interest. 25
- (5) For the purposes of sub-section (4) -
 - (a) "merit" means qualifications, experience, past achievement and reputation;
 - (b) "independence" means the ability to maintain and exercise independent judgment in the discharge of duties; 30
 - (c) "balance of the board" means that the board of a Financial Agency represent expertise in fields of law, finance, governance, economics or such other fields as may be identified, in a fair proportion; and
 - (d) "conflict of interest" means that persons appointed do not have interests which may conflict with the duties of such member. 35
- (6) If any vacancy in the board of a Financial Agency is not filled within a period of one hundred and eighty days from the date such vacancy arises, the Central Government must make a report on the reasons for the delay in the appointment within ninety days from the date on which the period of one hundred and eighty days expires, and lay such report before both Houses of Parliament. 40

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31. (1) Executive members of the board of a Financial Agency must contribute their entire time to the oversight and management of the Financial Agency. Executive members.
- (2) The board of a Financial Agency may permit, by writing, executive members to undertake such honorary work as is not likely to interfere with their duty as executive members. Executive members.

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32. (1) The Central Government must make rules to govern the nomination of persons as nominee members to the board of a Financial Agency. Nominee members.
- (2) While nominating persons as nominee members under this Act, due regard must be given to the qualifications, experience, past achievement and reputation of such persons. Nominee members.

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33. (1) The administrative law member is a member of the board of a Financial Agency who will be responsible for - Administrative law member.
- (a) the assessment and review of the performance of administrative law officers of that Financial Agency;
- (b) the review of decisions taken by administrative law officers of that Financial Agency under section 40B; and
- (c) other functions as provided by this Act.
- (2) The administrative law member must ensure that the allocation of duties, review of performance, and general service conditions of administrative law officers is carried out in a manner which maintains their independence and accountability.
- (3) The administrative law member will not be involved in any functions of the Financial Agency that conflict with the independence and neutrality of such member.
- (4) The provisions of this section will not apply to the Redress Agency or the Debt Agency.

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34. (1) The meetings of the board of a Financial Agency will be held in compliance with the requirements of the Second Schedule. Meetings of the board of a Financial Agency.
- (2) The board of the Financial Agency must make bye-laws to govern the proceedings of its meetings. Meetings of the board of a Financial Agency.
- (3) The bye-laws governing the proceedings of the meetings of the board of the Financial Agency must be consistent with the best practices of governance and transparency for deliberative bodies. Meetings of the board of a Financial Agency.

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35. (1) The board of every Financial Agency must discharge its duties by taking decisions through a majority vote of the members present at a meeting of the board of the Financial Agency. Decisions of the board of a Financial Agency.
- (2) Each member of the board of a Financial Agency will have one vote. Decisions of the board of a Financial Agency.
- (3) If there is an equality of votes, the person chairing the meeting will, unless otherwise provided, have a casting vote. Decisions of the board of a Financial Agency.

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(4) The board of a Financial Agency must make bye-laws to provide for the process of making decisions without the physical presence of the members of the board of the Financial Agency.

Conduct of members of the board of a Financial Agency

- 36. (1) Members of the board of a Financial Agency must, at all times, act honestly, and use reasonable diligence in the discharge of their duties. 5
- (2) Any member who has any direct or indirect interest in any matter coming up for the consideration at a meeting of the board of a Financial Agency will, as soon as possible after relevant circumstances have come to that member's knowledge, disclose the nature of interest at such meeting.
- (3) A disclosure made by a member of the board of a Financial Agency will be recorded in the proceedings of the meeting of the board of the Financial Agency, and such member must recuse from any deliberation or decision of the board of the Financial Agency with respect to that matter. 10

Validity of proceedings not affected.

- 37. No act or proceeding of the board of a Financial Agency will be invalid merely by reason of - 15
 - (a) any vacancy in, or any defect in the constitution of, the board of the Financial Agency;
 - (b) any defect in the appointment of a person as a member; or
 - (c) any procedural irregularity not affecting the merits of the case.

Conditions of service of members of the board of a Financial Agency.

- 38. (1) Members of the board of a Financial Agency will hold office for a term of five years or until the age of retirement under sub-section (2), whichever is earlier. 20
- (2) The age of retirement for executive members and nominee members will be the same as that for a Secretary to the Central Government.
- (3) The Central Government must make rules governing the terms of appointment of members of the board including - 25
 - (a) salary;
 - (b) leave;
 - (c) medical benefits; and
 - (d) any other aspect of employment.
- (4) When making rules under sub-section (3), the Central Government must consider the requirements of - 30
 - (a) maintaining independence of the board of the Financial Agency; and
 - (b) attracting requisite talent and expertise to the board of the Financial Agency.
- (5) The terms of appointment of any existing chairperson or member must not be varied, to their disadvantage, after their appointment. 35
- (6) The Central Government may make separate rules governing the terms of appointment for -
 - (a) non-executive members;
 - (b) nominee members; 40
 - (c) executive members; and

(d) executive members acting as chairpersons.

(7) Nominee members will serve on the board of a Financial Agency at the pleasure of the person nominating such member.

(8) In this section -

(a) in case of the Council, all references to the chairperson will include references to the Council Chairperson and the Council Chief Executive; and

(b) in case of the Redress Agency, all references to rules made by the Central Government will be replaced by bye-laws made by Regulators.

39. (1) Any member of the board of a Financial Agency may resign by giving a signed notice of resignation to the Central Government. Resignation.

(2) A member, after providing a notice of resignation, will continue to hold office until the earlier of -

(a) the date the Central Government appoints a person to the post vacated by such resignation; or

(b) the expiry of ninety days from the date the notice of resignation was provided to the Central Government.

(3) In relation to the Council Board, this section will apply only to the Council Chief Executive and the administrative law member of the Council Board.

40. A member of the board of a Financial Agency may be removed from office if such member has - Grounds for removal of members.

(a) been adjudged to be insolvent;

(b) been sentenced to imprisonment for one hundred and eighty days or more;

(c) been convicted of an offence involving moral turpitude;

(d) engaged in any employment during the tenure of appointment, in violation of the terms and conditions of service;

(e) acquired any financial or other interest contrary to their terms and conditions of service that is likely to prejudice their functions;

(f) failed to adequately disclose any direct or indirect pecuniary interest under section 36(2);

(g) made any material misrepresentation to the selection committee;

(h) abused their position so as to render their continuance in office prejudicial to the objectives of that Financial Agency; or

(i) has become physically or mentally incapable of discharging their duties.

41. (1) A member of the board of a Financial Agency may not be removed from office unless - Process for removal of members.

(a) such member has been given a reasonable opportunity of being heard; and

(b) a notification under sub-section (3) is made.

(2) If the Central Government proposes to remove a member of the board of a Financial Agency on any grounds under section 40, the Central Government must follow the following procedure -

- (a) the Central Government must establish a committee, chaired by a nominee of the Chief Justice of India, to inquire if the grounds for removal have been met;
- (b) the committee must have at least one retired judge of a High Court;
- (c) the committee must inform the Central Government, in writing, whether one or more grounds for removal has been met; and
- (d) if the committee has informed the Central Government that one or more grounds for removal has been met, then the Central Government must remove such member by publishing a notification in accordance with sub-section (3).

(3) A notification under this section must contain -

- (a) the grounds for the removal of such member under section 40; and
- (b) the facts that were considered by the Central Government to arrive at its decision.

(4) The member of the board of the Financial Agency will cease to hold office from the date of the notification under sub-section (3).

Casual vacancies.

42. (1) If a vacancy arises on the board of a Financial Agency for any reason other than under sections 39 or 40, the chairperson of the Financial Agency must immediately inform the Central Government.
- (2) The Central Government may appoint any person on the board of a Financial Agency to fill the vacancy on a temporary basis for a period not exceeding one hundred and eighty days, or until a person is appointed or nominated as the case may be, whichever is earlier.

Review committees.

43. (1) The members of the board of a Financial Agency must appoint at least two non-executive members from the board of the Financial Agency to constitute a review committee to review whether -
- (a) the Financial Agency is in compliance with applicable laws;
 - (b) the bye-laws of the board of the Financial Agency promote transparency and best practices of governance;
 - (c) the Financial Agency is in compliance with the decisions of the board of the Financial Agency; and
 - (d) the Financial Agency is managing risks to its functioning in a reasonable manner.
- (2) No member of the review committee may serve continuously for more than five years on such committee.
- (3) The provisions of this section will not be in derogation of the general powers of the board of the Financial Agency to constitute committees for other functions.
- (4) The review committee must maintain a system by which any person may communicate to the review committee, any incidence of -
- (a) violation of laws by the Financial Agency;
 - (b) theft or misappropriation of resources of the Financial Agency by any person;
 - (c) abuse of powers of the Financial Agency by any officer, employee or agent within the Financial Agency; or

(d) violation of any decision of the board of the Financial Agency by any officer, employee or agent of the Financial Agency.

(5) The board of the Financial Agency must make bye-laws governing information to be provided to the review committee.

5 (6) The review committee will make a report, at least once every financial year, of its findings under sub-sections (1) and (4) to the board of the Financial Agency and the report will be attached with the annual report of the Financial Agency.

(7) In this section, in case of the Council, the review committee will comprise nominee members.

10 44. (1) Unless provided otherwise, the board of a Financial Agency may, by order in writing, allocate functions of the Financial Agency under this Act to the chairperson of the Financial Agency or any other member or officer or employee of the Financial Agency, subject to any conditions that may be provided in the order.

Administrative powers and assignment of functions.

15 (2) Unless provided otherwise, the chairperson of a Financial Agency is the chief executive officer of the Financial Agency having powers of the general superintendence, direction and control in respect of all administrative matters of that Financial Agency.

20 (3) In this section, in case of the Council, reference to "chairperson of the Financial Agency" will be replaced by the "Council Chief Executive".

45. (1) A Financial Agency may appoint such officers and employees as are necessary for the efficient discharge of its functions.

Officers and employees of a Financial Agency

25 (2) The Financial Agency must make bye-laws to determine the procedure of selection, terms, compensation and conditions of the appointment and service of persons appointed under this section.

46. (1) Each Financial Agency must designate an appropriate number of employees as administrative law officers exclusively.

Administrative law officers.

30 (2) Each Financial Agency must ensure the independence and neutrality of administrative law officers by making bye-laws governing the terms of appointment of administrative law officers.

(3) The performance of the administrative law officer will only be appraised by the administrative law member of the board of the Financial Agency.

(4) The provisions of this section will not apply to the Redress Agency or the Debt Agency.

CHAPTER 12

ADVISORY COUNCILS

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47. Unless provided otherwise, the provisions of this Chapter will govern the matters in relation to functioning of the advisory council of the board of a Financial Agency.

Interpretation of this Chapter.

Advisory councils to the board of a Financial Agency.

- 48. (1) The board of a Financial Agency may set up advisory councils to advise the board with regard to any of the following -
 - (a) sectors of the financial system which require particular skill, information or expertise;
 - (b) specified classes of financial service providers regulated by the Financial Agency; or
 - (c) any other matter as the board of the Financial Agency may require.
- (2) The board of the Financial Agency must set up advisory councils if either of the following conditions is met -
 - (a) this Act or any other law enforced by the Financial Agency requires an advisory council to be constituted; or
 - (b) the board of the Financial Agency finds that it is expedient, necessary or relevant for the discharge of its functions to set up such advisory council.
- (3) Each advisory council must comprise experts in the issues for which the advisory council has been constituted.
- (4) No expert will serve as a member of an advisory council for a period longer than ten years.

Functions of the advisory council.

- 49. (1) The functions of an advisory council include -
 - (a) making representations to the board of the Financial Agency, in the form of advice, comments or recommendations, on the policies and practices of the Financial Agency;
 - (b) preparing and submitting reports advising the board of the Financial Agency on all draft regulations, prior to the expiry of the period for receiving comments from the public on such draft regulations;
 - (c) interacting with financial service providers and the public, as may be necessary to discharge its functions;
 - (d) on the request of any member of the board of the Financial Agency, providing advice to the board of the Financial Agency on any matter; and
 - (e) any other matter related to areas for which it has been constituted.
- (2) The functions mentioned in sub-section (1) will be limited to the issues for which the advisory council was constituted.
- (3) The advisory council will discharge its functions under this section by making reports to the board of the Financial Agency.
- (4) The Financial Agency must publish all reports received from the advisory council in accordance with the following -
 - (a) reports under sub-section (1)(b) must be published with the regulations; and
 - (b) all other reports must be published within a period of one hundred and eighty days of being submitted to the board of the Financial Agency.

Bye-laws governing advisory councils.

- 50. (1) The board of the Financial Agency must make bye-laws governing the functioning of advisory councils.
- (2) The bye-laws must include -

- (a) the process of selecting experts to be members of advisory councils;
- (b) the resources to be allocated to the advisory councils to discharge their functions;
- (c) the terms, compensation and conditions of appointment of members of the advisory council; and
- (d) any other provision required for the efficient functioning of the advisory council.

CHAPTER 13

REGULATIONS AND GUIDANCE

- 10 51. A Financial Agency may, by notification, make regulations, where required, consistent with this Act and any rules made thereunder to carry out the purposes of this Act. Power of a Financial Agency to make regulations.
52. (1) If a Financial Agency proposes to make any regulations, it must, acting through its board, publish a draft of the proposed regulations. Process of making regulations.
- 15 (2) Every draft of the proposed regulations which is published under this section must be accompanied by a statement setting out -
- (a) the objectives of the proposed regulations;
 - (b) the problem that the proposed regulations seeks to address;
 - (c) the underlying principles under this Act, relevant to the proposed regulations, and the expected outcome of the proposed regulations;
 - (d) how the draft regulations fulfil the provision of this Act under which the regulations are made;
 - (e) an analysis of costs and an analysis of benefits of the proposed regulations; and
 - (f) the process by which any person may make a representation in relation to the proposed regulations.
- 20 (3) If the Financial Agency prefers one principle over any other it must issue a statement of reasons for such preference with the proposed regulations.
- 25 (4) Before making the regulations, the Financial Agency must have regard to any representations made to it in accordance with sub-section (2)(f).
- 30 (5) To make the regulations -
- (a) the board of the Financial Agency must approve the regulations; and
 - (b) the Financial Agency must publish -
 - (i) all the representations received by it under sub-section (2)(f); and
 - (ii) unless specified otherwise, at least a general account of the response of the Financial Agency to the representations.
- 35 (6) If the regulations substantially differ from the proposed regulations published by the Financial Agency, the Financial Agency, in addition to complying with sub-section (5), must publish -
- 40 (a) the details and reasons for such difference; and

(b) an analysis of costs and an analysis of benefits of the differing provisions.

Emergency regulation making.

- 53. (1) A Financial Agency may dispense with the procedure under section 52, if the time taken to comply with such provision has the potential to cause considerable losses for consumers or financial service providers. 5
- (2) If a Financial Agency makes regulations under this section, it must -
 - (a) publish the reasons for invoking this section; and
 - (b) submit a report to the Central Government within reasonable time.
- (3) The regulations must be accompanied by the documents under sections 52(2)(a) to 52(2)(d). 10
- (4) Regulations made under this section will cease to have effect after a period of one hundred and eighty days from the date on which the regulations are notified under this section.

Standard of analysis of costs and analysis of benefits.

- 54. (1) When carrying out an analysis of costs and an analysis of benefits under this Chapter, the Financial Agency must consider the probable costs that will be borne by - 15
 - (a) financial service providers in complying with the regulations;
 - (b) consumers, both directly and indirectly;
 - (c) the Financial Agency in enforcing the regulations; and
 - (d) any other persons affected by the regulations. 20
- (2) The Financial Agency must consider the probable benefits that will accrue to the consumers and other persons as a result of the regulations.
- (3) The Financial Agency must use
 - (a) the best available data, and wherever not available, reasonable estimates, to carry out the analysis; and 25
 - (b) the best scientific method available to carry out the analysis when data is available to the Financial Agency.

Prospective application of regulations.

- 55. Except for regulations made under section 53, all regulations made by a Financial Agency must apply from an identified prospective date that is set out in such regulations, with due regard to the time necessary for persons impacted to arrange to comply with such regulations. 30

General guidance.

- 56. (1) A Financial Agency may publish general guidance with respect to - 35
 - (a) the operation of this Act and any regulations made under it;
 - (b) any matters relating to functions of the Financial Agency;
 - (c) meeting the objectives of the Financial Agency; or
 - (d) any other matter about which the Financial Agency finds it appropriate to provide information or advice.
- (2) All requirements of section 52 apply to the process of making general guidance, except the requirements of -

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- (a) section 52(2)(e); and
 - (b) sub-section 52(6)(b).
- (3) Violations of general guidance alone will not amount to violation of any provision of law or regulation enforced by the Financial Agency.
- 5 (4) A general guidance issued under this Act will be binding on the Financial Agency.
- (5) The Financial Agency may withdraw or amend any general guidance issued by it at any time for reasons to be recorded in writing and published.
- 10 57. (1) Any person may make an application to a Financial Agency seeking special guidance on transactions or activities governed by this Act. Special guidance.
- (2) The special guidance will be limited to the interpretation or applicability of laws or regulations enforced by the Financial Agency.
- (3) The Financial Agency may specify the manner in which it may charge fees proportional to the cost of providing special guidance.
- 15 (4) The Financial Agency may require the person seeking the special guidance to provide information relevant to the issue or transaction for which the special guidance is sought.
- (5) The Financial Agency must publish the application and special guidance provided by it.
- 20 (6) If the information provided by the person seeking special guidance, or if the nature of the special guidance is commercially sensitive, and the applicant makes a request to such effect, the Financial Agency may decide -
- (a) not to publish an application or special guidance for until such time the information remains commercially sensitive, subject to a maximum period of two years; or
 - 25 (b) to withhold the identities of applicants or parties involved.
- (7) No person has recourse to the Tribunal -
- (a) against the refusal of the Financial Agency to provide special guidance; or
 - (b) against the special guidance provided by the Financial Agency.
- 30 (8) Violation of a special guidance alone will not constitute a violation of any laws or regulations enforced by the Financial Agency.
- (9) A special guidance issued by a Financial Agency will be binding on such Financial Agency.
- 35 58. (1) Any person aggrieved by any regulations or general guidance issued by the Financial Agency may prefer an appeal to the Tribunal on the ground of being contrary to this Act, including that - Review by the Tribunal.
- (a) they were made without complying with the requirements of this Part;
 - (b) they exceeded the limits of the provision under which they were made;
 - (c) in the case of regulations, there was a material and substantial error in the analysis of costs or the analysis of benefits;
 - 40 (d) the conditions under section 53 did not exist for regulations made under that section;

- (e) the regulations were in gross disregard of the principles that Financial Agency was required to follow while making the relevant regulations; or
- (f) the substantial provisions of the regulations did not address the stated objects of the regulations.

(2) The Tribunal must set aside the regulations or general guidance if it determines that any of the grounds under sub-section (1) are met. 5

Review of regulations.

59. (1) All regulations made under this Act must be reviewed by the Financial Agency within three years of such regulations being issued.
- (2) The review must consist of -
- (a) an analysis of costs and an analysis of benefits of the regulations; 10
 - (b) an analysis of all interpretations of the regulations made by the Financial Agency, the Tribunal, any High Court or the Supreme Court; and
 - (c) an analysis of the applicability of the regulations to any changes in circumstances since such regulation was issued.
- (3) Every review under this section must be tabled before the board of the Financial Agency as soon as possible. 15
- (4) The Financial Agency must publish the review within one hundred and twenty days of being tabled before the board of the Financial Agency.

Bye-laws of Financial Agencies.

60. (1) If a Financial Agency is required to make bye-laws under any provision of this Act it must make such bye-laws in compliance of this section. 20
- (2) All proposals for making bye-laws by a Financial Agency, must be submitted to the chairperson of the Financial Agency.
- (3) On receipt of a proposal under sub-section (2), the chairperson must introduce the proposal in the form of an agenda in the next meeting of the board of the Financial Agency. 25
- (4) If the board of the Financial Agency approves the proposal in principle, the draft bye-laws must be made available to the public for comments for a period of thirty days.
- (5) The draft bye-laws must clearly state -
- (a) the provisions of the Act under which it is proposed to be issued; 30
 - (b) its objectives; and
 - (c) the issue it seeks to address.
- (6) The Financial Agency must publish all the comments received on the draft bye-laws and consider them before publishing the final bye-laws.

Process for making bye-laws in exigency.

61. (1) The procedure laid down in section 60 may not be adhered to by a Financial Agency in making bye-laws only if the circumstances so require. 35
- (2) The existence and details of such circumstances must be set out in writing by the Financial Agency and published.
- (3) Bye-laws made under sub-section (1) must clearly state the requirements contained in section 60(5). 40

(4) Bye-laws made under this section will remain in force for a period as may be identified by the Financial Agency, which may not exceed one hundred and eighty days.

5 62. The Central Government may, by notification, make rules where required for carrying out the purposes of this Act. Power of Central Government to make rules.

63. (1) The Central Government may make rules under this Act in accordance with the procedure laid down in this section. Process for making rules.
(2) The draft rules must be made available to the public for comment for thirty days.
10 (3) All comments received from the public must be published and considered by the Central Government before notifying the rules.
(4) If no date is identified in the notification of the rules, they will come into effect from the date of their publication.

15 64. (1) All regulations made by a Financial Agency, all bye-laws made by a Financial Agency and all rules made by the Central Government must be laid before each House of Parliament for a period of thirty days starting from the day on which the regulations, bye-laws, or rules are issued. Regulations, bye-laws and rules to be laid before Parliament.
(2) In calculating the thirty day period, no account is to be taken of any time during which Parliament is dissolved or prorogued or during which both Houses are adjourned for more than four days. 25
(3) The regulations, bye-laws, or rules, will be deemed to be approved by Parliament at the expiry of the thirty day period unless, before the end of that period, both Houses of Parliament agree that the regulations, bye-laws or rules -
25 (a) should not be made, in which case the regulations, bye-laws or rules will be of no effect; or
(b) should be made with certain modifications, in which case the regulations, bye-laws or rules will come into effect in the modified form.
(4) The annulment or modification of the regulations, bye-laws or rules by Parliament will not affect the validity of anything already done under the regulations, bye-laws or rules. 30

35 65. (1) A Financial Agency must refer a matter to the Council, if the Financial Agency is unable to arrive at an agreement with another Financial Agency, within one hundred and eighty days of commencing the process on any issue that requires such Financial Agencies to - Joint action by Financial Agencies.
(a) issue joint regulations under this Act; or
(b) agree on any action required to be taken under this Act.
(2) The Council must resolve any issue in accordance with the provisions under section 305.

40 66. (1) Each Financial Agency must enter into a memorandum of understanding with each Financial Agency in respect of obligations under this Act to co-ordinate with one another or to undertake joint action. Co-ordination between Financial Agencies.

- (2) The memorandum of understanding under this section may relate to -
 - (a) co-operation in making regulations, including joint regulations;
 - (b) co-operation for harmonising regulations governing similar matters;
 - (c) access to and sharing of information;
 - (d) cross-staffing of employees; or
 - (e) consultation regarding any important changes that may have been proposed by any party to the memorandum of understanding.
- (3) Every Financial Agency must publish a report of compliance with this section in its annual report.

CHAPTER 14

DISPOSAL OF APPLICATIONS

Applications generally.

- 67. (1) All applications required to be made to a Financial Agency under this Act must be disposed in accordance with this Chapter.
- (2) In this Chapter, an "applicant" means the person who makes an application to a Financial Agency.

Procedure for making applications.

- 68. (1) All applications under this Act must be made in the manner specified.
- (2) The Financial Agency must acknowledge the receipt of all applications, whether complete or not, within thirty days from receipt.
- (3) An applicant may, at any time, before the Financial Agency conveys its decision, by a second application to the Financial Agency -
 - (a) modify an existing application; or
 - (b) withdraw an application for variation and re-apply.
- (4) If an applicant withdraws an application for variation and re-applies, the Financial Agency must process the application afresh.

Additional information.

- 69. (1) The Financial Agency may require the applicant to provide additional information as it reasonably considers necessary to enable it to determine the application.
- (2) While requesting additional information, the Financial Agency must state the relevance of the additional information so sought.

Procedure for determination of applications.

- 70. (1) Where an application received by a Financial Agency is incomplete, the Financial Agency must inform the applicant in this regard within thirty days from the date of the receipt of the application.
- (2) The Financial Agency must decide all applications in accordance with the provisions and regulations governing the matter to which the application pertains.
- (3) The Financial Agency must not reject any application merely on the grounds that no regulations governing the subject matter of the application are in effect.

- (4) The Financial Agency must ensure that all applications are determined within a period of one hundred and eighty days from the date the application was received by the Financial Agency.
- 5 (5) If the Financial Agency does not reject an application within one hundred and eighty days from the date such application has been made, then that application will be deemed to have been accepted.
- (6) The period mentioned under sub-section (4) may be extended by the Tribunal on an application by the Financial Agency.
- 10 (7) If the Financial Agency proposes to reject an application, it must issue a show cause notice to the applicant.
- (8) If the Financial Agency decides to reject an application, it must issue a decision order to the applicant.
- (9) If the Financial Agency decides to accept an application, it must inform the applicant by issuing an approval order.
- 15 (10) The approval order, consistent with applicable regulations, must state -
 - (a) the scope of approval;
 - (b) the time-period for which the approval is effective;
 - (c) the provisions under which the approval is granted; and
 - 20 (d) any conditions, limitations or requirements subject to which the approval is granted.

- 71. (1) If a Financial Agency proposes to cancel any permission or approval granted in pursuance of an application otherwise than at the request of the person who made the application, then it must issue a show cause notice to such person.
- 25 (2) If the Financial Agency decides to cancel any permission or approval granted in pursuance of an application other than the request of the person who made the application, then it must give issue a decision order to such person.

Procedure for cancellation of any approval.

CHAPTER 15

INFORMATION AND INSPECTION

- 30 72. (1) This section applies only to information and documents reasonably required by a Financial Agency in connection with the pursuit of its objectives or the exercise of functions conferred upon it by this Act or any other law enforced by the Financial Agency.
- (2) The Financial Agency may make regulations requiring financial service providers to make reports in a particular form, manner and frequency.
- 35 (3) The Financial Agency may, by notice in writing given to any financial service provider, its financial representatives or related persons, require such person -
 - (a) to provide specified information; or
 - (b) to produce specified documents.
- 40 (4) The information or documents requested by the Financial Agency must be provided or produced -

Power to gather information.

- (a) before the end of such reasonable period as may be specified;
- (b) at such place as may be specified; and
- (c) in such form or manner as may be specified.

(5) The Financial Agency may require -

- (a) any information provided, whether in a document or otherwise, to be verified in such manner; or
- (b) any document produced to be authenticated in such manner, as it may reasonably require.

Regular inspections.

73. (1) A Financial Agency may carry out inspection of financial service providers at regular intervals. 30
- (2) The Financial Agency will record documents inspected and the finding of such inspections in a specified form.
- (3) The Financial Agency will publish regulations governing -
- (a) the intervals at which a financial service provider may be inspected;
 - (b) notice of inspection by the Financial Agency; 35
 - (c) the steps the financial service provider has to carry out to enable the inspection; and
 - (d) such other conditions as to enable the Financial Agency to collect accurate information about the financial service provider.
- (4) The regulations mentioned in sub-section (3) must balance the requirement of the Financial Agency with the requirement to prevent disruption in the business of financial service providers or impose unreasonable burden upon financial service providers. 40

CHAPTER 16

FUNCTIONING OF THE FINANCIAL AGENCY

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Minimum standard for publication of information.

74. (1) A Financial Agency must maintain a website or any other universally accessible repository of electronic information to -
- (a) record and publish all information that the Financial Agency is obligated to record or publish;
 - (b) provide a copy of all rules, regulations, bye-laws enforced and all guidance issued by the Financial Agency, including all amendments to such rules, regulations, bye-laws and guidance; 30
 - (c) provide information about the process and manner in which applications under this Act are to be made; and
 - (d) provide material information about the functions of the Financial Agency. 35
- (2) All information published on the website or other repository of the Financial Agency must be in an easily accessible and text-searchable format.
- (3) The board of the Financial Agency must review the quality of the website or other repository, based on international best practices, at least once every three years. 40

- (4) The board of the Financial Agency must publish the findings of the review under sub-section (3) with the annual report of the Financial Agency.
- (5) The Financial Agency may make regulations supplementing the requirements of this section.
- (6) Any information not recorded or published on the website or other repository of the Financial Agency will be presumed to not have been recorded or published for the purposes of this Act.

- 75. (1) Each Financial Agency is bound by the requirements of this section in its allocation and use of resources.
- (2) Each Financial Agency must prepare a report of expenditure with respect to each of its duties and objectives for each financial year.
- (3) Each Financial Agency must maintain a transparent system of allocation of resources to carry out its duties and meet its objectives as stated in its report of expenditure under sub-section (2).
- (4) The Central Government may make rules requiring the Financial Agency to make additional reports of its expenditure.
- (5) At least once every three years, the board of the Financial Agency must review the quality of the report of the Financial Agency with the requirements of this section.
- (6) The reports under this section must be published with the annual report of the Financial Agency.

Allocation and use of resources by a Financial Agency

- 76. (1) If any law requires the Financial Agency to carry out any function, the Financial Agency must develop a system to measure the efficiency with which that function was discharged.
- (2) The Financial Agency must measure its efficiency in relation to its functions, in accordance with the system developed under sub-section (1), in a reasonable and objective manner, for each financial year.
- (3) The Financial Agency must determine goals for the discharge of each function for which it has developed a system under sub-section (1) for the financial year.
- (4) The Financial Agency must, at the end of each financial year, prepare a report comparing information from sub-section (2) with the goals that were set for the financial year under sub-section (3).
- (5) The Central Government may make rules requiring the Financial Agency to make additional reports of its performance and discharge of functions.
- (6) At least once every three years, the board of the Financial Agency must review the quality of the report of the Financial Agency with the requirements of this section.
- (7) The reports under this section must be published with the annual report of the Financial Agency.
- (8) In this section, "reasonable and objective manner", in relation to the measurement of a system, includes -

Performance and efficiency of a Financial Agency

- (a) a system of measurement that best represents any function being measured;
- (b) a standardised system that allows comparison where possible; and
- (c) where possible, numerical systems of measurement.

Returns and reports.

77. (1) Each Financial Agency must furnish to the Central Government, at such time and in such manner and form as may be prescribed, or as the Central Government may direct, such returns and statements, and such particulars in regard to any proposed or existing operations of the Council as the Central Government may, from time to time, require. 5
- (2) The board of the Financial Agency must prepare and submit to the Central Government an annual report within ninety days from the end of a financial year. 10
- (3) The annual report must be in such manner and form as may be prescribed, and must give a true and full account of the performance of the Financial Agency in the previous financial year, including - 15
- (a) a review of the Financial Agency's activities in relation to the discharge of its functions and the achievement of its objectives;
 - (b) all information that is necessary to understand the discharge of functions and the achievement of the objectives of the Financial Agency, that has been published by the Financial Agency; 20
 - (c) all information that the Financial Agency is required to publish along with the annual report under this Act;
 - (d) a statement of the deliberations of the Financial Agency, accompanied by the records of meetings of the Financial Agency;
 - (e) a statement indicating any statutory obligation that the Financial Agency or the board of the Financial Agency has not complied with, and reasons for such non-compliance; 25
 - (f) a statement by the chairperson of the Financial Agency, in relation to the activities and performance of the Financial Agency;
 - (g) a statement of major activities the Financial Agency will undertake in the subsequent financial year; and 30
 - (h) a statement which any member of the board may wish to include.
- (4) A copy of the report received under sub-section (2) must be laid, as soon as possible after its receipt, before each House of Parliament.

Accounts and audit.

78. (1) Each Financial Agency must maintain proper accounts and other relevant records and prepare an annual statement of accounts, in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor-General of India. 35
- (2) The accounts of a Financial Agency must be audited annually by the government auditor. 40
- (3) The audit by the government auditor will not include an audit of performance of the Financial Agency.
- (4) The government auditor must -
- (a) certify the accounts of the Financial Agency; and

- (b) make an audit report.
- (5) The certified accounts and the audit report must be placed before the board of the Financial Agency and the board of the Financial Agency must record its observations on the audit report.
- 5 (6) The annual report of the Financial Agency must include -
 - (a) certified accounts and audit report as provided under sub-section (4); and
 - (b) the observations of the board of the Financial Agency under sub-section (5).
- 10 (7) In relation to sub-section (1), the Reserve Bank, while preparing its financial statements, must comply with accounting standards to the extent that it is, in the opinion of the Reserve Bank Board, appropriate to do so, having regard to the objects and functions of the Reserve Bank.
- (8) In relation to the audit of the accounts of the Reserve Bank, the government auditor, will not audit -
 - 15 (a) the deliberations, decisions or minutes of the Monetary Policy Committee under section 335, and the actions of the Reserve Bank under section 343 in relation to implementing monetary policy decisions;
 - (b) the transactions by the Reserve Bank under sections 345 and 346; and
 - 20 (c) any part of a discussion or communication between members of the Reserve Bank Board, members of the Monetary Policy Committee, and officers and employees of the Reserve Bank related to clauses (a) and (b).
- (9) In this section, "government auditor" means the Comptroller and Auditor-General of India, or any other person appointed by the Comptroller and Auditor-General of India in this regard.

- 25 79. (1) Every Financial Agency must arrange for a review of its performance and operations by a team of experts external to that Financial Agency. Review by external experts.
- (2) The review must take place once every three financial years.
- (3) Every Financial Agency must make bye-laws in relation to the following matters regarding the team of external experts -
 - 30 (a) the required composition of the team;
 - (b) the process of selection;
 - (c) the process of appointment;
 - (d) the terms of service; and
 - (e) the duration and terms of the review.
- 35 (4) The Financial Agency must ensure that -
 - (a) the team of external experts include experts in the same field as that of the Financial Agency; and
 - (b) there is no conflict of interest between the team of external experts and the Financial Agency.
- 40 (5) The review under this section must -
 - (a) be based on international best principles, as relevant;

- (b) give an opinion on whether the Financial Agency is suitably designed and operating effectively; and
 - (c) identify good practices and make proposals for the Financial Agency to consider.
- (6) The Financial Agency must ensure that the team of external experts has access to relevant information and resources as necessary to carry out the review. 5
- (7) The board of the Financial Agency must, within one hundred and eighty days of the review –
- (a) determine a programme of action to implement the report of the review, as appropriate; 10
 - (b) publish the report of the review, including all opinions and proposals made by the team of external experts; and
 - (c) publish the programme of action.
- Grants and loans by Central Government. 80. The Central Government may make to a Financial Agency, grants or loans of such sums of money as it thinks fit for being utilised for the purposes of this Act. 15
- Levy and collection of fees by a Financial Agency. 81. (1) A Financial Agency may levy and collect fees, as required for the discharge of its functions under this Act, in the relevant manner specified under this Act.
- (2) In levying fees, the Financial Agency must take into consideration one or more of the following factors, as may be relevant –
- (a) the nature, scope and size of business carried out by the financial service provider; 20
 - (b) the requirement that the levy of fees does not constrain competition;
 - (c) the requirement that the levy of fees is not disproportionate to the costs likely to be incurred by the Financial Agency in discharging the functions for the fees will be levied; and 25
 - (d) the financial requirements of the Financial Agency.
- Confidentiality. 82. (1) Each Financial Agency, and every member of board of a Financial Agency, officer, and employee of a Financial Agency must maintain the confidentiality of any financial regulatory data and other commercially sensitive information that is obtained or produced in the discharge of any of its functions under this Act, unless – 30
- (a) any provision of this Act permits or requires its publication or disclosure;
 - (b) any other law or any agreement in force permits or requires its publication or disclosure;
 - (c) the person from whom it was obtained, and, if different, the person to whom it relates, consents; 35
 - (d) it is already available to the public from other sources;
 - (e) it is in the form of a summary or collection of information so framed that it is not possible to ascertain from it information relating to any particular person; or 40
 - (f) it enables or assists the Financial Agency or the Central Government to discharge its functions under this Act.

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- (2) The obligation under sub-section (1) extends to every member appointed to an advisory council to the board of a Financial Agency.
- (3) No violation under this section is committed if the information is disclosed -
 - (a) in accordance with the exceptions contained in sub-section (1); or
 - (b) for the purpose of any legal proceedings, as may be directed by a body having appropriate jurisdiction.
- (4) Nothing in this section will be taken to be a restriction of the power of a public authority to exempt the disclosure of information under section 8 of the Right to Information Act, 2005 (22 of 2005).

PART IV

FINANCIAL CONSUMER PROTECTION

CHAPTER 17

OBJECTIVES AND PRINCIPLES

Objectives.

83. The Regulator must discharge its functions and exercise its powers under this Part with the objective of - 5

- (a) protecting and furthering the interests of consumers; and
- (b) promoting public awareness of matters relating to financial products and financial services.

Principles of consumer protection.

84. (1) The Regulator must have regard to the following principles while discharging its functions and exercising its powers under this Part - 10

- (a) the level of protection required by a consumer and the level of care required from a financial service provider, which may vary depending on
 - (i) the level of knowledge, experience and expertise of the consumer; 15
 - (ii) the nature and degree of risk embodied in the financial product or financial service being availed by the consumer;
 - (iii) the appropriateness of a financial product or financial service for different classes of consumers; and
 - (iv) the extent of dependence of the consumer on the financial service provider; 20
- (b) consumers must ordinarily take responsibility for their transactional decisions;
- (c) any obligation imposed on a financial service provider should be reasonably commensurate with the benefits for consumers, considered in general terms, which are expected to result from the imposition of that obligation; 25
- (d) competition in the markets for financial products and financial services is desirable in the interests of consumers and therefore -
 - (i) barriers to competition owing to adverse effects of regulatory actions should be minimised; and 30
 - (ii) there should be competitive neutrality in the treatment of financial service providers;
- (e) facilitating access to financial products and financial services is desirable in the interests of consumers; and
- (f) innovation in financial products and financial services is desirable in the interests of consumers. 35

(2) In interpreting this Part and in discharging its functions or exercising its powers under this Part, if the Regulator perceives a conflict between any of the principles contained in sub-section (1), or if more than one interpretation is possible, the Regulator must reconcile and manage the conflict giving preference to the principle which would be the most relevant for furthering its objectives under this Part. 40

- (3) The Regulator must also take into account information received from the Redress Agency under section 123 while discharging its functions and exercising its powers under this Part.

CHAPTER 18

PROTECTION OF CONSUMERS

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- 85. (1) A financial service provider must exercise professional diligence while entering into a financial contract or discharging any obligations under it.
- (2) In this section, "professional diligence" means the standard of skill and care that a financial service provider would be reasonably expected to exercise towards a consumer, commensurate with -
 - (a) honest market practice;
 - (b) the principle of good faith;
 - (c) the level of knowledge, experience and expertise of the consumer;
 - (d) the nature and degree of risk embodied in the financial product or financial service being availed by the consumer; and
 - (e) the extent of dependence of the consumer on the financial service provider.

Requirement of professional diligence.

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- 86. (1) An unfair term of a non-negotiated contract will be void.

Unfair terms in financial contracts.

- (2) A term is unfair if it -

- (a) causes a significant imbalance in the rights and obligations of the parties under the financial contract, to the detriment of the consumer; and
- (b) is not reasonably necessary to protect the legitimate interests of the financial service provider.

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- (3) The factors to be taken into account while determining whether a term is unfair, include -

- (a) the nature of the financial product or financial service dealt with under the financial contract;
- (b) the extent of transparency of the term;
- (c) the extent to which the term allows a consumer to compare it with other financial contracts for similar financial products or financial services; and
- (d) the financial contract as a whole and the terms of any other contract on which it is dependent.

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- (4) The Regulator may specify an illustrative list of terms that are considered to be unfair terms under this section.

- (5) A term is transparent if it -

- (a) is expressed in reasonably plain language that is likely to be understood by the consumer;
- (b) is legible and presented clearly; and
- (c) is readily available to the consumer affected by the term.

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- (6) If a term of a financial contract is determined to be unfair under sub-section (3), the parties will continue to be bound by the remaining terms of the financial contract to the extent that the financial contract is capable of enforcement without the unfair term.

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Non-negotiated contracts.

- 87. (1) In this Chapter, "non-negotiated contract" means a contract whose terms, other than the terms contained in section 88, are not negotiated between the parties to the financial contract and includes -
 - (a) a financial contract in which, relative to the consumer, the financial service provider has a substantially greater bargaining power in determining the terms of the financial contract; and
 - (b) a standard form contract.
- (2) In this section, "standard form contract" means a financial contract that is substantially not negotiable for the consumer, except for the terms contained in section 88.
- (3) Even if some terms of a financial contract are negotiated in form, the financial contract may be regarded as a non-negotiated contract if so indicated by -
 - (a) an overall and substantial assessment of the financial contract; and
 - (b) the substantial circumstances surrounding the financial contract.
- (4) In a claim that a financial contract is a non-negotiated contract, the onus of demonstrating otherwise will be on the financial service provider.

Terms that are unaffected.

- 88. (1) Section 86 does not apply to a term of a financial contract if it -
 - (a) defines the subject matter of the financial contract;
 - (b) sets the price that is paid, or payable, for the provision of the financial product or financial service under the financial contract and has been clearly disclosed to the consumer; or
 - (c) is required, or expressly permitted, under any law or regulations.
- (2) The exemption under sub-section (1)(b) does not apply to a term that deals with the payment of an amount which is contingent on the occurrence or non-occurrence of any particular event.

Unfair conduct prohibited.

- 89. (1) Unfair conduct in relation to financial products or financial services is prohibited.
- (2) In this Chapter, "unfair conduct" means an act or omission by a financial service provider or its financial representative that significantly impairs, or is likely to significantly impair, the ability of a consumer to make an informed transactional decision and includes -
 - (a) misleading conduct under section 90;
 - (b) abusive conduct under section 91; and
 - (c) such other conduct as may be specified.

Misleading conduct.

- 90. (1) Conduct of a financial service provider or its financial representative in relation to a determinative factor is misleading if it is likely to cause the consumer to take a transactional decision that the consumer would not have taken otherwise, and the conduct involves -
 - (a) providing the consumer with inaccurate information or information that the financial service provider or financial representative does not believe to be true; or

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- (b) providing accurate information to the consumer in a manner that is deceptive.
- (2) In determining whether a conduct is misleading under sub-section (1), the following factors must be considered to be "determinative factors" -
 - (a) the main characteristics of a financial product or financial service, including its features, benefits and risks to the consumer;
 - (b) the consumer's need for a particular financial product or financial service or its suitability for the consumer;
 - (c) the consideration to be paid for the financial product or financial service or the manner in which the consideration is calculated;
 - (d) the existence, exclusion or effect of any term in a financial contract, which is material term in the context of that financial contract;
 - (e) the nature, attributes and rights of the financial service provider, including its identity, regulatory status and affiliations; and
 - (f) the rights of the consumer under any law or regulations.

- 91. (1) A conduct of a financial service provider or its financial representative in relation to a financial product or financial service is abusive if it - Abusive conduct.
 - (a) involves the use of coercion or undue influence; and
 - (b) causes or is likely to cause the consumer to take a transactional decision that the consumer would not have taken otherwise.
- (2) In determining whether a conduct uses coercion or undue influence, the following must be considered -
 - (a) the timing, location, nature or persistence of the conduct;
 - (b) the use of threatening or abusive language or behaviour;
 - (c) the exploitation of any particular misfortune or circumstance of the consumer, of which the financial service provider is aware, to influence the consumer's decision with regard to a financial product or financial service;
 - (d) any non-contractual barriers imposed by the financial service provider where the consumer wishes to exercise rights under a financial contract, including -
 - (i) the right to terminate the financial contract;
 - (ii) the right to switch to another financial product or another financial service provider; and
 - (e) a threat to take any action, depending on the circumstances in which the threat is made.

CHAPTER 19

PROTECTION OF PERSONAL INFORMATION

- 92. In this Chapter, "personal information" means any information that relates to a consumer or allows a consumer's identity to be inferred, directly or indirectly, and includes - Meaning of personal information.
 - (a) name and contact information;
 - (b) biometric information, in case of individuals;

- (c) information relating to transactions in, or holdings of, financial products;
- (d) information relating to the use of financial services; or
- (e) such other information as may be specified.

Principles governing use of personal information.

93. (1) A financial service provider must –
- (a) not collect personal information relating to a consumer in excess of what is required for the provision of a financial product or financial service; 5
 - (b) maintain the confidentiality of personal information relating to consumers and not disclose it to a third party, except in a manner expressly permitted under sub-section (2);
 - (c) make best efforts to ensure that any personal information relating to a consumer that it holds is accurate, up to date and complete; 10
 - (d) ensure that consumers can obtain reasonable access to their personal information, subject to any exceptions that the Regulator may specify; and
 - (e) allow consumers an effective opportunity to seek modifications to their personal information to ensure that the personal information held by the financial service provider is accurate, up to date and complete. 15
- (2) A financial service provider may disclose personal information relating to a consumer to a third party only if –
- (a) it has obtained prior written informed consent of the consumer for the disclosure, after giving the consumer an effective opportunity to refuse consent; 20
 - (b) the consumer has directed the disclosure to be made;
 - (c) the Regulator has approved or ordered the disclosure, and unless prohibited by the relevant law or regulations, the consumer is given an opportunity to represent under such law or regulations against such disclosure; 25
 - (d) the disclosure is required under any law or regulations, and unless prohibited by such law or regulations, the consumer is given an opportunity to represent under such law or regulations against such disclosure;
 - (e) the disclosure is directly related to the provision of a financial product or financial service to the consumer, if the financial service provider – 30
 - (i) informs the consumer in advance that the personal information may be shared with a third party; and
 - (ii) makes arrangements to ensure that the third party maintains the confidentiality of the personal information in the same manner as required under this Part; or 35
 - (f) the disclosure is made to protect against or prevent actual or potential fraud, unauthorised transactions or claims, if the financial service provider arranges with the third party to maintain the confidentiality of the personal information in the manner required under this Part.
- (3) In this section, "third party" means any person other than the concerned financial service provider, including a person belonging to the same group as the financial service provider. 40

Regulations regarding personal information.

94. The Regulator may make regulations to –
- (a) provide additional requirements for the collection, storage, modification and protection of personal information by financial service providers, including – 45

- (i) the manner of maintenance of records of personal information and the time-periods for which the records are to be maintained; and
 - (ii) the manner in which records of personal information should be dealt with after the expiry of the specified period;
- 5 (b) exempt a class of financial service providers from the application of all or any portion of this Chapter or modify the manner in, or extent to which, all or any portion of the Chapter applies to them, subject to any specified conditions; or
- 10 (c) establish mechanisms to ensure that consumers have access to, and are given an effective opportunity to seek modifications to, their personal information.

CHAPTER 20

REQUIREMENT OF FAIR DISCLOSURE

- 15 95. (1) A financial service provider must ensure fair disclosure of information that is likely to be required by a consumer to make an informed transactional decision. Initial disclosures.
- (2) In order to constitute fair disclosure, the information must be provided -
- (a) sufficiently before the consumer enters into a financial contract, so as to allow the consumer reasonable time to understand the information;
 - (b) in writing and in a manner that is likely to be understood by a consumer belonging to a particular category; and

20 (c) in a manner that enables the consumer to make reasonable comparison of the financial product or financial service with other similar financial products or financial services.

(3) The Regulator may specify the types of information that must be disclosed to a consumer in relation to a financial product or financial service, which may include information regarding -

25 (a) main characteristics of the financial product or financial service, including its features, benefits and risks to the consumer;

(b) consideration to be paid for the financial product or financial service or the manner in which the consideration is calculated;

30 (c) existence, exclusion or effect of any term in the financial product or financial contract;

(d) nature, attributes and rights of the financial service provider, including its identity, regulatory status and affiliations;

35 (e) contact details of the financial service provider and the methods of communication to be used between the financial service provider and the consumer;

(f) rights of the consumer to rescind a financial contract within a specified period; or

40 (g) rights of the consumer under any law or regulations.

96. (1) A financial service provider must provide a consumer that is availing a financial product or financial service provided by it, with the following continuing disclosures - Continuing disclosures.

- (a) any material change to the information that was required to be disclosed under section 95 at the time when the consumer initially availed the financial product or financial service;
- (b) information relating to the status or performance of a financial product held by the consumer, as may be required to assess the rights or interests in the financial product or financial service; and
- (c) any other information that may be specified.

(2) A continuing disclosure must be made -

- (a) within a reasonable time-period from the occurrence of any material change or at reasonable periodic intervals, as applicable; and
- (b) in writing and in a manner that is likely to be understood by a consumer belonging to that category.

(3) The Regulator may specify -

- (a) the nature of information that must be disclosed on a continuing basis to a consumer that has availed of a specified financial product or financial service;
- (b) the time-period within which continuing disclosures of information are to be made for a specified financial product or financial service; or
- (c) circumstances in which the consumer will have a right to terminate the financial contract upon a continuing disclosure being made.

Regulations regarding disclosure requirements.

97. The Regulator may make regulations to -

- (a) provide for the manner in which a disclosure of information relating to a financial product or financial service has to be made to a consumer; or
- (b) exempt a class of financial service providers from the application of all or any portion of this Chapter or modify the manner in, or extent to which, all or any portion of the Chapter applies to them, subject to any specified conditions.

CHAPTER 21

REDRESS OF COMPLAINTS

Responsibility of financial service providers.

98. (1) A financial service provider must have in place an effective mechanism to receive and redress complaints from its consumers in relation to financial products or financial services provided by it, or on its behalf, in a prompt and fair manner.

(2) A financial service provider must inform a consumer, at the commencement of relationship with the consumer and at such other time when the information is likely to be required by the consumer, of -

- (a) the consumer's right to seek redress for any complaints, including through the Redress Agency; and
- (b) the processes followed by the financial service provider to receive and redress complaints from its consumers.

Regulations regarding redress of complaints.

99. (1) The Regulator must make regulations on the processes to be followed by a financial service provider to receive and redress complaints from its consumers in an effective manner.

(2) The regulations must provide for –

- (a) the process to be followed by a consumer to file a complaint with a financial service provider and the time-period within which the complaint must be filed; and
- (b) the process to be followed by a financial service provider to receive and redress complaints and the time limits for each step of the process.

(3) The regulations may, in addition, provide for –

- (a) the time-periods and intervals at which information under section 98(2) has to be provided;
- (b) the form and manner in which information under section 98(2) has to be provided, including a requirement to make the information available on a financial service provider's website;
- (c) a requirement to maintain records of each complaint received by a financial service provider and the measures taken for its redress;
- (d) a requirement to submit periodic reports to the Regulator about the receipt and redress of complaints in the specified manner;
- (e) an alternate dispute resolution mechanism for complaints in relation to specified financial products or financial services to be followed after, or in place of, the financial service provider's redress process;
- (f) the process to be followed where two or more financial service providers may be jointly responsible for the redress of a complaint; or
- (g) any other matter relevant to the redress of complaints.

CHAPTER 22

SUITABILITY OF ADVICE FOR RETAIL CONSUMERS

100. (1) A retail advisor must –

- (a) make all efforts to obtain correct and adequate information about the relevant personal circumstances of a retail consumer; and
- (b) ensure that the advice given is suitable for the retail consumer after due consideration of the relevant personal circumstances of the retail consumer.

(2) If it is reasonably apparent to the retail advisor that the available information regarding the relevant personal circumstances of a retail consumer is incomplete or inaccurate, the advisor must warn the retail consumer of the consequences of proceeding on the basis of incomplete or inaccurate information.

(3) If a retail consumer intends to avail of a financial product or financial service that the retail advisor determines unsuitable for the retail consumer, the retail advisor –

- (a) must clearly communicate its advice to the retail consumer in writing and in a manner that is likely to be understood by the retail consumer; and
- (b) may provide the financial product or financial service requested by the retail consumer only after complying with clause (a) and obtaining a written acknowledgment from the retail consumer.

Assessment of
suitability.

Regulations regarding suitability of advice.

101. (1) The Regulator must specify the financial products or financial services which may be provided to retail consumers or a class of retail consumers, only after advice has been given to them under section 100.

(2) The Regulator may specify -

- (a) the type of enquiries that need to be made to determine the relevant personal circumstances of retail consumers for a financial product or financial service; or
- (b) that certain types of communications issued by a financial service provider to a retail consumer would not constitute advice for the purposes of section 100.

(3) The Regulator must take into account the following factors while making regulations under sub-section (1) -

- (a) the extent to which the cost of seeking information about the relevant personal circumstances of retail consumers might restrict the access of retail consumers to the financial product or financial service; and
- (b) sufficiency of the disclosures made under sections 95 to 97 to allow retail consumers to assess the suitability of the financial product or financial service for their purposes.

Dealing with conflict of interests.

102. (1) A retail advisor must -

- (a) provide a retail consumer with information regarding any conflict of interests, including any conflicted remuneration that the retail advisor has received or expects to receive for making the advice to the retail consumer; and
- (b) give priority to the interests of the retail consumer if the advisor knows, or reasonably ought to know, of a conflict between -
 - (i) its own interests and the interests of the retail consumer; or
 - (ii) the interests of the concerned financial service provider and interests of the retail consumer, in cases where the advisor is a financial representative.

(2) The information under sub-section (1)(b) must be given to the retail consumer in writing and in a manner that is likely to be understood by the retail consumer and a written acknowledgement of the receipt of the information should be obtained from the retail consumer.

(3) The Regulator may specify -

- (a) the circumstances in which a benefit received by a retail advisor would, or would not, be considered to be a conflicted remuneration; or
- (b) the nature, type and structure of benefits permitted to be received by a retail advisor for a financial product or financial service.

(4) In this section, "conflicted remuneration" means any benefit, whether monetary or non-monetary, derived by a retail advisor from persons other than retail consumers, that would, under the circumstances, reasonably be expected to influence the advice given by the retail advisor to a retail consumer.

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CHAPTER 23

OTHER POWERS AND FUNCTIONS OF THE REGULATOR

103. (1) The Regulator must - General functions of the Regulator.

- (a) make regulations to carry out the purposes of this Part;
- 5 (b) issue guidance to financial service providers in respect of any matter referred to in this Part or the regulations made under it, whether or not -
 - (i) the Part expressly requires or enables the Regulator to make regulations on such matter; or
 - 10 (ii) a formal application seeking guidance has been made to it;
- (c) supervise, or cause to be supervised, financial service providers to ensure compliance with the provisions of this Part and the regulations made under it;
- 15 (d) take appropriate enforcement actions to deal with the violation of the provisions of this Part or the regulations made under it; and
- (e) carry out financial awareness programmes.

(2) The Regulator must make regulations within six months from the commencement of this Part to provide -

- 20 (a) the amount under section 2(140) for the purposes of determining whether a consumer is a retail consumer, which may vary for different financial products or financial services;
- (b) the manner of determining if the value of a financial product or of a financial service rendered meets the value of the amount specified for the purposes of section 2(140); and
- 25 (c) the net asset value and turnover for the purposes of section 2(61).

(3) The Regulator may from time to time modify the regulations made under sub-section (2).

104. (1) A financial service provider must ensure that no individual deals with consumers in connection with the provision of a financial product or financial service by it or on its behalf, including as an employee or financial representative, unless that individual is registered with the Regulator. Registration of individuals dealing with consumers.

- (2) The Regulator may specify -
- (a) the situations in which an individual would, or would not, be considered to be worthy of dealing with consumers;
 - 35 (b) the eligibility requirements to be satisfied by an individual in order to be registered in respect of specified financial products or financial services; or
 - (c) a code of conduct expected to be followed by an individual who is registered in respect of specified financial products or financial services.

40 105. (1) A financial service provider must file specified information with the Regulator in relation to - File and use process for financial products.

- (a) any financial product that it proposes to offer to consumers; or

- (b) any material variation to a financial product already offered to consumers.
- (2) A financial service provider must not offer a financial product referred to in sub-section (1) to consumers unless -
 - (a) it has filed the specified information with the Regulator in respect of the financial product; and
 - (b) a period of sixty days has elapsed from the date of filing of the specified information with the Regulator.
- (3) The Regulator may seek any additional information or clarifications in relation to the product from the financial service provider during the period of sixty days and the financial service provider must provide the same.
- (4) If the Regulator does not seek any additional information or clarifications, the financial service provider can commence offering the product to consumers after the expiry of the period of sixty days.
- (5) The Regulator must specify -
 - (a) the information required to be filed with it in relation to any financial product or a material variation to a financial product; and
 - (b) what would, or would not, constitute a material variation to a financial product.

Restrictions on financial contracts.

- 106. (1) The Regulator may specify -
 - (a) the terms and conditions that are to be, or are not to be, included in financial contracts with specified consumers for specified financial products or financial services; or
 - (b) restrictions on invitations or inducements to enter into financial contracts with specified consumers for specified financial products or financial services.
- (2) Any regulations made under sub-section (1) must be accompanied by a statement explaining -
 - (a) the other interventions made or considered by the Regulator to address the concerns sought to be addressed through the regulations; and
 - (b) the reasons why such other interventions were or would be insufficient, in the view of the Regulator, to address the concerns sought to be addressed through the regulations.

Responsibility of financial service providers for financial representatives.

- 107. (1) Any act or omission by a financial representative of a financial service provider, in connection with the provision of a financial product or financial service on behalf of the financial service provider, will also be deemed to be an act or omission by the financial service provider.
- (2) Nothing contained in sub-section (1) will make a financial service provider responsible for an offence committed by a financial representative.

CHAPTER 24

REDRESS AGENCY

Functions of the Redress Agency.

- 108. (1) The Redress Agency will redress the complaints of retail consumers, received directly or forwarded by the Regulator, in cases where -

- (a) the complainant has already made a complaint to the respondent and -
 - (i) the respondent has failed to resolve the complaint within the time-period specified by the Regulators; or
 - (ii) the complainant is not satisfied with the resolution of the complaint by the respondent;
 - (b) proceedings concerning the subject-matter of the complaint are not pending before any other competent court, tribunal or other authority set up by or under any other law for the time being in force; and
 - (c) a final order on the subject-matter of the complaint has not been made by any other court, tribunal or other authority.
- (2) The Redress Agency may in exceptional circumstances accept a complaint even if the conditions under section (1)(a) have not been satisfied.
- (3) The Redress Agency must discharge its function in a fair, informal, economical and expeditious manner, through -
- (a) mediation between the complainant and respondent to arrive at a voluntary settlement of the complaint; and
 - (b) if a complaint is not redressed through mediation, adjudication of the complaint.
- (4) The Redress Agency must put in place adequate systems, processes and infrastructure to enable it to discharge its functions in an efficient and effective manner.

109. (1) The following powers must be exercised by the Redress Agency Board and cannot be delegated to any other person -
- (a) making the bye-laws of the Redress Agency and regulations under section 117;
 - (b) appointing adjudicators under section 110;
 - (c) adopting the annual budget of the Redress Agency under section 122(1)(a); and
 - (d) adopting the annual report on the discharge of the Redress Agency's functions under section 123.

Restrictions on the power to delegate.

110. (1) The Redress Agency must appoint adjudicators having appropriate qualifications and experience, in accordance with its bye-laws.
- (2) Adjudicators appointed by the Redress Agency must be persons of ability, integrity and standing who have -
- (a) shown capacity in dealing with consumer protection issues, including redress of consumer disputes; or
 - (b) knowledge and expertise in the fields of law or finance.
- (3) The terms of appointment of a person as an adjudicator must ensure the independence of the person appointed.
- (4) The powers and functions of adjudicators under this Part may not be delegated to any other person.

Appointment of adjudicators.

CHAPTER 25

PROCEEDINGS BEFORE THE REDRESS AGENCY

Screening of complaints.

- 111. (1) A complaint that is received directly by the Redress Agency or forwarded by the Regulator must be screened before it is referred for mediation.
- (2) The Redress Agency may dismiss a complaint upon screening, or at any later time when the relevant information comes to its knowledge, on any of the following grounds -
 - (a) the complaint does not satisfy the conditions contained in section 108(1); or
 - (b) the complaint is *prima facie* frivolous, malicious or vexatious.
- (3) A dismissal of a complaint by the Redress Agency must be accompanied by a statement in writing giving the reasons and grounds for the dismissal.
- (4) A complaint that is not dismissed under this section must be referred to a mediator for mediation.
- (5) If a complaint is allowed to proceed for mediation under sub-section (4) no legal proceedings concerning the subject-matter of the complaint can be brought before any other court, tribunal or other authority while the matter is pending before the Redress Agency.

Mediation and settlement process.

- 112. (1) The mediator must assist the complainant and respondent to arrive at a voluntary settlement of the complaint.
- (2) If the complainant and the respondent arrive at a settlement through mediation, the mediator must record the settlement in writing in the form of a settlement agreement to be signed by the complainant, respondent and the mediator.
- (3) A complainant may challenge the settlement agreement before an adjudicator only on the ground that the consent to the settlement agreement was obtained by coercion, undue influence, misrepresentation or fraud.
- (4) The settlement agreement, unless it is determined to be invalid by the adjudicator, will be binding on the complainant and respondent and will be enforceable as though it were a decree of a civil court.
- (5) A complaint will be referred to an adjudicator for determination if any of the following events occurs and the complainant has not withdrawn the complaint -
 - (a) a settlement agreement has not been arrived at within the time limit set out under the regulations;
 - (b) the mediator is of the view that a settlement is not possible in the facts and circumstances of the case and informs the complainant and the respondent in writing of the decision along with reasons; or
 - (c) a settlement agreement is found by an adjudicator to be invalid under sub-section (4).

Determination by adjudicator.

- 113. (1) An adjudicator to whom a complaint has been referred must -
 - (a) examine the complaint, in accordance with the regulations made in this regard;

- (b) determine the complaint with reference to what is equitable in the circumstances, with due regard to -
 - (i) the provisions of this Act and the regulations, bye-laws and guidance under it;
 - (ii) the terms of the financial contract between the complainant and the respondent, which forms the basis of the complaint;
 - (iii) any code of conduct applicable to the respondent; and
 - (iv) past determinations made by the Redress Agency in similar cases; and
 - (c) communicate the determination made by the adjudicator to the complainant and the respondent, in writing, in the form of an adjudication order.
- (2) The adjudication order must -
- (a) set out the reasons for the determination;
 - (b) be signed by the adjudicator; and
 - (c) inform the complainant and the respondent of their right to appeal against the adjudication order before the Tribunal.
- (3) If the adjudicator determines a complaint in favour of the complainant, the adjudication order may -
- (a) make an award against the respondent of such amount as the adjudicator considers fair compensation, subject to the limits provided in the regulations for any -
 - (i) financial loss suffered by the complainant; or
 - (ii) loss or damage caused on account of material distress or material inconvenience suffered by the complainant; or
 - (b) direct that the respondent take such steps in relation to the complainant as the adjudicator considers just and appropriate.
- (4) An adjudication order providing for compensation may also provide for the amount payable under the award to bear interest at such rate and from such date as set out in the award.
- (5) An adjudication order is enforceable in the same manner as though it were a decree of a civil court.

- 114. Any person aggrieved by an adjudication order may challenge it in appeal before the Tribunal. Appeal to the Tribunal.
- 115. No court, tribunal or other authority will hear a claim on an issue that relates directly and substantially to the subject-matter of a complaint on which an adjudication order has been made under section 113, except an appeal under section 114. Finality of orders.
- 116. Any wilful contravention of an adjudication order made by the Redress Agency is punishable as a Class B offence under this Act. Offence.

CHAPTER 26

REDRESS AGENCY'S PROCEDURES

- 117. (1) The Regulators must make regulations to provide for -

Regulations relating to Redress Agency's procedures.

- (a) the time limit within which a complainant has to submit a complaint to the Redress Agency or to the Regulator and the circumstances in which the time limit may be extended by the Redress Agency; and
 - (b) the monetary limit on the award of compensation that may be made by the Redress Agency, which may contain -
 - (i) different limits for different kinds of complaints; or
 - (ii) lower sub-limits for compensation awarded on the grounds of distress or inconvenience suffered by a complainant.
- (2) Except as contained in sub-section (1), the Redress Agency must make regulations to provide for the procedure to be followed for receiving, screening, mediation and adjudication of complaints.
- (3) Regulations made under sub-section (2) may, among other things -
- (a) fix the time-periods for the internal proceedings of the Redress Agency;
 - (b) provide for the circumstances in which a complaint would be accepted by the Redress Agency even if the condition under section 108(1)(a) has not been satisfied;
 - (c) provide for the reference of a complaint, in identified circumstances and with the consent of the complainant, to another body, as may be provided in the bye-laws, with a view to its being determined by that body instead of the Redress Agency;
 - (d) provide a list of matters which are to be taken into account by adjudicators in determining whether an act or omission was fair and reasonable;
 - (e) make provision as to the evidence which may be required or admitted, the extent to which it should be oral or written and the consequences of a person's failure to produce any information or document which that person has been required to produce;
 - (f) provide for the circumstances and the manner in which an adjudicator may award costs;
 - (g) provide for the fees to be levied from financial service providers under section 122(1)(b) for the establishment and operation of the Redress Agency; and
 - (h) provide for the fees payable by respondents to the Redress Agency under section 122(1)(c), which may vary for different kinds of complaints.

Adjudicators vested with powers of civil court.

118. The adjudicators are not bound by the procedure laid down by the Code of Civil Procedure, 1908 (5 of 1908) but have the same powers as a civil court does under the Code of Civil Procedure, 1908 (5 of 1908) in respect of -
- (a) summoning and enforcing the attendance of any person and examining them on oath;
 - (b) requiring the discovery and production of documents;
 - (c) receiving evidence on affidavits;
 - (d) issuing commissions for the examination of witnesses or documents;
 - (e) reviewing its decisions;
 - (f) dismissing an application for default or deciding it ex parte;
 - (g) setting aside any order of dismissal of any application for default or any order passed by it ex parte; and
 - (h) any other matter that may be specified by the Regulators.

119. (1) The Redress Agency must make use of modern technology to improve access to the Redress Agency and to enable it to discharge its functions in an efficient manner. Use of technology.
- (2) The use of modern technology will include use of mechanisms that allow -
- (a) parties to submit documents and information to the Redress Agency through electronic means;
 - (b) parties and other concerned persons to participate in the processes of the Redress Agency from remote locations without being physically present;
 - (c) electronic filing and management of complaints;
 - (d) use of automated systems for scheduling the hearing of complaints; and
 - (e) providing of electronic access to complaint-related information to the parties to a complaint.
- (3) If a complainant accesses the Redress Agency using a mechanism that allows parties to participate in the processes of the Redress Agency from remote locations without being physically present, the respondent must also access the Redress Agency in the same manner.

CHAPTER 27

OTHER PROVISIONS GOVERNING THE REDRESS AGENCY

120. (1) The adjudicator has the power to award reasonable costs against the respondent and in favour of the complainant or the Redress Agency, for the purpose of providing a contribution to resources deployed in dealing with the complaint, if in the opinion of the adjudicator, the respondent's conduct was improper or led to an unreasonable burden on the complainant or the Redress Agency. Costs.
- (2) The adjudicator has the power to award reasonable costs against the complainant and in favour of the Redress Agency, for the purpose of providing a contribution to resources deployed in dealing with the complaint, if in the opinion of the adjudicator, the complaint is found to be without foundation or merit or the complainant's conduct was improper or led to an unreasonable burden on the respondent or the Redress Agency.
- (3) The adjudicator may, while making an award of costs, order that the amount payable under the award bears interest at a rate and as from a date stated in the adjudication order.
- (4) An amount due under an award made in favour of the Redress Agency is recoverable as a debt due to the Redress Agency.
121. (1) The Redress Agency may, by notice in writing given to any person who is a party to a complaint, require that person to provide any required information or documents which the Redress Agency considers necessary for the determination of the complaint. Power to call for information.
- (2) The information or documents must be provided or produced -
- (a) before the end of such reasonable period as may be required by the Redress Agency; and
 - (b) in the case of information, in such manner or form as may be required by the Redress Agency.

Funding.

122. (1) Funds for the establishment and operation of the Redress Agency will consist of -
- (a) allocations made by the Central Government of such sums of money as it thinks fit, based on the annual budget to be prepared by the Redress Agency and submitted to the Central Government before the start of each financial year; 5
 - (b) fees collected from financial service providers, in the manner provided under regulations made by the Redress Agency;
 - (c) fees collected from respondents, in the manner provided under regulations made by the Redress Agency; and 10
 - (d) costs imposed on the parties under section 120.
- (2) The Redress Agency must take into account the expenditure expected to be incurred by it in carrying out its functions and the funds available from other sources while determining the amount of fees payable by financial service providers for funding the Redress Agency. 15
- (3) The Redress Agency may collect the fees under sub-section (1)(b) through the Regulator.

Sharing of information with the Regulators.

123. The Redress Agency must, through the Data Centre, share information on complaints received, considered, settled and determined by it, with the Regulator on an ongoing basis, in order to facilitate the Regulator in effectively carrying out its functions. 20

Performance of the Redress Agency.

124. (1) Prior to the commencement of each year, the Regulators must, in consultation with the Redress Agency, determine -
- (a) the productivity, timeliness and service quality targets expected to be achieved by the Redress Agency in that year; 25
 - (b) the acceptable level of deviation from the targets determined under sub-section (a); and
 - (c) the systems to be used to accurately measure the functioning of the Agency.
- (2) The targets and systems determined under sub-section (1) must - 30
- (a) promote transparency;
 - (b) provide an accurate representation of functioning of the Redress Agency;
 - (c) consider the requirements of persons appearing before the Redress Agency;
 - (d) provide objective methods of measurement where possible;
 - (e) provide subjective methods of measurement where objective measurements are not possible; and 35
 - (f) incorporate global best practices in the measurement of functioning of bodies set up to address consumer complaints.
- (3) The targets under sub-section (1)(a) may include targets relating to -
- (a) the average cost per complaint expected to be incurred by complainants, respondents or the Redress Agency; 40
 - (b) the number of complaints expected to be processed by the Redress Agency within a given time-period; or

- (c) the average time expected to be taken by the Redress Agency for processing a complaint.
 - (4) The Redress Agency must publish -
 - (a) the targets and systems determined under sub-section (1); and
 - (b) details of the Redress Agency's performance against the targets and systems determined under sub-section (1).
125. (1) In addition to the requirements contained in section 77, the annual report of the Redress Agency must contain - Annual report of the Redress Agency.
- (a) a review of the Redress Agency's performance against the targets and systems determined under section 124; and
 - (b) any other requirements specified by the Regulators.
- (2) If the Redress Agency fails to achieve a target determined under section 124 and the extent of deviation exceeds the acceptable level determined under that section, the annual report must include an explanation containing reasons for the failure to achieve the target and the actions intended to be taken by the Redress Agency to remedy the situation.

CHAPTER 28
FINANCIAL AWARENESS

126. (1) The Regulator must undertake measures to promote financial awareness. Duty to promote financial awareness.
- (2) In this Part, "financial awareness" means the understanding and knowledge of members of the public regarding financial matters, including, the -
- (a) benefits of financial planning;
 - (b) rights and protections available to consumers of financial products and financial services; and
 - (c) features, costs, risks and benefits of different financial products and financial services.
- (3) The Regulator may, in discharge of the financial awareness function, make regulations to -
- (a) support the doing by other persons of anything that it considers would enhance financial awareness; or
 - (b) arrange for other persons to do anything that it considers would enhance financial awareness.
127. (1) The Regulator may establish a separate body corporate to carry out the promotion of financial awareness. Power to establish a financial awareness body.
- (2) If the Regulator decides to establish a financial awareness body, it must -
- (a) take such steps as are necessary to ensure that the financial awareness body is, at all times, capable of discharging the function of promoting financial awareness; and
 - (b) provide services to the financial awareness body which the Regulator considers would facilitate the promotion of financial awareness.

Mechanisms to achieve and monitor financial awareness.

- 128. (1) The Regulator must ensure that it has in place appropriate mechanisms to achieve and monitor the achievement of the financial awareness objective, which include -
 - (a) the inclusion of a budget relating to financial awareness in its annual budget; and 5
 - (b) the inclusion of an annual plan relating to financial awareness in its financial plan, which must set out -
 - (i) the targets of financial awareness for the year, which should, to the extent possible, be in the form of quantifiable targets;
 - (ii) relative priorities of each of the targets; 10
 - (iii) measures planned to achieve the targets;
 - (iv) the manner in which the extent of achievement of each of the targets is to be determined and monitored; and
 - (v) the allocation of resources towards implementing each of the targets. 15
- (2) In addition to the requirements contained in section 77, the annual report of the Regulator must include -
 - (a) details of the extent to which the targets for the year, as mentioned in the annual plan, have been met;
 - (b) an explanation containing reasons for any failure to achieve the targets stated in the annual plan and the actions intended to be taken to remedy the situation; and 20
 - (c) details of its latest accounts relating to the cost of pursuing the financial awareness function.
- (3) The Regulator must publish details of its performance against the financial awareness targets determined under sub-section (1)(h)(i). 25

CHAPTER 29

ADVISORY COUNCIL ON CONSUMER PROTECTION

Establishment of advisory council on consumer protection.

- 129. (1) The Regulator must establish and maintain a Consumer Advisory Council to carry out the functions under section 49 while representing the interests of consumers. 30
- (2) The functioning of this advisory council will be in accordance with Chapter 12, other than in the aspects provided here.
- (3) The Consumer Advisory Council will consist of a minimum of five and a maximum of nine members who are consumers or persons representing the interests of consumers, to be appointed by the Regulator. 35
- (4) The Regulator must ensure that the membership of the Consumer Advisory Council gives a fair degree of representation to experts in the fields of personal finance and consumer rights.
- (5) While appointing the members of the Consumer Advisory Council the Regulator must also take into account the need to ensure proper geographical representation from across the country. 40

(6) The Regulator must appoint one of the members of the Consumer Advisory Council to be the chairperson of the Consumer Advisory Council of the Consumer Advisory Council.

5 130. (1) The Regulator must take into account any representations or reports that are made to it by the Consumer Advisory Council in discharge of its functions. Role of the Consumer Advisory Council.

(2) If the Regulator disagrees with a view expressed, or proposal made, in the representation or report, it must give the Consumer Advisory Council a statement in writing of its reasons for disagreeing.

CHAPTER 30

10 INTERACTION BETWEEN THE COMPETITION COMMISSION AND THE REGULATOR

131. (1) The Competition Commission may submit its comments on draft regulations issued by the Regulator for public consultation under Part III. Consultation for draft regulations.

(2) The Regulator must take into account any comments that are submitted to it by the Competition Commission.

15 (3) If the Regulator disagrees with any comments made by the Competition Commission, it must give the Competition Commission a statement in writing with its reasons for disagreeing.

20 132. (1) This section applies where the Competition Commission is of the opinion that a negative effect has been created, or is likely to be created, on account of - Report by the Competition Commission.

(a) a regulatory provision or practice of a Regulator or a combination of regulatory provisions or practices; or

(b) a feature, or a combination of features, of a market that could be dealt with by regulatory provisions or practices.

(2) In this section -

25 (a) "negative effect" means the prevention, restriction or distortion of competition in a market for financial products or financial services;

(b) "regulatory provision" means any regulations, guidance or code issued by the Regulator under this Act; and

(c) "feature of a market" means -

30 (i) the structure of a market for financial products or financial services or any aspect of that structure; and

(ii) the conduct, whether or not in the market for the concerned financial products or financial services, of financial service providers or consumers.

35 (3) If the conditions contained in sub-section (1) are satisfied, the Competition Commission must submit a report to the Regulator stating -

(a) details of the Competition Commission's findings on the negative effect; and

(b) its recommendation on actions to be taken by the Regulator.

Response by
Regulator

133. (1) The Regulator must, within the period agreed to between the Regulator and the Competition Commission, provide a response to the Competition Commission stating how it proposes to deal with the Competition Commission's report.
- (2) The response must state -
- (a) whether it has decided to take any action, or to take no action; 5
 - (b) if it has decided to take action, what action it proposes to take; and
 - (c) reasons for its decisions.
- (3) The factors to be taken into account by the Regulator while deciding its response must include -
- (a) its principles, objectives and functions under the relevant Part to which the matter relates; 10
 - (b) representations made to the Regulator in connection with the matter by any person appearing to the Regulator to have a substantial interest in the matter; and
 - (c) any cost benefit analysis prepared by the Regulator in relation to the regulatory provision or practice that is the subject of the Competition Commission's report. 15
- (4) The response must be -
- (a) submitted to the Competition Commission; and
 - (b) published by the Regulator, along with the Competition Commission's report. 20

Competition
Commission's
power to issue
directions.

134. (1) If after the Competition Commission has made a report under section 132 and the Regulator has submitted its response under section 133, the Competition Commission continues to remain of the opinion that a negative effect is created under section 132(1), the Competition Commission may issue directions to the Regulator requiring it to take particular actions to remedy the negative effect. 25
- (2) If the Competition Commission issues a direction to the Regulator under this section, it must publish a statement containing details of the direction issued with reasons and submit a copy of it to the Central Government.
- (3) The Central Government must have a copy of the directions issued by the Competition Commission laid before the Parliament. 30

Reference by the
Competition
Commission.

135. (1) The Competition Commission must make a reference to the Regulator when it undertakes any proceedings under the Competition Act in which at least one of the parties is a financial service provider.
- (2) The reference must contain - 35
- (a) details of the circumstances relating to which proceedings are being undertaken by the Competition Commission;
 - (b) any particular issue relating to the proceedings on which the Competition Commission requires the Regulator's inputs; and
 - (c) any other matter agreed to between the Regulator and the Competition Commission. 40

(3) The Regulator must assess the reference and respond to the Competition Commission, within the period agreed to between the Regulator and the Competition Commission, with a report on the referred matter.

(4) The report must contain -

- (a) the Regulator's response, with reasons, to any particular issues referred by the Competition Commission for its inputs;
- (b) the Regulator's recommendations on factors that should be considered by the Competition Commission in relation to the proceedings, if any; and
- (c) information about the Regulator's decision to nominate a non-voting member under section 136.

(5) The Competition Commission must take into account the Regulator's report while making its decision on the referred matter.

136. (1) The Regulator may nominate a person as a non-voting member of the Competition Commission in any proceedings under the Competition Act if -

Appointment of non-voting member.

- (a) at least one of the parties to the proceedings is a financial service provider; and
- (b) it appears to the Regulator that a decision taken, or likely to be taken, by the Competition Commission may have a significant negative impact on the pursuance of the Regulator's objectives under this Act or any other law.

(2) The person nominated by the Regulator -

- (a) must be a member on the board of the Regulator or a senior official; and
- (b) must have knowledge of the subject matter to which the referred matter relates.

(3) The person nominated by the Regulator will be entitled to attend and participate in the Competition Commission's proceedings on the referred matter but will not be entitled to vote on it.

137. (1) The Regulator must make a reference to the Competition Commission to report any conduct of a financial service provider that appears to the Regulator to be a suspected violation of the Competition Act.

Reference by the Regulator.

(2) The reference must contain details of -

- (a) the circumstances in respect of which the reference is being made; and
- (b) the Regulator's reasons for suspecting a violation of the Competition Act.

(3) The Competition Commission must assess the reference and respond to the Regulator, within the period agreed to between the Regulator and the Competition Commission, with a report on the referred matter.

(4) The report must contain the Competition Commission's decision, with reasons, on whether or not to initiate proceedings under the Competition Act in relation to the referred matter.

138. (1) The Competition Commission and the Regulator must enter into a memorandum of understanding to establish the procedures for co-operation between them, within six months from the commencement of this Act.

Memorandum of understanding.

- (2) The memorandum of understanding must provide for -
 - (a) the period within which the Regulator must submit its response to the Competition Commission under section 133;
 - (b) the detailed process for references to be made by the Competition Commission to the Regulator and by the Regulator to the Competition Commission under sections 135 and 137;
 - (c) the process for appointment of a nominee by the Regulator as non-voting member of the Competition Commission under section 136;
 - (d) process for co-ordination between the Competition Commission and the Regulator in relation to the review of any combination involving a financial service provider, under this Act;
 - (e) exchange of information between the Competition Commission and the Regulator;
 - (f) the manner in which a market will be identified for the purposes of this Act; and
 - (g) any other matter that may be agreed to between the Regulator and the Competition Commission.
- (3) The Regulator and the Competition Commission may agree to revise the terms of the memorandum of understanding from time to time.

CHAPTER 31

EFFECT ON OTHER LAWS

Power to exclude application of the Consumer Protection Act, 1986.

- 139. (1) The Central Government may, by notification, provide that nothing contained in the Consumer Protection Act, 1986 (68 of 1986) will apply to a retail consumer in respect of any complaint covered under this Act, in such parts of India, as considered necessary, from such date as may be notified by the Central Government.
- (2) A notification under this section may be issued by the Central Government if it is satisfied that -
 - (a) the number of complaints being referred to the Redress Agency under this Act are significantly higher than the complaints referred to the consumer courts established under the Consumer Protection Act, 1986 (68 of 1986);
 - (b) the Redress Agency is effectively discharging its functions under this Act; and
 - (c) the issuance of the notification will not cause a significant detriment to the interests of retail consumers.

PART V

PRUDENTIAL REGULATION

CHAPTER 32

OBJECTIVES AND PRINCIPLES

s 140. (1) The Regulator must discharge its functions and exercise its powers under this Part with the objective of - Objectives.

- (a) promoting the safety and soundness of regulated persons; and
- (b) contributing to the stability and resilience of the financial system.

10 (2) The objective of promoting the safety and soundness of regulated persons must be advanced in a manner that seeks to -

- (a) ensure that the affairs of regulated persons are organised, overseen and managed in a manner that enables them to discharge the obligations owed to their consumers; and
- (b) maintain the probability of failure of regulated persons within a level acceptable to the Regulator.

15 (3) In this section, "failure of a regulated person" means -

- (a) the regulated person being unable to meet liabilities as they fall due; or
- (b) an action being initiated under Part VII to address a risk to the viability of the regulated person.

20 141. (1) The Regulator must take into account the following principles while discharging its functions and exercising its powers under this Part - Principles of prudential regulation.

- (a) any obligation imposed on regulated persons should be proportionate to
 - (i) the nature, scale and complexity of the risks inherent in the regulated activity being carried on by the regulated person;
 - (ii) the manner in which the regulated activity ranks on the factors contained in section 151(1)(b); and
 - (iii) in case of regulated persons that are Systemically Important Financial Institutions, the relevance of the regulated person for the stability and resilience of the financial system;
- (b) the feasibility of supervision by the Regulator and implementation of regulatory actions by regulated persons;
- (c) persons who control, oversee and manage the affairs of regulated persons must share the responsibility of ensuring the safety and soundness of the regulated persons;
- (d) minimisation of inconsistencies in the regulatory approach towards regulated activities that are similar in nature or pose similar risks to the fulfilment of the Regulator's objectives under this Part;
- (e) any obligation imposed on regulated persons should be consistent with the benefits, considered in general terms, which are expected to result from the imposition of that obligation;

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- (f) competition in the markets for financial products and financial services is desirable in the interests of consumers and therefore –
 - (i) barriers to competition owing to adverse effects of regulatory actions should be minimised; and
 - (ii) there should be competitive neutrality in the treatment of financial service providers;
- (g) facilitating access to financial products and financial services is desirable in the interests of consumers;
- (h) innovation in financial products and financial services is desirable in the interests of consumers;
- (i) regulatory actions should be carried out in a manner that is least detrimental to the global competitiveness of the financial system;
- (j) the effects of regulatory actions over a continuing period of time, which means a period of at least five years after a regulatory action is taken, should be considered; and
- (k) the effects of regulatory actions on the stability and resilience of the financial system, in particular, the need to minimise pro-cyclical effects, should be considered.

(2) In interpreting this Part and in discharging its functions or exercising its powers under this Part, if the Regulator perceives a conflict between any of the principles contained in sub-section (1), or if more than one interpretation is possible, the Regulator must reconcile and manage the conflict giving preference to the principle which would be the most relevant for furthering its objectives under this Part.

CHAPTER 33

AUTHORISATION TO CARRY ON THE BUSINESS OF PROVIDING FINANCIAL SERVICES

Prohibition on carrying on the business of financial services without authorisation.

142. (1) No person should carry on the business of providing a financial service in India, or purport to do so, whether on its own behalf or on behalf of any other person, unless the person has obtained an authorisation from the Regulator to carry on the business of providing that financial service in accordance with the provisions of this Part.
- (2) In this section, "providing a financial service in India" includes providing financial services to consumers in India, whether from within the territory of India or outside.
- (3) A person purports to provide a financial service in India if, whether or not intended, the person –
- (a) adopts the description of being authorised, or exempt from the requirement of being authorised, to provide the financial service; or
 - (b) conducts itself in a manner that indicates or is likely to indicate that the person is authorised, or exempt from the requirement of being authorised, to provide the financial service.

Offence.

143. Any contravention of section 142 is punishable as a Class B offence under this Act, except in cases where the contravention is found to be wilful, in which case it will be punishable as a Class A offence under this Act.

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144. (1) The requirement to obtain authorisation under section 142(1) will not apply to -
- (a) an individual registered with the Regulator under section 104;
 - (b) a financial representative of a financial service provider, if -
 - (i) the financial representative is carrying on an activity that is connected with the provision of a financial service for which the concerned financial service provider is authorised;
 - (ii) the concerned financial service provider has accepted responsibility in writing for the activities of the financial representative; and
 - (iii) the financial representative complies with such other requirements as may be specified.
 - (c) the Central Government or a State Government while carrying out specified financial services, if so provided under regulations made by the Regulator in this regard.
- (2) In this section, "concerned financial service provider" means the financial service provider on whose behalf a financial representative is acting.
145. (1) A request for authorisation to carry on a financial service must be made to the Regulator in the form of an application.
- (2) The Regulator may issue an approval order granting authorisation for the carrying on of any or all the financial services in respect of which an application is made after being satisfied that the person making the application -
- (a) satisfies the authorisation criteria specified by the Regulator under subsection (3), if any such authorisation criteria is specified; or
 - (b) shows sufficient evidence of being in a position to comply with the provisions of this Act.
- (3) The specified authorisation criteria in relation to a financial service may include requirements in relation to one or more of the following matters -
- (a) the capital structure of the applicant, including the minimum capital required to be held by it;
 - (b) the legal and organisational structure of the applicant;
 - (c) the ownership structure of the applicant, including restrictions on ownership of the applicant by specified persons or class of persons;
 - (d) the systems of governance required to be put in place by the applicant;
 - (e) fit and proper person criteria for persons engaged in the oversight or strategic management of the applicant;
 - (f) conditions to be satisfied in case the applicant is a member of a specified type of group;
 - (g) evidence of being in a position to comply with the relevant prudential requirements under Chapter 34, if, and to the extent, applicable; and
 - (h) any other criteria that the Regulator may specify.
146. (1) The Regulator must specify the categories of financial service providers that will be entitled to obtain authorisation through self-registration, subject to such conditions as may be specified.

Exemption from requirement to obtain authorisation.

Grant of authorisation.

Authorisation through self-registration.

- (2) The acknowledgment of an application for authorisation made by a person specified under sub-section (1) will constitute the grant of an authorisation under section 145 and the provisions of section 70 will not be applicable in such cases.
- (3) The self-registration process will not apply to any person that proposes to carry out a financial service -
 - (a) that is specified to be a regulated activity; or
 - (b) in respect of which any authorisation criteria has been specified.

Variation, suspension, or cancellation of authorisation.

147. (1) The Regulator may vary, suspend or cancel the authorisation of a financial service provider, either on the application of the concerned financial service provider or acting on its own. 10
- (2) The authorisation may be varied under sub-section (1) by -
- (a) adding or removing a financial service from the list of financial services for which the authorisation was granted;
 - (b) varying the description of a financial service for which the authorisation was granted; or 15
 - (c) varying the conditions on which the authorisation was granted.
- (3) The Regulator may vary, suspend or cancel an authorisation, acting on its own, if -
- (a) the financial service provider has failed, or is likely to fail, to satisfy the authorisation criteria under section 145, if applicable; 20
 - (b) the financial service provider has failed to carry on a regulated activity for which the authorisation was granted for a continuous period of eighteen months; or
 - (c) the action is required to be taken in order to meet any of the Regulator's objectives. 25
- (4) If the Regulator decides to vary, suspend or cancel an authorisation issued to a financial service provider acting on its own, it must issue a show-cause notice to the concerned financial service provider followed by a decision order.
- (5) The variation, suspension or cancellation of an authorisation under this section will not affect the validity of any financial contract entered into or made before the date of notification of the variation, suspension or cancellation by the Regulator. 30

Database of authorisations and exemptions.

148. (1) The Regulator will issue a unique identification number to each person permitted to carry out a financial service under this Act, whether by grant of an authorisation under section 145 or by virtue of an exemption under section 144. 35
- (2) The Regulator must maintain and keep updated at all times a publicly accessible database of -
- (a) persons authorised under section 145 to carry out a financial service; and 40
 - (b) persons exempted under section 144 from the requirement to obtain authorisation.
- (3) If the Regulator varies, suspends or cancels an authorisation under section 147 it must maintain a record of the same on the financial system database.

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149. A financial service provider may offer financial products to consumers in the manner provided under section 105. File and use process for financial products.
150. (1) The Central Government may prescribe any facility or instrument, in addition to those listed in section 2(72), to be a financial product if it allows a person to - Power to vary the meaning of financial products and financial services.
- 5
- (a) make a contribution of money or securities, where the person making the contribution does not have any day-to-day control over the use of the contribution, and the contribution is made with the objective of -
 - (i) getting a financial return or any benefit; or
 - (ii) safekeeping of the contribution;
 - 10 (b) manage, avoid or limit the financial consequences arising from -
 - (i) the happening or not happening of a particular event; or
 - (ii) fluctuations in receipts or costs, including prices, currency exchange rates and interest rates;
 - 15 (c) make payments, or cause payments to be made, otherwise than by the physical delivery of Indian currency; or
 - (d) borrow money.
- (2) The Central Government may prescribe any service, other than those listed in section 2(75), to be a financial service.
- 20 (3) The Regulator may specify any service or class of services, rendered by specified persons, to be excluded from the list of financial services under section 2(75), subject to such conditions as may be specified.

CHAPTER 34

PRUDENTIAL REQUIREMENTS

- 25 151. (1) In this Act, "regulated activity" means a financial service that is specified by the Regulator to be a regulated activity for the purposes of this Act, taking into account the following factors - Regulations regarding regulated activities.
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- (a) the inherent difficulties that may be faced by financial service providers carrying on the financial service in fulfilling the obligations owed by them to their consumers; and
 - (b) the nature of the relationship between financial service providers carrying on the financial service and their consumers, including -
 - 35 (i) the nature and extent of detriment that may be caused to consumers in case of non-fulfilment of obligations owed to them by the financial service providers;
 - (ii) the ability of consumers to access and process information relating to the safety and soundness of the financial service providers; and
 - (iii) the ability of consumers to co-ordinate among themselves to monitor the safety and soundness of the financial service providers.
- 40 (2) While specifying a regulated activity under sub-section (1), the Regulator must also specify the manner in which a category or sub-category of financial service ranks on the basis of the factors stated in section (1)(b).

(3) The regulations under this section must be made within six months from the commencement of this Part and may be modified from time to time.

Capital resource requirements.

152. (1) A regulated person must at all times -

- (a) maintain adequate capital resources that ensure that there is no significant risk that its liabilities cannot be met; 5
- (b) ensure that its capital resources are equal to or in excess of the capital resource requirements specified by the Regulator under sub-section (2)(b); and
- (c) monitor its compliance with the capital resource requirements on an ongoing basis and inform the Regulator of any actual or potential breach of the capital resource requirements. 10

(2) The Regulator must specify -

- (a) the manner in which the provisions of this section apply to different categories of regulated persons;
- (b) the capital resource requirements, both as to amount and quality, for different categories of regulated persons and the duration within which the requirements are to be met; 15
- (c) the manner in which the amounts or values of assets and liabilities are to be calculated for the purpose of meeting capital resource requirements;
- (d) the manner in which change in the value of assets and liabilities is to be recognised and calculated; 20
- (e) the financial resources that will not be taken into account as capital resources for the purposes of assessing compliance with the capital resource requirements;
- (f) the process to be followed by the regulated person in case of any actual or potential breach of its capital resource requirements; 25
- (g) circumstances that may constitute an actual or potential breach of the capital resource requirements; and
- (h) the consequences of non-compliance with the regulations made under this section. 30

(3) While making regulations under sub-section (2)(b), the regulator may provide for -

- (a) the manner in which capital instruments are to be classified into different tiers of capital resources;
- (b) limits on the use of different tiers of capital resources by regulated persons to meet the capital resource requirements; or 35
- (c) a requirement that a specified portion of the capital resources must be held in the form of specified capital instruments, which, in the opinion of the Regulator, would facilitate enhanced assessment of the regulated person by specified persons. 40

(4) If the Regulator makes regulations under sub-section (3)(a), it must take into account -

- (a) the extent to which a capital instrument is likely to absorb losses;
- (b) the permanence of the capital instrument and the extent of its availability, when required, including the extent of variation in its loss absorption capacity upon variation of time, context and circumstances; 45

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- (c) the manner in which the capital instrument ranks for repayment, compared to other debts and liabilities, upon winding up, dissolution or similar procedure involving the regulated person; and
- (d) the extent of fixed costs, including obligation to pay dividends or interest, associated with the capital instrument.

(5) In this section -

- (a) "capital resources" means financial resources held by a regulated person that are capable of absorbing unexpected losses; and
- (b) "capital instrument" means an instrument for making an investment in, or contribution to, the capital resources of the regulated person, including any security issued by or loan made to the regulated person.

153. (1) A regulated person must notify the Regulator, in writing, of its intention to issue a capital instrument which it intends to include within its capital resources.

Notice of issuance of capital instruments.

(2) The notice must be given at least one month before the intended date of issue, unless there are exceptional circumstances which make it impracticable to give notice of such period, in which event the regulated person must give such notice as is practicable in those circumstances.

(3) When giving notice, a regulated person must -

- (a) provide details of the amount of capital resources that the regulated person is seeking to raise through the intended issue and the person to whom the capital instrument is intended to be issued;
- (b) identify the tier of capital resources that the capital instrument is intended to fall within; and
- (c) provide details of any features of the capital instrument which are novel, unusual or different from a capital instrument of a similar nature previously issued by the regulated person or widely available in the market.

(4) The Regulator must specify -

- (a) capital instruments to which this section does not apply, which may be determined taking into account factors including, the extent to which capital instruments of a similar nature are widely available in the market or have been previously issued by the regulated person; and
- (b) circumstances that will be considered to be exceptional under sub-section (2), which may include situations where there is a risk of a regulated person's capital resources falling below its capital resources requirements if the notice period under that sub-section is observed.

154. (1) A regulated person must at all times maintain adequate liquidity resources, and should satisfy the liquidity requirements specified by the Regulator.

Liquidity requirements.

(2) A regulated person must manage and monitor its compliance with the liquidity requirements on an ongoing basis, including to ensure that -

- (a) its liquidity resources contain an adequate buffer of high quality, unencumbered assets; and
- (b) it maintains a prudent funding profile, including assets that are of appropriate maturities, taking account of the expected timing of its liabilities.

(3) The Regulator must specify -

- (a) the manner in which the provisions of this section apply to different categories of regulated persons;
 - (b) the liquidity requirements, both as to amount and quality, for different categories of regulated persons and the duration within which the requirements are to be met; 5
 - (c) the resources that will not be taken into account as liquidity resources for the purposes of assessing compliance with the liquidity requirements;
 - (d) requirements relating to the maintenance of a prudent funding profile for different categories of regulated persons;
 - (e) the process to be followed by regulated persons in case of any actual or potential breach of liquidity requirements; and 10
 - (f) the consequences of non-compliance with the regulations made under this section.
- (4) While making regulations under sub-section (3)(b), the Regulator may provide for - 15
- (a) the conditions that must be satisfied for a resource to be regarded as being a satisfactory liquidity resource for the purposes of meeting the liquidity requirements;
 - (b) requirements to maintain specified ratios or reserves to meet liquidity requirements; and 20
 - (c) limits on the use of different financial resources to meet the liquidity requirements taking into account the liquidity of such financial resources, as noted by the Regulator over a period of time.
- (5) In this section, "liquidity resources" mean the financial resources to be held by a regulated person in order to ensure that there is no significant risk that its liabilities cannot be met as they fall due. 25

Investment.

155. (1) A regulated person must invest its assets and the assets of its consumers in a prudent manner, taking into account the following principles -
- (a) investments must be made in assets whose risks can be properly identified, measured, monitored, managed, controlled and reported by the regulated person; 30
 - (b) investments must be made in a manner that ensures the security, quality, liquidity and profitability of the assets of the regulated person, taken as a whole;
 - (c) investments must be made taking into account the nature and duration of the regulated person's liabilities; 35
 - (d) in case of any conflict of interest, investments must be made in the best interests of the consumers of the regulated person; and
 - (e) assets must be properly diversified in order to avoid excessive exposure to any particular person, asset, sector or group, or geographical area and excessive accumulation of risk in the assets of the regulated person, taken as a whole. 40
- (2) The Regulator must specify -
- (a) the manner in which the provisions of this section apply to different categories of regulated persons; 45
 - (b) any investment restrictions applicable to a regulated activity; and

- (c) the consequences of non-compliance with the regulations made under this section.
 - (3) While making regulations under sub-section (2)(b), the Regulator must take into account the need -
 - (a) to ensure the security, quality, liquidity and profitability of the assets of the regulated person, taken as a whole;
 - (b) to ensure the protection of funds of consumers, which may be done through -
 - (i) a requirement to segregate the funds or assets of consumers from the other funds or assets of the regulated person; or
 - (ii) any other prohibition or restriction on the disposal of, or other dealing with, funds or assets belonging to consumers.
 - (4) The power to make regulations under sub-section (2)(b) must not be used by the Regulator to provide for quantitative restrictions on the composition of the assets of a regulated person, taken as a whole.
 - (5) In this section, "quantitative restrictions" include the imposition of maximum or minimum limits on the holding of any particular asset or category of assets.
156. (1) A regulated person must -
- Systems of
governance.
- (a) have in place effective systems of governance which provide for sound and prudent management of its affairs; and
 - (b) ensure that the systems of governance adopted by it are implemented, reviewed and updated on a regular basis.
- (2) A regulated person must take into account the following factors while determining its systems of governance for the purposes of sections 156 to 160 -
- (a) the nature, scale and complexity of its business;
 - (b) the diversity of its operations, including geographical diversity;
 - (c) the volume and size of transactions carried out by it;
 - (d) the degree of risk associated with each area of its operation; and
 - (e) its group-wide risks.
- (3) The systems of governance must include policies and procedures on -
- (a) governance and controls;
 - (b) risk management;
 - (c) internal audit; and
 - (d) where relevant, outsourcing.
- (4) The Regulator must specify -
- (a) the manner in which the provisions of sections 156 to 160 apply to different categories of regulated persons; and
 - (b) the consequences of non-compliance with the regulations made under sections 156 to 160.
- (5) The Regulator may also specify that -
- (a) regulated persons must put in place a written policy on any aspect of its systems of governance, including matters under sections 156 to 160; and

(b) the policies required to be put in place under clause (a) must be reviewed and revised periodically.

Governance and controls.

157. (1) A regulated person must have in place an appropriate organisational and governance structure with efficient policies and procedures to ensure that -

- (a) persons carrying on significant functions on its behalf are fit and proper persons; 5
- (b) there is a clear allocation and appropriate segregation of responsibilities within its organisation;
- (c) there are adequate systems for reporting, communication and co-operation within its organisation; 10
- (d) the performance of multiple tasks by individuals does not, and is not likely to, prevent the sound performance of their duties;
- (e) its executive remuneration policy is -
 - (i) consistent with its available resources and risk profile; and
 - (ii) minimises any potential conflict of interest; 15
- (f) it has in place appropriate administrative, accounting and internal monitoring procedures; and
- (g) it maintains adequate and orderly books and records, in the manner and for the periods specified by the Regulator.

(2) The Regulator must specify requirements relating to - 20

- (a) the appointment of persons, who are fit and proper persons, for the implementation of any of the systems of governance under sections 157 to 160;
- (b) preventing conflict of interest of persons responsible for carrying on significant functions in relation to regulated persons; and 25
- (c) the circumstances and manner in which the Regulator may replace the body responsible for the oversight of the regulated person's affairs or the members of such body.

(3) The Regulator may also specify requirements relating to -

- (a) appointment, responsibilities and process of appointment of persons carrying on significant functions, including a requirement to obtain approval before a person can carry on specified significant functions; 30
- (b) the size and composition of the bodies responsible for the oversight or strategic management of regulated persons;
- (c) the establishment of specified committees or groups for carrying out specified functions; 35
- (d) the processes to be followed by the bodies, committees and groups mentioned in clauses (b) and (c);
- (e) the structure or form of executive remuneration;
- (f) control and ownership structure of regulated persons; 40
- (g) systems and processes required to be put in place by regulated persons to ensure effective compliance with applicable laws and regulations and internal policies; and
- (h) restrictions on capital distributions by regulated persons under specified circumstances. 45

158. (1) A regulated person must have in place an effective risk management system comprising of policies and processes necessary to properly identify, measure, prioritise, monitor, manage and report on a continuous basis, the risks to which the regulated person is or could be exposed. Risk management.
- 5 (2) The risk management system put in place by the regulated person must -
- (a) be effective and well integrated into its organisational structure and decision making processes;
 - (b) enable it to properly identify and assess the risks to which it is, or could be, exposed in the short, medium and long-term;
 - 10 (c) take into account inter-dependencies of risks, concentration of a particular risk and overall risk tolerance levels;
 - (d) provide for the reporting of risk exposures to the bodies responsible for its oversight and strategic management;
 - (e) implement risk mitigation techniques that are appropriate according to the nature of the risks assumed by it; and
 - 15 (f) ensure that its affairs are conducted in a manner that enable it to cover its expected losses.
- (3) The Regulator may specify -
- 20 (a) the types of risks that need to be taken into account in relation to a regulated activity, which may include business risks, investment risks, operational risks, credit risks, concentration risks and liquidity risks;
 - (b) the types of risk management and risk mitigation techniques required to be followed in respect of a regulated activity;
 - (c) methods to be used for identifying, measuring and monitoring risks; and
 - 25 (d) reporting requirements to be complied with by a regulated person when it undertakes specified types of risks.
159. (1) A regulated person must have in place an effective internal audit system to - Internal audit.
- 30 (a) examine and evaluate the adequacy and effectiveness of its systems of governance; and
 - (b) issue recommendations based on the result of examinations and evaluations carried out in accordance with clause (a) and verify compliance with those recommendations.
- (2) The internal audit system must be designed in a manner that -
- 35 (a) ensures the independence and impartiality of the persons carrying out the internal audit function; and
 - (b) allows persons carrying out the internal audit function to -
 - (i) express their findings and recommendations to the bodies responsible for the oversight and strategic management of the regulated person; and
 - 40 (ii) communicate directly with any officer or employee of the regulated person and have complete and unrestricted access to all information and records, as they consider necessary for the discharge of their functions, subject to confidentiality requirements.
- (3) The Regulator may specify -

- (a) the procedures that must be followed by persons performing the internal audit function; and
- (b) requirements that certain findings that are made in exercise of the internal audit function must be notified to the body responsible for the oversight of the regulated person or to the Regulator.

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Outsourcing.

160. (1) In this section -

- (a) "outsourcing" means an arrangement between a regulated person and any other person by which the person performs a function or activity, whether directly or by sub-outsourcing, which would otherwise be performed by the regulated person itself; and
- (b) "service provider" means a person who performs a function or activity under an outsourcing arrangement with a regulated person.

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(2) This section will apply to the outsourcing of a function or activity to a service provider, whether or not the service provider is a financial service provider and irrespective of the service provider's place of business.

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(3) If a regulated person proposes to outsource any function or activity to a service provider, the regulated person must -

- (a) obtain the prior permission of the Regulator if the function or activity being outsourced is a critical function or activity specified by the Regulator under sub-section (6)(a);
- (b) remain fully responsible for discharging all of its obligations under this Act and regulations made under it in respect of that function or activity; and
- (c) ensure that the outsourcing of that function or activity does not -
 - (i) impair the quality of its systems of governance or impede the ability of the Regulator to monitor the compliance of its obligations by the regulated person;
 - (ii) cause an excessive increase in the risks faced by the regulated person; or
 - (iii) undermine the continuous and satisfactory provision of financial services to the consumers of the regulated person.

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(4) While choosing a service provider for outsourcing any function or activity, a regulated person must ensure that -

- (a) a detailed review is performed of the potential service provider's ability to deliver the required functions or activities satisfactorily;
- (b) there are no actual or potential conflicts of interest that may impair the service provider's ability to deliver to the required standard;
- (c) the service provider applies equivalent provisions to those that the regulated person would have to apply in respect of the confidentiality of consumer data, if applicable;
- (d) the outsourcing arrangement is not in breach of any law; and
- (e) the service provider is required to disclose any developments that may have a material impact on its ability to carry out the outsourced function or activity.

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- (5) The Regulator will continue to have the power to supervise outsourced functions and activities and the service provider to whom a function or activity is outsourced must co-operate with the Regulator in connection with the outsourced function or activity.
- 5 (6) The Regulator must specify -
- (a) the particular functions or activities that are considered to be critical functions or activities in relation to a regulated activity and which must not be outsourced without obtaining the Regulator's prior permission;
 - 10 (b) the conditions under which outsourcing of any function or activity may be performed, including any particular undertakings that the service provider may be required to provide; and
 - (c) continuous disclosure requirements in relation to the outsourced functions or activities.

161. (1) The Regulator may specify restrictions on -
- 15 (a) the activities, including categories of financial services, permitted to be carried out by -
 - (i) regulated persons engaged in specified regulated activities; or
 - (ii) subsidiaries or other persons under the control of regulated persons engaged in specified regulated activities; and
 - 20 (b) the creation of encumbrances on assets belonging to the regulated person or its consumers.
- (2) The Regulator must specify -
- (a) the manner in which the provisions of this section apply to different categories of regulated persons; and
 - 25 (b) the consequences of non-compliance with the regulations made under this section.

Restrictions on business and operations.

162. The Regulator may specify that certain classes of regulated activities are permitted to be carried out only if Corporation insurance has been obtained under Part VII.

Requirement to obtain Corporation insurance.

CHAPTER 35

AUDITORS AND ACTUARIES

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163. (1) A regulated person must appoint an auditor, actuary or any other person performing a similar function, as may be specified by the Regulator, to exercise the powers and functions under section 164.
- (2) The Regulator must specify -
- 35 (a) the categories of financial services that are regulated activities for the purposes of this section;
 - (b) requirements as to qualifications and experience to be satisfied by auditors and actuaries of regulated persons; and
 - (c) the powers, functions and responsibilities of auditors and actuaries acting for regulated persons, in addition to those specified in this Act.
- 40
- (3) The regulations made under sub-section (2) may provide for -

Appointment of auditors and actuaries.

- (a) the manner and time within which an auditor or actuary is to be appointed;
 - (b) a requirement for the Regulator to be informed of such appointment;
 - (c) provisions that enable the Regulator to make an appointment if no appointment has been made or information about such information has not been provided to the Regulator; and
 - (d) conditions relating to the term of office, remuneration, removal or resignation of an auditor or actuary.
- (4) An auditor or actuary appointed under this section must act in accordance with the regulations specified by the Regulator.

Powers and functions of auditors and actuaries.

164. (1) An auditor or actuary appointed under this Act to act for a regulated person -
- (a) will have the right to access the books and records of the regulated person at all times; and
 - (b) will be entitled to require such information and explanations from the regulated person or its officers, as it reasonably considers necessary for the performance of its duties as an auditor or actuary.
- (2) The Regulator may make regulations to specify that an auditor or actuary must communicate specified information or opinions to the Regulator on any matter that the Regulator reasonably believes to be relevant for the exercise of any of its functions.
- (3) The matters to be communicated to the Regulator under sub-section (2) may include matters relating to persons other than the concerned regulated person.
- (4) If the Regulator specifies that this section applies to any person other than auditors or actuaries it must also specify the manner and extent to which the section applies to them.

Disqualification.

165. (1) If it appears to the Regulator that an auditor or actuary appointed under this Act to act for a regulated person has failed to comply with the requirements imposed on it under this Act or regulations made under it, it may disqualify the person from acting as the auditor or actuary, as the case may be, for any regulated person or any particular category of regulated persons.
- (2) If the Regulator proposes to disqualify an auditor or actuary under this section it must give the person a show-cause notice after which if it makes a decision to disqualify the person it must issue a decision order.
- (3) The Regulator may cancel a decision notice imposing a disqualification imposed under this section if satisfied that the disqualified person will in future comply with the duty in question.
- (4) A person who has been issued a decision order under this section may appeal to the Tribunal.

Offence.

166. Any contravention of this Chapter is punishable as a Class C offence under this Act.

CHAPTER 36

PROVISIONS GOVERNING PARTICULAR TRANSACTIONS

Actions involving regulated persons.

167. (1) No person should carry out any of the following actions without complying with the provisions of this Act -

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- (a) a merger, amalgamation or restructuring involving a regulated person;
 - (b) the transfer or acquisition of control of, or significant interest in, a regulated person;
 - (c) sale, disposal or acquisition of the whole, or substantially the whole, of the undertaking of a regulated person or a significant portion of its assets or liabilities; or
 - (d) voluntary winding up, dissolution or similar action involving a regulated person or discontinuation of its business in any other manner.
- (2) A person that proposes to take an action under sub-section (1) must make an application to the Regulator.
- (3) The assessment of the application by the Regulator must be done taking into account, among others, the following factors –
- (a) the interests of consumers of financial products or financial services provided by the regulated person and any other persons who may be affected by the action envisaged under sub-section (1);
 - (b) the suitability and financial soundness of the person who will carry out the regulated activity if the action envisaged under sub-section (1) is effected; and
 - (c) the likelihood of compliance with the provisions applicable to the regulated activity under this Act, if the action envisaged under sub-section (1) is effected.
- (4) The Regulator must specify –
- (a) the manner in which the provisions of this section apply to different categories of regulated persons;
 - (b) the scope of the terms “significant interest” and “significant portion of assets or liabilities” in respect of each regulated activity governed by this section; and
 - (c) the information required to be submitted by any person that seeks to carry out an action under sub-section (1).

168. (1) A regulated person must ensure that transactions with related persons are entered into on an arms-length basis and the terms of such transactions are no more favourable than the terms contained in, or likely to be contained in, corresponding transactions with persons other than related persons.
- (2) The Regulator must specify –
- (a) the manner in which the provisions of this section apply to different categories of regulated persons;
 - (b) the categories of related person transactions that must be reported to the Regulator;
 - (c) any limits on the permissible value, frequency or proportion of related person transactions;
 - (d) the categories of related person transactions that are prohibited in relation to specified regulated activities; and
 - (e) the meaning of “relatives” for the purposes of sub-section 2(127)(c).
- (3) While making regulations under sub-section (2)(d), the Regulator must take into account –

Transactions with related persons.

- (a) the risks arising from the related person transaction to the safety and soundness of the regulated person;
- (b) the conflict of interest that may arise on account of the related person transaction; and
- (c) the manner in which the related party transaction may affect the ability of the regulated person to effectively discharge its obligations towards its consumers.

CHAPTER 37

FUNCTIONS AND POWERS OF THE REGULATOR

General functions of the Regulator.

169. The Regulator must - 10
- (a) make regulations to carry out the purposes of this Part;
 - (b) issue guidance to financial service providers in respect of any matter referred to in this Part or the regulations made under it, whether or not -
 - (i) the Part expressly requires or enables the Regulator to make regulations on such matter; or 15
 - (ii) a formal application seeking guidance has been made to it;
 - (c) supervise financial service providers to ensure compliance with the provisions of this Part and the regulations made under it;
 - (d) take appropriate enforcement action to deal with the violation of the provisions of this Part or the regulations made under it. 20

Conduct of stress tests.

170. (1) In this section, "stress tests" means tests to assess the ability of regulated persons to cope with possible events or future changes in economic conditions that could have unfavourable effects on their overall financial standing.
- (2) The Regulator may specify - 25
- (a) the requirement that regulated persons must conduct stress tests; and
 - (b) quantitative tools and methods for the conduct of stress tests by regulated persons.
- (3) If the Regulator makes regulations under sub-section (2), it must provide for the categories of regulated persons covered by those regulations. 30

Orders issued in exercise of supervisory functions.

171. (1) The Regulator may, in exercise of its supervisory functions, issue a show-cause notice, followed by a decision order to a regulated person if the Regulator concludes that the affairs of the regulated person are being conducted in a manner that contravenes, or is likely to contravene the requirements contained in section 158 or the regulations made under it. 35
- (2) The Regulator must specify -
- (a) the circumstances in which a decision order may be issued under sub-section (1); and
 - (b) the types of restrictions or requirements that may be imposed under the decision order, which must be appropriate for the purposes of addressing the deficiencies leading to their imposition. 40

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(3) The regulations made under sub-section (2)(b) may provide that decision orders issued under this section may impose -

- (a) restrictions on the manner in which the regulated person conducts its business; or
- (b) restrictions on the liabilities and financial obligations that may be undertaken by the regulated person.

(4) The Regulator must -

- (a) review compliance by the regulated person with the decision order issued to it under sub-section (1);
- (b) review the effectiveness of the decision order in addressing the deficiencies which led to the imposition of the restrictions or requirements; and
- (c) remove the restrictions or requirements when the regulated person has remedied the deficiencies, which led to their imposition, to the satisfaction of the Regulator.

15 172. (1) The Regulator may, under exceptional circumstances, issue a decision order to a regulated person setting additional capital resources requirements to be satisfied by the regulated person, if the Regulator finds that -

Additional capital resources requirements.

- (a) the risks undertaken by the regulated person deviate significantly from the basis on which the capital resources requirements under section 152 were determined by the Regulator;
- (b) the systems of governance of the regulated person deviate significantly from the standards contained in sections 156 to 160 or the regulations made under those sections, where -
 - (i) those deviations prevent it from being able to properly identify, measure, monitor, manage and report the risks that it is or could be exposed to; and
 - (ii) the application of other measures is in itself unlikely to improve the deficiencies sufficiently within an appropriate timeframe; or
- (c) the regulated person is a Systemically Important Financial Institution and contributes disproportionately, as compared to other Systemically Important Financial Institutions, to the risk to the stability and resilience of the financial system.

(2) The regulated person must make every effort to remedy the deficiencies that led to the imposition of the additional capital resources requirement under sub-section (1).

(3) The Regulator must -

- (a) periodically review the additional capital resources requirement imposed on a regulated person; and
- (b) remove the requirement when the regulated person has remedied the deficiencies which led to its imposition to the satisfaction of the Regulator.

(4) The Regulator must specify the circumstances in which an additional capital resources requirement may be imposed and the manner in which it will be calculated.

(5) In this section, "additional capital resources requirement" means a requirement to maintain additional capital resources over and above those required to be maintained as per the capital requirements contained in section 152(2)(b) or the regulations made under it.

Supervision of groups.

- 173. (1) The Regulator may specify the following requirements in cases where persons belonging to a group are engaged in carrying out more than one category of regulated activities -
 - (a) group-wide requirements to supplement any of the requirements contained in Chapter 34; or
 - (b) group-wide supervisory review and reporting procedures and intervention measures to ensure compliance with the group-wide requirements specified under clause (a).
- (2) The Regulator must specify the manner in which the provisions of this section apply to groups consisting of persons engaged in carrying out different categories of regulated activities.
- (3) While making regulations under sub-section (1), the Regulator must take into account the risk exposures inherent in groups carrying on specified regulated activities.

Responsibility of Regulators to co-operate.

- 174. The Regulators must enter into arrangements to co-operate with each other in connection with the authorisation, regulation and supervision of -
 - (a) financial service providers that are engaged in carrying out more than one financial service, and such financial services are regulated by different Regulators; and
 - (b) financial service providers belonging to groups where the members of the group are engaged in carrying out more than one financial service, and such financial services are regulated by different Regulators.

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PART VI

CONTRACTS, TRADING AND MARKET ABUSE

CHAPTER 38

PRINCIPLES RELATING TO CERTAIN CONTRACTS

- 5 175. (1) The provisions of this Part will govern contracts of insurance or contracts regarding securities, as the case may be. *Scope of this Part.*
- (2) The provisions of sections 176 to 180 will govern only contracts of insurance.
176. (1) The policy-holder has a duty of utmost good faith towards the insurer in relation to a contract of insurance, including while entering into such a contract. *Utmost good faith.*
- 10 (2) The Regulator may specify the meaning and scope of utmost good faith in relation to specified contracts of insurance.
177. (1) Unless specified, insurable interest will not be required to constitute a valid insurance contract. *Insurable interest.*
- 15 (2) The Regulator may specify the types of contracts of insurance that may require insurable interest.
178. (1) No insurer may refuse to record an assignment of a contract of insurance made in accordance with regulations. *Assignment of insurance policies.*
- (2) The Regulator may make regulations to restrict assignment in relation to specified classes of contracts of insurance.
- 20 179. The Regulator may make regulations to protect interests of policy-holders in the event of lapse of contracts of life insurance. *Lapse of contracts of life insurance.*
180. (1) Where an insurer is liable under a contract of insurance in respect of an act of a third party, the insured must disclose to the insurer, at the time of making the claim, if it has received any amount from the third party towards indemnification of the losses. *Subrogation.*
- 25 (2) If the insured has not received any amount from the third party before making the claim but receives such amount after the insurer has fully and finally settled the insured, the insurer has a lien on such amount up to the sum so indemnified.
- 30 (3) Subject to any contract to the contrary, the insurer will have a right of action against the third party only after it has fully and finally indemnified the insured.
181. (1) Every individual owner of financial product or beneficiary of a financial service may, at any time, nominate any individual to whom such financial product or benefit of financial service must be transmitted in the event of death of such individual owner. *Nomination.*
- 35

- (2) Where a financial product or benefits of a financial service are held jointly by more than one individual, the joint holders may together nominate any individual to whom all the rights in the financial product or benefits of the financial service will be transmitted to in the event of death of all the joint holders. 5
- (3) Notwithstanding anything contained in any other law for the time being in force or in any disposition, whether testamentary or otherwise, in respect of a financial product or financial service, where a nomination made in the specified manner purports to confer on any individual the right to vest the financial product or financial service, the nominee will, on the death of the owner of the financial product or beneficiary of the financial service or, as the case may be, on the death of the joint holders, become entitled to all the rights in the financial product or financial service, of the owner of the financial product or beneficiary of the financial service, or as the case may be, of all the joint holders, in relation to such financial product or financial service, to the exclusion of all other persons, unless the nomination is varied or cancelled in the specified manner. 10 15
- (4) Where the nominee is a minor, it will be lawful for the owner of a financial product or beneficiary of a financial service making the nomination, to appoint any individual to become entitled to the financial product or benefit of the financial service, in the event of the death of the nominee during minority. 20
- (5) Nominations under this section must be made in the manner as may be specified.
- (6) If the nature of the financial product or financial service is such that it is only applicable to the owner or beneficiary and no rights subsist on the death of such owner or beneficiary, then the provisions of this section will not create any such right. 25

Enforceability of derivatives.

- 182. (1) Derivative contracts traded over an exchange and non-exchange traded derivative contracts between sophisticated counterparties are not void notwithstanding anything contained in section 30 of the Indian Contract Act, 1872 (9 of 1872). 30
- (2) Under this section, "sophisticated counterparties" means any person other than a retail consumer under this Act.

CHAPTER 39

INFRASTRUCTURE INSTITUTIONS

Infrastructure Institution.

- 183. (1) Infrastructure Institutions include any person which act as -
 - (a) exchange;
 - (b) depository;
 - (c) trade repository;
 - (d) central counterparty; or 40
 - (e) settlement system including a settlement system in a payment system.
- (2) The Central Government may include any other person under sub-section (1) by notification in the Official Gazette.

184. All Infrastructure Institutions are financial service providers and the provisions of this Act apply to Infrastructure Institutions in addition to any requirement provided in this Chapter. Additional requirements.
185. (1) An Infrastructure Institution must make bye-laws to govern - Requirement for Infrastructure Institutions to make bye-laws.
- 5 (a) the financial services provided by it;
- (b) the direct participants dealing with it, to the extent required for the proper functioning of the financial service provided; and
- (c) anything incidental to clauses (a) and (b).
- 10 (2) No condition may be placed on persons using the financial services provided by the Infrastructure Institution unless provided in the bye-laws of the Infrastructure Institution.
- (3) No bye-laws of the Infrastructure Institution will be applicable unless approved by the Regulator.
186. (1) If an Infrastructure Institution proposes to make or amend any bye-laws, it must make an application to the Regulator. Procedure for making bye-laws.
- 15 (2) The application must contain a copy of the proposed bye-laws.
- (3) If the Regulator considers it appropriate, it may specify the Infrastructure Institution to publish the proposed bye-laws, invite comments on the bye-laws from the public and submit the comments received to the Regulator.
- 20 (4) The Regulator may reject an application under this section if any proposed bye-laws undermine the requirements contained in section 187(1).
- (5) The Regulator must decide the application under sub-section (1) in accordance with this Act.
187. (1) Whenever an Infrastructure Institution makes bye-laws it must ensure that the bye-laws - Principles governing bye-laws.
- 25 (a) promote the objectives and take into consideration the principles as the Regulator as contained in sections 83, 84, 140, and 141;
- (b) provide non-discriminatory access to all persons using its financial services;
- 30 (c) promote the objective that the Council is required to pursue as contained in section 290;
- (d) minimise market abuse; and
- (e) foster transparency.
- (2) In this section -
- 35 (a) "non-discriminatory access" includes -
- (i) not creating differential obligations for similarly placed parties availing any financial services provided by the Infrastructure Institution; and
- 40 (ii) not preventing similarly placed parties from availing any financial services provided by the Infrastructure Institution; and

(b) "transparency" means that adequate information about the functions and transactions carried out on the Infrastructure Institution are available to persons using the financial services provided by the Infrastructure Institution to make informed decisions about their transactions.

(3) In relation to exchanges, "transparency", in addition to the provisions contained in sub-section (2)(b), includes the requirement that an exchange must freely provide information about the issuer, price, volume and liquidity of all securities traded. 5

Requirement for governance and monitoring mechanisms.

188. (1) All Infrastructure Institutions must have adequate governance and monitoring mechanisms to identify and minimise market abuse. 10
(2) The Regulator may make regulations requiring Infrastructure Institutions to take measures to meet the requirements of this section.

Liability.

189. (1) An Infrastructure Institution and its officers and staff are not to be liable in damages for anything done or omitted in the discharge of regulatory functions of such Infrastructure Institution unless it is shown that the act or omission was in bad faith. 15
(2) "Regulatory functions" in this section means the functions of the Infrastructure Institution so far as relating to, or to matters arising out of, the obligations to which the Infrastructure Institution is subject under, or by virtue of, this Act.

Power of Regulator to give directions to an Infrastructure Institution.

190. (1) The Regulator may give directions to an Infrastructure Institution, if it appears to the Regulator that an Infrastructure Institution - 20
(a) has failed, or is likely to fail, to satisfy the authorisation requirements; or
(b) has failed to comply with any other obligation imposed on it by or under this Act.
(2) If the Regulator proposes to give directions under this section, it must issue a show cause notice. 25
(3) If the Regulator decides to give directions under this section, it must issue an decision order.
(4) Directions under this section must be limited to taking remedial measures relevant to preventing the Infrastructure Institution from failing to provide financial services. 30

Requirement of Infrastructure Institution to publish information.

191. (1) An Infrastructure Institution must publish information of its activities which - 35
(a) protect the interests of persons availing financial services from the Infrastructure Institution; and
(b) allow the Regulator and the Council to make informed decisions.
(2) The Regulator may make regulations specifying -
(a) the information which satisfies the conditions contained in sub-section (1);
(b) the form and manner in which information has to be published; and
(c) the frequency of the publication. 40

192. (1) While performing functions and exercising powers under this Chapter, the Regulator must ensure that appropriate balance is maintained between –
- Competition for Infrastructure Institution.
- (a) the requirements placed on the Infrastructure Institution under this Act; and
 - (b) the costs of setting up new Infrastructure Institutions and the costs to persons using financial services provided by Infrastructure Institutions.
- (2) The Regulator must publish a report every five years –
- (a) reviewing its conduct in relation to its functioning and exercise of powers contained in sub-section (1); and
 - (b) explaining the manner in which the balance contained in sub-section (1) has been achieved.

CHAPTER 40

CONTRACTUAL ISSUES PERTAINING TO INFRASTRUCTURE INSTITUTIONS

193. (1) When a transaction carried out using the services of an Infrastructure Institution attains finality, –
- Finality of transactions.
- (a) such transactions must not be reversed; or
 - (b) no court, tribunal or authority in an insolvency, dissolution or winding up proceeding must reverse the transaction.
- (2) The Regulator may specify the conditions under which a transaction attains finality.
- (3) The Regulator may specify different conditions for different transactions at different Infrastructure Institutions.
- (4) The provisions of this section applies notwithstanding any other provision of any other law for the time being in force.
- (5) Sub-section (4) does not bar any person from making a claim for compensation of any loss arising out of any transaction under any other law, subject to section 189.

194. (1) This section applies if all the following conditions are met –
- Lien of an Infrastructure Institution.
- (a) an Infrastructure Institution acts as a settlement system;
 - (b) a person uses the services provided by such Infrastructure Institution; and
 - (c) such person has deposited or placed in the possession of the Infrastructure Institution any asset or collateral for completion of any transactions.
- (2) The Infrastructure Institution will have lien over such asset or collateral until all transactions initiated or carried out by such person are completed.
- (3) The Infrastructure Institution may use such asset or collateral to settle any claims arising out of any transaction carried out by the person using the services provided by the Infrastructure Institution.
- (4) The provisions of this section applies notwithstanding –
- (a) any decision made in an insolvency, dissolution or winding up proceeding; or

(b) operation of any law for the time being in force.

Registration of transfer of financial product with depository.

195. (1) A depository must, on receipt of information, register the transfer of a security or other financial product in the name of the transferee.
- (2) Where a person opts to hold a security with a depository, the issuer must intimate such depository the details of allotment of the security and on receipt of such information the depository must enter in its records the name of the allottee as the beneficial owner of that security. 5
- (3) The Regulator may make regulations determining the form and content of information to be provided under this section.

Options to receive security certificate or hold securities with depository.

196. (1) Every person subscribing to securities offered by an issuer must have the option either to receive the security certificates or hold securities with a depository unless the securities are issued by way of public offering. 10
- (2) Every person subscribing to financial products, other than securities, must have the option either to receive such financial products in physical form or in dematerialised form with a depository. 15

Securities in depositories to be in fungible form.

197. (1) All securities or other financial products held by a depository must be dematerialised and must be in a fungible form.
- (2) Nothing contained in section 153 of the Companies Act, 1956 (1 of 1956) will apply to a depository in respect of securities held by it on behalf of beneficial owners. 20

Rights of depositories and beneficial owners.

198. (1) Notwithstanding anything contained in any other law for the time being in force, a depository will be the registered owner for the purposes of effecting and recording transfer of beneficial ownership of securities or other financial products on behalf of a beneficial owner.
- (2) The beneficial owner will be entitled to all the rights and benefits and be subjected to all the liabilities in respect of the securities or other financial products held by a depository. 25
- (3) The depository as a registered owner will have no voting rights or any other rights in respect of securities held by it except to the extent contained in sub-section (1). 30

Register of beneficial owners.

199. A depository must maintain a register and an index of beneficial owners of the security or other financial products in the manner provided in sections 150 to 152 of the Companies Act, 1956 (1 of 1956) to the extent specified.

Pledge or hypothecation of financial products held in a depository.

200. (1) A beneficial owner may create a pledge or hypothecation in respect of a security or other financial product owned by such beneficial owner, subject to any regulations. 35
- (2) The Regulator may specify a requirement of approval from the depository before creation of any pledge or hypothecation under sub-section (1).
- (3) Every beneficial owner must give intimation of such pledge or hypothecation to the depository and such depository must then make entries in its records accordingly. 40

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- (4) An entry in the records of a depository under sub-section (3) will be evidence of a pledge or hypothecation.
201. (1) A depository must furnish to the issuer or concerned financial service provider, information about the transfer of securities or other financial products in the name of beneficial owners or such intervals and in such manner as may be specified.
- (2) The issuer or financial service provider must make available to the depository copies of the relevant records in respect of securities or other financial products held by such depository as may be specified.
202. (1) If a beneficial owner seeks to opt out of a depository in respect of any security or other financial product, such beneficial owner must inform the depository accordingly.
- (2) The depository must on receipt of intimation under sub-section (1) make appropriate entries in its records and must inform the issuer or the concerned financial service provider.
- (3) The issuer or financial service provider must issue the certificate of security or other financial product to the beneficial owner or the transferee, as the case may be, within thirty days of the receipt of intimation from the depository.
- (4) The Regulator must make regulations regarding the mode and manner of intimation, fees and other incidental issues.
- (5) The duty on the issuer or financial service provider under sub-section (3) is subject to compliance with appropriate regulations under sub-section (4).
203. The Bankers' Books Evidence Act, 1891 (1B of 1891) applies in relation to a depository as if it were a bank as defined in section 2 of that Act.
204. (1) A depository must indemnify a beneficial owner for any loss caused to the beneficial owner due to the negligence of the depository or any direct participant of the depository.
- (2) Sub-section (1) is subject to any other law to the contrary.
- (3) Where the loss due to the negligence of any direct participant of the depository under sub-section (1) is indemnified by the depository, the depository has the right to recover the same from such direct participant.
205. (1) An Infrastructure Institution acting as a settlement system may lend securities to persons that use such services.
- (2) The Regulator may make regulations governing the lending of securities by Infrastructure Institutions.

Furnishing of information and records by depository and issuer.

Option to opt out in respect of any security.

The Bankers' Books Evidence Act, 1891 to apply to depositories.

Depositories to indemnify loss in certain cases.

Securities lending.

CHAPTER 41

ISSUE AND LISTING OF SECURITIES

206. (1) A public offering of securities must be pursuant to filing of a statement providing adequate information about the issuer and the security being issued, with the Regulator.

Public offering.

- (2) The Regulator may specify -
 - (a) what constitutes public offering;
 - (b) what constitutes adequate information; and
 - (c) the form and content of the information to be provided.
- (3) The Regulator may impose different conditions on public offering, for - 9
 - (a) different classes of securities; and
 - (b) different classes of issuers.
- (4) The Regulator may make regulations exempting specified issuers from complying with the provisions of this section.

Violations. 207. If any person makes a public offering in violation of this Act, then such person is liable to pay a penalty as may be specified. 10

Obligation in public offering. 208. (1) Every issuer making a public offering has an obligation to -

- (a) provide adequate information, before a public offering is made, about the issuer and the security to allow persons to make adequately informed decision to subscribe to such public offering; 15
- (b) provide adequate information, on a regular basis, about the issuer and the securities to allow persons to make adequately informed decisions about dealing in such securities; and
- (c) have in place systems of governance and processes to ensure that the functions of the issuer do not discriminate between owners of a class of securities of the issuer. 20

 (2) If the public offering is made by a person other than the issuer, then the person must provide information which is relevant for a potential subscriber of the issue to make an informed decision.
 (3) The Regulator must make regulations to enforce the provisions of this section including - 25

- (a) the information that must be provided under this section;
- (b) the form, manner and frequency with which such information must be provided; and
- (c) the systems of governance and processes the issuer must undertake. 30

Listing of securities on an exchange. 209. (1) Any security with respect to which a public offering has been made must be listed on an exchange.
 (2) If any class of securities is listed on an exchange, further issue of the same class of securities of the same issuer must be listed.

Application for listing of securities on an exchange. 210. (1) Any person seeking to list any security on an exchange must make an application to such exchange. 35
 (2) No such application to an exchange may be entertained unless it has been made -

- (a) with the consent of the issuer of the securities concerned; and

- (b) in the form and manner provided by the bye-laws of the exchange.
- (3) The exchange must inform the applicant of its decision on an application for listing within thirty days from the date on which the complete application is received.
- 5 (4) If the exchange rejects the application for listing it must give an decision order.
- (5) A person aggrieved by the order of the exchange contained in (4) may appeal to the Tribunal.

211. (1) An exchange must make bye-laws in relation to - Duties of an exchange.
- 10 (a) disclosure by the issuer of material information regarding the issuer or the security listed on the exchange within a definite time;
 - (b) the form and manner of application for listing; and
 - (c) the conditions for approval for listing.
- (2) The exchange must monitor the compliance of the issuer with its bye-laws.
- 15 (3) In addition to imposition of any penalty for violation of any bye-laws by the issuer, the exchange must inform the Regulator of any violation of the bye-laws by the issuer.

212. (1) Securities listed may be de-listed if any of the following conditions are met - De-listing.
- 20 (a) the issuer of the security makes an application for de-listing; or
 - (b) the security does not have enough liquidity and may be used for market abuse.
- (2) In deciding an application under clause (1)(a), the exchange must consider the effect the de-listing will have on all persons owning the securities.
- (3) The Regulator must make regulations governing the de-listing of securities.
- 25 (4) The Regulator and the exchange must ensure that de-listing process protects the interests of the persons who have purchased securities prior to such de-listing.
- (5) An exchange must de-list securities, if so directed by the Regulator, in accordance with regulations.
- 30 (6) If the Regulator proposes to make an order for de-listing it must issue a show cause notice to the issuer of the securities.
- (7) If the Regulator decides to make an order for de-listing it must issue an decision order to the issuer of the securities.
- (8) In case an exchange de-lists a security other than on a direction by the Regulator or application of the issuer, it must make a reasoned order.
- 35 (9) A person aggrieved by the order of the exchange contained in sub-section (8) may appeal to the Tribunal.

213. (1) Owners of securities listed on an exchange must be provided with the opportunity to sell their securities at a fair price in the event of an actual or potential change in the control of the issuer. Takeover.

- (2) The regulator must make regulations to -
 - (a) determine the criteria of change in control;
 - (b) ensure all owners of listed securities have adequate information to make informed decisions;
 - (c) the process for determining the fair price; and 5
 - (d) prevent any action which may prevent the determination of the fair price.
- (3) The Regulator -
 - (a) must, in consultation with the Corporation, specify the conditions under which specified transactions may be exempted from compliance with regulations under sub-section (2) for the purpose of carrying out transactions under Part VII; and 10
 - (b) may, in consultation with the Corporation, exempt a transaction from compliance with regulations under sub-section (2), by a reasoned order, for the purpose of carrying out transactions under Part VII.

Buy Back.

- 214. (1) The issuer must ensure that any buy back of securities by the issuer is carried out in a manner which - 15
 - (a) does not discriminate between owners of the securities;
 - (b) provides a fair value to persons from whom the securities are bought back; and
 - (c) is equitable to those who choose to sell their securities. 20
- (2) The Regulator must make regulations governing the buy back of securities by the issuer.
- (3) The regulations under sub-section (2) must specify:
 - (a) conditions of buy back;
 - (b) procedure of buy back; 25
 - (c) general obligations of issuer; and
 - (d) penalties for violation.

CHAPTER 42
MARKET ABUSE

Market abuse.

- 215. (1) A person is prohibited from committing market abuse. 30
- (2) A person commits market abuse if the conduct of such person is intended to interfere with free and fair operation of the securities market by hampering the ability of persons to make informed decisions in relation to dealing in securities, and is carried out to make a financial gain and includes criminal market abuse. 35
- (3) Criminal market abuse consists of -
 - (a) abuse of information as described in section 216;
 - (b) insider trading as described in section 217; or
 - (c) securities market abuse as described in section 218.

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216. (1) A person commits abuse of information, if that person, for the purpose of making a financial gain, - Abuse of information.
- (a) fails to disclose material information about a security when there is a legal obligation to disclose such information; or
 - (b) publishes information that the person knows is false, misleading, deceptive or will result in misrepresentation.
- (2) In this section, "publishes" include dissemination of information in any form which may be reasonably used by any person.
217. A person commits insider trading if that person, while in possession of unpublished price sensitive information, in breach of a fiduciary duty or other relationship of trust or confidence, for the purpose of making a financial gain - Insider trading.
- (a) deals, directly or indirectly, in securities; or
 - (b) discloses, actively or otherwise, unpublished price sensitive information to any other person likely to engage in insider trading.
218. (1) A person commits securities market abuse if such person, with the intention of making a financial gain, attempts to achieve or succeeds in achieving, results contained in sub-section (2), by - Securities market abuse.
- (a) dealing in securities, directly or indirectly; or
 - (b) using or employing fictitious, manipulative, deceptive or artificial devices or any other form of deception, scheme, artifice or contrivance.
- (2) Results intended by securities market abuse may be any of the following -
- (a) artificially creating, maintaining or affecting the price, liquidity, demand, supply, trading or market for securities; or
 - (b) giving false or misleading impression about the price, liquidity, demand, supply, trading or market for securities.
- (3) In this section, "conduct" includes any act, expression, omission or concealment, whether committed in a deceitful manner or not, and whether or not resulting in any wrongful gain or avoidance of loss, by -
- (a) any person;
 - (b) any other person with connivance of such person; or
 - (c) by agent of such person.
219. (1) The Regulator may make regulations specifying conduct which amounts to market abuse. Duties of the Regulator.
- (2) The regulations may require persons transacting in securities -
- (a) to refrain from taking specified actions; or
 - (b) to report transactions in securities.
- (3) The Regulator may make different regulations for different securities or different classes of persons.
- (4) The Regulator may exempt specified securities or specified classes of persons.

- (5) The Regulator may take enforcement actions, as applicable, against any person who commits, attempts to commit, or abets market abuse.
- (6) If the Regulator proposes to take any enforcement action against a person under this section it must give the person a show cause notice.
- (7) If the Regulator decides to take any enforcement action against a person under this section it must give the person an decision order. 5
- (8) Any enforcement action by the Regulator does not bar the Regulator from prosecuting such person for criminal market abuse, but any fine required to be paid as a result of a conviction for criminal market abuse may be set off against any amount paid for an enforcement action for the same cause of action. 10

Punishment for criminal market abuse.

- 220. (1) A person who commits or abets criminal market abuse, is punishable with Class A offence under this Act.
- (2) A person who attempts to engage in market abuse, is punishable with Class C offence under this Act.

PART VII

RESOLUTION OF FINANCIAL SERVICE PROVIDERS

CHAPTER 43

OBJECTIVES AND FUNCTIONING OF THE CORPORATION

5 221. The Corporation will be guided by the following objectives in carrying out its functions under this Part - Objectives.

(a) to protect and enhance the stability and resilience of the financial system;

(b) to enhance financial market efficiency through the efficient pricing and allocation of risk;

10 (c) to protect consumers of covered obligations up to a reasonable limit; and

(d) to protect public funds.

222. The role of the Corporation is to carry out the resolution of covered service providers in accordance with its objectives and the provisions of this Part. Role of the Corporation.

15 223. (1) The Corporation Board may provide an opinion to the Corporation on any matter relating to resolution as it finds relevant. Functions of the Corporation Board.

(2) The Corporation Board must disseminate information to the public relating to its functions in a transparent and accountable manner.

20 224. (1) The Corporation must ensure that the persons appointed as officers and employees have knowledge and experience in the regulation, supervision or resolution of financial service providers, including of Systemically Important Financial Institutions, bankruptcy and liquidation, or have knowledge of finance, economics, accountancy and law. Officers and employees of the Corporation.

(2) Each person appointed as an officer or employee will, before entering into any duties with the Corporation, take an oath of fidelity and secrecy in the form provided by bye-laws.

25 (3) The officers and employees of the Corporation may include such examiners as are necessary to carry out the functions under section 225.

CHAPTER 44

REGULAR AND SPECIAL EVALUATIONS

30 225. (1) An examiner must conduct such regular and special evaluations, in accordance with the provisions of this Chapter, as may be necessary to - Functions of examiners.

(a) provide by way of a rating, or any other means, an assessment of the safety and soundness of the covered service provider, including its financial condition;

35 (b) initiate any necessary contingency planning for the resolution of a covered service provider;

- (c) enable the Corporation to make a decision order regarding whether a covered service provider should be placed in the receivership of the Corporation; and
- (d) pay compensation relating to, and apply for the winding up of, a covered service provider.

(2) Every examiner must submit reports to the Corporation at such frequency and in such form and manner as may be specified.

Regular evaluations.

226. (1) An examiner will have the power, on behalf of the Corporation, to conduct the regular evaluation of -

- (a) a financial service provider that applies to the Corporation to become a covered service provider; and
- (b) a covered service provider, whenever the Corporation Board makes a decision order that an evaluation of such covered service provider is necessary.

(2) An examiner must conduct the regular evaluation under sub-section (1) in such form, manner and frequency as may be specified.

Special evaluations.

227. (1) An examiner will have the power, on behalf of the Corporation, to conduct a special evaluation of any covered service provider if the Corporation makes a decision order that -

- (a) a covered service provider is at a risk other than "low risk to viability" under the framework for prompt corrective action under Chapter 45; or
- (b) the special evaluation is necessary for the Corporation to exercise its authority for the resolution of a covered service provider.

(2) Before conducting a special evaluation, the Corporation must review the resolution plan submitted by the covered service provider.

(3) Where a special evaluation is carried out, the Corporation may -

- (a) bear the costs; or
- (b) charge the costs to the covered service provider in respect of which they were incurred.

(4) If the covered service provider is unable, or refuses, to pay the costs under sub-section (3)(b), the Corporation may recover such costs from the covered service provider as a debt due and payable to the Corporation.

Power to call for information.

228. (1) The Corporation, and any examiner appointed and acting on behalf of the Corporation, for the purposes of any actions undertaken under sections 225, 226, and 227 will have the power to access records of a covered service provider, whether in the course of conducting a regular or special evaluation, regarding the affairs of the covered service provider, or a person belonging to the same group, or its related person.

(2) The examiner must, without delay, inform the Corporation, in the specified form and manner, if, at any time, there comes to the attention of the examiner any change in the circumstances of the covered service provider that might have material consequences on the position of the Corporation.

Summoning witnesses and calling for information.

229. (1) For the purposes of this section, "agency" -

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- (a) means the Corporation, the Regulator, or the Tribunal, as the case may be; and
 - (b) includes any designated representative of a body under clause (a), including examiners.
- 5 (2) An agency conducting or carrying out any proceedings, evaluation, investigation, assessment, consideration or determination under this Part, may, by an order in writing, do any of the following -
- (a) call for such information or material from a covered service provider, or its related persons, as the agency determines necessary; or
 - 10 (b) summon such covered service provider, or its related persons, to depose before the agency as it determines necessary.
- (3) The information or material received under this section must be disseminated to the public only to the extent required under the Right to Information Act, 2005 (22 of 2005).
- 15 (4) An agency may apply to the Tribunal to enforce an order made under sub-section (2), and the Tribunal will have the power to require compliance with such order.
- (5) Where an agency conducts or carries out a proceeding, evaluation, investigation, assessment, consideration or determination under this Part at the instance of a covered service provider -
- 20 (a) the agency may bear such reasonable expenses and fees as it determines appropriate; or
- (b) require such expenses and fees to be paid by the covered service provider, or recover such expenses and fees from its assets.
- 25 (6) The recipient of a request under sub-section (2) is bound to -
- (a) produce the information or material, if available with it, to the agency in a timely manner; or
 - (b) attend the proceedings at a time and location as specified by the agency.
- 30 230. (1) While undertaking an enforcement action and imposing a monetary penalty under sections 225, 226, and 227 against a covered service provider, the Corporation may take into consideration the following factors -
- (a) the number of days that the covered service provider fails to permit an examiner to conduct a regular or special evaluation; or
 - 35 (b) the number of days that the covered service provider fails to provide any information required to be disclosed in the course of the regular or special evaluation.
- (2) While undertaking an enforcement action and imposing a monetary penalty under section 227(3), the Corporation may take into consideration the following factors -
- 40 (a) the number of days it fails to pay the costs; or
- (b) the number of days it fails to repay the cost due as debt to the Corporation.

Enforcement action under this Chapter

CHAPTER 45
PROMPT CORRECTIVE ACTION

Framework for prompt corrective action.

- 231. (1) The Corporation and the Regulator must make joint regulations to establish a framework for prompt corrective action for all covered service providers.
- (2) The Corporation and the Regulator, in establishing a framework for prompt corrective action, must take into account the following factors -
 - (a) the ability of a covered service provider to access additional capital;
 - (b) the ability of a covered service provider to promptly address supervisory concerns that may arise from time to time;
 - (c) the likelihood of the viability of the covered service provider deteriorating further if problems are not addressed within reasonable time; and
 - (d) the proportionality of any measures identified and specified by the framework to the risk to the viability of the covered service provider.
- (3) The framework for prompt corrective action must seek to -
 - (a) identify the risks to the viability of a covered service provider at an early stage;
 - (b) identify the remedial measures that may be taken by the Corporation, the Regulator, and any other public authority, in a manner that is timely and proactive; and
 - (c) identify the remedial measures that must be taken by covered service providers to reduce the probability of failure, and ensure that the measures are taken in a manner that is timely and proactive.

Risk assessment measure.

- 232. (1) "Risk assessment measure" means the risk assessment measures specified by the Regulator to assess the risk to viability of a financial service provider and includes a risk-based capital requirement.
- (2) The Regulator may make regulations to provide for the imposition or withdrawal of a risk assessment measure.
- (3) The Regulator must make regulations to provide, for each risk assessment measure, the levels at which a covered service provider has a low risk to viability, moderate risk to viability, material risk to viability, imminent risk to viability and critical risk to viability.
- (4) The Regulator must on a regular and periodic basis, review the risk assessment measures specified under sub-section (2) to determine whether the risk assessment measures are sufficient to -
 - (a) facilitate prompt corrective action; and
 - (b) prevent or minimise loss to the Resolution Fund.
- (5) While determining risk assessment measures, the Regulator must take into account standard business cycle conditions.
- (6) Regulations under this section must be issued only after consultation with the Corporation.

Low risk to viability.

- 233. (1) There is "low risk to viability" of a covered service provider if the Regulator makes a decision order that the covered service provider -

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- (a) significantly exceeds the required minimum level for each relevant risk assessment measure; and
 - (b) is resilient to most normal adverse business and economic conditions.
- 5 (2) Consequent to the decision order that there is low risk to viability of a covered service provider, the actions to be taken by the Corporation and the Regulator are provided in the Fourth Schedule.
- 10 234. (1) There is "moderate risk to viability" of a covered service provider if the Regulator makes a decision order that the covered service provider -
- (a) meets the required minimum level for each relevant risk assessment measure;
 - (b) is vulnerable to normal adverse business and economic conditions in a manner that could cause the covered service provider to be at material risk to viability if its concerns are not promptly addressed; and
 - (c) may recover if prompt corrective action is undertaken.
- 15 (2) Consequent to the decision order that there is moderate risk to viability of a covered service provider, the actions to be taken by the Corporation and the Regulator are provided in the Fourth Schedule.
- 20 235. (1) There is "material risk to viability" of a covered service provider if the Regulator makes a decision order that the covered service provider -
- (a) fails to meet the required minimum level for any relevant risk assessment measure; and
 - (b) may recover if prompt corrective action is undertaken.
- 25 (2) Consequent to the decision order that there is material risk to viability of a covered service provider, the actions to be taken by the Corporation and the Regulator are provided in the Fourth Schedule.
- 30 236. (1) There is "imminent risk to viability" of a covered service provider if the Regulator makes a decision order that the covered service provider -
- (a) is significantly below the required minimum level for any relevant risk assessment measure; and
 - (b) may recover if prompt corrective action is undertaken.
- (2) Consequent to the decision order that there is imminent risk to viability of a covered service provider, the actions to be taken by the Corporation and the Regulator are provided in the Fourth Schedule.
- 35 237. (1) There is "critical risk to viability" of a covered service provider if the Regulator makes a decision order that the covered service provider -
- (a) is significantly below the required minimum level for any relevant risk assessment measure; and
 - (b) will not recover even if prompt corrective action is undertaken.
- 40 (2) Consequent to the decision order that there is critical risk to viability of a covered service provider, the actions to be taken by the Corporation and the Regulator are provided in the Fourth Schedule.

Moderate risk to viability.

Material risk to viability.

Imminent risk to viability.

Critical risk to viability.

Capital distribution and executive remuneration.

- 238. (1) The Regulator may, by decision order, provide for the limits within which a covered service provider may make capital distribution or executive remuneration if the Regulator makes a decision order that, after doing so, the covered service provider is likely to be at greater risk to viability than it is before making such capital distribution or executive remuneration. 5
- (2) No covered service provider will make any capital distributions while it remains in default with regard to the payment of any assessment due to the Corporation.
- (3) This section will not apply if -
 - (a) there is a dispute between the covered service provider and the Corporation over the amount of such assessment; and 10
 - (b) if, pending final determination of the dispute, the covered service provider deposits with the Corporation a security for the disputed amount as the Corporation determines to be satisfactory.

Restoration plan.

- 239. (1) Every covered service provider must prepare a restoration plan and get it approved from the Regulator as soon as the Regulator makes a decision order that the covered service provider has moderate risk to viability. 15
- (2) The restoration plan must contain, in the event of specified circumstances affecting the viability of a covered service provider, the measures to be taken - 20
 - (a) to restore the covered service provider to low risk to viability; and
 - (b) to continue the carrying on of the whole or part of the business of the covered service provider by itself, or by any other person.
- (3) The Regulator must make regulations to provide for -
 - (a) the contents of the restoration plan other than what is contained in subsection (2); 25
 - (b) the manner by which a covered service provider may update its restoration plan; and
 - (c) the manner by which a covered service provider may get its restoration plan approved. 30
- (4) If the Regulator determines that a restoration plan fails to make satisfactory provision in relation to the matters required, the Regulator must take steps as it considers appropriate.
- (5) The steps that the Regulator may take include requiring the restoration plan to be revised. 35
- (6) The Regulator must submit a copy of every restoration plan approved by the Regulator to the Corporation, as soon as may be practicable after the approval is granted.
- (7) Regulations for restoration plans must have regard to the relevant international standards, if any. 40
- (8) Regulations under this section must be issued only after consultation with the Corporation.

240. (1) A covered service provider must prepare a resolution plan and get it approved from the Corporation as soon as the Regulator makes a decision order that the covered service provider has material risk to viability. Resolution plan.
- (2) The Corporation must make regulations to provide for the form, manner and frequency by which a covered service provider must prepare and update a resolution plan.
- (3) A covered service provider, in preparing or updating the resolution plan, must
- (a) minimise the potential loss from resolution;
 - (b) ensure that the resolution plan can be implemented without recourse to public funding;
 - (c) minimise the impact on financial stability;
 - (d) minimise detrimental effects on consumers; and
 - (e) allow decisions and actions to be taken and executed in a short span of time.
- (4) The resolution plan must identify –
- (a) the core business activities of the covered service provider;
 - (b) the parts of the business of the covered service provider which must be continued, either by that covered service provider or otherwise, or be allowed to fail; and
 - (c) the manner of such continuation or failure.
- (5) The resolution plan, with respect to the economic functions that may be critical to the functioning of the financial system, must –
- (a) identify functions that need to continue because the availability of those functions is critical to the financial system, or would need to be wound up in an orderly fashion so as to avoid financial instability;
 - (b) identify and consider ways of removing barriers that would prevent critical economic functions being resolved successfully; and
 - (c) isolate and identify critical economic functions from non-critical activities which could be allowed to fail.
- (6) The resolution plan must provide for one or more of the measures identified to be taken by the covered service provider, the Corporation, the Regulator, and any other public authority, as the case may be.
- (7) The Corporation must submit a copy of the resolution plan, including the modified resolution plan, as and when it is prepared or updated, to the Regulator, as soon as may be practicable after it is finalised.
- (8) Regulations for resolution plans must have regard to the relevant international standards, if any.

CHAPTER 46

POWERS AND DUTIES AS RECEIVER

241. The Regulator has the power to appoint the Corporation as receiver of a covered service provider in accordance with the provisions of this Part.

Power of Regulator to appoint Corporation as receiver.

Appointment as receiver

- 242. (1) The Corporation may apply to the Regulator, in the form and manner prescribed, for appointment as receiver of a covered service provider only if at least one of the following conditions is met -
 - (a) there is any concealment of the books, records or assets of the covered service provider, or any refusal to submit the covered service provider's books, records or affairs for evaluation or inspection to any examiner;
 - (b) the Corporation terminates or cancels all Corporation insurance that the covered service provider may have acquired in accordance with Chapter 50;
 - (c) the covered service provider materially fails to submit and implement a restoration plan within the time specified under section 239; or
 - (d) there is "imminent risk to viability" of a covered service provider under the framework for prompt corrective action contained in Chapter 45.
- (2) Upon receiving an application from the Corporation under sub-section (1), the Regulator, by order, must appoint the Corporation as receiver of the covered service provider.
- (3) Upon appointment as receiver of the covered service provider, the Corporation may, by decision order, direct -
 - (a) the vesting of shares and subordinate debt of the covered service provider in the Corporation; or
 - (b) the incorporation of a bridge service provider in accordance with the provisions contained in Chapter 48.
- (4) The Corporation will, upon appointment as receiver of the covered service provider, succeed to all rights, titles, powers, and privileges of the covered service provider, and of any shareholder, member, consumer, officer, or director of such covered service provider with respect to the covered service provider and the assets of the covered service provider.

Resolution order

- 243. (1) Upon appointment as receiver of a covered service provider, the Corporation may, by a resolution order, resolve the covered service provider, in one, or a combination, of the following modes of resolution -
 - (a) purchase in accordance with the provisions contained in Chapter 47;
 - (b) the incorporation of a bridge service provider in accordance with the provisions contained in Chapter 48; or
 - (c) temporary public ownership in accordance with the provisions contained in Chapter 49.
- (2) The resolution order may provide for an exemption from compliance with certain regulations, in accordance with section 213(3).
- (3) The Corporation may exercise any of its powers as a receiver contained in this Chapter under the resolution order.
- (4) The Corporation may modify the resolution order any time before any actions are taken in connection with it, as may be necessary.
- (5) The resolution order must provide for the actions that will be taken by the Corporation with regard to the covered service provider, including any process for compensation under Chapter 51.

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(6) The Corporation must provide a copy of the resolution order to the covered service provider and the Regulator as soon as may be practicable after the resolution order is issued.

244. Upon appointment as receiver of a covered service provider, the Corporation may, in accordance with any regulations made under this Part, take the following actions -

Power to manage covered service provider.

- (a) take possession and control of the assets and undertaking of the covered service provider;
- (b) take over the management of the covered service provider;
- (c) require any person related to the covered service provider to account for and deliver to the Corporation the possession and control of the assets of the covered service provider;
- (d) sell or otherwise dispose of the assets and undertaking in such other manner and on such terms and conditions as the Corporation determines to be appropriate;
- (e) arrange for the assumption by any person of all or part of the liabilities of the covered service provider;
- (f) conduct the business of the covered service provider to the extent that it deems necessary or beneficial to the receivership;
- (g) sue, defend, compromise and settle, in the name of the covered service provider, any claim made by or against it;
- (h) execute documents under the seal of the covered service provider;
- (i) do all such other things as may be necessary or incidental to the exercise of the Corporation's rights, powers, privileges and immunities as receiver; or
- (j) recover from the assets of the covered service provider all costs incurred in the receivership in priority over all other claims.

245. The Corporation may make regulations to provide for the performance of any function by any member or shareholder, director, partner, trustee or officer of any covered service provider for which the Corporation has been appointed receiver.

Functions of the officers, directors and shareholders of a covered service provider.

246. (1) Upon the Corporation being appointed as receiver of a covered service provider, there will be a stay on other proceedings involving the covered service provider to the extent provided for in this section.

Stay of proceedings.

(2) No action or other civil proceedings including any execution or enforcement proceedings may be commenced or continued against the covered service provider or in respect of its assets or liabilities.

(3) No action or other civil proceedings may be commenced or continued against any third party for the recovery of money, or for the enforcement of any security including any guarantee provided for the benefit of any covered service provider in respect of any liabilities of the covered service provider.

247. Nothing contained in the Indian Stamp Act, 1899 (2 of 1899) will affect the power of the Corporation to recommend that any document relating to a transfer of assets or liabilities of a covered service provider under this Part will not attract stamp duty, and such recommendation will ordinarily be followed by the Central Government.

Transfer not covered under Indian Stamp Act, 1899.

No termination or amendment of agreement.

- 24B. No person may terminate or amend any agreement with a covered service provider or claim an accelerated payment by reason only of -
 - (a) the covered service provider being placed in receivership; or
 - (b) the agreement being assigned to or assumed by the bridge service provider.

Agreements suspended.

- 249. Where an order appointing the Corporation as receiver is made under section 242, any provision in any agreement contrary to the provisions in that section is void. 5

CHAPTER 47

RESOLUTION BY PURCHASE

Process for purchase.

- 250. (1) The Corporation must estimate the net worth of a covered service provider under resolution using industry accepted best practices of valuation, as specified. 10
- (2) Any estimation of the net worth of a covered service provider under resolution made by the Corporation under this section is confidential, and must not be disclosed to any person, including any potential purchaser.
- (3) The Corporation must prepare and issue a bid package, which must contain all the initial information which a potential purchaser needs to be provided with before placing a bid. 15
- (4) The mode and manner of issuance of a bid package will be as specified.
- (5) Potential purchasers may submit an intention to bid to the Corporation in the manner and form, and within such time, as may be specified.
- (6) Based on the intentions to bid, the Corporation may approve or reject potential purchasers, in a manner as specified. 20
- (7) The Corporation must permit every approved potential purchaser to conduct due diligence of the covered service provider under resolution.
- (8) The Corporation must provide an opportunity for negotiations between the potential purchaser and the covered service provider before the submission of final bid. 25
- (9) The approved potential purchasers must submit a final bid after conducting the due diligence in such manner and form, and within such time, as may be specified.
- (10) Within such time-period after all approved potential purchasers submit their final bids, as may be specified in the bid package, the Corporation must inform one or more identified purchasers, in a manner specified. 30
- (11) When carrying out the process under this section, the Corporation must take into consideration -
 - (a) the composition of assets and liabilities of the covered service provider under resolution; 35
 - (b) the competitive and economic conditions prevalent in the financial system; and
 - (c) the need for expeditious resolution.

(12) When carrying out the process under this section, the Corporation must seek to -

- (a) maximise the number of potential purchasers;
- (b) explore multiple transaction structures;
- (c) give accurate and ample information to potential purchasers;
- (d) conduct thorough due diligence of potential purchasers;
- (e) minimise disruption to consumers of the covered service provider under resolution; and
- (f) minimise disruption to financial services provided by the covered service provider under resolution.

(13) In this section -

- (a) "bid package" means the set of documents necessary to invite bids to purchase the underlying assets or liabilities of a covered service provider under resolution;
- (b) "intention to bid" means a communication, in the form and manner specified, submitted by a potential purchaser to the Corporation, in response to a bid package, indicating an intention to bid for a covered service provider under resolution; and
- (c) "potential purchaser" means a person who has submitted an intention to bid.

251. The resolution order issued under section 243 for resolving a covered service provider by purchase may provide for all or any of the following -

Resolution order:
Purchase.

- (a) the identification of one or more purchasers;
- (b) the merger of the covered service provider under resolution with one or more of the purchasers; and
- (c) the transfer of the assets, liabilities and qualified financial contracts of the covered service provider under resolution to one or more of the purchasers.

252. (1) Where a resolution order directs the transfer of assets or liabilities of a covered service provider under resolution, which includes any qualified financial contracts, the Corporation must do either of the following -

Transfer of assets,
liabilities and
qualified financial
contracts.

- (a) transfer all the assets, liabilities and qualified financial contracts to a purchaser, or
- (b) transfer some of the assets, liabilities and qualified financial contracts to one or more purchasers.

(2) The Corporation must inform all persons who are parties to qualified financial contracts under transfer under this section, if any, within twenty-four hours of the transfer.

(3) A person who is a party to a qualified financial contract under transfer under this section cannot exercise any right under such contract by virtue of any provision in such contract, solely by reason of or incidental to the issuance of a resolution order against the covered service provider.

- (4) A resolution order under sub-section (1) may direct the transfer of assets or liabilities of a covered service provider under resolution, which includes any qualified financial contracts, to a foreign financial service provider only if the contractual rights of parties to such qualified financial contracts, are enforceable substantially to the same extent as permitted under this section. 5
- (5) In this section -
 - (a) "foreign financial service provider" means a financial service provider which is not an Indian financial service provider and any branch or agency of such financial service provider;
 - (b) "qualified financial contract" means any financial contract as may be specified by the Corporation; and 10
 - (c) "transfer of qualified financial contracts" includes the transfer to a purchaser of all of the following -
 - (i) all qualified financial contracts between any person and the covered service provider under resolution; 15
 - (ii) all claims of the person against the covered service provider under resolution under such contract, other than any claim which, under the terms of the contract, is subordinated to the claims of general unsecured creditors of the covered service provider under resolution; 20
 - (iii) all claims of the covered service provider under resolution against the person under such contract; and
 - (iv) all property securing or any other credit enhancement for such contract or any claim under such contract.
- (6) For the purpose of this section, parties to qualified financial contracts do not include the covered service provider under resolution. 25

Confidentiality and disclosure.

- 253. (1) Any bid package provided under section 250 is confidential, and may not be disclosed to any person other than those identified by the Corporation, until the purchase by a covered service provider is concluded.
- (2) The Corporation must, after the purchase is concluded, publish the relevant details about the transaction to the public in a transparent and accountable manner. 30

Provisions of Competition Act not applicable.

- 254. (1) The provisions of section 43A of the Competition Act will not apply to any party to the purchase of the assets and liabilities of a covered service provider under resolution by a purchaser under this Chapter. 35
- (2) In this section, "party" includes -
 - (a) the Corporation;
 - (b) the Regulator;
 - (c) the covered service provider under resolution; or
 - (d) the purchaser. 40

CHAPTER 48

RESOLUTION BY BRIDGE SERVICE PROVIDER

Establishment of bridge service provider

- 255. (1) The Corporation may establish one or more wholly owned subsidiaries as appropriate to be referred to as "bridge service provider".

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- (2) The general superintendence, direction and management of the affairs of the bridge service provider will vest in the board of the bridge service provider, which may exercise all powers and do all acts that may be exercised and done by the bridge service provider.
- 5 (3) The Corporation must appoint the board of directors of the bridge service provider.
- (4) The board of a bridge service provider must elect a chairperson who may also serve in the position of chief executive officer of the bridge service provider.
- (5) The Corporation may -
 - 10 (a) remove the directors of the board of a bridge service provider;
 - (b) fix the compensation of directors of the board of the bridge service provider and its senior management; and
 - (c) indemnify directors, officers, employees, and agents of a bridge service provider on such terms as the Corporation determines to be appropriate.
- 15 (6) The Corporation may, on its own, or whenever the board of the bridge service provider determines to be necessary, make available to the bridge service provider, upon such terms and conditions and in such form and amounts as the Corporation may determine, funds for the operation of the bridge service provider.
- 20 (7) The funds for the operation of the bridge service provider under sub-section (6) may be in addition to any portion of the share capital of the bridge service provider that may be purchased or retained by the Corporation.
- (8) Whenever the board of a bridge service provider, with the approval of the Corporation, determines it is advisable to do so, the board of the bridge service provider will cause capital stock of the bridge service provider to be issued and offered for sale in such amounts as it may determine.
- 25
- 256. (1) The resolution order issued under section 243 for resolving a covered service provider by a bridge service provider may direct all or any of the following -
 - 30 (a) the transfer of some or all of the assets or liabilities of the covered service provider under resolution to the bridge service provider; or
 - (b) the performance of any other temporary function by the bridge service provider which the Corporation may specify.
- (2) The transfer of any assets or liabilities under this section will be effective without any further approval under law.
- 35 (3) When issuing a resolution order under this section, the Corporation must keep in consideration the following factors -
 - (a) the extent to which the continued operation of the covered service provider is essential to provide adequate financial services in the community where such covered service provider is located;
 - 40 (b) the inability to effect a resolution by purchase under Chapter 47 immediately;
 - (c) the necessity to create conditions to enable the carrying out of a purchase under Chapter 47; and

Resolution order:
Bridge service
provider

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(d) the amount reasonably necessary to operate such bridge service provider, which should not exceed the amount reasonably necessary to liquidate the covered service provider under resolution.

(4) The resolution order under this section must be implemented fully within two years from the date of the issuance of the order. 5

(5) The Corporation Board may extend the period under sub-section (4) for one year at a time, not more than three times.

Termination and dissolution of bridge service provider

257. (1) The status of a bridge service provider must terminate at the earliest of the following circumstances -

(a) the bridge service provider is merged or consolidated with an entity other than the Corporation and other than another bridge service provider; 10

(b) the liabilities of the bridge service provider are assumed by an entity other than the Corporation and other than another bridge service provider;

(c) the assets of the bridge service provider are acquired by an entity other than the Corporation and other than another bridge service provider; or 15

(d) the expiration of the period under sub-section 256(4).

(2) If the status of a bridge service provider has not been terminated under sub-section (1), the Corporation must liquidate the bridge service provider upon the full implementation of the resolution order under section 256.

(3) The liquidation of a bridge service provider must be in accordance with the provisions laid down under Chapter 51. 20

CHAPTER 49

RESOLUTION BY TEMPORARY PUBLIC OWNERSHIP

Resolution order: Temporary public ownership.

258. (1) The resolution order issued under section 243 for resolving a covered service provider by temporary public ownership may provide for - 25

(a) the identification of a designated service provider; and

(b) the transfer of all or parts of the assets and liabilities of the covered service provider under resolution to the designated service provider.

(2) The resolution order may direct a designated service provider to -

(a) exercise normal shareholder rights in the covered service provider under resolution; 30

(b) manage the covered service provider under resolution; or

(c) exercise any other powers as may be specified in the resolution order.

(3) The designated service provider must introduce corporate governance arrangements in the covered service provider under resolution in line with best practice as soon as is reasonably practicable. 35

(4) The designated service provider may, subject to the approval of the Corporation, design, and implement a business plan, to operate the covered service provider.

(5) The Corporation may specify the requirements for a business plan under sub-section (4). 40

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- (6) The Corporation must monitor the implementation of the business plan to ensure that it continues to meet its objectives.
 - (7) When issuing a resolution order under this section, the Corporation must keep in consideration the following factors –
 - (a) the exercise of the power is necessary to resolve or reduce a serious threat to the stability of the financial system;
 - (b) the exercise of the power seeks to create and protect value for public funds, taking account of risk;
 - (c) the exercise of the power is subsequent to the Corporation having considered and eliminated the exercise of the power under Chapters 47 and 48; and
 - (d) the exercise of the power requires the Central Government to provide financial assistance in respect of the covered service provider for the purpose of resolving or reducing a serious threat to the stability of the financial system.
 - (8) Before issuing a resolution order under this section, the Corporation must consult the Council, in accordance with the provisions under section 287.
 - (9) In this section –
 - (a) “designated service provider” means a financial service provider that is a nominee of the Corporation, and may include a wholly owned subsidiary of the Corporation; and
 - (b) “financial assistance” means providing guarantees or indemnities, or any other kind of financial assistance, whether actual or contingent, as may be notified by the Central Government.
- 25 259. (1) The Corporation must terminate the resolution order under section 258 when it makes a decision order that the factors under section 258(7) are no longer met.
- (2) If necessary, the Corporation must liquidate the covered service provider under resolution after its decision order under this section.
- 30 (3) The liquidation of the covered service provider under resolution under this section must be in accordance with the provisions laid down under Chapter 51.

Termination of temporary public ownership and liquidation of covered service provider.

CHAPTER 50
RESOLUTION FUND

- 35 260. (1) The Corporation has the duty to insure –
- (a) each consumer of a specified category of covered obligations with a covered service provider to the extent of a specified limit; and
 - (b) each covered service provider to the extent of a specified limit.
- (2) The Corporation must specify –
- (a) the limits under this section; and
 - (b) the specified categories of consumers under sub-section (1)(a).
- 40

Duty to insure.

(3) The Corporation, in determining the limits under this section, must take into consideration its objectives under Chapter 43.

(4) The Regulation, in consultation with the Corporation, will determine the specified categories of covered obligations under this section, and in doing so, must take into consideration the following factors -

- (a) the nature and extent of detriment that may be caused to consumers in case of non-fulfilment of obligations owed to them by the covered service provider;
- (b) the lack of ability of consumers to access and process information relating to the safety and soundness of the covered service provider; and
- (c) the inherent difficulties that may arise for financial service providers in fulfilling those obligations.

Eligibility for Corporation insurance.

261. (1) The following financial service providers are eligible to obtain Corporation insurance under this Part -

- (n) each financial service provider that makes covered obligations for the purpose of this Part; and
- (b) each financial service provider designated by the Council as a Systemically Important Financial Institution.

(2) No financial service provider that is not eligible under sub-section (1) can obtain Corporation insurance under this Part.

Application process for Corporation insurance.

262. (1) Every financial service provider that is eligible under section 261 must apply to the Corporation for Corporation insurance, in the manner and form specified by the Corporation.

(2) For every financial service provider that is eligible and applies to the Corporation under sub-section (1), the Corporation must carry out an assessment within sixty days of that financial service provider making an application to the Corporation.

(3) If the Corporation, upon carrying out an assessment, makes a decision order that a financial service provider can be a covered service provider, the Corporation will issue Corporation insurance to that financial service provider under such terms and conditions as may be specified by the Corporation.

Assessment by Corporation.

263. (1) The Corporation must carry out an assessment of a financial service provider, in the specified form and manner, to make a decision order whether that financial service provider can be a covered service provider.

(2) A financial service provider may not obtain Corporation insurance if the Corporation has not carried out an assessment of that financial service provider.

Resolution Fund.

264. (1) There will be constituted a fund, established and maintained by the Corporation, called the Resolution Fund, to which will be credited all amounts received as premium from covered service providers, towards -

- (a) insuring each consumer of specified categories of covered obligations under section 260(1)(n); and
- (b) insuring against the resolution of each covered service provider under section 260(1)(b).

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- (2) The Resolution Fund will be applied for meeting -
- (a) the costs of compensation as may be incurred by the Corporation in the exercise of its duty under section 260; and
 - (b) the costs of resolution and any administrative costs and expenses as may be incurred by the Corporation in the exercise of its duty under section 260.
265. The Corporation may invest the amounts credited to the Resolution Fund, when not required by the Corporation, in promissory notes and securities of the Central Government and money market mutual funds. Conditions for the use of the Resolution Fund.
- 10 266. (1) The Corporation may specify revisions to the limits of Corporation insurance from time to time. Revision of Corporation insurance limits.
- (2) The revision of Corporation insurance limits must be guided by the principle of proportionality to the risk to viability of the covered service provider.
- 15 267. (1) The Corporation must specify, for the purposes of calculating premia, to undertake the following - Calculation of premia.
- (a) the manner of classification of covered service providers into different categories;
 - (b) the manner and methodology of assessment of premia payable by different categories of covered service providers;
 - 20 (c) the process of collection of premia from covered service providers; and
 - (d) the manner and mode of payment of premia by covered service providers to the Corporation.
- (2) The premia under this section will be collected by the Corporation once every six months.
- 25 (3) The regulations under sub-section (1)(a) will take into consideration the following factors -
- (a) the probability of failure of the covered service provider; and
 - (b) the consequences presented to the Corporation by the probability of failure of the covered service provider.
- 30 (4) No covered service provider may, without prior agreement with the Corporation, change a premium amount, interest or any other payment to be made to the Corporation by reason of a set-off or claim by the covered service provider against the Corporation.
- 35 268. (1) The premium under section 264(1)(b) will include administrative costs, which must be specified by the Corporation, and must include the following - Calculation of administrative costs.
- (a) the costs for a particular function or service, including the cost for making an application to the Corporation for Corporation insurance;
 - (b) any exemptions from or reductions in costs; or
 - (c) any remission of costs in whole or in part.
- 40 (2) In specifying costs under this section, the Corporation must take into account

- (a) adequacy in meeting the financial requirements and present and projected expenditures of the Corporation; and
- (b) fairness in comparison to the costs incurred by the Corporation for which the costs are payable.

Obligations of the Corporation.

269. (1) The Corporation must make pay-outs from the Resolution Fund when a resolution order under section 243 provides for the payment of a specified amount to specified consumers of a covered service provider, on the date on which the resolution order comes into force. 5
- (2) The Central Government must, in consultation with the Corporation, prescribe the maximum amount that may be made as pay-outs. 10
- (3) The Corporation may make pay-outs in instalments, if it is appropriate and necessary to do so.
- (4) The Corporation must make regulations to provide for the process of making pay-outs, which must include the following –
- (a) the notice period to be given by the Corporation to the consumers with respect to the pay-out; 15
 - (b) representations, if any, to be made by the covered service provider, or the consumers, to the Corporation in relation to the pay-out;
 - (c) any extension of the notice period; and
 - (d) alternate provisions for making payments to consumers who are not found or readily traceable, at the time of making pay-outs. 20
- (5) If a covered service provider makes a claim for compensation over and above its specified insured amount, such claim will be referred to the Corporation under the provisions of Chapter 51.
- (6) Any amount paid by the Corporation under this Chapter in respect of a covered obligation will, to the extent of the amount paid, discharge the Corporation from its liability in respect of that covered obligation. 25

Grounds for termination of Corporation insurance.

270. The Corporation retains the right to terminate the Corporation insurance of a covered service provider in any of the following circumstances –
- (a) if the covered service provider fails to pay premia for two consecutive periods; 30
 - (b) if the covered service provider has, by a decision order, been determined to be at critical risk to viability under section 237;
 - (c) the covered service provider or its directors or trustees have engaged or are engaging in unsafe or unsound practices in conducting the business or continuing the operations of the covered service provider; 35
 - (d) the covered service providers or its directors or its trustees have violated any applicable law, regulations or condition imposed by the Corporation or Corporation insurance or written agreement entered into between the covered service provider and the Corporation; 40
 - (e) the Regulator makes a decision order that the covered service provider is not engaged in the activity it is registered to carry on; or
 - (f) the Regulator withdraws any authorisation that it may have granted to the covered service provider.

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271. (1) If any of the circumstances under section 270 are met, the Corporation may, by a decision order, terminate the Corporation insurance of a covered service provider. Process for termination of Corporation insurance.
- (2) Before issuing an order under this section, the Corporation must -
- (a) inform the covered service provider of its intended actions;
 - (b) provide the time-period within which a representation may be made by the covered service provider to the Corporation, which may not be more than ninety days; and
 - (c) consider representations from the covered service provider, if such representation is made within the notice period provided.
- (3) The Corporation may extend the time-period for submitting representation, upon the request of the covered service provider, for a period of not more than ninety days, if it is satisfied that such a request is reasonable.
- (4) If no representation is received by the Corporation from a covered service provider with the time-period provided, the Corporation must terminate the Corporation insurance of that covered service provider.
- (5) If the Corporation insurance of a covered service provider is terminated, the Corporation must, without delay -
- (a) inform the covered service provider of such termination; and
 - (b) require the covered service provider to inform its consumers and the public at large of such termination, in the form and manner as may be specified.
272. (1) The Corporation may revoke the termination of the Corporation insurance of a covered service provider if it is satisfied that the reasons for termination have been suitably remedied or the risk to consumers or any other person has been averted or substantially reduced, to the satisfaction of the Corporation. Revocation of termination of Corporation insurance.
- (2) If the termination of Corporation insurance of a covered service provider takes place under section 270(6)(e), the Corporation may revoke the said termination and restore the Corporation insurance if that covered service provider pays all the amounts due by way of premia from the date of default till the date of payment, together with interest due on the date of payment.
273. (1) The Corporation may avail of a line of credit from the Central Government for a period of five years from the date of establishment of the Resolution Fund, in such form and manner as prescribed. Line of credit.
- (2) The Central Government may extend the line of credit upon a request by the Corporation, in the form and manner prescribed, as it thinks fit.
- (3) The terms of the line of credit must include the following -
- (a) the amount that may be borrowed by the Corporation under this section;
 - (b) the repayment schedule according to which the amount must be returned to the Central Government;
 - (c) the interest rate that the Corporation is obliged to pay on the amount availed under the line of credit; and

(d) the nature of investments the Corporation can make with the amount availed under the line of credit.

- (4) The Central Government will determine and review the terms of the line of credit, in accordance with this section.
- (5) The Corporation may, during the period that it avails the line of credit, apply to the Central Government, in the form and manner prescribed, for extension, renewal or temporary increase of credit.
- (6) Each request by the Corporation to the Central Government for extension, renewal or increase of credit under this section must be accompanied by a detailed report stating the reasons and need for such additional borrowing and its intended uses.
- (7) The Central Government may, upon a request by the Corporation under subsection (5), extend, renew, or temporarily increase the line of credit, for such period as it thinks fit.
- (8) The Corporation may use the amount availed under the line of credit for investment purposes, subject to section 265.
- (9) If the Corporation avails the line of credit for the resolution of an identified covered service provider, the Corporation may meet its repayment obligations against that line of credit by claiming to be a creditor of the first priority of that identified covered service provider, in accordance with section 280, if that covered service provider is liquidated or dissolved.

advertisement of Corporation insurance.

- 274. (1) The Corporation must make regulations to provide for the form and manner in which a covered service provider must advertise to the public at large about its Corporation insurance.
- (2) No financial service provider, or a person belonging to the same group, or its related person, may represent or imply that the financial service provider, or any obligation or amount credited to the Corporation, is insured or guaranteed by the Corporation, if such obligation or amount is not insured or guaranteed by the Corporation, including by -
 - (a) the use of the terms "Resolution Corporation", the "Corporation", "Corporation insurance", "Resolution Fund", the "Fund" or any other term that gives the impression that it is associated with the Corporation or the Resolution Fund, as part of the business name, or firm name, of any person, including any corporation, partnership, trust or any other entity; or
 - (b) the use of any other terms, signs or symbols as part of an advertisement or any other representation.

CHAPTER 51

COMPENSATION AND LIQUIDATION

Initiation of compensation.

- 275. (1) A resolution order issued under section 243 must provide for compensation in connection with the covered service provider under resolution.
- (2) Under this section, the Corporation must specify the categories of persons who are entitled to compensation from the resolution of the covered service provider under the resolution order.

(3) The Corporation may specify the categories of persons who may be entitled to compensation from the resolution of a covered service provider under a resolution order, and the time-period within which the determination under sub-section (2) must be made.

5 276. (1) After a determination under section 275(2), the Corporation must issue, within a specified time-period -

Compensation notice.

- (a) a general notice to the public; and
- (b) special notices to individuals who fall within the specified categories.

10 (2) The notices under sub-section (1) must be issued in a manner best suited to bring it to the attention of the public or the individuals, as the case may be.

(3) The notice under sub-section (1)(b) to every individual who falls within the specified categories must -

- (a) state the amount of entitlement to compensation of that individual;
- (b) state the proof of entitlement to compensation that that individual must provide to the Corporation; and
- (c) provide the form, manner and reasonable time-period within which individuals must respond to the notice.

(4) The Corporation may specify -

- (a) under sub-section (1)(a) and sub-section (1)(b), the form and the time period within which such notice must be issued; and
- (b) the proof of entitlement that specified categories of persons may provide under sub-section (3)(b).

(5) Every individual to whom a notice has been issued by the Corporation must respond in the form, manner and time-period provided.

25 (6) The Corporation may reject the entitlement to compensation of an individual if section (5) is not complied with.

(7) Regulations under this section must be issued only after consultation with the Regulator.

30 (8) In this section, "proof of entitlement to compensation" means all information or documentation, as may be specified, that an individual must present to the Corporation under section 276, to prove that that individual is entitled to the compensation.

35 277. (1) Any person, including an individual under sub-section 275(2), may object to the notices under sections 276(1)(a) and 276(1)(b), in connection with the resolution of a covered service provider under a resolution order, on one of the following grounds -

Objections to compensation notice.

- (a) that person has not been identified as an individual under sub-section 275(2) but is entitled to compensation;
- (b) that individual has complied with section 276(5) but has been rejected under section 276(6); or
- (c) that individual has been offered compensation of an amount less than their entitlement to compensation.

- (2) The form, manner and reasonable time-period within which objections to the notices under this section may be made must be in accordance with regulations made by the Corporation.
- (3) The Corporation must consider the objections to the notices received under this section, and determine whether the person making the objection is entitled to compensation, and the amount of such entitlement to compensation, from the resolution of the covered service provider under the resolution order.

Compensation order.

278. (1) The Corporation must issue a compensation order in accordance with the provisions of this section.
- (2) A compensation order must be issued within reasonable time, as may be specified, after issuing compensation notices under section 276, but not before the objections to the compensation notices have been received under section 277.
- (3) The compensation order must –
- (a) adhere to industry accepted best practices of valuation, as may be specified;
 - (b) after due consideration of sections 276(5), 276(6) and 277(3) –
 - (i) identify the persons or individuals who are to be given compensation;
 - (ii) identify the persons or individuals who will not be given compensation;
 - (c) identify the final amount of such compensation that is to be given, which may be different from the amount of entitlement to compensation under section 276(3)(a); and
 - (d) provide details of the mode, manner and time-period within which such compensation will be given.
- (4) The Corporation must specify –
- (a) the form and manner of issuing a compensation order;
 - (b) the valuation methods to be followed by the Corporation for the purposes of valuing compensation; and
 - (c) the mode, manner and time-period within which any compensation under a compensation order must be given.
- (5) An affected person under a compensation order has the right to appeal such order before the Tribunal in accordance with the provisions of section 282.

Payment of compensation.

279. (1) Any compensation to be given under a compensation order must be given by the Corporation in accordance with section 264(2).
- (2) Any amount given by the Corporation under this Chapter in respect of compensation to a person will, to the extent of the amount paid, discharge the Corporation from its liability in respect of that compensation to that person.

Liquidation of a covered service provider

280. (1) The Corporation must only apply for liquidation or dissolution of a covered service provider under resolution –
- (a) under section 257;
 - (b) if it so determines under section 259; or

- (c) if a covered service provider has, by decision order, been determined to be at critical risk to viability under section 237, and the Corporation determines that it is necessary to liquidate or dissolve that covered service provider.
- 5 (2) The Corporation must apply for liquidation or dissolution of the covered service provider under the law applicable to that covered service provider for liquidation or dissolution, within –
- (a) the duration specified in the resolution order; or
- (b) if the resolution order does not provide for a duration for such application, 10 within a period of thirty days from the date of the order.
- (3) Where the law applicable to the covered service provider for liquidation or dissolution provides for the appointment of a liquidator or such other person, as the case maybe, the Corporation is deemed to be the liquidator or such other person, as the case may be.
- 15 (4) Where a covered service provider is being liquidated or dissolved under the applicable law and where the Corporation has utilised proceeds from the Resolution Fund towards such covered service provider, the Corporation –
- (a) is deemed to be a creditor of the first priority of the covered service provider; and
- 20 (b) will be reimbursed by the liquidator or such other person as the case maybe, to the extent and in the manner provided under the applicable law.
- (5) Where the Corporation had availed a line of credit under section 273 to resolve the covered service provider being liquidated or dissolved, such amount must 25 be repaid first out of the proceeds of liquidation or dissolution.

CHAPTER 52

APPEALS

281. A resolution order issued by the Corporation under this Part is for all purposes final and conclusive and may not be questioned or reviewed by the Tribunal. No review of resolution order.
- 30 282. (1) An affected person under a compensation order issued under section 278 has the right to appeal against that compensation order before the Tribunal. Appeal against compensation order.
- (2) The form, manner and time-period within which such appeal must be made will be in accordance with this Act.
- (3) A person is an affected person under a compensation order if that person, 35 under that compensation order –
- (a) has been identified and offered compensation, but of an amount less than that person's entitlement to compensation; or
- (b) has been refused compensation, but is entitled to compensation.
- 40 283. (1) The Tribunal may, having regard to an appeal under section 282, order the payment of interest on the reassessed compensation amount, along with the reassessed compensation amount, if it determines that the such payment is just and reasonable. Payment of interest.

(2) The payment of interest under this section may be calculated at a rate and from a time that the Tribunal determines to be just and reasonable.

Review of decisions taken by the Corporation.

284. (1) A decision or determination of the Corporation may be reviewed by the Tribunal only if one of the following conditions are met -

- (a) the Corporation, in making the decision or determination, has made an error apparent on the face of record; 5
- (b) the Corporation, in making the decision or determination, has not considered all relevant material, or has relied on irrelevant material, in making a decision or determination; or
- (c) the Corporation, in making the decision or determination, has violated the principles of natural justice. 10

CHAPTER 53

INTERACTION WITH OTHER AGENCIES

Interaction between Corporation and Competition Commission.

285. (1) Prior to exercising any powers under Chapter 46, the Corporation must prepare a report detailing the effect that any action it is likely to take may have on competition in the relevant market. 15

(2) Prior to exercising any powers under Chapter 46, the Corporation must -

- (a) consult with the Competition Commission regarding the effect of the Corporation's proposed action on competition in the relevant market, including by way of providing the report prepared under sub-section (1); and 20
- (b) make available any data, information or material in the possession of the Corporation relating to the action it is likely to take, as may be required by the Competition Commission under the Competition Act.

(3) For the purpose of sub-section (2), sections 21 and 43A of the Competition Act will not apply. 25

(4) Any data, information or material obtained by the Competition Commission from the Corporation under sub-section (2)(b) will be treated as confidential in accordance with the provisions of section 57 of the Competition Act.

(5) The Competition Commission, in carrying out any evaluation or making any determination in relation to a matter on which a report has been provided by the Corporation under sub-section (2), must give due regard to section 20(4)(k) of the Competition Act. 30

(6) Sub-section (2) will not apply if the Corporation determines that -

- (a) it must act immediately in order to prevent the probable failure of a covered service provider; or 35
- (b) the exercise of its powers relates to a combination involving a covered service provider and one or more persons belonging to the same group as the covered service provider.

(7) Except the proviso to section 20(1) of the Competition Act, the provisions of section 20 of the Competition Act will not apply to a determination under sub-section (6) until the completion of an action taken by the Corporation under Chapter 46. 40

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- (8) Nothing contained in sub-section (7) will prevent the Competition Commission from reviewing a combination and suggesting modifications to the terms of a combination effected as a result of the exercise by the Corporation of its powers under Chapter 46 if the Competition Commission determines that the combination causes or is likely to cause an appreciable adverse effect on competition within the relevant market.
- (9) In this section, "relevant market" has the meaning assigned to it under section 2(r) of the Competition Act, as may be determined jointly by the Competition Commission and the Corporation for the purposes of this Part.

10 286. (1) The Corporation and each Regulator must seek to -

Interaction between Corporation and Regulator.

- (a) consult on a regular and frequent basis;
 - (b) co-ordinate on a regular and frequent basis;
 - (c) ensure and achieve harmonisation of regulatory action;
 - (d) issue regulations jointly and in a timely manner on the matters under sub-section (3), and any other matter as may be provided under this Act;
 - (e) make relevant information available to each other in a timely manner; and
 - (f) achieve all of the above in any other area considered relevant under this Part.
- 20 (2) The frequency of interaction with respect to a covered service provider should take into account the stage of risk to viability of the covered service provider.
- (3) The Corporation and the Regulator must make regulations jointly in a timely manner, on all the following -
- (a) the framework for prompt corrective action;
 - (b) the risk assessment of covered service providers;
 - (c) the actions to be taken with respect to a covered service provider at different stages of risk to the covered service provider; and
 - (d) the identification of emerging risks, their assessment, quantification and impact upon the financial sector.
- 30 (4) The Corporation must inform the Regulator if the Corporation considers taking any action with respect to a covered service provider under sections 234, 235, 236 or 237 under the framework for prompt corrective action.
- (5) The Regulator must provide the Corporation with the summary of risk assessment carried out by it in connection with covered service providers, on a regular basis, and in a timely fashion.
- 35 (6) The Regulator must inform the Corporation of its determination, with respect to a covered service provider, with regard to -
- (a) the risk to viability of the covered service provider;
 - (b) the reasons for such determination; and
 - (c) the measures that the Regulator proposes to take.
- 40 (7) The Regulator must provide the Corporation with copies of its intervention, if any, with respect to a covered service provider.

Interaction
between
Corporation and
Council.

287. (1) If there is a difference of opinion with regard to the issuance of regulations between the Corporation and the Regulator, the dispute will be resolved by the Council in accordance with the provisions under section 305.
- (2) Prior to initiating any measure in respect of a Systemically Important Financial Institution, the Corporation must –
- (a) inform the Council of the measures that the Corporation proposes to take; and
 - (b) take such measures only with the approval of the Council.

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CHAPTER 54

OTHER PROVISIONS GOVERNING THE CORPORATION

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Returns and
reports.

288. In addition to anything contained in this Act with regard to the annual report, the Corporation must submit to the Central Government the following additional information –
- (a) a statement setting out the value of the Resolution Fund;
 - (b) a statement mentioning the use of the Resolution Fund;
 - (c) a statement including details of actions taken against covered service providers; and
 - (d) any other statement that is necessary to give an accurate assessment of its functioning.

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Application of
other laws.

289. Nothing contained in any other law creating a body corporate carrying out a financial service will affect the applicability of the provisions of this Part against such body corporate.

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PART VIII

FINANCIAL STABILITY AND DEVELOPMENT COUNCIL

CHAPTER 55

OBJECTIVE AND FUNCTIONING OF THE FINANCIAL STABILITY AND DEVELOPMENT COUNCIL

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290. (1) The Council will pursue the objective of fostering the stability and resilience of the financial system, by - Objective.
- (a) identifying and monitoring systemic risk; and
 - (b) taking all required action to eliminate or mitigate systemic risk.
- 10 (2) The Council must have regard to India's international obligations, as relevant, in the process of achieving its objective.
291. (1) The office of the Council will consist of the Council Board, an Executive Committee, a Secretariat, and a Data Centre. Functioning of the Council.
- 15 (2) The Council Board must publish a report within thirty days of the beginning of every financial year to disclose all delegations to the office of the Council, or by the office of the Council for the previous financial year.
292. (1) There will be established, for the purposes of this Act, an Executive Committee which will have administrative and managerial control over the affairs of the Council. Establishment of the Executive Committee.
- 20 (2) The Executive Committee will comprise -
- (a) the Reserve Bank Chairperson as the chairperson of the Executive Committee;
 - (b) a nominee of the member mentioned under section 21(3)(a);
 - (c) the Financial Authority Chairperson;
 - 25 (d) the Corporation Chairperson;
 - (e) an administrative law member; and
 - (f) the Council Chief Executive.
293. (1) There will be established, for the purposes of this Act, a Secretariat which will assist the Council in the performance of its functions under this Act. Establishment of the Secretariat.
- 30 (2) The Secretariat will be headed by the Council Chief Executive.
294. (1) There will be established, for the purposes of this Act, a Data Centre by the name of the Financial Data Management Centre to perform the functions laid down in Chapter S7. Establishment of the Financial Data Management Centre.

(2) The Data Centre will be headed by a Data Centre Director who will be appointed by the Council Board in accordance with section 45.

CHAPTER 56
FUNCTIONS OF THE COUNCIL

Functions of the Council.

295. The Council must - 5
- (a) conduct data analysis and research;
 - (b) designate financial service providers as Systemically Important Financial Institutions;
 - (c) formulate and implement the application of system-wide measures to the financial system; 20
 - (d) promote co-operation and co-ordination among members and Financial Agencies;
 - (e) assist the members and Financial Agencies in the performance of their functions;
 - (f) assist the Central Government, members and Financial Agencies during a financial system crisis; and 15
 - (g) ensure the performance of all other actions that are required to be undertaken by the Council under this Act.

Principles.

296. (1) The Council must, while discharging its functions and exercising its powers under this Act, ensure that its actions - 20
- (a) take into account the principles of proportionality between the costs imposed and the benefits expected to be achieved;
 - (b) seek to reduce the potential for regulatory inconsistencies;
 - (c) do not cause a significant adverse effect on the competitiveness of the financial system; 25
 - (d) do not cause a significant adverse effect on the growth of the financial system in the medium or long-term; and
 - (e) lead to greater transparency and sharing of material information in relation to the financial system.
- (2) If a proposed action of the Council is likely to conflict with any principle under sub-section (1), the Council has a duty to explain before it can continue with the proposed action. 30
- (3) In sub-section (2), a "duty to explain" means that the Council must publish -
- (a) the principles that are likely to conflict with the proposed action, and the extent of such conflict; 35
 - (b) the efforts taken by the Council to reconcile its proposed action with the principles; and
 - (c) a justification of the proposed action in relation to the achievement of its objective.

Data analysis and research.

297. (1) The Council must monitor and analyse all accessible data, and conduct such research, as is relevant to the achievement of its objective. 40

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- (2) The functions of the Council relating to the monitoring and analysis of accessible data and conducting research include -
 - (a) developing expertise and information systems to monitor and conduct statistical, mathematical, financial and related analysis of accessible data;
 - (b) identifying trends in the financial system that assist in the identification, measurement, and monitoring of systemic risk in the financial system;
 - (c) developing system-wide measures, systemic indicators for designating Systemically Important Financial Institutions, and other tools that may be used to eliminate or mitigate systemic risk in the financial system;
 - (d) studying the impact on the financial system of any measures, systemic indicators, or tools that have been developed under clause (c) in the financial system; and
 - (e) analysing international best practices for the efficient discharge of its functions.
- (3) The Council must publish the results of its data monitoring, data analysis and research frequently, and at least once every one hundred and eighty days.

- 298. The Council may specify the collection of financial regulatory data where -
 - (a) such data is relevant to the achievement of its objective; and
 - (b) the relevant Financial Agency has not specified the submission of such data.

Council's access to data.

- 299. (1) The Council must specify the systemic indicators for designating financial service providers as Systemically Important Financial Institutions.
- (2) The Council must review regulations under sub-section (1) every financial year.
- (3) The Council, in determining the systemic indicators, must consider all of the following factors -
 - (a) the nature of the financial service or financial product provided, if any by the financial service provider;
 - (b) the size of the financial service provider;
 - (c) the interconnectedness of the financial service provider with the financial system, and other parts of the economy;
 - (d) the substitutability of the financial service, the financial product or the financial service provider in the financial system; and
 - (e) any additional factors as may be specified.
- (4) In addition to the requirements under section 52(2), the following documents must accompany the draft regulations -
 - (a) a statement explaining the application of the systemic indicators to the data of various categories or classes of financial services, financial products and financial service providers;
 - (b) the time-period within which the Council will designate financial service providers as Systemically Important Financial Institutions;
 - (c) the conditions and process of deciding requests for exemption from such designation; and
 - (d) the time-period within which the Council will convey its decision in relation to any requests for exemption from such designation.

Determination of systemic indicators.

Application of systemic indicators to financial service providers.

- 300. (1) The Council must review as frequently as required, and at least once every financial year, the applicability of the systemic indicators contained in regulations made under section 299(1) to financial service providers to identify which financial service providers are to be designated as Systemically Important Financial Institution. 5
- (2) If the Council proposes to designate a financial service provider as a Systemically Important Financial Institution it must issue a show cause notice to such financial service provider.
- (3) If the Council decides to designate a financial service provider as a Systemically Important Financial Institution it must issue a decision order. 10
- (4) If any Systemically Important Financial Institution carries out a financial service that is not allocated to a Regulator under section 11, the Council must, through the decision order mentioned in sub-section (3), identify the Regulator who will regulate such Systemically Important Financial Institution.

Formulation of system-wide measures.

- 301. (1) The Council may, for the purpose of implementation under section 302, specify the formulation of any system-wide measure specified in the Third Schedule. 15
- (2) In its formulation of the system-wide measure, the Council should consider the following factors -
 - (a) that the system-wide measure applies to the entire financial system; or
 - (b) that the system-wide measure applies to a substantial part of the financial system that is exposed to, or is contributing to, a similar source of systemic risk. 20
- (3) In addition to the requirements under section 52(2), the following documents must accompany the draft regulations -
 - (a) the scope of implementation of the system-wide measure; 25
 - (b) an explanation of the possible implementation of the system-wide measure to specified types of financial services, financial products, or financial service providers; and
 - (c) the parameters of discretion that will be provided to the Financial Agencies in the implementation of the system-wide measure. 30
- (4) The formulation of the system-wide measure, as specified under sub-section (1) will be implemented by the Financial Agencies, as appropriate, in accordance with section 302.
- (5) Any action to be taken by the Council under this section must only be taken by the Council Board. 35

Implementation of system-wide measures.

- 302. (1) The Council may, by order in writing, direct the implementation of a system-wide measure, if it determines that such implementation is required to achieve the Council's objective.
- (2) The order under sub-section (1) must -
 - (a) identify the parameters of application of the system-wide measure; 40
 - (b) identify the Financial Agencies that will implement such system-wide measure;

- (c) direct the Financial Agencies to exercise their powers to ensure the implementation of such system-wide measure;
 - (d) allocate specific implementation to specific Financial Agencies, if the measure requires implementation by more than one Financial Agency; and
 - 5 (e) direct the Financial Agencies to monitor and review the implementation of the system-wide measure and report to the Council as frequently, and in such form and manner, as may be provided for in the order.
- (3) The existence of the order is relevant to the exercise of any discretion conferred on the Financial Agencies.
- 10 (4) The Council must regularly, and at least once every financial year, review the effectiveness of all orders issued under this section.
- (5) If the Council determines that a specific system-wide measure no longer contributes to its objective, then it must -
- 15 (a) revoke the implementation of such system-wide measure, through an order in writing, to the Financial Agencies directed to implement the system-wide measure under sub-section (2)(c); or
 - (b) suitably modify such system-wide measure in accordance with the procedure in section 301, before ordering the implementation of the modified system-wide measure under sub-section (1).
- 20 (6) The Council must conduct an analysis of the impact of any revoked, or modified system-wide measure within one year of such revocation or modification.
- (7) Any action to be taken by the Council under this section must only be taken by the Council Board.
- 25 303. (1) The Council must facilitate co-ordination and co-operation among Financial Agencies. Facilitating co-ordination and co-operation.
- (2) The functions of the Council relating to the facilitation of co-ordination and co-operation include -
- (a) the review and examination of concerns of regulatory inconsistencies;
 - 30 (b) the identification of gaps in actions of the Financial Agencies in dealing with similar matters; and
 - (c) the facilitation of knowledge-sharing and cross-staffing.
304. The Council may, upon direction from, or in consultation with, the Central Government - Co-ordination and co-operation at international forums.
- 35 (a) co-ordinate and co-operate with, and represent India at, specified international forums and foreign regulatory bodies, as may be necessary to achieve its objective;
 - (b) seek to initiate knowledge-sharing and cross-staffing with international forums and foreign regulatory bodies, as may be necessary to achieve its objective; and
 - 40 (c) undertake actions that are required to be taken as a result of India's international obligations, as may be necessary to achieve its objective.

Resolution of disputes.

305. (1) The Council Board must resolve any dispute between two or more of its members or between any of its members and other Financial Agencies, or between Financial Agencies.
- (2) The Council Board must resolve a dispute under this section only if at least one of the following conditions is met –
- (a) a member or a Financial Agency submits a written request to the Council Board for the determination of such dispute; or
 - (b) in the opinion of the Council Board, a dispute exists between two or more of its members, or between any of its members and other Financial Agencies, or between Financial Agencies, that has the potential to cause regulatory uncertainty and adversely impact the stability of the financial system.
- (3) Before resolving any dispute under this section, the Council Board must, as soon as practicable, and within ninety days of receiving such written request, or coming to an opinion that a dispute exists –
- (a) determine that the parties involved in the dispute have failed to resolve the dispute in good faith;
 - (b) provide a copy of the written request, or a statement of its opinion, to all parties to the dispute;
 - (c) undertake to seek the agreement of all parties to the dispute in relation to the resolution of such dispute by the Council Board; and
 - (d) publish the procedure of dispute resolution that the Council Board intends to follow, as described in sub-section (4).
- (4) The Council Board must follow a procedure of dispute resolution that is necessary to resolve the dispute fairly and expeditiously and is in conformity with the principles of natural justice.
- (5) The Council Board must resolve all disputes as soon as possible, and at least within one year of publishing the procedure of dispute resolution.
- (6) In resolving a dispute under sub-section (4), the Council Board must ensure that, where a dispute relates to any action taken by a Financial Agency including the extent of jurisdiction of a Financial Agency in taking such action, the decision of the Council Board does not –
- (a) exempt the statutory duties of a party to the dispute; or
 - (b) divest a party to the dispute of any authority derived from this Act, or any other law currently in force.
- (7) A decision made by the Council Board under this section must be in writing, and published immediately.

Role of the Council during a financial system crisis.

306. (1) The Council must specify, as frequently as appropriate, the parameters for the identification and determination of a financial system crisis.
- (2) The Council must specify, in preparation for assistance during a financial system crisis, a statement of action in relation to potential financial system crises.
- (3) The statement of action under sub-section (2) must –
- (a) be updated every financial year;
 - (b) take into account international best practices in relation to assistance during various types of financial system crises;

- (c) contain a statement of policy in relation to the provision of fiscal assistance or other extraordinary assistance by the Central Government; and
 - (d) describe, in general terms, the manner in which the Council may provide assistance to the Central Government and Financial Agencies for various types of financial system crises.
- 5
- (4) If the Central Government, on its own, or upon advice from the Council, determines that there is a financial system crisis, the Council must assist the Central Government, and Financial Agencies as required, and particularly as mentioned in sub-section (5).
- 10
- (5) The Council must –
- (a) provide and conduct such data analysis and research as may be necessary to understand and resolve the financial system crisis;
 - (b) assist Financial Agencies in their efforts relating to resolving the financial system crisis;
 - 15 (c) provide advice to the Central Government in relation to the provision of fiscal assistance or other extraordinary assistance;
 - (d) initiate an audit of all actions leading up to, and taken during, the financial system crisis, and publish the results of the audit within a period of one year after the commencement of the financial system crisis; and
 - 20 (e) where the financial system crisis continues for a period beyond one year, initiate an audit as described in this sub-section for every year of the financial system crisis, until such financial system crisis has ended.

CHAPTER 57

FINANCIAL DATA MANAGEMENT CENTRE

- 25 307. (1) The Council must make bye-laws to provide for the creation of a financial system database, including the process of upgrading the capabilities of the financial system database.
- (2) The Data Centre must administer and supervise the functioning financial system database.
- 30 (3) The Data Centre must have regard to international best practices in the administration and supervision of the financial system database.
- (4) The Data Centre must publish reports in relation to the functioning of the financial system database frequently, and at least once every ninety days.
- 35 (5) The Data Centre may enter into agreements with any person for the purpose of administration of the financial system database.

Creation, administration and supervision of the financial system database.

308. (1) The Data Centre must ensure that its actions –
- (a) lead to efficient and accurate means of accessing financial regulatory data;
 - (b) reduce the costs of reporting of financial regulatory data;
 - (c) actions seek to protect the confidentiality, privacy and security of financial regulatory data; and
 - 40 (d) increase access to material information about the financial system.

Principles to be followed by the Data Centre.

(2) The principles to be followed by the Data Centre under this section are in addition to the principles to be followed by the Council under section 296.

Submission of financial regulatory data to the financial system database.

- 309. (1) Every Financial Agency must submit financial regulatory data -
 - (a) only in electronic form; and
 - (b) only through the financial system database at the first instance. 5
- (2) Nothing in this section restricts the power of a Financial Agency under law to seek the submission of financial regulatory data in any form other than electronic form, where such data cannot be adequately converted to electronic form, provided that the Data Centre is informed.
- (3) Nothing in this section restricts the power of a Financial Agency to seek the submission of data other than financial regulatory data to any person other than the financial system database, where such data may be required for the purposes of an investigation by such Financial Agency. 10
- (4) Nothing in this section restricts the power of a Financial Agency under law to specify the content and nature of financial regulatory data that must be submitted by a financial service provider. 15
- (5) Nothing in this section prevents a Financial Agency from maintaining a separate database of financial regulatory data that may be transmitted to it by the financial system database.

Access to financial regulatory data by a Financial Agency or Central Government.

- 310. (1) The Council must enter into a memorandum of understanding with a Financial Agency that seeks the submission of regulatory financial data, or the Central Government, as required. 20
- (2) The Council must enter into a memorandum of understanding with a Financial Agency that seeks to share financial regulatory data, or other data, with one or more Financial Agencies. 25
- (3) The memoranda of understanding described under sub-sections (1) and (2) must clearly set out the terms and conditions of access and use by the recipient Financial Agency for such financial regulatory data, or other data.

Access to financial regulatory data by the Council.

- 311. (1) The Council must specify the terms and conditions of the Council's access to the financial system database. 30
- (2) The Council must receive such access to the financial system database as may be required to achieve its objective.

Access to financial regulatory data by the public.

- 312. The Council must, in consultation with relevant Financial Agencies, specify a statement of policy regarding the access to financial regulatory data in the financial system database, by members of the public, which includes - 35
 - (a) the terms and conditions of access to financial regulatory data in the financial system database by members of the public, including the fees payable for such access;
 - (b) the categories of financial regulatory data that may be instantly accessed by members of the public; 40
 - (c) the categories of financial regulatory data that may be accessed by members of the public only after a particular time-period; and

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(d) the categories of financial regulatory data that may never be available for access.

313. (1) Whoever wilfully commits any of the following acts in relation to the financial system database, commits a Class A offence -

Offences in relation to the financial system database.

- 5 (a) without being authorised to do so, accesses or secures access, or denies, or causes a denial of access, to the financial regulatory data in the financial system database;
- 10 (b) without being authorised to do so, downloads, extracts, copies, or reproduces in any form, financial regulatory data in the financial system database;
- (c) knowingly introduces or causes to be introduced, any computer virus or other computer contaminant into the financial system database;
- (d) knowingly damages or causes the damage of any financial regulatory data in the financial system database;
- 15 (e) without authorisation, disrupts or causes disruption to the functioning of the financial system database;
- (f) knowingly damages, destroys, deletes, alters, diminishes in value or utility, or affects by any means, the financial regulatory data in the financial system database; or
- 20 (g) knowingly provides any assistance to any person to do any of the acts mentioned above.

(2) In this section, the expressions "computer contaminant", "computer virus" and "damage" have the meanings respectively assigned to them under section 43 of the Information Technology Act, 2000 (21 of 2000).

CHAPTER 58

OTHER PROVISIONS GOVERNING THE COUNCIL

314. The provisions of section 35 will apply to the Council Board in the following manner -

Decision making in the Council Board.

- 30 (a) all provisions of the section will apply when there is a financial system crisis; and
- (b) where there is no financial system crisis, the Council Chairperson must seek to secure all decisions that the Council is authorised or required to make only by arriving at a consensus.

315. (1) There will be constituted a fund, established and maintained by the Council, to which the following will be credited -

Fund.

- (a) all grants, loans, and fees received by the Council; and
- (b) all sums received by the Council from such other sources as may be decided upon by the Central Government.

(2) The fund will be applied for meeting -

- 40 (c) the salaries, allowances and other remuneration of the members, officers, and employees of the Council;

- (b) the expenses of the Council in performing its functions; and
- (c) any other costs and expenses as may be incurred by the Council in the performance of its functions under this Act.

Annual report.

316. In addition to the requirements under section 77, the Council must submit the following additional information in its annual report –

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- (a) a statement setting out the value of the fund of the Council;
- (b) a statement mentioning the use of the fund by the Council for the previous financial year;
- (c) all significant trends identified in the financial system relevant to the objectives of the Council;
- (d) an assessment of the stability and resilience of the financial system;
- (e) an assessment of the functioning of the Council in relation to India's international obligations, as relevant; and
- (f) any other statement that is necessary to give an accurate assessment of the functioning of the Council.

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PART IX

DEVELOPMENT

CHAPTER 59

OBJECTIVE AND FUNCTIONS

5 317. (1) The Regulator must pursue the objective of fostering the development or improvement of market infrastructure or market process under this Part. Objective.

(2) In this section –

10 (a) “market infrastructure” means an infrastructure that is provided, operated or maintained by the Regulator, the Central Government or an Infrastructure Institution; and

(b) “market process” means a process that is followed by any or all financial service providers.

15 318. The Regulator may, through regulations, adopt any of the following measures to pursue its objectives contained in section 317(1) – Functions.

(a) measures to modernise market infrastructure or market process, including in particular, the adoption of new technology;

(b) measures to provide for product differentiation, or enlarging consumer participation; or

20 (c) measures to align market infrastructure or market process with international best practices.

25 319. (1) The Central Government may notify, by an order in writing, a direction to a Regulator to ensure the provision of any identified financial service, on such conditions as may be contained in the order, – Power of Central Government to direct Regulators for provision of financial service.

(a) by any identified category of financial service providers; or

(b) to any identified consumers or classes of consumers.

(2) The directions under this section must be with a view to ensure effective and affordable access of financial services to persons who would ordinarily not have such access.

30 (3) The Central Government will reimburse the cost of granting such access by providing either cash or cash equivalents, or tax benefits to identified financial service providers.

35 320. The following principles must be taken into account by the Regulator when adopting any measures under section 318, and by the Central Government when issuing any directions under section 319 – Principles.

(a) minimising any potential adverse impact on the objectives of –

(i) the Regulator under Part IV;

(ii) the Regulator under Part V; and

(iii) the Council under Part VIII;

- (b) minimising the adverse impact on the ability of the financial system to achieve an efficient allocation of resources;
- (c) minimising the impact on the ability of consumers to take responsibility for their transactional decisions; and
- (d) ensuring that any obligation imposed on a financial service provider is consistent with the benefits, considered in general terms, that are expected to result from the imposition of that obligation. 5

Need for measures.

321. (1) A Regulator may adopt a measure under section 318 only after it has determined that in the absence of adopting such measure, the market infrastructure or market process will fail to – 10
- (a) develop or improve adequately; or
 - (b) function poorly.
- (2) A Regulator must consult and co-ordinate with every other Regulator on a regular and frequent basis to identify instances where the adoption of such measures may be required or justified, and assess whether such intervention 15 would develop or improve market infrastructure or market process.

CHAPTER 60

PROVISIONS FOR REVIEW

Review of measures and directions.

322. (1) There must be a review of –
- (a) every measure that has been adopted under section 318; and 20
 - (b) every direction that has been issued under section 319.
- (2) A review under this section must be carried out at least once every twelve months after the adoption of the measure, or the issuance of the directions, as the case may be.
- (3) A review under this section must – 25
- (a) examine the efficacy and the impact of the measure or direction under review;
 - (b) estimate the cost of having introduced such a measure or direction in the financial system; and
 - (c) seek to identify best practices and make proposals to the Regulator or the Central Government, as the case may be, for any modifications that may be required in respect of such measure. 30
- (4) The findings of the review must be submitted to the Agency as a report of recommendations.
- (5) There must be no conflict of interest between the team of experts and the Agency under review. 35
- (6) The Agency must ensure that the team of experts has access to relevant information and material as necessary to carry out the review.
- (7) The Agency must publish –
- (a) every review submitted under sub-section (4); and 40

(b) all information or data collected for the purpose of the review in a manner that does not allow information relating to any particular person to be ascertained from it.

5 (8) In this section, "Agency" means the Central Government or the Regulator, as the case may be.

323. A review under section 322 must be arranged -

Obligation to arrange for review of measures and directions.

- 10 (a) by a Regulator if a measure under section 318 is implemented by only that Regulator;
- (b) by the Central Government if a direction under section 319 is issued to not more than one Regulator; or
- (c) by the Council if -
- (i) a measure under section 318 is implemented by more than one Regulator; or
 - (ii) a direction under section 319 is issued to more than one Regulator.

15 324. (1) The Council must collect and analyse all accessible data, and conduct research, that is relevant to the achievement of the objectives under this Act.

Research and analysis by the Council.

(2) The Council must -

- 20 (a) review and analyse the design and implementation of a measure or direction under sections 318 and 319; and
- (b) seek to facilitate co-ordination between the Regulators and identify areas where action needs to be taken by the Regulators to achieve the objectives under this Act, if -
- (i) a measure under section 318 is implemented by more than one Regulator; or
 - (ii) a direction under section 319 is issued to more than one Regulator.

25

(3) The findings of the Council must be -

- (a) submitted to the Central Government and each Regulator; and
- (b) published.

30 325. (1) The Council may call for such information or material as it determines necessary from the Regulator, Central Government, or financial service provider to carry out its functions under this Act.

Collection of information or material by the Council.

(2) The recipient of a request under sub-section (1) is bound to provide the information or material, if available with it, to the Council in a timely manner.

35 (3) The Central Government must prescribe the procedure to be followed by the Council to requisition information under this section.

PART X

RESERVE BANK OF INDIA

CHAPTER 61

OBJECTIVES AND FUNCTIONING OF THE RESERVE BANK

Objectives.	326. The objectives of the Reserve Bank under this Part, are to -	5
	(a) formulate and implement monetary policy; and	
	(b) carry on other activities of a central bank, including -	
	(i) to issue currency of India;	
	(ii) to transact certain business of the Central Government and the State Government, as contained in section 348 and section 349 respectively; and	10
	(iii) to act as banker to banking service providers.	
Capital of the Reserve Bank.	327. (1) The capital of the Reserve Bank may be increased by -	
	(a) payment of additional amounts to the Reserve Bank by the Central Government; and	15
	(b) subscription to additional capital of the Reserve Bank by the Central Government.	
	(2) Any increase in capital of the Reserve Bank must be notified in the Official Gazette.	
Reserve Bank Board.	328. The Reserve Bank Board will -	20
	(a) approve the budget and operating plan of the Reserve Bank; and	
	(b) be responsible for such other matters as provided under this Act, or any other Act.	
Quorum for the meetings of Reserve Bank Board.	329. The quorum of a meeting of the Reserve Bank Board will be at least half of the members of the Reserve Bank Board, at least one of whom must be the Reserve Bank Chairperson, or, in the absence of the Reserve Bank Chairperson, the executive member designated by the Reserve Bank Board to act in such capacity.	25
Advisory council on banking and payment.	330. (1) The Reserve Bank Board will be supported by advisory councils in the following areas -	
	(a) banking; and	30
	(b) payments.	
	(2) The advisory councils on banking and on payments must, in addition to the matters contained in section 49, prepare and submit to the Reserve Bank Board an annual statement on the material developments in their respective fields and recommendations in relation to such developments.	35

CHAPTER 62

MONETARY POLICY FUNCTION

- 5 331. (1) The objectives of the Reserve Bank in the discharge of its monetary policy function must be provided by the Central Government, in consultation with the Reserve Bank Chairperson, by way of a written statement, which identifies and provides -
- Statement on objectives of monetary policy.
- (a) an explanation of the predominant objective of the Reserve Bank in discharge of its monetary policy function; and
 - (b) an explanation of any additional objectives, if relevant, and the order of priority in which the additional objectives must be achieved.
- 10 (2) The statement under sub-section (1) must -
- (a) provide quantified medium-term targets in respect of each objective;
 - (b) enumerate the circumstances under which the Central Government may determine that the Reserve Bank has failed to achieve the provided targets; and
 - (c) elaborate the manner in which the Reserve Bank will communicate to the Central Government -
 - (i) the reasons for its failure to achieve the provided targets under clause (a);
 - (ii) any remedial action proposed to be taken by the Reserve Bank; and
 - (iii) an estimate of the time-period within which the provided targets would be achieved pursuant to such remedial actions.
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- 25 332. (1) The Central Government must issue the statement under section 331 within one week from the day on which this Act comes into force.
- (2) The Central Government must, at least once every two years beginning on the day on which this Part comes into force, review the statement issued under sub-section 331(1), in consultation with the Reserve Bank Chairperson.
- (3) The Central Government must -
- (a) publish the statement under section 331;
 - (b) place a copy of the statement before Parliament; and
 - (c) provide a copy of the statement to the Reserve Bank.
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333. (1) There will be a committee known as the Monetary Policy Committee, which will be responsible for formulating the monetary policy of the Reserve Bank.
- Monetary Policy Committee.
- (2) The Monetary Policy Committee will consist of -
- (a) the Reserve Bank Chairperson, as chairperson of the Monetary Policy Committee;
 - (b) one executive member of the Board of the Reserve Bank, as designated by the Reserve Bank Board;
 - (c) two members, appointed by the Central Government, in consultation with the Reserve Bank Chairperson; and
 - (d) three members appointed by the Central Government.
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- (3) The Central Government may nominate a representative to attend any meeting of the Monetary Policy Committee.

- (4) All members appointed under sub-sections (2)(c) and (2)(d) must possess adequate knowledge and experience in the field of economics or finance which would be relevant for the discharge of the functions of the Monetary Policy Committee.
- (5) A person must not be appointed as a member of the Monetary Policy Committee under sub-sections (2)(c) and (2)(d), if such person -
 - (a) is a member of the Reserve Bank Board or any advisory council of the Reserve Bank;
 - (b) is a public servant; or
 - (c) is a member of Parliament or state legislature.
- (6) The administrative law member of the Reserve Bank Board cannot be appointed to the Monetary Policy Committee under sub-section (2)(b).
- (7) No person may be appointed as a member of the Monetary Policy Committee, if such person -
 - (a) has any financial or other interest that is likely to prejudicially affect their functions as a member of the Monetary Policy Committee; or
 - (b) attracts any of the grounds for removal of members of the Monetary Policy Committee mentioned in the Fifth Schedule.
- (8) The Reserve Bank must, by way of bye-laws, define what constitutes an interest under sub-section (7)(a).

Meetings of the Monetary Policy Committee.

- 334. (1) The Monetary Policy Committee must meet at least every two months during a financial year.
- (2) The meeting schedule of the Monetary Policy Committee for a financial year must be published by the Reserve Bank at least one week before the first meeting in that financial year.
- (3) The meeting schedule may be changed only -
 - (a) by way of a decision taken at a prior meeting of the Monetary Policy Committee; or
 - (b) if, in the opinion of the Reserve Bank Chairperson, a meeting is required and advance intimation has been provided to the members of the Monetary Policy Committee.
- (4) The decision to hold a meeting under sub-section (3)(b) must be published by the Reserve Bank as soon as practicable.
- (5) Prior to every meeting, the members of the Monetary Policy Committee must review -
 - (a) the report issued by the Reserve Bank under section 341(1)(a); and
 - (b) any information which the Monetary Policy Committee has requisitioned and obtained under section 339.

Quorum and decision making.

- 335. (1) The quorum of a meeting of the Monetary Policy Committee will be five members, at least one of whom must be the Reserve Bank Chairperson and in the absence of the Reserve Bank Chairperson, the executive member designated by the Reserve Bank Board to act in such capacity.

- (2) Each member of the Monetary Policy Committee will have one vote.
 - (3) Decisions in a meeting will be taken by a majority of the votes of the members of the Monetary Policy Committee present.
 - (4) The decisions of the Monetary Policy Committee will be binding on the Reserve Bank, unless such decision has been superseded by the Reserve Bank Chairperson under 336.
336. (1) In exceptional and unusual circumstances, if the Reserve Bank Chairperson disagrees with a decision taken at a meeting of the Monetary Policy Committee, the Reserve Bank Chairperson will have the right to supersede such decision.
- (2) The right under sub-section (1) will not be available to any person chairing the meetings of the Monetary Policy Committee, in place of the Reserve Bank Chairperson during the absence of the Reserve Bank Chairperson.
- (3) If the Reserve Bank Chairperson exercises the right under sub-section (1), an explanatory statement must be -
- (a) submitted by the Reserve Bank Chairperson to the Central Government on the same day when the meeting where such right was exercised is held; and
 - (b) published along with the minutes of the meeting in which the right has been exercised by the Reserve Bank Chairperson.
- (4) The statement under sub-section (3) must include -
- (a) the details of the decision of the Monetary Policy Committee which has been superseded; and
 - (b) the reasons resulting in the exercise of the right under this section.
337. The Monetary Policy Committee must ensure that the Reserve Bank publishes the decisions taken at the meeting of the Monetary Policy Committee on the day on which such decision is taken.
338. (1) The Monetary Policy Committee must ensure that the Reserve Bank publishes the minutes of the meetings of the Monetary Policy Committee within three weeks after each meeting.
- (2) Minutes of the meeting must record, in relation to every decision of the Monetary Policy Committee, the voting preference and reasons for voting of each member of the Monetary Policy Committee, present in such meeting.
339. (1) The Monetary Policy Committee may, by a statement in writing, require the Reserve Bank to provide such information that the Monetary Policy Committee considers necessary or expedient to discharge its duties under this Chapter.
- (2) The statement must indicate -
- (a) the form or manner in which the information must be provided;
 - (b) the time within which the information must be provided;
 - (c) the entities, if any, in relation to which the information must be provided; and
 - (d) the period in relation to which information must be provided.

Right of Reserve Bank Chairperson to supersede decision of Monetary Policy Committee.

Publication of decisions.

Publication of minutes.

Power to obtain information.

- (3) If the Monetary Policy Committee requires information relating to a individual financial service provider, it must obtain the approval of the Reserve Bank Board before obtaining such information.

Power of the Reserve Bank Board to make bye-laws for procedure of Monetary Policy Committee.

- 340. The Reserve Bank Board must make bye-laws in relation to the procedures of the Monetary Policy Committee, including -
 - (a) the manner of publication of schedule of meetings under section 334(2);
 - (b) the manner of publication of decisions under section 337;
 - (c) the manner of publication of minutes of meetings under section 338;
 - (d) process for requisitioning information from the Reserve Bank under section 339 and the process for obtaining the approval of the Reserve Bank Board under sub-section 339(3);
 - (e) the manner and process of recording and counting of votes at the meeting;
 - (f) conduct of meetings, including provision for meetings to be held without the physical presence of a member;
 - (g) the manner of noting of minutes of the meetings; and
 - (h) any other matters in relation to activities of the Monetary Policy Committee.

Reports in relation to monetary policy.

- 341. (1) The Reserve Bank must -
 - (a) submit a report to the Monetary Policy Committee, at least three days prior to each meeting of the Monetary Policy Committee, containing information relevant to the decisions to be made by the Monetary Policy Committee in that meeting; and
 - (b) publish a quarterly report containing -
 - (i) a review of the monetary policy decisions published by the Reserve Bank during such quarter;
 - (ii) an assessment of the developments in relation to monetary policy in the economy during the period to which the report relates; and
 - (iii) an indication of the approach which may be adopted by the Reserve Bank to meet its objectives in relation to monetary policy.
- (2) A report submitted to the Monetary Policy Committee under sub-section (1)(a) must be published simultaneously with the submission of the report to the Monetary Policy Committee.
- (3) Any report under sub-section (1)(b) must be published after approval of the Monetary Policy Committee.

Reserve power of the Central Government.

- 342. (1) The Central Government may provide a recommendation in writing, on monetary policy, to the Reserve Bank, if it is satisfied that such recommendation is required on account of extreme economic circumstances.
- (2) Upon the receipt of a recommendation from the Central Government under sub-section (1), the Reserve Bank Chairperson must provide a copy of such recommendation to the Monetary Policy Committee as soon as possible and at any rate, prior to the first meeting of the Monetary Policy Committee which is to be held after the date of receipt of such recommendation.

- (3) The Monetary Policy Committee must consider the recommendation of the Central Government provided under sub-section (1) in the first meeting of the Monetary Policy Committee held after the date of receipt of such recommendation.
- (4) If the Monetary Policy Committee rejects the recommendation of the Central Government wholly or substantially, the Central Government may, by an order in writing, direct the Reserve Bank on matters with respect to monetary policy.
- (5) The order under sub-section (4) -
- (a) may be issued only after consultation with the Reserve Bank Chairperson;
 - (b) must be laid before both Houses of Parliament for approval; and
 - (c) will cease to have effect at the end of the following period, whichever is earlier -
 - (i) twenty-eight days from the date on which the order is made, unless it is approved by a resolution of each House of Parliament before the end of that period, in accordance with sub-section (6); or
 - (ii) ninety days from the date on which the order is made.
- (6) In calculating the period of twenty eight days for the purposes of sub-section (5)(c)(i), no account is to be taken of any time during which Parliament is dissolved or prorogued or during which either House of Parliament is adjourned for a continuous period of more than four days.
- (7) Any objectives provided to the Reserve Bank by the Central Government under section 331 will not have effect while an order under sub-section (4) is in force.

CHAPTER 63

OTHER CENTRAL BANK POWERS

- 25 343. (1) The Reserve Bank has such powers as are necessary to carry out its functions as a central bank under this Act.
- (2) Powers under sub-section (1) include the power to -
- (a) receive money on deposit and pay interest on the deposits;
 - (b) purchase, sell, discount and rediscount bills of exchange, promissory notes and treasury bills;
 - (c) purchase and sell government securities;
 - (d) hold, purchase and sell securities issued by foreign countries;
 - (e) maintain deposits with other banks, including foreign banks;
 - (f) purchase and sell special drawing rights issued by the International Monetary Fund;
 - (g) purchase, sell and otherwise deal in gold, specie and other precious metals;
 - (h) establish credits and give guarantees;
 - (i) open accounts in a central bank in any other country or in the Bank for International Settlements or any other international or regional bank, and to act as agent or mandatory or depository or correspondent for any of those banks or organisations and pay interest on any of those deposits;
 - (j) issue bills and drafts and effect transfers of money; and

General powers of the Reserve Bank.

(k) acquire, hold, lease or dispose immovable property.

(3) In this section "International Monetary Fund" has the meaning assigned to it under the International Monetary Fund and Bank Act, 1945 (47 of 1945).

Business which the Reserve Bank may not transact.

- 344. (1) Unless the Reserve Bank, in the pursuit of its objectives under this Part is acting in accordance with its powers, it must not –
 - (a) engage in trade or otherwise have a direct interest in any commercial, industrial, or other undertaking, other than where such interest has been acquired for the satisfaction of any of its claims;
 - (b) purchase any capital, including any shares of any banking service provider, or, of any other person, or grant loans against such capital or shares; or
 - (c) advance money on the mortgage of, or otherwise against the collateral of, immovable property or documents of title relating to such immovable property, or become the owner of immovable property.
- (2) Any interest of the nature under sub-section (1)(b), acquired by the Reserve Bank for the satisfaction of its claims, will be disposed of at the earliest.
- (3) The provisions of sub-section (1)(c) will not prevent the Reserve Bank from acquiring or holding property necessary for its business or residential premises for its use.

Temporary liquidity assistance.

- 345. (1) The Reserve Bank may provide short-term funds against adequate collateral to system participants for which the Reserve Bank directly operates payment systems, in order to meet a shortage of funds of such system participants.
- (2) The Reserve Bank must make regulations to provide for –
 - (a) the procedure for availing assistance under sub-section (1); and
 - (b) the manner in which relevant information in relation to the utilisation of assistance under this section, will be shared with relevant Financial Agency for regulatory purposes.
- (3) In this section, short-term means overnight or any such other period as may be notified by the Reserve Bank for the purpose of this section.

Emergency liquidity assistance.

- 346. (1) The Reserve Bank may provide liquidity assistance against adequate collateral to a financial service provider or, a class of financial service providers, in case of shortage of funds, including where such shortage arises on account of severe or unusual stress in the financial system.
- (2) The Reserve Bank must make regulations to provide for –
 - (a) the nature of collateral to be provided by a financial service provider to avail liquidity assistance under this section; and
 - (b) additional criteria to receive assistance under this section.
- (3) Prior to extending assistance under this section, the Reserve Bank must consult –
 - (a) the relevant Regulator, when assistance is sought to be provided to a financial service provider not regulated by the Reserve Bank under Part V; and

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- (b) the Corporation, when assistance is sought to be provided to a covered service provider.
 - (4) The Reserve Bank must make a determination with regard to the matters under sub-section (2) prior to extending assistance to a financial service provider under this section.
 - (5) No person will have recourse to the Tribunal against the determination made by the Reserve Bank under sub-section (4).
 - (6) The Reserve Bank must make regulations to provide for -
 - (a) the procedure to be followed by a financial service provider for availing liquidity assistance under sub-section (1); and
 - (b) the manner in which relevant information in relation to the utilisation of assistance under this section, will be shared with relevant Financial Agency for regulatory purposes.
 - (7) The Reserve Bank will be guided by the following principles while extending liquidity assistance under this section -
 - (a) confidentiality regarding the use of this assistance by financial service providers; and
 - (b) expediency in making a decision to extend assistance under this section.
347. (1) In order to reduce risks relating to payments and settlement, arising from the failure of identified financial service providers, the Reserve Bank must maintain a real time gross settlement system for transferring payments of funds.
- Payment system of the Reserve Bank.
- (2) In this section -
 - (a) "the payment system" means the real time gross settlement system under sub-section (1); and
 - (b) "identified financial service providers" means -
 - (i) banking service providers;
 - (ii) Infrastructure Institutions which provide clearing and settlement services and have been designated Systemically Important Financial Institutions by the Council; and
 - (iii) any other financial service provider notified by the Central Government, in consultation with the Reserve Bank.
 - (3) The Reserve Bank must make regulations governing -
 - (a) the mode of operation of the payment system;
 - (b) the conditions under which the access to the payment system may be withdrawn; and
 - (c) all other issues connected or related to the payment system.
 - (4) If access of an identified financial service provider to the payment system is withdrawn under sub-section (3)(b), then the Regulator must cancel the authorisation of such identified financial service provider to act as a banking service provider; or, to act as an Infrastructure Institution which provides clearing and settlement services, where -
 - (a) if the Reserve Bank proposes to withdraw the access to the payment system, it must issue a show cause notice to the identified financial service provider; and

(b) if the Reserve Bank proceeds to withdraw the access to the payment system, it must issue a decision order to the identified financial service provider.

(5) The payment system will be an Infrastructure Institution for the purposes of section 193 and no other provision of this Act will apply to the payment systems. 5

Business of the Central Government.

34B. (1) The Central Government must -

- (a) entrust the Reserve Bank with all its money, remittance, exchange and banking transactions in India; and
- (b) deposit, free of interest, all its cash balances with the Reserve Bank. 10

(2) The Reserve Bank will accept monies on account of the Central Government and will make payments up to the amount standing to the credit of its account.

(3) The Reserve Bank will carry out exchange, remittance and other banking operations for the Central Government.

(4) All actions under sub-section (1) will be in accordance with the conditions agreed between the Reserve Bank and the Central Government. 15

(5) Any agreement under sub-section (4) will be laid before Parliament, as soon as practicable and must be published by the Reserve Bank.

(6) Sub-section (1) does not prevent Central Government from carrying on money transactions or holding requisite balances at places where the Reserve Bank has no branches or agencies. 20

(7) The Reserve Bank will include a description of the business of Central Government carried on by the Reserve Bank in its annual report.

Business of State Governments.

349. (1) The Reserve Bank, by agreement with a State Government, may -

- (a) undertake all the money, remittance, exchange and banking transactions in India of such State; and
- (b) maintain the deposit of all cash balances of the State with itself, free of interest. 25

(2) Any agreement under sub-section (1) will be laid before Parliament, as soon as practicable and must be published. 30

(3) The Reserve Bank must include details of the business of State Governments carried on by the Reserve Bank in its annual report.

Right to issue bank notes.

350. (1) The Reserve Bank will have the sole right to issue bank notes in India.

(2) Every bank note issued by the Reserve Bank will be legal tender at any place in India in payment or on account for the amount expressed on it, and will be guaranteed by the Central Government. 35

(3) The Reserve Bank, after considering the recommendations of the Central Government, must notify -

- (a) the denomination value of the bank notes to be issued by the Reserve Bank; and
- (b) the form, design and material of the bank notes. 40

- (4) The Central Government, on the recommendation of the Reserve Bank, may by notification, direct -
- (a) the non-issue, or discontinuance of issue, of bank notes of certain denominational values; or
 - (b) that any series of bank notes of any denomination will cease to be legal tender in accordance with the conditions mentioned in the notification.
- (5) The Reserve Bank will not reissue bank notes, which in its opinion are torn, defaced or excessively soiled.
- (6) No person will have the right to recover from the Central Government, or, the Reserve Bank, the value of any lost, stolen, mutilated or imperfect bank note.
- (7) The Reserve Bank, with the sanction of the Central Government, may by notification, provide conditions under which value of a note described under sub-section (6) may be refunded as of grace.
- (8) The Reserve Bank will not be liable for the payment of any stamp duty under the Indian Stamp Act, 1899 (2 of 1899), in respect of bank notes issued by it.
351. (1) The Reserve Bank will issue bank notes through a separate and wholly distinct department called the Issue Department. Issue Department.
- (2) The aggregate assets of the Issue Department must be an amount not less than the total liabilities of the Issue Department.
- (3) The Reserve Bank, in consultation with the Central Government, must make bye-laws in relation to the nature, minimum value and other aspects relating to the assets of the Issue Department.
- (4) The assets of the Issue Department will not be subject to any liability other than the liabilities of the Issue Department.
- (5) The liabilities of the Issue Department will be an amount equal to the total bank notes in circulation at that point of time.
- (6) The Issue Department will not issue bank notes to any person except in exchange for other bank notes or for such coin, bullion or securities as may be notified by the Reserve Bank in this regard.
352. (1) The Central Government will not put into circulation any rupee coins, except through the Reserve Bank. Issue of rupee coins.
- (2) The Reserve Bank will not dispose of rupee coins otherwise than for the purposes of circulation.
- (3) The Reserve Bank will, in exchange for bank notes, supply notes of lower value and rupee coins in such quantities, which in the opinion of the Reserve Bank, are required for circulation.
- (4) The Central Government will supply coins to the Reserve Bank on demand for the purpose of supply under sub-section (3).
- (5) If the Central Government fails to supply coins upon demand by the Reserve Bank, the Reserve Bank will be released from the obligation under sub-section (3).

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Obligation to supply different forms of currency.

353. The Reserve Bank will issue rupee coins on demand in exchange for bank notes and will issue bank notes on demand in exchange for coins which is legal tender under the Indian Coinage Act, 2011 (11 of 2011).

Issue of demand bills and notes.

354. (1) No person, other than the Reserve Bank, or, the Central Government, where expressly authorised, will – 5

- (a) draw, accept, make or issue any bill of exchange, hundi, promissory note or engagement for the payment of money payable to bearer on demand;
- (b) borrow, owe or take up any sum or sums of money on the bills, hundis or notes payable to bearer on demand of any such person; or
- (c) make or issue any promissory note expressed to be payable to the bearer of the instrument. 10

(2) Sub-section (1) does not prevent any cheque or drafts, including hundis, which may be payable to the bearer on demand, to be drawn on a person's account with a banker, shroff or agent.

(3) In this section, the phrases "bill of exchange", "promissory note", "cheque", "draft" and "banker" have the meaning assigned to them under the Negotiable Instruments Act, 1881 (26 of 1881). 15

Power of Reserve Bank to obtain information.

355. (1) The Reserve Bank must specify the procedure for the Reserve Bank to obtain information relevant for its functions under this Part.

(2) A person must comply with a request for providing information issued under sub-section (1) and provide the required information or documents, in its possession or power, to the Reserve Bank. 20

CHAPTER 64

ACCOUNTS OF THE RESERVE BANK

Statement of assets and liabilities.

356. (1) The Reserve Bank must prepare and publish a statement of its assets and liabilities on a weekly basis. 25

(2) The statement must relate to assets and liabilities as at the close of business of the day on which such statement is prepared.

(3) If a day on which a statement is to be prepared is a holiday, as notified by the Central Government, then the statement must be prepared and published on the last business day preceding that day. 30

(4) A copy of the statement must be submitted to the Central Government.

Allocation of surplus profits.

357. (1) The Reserve Bank Board must maintain a policy in relation to the payment of surplus profits to the Central Government.

(2) In accordance with its policy, the Reserve Bank must pay profits held by it to the Central Government, after making adequate provisions for – 35

- (a) reserves to meet future contingencies; and
- (b) bad and doubtful debts, depreciation in assets, contributions to staff and superannuation funds and for all other matters for which provision are usually provided for by a banking service provider. 40

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Part X: 65. OTHER PROVISIONS IN RELATION TO THE RESERVE BANK

- (3) The Reserve Bank must publish the policy issued under sub-section (1) and any modifications made to such policy from time to time.
- (4) The annual financial statements prepared by the Reserve Bank must clearly explain the provisions made by the Reserve Bank, along with the reasons for every provision.

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CHAPTER 65

OTHER PROVISIONS IN RELATION TO THE RESERVE BANK

- 35B. The Reserve Bank's obligation to comply with the provisions relating to the manner of publication of information as contained in Part III, does not release the Reserve Bank from the obligation to comply with a higher standard of publication, if provided elsewhere under this Act or any other law.

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Manner of
publication of
information.

PART XI

CAPITAL CONTROLS

CHAPTER 66

OBJECTIVES AND PRINCIPLES

Objectives.

- 359. (1) The functions and powers under this Part must be discharged and exercised by the competent authority with the objectives of –
 - (a) facilitating capital account transactions in a manner that encourages investment and economic growth in India;
 - (b) managing adverse short-term fluctuations in balance of international payments; and
 - (c) ensuring review of capital account transactions that could affect national security.
- (2) In this Part, "competent authority" means –
 - (a) the Central Government for making rules under this Part; or
 - (b) the Reserve Bank for making regulations under this Part.

Principles.

- 360. The following principles must be taken into consideration while discharging functions and exercising powers by the competent authority under this Part –
 - (a) similar investments made by residents and non-residents in India must be treated similarly, to the extent practicable;
 - (b) investment restrictions must be so designed that the benefits of policies relating to capital account transactions outweigh the potential impact of such restrictions;
 - (c) investment measures must be tailored to the particular risks posed by particular investment proposals; and
 - (d) policies that restrict capital account transactions on national security considerations must be used only when other policies cannot be used to eliminate such national security considerations.

CHAPTER 67

SCOPE AND CERTAIN OTHER MATTERS

Scope.

- 361. (1) Cross-border trade in goods, services, payment transactions or other current account transactions are not subject to any restrictions, conditions or prohibitions under this Part.
- (2) Capital account transactions are subject to restrictions, conditions or prohibitions, if any, contained in this Part, or as may be prescribed or specified under this Part.

Emergency circumstances.

- 362. The following circumstances or conditions will be considered emergency circumstances or conditions under this Part –
 - (a) the outbreak of a natural calamity in India;

- (b) grave and sudden changes in domestic economic conditions;
- (c) grave and sudden changes in foreign economic conditions;
- (d) if international payments and international finance are facing or expected to face serious difficulties;
- 5 (e) the proclamation of national emergency under Article 352 of the Constitution of India; or
- (f) the proclamation of financial emergency under Article 360 of the Constitution of India.

CHAPTER 68

10 INWARD FLOWS

363. (1) For carrying out the purposes of this Part, the Central Government will make rules in accordance with this Chapter in relation to inward flows. Power to make rules.
- (2) The Central Government must prescribe criteria that qualified foreign investors must meet.
- 15 (3) The Central Government may prescribe -
- (a) the prohibition of one or more classes of inward flows; or
 - (b) procedures, conditions, limits, restrictions or approval requirements in relation to -
 - (i) any class or classes of inward flows;
 - 20 (ii) the acquisition or transfer of immovable property situated in India, by a qualified foreign investor;
 - (iii) any borrowing by a resident from a non-resident; or
 - (iv) the giving of any guarantee or surety in respect of any borrowing, obligation or other liability, by a non-resident.
- 25 364. (1) Nothing contained in section 63 will apply to rule-making by the Central Government under this Part. Rule making process.
- (2) The Central Government may make rules for the implementation of this Part and must consult the Reserve Bank before making draft rules under this section.
- 30 (3) The consultation with the Reserve Bank must relate to -
- (a) the problem to be addressed and the goals sought to be achieved as well as the alternatives available for addressing the problem or achieving the goals;
 - (b) the economic rationale, including the expected benefits and likely costs; and
 - 35 (c) the effect on investment climate, efficiency, and balance of payments.
- (4) Subsequent to consultations with the Reserve Bank, the Central Government must make rules in accordance with the process contained in section 52.
- 40 365. (1) Unless provided otherwise, nothing contained in Chapter 13 will apply to emergency rules made under this Part. Emergency rule making.

- (2) The Central Government may make rules in accordance with this section, in any circumstance or condition contained in section 362 without complying with the process contained in section 364.
- (3) If any condition or circumstance contained in section 362 exists, the Central Government must consult the Reserve Bank prior to making rules under this section, within fifteen days from the day on which a condition or circumstance was determined by the Central Government to be an emergency condition or circumstance. 5
- (4) Upon consultation with the Reserve Bank, the Central Government may make rules, temporarily suspending - 10
 - (a) any payments or receipts on account of any inward flow, or the whole or a part of any inward flow;
 - (b) borrowings from any non-resident; or
 - (c) any payment to non-resident or mandating prior approval or safe-keeping of part of any funds borrowed from any non-resident. 15
- (5) The rules made under this section must be accompanied by the documents contained in sections 52(2)(a) to 52(2)(d).
- (6) The rules made under this section must be laid before the Parliament.
- (7) Unless withdrawn earlier, the rules made under this section will cease to be in force on the expiry of ninety days from the date on which the rules come into effect. 20
- (8) If the Central Government determines that the rules made under this section are required to be in force for a period of more than ninety days, it must make the rules by following the procedure contained in section 364.

CHAPTER 69

25

OUTWARD FLOWS

Power to make regulations.

- 366. (1) For carrying out the purposes of this Part, the Reserve Bank will make regulations in accordance with this Chapter in relation to outward flows.
- (2) The Reserve Bank may specify procedures, conditions, limits, restrictions or approval requirements in relation to - 30
 - (a) any class or classes of outward flows;
 - (b) the acquisition or transfer of immovable property situated outside India, by a resident;
 - (c) any borrowing by a non-resident from a resident; or
 - (d) the giving of any guarantee or surety in respect of any borrowing, obligation or other liability, by a resident to a non-resident. 35

Process for making regulations.

- 367. (1) The Reserve Bank must consult the Central Government before making draft regulations under this section.
- (2) The consultation with the Central Government must relate to the matters contained in section 364(3). 40

368. (1) Unless provided otherwise, nothing contained in section 53 will apply to emergency regulations made under this Part. Emergency regulation making.
- (2) The Reserve Bank may make regulations in accordance with this section, in any of the circumstances or conditions contained in section 362 without complying with the process contained in section 367.
- (3) If any condition or circumstance contained in section 362 exists, the Reserve Bank must consult the Central Government prior to making regulations under this section, within fifteen days from the day on which a condition or circumstance was determined by the Reserve Bank to be an emergency condition or circumstance.
- (4) Upon consultation with the Central Government, the Reserve Bank may make regulations temporarily suspending -
- (a) any payments or receipts on account of any outward flow, or the whole or a part of any outward flow; or
- (b) borrowings by any non-resident from any resident.
- (5) The regulations made under this section must be accompanied by the documents contained in sections 52(2)(a) to 52(2)(d).
- (6) The regulations made under this section must be laid before the Parliament.
- (7) Unless withdrawn earlier, the regulations made under this section will cease to be in force on expiry of ninety days from the date on which the regulations come into effect.
- (8) If the Reserve Bank determines that the regulations made under this section are required to be in force for a period of more than ninety days, it must make the regulations by following the procedure contained in section 367.

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CHAPTER 70

AUTHORISED DEALERS

369. (1) The Reserve Bank must specify the conditions or requirements to be satisfied by an authorised dealer. General.
- (2) The regulations must -
- (a) be neutral to the legal structure of a person; and
- (b) allow any person meeting the conditions or requirements to act as an authorised dealer.
- (3) The regulations may require any person to obtain authorisation from the Reserve Bank to act as authorised dealer.
370. (1) Only authorised dealers may, for capital account transactions, - Dealing in foreign exchange for capital account transactions.
- (a) deal in or transfer any foreign exchange to any person; or
- (b) receive, in any manner, any payment by order or on behalf of any non-resident.

- (2) Any person may sell or draw foreign exchange for a capital account transaction, to or from an authorised dealer, in accordance with the provisions of this Part or as may be specified.

Undertaking of transactions by authorised dealers.

371. (1) Prior to undertaking a transaction on behalf of any person, an authorised dealer must be reasonably satisfied that the transaction -
- (a) is genuine;
 - (b) will not involve a contravention of the provisions of this Part or rules or regulations made under this Part; and
 - (c) is not designed to contravene or evade provisions of this Part or rules or regulations made under this Part.
- (2) In order to be reasonably satisfied, the authorised dealer -
- (a) must review and verify the documents and declarations made;
 - (b) must ensure compliance with provisions of this Part and the rules or regulations made under this Part; and
 - (c) may require any person on behalf of whom the transaction is to be undertaken, to make declarations and provide information as the authorised dealer may reasonably require under the circumstances.
- (3) The authorised dealer must refuse, in writing, to undertake a transaction if it determines that a person refuses to comply, or unsatisfactorily complies, with any requirement of the authorised dealer contained in sub-section (2)(c).
- (4) Any person aggrieved by a refusal of the authorised dealer under sub-section (3) may file a complaint, in such manner as may be specified, with the Reserve Bank.
- (5) If the authorised dealer has a reason to believe that any contravention or evasion of this Part or rules or regulations made under this Part is contemplated under sub-section (3), it should report the matter to the Reserve Bank, as soon as possible.

CHAPTER 71

NATIONAL SECURITY AND REVIEW

Capital account transactions affecting national security.

372. (1) A capital account transaction affects national security if it involves any of the following -
- (a) ownership of critical infrastructure by a foreign investor;
 - (b) ownership of critical technologies by a foreign investor;
 - (c) control or ownership of assets in India by a foreign government;
 - (d) a non-resident or a foreign government -
 - (i) which presents a threat to the peaceful existence of India with other nations; or
 - (ii) which presents a threat, or a major disruption, to foreign relations of India; or
 - (e) any other matter as may be prescribed or specified, as the case may be.
- (2) In this section -

- (a) "critical infrastructure" means systems and assets, whether physical or virtual, so vital to India that the incapacity or destruction of such systems or assets would have a debilitating impact on the Indian economy; and
 - (b) "critical technologies" means technology, critical components, or items essential to national defence.
- 5
373. (1) Any person who has received a decision order or any approval order from the Central Government may apply to the senior officer of the Central Government for review of such order, within fourteen days from the date of receipt of such order.
- 10
- (2) If the senior officer finds that there is an apparent error in the order, the senior officer may amend or set aside such order.
- (3) The senior officer must convey its decision within a period of one month from the receipt of the application under sub-section (1).
- (4) The senior officer must give a reasoned decision.
- 15
- (5) An appeal from the order of the senior officer will lie to the Tribunal.
- (6) In this section, "senior officer" means an officer of the Central Government not below the rank of Secretary to the Government of India, having the competence necessary for dealing with applications under Chapter 14, and designated by the Central Government to act as senior officer for the purpose of this Part.
- 20
- (7) An administrative law member reviewing the order of the Reserve Bank in relation to this Part, under section 403, must follow the procedure contained in this section.
- Review by senior officers.

CHAPTER 72

ANNUAL REPDRTS AND MISCELLANEOUS

- 25 374. (1) The Central Government must publish an annual report within ninety days of the expiry of the year for which the report relates to.
- Annual report of the Central Government.
- (2) The annual report must contain -
- (a) the rules and amendments to rules made by the Central Government under this Part;
 - 30 (b) a summary of cost-benefit analysis for the rules made by the Central Government under this Part;
 - (c) an analysis of each inward flow affecting national security, including the nature of the acquisitions and potential impact on critical infrastructure or critical technologies;
 - 35 (d) an analysis of effectiveness of the rules made by the Central Government under this Part; and
 - (e) such other matters as are necessary to give a complete disclosure and analysis of the performance of functions by the Central Government under this Part.
- 40 (3) In addition to the annual report under sub-section (1), the Central Government must publish a table showing -
- (a) by sector, product and country of foreign ownership, the number of acquisitions reviewed by the Central Government;

- (b) the total number of approvals granted by the Central Government;
- (c) the total number of applications rejected by the Central Government;
- (d) the total number of decisions along with a summary of decisions of the senior officer;
- (e) the total number of decisions of the senior officer upheld by the Tribunal along with a summary of such decisions of the Tribunal; and 5
- (f) the total number of decisions of the senior officer struck down by the Tribunal along with a summary of such decisions of the Tribunal.

Annual report of the Reserve Bank.

375. (1) In addition to the requirements contained in section 77, the annual report of the Reserve Bank must contain - 10

- (a) the regulations and amendments to regulations made by the Reserve Bank under this Part;
- (b) a summary of cost-benefit analysis for the regulations made by the Reserve Bank under this Part;
- (c) an analysis of each outward flow affecting national security; 15
- (d) an analysis of effectiveness of the regulations made by the Reserve Bank under this Part; and
- (e) such other matters as are necessary to give a complete disclosure and analysis of the performance of functions by the Reserve Bank under this Part. 20

(2) In addition to the annual report under sub-section (1), the Reserve Bank must publish a table showing -

- (a) by sector and product, the number of acquisitions reviewed by the Reserve Bank;
- (b) the total number of approvals granted by the Reserve Bank under this Part; 25
- (c) the total number of applications rejected by the Reserve Bank in this Part;
- (d) the total number of investigations conducted the Reserve Bank in this Part;
- (e) the total number of decisions along with a summary of decisions of the administrative law member of the Reserve Bank under this Part; 30
- (f) the total number of decisions of the administrative law member of the Reserve Bank under this Part upheld by the Tribunal along with a summary of such decisions of the Tribunal; and
- (g) the total number of decisions of the administrative law member of the Reserve Bank under this Part struck down by the Tribunal along with a summary of such decisions of the Tribunal. 35

Modifications of certain sections of this Act.

376. (1) For the purposes of the applicability of this Part, the provisions of certain sections in this Act will be modified to the extent provided in this section.

(2) The obligation on Financial Agencies in relation to review of regulations contained in section 59 will also be applicable to the Central Government for the rules made by it under this Part. 40

(3) All references to "Financial Agency" contained in Chapter 14 will be replaced with "competent authority".

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- (4) All references to "financial service provider" contained in Chapters 15 and 77 will be replaced with "authorised dealer or any person involved in a capital account transaction".
- (5) The words "or any rules made by the Central Government under Part XI" will be added after -
- (a) the word "Agency" contained in section 58(1); and
 - (b) the word "regulations" contained in sections 58(1)(c), 58(1)(e), 58(1)(f), 58(2), 426(4)(a) and 394(f).
- (6) The following clause will be added in section 58 -
- (a) the conditions contained in section 362 did not exist for rules or regulations, as the case may be, made under that section.
- (7) The word ", rules" will be added after the word "regulations" contained in section 436(1)(b).
- (8) The words "or prescribed" will be added after the word "specified" contained in section 68(1).
- (9) The following sub-section will be added after section 70(10) -
- (a) In relation to the applications made under Part XI, the requirement to give show cause notice contained in sub-section 70(7) will not apply if the competent authority provides in the decision order or the approval order, as the case may be, that such order is in the interest of national security considerations contained in section 372.
- (10) The following sub-section will be added after section 71(2) -
- (a) If the competent authority proposes to cancel any approval granted by it under Part XI, other than the approvals granted under Chapter 70, it must
 - (i) take into account the investment protection agreement entered into between the Central Government and the government of the country of which the non-resident is resident, if any;
 - (ii) provide for adequate compensation to the non-resident, or the resident, as the case may be; and
 - (iii) provide for reasonable time-period to divest to the non-resident or the resident, as the case may be.
- (11) The following sub-section will be added after section 394(1) -
- (a) Where the Central Government has information or reasonable grounds to suspect that any authorised dealer or any person involved in a capital account transaction is violating or has violated any provision of any law or rules made under Part XI, or any condition of any approval granted by the Central Government, the Central Government must share such information on the basis of such grounds, as the case may be, with the Reserve Bank and the Reserve Bank must investigate such authorised dealer or person involved in a capital account transaction.
- (12) The words "approval order under Part XI" will be added after the words "decision order" in section 403.
- (13) The following clause will be added after section 407(3)(c) -

(a) condition of any approval order granted by the competent authority under Part XI.

(14) The following sub-section will be added after section 407(3) -

(a) In relation to Part XI, enforcement action includes -

- (i) direction for reversal of transaction; 5
- (ii) direction to the qualified foreign investor to divest itself of control or of its investment in or transactions with the resident;
- (iii) direction to the resident to divest itself of control or of its investment in or transactions with the non-resident;
- (iv) declaration of annulment of transaction; 10
- (v) direction for amendment of the structure of the transaction; or
- (vi) direction to authorised dealer to undertake a transaction.

(15) The following sub-section will be added after section 408(3) -

(a) In addition to the factors contained in sub-section 408(2), the Reserve Bank must take into account the investment protection agreement entered into between the Central Government and the government of the country of which the non-resident is resident, if any. 15

PART XII

PUBLIC DEBT MANAGEMENT AGENCY

CHAPTER 73

OBJECTIVE AND FUNCTIONING OF THE DEBT AGENCY

5 377. The Debt Agency has the objective of minimising the cost of raising and servicing public debt over the long-term within an acceptable level of risk at all times, under the general superintendence of the Central Government, as provided by this Part.

Objective.

378. (1) There will be a Debt Agency Advisory Council to advise the Debt Agency Management Committee under this Part.

Establishment of the Debt Agency advisory Council.

10 (2) The functioning of this advisory council will be in accordance with Chapter 12, other than in the aspects provided here.

(3) The Debt Agency Advisory Council will comprise -

(a) a member designated as chairperson;

15 (b) an officer of the Central Government higher than the rank of its officer in the Debt Agency Management Committee as member;

(c) an officer of the Reserve Bank higher than the rank of its officer in the Debt Agency Management Committee as member;

(d) four experts as members; and

(e) the Debt Agency Chief Executive as member.

20 (4) The members of the Debt Agency Advisory Council will be appointed by the Central Government.

(5) The members of the Debt Agency Advisory Council cannot be the same as the members of the Debt Agency Management Committee, except for the Debt Agency Chief Executive.

25 (6) Members of the Debt Agency Advisory Council must be persons who have shown capacity in dealing with problems relating to public debt, public finance or financial markets, or have knowledge and experience of accountancy, economics, finance or law.

30 (7) The Debt Agency Advisory Council must meet at least once in a quarter to review the borrowing programme for the upcoming quarter, and as and when it is called upon by the Debt Agency Management Committee to provide an opinion on any matter under this Part.

379. (1) The Debt Agency Advisory Council must provide its opinion on any matter referred to it by the Debt Agency Management Committee.

Functions of the Debt Agency Advisory Council.

35 (2) The Debt Agency Advisory Council may provide its opinion on any activity of the Debt Agency as it finds relevant.

(3) The Debt Agency Advisory Council must advise the Debt Agency Management Committee to disseminate information relating its functions to the public in a transparent, accountable and timely manner.

CHAPTER 74

FUNCTIONS OF THE DEBT AGENCY

Functions.

380. The Debt Agency will –

- (a) manage the public debt, cash and contingent liabilities of the Central Government; and
- (b) undertake other activities incidental to the functions under this section.

5

Public debt management.

381. (1) The Debt Agency must manage the public debt, in accordance with this Part, and any rules made thereunder.

(2) The Debt Agency must submit a draft annual public debt plan, in such form as may be prescribed, for the following financial year, to the Central Government, not later than 1st January of each year.

10

(3) Before the draft annual public debt plan is submitted to the Central Government, the Debt Agency must –

- (a) seek the opinion of the Debt Agency Advisory Council under section 379(1); and
- (b) if the Debt Agency disagrees with the opinion of the Debt Agency Advisory Council, publish a written opinion explaining why it so disagrees.

15

(4) The draft annual public debt plan must take into account –

- (a) the opinion of the Debt Agency Advisory Council under section 379(1);
- (b) the current public debt portfolio, including inherent risks and vulnerabilities, of the Central Government;
- (c) the forecasts of revenue and expenditure of the Central Government;
- (d) the prevailing and evolving market conditions for government securities;
- (e) aspects of efficiency such as costs, risks and phasing of borrowing and repayments; and
- (f) such other factors as the Debt Agency considers appropriate.

20

25

(5) The draft annual public debt plan must advise on –

- (a) the composition of the borrowing and repayment of public debt, including the amount, structure, maturity, currency, indexing, and mode of issuance of public debt; and
- (b) the optimal annual calendar for the issuance of public debt.

30

(6) The draft annual public debt plan may advise on –

- (a) the medium-term and long-term debt strategy of the Central Government; and
- (b) the policy to mitigate risks to the debt portfolio, including any limits that may be placed for such risks.

35

(7) The Central Government must approve the draft annual public debt plan, with or without modifications, each year for the following financial year, and communicate the same to the Debt Agency, as soon as may be practicable.

(8) The Central Government may modify the annual public debt plan any time during the year as may be necessary, in consultation with the Debt Agency.

40

- (9) The Debt Agency must implement, to the best of its abilities, the annual public debt plan as approved and modified by the Central Government from time to time.
- 5 (10) The Debt Agency must prepare a public debt management plan for the Central Government on daily, weekly or monthly basis, as the Debt Agency may determine to be practicable and necessary, in consultation with the Central Government.
- (11) The Debt Agency must disseminate information relating to public debt management and the annual public debt plan to the public in a transparent, accountable and timely manner.
- 10 (12) In this section -
 - (a) "annual public debt plan" means the annual plan for managing public debt as approved by the Central Government; and
 - 15 (b) "draft annual public debt plan" means the calendar of the Central Government for borrowing and repayment of public debt during the next financial year, as proposed by the Debt Agency to the Central Government.

382. (1) The Debt Agency must undertake cash management for the Central Government, in accordance with this Part, and any rules made thereunder. Cash management.
- 20 (2) The functions of the Debt Agency relating to cash management include -
 - (a) co-ordinating with the departments, ministries and agencies of the Central Government and the Reserve Bank to estimate the cash balances every day;
 - (b) monitoring the cash balances of the departments, ministries and agencies of the Central Government;
 - 25 (c) advising the Central Government on measures to promote efficient cash management practices and to deal with surpluses and deficits; and
 - (d) managing cash balances of the Central Government.
 - (3) The Debt Agency must prepare a cash management plan for the Central Government on daily, weekly or monthly basis, as the Debt Agency may determine to be practicable and necessary, in consultation with the Central Government.
 - 30 (4) The periodic cash management plan must take into consideration -
 - (a) the forecasts of cash flows of the Central Government;
 - (b) synchronisation of cash flows with public debt management; and
 - 35 (c) aspects of efficiency such as costs and risks associated with cash flows and measures to deal with deficit and surplus.
 - (5) The Central Government must approve the periodic cash management plan, with or without modifications, each year, and communicate the same to the Debt Agency, as soon as may be practicable.
 - 40 (6) The Central Government may modify the periodic cash management plan at any time as may be necessary, in consultation with the Debt Agency.
 - (7) The Debt Agency must implement, to the best of its abilities, the periodic cash management plans as approved and modified by the Central Government.
 - (8) The Debt Agency must disseminate information relating to cash management to the public in a transparent, accountable and timely manner.

Contingent liabilities.

383. (1) The Debt Agency must manage contingent liabilities for the Central Government, in accordance with this Part, and any rules made thereunder.
- (2) The functions of the Debt Agency relating to the management of contingent liabilities include -
- (a) developing, maintaining and managing a database of contingent liabilities; 5
 - (b) managing and monitoring contingent liabilities;
 - (c) undertaking risk assessments in relation to contingent liabilities; and
 - (d) advising the Central Government on the pricing and issuance of contingent liabilities, and the arrangement of contingent lines of credit. 10
- (3) The Debt Agency must undertake risk assessments in relation to contingent liabilities on an annual basis, and in accordance with international methodology and practice.
- (4) The Debt Agency must disseminate information relating to contingent liabilities to the public in a transparent, accountable and timely manner. 15

Research and information.

384. The Debt Agency must -
- (a) develop, maintain and manage information systems that are necessary to carry out its functions efficiently;
 - (b) disseminate information and data relating to its functions to the public in a transparent, accountable and timely manner; and 20
 - (c) conduct and foster research relevant for the efficient discharge of its functions.

Fostering the market for government securities.

385. (1) The Debt Agency must take steps to foster a liquid and efficient market for government securities.
- (2) In the discharge of its functions under this section, the Debt Agency will advise the Regulator, the Central Government or any public authority on the policy and design of the market for government securities. 25
- (3) In carrying out the functions under this section, the Debt Agency must seek to ensure -
- (a) equal access in the market for government securities; 30
 - (b) growth and diversity in the investor base for government securities;
 - (c) fair competition in the market for government securities; and
 - (d) transparency in the issuance and trading of government securities.

Services to others.

386. (1) The Debt Agency may, on behalf of any public authority, as may be permitted by the Central Government, or any State Government - 35
- (a) carry out the functions under section 380; or
 - (b) provide technical assistance to enable the public authority or State Government, as the case may be, to carry out the functions under section 380.
- (2) The Debt Agency must not carry out any function under this section if there is a conflict of interest with the obligations of the Debt Agency under this Part. 40

- (3) The functions carried out under this section must be subject to a written agreement to this effect between the Debt Agency and the public authority or State Government concerned.
- (4) Unless excluded by the written agreement, provisions of this Part will apply, with the necessary modifications, to the functions carried out under this section.
- (5) For an agreement under this section to be valid, it must -
 - (a) require the Debt Agency to carry out, or provide technical assistance to enable the carrying out of, at least one of the functions provided under sections 381, 382 or 383; and
 - (b) be published.
- (6) In this section, "technical assistance" means any advice, assistance or training pertaining to the functions under section 380.

387. (1) The Debt Agency may, from time to time, in writing, call for such information or material as it determines necessary from the Central Government, any State Government, or any public authority, to carry out its functions under this Part.
- (2) The information or material that may be called for by the Debt Agency includes information or material relating to -
- (a) public debt;
 - (b) contingent liabilities;
 - (c) cash balances; and
 - (d) forecasts of daily cash flows and net cash requirements.
- (3) The information or material received under this section will be disseminated to the public only to the extent required under the Right to Information Act, 2005 (22 of 2005).
- (4) The recipient of a request under sub-section (1) is bound to provide the information or material, if available with it, to the Debt Agency in a timely manner.

Collection of information or material.

388. The Debt Agency must not raise funds or undertake transactions in financial markets on its own behalf.

Bar on transactions.

CHAPTER 75

POWERS OF THE CENTRAL GOVERNMENT

389. (1) The Central Government may issue to the Debt Agency, by an order in writing, directions on policy from time to time.
- (2) The decision of the Central Government as to whether a direction is one of policy or not is final.
- (3) Before issuing any directions under this section -
- (a) the Debt Agency must be given a reasonable opportunity to be heard to express its views; and
 - (b) the Central Government must publish any views expressed by the Debt Agency in a manner best suited to bring them to the attention of the public, and consider the same.

Power of Central Government to issue directions.

(4) The Debt Agency is bound by any directions issued under this section in the exercise of its powers or the performance of its functions under this Part.

Power of Central Government to temporarily supersede Debt Agency in exigency.

- 390. (1) The Central Government may, by notification, temporarily supersede the Management Committee at any time, if the Central Government is of the opinion that –
 - (a) on account of an emergency, the Debt Agency is unable to perform its functions; or
 - (b) the Debt Agency has persistently defaulted either in complying with any direction issued by the Central Government under this Part or in the performance of its functions.
- (2) The notification must provide for the period of supersession, which may not exceed a period of one hundred and eighty days.
- (3) Before issuing the notification, the Central Government must –
 - (a) give a reasonable opportunity to the Debt Agency to make representations against the proposed supersession; and
 - (b) consider representations, if any, made by the Debt Agency.
- (4) Upon the publication of the notification –
 - (a) all the members of the Management Committee will, as from the date of supersession, vacate their offices; and
 - (b) all the powers and functions which may be exercised or performed by or on behalf of the Debt Agency, will, until the Management Committee is reconstituted under section 24, be exercised and performed by such person or persons as the Central Government may direct.
- (5) Before the period of supersession expires, the Central Government must take action towards reconstituting the Management Committee.
- (6) The Central Government may reconstitute the Management Committee of the Debt Agency by fresh appointments, and no person who vacated office under sub-section (4)(a) will be deemed disqualified for appointment.
- (7) The Central Government must, at the earliest, lay before each House of Parliament, the notification and a report of the action taken under this section and the circumstances leading to such action.

CHAPTER 76

OTHER PROVISIONS GOVERNING THE DEBT AGENCY

Fees.

- 391. (1) The Debt Agency may, in consultation with the Central Government, make bye-laws to provide for fees payable in respect of its services rendered under this Part.
- (2) The bye-laws may levy the fees on the basis of the kind or scale of service rendered.
- (3) While levying fees, the bye-laws must take into account –
 - (a) the financial requirements of the Debt Agency; and
 - (b) the costs associated with the service for which the fee is being levied.

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(4) For services provided under section 386, if the fees are not provided for by by-laws, the Debt Agency may provide for the fees through the agreement entered into under that section.

5 392. (1) There will be constituted a fund, established and maintained by the Debt Agency, to which the following will be credited - Fund.

- (a) all grants, loans, and fees received by the Debt Agency; and
- (b) all sums received by the Debt Agency from such other sources as may be prescribed by the Central Government.

10 (2) The fund will be applied for meeting -

- (a) the salaries, allowances and other remuneration of the members, officers, and employees of the Debt Agency;
- (a) the expenses of the Debt Agency in performing its functions under this Part; and
- (c) the expenses on objects and for purposes authorised by the Act.

15 393. (1) The Central Government is liable to meet the obligations arising from -

- (a) any financial transaction authorised by the Central Government that is undertaken by the Debt Agency; or
- (b) any funds that are raised on behalf of the Central Government by the Debt Agency.

Liability for financial transactions.

20 (2) A State Government or public authority is liable to meet the obligations arising from -

- (a) any financial transaction authorised by that State Government or public authority that is undertaken by the Debt Agency; or
- (b) any funds that are raised on behalf of that State Government or public authority by the Debt Agency.

PART XIII

INVESTIGATIONS, ENFORCEMENT ACTIONS AND OFFENCES

CHAPTER 77

INVESTIGATIONS

5

Commencing investigations.

- 394. (1) Where a Financial Agency has information or reasonable grounds to suspect that any person is violating, or has violated, any provisions of the Act or relevant regulations, the Financial Agency may investigate such violation.
- (2) The Financial Agency must appoint one or more competent individuals to investigate the financial service provider and record such appointment. 10
- (3) The record of appointment must provide for -
 - (a) the person who will be responsible for carrying out the investigation;
 - (b) reason for such appointment;
 - (c) scope of the investigation;
 - (d) the time for the investigation, which will not exceed one hundred and eighty days at the first instance; and 15
 - (e) the method of reporting of the investigation.
- (4) The Financial Agency may modify the terms of appointment contained in sub-section (3)(e), if the circumstances of the investigation require such modification. 20
- (5) In this Chapter, "investigator" means an individual appointed under sub-section (2).

Process of investigation.

- 395. (1) An investigator may exercise powers contained in sub-section (3) over -
 - (a) any financial service provider;
 - (b) any person who is an employee or financial representative of any financial service provider; 25
 - (c) any person carrying out any activity subject to regulation by the Financial Agency under the authority of law, with or without the permission of the Financial Agency, and the person in control of such person;
 - (d) any related person of financial service provider; 30
 - (e) any other person who has been a party to any regulated activity or has information relevant or helpful to the investigation being carried out; and
 - (f) any person suspected of market abuse.
- (2) The investigator may exercise the powers contained in this section only after - 35
 - (a) recording the reasons stating the relationship between the person over whom the power is being exercised and the scope of the investigation under section 394(3)(c); and

- (b) providing the reasons recorded to such person, along with any order exercising such powers.
- (3) The investigator may order a person under sub-section (1) to -
 - (a) respond to the questions of the investigator, in person or any form of convenient communication; and
 - (b) produce any document or information the investigator may require.
- (4) The investigator may make copies of any document produced.
- (5) The investigator will have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908) while trying a suit, in respect of the following matters -
 - (a) summoning and enforcing the attendance of any individual including government officials;
 - (b) requiring such individuals to produce relevant records and documents; and
 - (c) recording their statements.
- (6) Any copy of a document or record made by the investigator will be presumed to be true and accurate unless evidence is produced to the contrary.

- 396. (1) An investigator may -
 - (a) enter the premises of any person without prior notice; and
 - (b) seize and retain custody of books, accounts, or any other records of the person.
- (2) If an investigator proposes to use the powers under sub-section (1), the investigator must make an application to a Judicial Magistrate of the first class of the district where the head office of the Financial Agency is situated.
- (3) The Judicial Magistrate may issue an order authorising the investigator to carry out the actions contained in sub-section (1) if the investigator satisfies the Judicial Magistrate that -
 - (a) the person may not co-operate with the investigation; or
 - (b) any direction in the person may lead to destruction of information or records which is required by the investigator.
- (4) The order of the Judicial Magistrate under sub-section (3) will have the same legal effect as a warrant issued by an appropriate court under the Code of Criminal Procedure, 1973 (2 of 1974).
- (5) The investigator may retain books, accounts or any other records seized under this section, for a period not exceeding thirty days.

Powers of the investigator.

397. After the conclusion of the investigation or lapse of time allocated in the appointment order, the investigator will make a final report to the Financial Agency.

Report of the investigator.

398. (1) This section applies if, pending investigation under section 395, the investigator has reasonable grounds to believe that any person mentioned in Section 395(1) is taking, or about to take, any action which -

Preventive measures during investigation.

- (a) constitutes a violation of any provision of law or regulations enforced by the Financial Agency; and
- (b) may prevent the investigator from collecting information or evidence.
- (2) The investigator may apply to an administrative law member for a decision order requiring a person to take actions contained in sub-section (5). 5
- (3) An application under sub-section (2) must be accompanied with reasons for the investigator considering a decision order under this section to be necessary.
- (4) The administrative law member must issue a decision order under sub-section (2) only when the administrative law member has reasonable grounds to believe that - 10
 - (a) the actions of the person disclose apparent violation of laws and regulations enforced by the Financial Agency;
 - (b) if no order is passed, persons availing financial services from the financial service provider will suffer injury which may not be compensated adequately after the investigation is complete; 15
 - (c) if no order is passed, the investigator will not be able to effectively carry out the investigation; or
 - (d) if no order is passed, any eventual remedy or penalty that may be imposed by the Financial Agency, after the investigation is complete, will not be enforceable due to change of circumstances. 20
- (5) The administrative law member will have the power to issue a decision order against any financial service provider or person suspected of being involved in market abuse -
 - (a) to cease or desist from carrying out such specified activities as would meet the objectives contained in sub-section (4); 25
 - (b) to keep specified records in a manner and form specified by the investigator; and
 - (c) to keep any monies collected from consumers in a separate account or deposit such monies with the Financial Agency.
- (6) Before passing a decision order under this section, the administrative law member will consider the requirements contained in sub-section (4) and the requirement of causing least possible disruption to the person to whom such order applies. 30
- (7) In exceptional circumstances, a decision order under this section may be passed without hearing the person on whom such decision order is passed, but such person will be given a hearing at the earliest possible opportunity before an administrative law member. 35
- (8) After a hearing under sub-section (7), the administrative law member must make a new decision order modifying, confirming, recalling or setting aside the previous order. 40
- (9) A decision order passed under this section will remain in force for a period of ninety days.
- (10) Upon the expiry of ninety days, if the investigation under section 395 has not been completed, the decision order may be extended by the administrative law officer, upon an application by the investigator to extend the decision order for a further period of ninety days if - 45

-398-

- (a) the conditions contained in sub-section (4) have been met; and
- (b) the administrative law member, by a decision order, determines that a longer period is appropriate for completion of the investigation.

(11) Any person who wilfully violates a decision order passed under this section commits a Class A offence.

CHAPTER 78

NOTICES

399. (1) The Financial Agency must issue a show cause notice to a person against whom it proposes to undertake an enforcement action. Show cause notice for enforcement action.
- 10 (2) The show cause notice must contain an assessment by the Financial Agency of the manner in which the factors under section 408 are applicable to the violation committed by the person.
- (3) A person to whom a show cause notice is issued may produce evidence to disprove the existence or applicability of any of the factors under section 408 that are identified by the Financial Agency in the show cause notice. Content and standard of show cause notices.
- 15 20 25 30
400. (1) A show cause notice must -
- (a) be in writing;
 - (b) state the action which the Financial Agency proposes to take;
 - (c) give causes requiring the proposed action;
 - (d) comply with section 401; and
 - (e) if section 401 applies, describe its effect and state whether any material exists to which the person concerned must be allowed access under it.
- (2) The show cause notice must provide for a reasonable period, which must not be less than twenty-eight days, within which the person to whom it is issued may make representations to the Financial Agency.
- (3) The Financial Agency may extend the period provided for in the notice.
- (4) After the period under sub-section (2), as may have been extended under sub-section (3), has expired, the Financial Agency must decide, within a reasonable period, whether to issue the person concerned a decision order.
- (5) In sub-section (2), the opportunity to make representations must include a hearing before an administrative law officer, either in person or through electronic communication.
401. (1) When a Financial Agency issues any show cause notice or decision order, it must - Access to material with regard to show cause notice and decision order.
- 35 (a) allow the noticee access to the material that was relied upon in taking the decision which gave rise to the obligation to issue the show cause notice or decision order; and
- (b) allow the noticee access to any material that might undermine that decision.

- (2) The provisions of this section will not bar any court, tribunal or other authority from requiring any information in proceedings before such court, tribunal or other authority.
- (3) In this section, "notice" means a show cause notice or decision order applies. 5

Content and standard of decision orders.

402. (1) A decision order must -
- (a) be in writing;
 - (b) give the Financial Agency's reasons for the decision to take the action to which the order relates;
 - (c) state whether the Financial Agency has depended on any materials contained in section 401; and 10
 - (d) clearly state -
 - (i) any right to have the matter referred to the Tribunal which is given by this Act; and
 - (ii) the procedure for such a reference. 15
- (2) If the decision order was preceded by a show cause notice, the action to which the decision order relates must be the same action proposed in the show cause notice.
- (3) A decision order does not become effective until thirty days have elapsed from the date of issue of the decision order. 20
- (4) A decision order which requires a person to take certain identified actions must provide reasonable time to such person to perform such actions.

Procedure for review of decision orders.

403. (1) Any person who has received a decision order may make an application to the administrative law member of the board of the Financial Agency for review of the decision order, within fourteen days from the date of such order. 25
- (2) If the administrative law member finds that there is an apparent error in the decision order, the administrative law member may set aside the decision order.

Conclusion of proceedings through discontinuance notice.

404. (1) The Financial Agency must give a discontinuance notice to the concerned person if it decides not to take - 30
- (a) the action proposed in a show cause notice; or
 - (b) the action to which a decision order relates.
- (2) A discontinuance notice will not be given with respect to an application for an authorisation to carry on a financial service.
- (3) A discontinuance notice must identify the action or actions which are being discontinued. 35

Confidentiality of certain notices.

405. (1) The Financial Agency must not publish a show cause notice and must keep it confidential.
- (2) A discontinuance notice may be published by the Financial Agency if the person to whom such discontinuance notice requests such publication. 40

- (3) The Financial Agency must publish all decision orders unless they fall under the exception under sub-section (4).
- (4) A Financial Agency may not publish a decision order, if not publishing such notice is in the interests of the consumer, and the reasons for the same are recorded in writing by the Financial Agency.
- (5) The Financial Agency must publish a compounding order to the extent it refers to the proceedings and the terms of the order.

406. (1) The Financial Agency must make regulations governing the show cause notices and decision orders it issues. Requirement to make regulations.
- 10 (2) The regulations must -
- (a) ensure that show cause notices and decision orders are issued by administrative law officers only;
 - (b) ensure that responses to show cause notices are received and considered by administrative law officers only; and
 - 15 (c) state the procedure the Financial Agency will follow to issue decision orders.
- (3) The Financial Agency must make a report of every violation of regulations made under this section and include such report as a part of the annual report of the Financial Agency.

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CHAPTER 79
ENFORCEMENT ACTIONS

407. (1) Each of the following constitutes an "enforcement action" under this Act - Types of enforcement actions.
- (a) issuance of a private warning;
 - (b) issuance of a public statement;
 - 25 (c) issuance of a direction requiring the person to correct the violation;
 - (d) imposition of a monetary penalty; and
 - (e) variation, suspension, or cancellation of an authorisation, permission or registration granted by the Financial Agency to the person, which are related to the violation.
- 30 (2) When a Financial Agency issues a private warning, it must not publish such warning, but may provide copies of the warning to any other Financial Agency.
- (3) The appropriate Financial Agency may undertake one or more enforcement actions against a person for violation of -
- (a) any applicable provision of this Act;
 - 35 (b) any applicable regulations made by the Financial Agency under this Act; or
 - (c) any order or direction issued by the Financial Agency under this Act.

408. (1) Any enforcement action taken by a Financial Agency must be proportionate to the violation in respect of which the enforcement action is proposed to be undertaken. Factors for determining appropriate enforcement action.
- 40

- (2) The Financial Agency must consider the following factors while determining the enforcement action to be taken against a person -
 - (a) the nature and seriousness of the violation committed by the person, including whether the violation was -
 - (i) deliberately carried out by the person; 5
 - (ii) caused due to the recklessness of the person; or
 - (iii) caused due to negligence on the part of the person;
 - (b) the consequences and impact of the violation, including the extent of -
 - (i) benefit or unfair advantage gained by the person as a result of the violation; and 10
 - (ii) loss caused, or likely to be caused, to consumers or any other persons as a result of the violation;
 - (c) the conduct of the person after the occurrence of the violation; and
 - (d) prior violations or offences committed by the person.
- (3) If the violation was due to a negligence under sub-section (2)(a)(iii) and did not cause any substantial loss to any person, the Financial Agency must not impose any enforcement as contained in section 407(1)(e). 15

Maximum amount of monetary penalties.

- 409. (1) The maximum monetary penalty that may be imposed by the Financial Agency under section 407(1)(d) will be determined in the following manner -
 - (a) if the Financial Agency determines that the violation under section 407(3) was committed deliberately by the person, the maximum monetary penalty that may be imposed will be higher of - 20
 - (i) three times the amount of the loss caused, or likely to have been caused, to consumers or any other persons as a result of the violation; or 25
 - (ii) three times the amount of the benefit or unfair advantage gained by the person as a result of the violation;
 - (b) if the Financial Agency determines that a violation under section 407(3) was caused due to the recklessness of the person, the maximum monetary penalty that may be imposed will be higher of - 30
 - (i) two times the amount of the loss caused, or likely to have been caused, to consumers or any other persons as a result of the violation; or
 - (ii) two times the amount of the benefit or unfair advantage gained by the person as a result of the violation; or 35
 - (c) if the Financial Agency determines that the violation under section 407(3) was caused due to the negligence of the person, the maximum penalty that may be imposed will be the higher of -
 - (i) one and a half times the amount of the loss caused, or likely to have been caused, to consumers or any other persons as a result of the violation; or 40
 - (ii) one and a half times the amount of the benefit or unfair advantage gained by the person as a result of the violation.
- (2) The total amount of the monetary penalty must not be more than rupees one crore, or any amount that the Central Government may prescribe from time to time, if the amount of loss caused, or likely to have been caused, is - 45
 - (a) not substantial; or

- 402 -

(b) cannot be reasonably estimated.

410. (1) A Financial Agency may compensate persons who have been affected by a violation, under this section, if the following conditions are met - Compensation to persons affected by violation.
- (a) the loss suffered by the persons is directly attributable to the violation;
 - (b) the persons who have suffered loss due to the violation can be reasonably identified; and
 - (c) the amount recovered by the Financial Agency is sufficient to provide some compensation to all similarly situated persons.
- (2) If the Financial Agency decides to pay compensation under this section, it must make an notice stating the conditions a person has to meet to qualify for such compensation.
- (3) The Financial Agency must keep any amount collected as monetary penalties for this section for a period of two years.
- (4) A person must approach the Financial Agency for compensation under this section within a period of two years from the date of the publication of the notice under sub-section (2).
- (5) After the expiry of the period of two years, the Financial Agency must transfer any amount kept for the purposes of this section to the Consolidated Fund of India.
- (6) This section does not prevent any aggrieved person from pursuing any other legal remedies against a person who has committed a violation, provided that any amount payable by a person who has committed a violation to an aggrieved person must be reduced by any amount the aggrieved person has received under this section.
411. A Financial Agency must transfer all monies collected by it from the imposition of any penalties under section 407(1)(d), subject to any amount kept under section 410, to the Consolidated Fund of India. Transfer of penalties to the Consolidated Fund of India.

CHAPTER 80

COMPOUNDING ACTIONS AND NOTICE

412. (1) Any person may make an application to a Financial Agency requesting for a compounding action if - Application for compounding action.
- (a) such person apprehends enforcement action; or
 - (b) such person has received a show cause notice.
- (2) An application for a compounding action may be made at any time before a decision order concerning the same matter has been issued to the person by the Financial Agency.
- (3) The Financial Agency must dispose of an application for compounding action within ninety days from the receipt of the application.
- (4) The application for compounding action must be decided by an administrative law officer.

Procedure for making compounding order.

(5) If the application for compounding action is rejected by the Financial Agency, it must issue a decision order to the person making the application.

413. (1) If an application for a compounding action is acceptable to the Financial Agency, it may issue a compounding order to the person making the application.

(2) A compounding order must be issued by an administrative law officer. 5

(3) In a compounding order, the Financial Agency may -

(a) require the person to pay an amount towards settlement charges;

(b) restrain the person from undertaking particular actions; or

(c) impose a combination of any of the actions mentioned above.

(4) The Financial Agency must not take any enforcement action against a person on an issue which constitutes a violation under section 407(3), if that issue is the subject matter of a compounding order. 10

(5) The restriction under sub-section (4) will not be applicable if the person making the application for compounding action -

(a) withholds any material fact regarding the compounding action from the Financial Agency; or 15

(b) misleads the Financial Agency in any other manner in connection with the application for compounding action.

(6) The Financial Agency must not initiate any criminal proceedings under this Act on a matter in relation to which a compounding order has been issued. 20

(7) If the compounding order is issued after the institution of criminal proceedings, the Financial Agency or the noticee must make an application to the court before which such criminal proceedings are pending, to compound such offence in terms of the compounding order.

(8) Before issuing a compounding order the Financial Agency must provide the concerned person with a statement containing the conditions or requirements it proposes to impose under sub-section (3). 25

(9) If the person rejects the conditions contained in sub-section (8), then the Financial Agency must not issue any compounding order.

(10) Any offer made by a person in proceedings under this section will not be to the prejudice of the person in any other proceedings or imposition of enforcement actions by a Financial Agency. 30

(11) A person is presumed to have rejected the conditions contained in sub-section (8), if such person does not respond within fourteen days of the statement being issued. 35

(12) A person who has received a compounding order has no right to approach the Tribunal against any content of the compounding order.

(13) If the person with respect to whom a compounding order has been issued, wilfully violates any requirements or conditions of such compounding order, the person commits a Class A offence. 40

(14) A compounding order under this section does not amount to the application of an enforcement action under this Act.

- 404 -

414. (1) Each Financial Agency must make regulations regarding the manner and process governing compounding orders so as to ensure that compounding is carried out in a transparent, consistent and impartial manner. Regulations concerning compounding.
- (2) The regulations under sub-section (1) must provide for -
- (a) the list of violations that cannot be compounded;
 - (b) the list of violations that may be compounded;
 - (c) the method of calculating any monetary penalty that may be imposed under a compounding order;
 - (d) the considerations that the Financial Agency may take into account while issuing a compounding order; and
 - (e) the process for making an application for compounding action.

CHAPTER 81

OFFENCES UNDER THIS ACT

415. (1) The punishment for - Description of offences.
- (a) a Class A offence is a fine, or imprisonment not less than two years but up to ten years, or both;
 - (b) a Class B offence is a fine, or imprisonment up to two years, or both; and
 - (c) a Class C offence is a fine.
- (2) All offences under this Act are non-cognisable and compoundable.
- (3) If any act is punishable under provisions of any other law, the provisions of this Act will not be in derogation to such provisions.
416. (1) No criminal proceedings for any offence under this Act against any person may be initiated except by an application from the Financial Agency. Institution of proceedings for offences.
- (2) Criminal proceedings for any offence under this Act must be instituted before a Court of Session.
- (3) The Central Government may make a notification designating a particular Court of Session or establishing a Court of Session for trying offences under this Act.
- (4) A Financial Agency may appoint an advocate to act as a public prosecutor for any offence committed under this Act.
- (5) A prosecutor appointed by a Financial Agency under this section will be deemed to be a public prosecutor under the Code of Criminal Procedure, 1973 (2 of 1974).
- (6) The Central Government may make rules for the purpose of this section.
417. (1) The following factors are to be taken into account while determining the appropriate period of imprisonment and fine under for an offence - Factors to be considered for punishment.
- (a) the role of the person in the commission of the offence; and
 - (b) the factors contained in sections 408(2)(b), 408(2)(c) and 408(2)(d).

- (2) The maximum amount of fine to be levied upon a person for an offence will be the higher of -
 - (a) three times the loss caused by the person; or
 - (b) three times the gain made by the person.
- (3) If the loss caused or the gain made by the person cannot be reasonably determined, the maximum fine that may be imposed is rupees one crore. 5
- (4) The prosecution of a person for any offence under this Act will not bar any enforcement action imposed on such persons, but any fine imposed for an offence may be reduced by any penalty paid to a Financial Agency for the same violation. 10

Violations by bodies corporate.

- 418. (1) If any violation under any this Act is found to have been committed by a body corporate, then an officer of the body corporate is liable, if -
 - (a) the violation is shown to have been committed with the consent or connivance of the officer; or
 - (b) the violation is attributable to any wilful neglect on the part of the officer. 15
- (2) Any criminal proceedings or enforcement action against either the officer or the body corporate will not be a bar against proceedings against the other.
- (3) In this section, "officer" includes director, member of the managing committee, chief executive, manager, secretary, individuals in control, and persons who purport to be officers with knowledge of the body corporate. 20

CHAPTER 82

MISCELLANEOUS

Misleading a Financial Agency

- 419. (1) A person that, in purported compliance with any requirement imposed by or under this Act, knowingly gives a Financial Agency material information which is false or misleading, is guilty of a Class A offence. 25
- (2) Sub-section (1) applies only to a requirement in relation to which no other provision of any Act creates an offence in connection with the giving of information.

General procedures.

- 420. (1) The Financial Agency must make regulations governing the process it will follow in implementing provisions of this chapter. 30
- (2) The Financial Agency must make general guidelines stating it -
 - (a) interpretation of the provisions of this Chapter; and
 - (b) the method it will apply in determining the enforcement action and penalty to be imposed.
- (3) While taking an enforcement action under this Act, the Financial Agency may impose a lower penalty after recording reasons for doing so. 35

PART XIV

FUNCTIONS, POWERS AND DUTIES OF THE
TRIBUNAL

CHAPTER 83

PRESIDING OFFICER AND MEMBERS

5

421. (1) A person will not be qualified for appointment as the Presiding Officer of the Tribunal unless such person -

Qualification of Presiding Officer and members.

(a) is a sitting or retired Judge of the Supreme Court or a sitting or retired Chief Justice of a High Court; or

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(b) is a sitting or retired Judge of a High Court who has completed not less than seven years of service as a Judge in a High Court.

(2) A person will not be qualified for appointment as member of the Tribunal unless that person is a person of ability, integrity and standing who has shown capacity in dealing with problems relating to finance and has qualification and experience of law, finance, economics or accountancy.

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(3) A person may not be appointed as member of the Tribunal within two years from retiring or resigning as a member of the board or employee of any Financial Agency.

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422. (1) The Central Government must constitute a selection committee in accordance with the First Schedule for selection of the persons for appointment as Presiding Officer or members of the Tribunal.

Selection of Presiding Officer and members of the Tribunal.

(2) The selection committee must comply with the procedure laid down in the First Schedule.

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(3) The Central Government must appoint the members of the Tribunal from the persons nominated by the selection committee in consultation with the Chief Justice of India.

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(4) In the event of a temporary vacancy in the office of the Presiding Officer, the Central Government may nominate one of the members of the Tribunal as an officiating Presiding Officer for a period not exceeding one hundred and eighty days, having regard to suitability for effective oversight and administration of the Tribunal's adjudicating functions.

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(5) If any vacancy in the Tribunal is not filled within a period of one hundred and eighty days from the date such vacancy arises, the Central Government must make a report on the reasons for the delay in the appointment.

(6) The report mentioned under sub-section (5) will be laid before both Houses of Parliament.

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423. (1) The Presiding Officer and members of the Tribunal will hold their respective offices till they reach the age of seventy years.

Conditions of service of Presiding Officer and members.

(2) The salary and other entitlements of the Presiding Officer will be the same as the Chief Justice of a High Court.

- (3) The salary and other entitlements of the members will be the same as a Judge of a High Court.

Resignation.

424. (1) The Presiding Officer or any member of the Tribunal may resign by giving a signed notice of resignation to the Central Government.
- (2) On receipt of a notice of resignation, the Central Government must forward a copy of such notice to the Chief Justice of India.
- (3) The Presiding Officer or any member of the Tribunal, after providing the notice of resignation, will continue to hold office till the earlier of -
- (a) the date the Central Government appoints a person to the post vacated by such resignation; or
 - (b) the expiry of one hundred and eighty days from the date of providing of the notice of resignation.

Removal of Presiding Officer or member of Tribunal.

425. (1) The Presiding Officer or any member of the Tribunal may be removed on the same grounds as a member of the board of the Financial Agency under section 40.
- (2) The procedure for removal of Presiding Officer or any member of the Tribunal must be the same as a member of the board of the Financial Agency under section 41, provided that no Presiding Officer or member of the Tribunal may be removed without consulting the Chief Justice of India.

CHAPTER 84

FUNCTIONING

Power of the Tribunal.

426. (1) The Tribunal will have the same powers as are vested in a Civil Court under the Code of Civil Procedure, 1908 (5 of 1908).
- (2) Every proceeding before the Tribunal will be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code, 1860 (45 of 1860).
- (3) The Tribunal will be deemed to be a civil court for all the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973 (2 of 1974) while trying a suit, in respect of the following matters -
- (a) summoning and enforcing the attendance of any person and examining the person on oath;
 - (b) requiring the discovery and production of documents;
 - (c) receiving evidence on affidavits;
 - (d) issuing commissions for the examination of witnesses or documents;
 - (e) dismissing an application for default or deciding it *ex parte*;
 - (f) setting aside any order of dismissal of any application for default or any order passed by it *ex parte*;
 - (g) ordering the attachment of any property; and
 - (h) any other matter which may be notified by the Central Government.
- (4) The Tribunal may -

- (a) set aside any regulations;
 - (b) modify, suspend or confirm any order, notice or direction of a Financial Agency or Central Government; or
 - (c) instruct a Financial Agency to issue a new order, notice or direction.
- 5 (5) The Tribunal must attempt to dispose any appeal before it within a period of one hundred and eighty days from the date of receipt of any appeal.
- (6) If the Tribunal does not dispose any appeal within one hundred and eighty days it must record such incidence and publish it with its annual report.
- 10 427. (1) If a monetary penalty imposed on any person has been finally upheld and such person fails to deposit such penalty within a reasonable time, the Financial Agency may make an application to the Tribunal for attachment of the properties of the person for recovery of such penalties. Power of Tribunal to recover penalties.
- (2) If the Tribunal is satisfied that the person has defaulted in payment of penalty, it may issue an order attaching properties of the person.
- 15 (3) The order of the Tribunal attaching properties will have the same effect as a decree of a court under the Code of Civil Procedure, 1908 (5 of 1908).
- (4) In this section, "property" includes tangible and intangible property.
- 20 428. (1) The Presiding Officer will be responsible for the functioning of the Tribunal and have all powers incidental to the discharge of such duties. Functions of Presiding Officer.
- (2) A person appointed as a Presiding Officer must, in carrying out the functions of that office, have regard to -
- (a) the need for the Tribunal to be accessible;
 - (b) the need for proceedings before the Tribunal -
 - (i) to be fair; and
 - (ii) to be handled quickly and efficiently;
 - (c) the need for members of any bench of the Tribunal to be experts in the subject matter of, or the law to be applied in, cases in which they decide matters; and
 - (d) the need to develop innovative methods of settling the types of disputes that may be brought before the Tribunal.
- 25
- 30
429. (1) The Presiding Officer may constitute benches composed of members of the Tribunal. Presiding Officer's power to constitute benches.
- (2) Benches may be created at any location, or for any type of proceeding.

CHAPTER 85
ADMINISTRATION

430. (1) The Tribunal will be supported by a registry, which will be headed by a registrar. Registry of the Tribunal.
- (2) The registrar will be appointed by the Central Government in consultation with the Presiding Officer.

- (3) The registrar will be responsible for the following functions -
 - (a) establishing an effective and efficient system to support the business of the Tribunal; and
 - (b) discharging administrative functions of the Tribunal, including in relation to matters dealing with all staff of the Tribunal. 5
- (4) The registrar will be subject to the supervision of the Presiding Officer in the discharge of such functions.

Requirement of the registry to provide computerised services.

- 431. (1) The registry must develop systems and procedures to ensure functions of the Tribunal are provided through computerised systems that are easily accessible.
- (2) The registry must develop systems to - 10
 - (a) allow all parties to submit documents through electronic means;
 - (b) schedule hearings of the Tribunal in an efficient manner;
 - (c) provide systems for recording evidence of witnesses communication systems;
 - (d) enable parties to present their case without requiring their personal appearance at the Tribunal, through electronic means; and 15
 - (e) enable public viewing of proceedings, including by way of transmission of hearings by electronic means.
- (3) The Presiding Officer may direct the usage of electronic means enabled pursuant to this section in proceedings wherever appropriate. 20

Staff of the Tribunal.

- 432. (1) The Tribunal will have staff comprising such types, categories and number of officers and other employees as may be required to assist the Tribunal in the effective discharge of its functions, as determined by the Central Government.
- (2) If the Presiding Officer, based on the recommendation of the registrar, is of the opinion that more employees or different categories of employees are required to ensure the effective functioning of the Tribunal, then the Presiding Officer must make a requisition to the Central Government in this regard. 25
- (3) The officers and other employees of the Tribunal must discharge their functions under the general superintendence of the registrar.
- (4) The salaries and allowances and conditions of service of the officers and other employees of the Tribunal will be such as may be prescribed by the Central Government. 30

Finances of the Tribunal.

- 433. (1) The registrar must prepare a report, each financial year, stating the financial requirements of operating the Tribunal.
- (2) The report must be made in consultation with the Presiding Officer and the Central Government. 35
- (3) The registrar must forward the report to the Financial Authority and the Reserve Bank.
- (4) The Financial Authority and the Reserve Bank must provide the Tribunal with funds to meet the financial requirements set out in the report in accordance with the time schedule contained in the report. 40

(5) The Tribunal must make provision in its procedural rules to charge fees for appeals.

434. (1) The Presiding Officer, in consultation with the registrar, must formulate systems to accurately measure the functioning of the Tribunal and each member of the Tribunal.

Performance of the Tribunal.

(2) The Presiding Officer, in consultation with the registrar, must create targets for performance of each measure for each financial year.

(3) The systems and targets mentioned in the previous sub-sections must -

(a) promote transparency;

(b) provide an accurate representation of functioning of the Tribunal;

(c) consider the requirements of persons appearing before the Tribunal;

(d) provide objective methods of measurement where possible;

(e) provide subjective methods of measurement where objective measurements are not possible; and

(f) incorporate global best practices in measurement of functioning of other tribunals and courts.

(4) The Presiding Officer must review the systems created under sub-section (1) once every three years to -

(a) incorporate global best practices;

(b) update the systems of measurement; and

(c) include new metrics of measure of processes and functions.

435. (1) The registry of the Tribunal must publish a report within ninety days of the end of every financial year

Annual report of the Tribunal.

(2) The report must contain -

(a) audited financial statements of the Tribunal;

(b) the details of measurement of the functioning of the Tribunal in accordance with section 434; and

(c) the targets for the following financial year in accordance with section 434.

CHAPTER 86

JURISDICTION AND APPEALS

436. (1) The Tribunal will have jurisdiction in the following instances -

Jurisdiction of the Tribunal.

(a) from any decision order;

(b) from any regulations or general guidance in accordance with section 58;

(c) from any adjudication order of the Redress Agency under section 114;

(d) from any decision of the Regulator to disqualify an auditor or actuary under section 165(4);

(e) from any order of the exchange under section 210;

(f) from any order of an exchange under section 212;

- (g) from any compensation order under section 282; and
- (h) from any order of the senior officer under section 373.

- (2) No appeal will lie against a show cause notice or compounding order issued by a Financial Agency.
- (3) All appeals to the Tribunal against any order of a Financial Agency must be made within sixty days of the date of the order. 5
- (4) The Tribunal may, if it is satisfied that such party was prevented by sufficient cause from filing the appeal within sixty days, allow an appeal to be filed within a further period not exceeding thirty days.
- (5) Sub-section (3) does not apply to appeals against regulations and guidance under section 58. 10
- (6) No civil court will have jurisdiction to entertain any suit or proceeding in respect of any matter which the Tribunal is empowered by or under this Act to determine, and no injunction will be granted by any court, tribunal or other authority in respect of any action taken, or to be taken, in pursuance of any power conferred by or under this Act or rules made hereunder. 15

Appeal to Supreme Court.

- 437. (1) An aggrieved party may appeal to the Supreme Court of India against the order of the Tribunal only on a question of law, within a period of ninety days from the receipt of the order of the Tribunal.
- (2) The Supreme Court may, if it is satisfied that such party was prevented by sufficient cause from filing the appeal within ninety days, allow an appeal to be filed within a further period not exceeding sixty days. 20

CHAPTER 87

PROCEDURE

Procedure of the Tribunal.

- 438. (1) The Tribunal will not be bound by the procedure laid down in the Code of Civil Procedure, 1908 (5 of 1908). 25
- (2) The Tribunal will have a procedure committee which will be responsible for making the rules of procedure to be followed by the Tribunal
- (3) The Tribunal, acting through the procedure committee, may evolve its own procedure which will be guided by the following principles – 30
 - (a) that the principles of natural justice are followed;
 - (b) that the Tribunal system is accessible and fair;
 - (c) that the proceedings are handled quickly and efficiently;
 - (d) that the procedure allows for conduct of proceedings by electronic means, where possible; and 35
 - (e) that rules of procedure are simple and clear.
- (4) The Tribunal must ensure that the entire proceedings of the Tribunal are recorded and published.
- (5) The Presiding Officer, by recording reasons in writing, may prevent the publication of certain proceedings. 40

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439. (1) The procedure committee of the Tribunal will comprise -

Composition and function of procedure committee of the Tribunal.

- (a) the Presiding Officer;
- (b) the registrar of the Tribunal; and
- (c) three experts in the field of law, nominated by the Presiding Officer.

5 (2) The procedure committee must undertake the following functions -

- (a) make rules governing proceedings of the Tribunal, which will come into effect upon being notified by the Central Government;
- (b) make rules governing payment of fees payable for filing appeals in the Tribunal, which may vary depending on the nature of the appeal preferred;
- 10 (c) identify measures or parameters for determining the performance of the registry; and
- (d) any other function which may be delegated to the procedure committee.

(3) The procedure committee will have the power to consult such persons as it considers appropriate in the discharge of its functions.

15 (4) The procedure committee must publish, including by electronic means, the rules made by it.

20 440. (1) Every order made by the Tribunal will be enforced by it in the same manner as if it were a decree made by a court, and it will be lawful for the Tribunal to send, in case of its inability to execute such order, to the court within the local limits of whose jurisdiction -

Enforcement of order of the Tribunal.

- (a) in the case of an order against a company, the registered office of the company is situated; or
- (b) in the case of an order against any other person, place where the person concerned resides or carries on business or personally works for gain, is situated.

25

(2) Nothing contained in sub-section (1) will affect the power of the Tribunal to transmit any order made by it to a civil court having local jurisdiction, and such civil court will execute the order as if it were a decree made by that court.

30 441. Any person may appear before the Tribunal in person, or authorise one or more -

Appearance before the Tribunal.

- (a) of its officers;
- (b) advocate;
- (c) chartered accountant;
- (d) company secretary; or
- (e) cost accountant.

35 442. The provisions of the Limitation Act, 1963 (36 of 1963), will, as far as may be, apply to an appeal made to the Tribunal.

Limitation.

PART XV

MISCELLANEOUS

- 413-
- Members, officers, and employees of all Financial Agencies to be public servants. 443. The members, officers, and employees of all Financial Agencies, or any other person who has been delegated any function by any Financial Agency, or by the Central Government, will be deemed, when acting or purporting to act in pursuance of any of the provisions of this Act, to be public servants within the meaning of section 21 of the Indian Penal Code, 1860 (45 of 1860). 5
- Protection of action taken in good faith. 444. No suit, prosecution or other legal proceedings will lie against the Central Government or any Financial Agency or their members, officers, employees, or delegate, for anything which is done, or intended to be done, in good faith done under this Act. 10
- Application of other laws not barred. 445. (1) The provisions of this Act are in addition to, and not in derogation of, the provisions of any other law for the time being in force.
(2) Unless provided otherwise, nothing contained in this Act will affect the application of any other law. 15
- Exemption from tax. 446. Nothing contained in any law or enactment in force, in relation to taxation, including the Wealth Tax Act, 1957 (27 of 1957) and the Income Tax Act, 1961 (43 of 1961), will make any Financial Agency liable to pay wealth tax, income tax, service tax, or any other tax or duty with respect to its wealth, income, services, profits or gains. 20
- Liquidation. 447. No Financial Agency will be placed in liquidation save by order of the Central Government, in such manner as it may direct.
- Prohibition on avoiding this Act. 448. (1) A person must not, either alone or with others, engage in any conduct that can be reasonably construed as being done for the purpose of avoiding, or abusing, the application of this Act, unless such conduct is justified by legitimate needs of a financial, economic or legal nature. 25
(2) Any person who violates sub-section (1) commits a Class C offence.
- Power of Central Government to remove difficulties. 449. (1) If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, in consultation with the concerned Financial Agency or Tribunal, make provisions that appear to it to be necessary for removing the difficulty, through a notification. 30
(2) The Central Government must not notify any provision that is inconsistent with the provisions, intent or purpose of this Act.
(3) The power of the Central Government to remove difficulties, as described in sub-section (1) will not extend to the removal of difficulties in the regulations, or bye-laws of any Financial Agency. 35
(4) The Central Government's power to issue orders under this section may be exercised at any time prior to the expiry of three years from the commencement of this Act.
(5) The Central Government must lay every order made under this section before each House of Parliament. 40
- Repeals and savings. 450. The Central Government may notify the repeal of the legislations listed in the Sixth Schedule, in whole or in part, from time to time, in accordance with a schedule of giving effect to the provisions of various Parts of this Act.

PART XVI
SCHEDULES

Schedule 1: Selection committee

See section 30, Part III

Selection committee

(1) Constitution of selection committee

- (a) The Central Government will maintain a list of at least ten independent experts from the fields of finance, law, and economics who are available to serve as experts of the selection committee.
- (b) The selection committee will consist of -
(i) a chairperson of the selection committee;
(ii) three independent experts; and
(iii) a variable member as defined in item (e) of this Paragraph.
- (c) The chairperson of the selection committee will be -
(i) a nominee of the Chief Justice of India, for the selection of the Presiding Officer and members of the Tribunal; and
(ii) a nominee of the Central Government, in all other circumstances.
- (d) The chairperson of the selection committee must select the three independent experts from the list maintained by the Central Government as members of the selection committee.
- (e) The variable member will be -
(i) a nominee of the Central Government for the selection of chairperson; or
(ii) the chairperson of the Financial Agency for selection of all other members of the board of that Financial Agency.
- (f) The Central Government must provide the selection committee with adequate resources to advertise the vacancies in the board and carry out the selection in an efficient manner.

(2) Procedure to be followed by the selection committee

- (a) The selection committee must make a document stating the procedure it will follow for selecting persons.
- (b) The procedure must be fair, transparent and efficient.
- (c) The selection committee must widely advertise the vacancy and the procedure for selecting person in the best possible way to attract attention of suitable candidates.
- (d) Selection committees may consider persons who have not applied after recording reasons for considering such persons.
- (e) The selection committee may nominate up to three persons for every vacancy for which it has been constituted.
- (f) The selection committee must complete its process within one hundred and twenty days of being constituted.

Schedule 2: Procedure of meetings of the board of the Financial Agency

See section 34, Part III

Procedure of meetings of the board of the Financial Agency

- (1) The board of a Financial Agency must meet as frequently, and at such place, as may be provided for by bye-laws. 5
- (2) The members may attend meetings of the board of a Financial Agency using mechanisms that allow members to participate in the meetings from remote locations without being physically present.
- (3) The quorum of a meeting of the board of a Financial Agency will be more than half of the number of members appointed to the board of the Financial Agency. 10
- (4) The chairperson of a board must convene a meeting within reasonable time, if two or more members of the board of the Financial Agency make a request in writing.
- (5) If the chairperson fails to convene a meeting within thirty days of a request in writing, the members may convene a meeting without the chairperson. 15
- (6) Each member of the board of the Financial Agency must be given at least seven days notice of a meeting, unless the circumstances require the meeting to be convened with shorter notice.
- (7) The chairperson of the Financial Agency will chair the meetings of the board of the Financial Agency. 20
- (8) If the chairperson of the Financial Agency is not present at a meeting, the person who has served as member for the longest period of time will chair the meeting, unless otherwise specified.
- (9) The secretary of the board of the Financial Agency will be responsible for keeping the records of every meeting of the board of the Financial Agency. 25
- (10) The records will be published by the Financial Agency within three weeks of each meeting.
- (11) Selected portions of records may not be published if such portions meet any of the following conditions –
 - (a) they relate exclusively to functions of individuals within the Financial Agency; 30
 - (b) they relate to information that has been obtained from a person in confidence, where such information is exempt from disclosure by that person under the Right to Information Act, 2005 (22 of 2005);
 - (c) they involve discussion of a particular instance of violation of laws or censuring any person; 35
 - (d) they disclose information about a particular investigation which is ongoing;
 - (e) they disclose techniques and procedures for investigation or inspection;
 - (f) they disclose information of a commercial nature relating to a financial service provider which has been obtained for regulatory purposes; or 40
 - (g) they deprive a person of a right to a fair and impartial adjudication.

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- (12) The selected portions of records may be published with appropriate delay if such portions meet any of the following conditions -
- (a) they are likely to lead to major instability in the financial system;
 - (b) they are likely to significantly frustrate implementation of an action proposed by the Financial Agency or its board, where such action has not been disclosed to the public; or
 - (c) they involve discussion of any particular legal proceeding before a tribunal, court or arbitrator.
- (13) The publication of records relating to a particular meeting, may be delayed or prevented only if the board of the Financial Agency, in such meeting -
- (a) records the reason under items (11) or (12) of this Paragraph applicable in respect of each portion of the records;
 - (b) the majority of members present at the meeting, vote in favour of such action for each portion of the records separately; and
 - (c) the vote of each member is recorded and published in accordance with item (10) of this Paragraph.
- (14) Portions of records delayed for publication must be published by the Financial Agency within six months, or as soon as the reasons for their delay cease to be applicable, whichever is earlier.
- (15) In this section, "records" means the agenda, proposals, and decisions taken at the meeting, and includes the votes of each member of the Financial Agency.

Schedule 3: System-wide measures

See section 301, Part VIII

System-wide measures

(1) The following system-wide measures will be the subject of the decisions of the Council under section 301 –

5

- (a) a counter-cyclical capital buffer seeking to address pro-cyclical effects in the financial system.

Schedule 4: Actions of Regulator and Corporation consequent to determining the risk to viability of covered service providers

See sections 233, 234, 235, 236 and 237, Part VII

5 Actions of Regulator and Corporation consequent to determining the risk to viability of covered service providers

(1) Actions consequent to low risk to viability of a covered service provider -

10 (a) Consequent to the determination that there is low risk to viability of a covered service provider, the Corporation may monitor the covered service provider based on regulatory data, reports from examinations and inspections, if any, and any other data that may be available to the Corporation.

(2) Actions consequent to moderate risk to viability of a covered service provider -

15 (a) Consequent to the determination that there is moderate risk to viability of a covered service provider, the Corporation may, in addition to the actions under Paragraph (1), conduct a special examination of the affairs of the covered service provider to assess its health, and communicate its concerns to the covered service provider.

(3) Actions consequent to material risk to viability of a covered service provider -

20 (a) Consequent to the determination that there is material risk to viability of a covered service provider, the Corporation may, in addition to the actions under Paragraph (2) -

(i) require the covered service provider to prepare a resolution plan; and

25 (ii) intensify engagement on the resolution plan, including obtaining all the information related to the plan.

(4) Actions consequent to imminent risk to viability of a covered service provider -

30 (a) Consequent to the determination that there is imminent risk to viability of a covered service provider, the Corporation must within ninety days of determination, apply for receivership under Chapter 46.

(b) Consequent to the determination that there is imminent risk to viability of a covered service provider, the Corporation may, in addition to the actions under Paragraph (3), and upon appointment as receiver, exercise any powers under Chapter 46.

(5) Actions consequent to critical risk to viability of a covered service provider -

(a) Consequent to the determination that there is critical risk to viability of a covered service provider, the Regulator must withdraw any authorisation that it may have granted to the covered service provider.

40 (b) Consequent to the determination that there is critical risk to viability of a covered service provider, the Corporation must -

(i) if the Corporation is of the opinion that the covered service provider is about to become insolvent, terminate or cancel all Corporation insurance that the covered service provider may have acquired, in accordance with Chapter 50; and

- (ii) apply for liquidation, in accordance with the provisions under Chapter 51.
- (c) Consequent to the determination that there is critical risk to viability of a covered service provider, the Corporation may carry out any actions under Paragraph (4).

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Schedule 5: Members of the Monetary Policy Committee

See section 333, Part X

Members of the Monetary Policy Committee

- 5 (1) In this Schedule, the term "member of the Monetary Policy Committee" excludes the members appointed under section 333(2)(b) and the Reserve Bank Chairperson.
- (2) Every member of the Monetary Policy Committee will be appointed for a term of four years.
- 10 (3) A member of the Monetary Policy Committee may resign by giving a written notice of resignation of at least six weeks duration to the Central Government, with a copy to the Reserve Bank Chairperson.
- (4) The terms and conditions of service of the members of the Monetary Policy Committee including honorarium will be provided for by the Reserve Bank by way of bye-laws and published.
- 15 (5) The Reserve Bank Board may remove a member of the Monetary Policy Committee, if it is satisfied that such member has -
 - (a) been absent from the Monetary Policy Committee's meetings for more than three consecutive meetings, without obtaining prior leave;
 - 20 (b) developed any interest under section 333(7)(a) of this Act or it is discovered that the member had failed to adequately disclose such interest prior to their appointment;
 - (c) been at any time, or is, adjudged insolvent;
 - (d) been convicted of an offence, where such an offence does not constitute a minor offence;
 - 25 (e) acted in a manner which amounts to abuse of position that such member holds or renders the member's continuance in office prejudicial to the objectives of the Monetary Policy Committee or the Reserve Bank; or
 - (f) become physically or mentally incapable of discharging a member's duties.
- 30 (6) The principles of natural justice must be observed in relation to the procedure followed by the Reserve Bank Board, for the removal of any member of the Monetary Policy Committee.

Schedule 6: Repeal of other laws

See section 450, Part XV

Repeal of other laws

- (1) The Securities Contracts (Regulation) Act, 1956 (42 of 1956)
- (2) The Securities and Exchange Board of India Act, 1992 (15 of 1992) 5
- (3) The Depositories Act, 1996 (22 of 1996)
- (4) The Public Debt Act, 1944 (18 of 1944)
- (5) The Government Securities Act, 2006 (38 of 2006)
- (6) The Reserve Bank of India Act, 1934 (2 of 1934)
- (7) The Insurance Act, 1938 (4 of 1938) 10
- (8) The Banking Regulation Act, 1949 (10 of 1949)
- (9) The Forward Contracts (Regulation) Act, 1952 (74 of 1952)
- (10) The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970)
- (11) The Deposit Insurance and Credit Guarantee Corporation Act, 1961 (47 of 1961) 15
- (12) The Foreign Exchange Management Act, 1999 (42 of 1999)
- (13) The Insurance Regulatory and Development Authority Act, 1999 (41 of 1999)
- (14) The Payment and Settlement Systems Act, 2007 (51 of 2007)
- (15) The Acts establishing bodies corporate involved in the financial sector (for example, The State Bank of India Act, 1955 (23 of 1955) and The Life Insurance Corporation Act, 1956 (31 of 1956)). 20

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REPORT

JOINT COMMITTEE TO EXAMINE THE CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF PROFIT

Presented to Lok Sabha on 22.12.2008
Laid in Rajya Sabha on 22.12.2008



LOK SABHA SECRETARIAT
NEW DELHI

December/Agrahayana, 1930 (Saka)

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JOINT COMMITTEE TO EXAMINE THE CONSTITUTIONAL AND
LEGAL POSITION RELATING TO OFFICE OF PROFIT

COMPOSITION OF THE COMMITTEE

Shri Iqbal Ahmed Saradgi — *Chairman*

MEMBERS

Lok Sabha

2. Shri V. Kishore Chandra
5. Deo
3. Shri Santosh Gangwar
4. Dr. Satyanarayan Jatiya
- *5. Shri Ganesh Prasad Singh
6. Shri A. Krishnaswamy
7. Shri Madhusudan Mistry
8. Shri Mohammad Salim
9. Shri Rajesh Verma
- **10. Vacant

Rajya Sabha

11. Shri Virendra Bhatia
12. Shri Arun Jaitley
13. Shri Ram Jethmalani
14. Dr. Abhishek Manu Singhvi
15. Shri Sitaram Yechury

SECRETARIAT

- | | | |
|----------------------|---|-----------------------------------|
| 1. Shri P.K. Grover | — | <i>Joint Secretary</i> |
| 2. Shri R.S. Misra | — | <i>Director</i> |
| 3. Shri Kusal Sarkar | — | <i>Deputy Secretary-II</i> |
| 4. Shri D.K. Arora | — | <i>Senior Committee Assistant</i> |

*Nominated w.e.f. 22 May, 2008 vice Shri Raghunath Jha resigned.

** Vice Prof. Ram Gopal Yadav (ceased to be member of Lok Sabha consequent on his election to Rajya Sabha w.e.f. 14.11.2008)

INTRODUCTION

1. The Chairman, Joint Committee to examine the constitutional and legal position relating to office of profit having been authorized by the Committee to submit the report on their behalf, present this report of the Committee.

2. The Lok Sabha at its sitting held on Thursday, the 17 August, 2006 adopted the following Motion (Appendix-I) regarding constitution of Joint Committee to examine the constitutional and legal position relating to Office of Profit.

"That a Joint Committee of Houses to be called the Joint Committee to examine the constitutional and legal position relating to Office of Profit be constituted consisting of fifteen members, ten members from this House to be nominated by the Speaker including the Chairperson of the Joint Committee and five members from the Rajya Sabha to be nominated by the Chairman, Rajya Sabha....."

3. The Motion was forwarded to Rajya Sabha for its concurrence and the Rajya Sabha concurred in it on 18 August, 2006. Consequently, in accordance with the motions adopted by both the Houses, Joint Committee to examine the constitutional and legal position relating to Office of Profit was constituted on Wednesday, the 30 August, 2006 consisting of ten Members from the Lok Sabha and five Members from the Rajya Sabha.

4. The Committee held 15 sittings in all.

5. As Chairman of JPC, I would like to place on record my sincere gratitude to the members for their active participation in the Committee's deliberations and their valuable contribution to arrive at the conclusions.

6. The Committee wish to express sincere thanks to the Officers of the Ministry of Law & Justice (Legislative Department) for making available the material called for in connection with the examination of the subject. The Committee also wish to thank all the constitutional and legal experts, political parties/groups in Parliament, State/U.T. Governments, Institutions and members of general public who have contributed through their valuable suggestions/opinions to enable the Committee to arrive at a conclusion and present their report.

7. The Committee would like to place on record their deep sense of appreciation for the invaluable assistance rendered to them by the officers and staff of the Lok Sabha Secretariat attached with the Committee.

8. The Committee considered and adopted the Report at their sitting held on 16 December, 2008.

NEW DELHI;
16 December, 2008
25 Agraahayana, 1930 (Saka)

IQBAL AHMED SARADGI,
Chairman,
Joint Committee to examine the Constitutional and
Legal Position Relating to Office of Profit.

REPORT

CHAPTER I

INTRODUCTORY

The Parliament (Prevention of Disqualification) Amendment Bill, 2006 was assented to by the President on the 18th August, 2006. While reconsidering the Parliament (Prevention of Disqualification) Amendment Bill, 2006 by the Lok Sabha on 31st July, 2006 an assurance was given on the floor of the House that the various points raised in the message of the Hon'ble President will be examined by the Joint Committee of both the Houses of Parliament. Accordingly, the Hon'ble Minister of Law and Justice moved a motion in Lok Sabha on 17 August, 2006 for constitution of a joint Committee to examine the constitutional and legal position relating to office of profit. The motion was adopted by Lok Sabha on the same day *i.e.* on 17 August, 2006. The motion provided for inclusion of the following members of Lok Sabha:—

1. Shri V. Kishore Chandra S. Deo
2. Shri Santosh Gangwar
3. Dr. Satyanarayan Jatiya
4. Shri Raghunath Jha
5. Shri A. Krishnaswamy
6. Shri Madhusudan Mistry
7. Shri Mohammad Salim
8. Shri Iqbal Ahmed Saradgi
9. Shri Rajesh Verma
10. Prof. Ram Gopal Yadav

2. The motion regarding appointment of the Committee was concurred in by Rajya Sabha on 18 August, 2006 and included the following members of Rajya Sabha:—

1. Shri Virendra Bhatia
2. Shri Arun Jaitley
3. Shri Ram Jethmalani
4. Dr. Abhishek Manu Singhvi
5. Shri Sitaram Yechury

3. Hon'ble Speaker appointed Shri Iqbal Ahmed Saradgi as Chairman of the Committee.

4. Thus, a Committee of 15 members of Parliament (10 from Lok Sabha and 5 from Rajya Sabha) was constituted as Joint Committee to examine the constitutional and legal position

relating to office of profit with the following terms of reference:-

- (i) to examine in the context of settled interpretation of the expression "office of profit" in Article 102 of the Constitution and the underlying constitutional principles therein, and to suggest a comprehensive definition of "Office of Profit";
- (ii) to recommend, in relation to "office of profit", the evolution of generic and comprehensive criteria which are just, fair and reasonable and can be applied to all States and Union Territories;
- (iii) to examine the feasibility of adoption of system of law relating to prevention of disqualification of Members of Parliament as existing in the United Kingdom and considered by the Constitution (Forty-Second Amendment) Act, 1976; and
- (iv) to examine any other matter incidental to the above.

5. The Committee were expected to present a report to Parliament by the first day of last week of Winter Session 2006. But the Committee had to seek five extensions (on 12.12.06, 14.05.07, 07.09.07, 29.11.07 and 30.04.08) of time for presentation of the report.

6. At their first sitting held on 14 September, 2006 the Committee held discussion among themselves regarding the concept of office of profit and deliberated upon the broad procedures to be adopted by the Committee for its working. The Committee also decided to issue *press communique* inviting suggestions/views in the form of memoranda from constitutional/legal experts, academicians, law institutes, bar councils, public bodies or individuals. In response, the Committee received 57 memoranda (Appendix-II). The Committee also decided to seek the views of all Parliamentary Parties/Groups, and State Governments on the subject. The Committee were also given a briefing by the representatives from the Ministry of Law and Justice (Legislative Department).

7. At their sitting held on 19 October, 2006 the Committee took stock of the action taken in pursuance of the decisions taken by the Committee at their first sitting and shortlisted the names of experts who might be asked to appear before the Committee for oral evidence. The Committee also held discussion with the representatives of Ministry of Law and Justice (Legislative Department) and sought certain clarification and material.

8. At their third sitting held on 17.11.06, the Committee heard the views of constitutional and legal experts : Shri Fali S. Nariman, Senior Advocate and Shri Rustom S. Gae, former Law Secretary, Government of India on matter under reference to the Committee.

9. At their fourth sitting held on 1 December, 2006 the Committee heard views/suggestions of Sarvashri Rajeev Dhavan and Harish N. Salve, both Senior Advocates.

10. At their sitting held on 20 March, 2007 the Committee heard the views of the representatives of Ministry of Home Affairs, NCT of Delhi and Union Territory of Puducherry.

11. At their sitting held on 9 May, 2007 the Committee held discussion and decided to seek extension of time for presentation of their report till the first day of last week of Monsoon Session, 2007. The motion for extension of time for presentation of the report was moved on 14.5.2007 which was adopted by the House on the same day.

12. At their sitting held on 23 August, 2007 the Committee heard the views of the representatives of the State Government of Gujarat on the terms of reference of the JPC.

13. At their sitting held on 5 September, 2007 the Committee decided to seek extension of time for presentation of the report till the first day of the last week of the Winter Session, 2007. The motion was moved in and adopted by the House on 07.09.2007.

14. At their sitting held on 31 October, 2007 the Committee heard the views of the representatives of Governments of North Eastern States on matters under reference of the JPC.

15. The Committee heard the views of the representatives of State Government of Rajasthan at their sitting held on 27.11.07. The Committee also proposed to seek extension of time for presentation of their report till the last day of the Budget Session, 2008. The motion for extension of time for presentation of the report was moved on 29.11.07 which was adopted by the House on the same day.

16. At their sitting held on 28 April, 2008 the Committee heard the views of representatives of State Government of Uttar Pradesh. The Committee also decided to seek extension of time for presentation of the report till the last day of Monsoon Session, 2008.

17. At their sitting held on 5 June, 2008 the Committee heard the views of State Governments of Orissa and Chhattisgarh. Similarly, at their sittings held on 20 August and 9 September, 2008 the Committee heard the views of State Governments of Madhya Pradesh and Kerala respectively.

18. The Committee undertook study visits to Mumbai and Bangalore (17 to 19 January, 07), Kolkata and Chennai (8 and 9 February, 07) Chandigarh and Shimla (25 to 27 June, 07), Patna (on 08.02.08) and Hyderabad (on 31.07.08) and held informal discussions with the representatives of respective State Governments.

CHAPTER II

ORIGIN AND CONCEPT OF OFFICE OF PROFIT IN INDIA

The concept of disqualifying a holder of office of profit under the Government for being chosen as and for being, a member of the legislature originated from the need in democratic Governments to limit the control and influence of the Executive over the legislature by means of an undue proportion of office holders being members of the legislature. Further, holding of certain offices was considered incompatible with membership of legislatures due to physical impossibility of a person attending in two places, or heavy duties being usually attached to those offices. Exception was, however, made in the case of Ministers and other members of Government with a view to having effective coordination between the executive and the legislature and making the executive accountable to the Legislature.

2. The concept of disqualifying the holder of an office has developed as a necessary and inseparable part of a democratic government. The Government of India Act, 1935, made a clear and precise statement in this direction. Sub-section (1) of section 26 of the Government of India Act, 1935 provided disqualification for membership of the Federal Legislature which read as follows:-

"26.(1) A person shall be disqualified for being chosen as, and for being, a member of either Chamber-

(a) if he holds any office of profit under the Crown in India, other than an office declared by Act of the Federal Legislature not to disqualify its holder.

....."

3. Similarly sub-section (1) of section 69 of the said Act provided disqualification of membership of a Provincial Legislative Assembly or Legislative Council which read as follows:-

"(1) A person shall be disqualified for being chosen as and for being a member of either Chamber-

(a) if he holds any office of profit under the Crown in India, other than an office declared by Act of the Federal Legislature not to disqualify its holder.

....."

4. These sections 26(1) (a) and 69 (1) (a) of the Government of India Act, 1935 with consequential changes were taken in the "first draft Constitution of India" prepared by the Constitutional Advisor as Articles 68 and 141. Relevant portion of these Articles is reproduced below:

"(1) A person shall be disqualified for being chosen as, and for being, a member of either House of the Federal Parliament—

(a) if he holds any office of profit under the Federation or any unit other than an office declared by Act of the Federal Parliament not to disqualify its holder.

....."

5. For the purposes of this section a person shall not be deemed to hold an office of profit under the Federation or any unit by reasons only that he is a Minister either for the Federation or for a Province."

6. The above draft articles alongwith other draft articles of the Constitution prepared by the Constitutional Advisor were considered by the Drafting Committee chaired by Dr. B. R. Ambedkar at their meetings held between 1947 and 1948 and the same were extensively revised. The Draft Constitution prepared by the Drafting Committee suggested the following Articles on the above subject:

(1) A person shall be disqualified for being chosen as, and for being, a member of either House of Parliament—

- (a) if he holds any office of profit under the Government of India or the Government of any State other than an office declared by Parliament by law not to disqualify its holder;
- (b) if he is of unsound mind and stands so declared by a competent court;
- (c) if he is an undischarged insolvent;
- (d) if he is under any acknowledgement of allegiance or adherence to a foreign power, or is a subject or a citizen or entitled to the rights or privileges of a subject or a citizen of a foreign power; and
- (e) if he is so disqualified by or under any law made by Parliament.

7. For the purposes of this Article, a person shall not be deemed to hold an office of profit under the Government of India or the Government of any State by reasons only that—

- (a) he is a Minister either for India or for any State for the time being specified in Part II of the First Schedule; or
- (b) he is a Minister for any State for the time being specified in Part III of the First Schedule and he is responsible to the Legislature of the State, or where there are two Houses of the Legislature of the State, to the Lower House of such Legislature and if not less than three-fourths of the members of such Legislature or House, as the case may be, are elected.

8. A person shall be disqualified for being chosen as, and for being, a member of the Legislative Assembly or Legislative Council of a State—

- (a) if he holds any office of profit under the Government of India or the Government of any State for the time being specified in the First Schedule other than an office declared by the Legislature of the State by Law not to disqualify its holder.
- (b) if he is of unsound mind and stands so declared by a competent court.
- (c) if he is an undischarged insolvent.
- (d) if he is under any acknowledgement of allegiance or adherence to a foreign power, or is a subject or a citizen or entitled to the rights or privileges of a subject or a citizen of a foreign power.
- (e) if he is so disqualified by or under any law made by the Legislature of the State.

9. The above draft Articles as settled by the Drafting Committee were widely circulated to invite comments and suggestions. The Drafting Committee further revised the said articles in the "Revised Draft Constitution: November, 1949". The following Articles were suggested:—

(1) A person shall be disqualified for being chosen as, and for being, a member of either House of Parliament—

- (a) if he holds any office of profit under the Government of India or the Government of any State other than an office declared by Parliament by law not to disqualify its holder;
- (b) if he is of unsound mind and stands so declared by a competent court;
- (c) if he is an undischarged insolvent;
- (d) if he is not a citizen of India, or has voluntarily acquired the citizenship of a foreign State, or is under any acknowledgement of allegiance or adherence to a foreign State;
- (e) if he is so disqualified by or under any law made by Parliament.

(2) For the purposes of this Article, a person shall not be deemed to hold an office of profit under the Government of India or the Government of any State by reason only that he is a Minister either for the Union or for such State.

10. The above provisions were discussed in the Constituent Assembly and after discussion the said provisions were adopted as Articles 102 (1) (a) and 191 (1) (a) respectively.

Art. 102(1)(a) of the Constitution of India reads as under:—

"102(1) A person shall be disqualified for being chosen as and for being a member of either House of Parliament—

(a) if he holds any office of profit under the Government of India or the Government of any State, other than office declared by Parliament by law not to disqualify its holder."

11. The Constitution, however, has not defined what constitutes an office of profit, the holder of which would disqualify a member within the meaning of the said Article. The Parliament has, however, been empowered to declare by law the offices, the holding of which would not disqualify a member. To constitute an 'office of profit' under Art.102(1) (a) of the Constitution, three conditions are to be satisfied—there should be an 'office' to which an appointment is made; it should be an 'office of profit' and the 'office' should be one under the Government.

12. The Parliament and State Legislatures are, however, empowered to exempt any such office entailing disqualification. The Parliament (Prevention of Disqualification) Act, 1959 specifies certain offices, which will not come within the purview of the disqualification, and several offices have been added after enactment of the law. Acts of the respective legislatures prescribe the exemptions of the state legislatures. This rule is founded on the imperative need for neutrality and impartiality in the realm of public service.

13. In pursuance of Article 102 (1) (a), the Parliament had enacted the following Acts for the purposes of declaring offices, the holding of which shall not incur disqualifications for membership of Parliament—

- (a) The Parliament (Prevention of Disqualification) Act, 1950 (XIX of 1950)
- (b) The Parliament (Prevention of Disqualification Act), 1951 (LXVIII of 1951)
- (c) The Prevention of Disqualification (Parliament and Part C State Legislatures) Act, 1953 (1 of 1954)

14. Since none of the above enactments had decided the matter appropriately covering all the necessary aspects of the problems to the satisfaction of all concerned, the Hon'ble Speaker, Lok Sabha in consultation with the Hon'ble Chairman of the Rajya Sabha on the expressed desire of members of various political parties, constituted a Joint Committee under the Chairmanship of Pandit Thakurdas Bhargava, M.P. to study various matters connected with the disqualification of members under Article 102(1)(a) of the Constitution with the following terms of reference:—

- to study various matters connected with disqualification of members, to make recommendation in order to enable the Government to consider the lines along which a comprehensive legislation should be brought before the House; and
- collect facts, data and make suggestion as to how the matter should be dealt with.

15. The Joint Committee presented their report to Parliament in November, 1955. In the view of the Bhargava Committee, Members of Parliament should be encouraged to serve on such committees, which are of an advisory character and represent the local or popular point of view, in a manner, which will effectively influence the official point of view. Members of Parliament by virtue of their membership are in a position to say and represent certain matters with some authority and confidence, and their views are likely to go a long way in influencing the view point of officials. But at the same time, it felt that consistent with the above view expressed, Members of Parliament should not be permitted to serve on committees, commissions etc. which jeopardize their independence or which will place them in a position of power or influence or in a position where they receive some patronage from Government or are themselves in a position to distribute patronage. The Committee recommended, among other things, that a Standing Committee of Parliament might be constituted to undertake the work of continuous scrutiny in respect of existing and future office of profit. Accordingly, the Joint Committee on Office of Profit were constituted for the first time in August, 1959 during the Second Lok Sabha. Since then the Committee has been constituted from time-to-time after each General Election for the duration of the term of the House except during the term of Sixth Lok Sabha when no such Committee were constituted. The functions of the Committee are:

- (i) to examine the composition and character of all existing 'Committees' and all 'Committees' that may be constituted, membership of which may disqualify a person for being chosen as, and for being, a member of either House of Parliament under Article 102 of the Constitution.
- (ii) to recommend in relation to the 'Committee' examined by it what offices should disqualify and what offices should not disqualify.
- (iii) to scrutinize from time-to-time the Schedule to the Parliament (Prevention of Disqualification) Act, 1959 and to recommend any amendment in the said schedule, whether by way of addition, omission or otherwise.

16. The Committee examine the detailed particulars regarding the composition, character, etc. of the "committees" constituted by the Ministries/Departments of the Central Government as well as the State Governments. The Committee also examine various queries received from Members of Parliament pertaining to "Office of Profit" and express their opinion in appropriate cases. The Committee, however, do not examine the composition and character of 'Committees' which consist wholly of officials or which are constituted for *ad hoc* purposes. Further, during the Third Lok Sabha, the Committee decided that the composition and character etc. of the bodies registered under the Societies Registration Act need not generally be examined unless any particular case merited consideration.

17. The Committee also decided [(8th Report (8th LS)] that all the Ministries of Government of India and the State Governments might be asked to obtain prior approval of the Speaker, Lok Sabha or Chairman, Rajya Sabha as the case may be before nominating any Member of Parliament to any Government Committee/Body, unless the Act under which such Committee/Body have been set up to provide for appointment of an M.P. or where Members of Parliament are saved from incurring disqualification by the provisions in the relevant Act itself as is the case with the Rubber Board, Coffee Board, Tea Board etc.

18. Proposals received from the Central/State Govts. seeking Speaker's approval for nomination of Members of Parliament on various Committees/Bodies constituted by them are examined by the Committee as to whether the office of Member/Director/Chairman of the Govt. body in question constitute an Office of Profit under the Government which would disqualify the member for being a Member of Parliament. The Committee also examine requests received from Members of Parliament seeking clarification about the Office of Profit under Government and members are apprised of the views of the Committee.

CHAPTER III BACKGROUND ANALYSIS

A. First Term of Reference

to examine, in context of settled interpretation of the expression "office of profit" in Article 102 of the Constitution and the underlying constitutional principles therein, and to suggest a comprehensive definition of "office of profit".

1.1 An office of profit is a term used in a number of national constitutions to refer to executive appointments. A number of countries forbid members of the legislatures from accepting an office of profit under the executive as a means to secure the independence of the legislature and preserve the separation of powers. In all democracies like United States of America and the United Kingdom, the holders of offices under the Government, as a rule are disqualified for being Members of the Legislature. The inherent idea seems to be that the personal and pecuniary interest should not come in the way of discharging their obligations by the legislators. In India, this principle is embodied in Articles 102 (1)(a) and Article 191(1)(a) of the Constitution.

1.2 The principle contained in Art. 102 is based on sound public policy of ensuring impartiality and neutrality in the public service and avoidance of conflict between duty and interest of an elected member, enabling him to carry on his duties freely and fearlessly without being subjected to any governmental pressure thereby maintaining purity of the legislature. The provision is undoubtedly designed to protect independence of Members of Parliament. The object of Art. 102 (1) (a) is to disqualify a person from the membership of Parliament if he is obliged by the Government for an office of profit which carries profit or benefit and thus compromising his independence.

Constitutional Provisions

1.3 The expression "office of profit" occurs in the following articles of the Constitution namely:—

Article 18(3)—No person who is not a citizen of India shall, while he holds any office of profit or trust under the State, accept without the consent of the President any title from any foreign State.

Article 18(4)—No person holding any office of profit or trust under the State shall, without the consent of the President, accept any present, emolument or office of any kind from or under any foreign State.

Article 58(2)—A person shall not be eligible for election as President if he holds any office of profit under the Government of India or the Government of any State or under any local or other authority subject to the control of any of the said Governments.

Article 66(4) A person shall not be eligible for election as Vice-President if he holds any office of profit under the Government of India or the Government of any State or under any local or other authority subject to the control of any of the said Governments.

Explanation—for the purposes of this article, a person shall not be deemed, to hold any office of profit by reason only that he is the President or Vice-President of the Union or the Governor of any State or is a Minister either for the Union or for any State.

Art.102 (1)(a) of the Constitution of India reads as under:—

"102(1). A person shall be disqualified for being chosen as and for being a member of either House of Parliament—

(a) if he holds any office of profit under the Government of India or the Government of any State, other than the office declared by Parliament by law not to disqualify its holder."

Explanation : for the purposes of this clause a person shall not be deemed to hold an office of profit under the Government of India or the Government of any State by reason only that he is a Minister either for the Union or for such State.

Article 158(2) The Governor shall not hold any other office of profit.

Article 191(1) A person shall be disqualified for being chosen as, and for being, a member of the Legislative Assembly or Legislative Council of a State—

(a) if he holds any office of profit under the Government of India or the Government of any State specified in the First Schedule, other than an office declared by the Legislature of the State by law not to disqualify its holder.

Explanation : for the purposes of this clause a person shall not be deemed to hold an office of profit under the Government of India or the Government of any State specified in the First Schedule by reason only that he is a Minister either for the Union or for such State.

1.4 The expression "office of profit" has not been defined in the Constitution or any other statute. It has, therefore, been open to the courts to explain the significance and meaning of this concept. Most of the cases which are arisen under Article 191(1)(a) of the Constitution are only relevant to Article 102(1)(a) of the Constitution as both these provisions are identical, in text and purpose.

1.5 In pursuance of above Articles, the Parliament (Prevention of Disqualification) Act, 1959 (Annexure-I) was enacted by Parliament. The said Act has been amended from time-to-time to include office exempted from disqualification from the purview of office of profit. A list of amendments made *vis a vis* the offices exempted from the purview of office of profit is enclosed (Annexure-II). In pursuance of Article 191(1)(a) of the Constitution, the State Legislatures have enacted their own laws relating to removal of disqualification. A list of State enactments is enclosed (Annexure-III)

1.6 If any question arises as to whether a Member of Parliament has become subject to any of the disqualification laid down in the Constitution including the one whether he is holding an Office of Profit or not, the question is referred for the decision of the President and his decision is final. However, before giving any decision on any such question, Art.103(2) requires the President to consult the Election Commission and the Commission may make such enquiry as it deems fit. It is important to note that in this matter the President does not act on the advice of Council of Ministers.

1.7 The underlying object of this constitutional provision is to secure independence of the Members of Parliament or a State Legislature and to ensure that Parliament or the State Legislature does not contain persons who have received favours or benefits from the Executive Government and who consequently, being under an obligation to the Executive, might be amenable to its influence. Obviously, the provision has been made in order to eliminate or reduce the risk of conflict between duty and self-interest among the Legislators.

Connotation of the word 'office'

1.8 In the usual sense of the word an 'office' means a right to exercise a public or private employment and to take the fees and emoluments there unto belonging* "In its fullest sense an office embraces the elements of tenure, duration, duties and employments, but the emoluments is not essential to office."** it has also been held that an office is an employment on behalf of Government in any State or public trust and one not merely transient, occasional or incidental.***

1.9 According to the @Supreme Court, the following connotation of 'office' given by Justice Rowlatt in *Great Western Railway Company Vs. Baker* can appropriately be applied to the word 'office' in Article 191 of the Constitution.

"...an office or employment which was a subsisting, permanent, substantive position which has an existence independent from the persons who filled it, which went on and was filled in succession by successive holders; and if you merely had a man who was engaged in whatever terms, to do duties which were assigned to him, his employment to do those duties did not create an office to which those duties were attached. He merely was employed to do certain things and that is an end of it; and there was no office or employment existing in the case as a thing, the so-called office or employment was merely an aggregate of the activities of the particular man for the time being....."

1.10 The words 'its holder' occurring in Article 191 (1) (a) of the Constitution indicate that there must be an office which exists independently of the holder of the office. The very fact that the Legislature has been authorized by Article 191 to declare that an office of profit would not disqualify its holder contemplates the existence of an office apart from its holder.

Connotation of holding an office

1.11 A person is disqualified for being chosen as a member of Legislature if he holds an office of profit under the Government at the time of filing his nomination paper. The disqualification is not removed on his submitting an unqualified resignation of his office or by ceasing to work but only when the resignation has been accepted by the proper authority prior to the filing of the nomination paper (*Election Tribunal, Beharmpur, in Ram Murry Vs. Sumba Sadar 2, E.L.R., 330*). The disqualification is not removed if the resignation has been accepted by an authority not competent to accept it. In such a case the acceptance of the resignation is invalid and the person submitting his resignation will be disqualified since it must be considered to have continued to hold office. (*Election Tribunal, Rajnandgaon, in Thakur Daoo Singh Vs. Ram Krishna Rathor, 4 E.L.R., p.34*).

* Stroud's Judicial Dictionary (1953) Ed.

** Webster's New International Dictionary of the English Language (1953), Vol. w

*** 20 John Rep.492, 7th Ohio State 556

@ Smt. Xanta Kathuria Vs. M. Manak Chand Khurana, E.L.R. Vol.XLIII, p.58

1.12 The disability under Articles 102 and 191 being a constitutional one, it cannot be removed by acceptance of resignation from an office of profit with retrospective effect. (Kamta Prasad Upadhyaya Vs. Sarjoo Prasad Tiwari and others, E.L.R., Vol. XXXV, p.10).

Connotation of 'profit'

1.13 To define 'profit' is more difficult. It normally connotes any advantage benefit or useful consequence. In India, however, the Election Tribunals/Courts have construed "pecuniary gain" to be an essential ingredient of 'profit'. According to the Election Tribunal, Mangalore in^{**} *Shivaramo Karanth Vs. Venkatoramano Gowda and others*, 'pecuniary advantage' is an essential element of 'office of profit.' If honour and prestige were sufficient to constitute 'office' then any office under the Government though strictly honorary, would be hit. In the words of the Tribunal,

"We do not consider that the Constitution intended to impose a wholesale ban on every type of office, irrespective of whether any remuneration is attached to it or not. We decline to place such a construction, as we believe, that such an intention does not follow from a reading of the clause."

1.14 In another case (*Chander Nath Vs. Kunwar Jaswant Singh*),* it was held that the membership of a District Vittran Committee, which was constituted for the purpose of controlling the distribution of controlled commodities, i.e. foodgrains, sugar, cloth, etc. to the people in the district, did not constitute an 'office of profit' as a member did not receive any remuneration either in cash or in kind, even though it was contended that the Committee carried with it a lot of influence.

Judicial Interpretation of Article 102 of the Constitution

1.15 As already stated the expression "holds any office of profit under the Government" occurring in the Article 102(1) of the Constitution has nowhere been defined precisely. Its meaning has to be gathered from the construction of the words used and pronouncements of judicial tribunals.

1.16 In the case of *Guru Gobinda Basu Vs. Sankari Prasad Ghosal*. [AIR 1964 SC 254] the Supreme Court pointed out that one of the dominant tests to determine this question would be the location of Powers of appointing and removing authority to or from the office. After reviewing some decisions, the Supreme Court in *Guru Gobinda Basu's* case observed as follows:

"It is clear from the aforesaid observations that in Maulana Abdul Shokur's case, (AIR 1958 SC 52) the facts which were held to be decisive were (a) the power of the Government to appoint a person to an office of profit or to continue him in that office or revoke his appointment at their discretion, and (b) payment from out of Government revenue though it was pointed out that payment from a source other than Government revenues was not always a decisive factor."

* E.L.R. Vol.III, p.147

** E.L.R. Vol.III, p.187

1.17 In another case Pradyut Bardoloi Vs. Swapan Roy [AIR 2001 5C 296], the Supreme Court observed that a variety of situations have come up for the consideration of the court wherein the court was called upon to apply the determinative test so as to find out whether a case of holding an office of profit under the Government was made out or not. The first and foremost question to be asked is whether the Government has power to appoint and remove a person to and from the office? If the answer is in the negative, no further enquiry is called for, the basic determinative test having failed. If the answer is in the affirmative further probe for the remaining ingredients of an office of profit will have to be undertaken. In the Pradyut case, the courts further observed that the inquisitive over-view-eye would finally query that whether on account of holding of such office—would the Government be in a position to so influence him as to interfere with his independence in functioning as a Member of Legislative Assembly or would his holding of the two offices namely one under the Government and the other being Member of Legislative Assembly involve a conflict of interests *inter se*? This is how the issue has to be approached and resolved.

1.18 As referred above, in the Shivamurthy Swami Inamdar etc. Vs. Agadi Sanganna Andanappa [(1971) 3 SC 870] it was observed by the Supreme Court that the Court in several decisions has laid down the tests for finding out whether an office in question is an office under the Government and whether it is an office of profit. Those tests are:—(1) Whether the Government makes the appointment; (2) Whether the Government has the right to remove or dismiss the holder; (3) Whether the Government pays the remuneration; (4) What are the functions of the holder? Does he perform them for the Government; and (5) Does the Government exercise any control over the performance of those functions?

1.19 The proposition of the law laid down in the above cases may indicate that the expression "holds an office of profit under the Government" is settled. But a look at the recent decisions of the Supreme Court reveal that it is not so in all the cases and in all situations. In the recent Supreme Court decision in Shibu Soren Vs. Dayanand Sahay AIR 2001 SC 2583, the Court observed as follows:

With a view to determine whether the concerned office is an "office of profit" the Court must, however, take a realistic view. Taking a broad or general view, ignoring essential details is not desirable nor is it permissible to take a narrow view by which technicality may overtake reality. It is a rule of interpretation of statutes that the statutory provisions are so construed as to avoid absurdity and to further rather than defeat or frustrate the object of the enactment.

While interpreting statutory provisions, Courts have to be mindful of the consequences of disqualifying a candidate for being chosen as, and for being a member of the legislature on the ground of his holding an office of profit under the State or the Central Government, at the relevant time. The Court has to bear in mind that what is at stake is the right to contest an election and to be a member of the legislature indeed a very important right in any democratic set up. A practical view not pedantic basket of tests must, therefore, guide the Courts to arrive at an appropriate conclusion."

1.20 In the recent Supreme Court decision in *Jaya Bachchan Vs. Union of India* (2006 5 SCALE 411) the Supreme Court observed that

"the question whether a person holds an office of profit is required to be interpreted in a realistic manner. Nature of the payment must be considered as a matter of substance rather than of form. Nomenclature is not important. In fact mere use of the word 'honorarium' cannot take the payment out of the purview of profit, if there is pecuniary gain for the recipient. Thus, if the pecuniary gain is receivable in connection with the office then it becomes an office of profit, irrespective of whether such pecuniary gain is actually received or not."

1.21 On the basis of the above analysis, according to the Ministry of Law & Justice (Legislative Department) it seems that the expression office of profit occurring in Article 102 of the Constitution has assumed a settled expression.

1.22 Under varying circumstances judgments have been delivered by the courts in the past depending upon the peculiarity of each case. The grayness of the area can be gauged from the fact that on a number of occasions, the judgments of the Election Tribunals have been reversed by the High Court and on many other occasions, the Supreme Court has reversed the judgments of the High Courts. Furthermore, even in the Supreme Court, there have been instances when an issue was referred to a five-bench judge, three judges gave one judgment and two judges gave different judgement on the same issue. These facts reflect the complexity involved in interpretation of the term holder of an office of profit under the Government for the purpose of incurring/prevention of disqualification from the membership of legislature. A compilation of some of the decisions of the courts and tribunal is placed at Annexure IV.

'Settled' Interpretation of the term "office of profit" in Article 102

1.23 The expressions which assume significance are "office", "profit" and "under the Government". In order to bring a case within Article 102 (1)(a) of the Constitution it must first be proved that what was held was an "office". The word "office" means no more than a position to which certain duties are attached. Thus, if a person does not hold office he is not disqualified even if he is making a profit e.g. a lawyer engaged by the Government to appear in a case on its behalf and paid fee by it holds no office and thus is not disqualified to be chosen as, and for being, a Member of Parliament. The word "profit" connotes the idea of pecuniary gain.

1.24 Hence, in deciding any question whether the office really carried any profit, the amount of money receivable by a person by virtue of holding such office becomes material.

1.25 An important expression which occurs in Article 102 (1) (a) of the Constitution is "under the Government". As discussed earlier the courts have enunciated certain broad criteria for determining whether a particular office could be termed as an office of profit under the Government for the purposes of Article 102 (1) (a) and Article 191 (1) (a) of the Constitution. These are as follows:—

- (a) Whether Government makes the appointment?
- (b) Whether Government has a right to remove or dismiss the holder of office?
- (c) Whether the Government pays the remuneration?

(d) What are the functions of the holder of office? and

(e) Does the Government exercise any control over the performance of those functions?

1.26 Whether an office in order to be characterized as an office of profit under the Government should satisfy these tests or whether any one or more of them may be decisive of its true nature has been the subject matter of several cases decided by the Supreme Court. But no decision appears to lay down conclusively the character of an office of profit under the Government although the court has no doubt determined in each case whether a particular office involved in the case before it was or was not an office of profit under the Government.

Definition of the term "Office of profit"

1.27 The Joint Committee to examine the constitutional and legal position relating to office of profit has been mandated to examine in context of settled interpretation of the expression "office of profit" in Article 102 of the Constitution and the underlying principles therein and to suggest a comprehensive definition of office of profit. The Committee invited comments/views from Political Parties/Groups in Parliament, general public/institutions/constitutional and legal experts. The Committee also took up the issue with the Ministry of Law and Justice (Legislative Department) Government of India and all the State Governments/U.Ts. The comments/views so received are summarised in succeeding paragraphs:-

POLITICAL PARTIES IN PARLIAMENT

1.28 In response to the requests sent to political parties/groups in Parliament for sending their comments in the subject matter, the following views were received by the JPC:-

Indian National Congress

1.29 The expression "office of profit" has not been defined in the Constitution or in any other Act not because it was impossible to define it but because it was not easy to frame an all embracing definition covering all the different kinds of offices which existed under the Government and those which might be created under it in the times to come. Under the existing legal framework, the only way to exempt the holder of an office which conferred executive, judicial or legislative powers or which entitled the holder to draw any allowances other than compensatory allowance was to exempt such office by making a specific legislative provision to that effect. Accordingly, a comprehensive legislation, namely, the Parliament (Prevention of Disqualification) Act, 1959 was enacted repealing the previous statutes on the subject. The Parliament (Prevention of Disqualification) Act, 1959 has been amended from time to time and the latest amendment to this Act has been carried out *vide* the Parliament (Prevention of Disqualification Amendment) Act, 2006 which received the assent of the President on 18 August, 2006.

Shiv Sena Parliamentary Party

1.30 The following broad norms might be taken into account in formulating the recommendations of the Committee:-

- (i) the law relating to office of profit should conform to the provisions of Articles 102 and 103 of the Constitution and the decisions of the Supreme Court in relation to these provisions.

- (ii) there should be a clear distinction between an office which was *sui generis* and identifiable with the privileges of the Members of the Parliament as distinct from an office which carried with it the broad contours of executive and financial powers capable of dispensing patronage.
- (iii) The law providing for exemption of members in relation to an office of profit should not become an alibi for extending patronage to Members of Parliament. This would negate the spirit of Articles 102 and 103 of the Constitution.
- (iv) The law on office of profit should be capable of being adopted by the States on uniform basis.

Lok Janshakti Party

1.31 The term 'office of profit' should be defined and the definition should not be exhaustive but inclusive since in view of rapid development in various sectors of the economy, it was not possible to predict participation of the Government in any entity in a particular sector of the economy.

An inclusive definition was also necessary because there was no consensus among the various States on the definition of office of profit and therefore every State Government according to its sweet-will exempted certain offices from the operation of Art. 102 r/w Art.103 to take political mileage.

Certain and definite definition of 'office of profit' would also be in the larger interest of the nation and public at large as it would end chaos and enable every citizen as well as MP to know the law before hand.

The following suggestions have been submitted for consideration of the JPC:—

1. The parliamentarian holding any 'office of profit' but only benefiting to the extent of adjustment of expenses incurred, should be exempted from operation of Art. 102 and 103 or other disqualification on account of holding 'office of profit'.
2. The parliamentarian holding any 'office of profit' should have right to vote and to exercise other administrative/managerial powers or authority as might be invested under the rules of the said office.
3. The parliamentarian should be allowed to hold 'one', 'office of profit' and should be exempted from the operation of Art. 102 r/w Art. 103.
4. Any office in which there was no remuneration, should not be included in the definition of office of profit.

The proposed definition of "office of profit" was as follows:—

- a. any office under the State or the Union Government in which any remuneration was paid and the person should not hold more than one any such office.
- b. Any office under the State or the Union Government which gave the voting power to the member of such office.
- c. Any office under the State or the Union Government which gave the power or authority to make or approve rules for the management, or which gave control over the financial matters.

Explanation: Any 'office' in which the 'holder' did not draw any pecuniary or other monetary benefits or allowances, and the person was only reimbursed of his expenses should not be included in the definition of the 'Office of Profit'.

Muslim League Kerala State Committee

1.32 It has been stated that the following tests have to be done to determine whether a person is holding an Office of Profit.

1. The power of the Government to appoint a person in office or to revoke his appointment at its discretion was one of the major factors. But, here again a mere control over the appointment would not be sufficient.
2. The payment of salary to a person holding a particular post was being given out of Government's exchequer was an important factor as well as pecuniary benefit to the holder of Office.
3. The nature and degree of control the Government had over the post for its financial needs and the functional aspect, namely whether the body was discharging any important governmental function or just some function which was merely advisory in character was another factor to be considered.
4. One more test had to be applied to see whether the post was an Office of Profit or not. The test was to see how much the person holding the Office was dependent on the Government or the influence the Government would have on him. In other words, holding an Office would curb his independence to function and to speak without fear or favour as Member of Parliament. If a person holding a post which was advisory in nature and without any executive authority on the functioning of the office he held, should definitely be exempted from the purview of Office of Profit. But any payment of honorarium or even making use of other perks except TA/DA for attending the meeting of the Body/Authority of which he was a Member or Chairman should be avoided.
5. Removal or disqualification from holding the position should specifically be mentioned at the State as well as Central level.

General public

1.33 Some of the important views received from the general public in response to a press communiqué are as follows:—

1.34 Shri Rustam S. Gae, Senior Advocate and former Law Secretary to Government of India appeared before the JPC to tender his views and stated that so long as the exemptive power under Article 102 (1) (a) was exercised reasonably and with due restraint and in a manner which did not drain out the Article of its real content or disregard any constitutional guarantee or mandate, the court would not interfere. (*Bhagwandas V. Haryana AIR 1974 SC 2355*). In the absence of any principle to be applied for creating under it exceptions to disqualification specified in Article 102, the explanation would serve as an aid to the construction of Clause (a) in general and declaring by law of office of profit not to disqualify holders from disqualification in particular. It would, therefore, be useful to follow the example provided by the explanations while enacting the law under Article 102(1) (a) exempting offices from disqualification. Provisions set out in the

explanation or provisions akin thereto would serve as a guide in determining the nature of the law to be enacted under Article.

1.35 Similarly, in response to press communiqué one Shri Sitaram Aggrawal suggested the following definition:-

the term "office of profit" means and includes holding any position by a Member of Parliament or his/her spouse in Government or its associate bodies or institutions and entitled to there for anything by way of remuneration, whether actually obtained or not. The remuneration may be by way of salary, fee, commission, perquisites, the right to occupy free of rent any premises as a place of residence, or otherwise, and it includes all benefits or advantages having a money value derived from the Government.

Explanation: Government means and includes Central Government, State Government, semi-government, public sector undertaking, bodies and institutions established, aided or supported directly or indirectly by Government including through MPLAD fund etc.

1.36 He had further stated that anything connected with or related to Constitution, whether any clarification of a word, term, etc. or amendment to existing content including definition of "office of profit" in the Constitution could be and should be only by adopting procedure of law for amendment to Constitution under its Article 368.

1.37 Further any office of profit held by any MP, MLA or MLC in contravention of Constitution of India was *ab initio* and no law passed by Parliament or Legislature by simple majority could revalidate the void action or holding of profit by an MP, MLA or MLC retrospectively. Moreover, any declaration of exclusion of office not covered by office of profit would be applicable only prospectively *i.e.* only after declaration as such through Constitution of India.

1.38 Submitting his views to the JPC, Shri Ashoke Kr. Singhi had observed that while defining 'office of profit' under Government under Art. 102(1) our Constitution mandated the State to take multiform public welfare and socio-economic activities involving technical persons.

1.39 Likewise, suggesting definition one Shri Bhanwar Lal Sharma had stated that the term office of profit could be defined in a fair and transparent way in the following manner, which could be made applicable to Members of Parliament/MLAs of all States/UTs:-

Office of profit "the office wherein the MP/MLA received additional salary/allowances/honorarium from the Union funds in the Union/State/Union Territories even getting salary/allowances and other facilities from the Union funds which was against the provisions of Article 102(2)."

MINISTRY OF LAW AND JUSTICE (LEGISLATIVE DEPARTMENT) GOVERNMENT OF INDIA

1.40 The Ministry of Law and Justice were of the view that any comprehensive definition of the term "office of profit" which cast the net so wide that all our citizens with specialities and know-how offering some voluntary services in para-official, statutory or like projects run or directed by the Government or controlled by the State were inhibited from entering elected organs of public administration might be detrimental to the democracy itself. Equally, it was to be seen that Members of Parliament who were willing to offer their services in para-official, statutory body or non-statutory bodies run or directed by the Government should not receive

remuneration apart from the salary as Member of Parliament and reimbursement of reasonable expenses. Thus, it seemed difficult to provide a comprehensive statutory definition of the term "office of profit". However, the Ministry had attempted a tentative definition for consideration by the JPC which was as follows:-

"In Article 102 of the Constitution, in clause (1) for the Explanation, the following Explanations shall be substituted, namely:-

Explanation I. For the purpose of this clause-

(I) "Office of profit" means-

Any office-

(i) under the control of the Government of India, or the Government of a State, as the case may be, whether the salary or remuneration for such office is paid out of the public revenue of the Government of India or of the Government of State; or

(ii) under a body, which is wholly or partially owned by the Government of India or the Government of any State and the salary or remuneration is paid by such body; and

(A) the holder of office under sub-clause (i) is capable of exercising legislative, judicial or quasi-judicial power;

(B) the holder of office under sub-clause (ii) is capable of exercising powers by means of disbursement of funds, allotment of lands, issuing of licenses and permits or making of public appointments or granting of such other favours of substantial nature.

(II) A person shall not be deemed to hold an office of profit under the Government of India or the Government of any State by reason only that he is a Minister either for the Union or for such a State."

Explanation II. For the purposes of this clause the expression-

(a) "office" means the permanent substantive position which exists independently of the holder of the office;

(b) "remuneration" means any pecuniary gain commensurate with the status and responsibilities attached to the office;

(c) "salary" means salary or pay scale attached to the office whether or not the holder of such an office draws such salary.

After Clause (1), the following clause shall be inserted, namely:-

"(1A) Notwithstanding anything contained in sub-clause (a) of clause (1) if a member of either House of Parliament has become subject to any disqualification mentioned in that sub-clause he shall not be so disqualified unless he has not resigned from such office which is the subject to disqualification."

1.41 On being asked whether the proposed definition would be applicable to States also, the Legislative Department in their O.M. (dt. 06.06.08) stated that the tentative definition was proposed to be inserted under article 102 of the Constitution which was applicable in the cases of Members of Parliament only.

1.42 When it was pointed out that according to a legal expert, any definition of 'office of profit' could be introduced only by an amendment to Article 366 of the Constitution which defined the phrases and words used in various provisions of the Constitution, Ministry of Law and Justice (Legislative Department) (O.M. dt. 21.4.08) stated that once the question of bringing in the definition of the term "office of profit" was decided, the question of placement of the same in Article 366 of the Constitution might be settled by them.

STATE GOVERNMENTS

1.43 Besides inviting their considered views in the matter, the draft definition of the Ministry of Law and Justice (Legislative Department) Government of India was circulated to all the State Governments/Union Territories to elicit their comments whether the 'definition' defined the expression of "office of profit" comprehensively in the context of the underlying constitutional provisions. The views expressed by the State Governments/UTs, were as follows:-

1.44 The State Government of Karnataka were of the view that on the lines of principles laid down in different judgments, a compartmentalized definition of the term, was difficult to arrive at. It had further been stated that Parliament might lay down some comprehensive guidelines to determine the office of profit and rest had to be left to the courts to decide depending on fact of the each case and the merit therein. On the issue of liberal interpretation of concept of office of profit, the State Government was of the opinion that "Liberalized view of including a large number of offices in the "schedules" for being exempted by declaring such office from disqualification:-

- (i) would defeat the purpose of constitutional provision in Articles 102(1) and 191(1), which stipulated its intention that representatives of the people must associate only with the developmental activities and other activities, which had a direct connection with the welfare of the people. The exemption would empower the member to restrict his function to executive, financial or some times judicial function.
- (ii) members appeared incompatible due to physical impossibility of attending in two places due to heavy duties attached to the office.
- (iii) proper scrutiny of implementation of Government's projects might be affected and the intended object of the project would be an utter failure.

Therefore, Parliament could lay down general generic or comprehensive guidelines and rest be left to the State Legislatures to take care about."

1.45 The JPC visited Kolkata to hold discussion with the representatives of State Government of West Bengal to elicit their views. According to the State Government of West Bengal, the Governments should continue to be guided by the provision of Article 102 (1) (a) for Members of Parliament and Article 191 (1) (a) relating to Members of the State Legislatures. Only offices specially exempted by the Parliament or by the State Legislature by law should not disqualify the holder of the office. As regards the provision of disqualification for membership, the State Government observed that the existing constitutional provisions did not disqualify Members of Parliament or State Legislature from holding offices under any local or other authority, which included the State Planning Board, District and Metropolitan Planning Committees, Zila Parishads, Panchayat Samitis, Municipalities, Notified Area Authorities, Development Authorities etc.

1.46 As regards the definition of office of profit the State Government of West Bengal stated that any attempt to define 'office of profit' comprehensively would be extremely difficult because there was every chance of leaving aside offices, which might be created in future. It was their view that the present constitutional position of separately exempting offices from disqualification by law, as provided in Articles 102(1) and 191(1) of the Constitution might continue. On the issue of authority to decide on the disqualification, the State Government opined that while the Governor took decision, the opinion of the Election Commission should not be decisive. They had also submitted that amendment of Articles 103 (2) and 192 (2) should be considered so that the Constitutional Head of the Union or the State Government might take a final reasoned view in consideration of all appropriate legal advice including the opinion of the Election Commission.

1.47 According to the State Government of Tamil Nadu it was for the Courts to explain the significance and meaning of the term 'office of profit' thus the final interpretation rested with the courts and not with the Parliament. It had also been stated that to define the expression 'office of profit', the Constitution had to be amended suitably. As the said term was not specific, it appeared that the framers of the Constitution had not defined the said expression. Further, to prevent disqualification of members from the Board or any other authority for being member of Parliament or Member of Legislative Assembly, a specific provision had to be made in the legislation itself declaring that the holding of such office should not disqualify its holder for being chosen as, and for being a member of either House of Parliament or member of Legislative Assembly, as the case might be. Whether a person held office of profit had to be determined based on the facts and circumstances of each case and considering the relevant statutory provisions.

1.48 During their visit to Patna the Committee held discussions with the representatives of the State Government of Bihar. The Government of Bihar were of the view that the subject matter under discussion did not need any debate if federal character of our governance was at all intended to be preserved. The basic structure of the Constitution had to be preserved by giving the States to formulate their own views in consonance with their concept of unity within federal fabric.

1.49 On the question of feasibility of Definition of 'Office of Profit', a representative of the State Government of Bihar stated that it needed no further elucidation. It must be left at the hands of the popular will of the State else every time it would be kept alive for being handled by the party/parties in power at the Centre. According to them the popular will have no other substitute and could not even be replaced by the judicial pronouncements in the present context. So, it would not be appropriate to exhaustively define "office of profit". At best definition might be illustrative only.

1.50 Similarly while expressing their views, a representative of the State Government of Punjab during discussion with the Committee stated that "Office of Profit" had not been defined under the Constitution. Hence it should be left open to the concerned Legislature to look into it and to take a decision whether a particular post or office held by the member of the Legislative Assembly/Legislative Council should be termed as an office of profit or not. In their view the scheme of the Constitution was in consonance with this spirit as the position with regard to a particular post/office depended upon the peculiar situation and circumstances prevailing in that particular State and could also differ from time to time. According to them while drafting the Constitution, it might not have been found necessary to specify and define the office of profit

and was left open for the concerned Legislature to delve into the situation then prevalent and took a decision thereon in accordance with the constitutional provisions. In the case of State Legislature this power had been specifically provided under Article 191(1) of the Constitution. Therefore, providing for a definition in relation to the office of profit would not be advisable.

1.51 Emphasizing further, a representative of the State Government of Punjab stated that a definition of

"Office of Profit" was not feasible as each State had its own peculiar circumstances. By giving a definition to the expression "Office of Profit" would curtail the freedom which had to be exercised by the Legislature. By providing for a definition all decisions taken by the Legislature in exercise of its constitutional powers would be open to challenge before the Courts, leading to more confusion and uncertainty rather than settling the issue. They again emphasized that there could be some suggestive guidelines to declare an office/post to be an "Office of Profit". But no definition should be given which would bind or curtail the powers/discretion of the Legislature, as there were different circumstances and situations in different States, upon which only the Legislature of that State would be in a position to take a decision thereon.

1.52 In a written reply, the State Government of Himachal Pradesh furnished the following definition of 'office of profit'

Office of profit means an office:-

- (i) (a) which carries with it certain emoluments or the order of appointment and state that the person appointed is entitled to certain emoluments even if the holder chooses not to receive/draw such emoluments; and
- (b) which is capable of yielding a profit or pecuniary gain and not whether the person actually obtained a monetary gain

Explanation: For removal of doubts it is clarified that if "pecuniary gain is receivable" in connection with the office, then it becomes an office of profit, irrespective of whether such pecuniary gain is actually received or not.

- (ii) the payment of honorarium, in addition to daily allowances in the nature of compensatory allowances, rent free accommodation and Chauffeur driven car at State expense, are clearly in the nature of remuneration and a source of pecuniary gain and hence constitute an office of profit. In other words if the office carries with it, or entitles the holder to, any pecuniary gain other than the office will be an office of profit for the purpose of Article 102 (1) (a) and Article 191 (1) (a) of the Constitution.

1.53 On being pointed out that the definition attempted by the Government of Himachal Pradesh evidently took into account only one of the aspects viz. pecuniary gain and did not address the other criteria involved, a representative of the State Government of Himachal Pradesh during discussions with the JPC at Shimla stated that in such case the definition of expression office of profit circulated to them by JPC was comprehensive in the context of underlying constitutional principles. However, the State of Himachal Pradesh had some reservation on the draft clause (1A) proposed to be inserted after existing clause (1) of Article 102 of the Constitution. According to them the manner in which the proposed clause had been drafted, it

had the effect of giving unrestricted discretion to the Legislators to continue in office notwithstanding occurrence of disqualification if he did not resign. In the opinion of the State Government on the face of express provisions of Articles 103 and 192 of the Constitution of India there was no need to insert the proposed clause (1 A).

1.54 They further added that the expression office of profit under the Government in Article 102 (1) and 191 (1) of the Constitution was wider than the expression post or service under the Government because while the relationship of master and servant was essential for the application of Article 309 to 314, there was no need for any such relationship for attracting Article 102 (1) (a) or Article 191 (1) (a). According to them the object of these Articles was to maintain the independence of Members of Legislature from any sort of Government control or influence. Therefore, when Government had a say in the matter of appointment or removal of a person, he should not be allowed to sit in the Legislature, even though by such appointment, the relationship of master and servant was not constituted between such person and the Government. Thus while defining the expression the "office of profit" under the Government this factor had been kept in view in order to prevent disqualification. The expression offices of profit was a technical expression and took in its fold different categories, all of which would not be possible to exhaust by Legislation. Thus keeping in view the existing provisions of the Constitution and the interpretation given by the Apex Court from time to time on expression office of profit under the Government, a well-considered Legislation was required in order to avoid unhealthy situations.

1.55 The JPC during their study visit to Chandigarh held informal discussions with the representatives of State Government of Haryana. The representatives of State Government of Haryana were of the view that the exercise of such legislative powers of exemption of offices should be left entirely to the wisdom of respective Legislatures. If any deviation in law was made in this regard then it was likely to impair the legislative competence of the Legislature and was bound to curtail the legislative powers of the States, which was against the principle of federation as envisaged in the Constitution. Therefore, it should be left to the wisdom of the Legislature to exempt any office of profit for the said purpose. It had further been stated that framers of the Constitution envisaged that there might be certain offices under the Government to which appointment might be made of persons having special qualifications or experience in certain fields and whose service as a member of Parliament and State legislature might also be of value in public interest. Therefore, in the Constitution plenary powers had been given to Parliament and State Legislature as the case might be, to exempt such offices from the purview of the dis-qualificatory provisions relating to their Houses under Articles 102(1)(a) and 191(1)(a).

1.56 They were further of the view that in case it was considered necessary to define the office of profit then it should be defined in the light of the judgments delivered by the Hon'ble Supreme Court. It should be added therein that an office of profit was an office, which was capable of yielding a profit or pecuniary gain including honorarium. Therefore, holding an office under the Government would be one to which some pay, salary, emoluments, remuneration or non-compensatory allowance was attached.

1.57 A representative of the State Government of Gujarat appeared before the JPC to tender views on the subject under consideration of the JPC and stated that it was not possible to make an exhaustive definition of the term "office of profit" which could be made applicable to each of the States and Union Territories and it seemed that it was not necessary too because it would be proper for each of the State and Union Territory to consider which office amounts to

"office of Profit" separately. According to them whether a particular post was office of profit within the meaning of Articles 102 and 191 of the Constitution of India, could be decided on case-to-case basis considering the nature of the post and the guidelines and criteria laid down by the Supreme Court of India as it was ultimately the court to determine the application of those tests to a particular situation, nor was there any scope to bar the jurisdiction of the Court.

1.58 Considering the vastness and diverse needs of the States, in their written reply submitted to the JPC, the State Government of Madhya Pradesh had also stated that being a federal democratic country it should be left to the States to frame their own laws relating to office of profit. According to them one central law relating to prevention of disqualification of Members of States legislature might not be able to address the requirements of all the States. During evidence before the JPC, a representative of the State Government reiterated that it might not be feasible to draw up a comprehensive enough definition to cover all the situations prevalent in all the States of the Union.

1.59 According to Government of Rajasthan the term 'office of profit' had been used in various Articles of Constitution like Articles 58, 64, 102, 191 etc. and was germane to determine the eligibility of holder of various constitutional offices and, therefore, the term should have a reasonably clear and exhaustive criteria so as to enable one to determine as to which office was or was not an office of profit. A prior determination of the meaning of term would definitely remove the uncertainty. Therefore, the State Government of Rajasthan was in favour of developing a generic definition that might serve an ultimate guide in determining as to whether an office was or was not an office of profit.

1.60 Simultaneously, the State Government of Rajasthan was also of the view that in democratic nations the question as to what should be the law (including the value judgment) had to be decided by the representative of the people and what was the law was to be decided by the Court. Therefore, what factors would bring an office within the purview of 'office of profit' might be and should be decided by the representatives of people and the decision as to whether the given factors existed in a particular office should be left to the courts. The State Government had neither attempted any definition nor commented upon the draft definition that was presented to them except for suggesting incorporation of several posts/offices in the Part-II of the exemption which should not be deemed to hold office of profit under the Government.

1.61 On the question of amending the Constitution and making it obligatory for the State Legislatures to be guided by such principles as Parliament may by law provide in regard to the matter, a representative of the State Government of Rajasthan stated that constitutional amendment should be directed to achieve two objectives. First amendment should define the term 'office of profit' and secondly it should lay down the principles, which might be followed by the States while exempting office of profit under Article 191. These principles might comprise the general elements of the offices holding of which would derogate the position or efficiency of a member as representative of people.

1.62 Similarly, the State Government of Kerala was of the view that some workable definition should be evolved avoiding much scope for judicial intervention, at the same time leaving to the concerned legislatures to decide the disqualifications through enactments.

1.63 On the other hand the State Governments of Goa and Assam were of the view that there was no necessity to define the term "office of profit" under Articles 102(1)(a) and 191(1)(a) of

the Constitution of India as the said term had been defined by the Hon'ble Supreme Court in its various judgments on the subject delivered from time to time and the same was binding by virtue of Article 141 of the Constitution of India.

1.64 According to Government of Arunachal Pradesh membership of Legislature in certain bodies, committees and offices pertaining to developmental activities for the welfare of the people was essential. However, such Bodies, committees and offices should be of advisory character and membership thereof should not carry any remuneration except the actual expenditure, which might have to be incurred in discharging their duties. The Members of Legislature being peoples representatives should have their basic right to guide in the field of various development activities for the welfare of the people for which their membership in various committees, bodies, were felt essential. Accordingly, a definition of the 'office of profit' as well as comprehensive criteria was required to be evolved for their application to all States and UTs.

1.65 Towards this end, the Government of Arunachal Pradesh had found the definition of office of Profit, which was circulated to them, to be comprehensive, just and fair for uniform application to all States and UTs.

1.66 The State Government of Manipur had stated that in their State different ethnic mix of population and different tribes had their political aspirations and each tribe expected their leaders to represent them in Government. Therefore, the State Government of Manipur would like to have its own definition under its own Act and would continue thereunder.

1.67 In the view of the State Government of Sikkim the issue of office of profit should be governed as per the laws that would be framed or were being framed by different State Governments and union Parliament from time to time based on their requirement. It had further been stated that office of profit should be legally supported on the matter of specific law made by them. It had also been stated that each State should evolve its own legal basis without being governed by any uniform law although on principle there might be uniformity.

1.68 On defining the term 'office of profit' the State Government of Tripura were of the view that a comprehensive definition of "office of profit" be included in the Constitution and the authority of the State Legislature to make laws relating to the members of State Legislature should remain. The proposal for amending the Constitution to bring about a comprehensive definition of office of profit for uniform application to all States was most needed. However the State Government of Tripura were of the considered view that the power of the State Legislature to make laws in respect of the members of State Legislature under Article 191 of the Constitution should remain with the States to enable them to meet the peculiar requirements of their States.

1.69 Agreeing with the draft definition sent to them, the Government of Tripura had stated that it defined the expression of 'office of profit' comprehensively in the context of the underlying constitutional principles.

1.70 While replying to queries made by the JPC State Government of Meghalaya provided a definition stating that "Office of profit means any office where pecuniary benefits or remunerations whether in the form of salary or honorarium whatever might be called, was paid for holding such office/post but will not include any office/post which was declared not to disqualify the holder of such office/post by law made by Parliament or the Legislature of the State/Union Territories."

1.71 The State Government of Mizoram had endorsed the draft definition sent to them by JPC and had further advised that the expression *viz.* "a Minister either for the Union or for such a State" occurring in clause (ii) of the Explanation-I may be replaced by the expression *viz.* "a Minister either for the Union under article 75 or for such a State under article 164 of the Constitution, so that those who had been assigned the rank or status of Minister may be kept outside."

1.72 Contrary to the views expressed by State Government of Mizoram, the State Government of Nagaland had stated that suggested definition did not define the 'Office of Profit' comprehensively. According to them, the definition of 'Office of Profit' in the proposed Article was same as the definition of 'remunerative political post' provided in Article 361B. In their view there was no need to define both remuneration and salary in Explanation II. The proposed sub-clause (1A) in the proposed Article would defeat the constitutional purpose of punishing holders of Office of Profit. Accordingly, the State Government of Nagaland had suggested that Articles 102(1) and 191(1) might be rewarded as follows:—

"102. Disqualifications for membership.—(1) A person shall be disqualified for being a member of either House of Parliament,—

(a) if he holds any remunerative political post;

Explanation: (1) "remunerative political post" shall have the same meaning assigned to it in Article 361B.

(2) For the purposes of this clause a person shall not be deemed to hold a remunerative political post by reason only that,—

(i) he is a Minister or a Parliamentary Secretary either for the Union or for such State;

(ii) as a Minister or a Parliamentary Secretary, he holds any other remunerative political post in *ex officio* capacity; and

(iii) he holds any office in the affairs of either House of Parliament.

Provided that no remunerative political post shall be deemed as such within the meaning assigned to it under Article 361B, if the salary or remuneration, as compensatory in nature, payable in respect of that remunerative political post or posts together, exceeds ten per cent of the total emoluments paid to a person as a Minister or a Parliamentary Secretary or a member per month, as the case may be."

1.73 As regards the coinage of the Constitutional term "remunerative political post" and "office of Profit", the State Government of Nagaland in a written reply sent to the JPC stated as under :—

"the Government of Nagaland infers that the Union Government while drafting the Constitutional law, sought to deliberately avoid the using of the term "office of profit" in article 361 B for the reason that when the explanations to Articles 102(1) and 191(1) exempt offices of "Ministers" from being as offices of profit, it would be contradictory to include them while framing article 361B. The Union Ministry might have been in search of a different terminology which includes the office of "Minister" as a prohibited post.

1.74 That being the inference, the Government of Nagaland feels that but for the following three substantial differences, both the terms are substitutable :

- (1) "office of profit" excludes "Ministers" while "Remunerative Political Post" includes "Ministers";
- (2) Articles 102(1)(a) and 191(1)(a) provides powers to Union and State Legislatures to exempt certain offices from being deemed as offices of profit, while article 361B does not provide such power; and
- (3) Articles 102(1)(a) and 191(1)(a) apply to both sitting members and contesting candidates while article 361B applies only to members of Legislatures disqualified under the Tenth Schedule.

Almost all the tests laid down by courts to identify an office of profit have already been laid down in article 361B for identification of a remunerative political post. Indeed, a partial definition (of office of profit) is available in article 361B. Government of Nagaland continues to believe that the term "remunerative political post" is not far different from the term "office of profit". It also believes that the term is quite avoidable and the contents of article 361 B should appropriately be incorporated into the Tenth Schedule of the Constitution itself (without using the words "remunerative political post")

The Committee were further informed that there was no office in the executive realm that did not involve exercise of power or influence and, therefore, only "pecuniary benefits" were the only true tests to identify an office as office of profit. Profit is thus quantifiable by remuneration and as given in the model article of the Government of Nagaland, profit should be limited to 10% of the remuneration of the Minister or a Member, as the case may be. The other subjective tests whether the office involved any exercise of power or influence should not be gone through and all office holders (including member of legislatures) in the Government must be subjected to specific accountability tests."

1.75 Notwithstanding above the State Government of Nagaland were of the view that as anti-defection law was in place which strictly organized the House on party lines and thereby the Government, any presumption that the office of profit would act as a lure for members to cross floor was simply anachronistic. Might be before the advent of the anti-defection law, the presumption would have matured into a fact. The idea of office of profit itself had thus become outdated warranting removal from the Constitution.

1.76 Similarly, in a written reply the State Government of Uttarakhand were of the opinion that a comprehensive definition of 'office of profit' should be introduced. However, in the proposed amendment in Explanation I "After Clause (1), the following Clause.....subject to the disqualification" should not be inserted otherwise the very purpose of clause (a) of Articles 102(1) and 191(1) would be defeated.

1.77 In the view of the State Government of Uttar Pradesh it might not be feasible to have a workable definition of the "office of profit" because of various factors involved in it. The tests enunciated by the Hon'ble Supreme Court might be applied in different situations and an opinion might be formed accordingly. The tests for determining whether an office was an "office of profit" or not might be different in different situations and therefore, a blanket definition might not be workable or exhaustive. Instead of having a blanket definition, it would be better to evolve general principles and tests in this regard.

1.78 Giving suggestion on the draft definition, they were of the view that the draft definition of the expression of "office of profit" appeared to be relevant and comprehensive but it could not be said to be exhaustive. There might be occasions when the draft definition might not cover the situation. Hence along with such a definition scope might be left to further examine the expression of "office of profit", if a need so arose.

1.79 The Government of Uttar Pradesh were further of the view that the doubts should be cleared conclusively about the expression of "office of profit" so that the representatives of public did not have to face uncertainty about it.

1.80 The JPC visited Mumbai to hold informal discussion with the representatives of State Government of Maharashtra. The views of the State Government have also been considered elsewhere in the report.

1.81 According to State Government of Chhattisgarh "office of profit" means an office held, under Government of India or Government of any State, by a person in any committee or statutory body constituted or framed under any law, or by resolution, notification or direction of the Government of India or State Government and for which salary or remuneration was payable *in lieu of* discharging the duty, and included a body subordinate to State Government having effective control over the body for its functioning. But it should not include the post held *ex-officio* or any temporary office established or constituted for enquiry or examination not of permanent character.

"Explanation : Remuneration or salary does not include the traveling facility like providing vehicle with driver and allowance, infrastructure facility for office like furniture, computer, stationery, staff, electricity, telephone or others and fixed honorarium compensatory in nature."

1.82 While expressing their views, the State Government of Orissa in a written reply had stated "it is necessary to define the expression 'office of profit' in unambiguous terms. The definition should first spell out the meaning of the word 'office' and then proceed to explain the expression 'office of profit'." They were of the view that doubts were sometimes expressed whether a Minister holding certain positions in an *ex-officio* capacity outside the Government Departments could be disqualified on the grounds of holding an office of profit. The new definition should clearly state that all positions held by a Minister in his *ex-officio* capacity with or without remuneration should be excluded from the purview of the office of profit since by virtue of being a Minister he was already holding an office of profit under the scheme of things of the parliamentary system of democracy.

1.83 As far as MLAs/MPs other than the Ministers were concerned, the law should clearly state whether they could be appointed as Heads or Members of Statutory Bodies with or without remuneration. It should also clarify whether reimbursement of expenditure incurred by MLA/MP for attending meetings and duties of bodies where they were nominated, as Members would amount to holding office of profit. If reimbursement of such expenditure was not to be treated as holding an office of profit, reasonableness of the extent to which such reimbursement was to be permitted might also clearly be defined. Any legislation should not only address the issue in letter but also in spirit.

1.84 A statement showing the synopsis of comments of the State Governments in the context of settled interpretation of the expression "office of profit" in Article 102 of the Constitution and the underlying constitutional principles therein, and suggesting a comprehensive definition of "office of profit" (first term of reference) is enclosed at Annexure V.

Institutions

1.85 During their study visit to Kolkata, the JPC also held informal discussions with the representatives of Council for Political Studies, Kolkata. In regard to definition of the term of office of profit, a representative of the Council suggested that by way of constitutional amendment, a new paragraph with the following lines be added to the explanation following Article 102 (1) and Article 191 (1):

"An office, that is, a substantive position independent of its incumbent, under the Union or State Government or any public body under the authority of any of these Governments, carrying any emolument, honorarium or allowance shall be deemed to be an office of profit. However, compensatory allowances attached to such office for meeting the expenses actually incurred for travel, board, lodging and conveyance shall not make it an office of profit."

1.86 They further stated that "the context of other Articles in which the term 'office of profit' had been used was completely different from one another. So a general definition was not desirable. According to the Council the suggested change might be restricted only to Article 102 (1) and Article 191 (1)."

1.87 Further, there were a large number of offices in the Union and State Governments, which did not find a mention either in the Schedule or Table annexed to the Parliament (Prevention of Disqualification) Act, 1959. Uncertainty would also prevail about the offices that might be enacted in future.

1.88 During their study visit to Bangalore, the JPC, besides holding discussions with the representatives of State Government of Karnataka, held discussion with the representatives of National Law School, Bangalore to elicit their views on matters under reference of the JPC. While deliberating with the Committee, a representative of the University stated that the aspects viz. compulsion of coalition Governments both at the Centre as well as in the States, various local factors/conditions which vary from State to State and private interest of legislators should be taken into account while evolving definition/generic criteria on office of profit.

1.89 Explaining various issues of offices of profit, a representative of the University, stated that the office of profit disqualification sought to maintain two constitutional principles: (i) the separation of power between the legislature and the executive and (ii) the prevention of the possibility of a conflict between duty and interest for an individual who had to perform the role of the legislator and a member of the executive. The explanation to Articles 102 and 191 created an exception to the blanket application of the separation of powers principle by allowing for Ministerial offices to be exempted from the office of profit disqualification to accommodate the Westminster Parliamentary model of Government. Therefore, they had stated that no further definition was necessary and the Parliament might by law include only such offices which were ministerial in character but not in nomenclature. While such an approach did not eliminate ambiguity entirely, when combined with an institutional mechanism that applied these principles in a definitive fashion, a greater degree of clarity could be achieved in this area of law.

1.90 They had further stated, "the essential feature of an office is that it must exist independent of its holder. However, even if there be no such independent existence, the court may still use a purposive interpretation and hold that on specific facts of the case, the candidate in substance held an 'office of profit'."

1.91 Further submitting their suggestion in regard to definition of office of profit given by the Ministry, a representative of the University stated that definition attempted to crystallize the legal decisions on that issue by putting together criteria to help legislators, the designated authority and the courts to determine offices which might lead to disqualification. Those criteria identified by the court in specific cases, however, were neither complete nor consistently applied. The courts had persistently held that the cases were to be determined on a case-to-case basis where different weights were attached to these criteria to arrive at a cumulative assessment of whether an office was an office of profit.

1.92 The Law School were further of the view that a more elaborate definition of the office of profit was likely to result in more disputes and arguments about the meaning or phrases used in the definition. Such an approach of a criteria definition was misconceived and to that extent the proposed definition was unlikely to resolve the problems and concerns raised.

1.93 In regard to application of definition restricted to Articles 102 and 191, a representative of the University stated that a uniform definition for the term 'office of profit' to apply to the entire Constitution by including it in Article 366 would be problematic and hence not desirable. Further making a definition of 'office of profit' evolved in context of Article 19, applicable to Article 18 would be to confuse differing policy objectives. The latter sought primarily to ensure that persons under the Government were immune from foreign influence of any kind. Problems of over-inclusion and under-inclusion might arise as a result of applying the same definition across the Constitution, regardless of specific context.

1.94 On the issue of opportunity for resignation the School was of the view that the Committee might propose to allow a 2 months moratorium period after the constitution of a new House to those elected members who held office of profit to resign these offices. A recommendation to shift the effective date for the assessment of disqualification under the office of profit category from nomination date to adapt 2 months after the constitution of the House might provide all prospective candidates to contest elections and ensure that no unnecessary disqualification took place.

Constitutional and legal experts

1.95 On the issue of defining the term "office" or "office of profit"—Shri Fali S. Nariman, Senior Advocate submitted before the Committee 'I am of the view that to attempt a definition universally applicable to each and every case as it arises is just not feasible. I do not think that the draft definition suggested in the list of points which may be used by the Joint Parliamentary Committee would cover all possible cases that could conceivably arise in future. I am of the opinion that each case must be left to be judged in the light of relevant provisions of the statute in question establishing or creating the "office" and in the light of its own peculiar facts; always keeping in view the overall object of enacting Article 102(1) (a) and Article 191 (1)(a) which is that there should not be seen to be any conflict between the duties and interests of an elected member. In other words, these Articles are designed to ensure that Parliament and State Legislatures do not have Members who receive from the Executive largesse or benefits in any form—and who

may on that account be perceived as being under its obligation, and thus, become amenable to its influence, whilst discharging important legislature functions.This purposive interpretation of Articles 102 (1)(a) and 191 (1)(a) has received acceptance from the Courts ever since the Constitution was enacted—right up to the leading case of Shibu Soren Vs. Dayanand Sahaay. Any new approach to these Articles would create unnecessary confusion in settled law.'

1.96 For overcoming the imbroglios related to the issues, his views were as follows:—

"I would recommend the insertion of a specific provision in the Constitution to the following effect *viz.* that a person shall not be disqualified for being chosen as, and for being a Member of either of House of Parliament or of a State legislature, only because that person holds an office under the Government of India or the Government of any State, whether it be an office or office of profit or not, so long as that person does not in fact receive or enjoy any benefit. Whatsoever, monetary or otherwise, in connection with the holding of that office."

1.97. Shri Nariman further opined that—

"it should also be clarified in a sub-clause inserted in article 103 (and in corresponding provision article 192) that where a person holds any office (whether an office of profit or otherwise) under the Government of India or the Government of any State, and a question arises as to whether that person has or has not received, or has or has not enjoyed a benefit (monetary or otherwise) in connection with the holding of that office, the burden of proving that he or she has not received or enjoyed any benefit with reference to that office shall be on the person who holds that office."

The above should be in addition to the existing prevention of disqualification law as enacted and as amended.

1.98 According to Shri Nariman provisions, as suggested above would enable responsible Members of Parliament and responsible Members of State Legislature to freely perform additional public duties that might be entrusted to them by Central or State Government authorities from time to time without any possible risk arising out of a conflict of interest. In other words, it would enable the Centre and the State (in the course of their ever increasing welfare activities) to avail of the services of public-spirited Members of Parliament (and of State Legislatures), without fear of it being perceived by the public as the exercise of some form of control by the Centre (or the State) over its elected representatives in legislative bodies.

1.99 As regards proposed definition, Shri Harish Salve, Senior Advocate had put forth his views to the Committee as follows :

"The proposed definition of Office of Profit, I find, would be incompatible with the constitutional philosophy underlying Article 102. That is for two reasons. Sir, we are now getting into very grey areas. It will defeat certainty because it excludes very bodies which are wholly or partly owned and the holder of an office which is capable of exercising legislative, judicial and quasi-judicial powers. Again, what is legislative power and power of legislative character is a very nebulous concept. Price fixation is legislative in character and framing of policy is also legislative in character. What is quasi-judicial power? Anybody who has the power to hire and fire an employee exercises quasi-judicial power. The principle of fairness today has been extended to such an extent by the Supreme Court that quasi-judicial power is, again, a very

nebulous concept. If the whole idea is to bring certainty in the law, bringing in these will bring in more uncertainty in the law.

Secondly, these kinds of exclusions are uncalled-for. A perception of conflict arises not because of the nature of powers you exercise. The perception of conflict arises because you are earning a profit from the Government; you are earning an income or gain from the Government, and you are now holding that Government accountable for it. This is the perceived conflict. How does it matter what powers you exercise? I think that, even conceptually, these qualifications are totally uncalled-for.

As far as the definition of profit is concerned, I do not see any reason for it not applying across the board. I am asking this because the basic philosophy is the same, namely, preventing conflict. If the definition comes in, then it is much better if it governs all these Articles that are quoted, namely, 18, 58, 59, 64, 66, and 102, and puts all of them on par."

1.100 On the issue of identifying an office of profit one of the suggestions, given by Shri Harish Salve, Senior Advocate, had been to classify the agencies and bodies into the following four categories keeping in view the nature of functions and activities being performed by them:—

- (i) Directly under the Government;
- (ii) Statutory authorities or Corporations in which Government have the power either to appoint or remove or both;
- (iii) Public Sector Undertakings owned wholly or partly by the Government where the Government have the power to appoint or remove; and
- (iv) 'Other bodies' significantly funded by the Government where the Government have pervasive control.

1.101 He had suggested that a list of 'other bodies' at (iv) above, had to be prepared by a designated committee which would decide as to which post/office could be exempted or debarred for its holder for being chosen as and for being a member of either House of Parliament. For the offices under Sl.No. (i) to (iii) above, his suggestion appeared to be that those categories of offices should not be included in the exempted list.

1.102 On incorporation of an enabling provision in the Constitution for an elected Member of Parliament to exercise an option to resign from an office in the event of the office he was holding was determined to be an "office of profit" under the Government without losing his membership of the House, Shri Salve during evidence before the JPC stated as under :—

"...Once you have a list, of course, the person knows if he is joining a prohibited category. But if he is not in the list and you add something to the list, then you must give him a chance that within 3-4 months he should choose whatever is appropriate and whichever he wants to continue."

1.103 The thrust of his argument in favour of having such a clause was that it made perfect sense to have such provision, as after having done all the hard work in getting elected to Parliament or State Legislature the members should not find themselves on the wrong side of the law simply on account of holding some office/post which otherwise were perfectly alright until

they got elected but subsequently turned out to be office of profit under the intense glare of legal scrutiny rendering them disqualified from being chosen as or being a member of the legislature. And they could not do anything about it. In this connection the Committee also wondered why only membership had to be sacrificed, especially when they had been elected by the people, and not the office/post which was the root cause of the problem.

1.104 In his submission before the JPC Shri Rajeev Dhavan, Senior Advocate had stated that the power of exemption must follow a rigorous procedure to ensure that it was not misused. Any appointment must be for the public interest, and under conditions of transparency and accountability. He had proposed that :-

- "(a) the system be operated so that appointment are made only in the public interest;
- (b) the appointments be approved by the Cabinet;
- (c) A public statement needed to be made that such an appointment is in the public interest with an explanation (a) giving the reasons for such an appointment; and (b) full disclosure of the perks and emoluments;
- (d) The public statement must be simultaneously placed before the House concerned;
- (e) The appointment be for the terms of that Parliament; and
- (f) All efforts be made to make the appointments on a voluntary and pro bono basis."

1.105 Shri Dhavan had also introduced a concept whereby a distinction had been made between 'being chosen as' and 'for being' a member of the legislature. According to this view currently, article 102 and 191 envisaged an absolute disqualification, i.e. all offices of profit must be given up before the election. However, this absolute disqualification was too wide and unnecessary. According to him there was a distinction between two fundamental principles as to why the 'office of profit' concept was created. Broadly, these prohibitions applied to legislators (a) to prevent undue influence during elections; and (b) to avoid a 'conflict of interest' after elections. For this reasons, he had proposed that (i) the question of undue influence be dealt with under the applicable electoral law on the basis of which 'office of profit' holders must resign all their posts before filing their nominations for elections; and (ii) avoiding the problems posed by conflict of interest could be resolved by an elected legislator resigning his remaining offices of profit after the elections. On the basis of this distinction there might be:-

- (a) offices that must be given up before an election;
[such persons (civil servant under Articles 310 and 311 and members of Judiciary), must resign their office before becoming candidate in an election. This was in order to ensure that (1) undue advantage in the electoral process was avoided; and (2) conflict of interest was eliminated in so far as process of election was concerned] and;
- (b) offices (under Article 12 institutions or bodies and legislators or some other legislative body or Panchayat) that must be given up after an election but before taking oath as a member of the legislature.

1.106 For this purpose Articles 102 and 191 would require to be amended to categorize disqualifications into those for 'being chosen as' and for 'being' a Member of the Legislature.

The question of a uniform approach to the States was resolved if amendments were made to corresponding Articles in the 'Constitution', for both the Centre and the States. Statutorily this would mean that Section 9A and 10 of the Representation of People Act, 1951 (which provides an absolute disqualification for persons holding government contracts or an officer of a government company), would have to be repealed. However, the parliamentary scrutiny was necessary which could be achieved in the following two ways:-

- "(i) At the beginning of every Parliament, a full declaration must be made by all MPs/ MLAs. The list of offices held by MPs/MLAs could then be scrutinized by the Joint Parliamentary Committee on the basis of the three criteria mentioned above, after which it could determine whether Parliament should validate those offices.
- (ii) Thereafter, if the Government made any appointment of a legislator to an office, it must be referred to the Joint Parliamentary Committee. The findings of the Committee, although recommendatory, must be taken into account in the final determination by the Election Commission if a question arose under Article 103."

1.107 The Committee pointed out that the Committee had been mandated to suggest a comprehensive definition of the office of profit in the context of settled interpretation of the expression in Article 102 of the Constitution. It had to take the constitutional scheme as it was. It was not authorized to interpret how Article 103 should be changed. It could not even make distinctions between pre-election disqualification and post election disqualification because Article 102 was committed to that. The same disqualification applied and that was the settled aspect of the matter. Any deviation on that count had to be through constitutional amendment only. Shri Dhavan however was of the opinion that on the basis of a reading of part (ii) of the terms of reference, it did not restrict the Committee to merely defining an office of profit within the framework of constitutional provisions as they stood but were wider in scope.

1.108 In a written reply to the JPC, Shri K.K.Venugopal, Senior Advocate had stated that any definition of 'Office of Profit' could be introduced only by an amendment to Article 366 of the Constitution as Article 366 defined the phrases and words used in various provisions of the Constitution. Parliament would not be having free hand to pass a law by giving its own interpretation to any word or phrase. The Courts had already examined and analyzed the phrase 'Office of Profit' and had given its own interpretation.

1.109 If an amendment was brought about to the Constitution defining the phrase 'office of profit' in Article 366, an appropriate definition would be:

" 'Office of profit' means an office which exists independent of the holder and here the remuneration, compensation and perquisites, by whatever name called, would give to the holder of the office some pecuniary gain other than compensation covering out of pocket expenses such as stay, travel and dally allowances."

1.110 Shri P.P. Rao, Senior Advocate, Supreme Court of India in a written reply submitted to the JPC had suggested "there is no need to unsettle the settled law in this area. If Parliament feels that certain offices should be exempted from the operation of provisions of Article 102(1) (a) and Article 191(1)(a), it is open to Parliament to enact a law for this purpose so long as the principle underlying the disqualification is maintained. However, the validity of such a law would be subject to judicial review on the ground that it is unreasonable and arbitrary or amounts to colorable exercise of power."

1.111 According to Dr. Mahendra P. Singh, former professor Head & Dean, Faculty of Law, University of Delhi, the best solution of the problem lies in adding a definition/explanation of "office of profit" next to the existing explanation in Articles 102 and 191 on the following lines:

Suggested definition: office of profit is an office which provides any pecuniary gain to its holder other than the meeting out of actual expenses incurred in or utilization of any facilities for the performance of the duties of that office.

By way of precaution a further explanation may be added to the following effect:

For the purpose of this clause a person holds an office under the Government of India or the Government of any State if such appointment is made by the President of India or the Government of the State as the case may be.

1.112 Shri J.S. Verma, Former Chief Justice of India in a written reply had forwarded his views as under:—

- (i) The underlying constitutional principle debarring the holder of an 'office of profit', 'under the Government' from being a member of Parliament is to insulate the legislature from executive influence and to prevent any conflict of interest in the member must guide the interpretation of the express 'office of profit'. The evolution of the generic and comprehensive criteria which are just, fair and reasonable for uniform application would then emerge from such a meaning.
- (ii) In India, a unified judiciary with the Supreme Court at the apex level ensures a uniform standard and meaning of the rule of law throughout the country. Hence, there would be no scope for conflicting interpretations of the meaning of 'office of profit' after evolution of a generic and comprehensive criteria emerging from it.
- (iii) The difficulty arises because of the ambiguity created by the latter part of sub-clause (a) of clause (1) of Art. 102—'other than an office declared by Parliament by law not to disqualify its holder'. The provision while so empowering the Parliament to create exceptions to the disqualification prescribed in the first part, it does not specify the principle to be applied in creating exceptions to the general rule. That being so, the principle governing the exercise of power by the Parliament has to be deduced on the basis of general rules of interpretation, reading the provision as a whole and bearing in mind the avowed object. Any interpretation, which renders the provision otiose by the second part neutralizing the first part, has to be rejected. An interpretation, which empowers the Parliament to destroy the disqualification relating to a basic feature, has to be rejected. If the amending power of the Parliament under Art. 368 cannot destroy a basic feature of the Constitution; it cannot be so done by a law enacted under Art. 102(1) (a).
- (iv) In the case of ambiguity, a construction that results in absurdity or anomaly, or which renders the provision otiose has to be rejected and preference must be given to that construction which avoids that result. This is a settled rule of interpretation of statutes. To a Constitution, which enacts principles for application at all times, this rule has greater application to avoid erosion of a constituent principle. 'Absurdity' in this context is 'something which would be absurd with reference to the other words of the statute as to amount to repugnance'. If two views are possible, one, which

results in an anomaly and the other not, it is the latter view which must be taken. A statute must be read as a whole and one part of it should be construed with reference to the other parts so as to make a consistent enactment of the whole statute. It cannot be assumed that the enactment had 'given with one hand what it took away with the other'. These are settled rules of construction. The law enacted by the Parliament under Art.102(1)(a) must be subject to this inherent limitation.

- (v) The Explanation to clause (1) of Art.102, which exempts the Ministers from disqualification, is relevant as an aid to construction.
- (vi) An Explanation may also serve as a proviso to carve out an exception from the general rule in the main enacting provision. This is the purpose served by the Explanation to clause (1) of Art. 102, and it is an integral aid to the construction of the whole sub-clause (a) in Art. 102.
- (vii) It follows, that the second part of sub-clause (a) in Art. 102 empowers the Parliament to make law exempting offices of profit under the Government like that only of a Minister, and no others. Every office of profit exempted by the law will have to satisfy the generic test for its validity. Such a construction alone makes sense of the provision read as a whole. This is also in accord with the nature of our polity.

1.113 In a written response Shri R.R. Singh retired professor, Delhi University had stated that the elected representatives of the people by upholding constitutional norms, in letter and spirit, should confine themselves mainly to legislative functions and continuous interaction with citizen on national issues. Other offices (including OoP) should be left to the charge of citizens of eminence based on an evolved criterion.

Opinion of Attorney General

1.114 In view of the issues discussed in the foregoing paragraphs, the moot point was whether a comprehensive definition of the term "office of profit" could be given on the basis of constitutional provisions and judicial pronouncements made so far. Opinion of Attorney General was sought by the Ministry of Law & Justice (Legislative Department) in this regard way back in 1994.

1.115 In his reply (dt. 26.10.94) Attorney General opined against laying down any particular criteria defining office of profit as the judgments of the Courts were enough guidelines to determine whether a particular office was an office of profit or not and a workable definition did not appear to be feasible. The Attorney General reiterated (on 04.05.2006) his views on expression of "office of profit" and stated:-

"My opinion was sought on the aforesaid proposal in 1994. I had opined against laying down any particular criteria defining 'office of profit' as the judgments of the court were enough guidelines to determine whether a particular office is an office of profit or not and a workable definition did not appear to be feasible vide my opinion dated 26.10.1994. No statutory explanation was, therefore, added. Though a long time has passed and I have re-looked at the entire matter, I have not been able to persuade myself to change my earlier opinion."

B. Second Term of Reference

to recommend, in relation to "office of profit", the evolution of generic and comprehensive criteria which are just, fair and reasonable and can be applied to all States and Union Territories.

[Since the issues of uniform principles/common criteria and evolving a definition on 'office of profit' are interwind and are not mutually exclusive, it is felt that the discussions made under heading A on first term of reference of the JPC should be read with discussions made hereunder to have a better understanding and appreciation of the subject.]

2.1 A large number of Boards, Committees and authorities are set up for carrying out or supervising the myriads of activities undertaken by the Government. It is a principle accepted by all democratic governments that the representatives of the people should be increasingly associated with such activities, which have a bearing on the welfare of the people. The participation of the representatives of the people in the developmental activities makes them more focused and result oriented. Legislatures, therefore, while creating statutory bodies make provisions for the representation of legislators on them. But, innumerable bodies other than these statutory bodies also come to be formed in exercise of the executive powers of the Government for specific purposes. The legislators are sought to be nominated to such bodies.

2.2 In view of the Ministry of Law & justice (Legislative Department) as a matter of strict constitutional position, the power so far as Members of Parliament are concerned is with Parliament and power so far as Members of State Legislatures are concerned is with the respective State Legislatures. According to the constitutional position, Parliament and the State Legislatures have the plenary authority within their allotted fields of jurisdiction under the Constitution as it stands today to enforce any uniformity. A State is free to adopt whatever policy it likes. It is only through persuasion or discussion that it would be possible within the existing framework to achieve some degree of uniformity in this field.

2.3 Under Article 191 of the Constitution, most States have enacted their own respective statutes exempting certain posts from disqualification. The States have followed the approach in the Central statute by specifying the exempted offices in the Act and the Schedule accompanying it. An analysis of the trends of exemption by the States reveals no definite pattern except for the fact that selection of offices of profit qualifying for exemption has been ad hoc and devoid of principled consideration. It has been seen that some Boards/Corporations/Bodies have been given exemption in some States like the Fishery Boards, Haj Committee or other such boards but similar bodies have not been given exemptions in other States.

Uniform criteria and applicability to States

2.4 A large number of offices under the Government has been exempted from disqualification by several States Removal/Prevention of Disqualification Acts, without taking into consideration their nature of duties or remuneration and that a view has been held that the only feasible method would be to amend the Constitution and make it obligatory for the States Legislatures to be guided by such principles that Parliament may by law provide in regard to the matter. The Joint Committee on Offices of Profit (JCOP) were of the view that if the real spirit of Articles 102 and 191 of the Constitution is to be maintained sacrosanct, the enabling exemption provision should be kept within its bounds and restricted in its scope both in regard to the areas of operation and legislative competence. Otherwise, the object of the imposition of the

disqualifications as envisaged will become frustrated. The JCOP, therefore, urged (9th Report-7th L5) the Ministry of Law, Justice and Company Affairs to take necessary steps for bringing legislation to evolve uniform principles in regard to disqualification for holding office of profit under articles 102(1) and 191 (1) of the Constitution in consultation with the Central Government, State Governments and Union Territory Administrations, in the light of the recommendations/observations made in their report. The then Ministry of Law, Justice and Company Affairs invited the comments of the State Governments/Union Territories on the recommendations made by the JCOP. As per replies furnished by the Ministry of Law, Justice and Company Affairs (*vide* O.M. 17(9)/2006-Leg.III dated 28.12.06) five States (*i.e.* the States of Assam, Goa, Kerala, Karnataka and Madhya Pradesh) were in favour of having a legislation evolving uniform principles. Eight States (*i.e.* the States of Andhra Pradesh, Haryana, Meghalaya, Mizoram, Orissa, Rajasthan, Sikkim and Uttar Pradesh) were not in favour of legislation adopting uniform principles. No specific comments were received by them from other State Governments. In view of lack of consensus, the Ministry of Law, Justice and Company Affairs did not reportedly pursue the matter. The States/Union Territory-wise views reportedly received (as on 01.04.92) by the Ministry of Law, Justice & Company Affairs and furnished to the JPC were as under:-

1. Andhra Pradesh

The State Government should continue to retain the power of declaring a holder of particular office not to disqualify as envisaged in Article 191(1)(a) of Constitution of India. Thus, there does not appear to be need for any uniformity in the legislation concerning disqualification.

2. Arunachal Pradesh

No views.

3. Assam

Agree on the condition that all the provisions of the Assam State Legislature Members (Removal of Disqualification) Act, 1950 should be incorporated in the proposed legislation.

4. Goa

In favour.

5. Haryana

It is not essential to have the law in question in the State in consonance with the law of the Parliament. The legislature is competent to frame such law under the provisions of Article 191(1) of the Constitution.

6. Jammu and Kashmir

The practice of Ministers being Chairman of Public Sector Undertakings have been found to be not affecting incumbents to disqualification. Also, the State Government would be willing to amend its law on the subject (the J&K) Legislative (Prevention of Disqualification) Act, 1962 keeping in view any uniform policy that may be evolved for the rest of the country.

7. Karnataka

The view of the Committee are reasonable and may be accepted.

8. Kerala
The State Government have accepted the guidelines suggested by the Joint committee for Members of Legislature and have decided to amend the Kerala Legislative Assembly (Removal of Disqualification) Act, 1951 accordingly.
9. Madhya Pradesh
Agrees with the views of the Joint Committee regarding uniform principles in regard to disqualification.
10. Meghalaya
Not in favour of uniformity as the local conditions vary to a considerable extent. In case a uniform policy is to be laid down the matter should be discussed in depth by all the legislatures.
11. Mizoram
The Government of Mizoram is not in favour of delegating power entirely to Parliament and is inclined to maintain status quo in this regard as at present.
12. Orissa
The State Government would prefer a law regarding disqualification under Article 191 (1)(e) and not a separate law on the subject.
13. Punjab
The issue involved have political overtones. The views of the State Government in correct perspective could be sent after the revival of legislature and installation of popular Government.
14. Rajasthan
It should be left to the State Governments to take appropriate action to adopt the principles which the Parliament by law provide.
15. Sikkim
The power given to the State Legislature under Article 191 (a) of the Constitution to declare what are not Offices of Profit are the exclusive domain of the State Legislature and it is not open to tamper with that power.
16. Tripura
The Government of India may frame general guidelines regarding uniformity in the principles to be followed by Parliament and State Legislature regarding disqualification. The State Government will take appropriate decision in the matter thereafter.
17. Uttar Pradesh
Not in favour.
18. Himachal Pradesh
The comments are not received.

2.5 Now the Joint Committee to examine the constitutional and legal position relating to office of profit has also been mandated to suggest evolution of generic and comprehensive criteria which are just, fair and reasonable and can be applied to all States and Union Territories. The JPC took up the issue with the State Governments/UTs besides the political parties/groups in Parliament and other legal/constitutional experts and invited their considered views in the matter.

8. Kerala
The State Government have accepted the guidelines suggested by the Joint committee for Members of Legislature and have decided to amend the Kerala Legislative Assembly (Removal of Disqualification) Act, 1951 accordingly.
9. Madhya Pradesh
Agrees with the views of the Joint Committee regarding uniform principles in regard to disqualification.
10. Meghalaya
Not in favour of uniformity as the local conditions vary to a considerable extent. In case a uniform policy is to be laid down the matter should be discussed in depth by all the legislatures.
11. Mizoram
The Government of Mizoram is not in favour of delegating power entirely to Parliament and is inclined to maintain status quo in this regard as at present.
12. Drissa
The State Government would prefer a law regarding disqualification under Article 191 (1)(e) and not a separate law on the subject.
13. Punjab
The issue involved have political overtones. The views of the State Government in correct perspective could be sent after the revival of legislature and installation of popular Government.
14. Rajasthan
It should be left to the State Governments to take appropriate action to adopt the principles which the Parliament by law provide.
15. Sikkim
The power given to the State Legislature under Article 191 (a) of the Constitution to declare what are not Offices of Profit are the exclusive domain of the State Legislature and it is not open to tamper with that power.
16. Tripura
The Government of India may frame general guidelines regarding uniformity in the principles to be followed by Parliament and State Legislature regarding disqualification. The State Government will take appropriate decision in the matter thereafter.
17. Uttar Pradesh
Not in favour.
18. Himachal Pradesh
The comments are not received.

2.5 Now the Joint Committee to examine the constitutional and legal position relating to office of profit has also been mandated to suggest evolution of generic and comprehensive criteria which are just, fair and reasonable and can be applied to all States and Union Territories. The JPC took up the issue with the State Governments/UTs besides the political parties/groups in Parliament and other legal/constitutional experts and invited their considered views in the matter.

STATE GOVERNMENTS

2.6 The views of the State Governments are brought out in succeeding paragraphs.

2.7 The State Government of Karnataka were of the view that it would be better to evolve a generic and comprehensive criteria to define 'office of profit' which could be applied uniformly to all the States and Union Territories. They had also stated that the criteria laid down by the apex court in *Jaya Bachchan Vs. Union of India* could settle the matter to decide whether an office was an 'office of profit' or not. The decision pronounced in the above case read as under:-

"for deciding the question as to whether one is holding an office of profit or not, what is relevant is whether the office is capable of yielding a profit or pecuniary gain and not whether the person actually obtained a monetary gain. If the pecuniary gain "is receivable" in connection with the office then it becomes an office of profit irrespective of whether such pecuniary gain is actually received or not. If the office carries with it, or entitles the holder to, any pecuniary gain other than reimbursement of out of pocket actual expenses, then the office will be an office of profit for the purpose of Article 102 (1) (a)."

2.8 They had further added that being a cumbersome process to update from time to time the Schedule to the Parliament (Prevention of Disqualification) Act, 1959 to define certain offices which could be exempted from considering in terms of office of profit, it would be better to lay down general criteria to spell out whether an office was an office of profit or not and if need be Articles 102(1) and 191(1) of the Constitution be amended suitably to incorporate the uniform principles. The law relating to office of profit could not be different from State to State.

2.9 The State Government of Maharashtra were of the view that it would be more appropriate to have in relation to the "office of profit" a generic and comprehensive criteria which were just fair and reasonable and could be applied to all States and Union Territories on the lines of the recent ruling of the Supreme Court as laid down in *Jaya Bachchan's* case. As regards, generic and comprehensive criteria which could be applied to States, the State Government were of the view that "the holder of any office of the Government of India or the Government of the State which was capable of yielding a profit or a pecuniary gain, whether the person holding the office actually obtained a monetary gain or not, should be disqualified for being chosen as, or for being a Member of Parliament or Member of the State Legislature."

2.10 The Committee pointed out that a large number of offices under the Government had been exempted from disqualification by several State Removal/Prevention of Disqualification Acts, without taking into consideration their nature of duties or remuneration and that a view had been held that the only feasible method would be to amend the Constitution and made it obligatory for the State Legislatures to be guided by such principles as Parliament might by law provide in regard to the matter. In a written response to this point, the State Government had stated that it was difficult to agree with the opinion and that it was equally difficult to suggest any method by which the objective of uniform application to States, of criteria regarding disqualification in relation to "office of profit" could be achieved. However, during discussion with the JPC, the representatives of the State Government of Maharashtra agreed that the only method by which uniform application of the criteria regarding disqualification to all States could be achieved was by a Constitutional amendment.

2.11 During discussion with the State Government of West Bengal at Kolkata, a representative of the State Government stated that in the absence of any definition of the term 'office of profit' it would be extremely difficult to define generic and comprehensive criteria for such offices. It was their view that holding a whole-time office remunerated either by salary or fees should disqualify the holder of that office and offices specifically exempted by law should continue, as prescribed in the Constitution, since Articles 102 (1)(a) and 191(1)(a) contemplate exemption of offices individually by name.

2.12 According to them offices were to be specifically exempted by law under the Constitution. Since there had to be separate laws for Members of Parliament and Members of State Legislature, it was obvious that there could be no one to one correspondence between the lists of exempted posts. However, the State Government had no objection for evolution of uniform principles after wide discussion.

2.13 On being asked whether there was any criteria, other than restriction on holding whole time office and remuneration, being followed by the State Government in granting general exemption from disqualification to the offices under the Central Government, a representative of the State Government stated that there was no criteria (other than restrictions on holding whole-time office and remuneration) that had been followed in granting general exemption from disqualification other than those specified in Section 2 (i) (a), (b), (c) and (d) of the West Bengal Legislature (Removal of Disqualification) Act, 1952.

2.14 On being pointed out that a view had been held that the only feasible method would be to amend the Constitution and made it obligatory for the State Legislatures to be guided by such principles as Parliament might by law provide in regard to the matter, a representative of the State Government of West Bengal stated that they did not agree with the said view and opined that the State Legislature should have a free hand to legislate in accordance with specific provisions of Article 191 of the Constitution. However, in their view it was difficult to evolve uniform criteria because each State frames its own legislation taking into account the local conditions.

2.15 During their interaction with the JPC, the representatives of State Government of Bihar did not agree on evolution of uniform principle. They were also of the view that what offices should not disqualify must be left within the domain of the State Legislature and no ways and means be devised to put any vertical cap in the name of uniform application to States of criteria regarding disqualification in relation to office of profit

2.16 The Committee also visited Chandigarh and Shimla and held discussion with the representatives of State Government of Punjab, Himachal Pradesh and Haryana on matters under reference of the JPC. The Committee were informed that the Government of Punjab were not in favour of evolving a uniform principle in regard to disqualification from holding Office of Profit under Articles 102(1) and 191(1) of the Constitution. However, they were of the view that there should be some guiding principles which could be suggestive in nature for declaring a particular post or office to be an office of profit and it should be left open ultimately to the Legislature to decide in its wisdom and in exercise of its powers conferred on it under the Constitution to determine whether any office/post is an 'Office of Profit' or not taking all relevant facts into consideration and in case if it was decided that there should be guidelines and principles for declaring a post/office as an Office of Profit, then the only feasible method would be to amend the Constitution.

2.17 According to Government of Himachal Pradesh, taking into account the following suggestion a comprehensive criteria had to be laid down for constituting office of profit without compromising with the object sought to be achieved by the provisions of Article 191 (1) (a) and Article 102 (1) (a) :-

1. *An office will be an office of profit which is capable of yielding profit or a pecuniary gain.*
2. *The holding of office must be under the Central or State Government and State or Central Government must have power of appointment and removal from office.*
3. *The office is attached with some pay, salary, emolument, remuneration or non-compensatory allowance.*
4. *The source of pecuniary gain must be at State expense.*
5. *If the pecuniary gain is receivable in connection with the office then it will be an office of profit irrespective whether such pecuniary gain is received or not.*
6. *If there is re-imbusement of money other than spent from pocket/actual expenses it will be an office of profit. Where the holder of office exercises executive and financial powers and is in a position to wield influence and patronage then the holder of office will fall within the ambit of office of profit irrespective of the facts he is getting only compensatory allowance."*

2.18 Thus if a Member of a body got only compensatory allowance and body exercised merely an advisory functions then no disqualification would arise. But if the allowances given were more than compensatory allowance and/or the body exercised executive and financial powers and was in a position to wield influence or patronage, then its membership could not be excluded from disqualification. That was the only interpretation, which could be placed by applying the test for determining the office of profit. The JPC might evolve a uniform criteria to be applicable in all States because the existing provisions of the enactments in question could not pass the true test of the law laid down by the Hon'ble Supreme Court from time to time while interpreting the provisions of Articles 102 (1) and 191 (1) of the Constitution. It was, therefore, necessary to reduce the risk of conflict between the duty and interest amongst members of the Legislature so as to ensure that the concerned Legislature did not come under an obligation of the executive, on account of receiving pecuniary gain or profit, which might render him amenable to influence of executive while discharging his obligation as a Legislature.

2.19 Adding further a representative of the State Government of Himachal Pradesh stated that they were in agreement with the opinion of the JPC that the only feasible method was to amend the Constitution and make it obligatory for the State Legislature to be guided by such principles as Parliament might by law provide in regard to the matter.

2.20 The State Government of Haryana were of the view that being a Federal System of Governance in the country and in order to preserve and protect this structure, there was no need to evolve uniform principles. The exemption of offices might vary from State to State depending upon varieties of needs and circumstances in each State.

2.21 The State Government of Chhattisgarh were of the view that office of profit from which a person might be saved from disqualification should be provided in the schedule post-wise and

class of post-wise declaring with its applicability to all States and Union Territories leaving no exception so that it should be applicable uniformly to all States leaving no room for ambiguity. But such office of profit held by a person should not be more than three at any point of time.

2.22 Normally a person should not be appointed to any office or post declared by law not to disqualify, if he holds three or more offices of profit as *ex-officio* at any point of time.

2.23 The State Governments of Assam, Madhya Pradesh, Gujarat, Manipur and Nagaland were not in favour of evolving any uniform criteria which could be made applicable to all States and Union Territories primarily due to the fact that evolving common criteria would be detrimental to the concept of federalism as envisaged in our Constitution to enable each State to draw its own criteria depending on its own needs including political aspirations and needs of the society.

2.24 On the issue of evolving criteria the State Government of Nagaland were of the view that there was no office in the executive realms which did not involve exercise of power or influence. Again on uniform application of criteria, they were of the view that such uniform principles could be evolved by Parliament only for members of Parliament and not for the members of the State Legislature, as Parliament did not have the legislative competency in view of provisions in article 191(1) of the Constitution. Subsequently, however, on a specific query whether the Parliament had the competency under Article 368 to amend the article 191(1) without effecting suitable legislations for incorporating in so far as office of profit was concerned, the State Government of Nagaland stated that it was possible but having a uniform definition would be difficult.

2.25 On the other hand, though the State Governments of Andhra Pradesh, Arunachal Pradesh, Kerala, Mizoram, Rajasthan, Tamil Nadu, Tripura, Uttaranchal, West Bengal, Meghalaya and Sikkim were broadly in favour of evolving a uniform criteria keeping in view the local conditions of each State and other required elements involved in deciding an office of profit, they had not furnished any concrete suggestion in this regard.

2.26 A statement showing the comments of the State Governments (as received by the JPC) in regard to evolution of generic and comprehensive criteria, which are just fair and reasonable and can be applied to all States and Union Territories, (second term of reference) is at Annexure VI.

Ministry of Law and Justice (Legislative Department)

2.27 The Ministry of Law and Justice (Legislative Department) opined that without amendment of the Constitution, statutory uniform principles could not be evolved. The uniform principles might be evolved by the JPC, which might be conveyed to the State Governments for their guidance.

2.28 Further the Legislative Department had stated (O.M. dtd. 21.4.08) that technically it would be open to Parliament to lay down principles and guidelines by saying that "if a person is found to be holding an office which satisfies certain principles and guidelines, then the holder of that particular office will stand disqualified." But that might give rise to many practical complications and difficulties. First, that might open flood gates of disputes because the determination of the fact as to whether the holder of any particular office other than the office of profit would fall within the guidelines or principles, would itself be a point of dispute or form

part of that dispute. Secondly, there would be an increase in the reference under Article 103 of the Constitution virtually leading to an enormous rise in the election petitions to be decided by the President and Election Commission, because any number of petitions could be filed then on the basis that a particular person was not disqualified as his case was not covered by the guidelines which were proposed to be laid down. With regard to the guidelines that a member would be disqualified if he held an office where he was in a position to wield influence or distribute patronage, the Ministry were of the view that the trend of Judicial decisions had been to equate profit in terms of money or assess in terms of pecuniary gain. Mere patronage under Articles 102 (1) (a) and 191 (1) would not disqualify.

2.29 The Legislative Department were also of the view (O.M. dtd. 6.6.08) that our constitutional scheme recognized federal structure and the States were free to express their views within the constitutional framework. Our Constitution distributed legislative powers between the Centre and States.

2.30 On being asked to elaborate the possible way to overcome the problem if the States were not in favour of uniform criteria being followed by all States, the Legislative Department in their O.M. (dtd. 6.6.08) stated that this problem could be overcome by suitably amending the Constitution on the lines of the Constitution (Forty Second Amendment) Act, 1976. By the Constitution (42nd Amendment) Act, 1976, Article 102(1)(a) of the Constitution was substituted by a new article whereby the Parliament was given power to declare offices which will disqualify its holder. The power was given to the Parliament in respect of membership of Parliament as well as of the State Legislature. As the provisions of Article 102 (1)(a) as substituted by the Constitution 42nd Amendment were repealed by the Constitution 44th Amendment Act, 1978, the traditional exemption route had been followed so far.

Institutions

2.31 During their study visit to Bangalore, the JPC also held discussions with the representatives of National Law School, Bangalore on the terms of the reference of the Committee. On being asked about the evolution of uniform criteria applicable to all States/UTs, a representative of the University stated that to achieve uniformity among all State legislations and the Central legislation, Article 191 be amended to include a principled definition of the office of profit which might be identical to an explanation to Article 102. These definitions would exemplify the present explanation to these Articles and would allow the States to make laws that specify analogous offices, which might not named to be Minister.

Constitutional/legal experts

2.32 Expressing his views on the issue, Shri K.K.Venugopal, Senior Advocate in a written reply had stated that the purpose of disqualifying a Member of Parliament/ Legislature holding an office of profit was to prevent the conflict between duty and interest so that the Member could function independently and free of any sub-servience to the Government. If a liberal view was given to the concept of "office of Profit", it would defeat the purpose and would make the Article 75 (1A) ineffective. Therefore, the Member of Parliament/Legislature should be given additional function attached to any other office on the basis of his background qualifications and experience and should not result in any pecuniary gain.

Joint Committee on Office of Profit (JCOP)

2.33 The Joint Committee on Office of profit (JCOP) under the Chairmanship of Shri Chandrabhushan Singh, M.P. also submitted a memorandum to the JPC which is reproduced as under:-

As far back as in 1984, the Joint Committee on Offices of Profit felt the need to evolve uniform principles in regard to disqualification for holding office of profit under Articles 102 (1) and 191 (1) of the Constitution. After examining the matter in detail, the Committee had noted in their 9th Report (7th Lok Sabha) that members of State and Union Territory Legislatures had been appointed on various Corporations/Boards/Committees etc. set up by the State Governments and the Union Territory Administrations which enjoy wide and excessive powers. By virtue of the provisions contained in most of the State Removal/Prevention of Disqualifications Acts, the members of State/Union Territory Legislatures were exempted from disqualification in spite of holding offices of profit whereas in view of the guidelines followed by the Joint Committee on Offices of Profit, Members of Parliament, if appointed on those Corporations/Boards/Committees etc. would incur disqualification by virtue of such bodies exercising excessive executive, financial or judicial powers or members' being entitled to draw remuneration more than the 'compensatory allowance' as defined in Section 2 (a) of the Parliament (Prevention of Disqualification) Act, 1959. The Committee strongly felt the need for evolving of uniform principles in regard to disqualification for membership under articles 102 (1) (a) and 191 (1) (a) of the Constitution, and the only feasible method could be to amend the Constitution and make it obligatory for the State Legislatures to be guided by such principles as Parliament may by law provide in regard to the matter. Alternatively, as the State Legislatures are plenary authorities within their allocated spheres, the Committee would like to recommend to the State Legislatures to take appropriate action to adopt the principles evolved by the Joint Committee on Offices of Profit. The Committee were also of the view that the objectives proposed to be served by the Constitutional Amendment could also be achieved to some extent by making a law to that effect by Parliament under Article 191 (1) (e) of the Constitution, whereby it could be provided that holders of offices which enjoy executive, financial judicial/quasi judicial powers or which would place them in a position where they could receive some patronage from Government or are themselves in a position to distribute patronage or are entitled to any remuneration other than the compensatory allowance, as defined in Section 2 (a) of the Parliament (Prevention of Disqualification) Act, 1959, would incur disqualification. The Committee recommended that exemption from disqualifying holder of an office of profit should be so restricted as to cover only those offices held by members in Corporations/Boards/Committees etc. directly constituted and controlled by the Legislature. The members appointed to Corporations, Boards, Committees etc. whether controlled by Government directly or by statutory or non-statutory agencies created by State, should not enjoy any such exemption. The Committee were of the opinion that free exercise of legislative powers given under article 191 (1) (a) of the Constitution without circumspection or restraint, had greatly undermined the independent functioning of the members of the Legislature in many parts of the country. Offer of blandishment to members through their appointment to various offices of profit in certain corporations/undertakings/boards etc. constituted by the State Governments and exempting those offices from disqualification by legislative enactment without great care were being resorted to freely and increasingly in recent times. The Committee were of the view that if the real spirit of articles 102 and 191

of the Constitution was to be maintained sacrosanct, the enabling exemption provisions should be kept within its bounds and restricted in its scope both in regard to the areas of operation and legislative competence. Otherwise, the object of the imposition of the disqualification as envisaged in the Constitution would become frustrated. The Committee, therefore, urged the Ministry of Law, Justice and Company Affairs to take necessary steps for bringing legislation to evolve uniform principles in regard to disqualification for holding offices of profit under articles 102 (1) and 191 (1) of the Constitution, in consultation with the Central Government, State Governments and Union Territory Administrations, in the light of the recommendations / observations contained in the Report, at an early date. The Ministry of Law and Justice reportedly did not pursue the matter due to lack of consensus among the State/Union Territories. Thus, there is an urgent need for evolving definition of Offices of Profit which should be based on uniform principles.

2.34 On the question of uniform criteria/principle it may be pertinent to mention here that in order to determine whether an office held by a person is an office of profit under the Government, the Joint Committee on Office of Profit, in their Tenth Report (7th Lok Sabha), presented to Lok Sabha on 7 May, 1984 laid down the following guiding principles:

"The broad criteria for the determination of the question whether an office held by a person is an office of profit have been laid down in judicial pronouncements. If the Government exercises control over the appointment to and dismissal from the office and over the performance and functions of the office and in case the remuneration or pecuniary gain, either tangible or intangible in nature, flows from such office irrespective of whether the holder for the time being actually receives such remuneration or gain or not, the office should be held to be an office of profit under the Government. Otherwise, the objection of imposition of the disqualification as envisaged in the Constitution will become frustrated. This first basis principle should be the guiding factor in offering positions to a member of the legislature."

2.35 Keeping the above position in view, the Joint Committee on Offices of Profit have been following the under-noted criteria to test the Committees, Commissions, etc. for deciding the question as to which of the offices should disqualify and which should not disqualify a person for being chosen as, and for being a Member of Parliament:—

- (i) Whether the holder draws any remuneration like sitting fee, honorarium, salary, etc. i.e. remuneration other than the 'compensatory allowance' as defined in Section 2(a) of the Parliament (Prevention of Disqualification) Act, 1959;

(the principle thus is that if a member draws not more than what is required to cover the actual out of pocket expenses and does not give him pecuniary benefit, it will not act as a disqualification).

- (ii) Whether the body in which an office is held, exercises executive, legislative or judicial powers or confers powers of disbursement of funds, allotment of lands, issue of licenses, etc. or gives powers of appointment, grant of scholarships, etc. and ;
- (iii) Whether the body in which an office is held wields influence or power by way of patronage.

If reply to any of the above criteria is in affirmative, then, the office in question will entail disqualification.

2.36 The Committee generally applies two tests in deciding whether a member of a body ought to be exempted from disqualification *i.e.* (a) the emoluments and allowances attached to the members; and (b) the nature and function of the body.

2.37 If a member of a body gets only compensatory allowance and the body exercises merely an advisory function, then no disqualification would arise. But if the allowances given are more than compensatory allowances and/or the body exercise executive and financial powers and is in a position to wield influence and patronage, then its membership would not be exempted from disqualification.

2.38 Based on the recommendations of the Joint Committee, exemptions have been made by adding certain offices to the list from time to time.

Administrative Reforms Commission

2.39 It may be pertinent to mention here that the Hon'ble President of India had set up Second Administrative Reforms Commission (in 2005) under the Chairmanship of Shri Veerappa Moily to prepare a detailed report for revamping the public administration system. The Commission submitted their Fourth Report titled 'Ethics in Governance' in January, 2007 which *inter-alia* include the recommendation of the Commission on 'office of profit'. The relevant extracts are as under:-

2.6.5 there is need to re-examine the definition of office of profit. Articles 102 and 191 of the Constitution relating to office of profit have been violated in spirit over the years even when the letter is adhered to. As a result, the legislatures kept on expanding the list of exemptions from disqualification under Articles 102 and 191. For instance, the Act 10 of 1959 listed scores of offices in the exemption from disqualification under Article 102. There does not appear to be a clear rationale to such a list, except perhaps the expediency to protect holders of certain offices from time to time. Similar laws have been enacted by State Legislature under Article 191, exempting hundreds of offices from disqualification for the State Legislature. Each time a legislator is appointed by the executive to an office, which might be, classified an office of profit, a law is enacted including that office in the list of exempted categories.

2.6.6 Often, the crude criterion applied is whether or not the office carries a remuneration. In the process, the real distinction of whether executive authority is exercised in terms of decision making or direct involvement in deployment of public funds is often lost sight of. The Supreme Court's clarification about the appointment and removal being in the hands of the executive branch of Government does not help either, because many appointments made may be in advisory capacities.

2.6.9 Therefore it seems necessary to sharply define office of profit to ensure clearer separation of powers. Legislators who are not Ministers often do have significant expertise from their own personal or professional background. In addition, their experience in public service gives them unique insights and understanding of public policy. Such expertise and insights would be valuable inputs to the executive in policy making. Therefore, Committees and Commissions of a purely advisory nature can be constituted with legislators. The mere fact of such positions carrying certain remuneration and other perks does not make them executive offices. The Constitution recognized that holding of such offices in expert and

advisory bodies does not violate separation of powers and left it to Parliament and State Legislatures to exempt such non-executive offices from disqualification. But appointment in statutory or non-statutory executive authorities with direct decision making powers and day-to-day control of field personnel, or positions on the governing boards of public sector undertakings or as Government nominees in private enterprises clearly carry direct executive responsibilities and involve decision making powers. Giving discretionary powers to legislators to sanction or approve public works is clearly an exercise of executive function, whether or not the Government appoints the legislators to a designated office. It is necessary to sharply distinguish executive functions and exercise of executive authority while defining office of profit, irrespective of whether such a role of office carries remuneration and perks.

2.6.10 Given these circumstances, it would be appropriate to amend the law on the following lines:

- All offices in purely advisory bodies where the experience and insights of a legislator would be inputs in governmental policy will not be treated as offices of profit, irrespective of the remuneration and perks associated with such an office.
- All offices involving executive decision making and control of public funds, including positions on the governing boards of public undertakings and statutory and non-statutory authorities directly, deciding policy or managing institutions or authorizing or approving expenditure shall be treated as offices of profit, and no legislator shall hold such offices. (Discretionary funds at the disposal of legislators or the power to determine specific projects and schemes, or select the beneficiaries or authorize expenditure shall constitute discharge of executive functions and will invite disqualification under Articles 102 and 191, irrespective of whether or not a new office is notified and held.)
- If a serving Minister, by virtue of office, is a member or head of certain organizations like the Planning Commission, where close coordination and integration between the Council of Ministers and the organization or authority or committee is vital for the day-to-day functioning of Government, it shall not be treated as office of profit.

C. Third term of reference

to examine the feasibility of adoption of system of law relating to prevention of disqualification of members of Parliament as existing in the United Kingdom and considered by the Constitution (Forty-Second Amendment) Act, 1976

3.1 The concept of office of profit originated in the House of Commons in the sixteenth century when the prolonged absence of member due to their pre-occupation with the duties of the executive was considered to be inconsistent with a seat in Parliament. It was also felt necessary to exclude the executive officers from the membership of the House in order to reduce the influence of the Crown on Parliament. This concept gained greater strength in the following centuries and a large number of offices came to be treated as disqualifying offices in U.K. A number of laws were enacted during this long period listing out the disqualifying offices.

3.2 Thus, the concept of office of profit has a history of more than three centuries during which period it has undergone many changes and is yet far from being precisely understood and defined. The confused state of law in this respect and obsolete character of many of the relevant legal provisions are the legacies of the evolution of this idea through different phases of history in the United Kingdom.

3.3 There are three principal phases in the development of concept of office of profit in the United Kingdom on the basis of which the law on the subject developed in India.

(1) The first phase : The "privilege" phase before 1640

The attitude of the sixteenth century House of Commons to the question of holding by its Members office under the Crown first appears in a jealous insistence on its own prior claim to their services. In consequence, the criterion which was applied to an office was not the extent to which the Crown could exert its influence, but compatibility with the physical attendance of the holder on the service of the House. This phase of the Common's attitude to paid office left a permanent mark on the law in the shape of the common law disqualification of judges and clergy; it also affected the position of sheriff and ambassadors.

(2) The Second Phase: "Corruption" phase - from 1660

In this phase the holding of paid Crown office was made incompatible with the membership of the House of Commons. In this period, the House of Commons enacted two Acts, namely, the Act of settlement, 1701 and the succession to the Crown Act, 1705. The succession to the Crown Act, 1705 re-enacted after the Union with Scotland in 1707, commonly known as the Statute of Anne. Section 24 of that Act provides that no person holding an office or place of profit *under* the crown created since 25th October 1705 should be able to sit in the House of Commons. A similar absolute disqualification is applied to certain named offices and also to persons holding any pension under the Crown. Section 25 of the said Act, however, states that if any person, being a Member, accepts any office of profit *from* the Crown, his election is avoided and a new writ is to issue, but he is capable of being elected again. The apparent conflict between the two sections has been resolved by applying section 25 to old offices *i.e.*, those created before 1705, although it is not so expressly stated. But many other anomalies have arisen in great part as a result of an attempt to draw a distinction between the alternative use of the words "under the Crown" and "from the Crown" in sections 24 and 25 of the said Act.

(3) The third phase: "the Ministerial responsibilities" phase after 1705.

Although the division into "old" and "new" offices continued to pose many problems in determining the category into which any particular office fell, its force in fostering any nascent theory of separation of powers was soon spent. Neither of the two sections indeed expressed any constitutional distinction between ministerial and other office, yet section 24 by its veto on the capacity of holders of newly created office to sit in the House could have produced a Government the majority of whose members were outside the House.

2. Thus, it is evident that disqualification of certain office holders from membership of House of Commons has existed since the early seventeenth century. These were previously scattered through public and private Acts and the journals of the House. By the year 1940, the confusion about the actual and intended scope and effect of existing disqualifying provisions, together with fears about the effects on Parliamentary democracy of special war-time appointments of Members, led to the appointment of a Select Committee (Herbert Committee).

3. The Herbert Committee looked particularly of the law and practice governing the disqualification of those holding "offices or places of profit under the Crown" and the report (HC 120, 14 October 1941) contained recommendations for legislation to replace earlier statutes. After the war and the reconstruction period, work began in 1949 on drafting a Bill to put the Herbert Committee recommendations into effect. However, there was a serious difficulty in arriving at satisfactory legal expression of some of the concept recommended by the Herbert Committee and it was not until 1955 that a Bill finally went to the House.

4. Progress was difficult and further a Select Committee, Spens Committee was set up in 1956 to reconsider the Bill. The Committee stated that certain offices are incompatible with membership of the House of Commons, some as involving physical impossibilities of simultaneous attendance in two places some because of possible patronage, and other because of conflict of duties. The Spens Committee examined the Bill after second reading and made several recommendations but the revised Bill was not officially enacted until the 1956-57 sessions. Legislation was finally enacted as the House of Commons Disqualification Act, 1959. This was re-enacted in 1975 when offices disqualifying from the Northern Ireland Assembly were separated out and covered by the Northern Ireland Assembly Disqualification Act, 1975.

3.4 There is not as yet any comprehensive statute on the subject in the United Kingdom. But a Bill known as "House of Commons Disqualification Bill" was introduced in the House in 1955. Thus, the major legislation governing disqualification is consolidated in the House of Commons Disqualification Act, 1975. (see Annexure-VII) The main purpose of disqualification is to ensure that Members are fit and proper to sit in the House, are able to carry out their duties and responsibilities free from any undue pressures from other sources. It is to be ensured that an office held by an individual is not adversely affected by his membership of Parliament. Thus where a member holds some publicly funded position, his performance in that position should not be jeopardized by his role as a Member, either on conflict of interest grounds or because the position might require demonstrable political neutrality.

3.5 The House of Commons (Disqualification) Act, 1975 disqualifies a large number of public office holders. It is the single most important legal measure affecting eligibility for parliamentary candidature. It lays down six classes of office holders who are disqualified, namely:—

- (1) Holders of certain judicial offices including High Court and Court of Appeal judges (Law Lords are disqualified already by virtue of being members of the House of Lords)

- (2) Civil servants, whether established or not, and whether full-time or part-time;
- (3) Members of the regular armed forces;
- (4) Full-time police officers;
- (5) Members of the Legislature of any country outside the Commonwealth; and
- (6) Holder of any of the offices listed in Schedules of the Act.

3.6 The Act also limits the number of Ministers who can sit in the House of Commons at a time. The list is set out in Schedule I of the Act and is very lengthy. Regular updates are published. The Act enables the government to add or vary the list from time to time by Parliamentary resolution and an order in Council. The Judicial Committee of the Privy Council has jurisdiction to decide matters in relation to jurisdiction under 1975 Act provided that an election petition is not pending or that the Commons has not made an order directing that the disqualification should be disregarded.

3.7 The law in the United Kingdom in relation to disqualifications however has undergone certain important changes in recent times. These are as follows:

- (i) the enactment of the House of Lords Act, 1999 by which hereditary peers are no longer disqualified from membership of the Commons;
- (ii) the Disqualification Act, 2000 amended the 1975 Act so that members of the legislature in Ireland are not disqualified from being members;
- (iii) the House of Commons (Removal of clergy disqualification) Act, 2001 that removed prohibitions against clergy sitting in the Commons;

3.8 Importantly, there appears to be no criteria in the schedule for what exactly constitutes an office of profit under the Crown. Some recent amendments to Schedule I are as follows:

- (i) Member of the Immigration Services Tribunal inserted by the Immigration and Asylum Act, 1999
- (ii) Adjudicator to Her Majesty's Land Registry inserted by the Land Registration Act, 2002.

3.9 One clear merit of the approach followed in the United Kingdom is that there is no ambiguity surrounding whether or not the holding of a particular office would result in disqualification. If an office is listed in the schedule then it would result in a disqualification, and if it is not listed then it would not. The clarity of the position is also evident by the fact that till date no application has been made to the judicial committee of the Privy Council, which has the jurisdiction to decide matters relating to disqualification under the 1975 Act, in relation to a claim that a person purporting to be a Member of the House is disqualified under the Act.

Feasibility of adoption of law relating to prevention of disqualification of Members of Parliament as existing in the United Kingdom and considered by the Constitution (Forty Second Amendment) Act, 1976

3.10 At present we have the Parliament (Prevention of Disqualification) Act, 1959 which declares certain offices of profit under the Government which do not disqualify or which disqualify holders thereof for being chosen as, or for being members of Parliament. The Act contains

5 sections and a schedule, which has two parts containing names of bodies under the Central Government, which disqualify their holders. Section 3 of the Act specifies the offices, which do not disqualify their holders. The Act has been amended from time to time to include offices in the category of exempted offices. Recently in 2006, this Act has been amended to include 55 more bodies in the category of exempted offices. This amendment has been given retrospective effect from 1959 although many bodies which have been so exempted from disqualification through this amendment, did not exist in 1959.

3.11 The Act of 1959 contains a Schedule, which is in two parts, viz. Part I and Part II. Part I contains statutory or non-statutory bodies under the Central Government as well as certain State Governments which disqualify the holders of the office of Chairman of these bodies. Part II of the Schedule contains statutory or non-statutory bodies under the Central Government as well as the State Governments of Andhra Pradesh, Bihar, Kerala, Tamil Nadu and Punjab which disqualify the holders of the office of Chairman and Secretary of such bodies.

3.12 These provisions of the Act make it clear that exemption from disqualification in respect of offices specified in Section 3 is available only when the holders are entitled to not more than compensatory allowance. Compensatory allowance has been defined in the Act as "any sum of money payable to the holder of an office by way of daily allowance (which should not exceed the amount of daily allowance of a member of Parliament), any conveyance allowance, house rent allowance or travelling allowance for the purpose of enabling him to recoup any expenditure incurred by him in performing the functions of that office." Compensatory allowance is the key factor in determining whether the holder incurs disqualification or not. Compensatory allowance is treated as an allowance to compensate certain expenditures incurred by the holder of the office in the performance of his duties. However, in the case of offices specified in the Schedule, no such exemption from disqualification is given to the holders of the offices like those of the Chairman and Secretary.

3.13 There are certain basic differences between the Indian Act and the House of Commons Disqualification Act. The House of Commons Act did not adopt the concept of compensatory allowance in the context of office of profit, whereas this allowance is a major factor in the determination of an office of profit in the Indian law. The House of Commons Act specifies the disqualifying offices fairly exhaustively and declares that no other office or place of profit under the Crown shall disqualify the holder for the membership of the House. The Indian law specifies the offices, which disqualify as well as those which do not disqualify. It does not, however, contain any definitive declaration in regard to non-disqualifying offices other than those specified in the Schedule. Further, any office under the Government, which fetches remuneration higher than compensatory allowance, is an office of profit except the offices exempted under the Constitution and the concept of disqualification on the ground of office of profit does not seem to apply to the membership of the House of Lords, which is a House of hereditary peerage. The Indian law applies to both Houses of Indian Parliament and Article 191(1) covers the State Legislatures. The State Legislatures have also enacted laws in this regard.

3.14 Similarly, the Constitution of India exempts all Ministers of the Union Government as well as of the States from disqualification on account of holding an office of profit. The House of Commons law has put a restriction on the number of ministers who can sit and vote in the House.

Section 2 of the House of Commons Act says that not more than ninety-five ministers can sit and vote in the House of Commons at any one time. Others will have to wait till a vacancy arises either by death, resignation or otherwise. But this restriction, as can be seen from the Act, is confined to the entitlement to sit in the House and vote. In other words, those ministers in excess of ninety-five who cannot sit and vote in the House are not disqualified for the membership of the House as such. They remain members of the House.

3.15 The term "office of profit" has not been defined either in the House of Commons Act or the Indian Act. The reason is not clear. No doubt, the law on this subject was very complex in UK until it was consolidated in the twentieth century. But, that by itself is not a reasonable ground for not defining the term. In India too an attempt by way of constitutional amendment was made in 1976 to adopt the procedure being followed in UK.

3.16 In line with the UK procedure as regard disqualification of members on the grounds of holding Office of Profit, Section 19 of the Constitution (Forty Second Amendment) Act, 1976 amended article 102(1) (a) in the following manner:-

19. In article 102 of the Constitution, for sub-clause (a) of clause (1), the following sub-clause shall be substituted, namely:-

(a) if he holds any such office of profit under the Government of India or the Government of any State as is declared by Parliament by law to disqualify its holder.

Similarly, section 32 of the said constitutional amendment amended article 191(1) (a) of the Constitution in the following manner:-

32. In article 191 of the Constitution, for sub-clause (a) of clause (1), the following sub-clause shall be substituted, namely:-

(a) if he holds any such office of profit under the Government of India or the Government of any State specified in the First Schedule as is declared by Parliament by law to disqualify its holder."

3.17 It may be seen that sections 19 and 32 of the Constitution (Forty-Second Amendment) Act, 1976 aimed to reverse the basis of disqualification by providing that only those offices which are specified by law made by Parliament will disqualify the holder on the lines of the United Kingdom law, namely the House of Commons Disqualification Act, 1975.

3.18 The above amendments in 1976 were brought with a view that there should be an exhaustive list of offices by a Parliamentary legislation which disqualify its holder for being chosen, as for or being a member of either House of Parliament or State Legislature. The power to enact law to declare offices of profit, which would attract disqualification of its holder for being chosen as or being a member of a State Legislature, was also vested in the Parliament. However, the sections 19 and 32 of the said constitutional amendment were not brought into force and the same were omitted *vide* section 49 of the Constitution (Forty Fourth Amendment) Act, 1978. It was felt in regard to the amendment made by the Constitution (42nd Amendment), Act 1976 that it would jeopardize the independence to Members of Legislatures and would enable the Government of the day to pack the legislature with persons who would hold offices of profit for continuance in which they would be dependent upon Government.

3.19 Now the JPC have also been mandated to examine and recommend whether the present method of declaring an office of profit which would not disqualify its holders from being a member of a legislature is appropriate or a provision as added by the Constitution (42nd amendment) Act which, may provide that an office which is declared would disqualify its holder would be more appropriate. The Committee deliberated on the issue and invited considered views of State Governments, political parties/groups in Parliament, legal luminaries and general public interested on the subject matter. The JPC received diverse views on the issues, which have been brought out in the succeeding paragraphs.

Constitution/legal Experts

3.20 While deliberating with JPC, Shri Rajeev Dhavan, Senior Advocate was of the view that the United Kingdom, under the House of Commons Disqualification Act, 1975 used the method of 'disqualification' rather than the prevention of disqualification. That meant that apart from the holder of an office which was listed under the Act, no other person was disqualified from being a legislator. An attempt was made to adopt the U.K. approach through the 42nd Amendment Act. In the definition of 'office of profit' suggested, the listing of some offices that would disqualify its holder is in accordance with the UK method of 'disqualification' rather than the 'prevention of disqualification'.

3.21 Shri Harish N. Salve, Senior Advocate, Supreme Court of India during evidence before the JPC was of the view that the UK law might not be adopted in India as there were stark differences between the ground realities of both the countries.

3.22 During his evidence before the JPC, Shri Fali S. Nariman also stated "we should not go by the U.K. procedure for the reason that United Kingdom does not have a written constitution. There, the Parliament is supreme. Not only it is supreme, as said in Keshav Singh's case, it is the High Court of Parliament. So it exercises even judicial power in England. There Courts do not have power to strike down laws of Parliament. They can only declare that these laws will not be operative until Parliament otherwise decides. Whereas in India the Constitution is Supreme. Thus, there should not be a negative list as attempted by Constitution 42nd Amendment Act, 1976 which amended Article 102 and Article 191. The provision regarding disqualification as envisaged by Constitution 42nd Amendment should not be reintroduced."

Institutions

3.23 During course of the discussion with JPC, a representative of the National Law School, Bangalore too had stated that despite its effective functioning in the UK, blindly importing the British approach, without consideration of the relevant practice in this regard, in India would be futile.

3.24 Similarly, a representative of the Council for Political Studies, Kolkata during their discussion with the JPC observed as under:

"we do not approve revival of the changes in Articles 102 and 191 brought out in by the 42nd (Amendment) Act, 1976. Such changes it may be recalled, were perfectly in tune with the attempt by the said Amendment to vest Parliament with unlimited authority. However, a fully sovereign Parliament does not go with the spirit of the Constitution—the spirit that has been reinforced by the Courts's judgement on the unamendability of the basic structure.

He further added that "if Parliament by its Act goes on exempting offices from the bar imposed by Article 102 (1), then it will be an amendability of the basic structure." He further added that "if Parliament by its Act goes on exempting offices from the bar imposed by Article 102 (1) then it will be an unending process. After all, the Parliament at a particular point of time, cannot foresee all the offices that may come up in future."

Political Parties in Parliament

3.25 The Committee also invited comments of the political parties/groups in Parliament in this regard. Some of the views received from the political parties/groups are as under:-

3.26 The National Congress Party were of the view that if a list of disqualifying offices was to be established, it should be done with reference to objective criteria, which could be laid down for uniform application in all the legislative bodies of the country.

3.27 The Rashtriya Janata Dal were of the view that the guiding model for formulating or identifying the concept of 'Office of Profit' for Parliament of India should be the House of Commons Disqualification Act, 1975. According to them a person should be allowed to hold one post and no further change/additions should be allowed in the office of profit already defined. However, in exceptional circumstances only, if amendments were required prior approval of Hon'ble Speaker should be obtained after detailed consideration of the matter by the Committee relating to Office of Profit.

3.28 The RJD had further stated that the House of Commons Act applied only to that House and the concept of disqualification on the ground of office of profit did not seem to apply to the membership of the House of Lords.

STATE GOVERNMENTS

3.29 The Joint Committee invited comments/views of the State Governments/UTs on this issue. The views received from the State Governments are enumerated hereunder.

3.30 The State Government of Tamil Nadu was of the view that as per Section 1 (1) of the House of Commons Disqualification Act, 1975 a person who had held any office described in Schedule I of the Act was disqualified from membership of the House of Commons. However, the power to amend the said Schedule I by order had been conferred on Her Majesty after a resolution was passed in the House of Commons to that effect. That was not the procedure adopted in our country. Only by undertaking a legislation, the schedule which forms part of the Act is amended. Therefore, by undertaking a legislation offices might be declared as offices of profit and that the holder thereof would be disqualified for being chosen as and for being a member of legislature. The Government of Tamil Nadu were thus in favour of adoption of system of law relating to prevention of disqualification of members of Parliament as existing in the United Kingdom and considered by the Constitution (Forty-Second Amendment) Act, 1976.

3.31 While expressing their views before the JPC during their study visit to Bangalore, a representative of the State Government of Karnataka stated that adoption of system as exist in U.K. was only the best possible source at present in view of the fact that:-

- (i) no comprehensive definition of office of profit was possible.
- (ii) The holder was certain to know before hand which offices would disqualify him.
- (iii) If a list of Schedule was provided, a new office could not be included immediately, unless a cumbersome process of amendment was followed.

3.32 Adding further on the issue, a representative of the State Government of Karnataka observed "on account of certainty and clarity it was necessary to reintroduce provision regarding disqualification as envisaged in Constitution 42nd Amendment Act, 1976."

3.33 The State of Himachal Pradesh had no objection for the adoption of system of law relating to Prevention of Disqualification of Members of Parliament as existing in the United Kingdom if such law had stood the judicial scrutiny and had achieved the objective of maintaining the independence of Members of Legislatures from any sort of Government control or influence.

3.34 Similarly, agreeing with the adoption of system of law as existing in UK, the State Government of Haryana was of the view that negative list should be incorporated in the relevant laws by Parliament or State Government as the case might be.

3.35 As regards adoption of system of law as existing in U.K. the State Government of Rajasthan were of the view that U.K. pattern certainly had the benefit of clarity and certainty and adoption of the pattern would be improvement over our existing law. However, the power to declare office of profits under Article 191 should remain with the State Legislature. Similarly, the State Governments of Uttar Pradesh and Uttarakhand were of the view that the provisions regarding disqualification as envisaged by the Constitution (42nd amendment) Act, 1976 might be revived and reintroduced because if a negative list of the office is provided, it would certainly bring about clarity about the expression of office of profit. It would also clear all doubts and it would curtail the scope of liberal interpretation of the term.

3.36 In their written replies the State Governments of Andhra Pradesh, Chhattisgarh, Kerala, and Mizoram were conceptually in favour of reintroduction of the provision regarding disqualification as envisaged by the Constitution (42nd Amendment) Act, 1976.

3.37 On the question of reintroduction of provision regarding disqualification as envisaged in Constitution 42nd Amendment Act, 1976, a representative of the State Government of Maharashtra during study visit of the JPC to Mumbai stated that there was adequate provision in our Constitution and Parliament had also enacted Members of Parliament (Prevention of Disqualification) Act, 2006 which would govern the entire arena. It would, therefore, not be necessary to adopt system of law as existing in U.K. since U.K. did not have a written constitution.

3.38 The State Governments of Assam, Bihar, Gujarat, Punjab, West Bengal, and Tripura did not favour reintroduction of the provisions regarding disqualification as envisaged by the Constitution (42nd Amendment) Act, 1976 primarily due to the fact that power of the State Legislature as envisaged under the Article 191 should not be abrogated by the Parliament especially since it related to a State subject. Similarly, in a written reply the State Government of Nagaland stated that "It will be too late to go back to the Constitution (42nd Amendment) Act, 1976 the provisions of which were substantially overridden by the Constitution (44th Amendment) Act, 1978. It would not be prudent to set the Parliamentary clock back by three decades. The political, social, economic and constitutional relevance of those provisions has simply been rendered comatose by mere afflux of time.

3.39 On the other hand the State Governments of Arunachal Pradesh, Manipur, Meghalaya, Sikkim, Jammu & Kashmir, Goa, Orissa and Jharkhand did not furnish any comments in this regard.

3.40 A synopsis of the views received from the State Governments and UTs in regard to feasibility of adoption of law relating to prevention of disqualification of Members of Parliament as existing in the United Kingdom and considered by the Constitution (Forty-second Amendment) Act, 1976 (third term of reference) is at Annexure VIII.

3.41 The Ministry of Law & Justice (Legislative Department) did not offer their view in regard to adoption of system of law relating to prevention of disqualification of Members of Parliament as existing in the United Kingdom and considered by the Constitution (Forty-Second Amendment) Act, 1976.

D. Any other matter incidental to the terms of reference of the JPC

4.1 Some of the views/comments made by the representatives of various State Governments, experts and the issues that had cropped up during the discussions incidental to the terms of reference of the JPC are as follows:-

- (i) In the opinion of Shri Fali S. Nariman, Senior Advocate and National Law School, Bangalore and a few others, there should not be any retrospective exemption from disqualification of certain offices of profit by legislation.
- (ii) Almost all the State Governments are unanimous in their opinion that there should not be any authority other than those prescribed in the law to determine whether an office is an 'office of profit' or not.
- (iii) There is no Committee similar to the JCOP in Parliament in any State Legislature.
- (iv) Introduction of negative list on the pattern of U.K. law would obviate the need for having a definition of 'office of profit' and evolving of uniform criteria.
- (v) The Constitution (Ninety First) Amendment Act, 2003 has placed a ceiling on Council of Ministers in the Union and the States [Articles 75(1A) and 164 (1A)] and prohibited members being disqualified on grounds of defection from holding any "remunerative political post" till they get re-elected (Article 361 B). The very purpose of the amendment would be defeated if one were to liberally interpret the concept of "office of profit" so as to comprehend within its scope for giving exemption to a very large number of offices from disqualification under Article 102 (1)(a), circumventing the provisions of these Articles. Opinion of the State Governments was invited in this regard. Majority of the States have not disagreed with this, although they want the existing provisions of the Constitution to remain as they are for serving the respective intended purpose.

4.2 A summary of views of State Governments/U.Ts. on issues incidental to the above three terms of the reference is enclosed at Annexure IX.

PART II

CONCLUSIONS AND RECOMMENDATIONS

The terms of reference of the Joint Committee to examine the constitutional and legal position relating to office of profit as per the motion adopted in Lok Sabha on 17.8.2006 and concurred in by Rajya Sabha on 18.8.2006 are as follows :-

- (i) to examine, in the context of settled interpretation of the expression "office of profit" in Article 102 of the Constitution and the underlying constitutional principles therein, and to suggest a comprehensive definition of "office of profit";
- (ii) to recommend in relation to "office of profit", the evolution of generic and comprehensive criteria which are just, fair and reasonable and can be applied to all States and Union Territories;
- (iii) to examine the feasibility of adoption of system of law relating to prevention of disqualification of Members of Parliament as existing in the United Kingdom and considered by the Constitution (Forty-Second Amendment) Act, 1976; and
- (iv) to examine any other matter incidental to the above.

2. Based on the material placed/evidence tendered before them the Committee have made analysis of each of the above terms of reference. Some of the views/ideas being discussed in the succeeding paragraphs may not strictly be under the terms of reference (i) to (iii) above, but all the same are germane in so far as understanding the issues in right perspective is concerned and are incidental to the terms of reference of the JPC.

(i) Need for definition and its feasibility

3. The constitutional experts including the Attorney General of India were of the opinion that while a definition of 'office of profit' was a theoretical possibility, its application, encompassing the entire gamut on the issues involved, to have the desired results would be very difficult in terms of interpretation of the words/phrases/clauses contained in it which would result in numerous court cases. Therefore, majority of them were not in favour of evolving any definition. According to the Ministry of Law & Justice (Legislative Department), the Attorney General of India had opined against laying down any particular criteria defining office of profit as the judgments of the Courts were enough guidelines to determine whether a particular office was an office of profit or not and a workable definition did not appear to be feasible.

4. The Ministry of Law & Justice (Legislative Department) were also of the opinion that evolving of common criteria would open flood gates of disputes because the determination of the fact as to whether the holder of any particular office other than the office of profit would fall within the guidelines or principles, itself would be a point of dispute or form part of that dispute. Moreover, there would be an increase in the reference under Article 103 of the Constitution

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virtually leading to an enormous rise in the election petitions to be decided by the President and Election Commission.

5. Many of the States were also against any uniform definition, although on different grounds altogether. They had apprehensions that it might go against the federal structure of the Constitution thus curtailing their legislative powers and in the process undermining their authority. Some of them were of the opinion that the definition might at best be illustrative only. Nevertheless a few States had endorsed the draft definition provided by the Ministry of Law & Justice, as according to them it was quite comprehensive although not exhaustive.

6. The Committee feel that a precise definition is very necessary, primarily because without knowing what constitutes an office of profit and what does not, the exercise of giving exemptions from holding any office of profit seems to be a vacuous one. The Committee do not, therefore, agree with the doubts expressed that it may lead to heavy litigation. On the contrary it will lessen the risk of litigation. The task must, therefore, be performed, however, difficult it may be.

7. If the Parliament or any legislature feels that the definition covers an office that does not really advance the policy and purpose of the Constitution, *ad hoc* legislation may be resorted to for removing the disqualification in advance or on discovery.

8. As regards apprehensions by the State Governments that enactment of law on definition might go against the spirit of federal structure of the country, the Committee would like to recall the views expressed by the Government of Tripura according to which while the power of the State legislatures to make laws under article 191 should remain with the States, there was a need for amending the Constitution to bring about a comprehensive definition of office of profit for uniform application. Taking the cue the Committee feel that federalism has to survive through some common denominator *vis-a-vis* the country as a whole. A pointer in this regard is the existing almost identical language and provision of Articles 102(1)(a) and 191(1)(a). The States have the liberty to enact laws on creating exceptions for disqualification from offices of profit but not to define the term 'office of profit' itself, it is felt. In this regard the views expressed by a former Chief Justice of India are also perhaps worth mentioning according to which in India, a unified judiciary with the Supreme Court at the apex level ensures a uniform standard and meaning of the rule of law throughout the country. Hence, there would be no scope for conflicting interpretations of the meaning of 'office of profit' after evolution of a generic and comprehensive criteria emerging from it.

9. On the other hand the fall out of not having a definition of office of profit is there to be seen for all in whatever had happened in the year 2006 in the run up to the constitution of the Joint Committee to examine the constitutional and legal position relating to office of profit which need not perhaps be elaborated here.

10. To summarise, the advantages of having a definition of the office of profit would *inter-alia* be as follows:—

- (i) it would impart clarity to a large extent as to what is an office of profit and what is not;
- (ii) it will reduce the arbitrariness, in such appointments and Governments would be extremely circumspect;

- (iii) the legislators can make an informed choice before accepting any office under the Government;
- (iv) chances of litigation would be reduced as (a) constitutional validity of the definition would not be in doubt as this would be largely based on the criteria evolved by the courts themselves through their various judgments, (b) arbitrariness would be vastly reduced in matter of appointments;
- (v) with overall discipline in the system number of such appointments would fall substantially which is a matter of concern presently;
- (vi) transparency through enactment of law would improve the public image of the legislators which is very important for representatives of the public.

(ii) Generic Criteria and definition

11. The Committee feel that the issues relating to uniform principles/common criteria and evolving a definition of 'office of profit' and their application to various States are inter-linked and are not mutually exclusive. It is also felt that before defining the term 'office of profit' it is essential to evolve the principles and generic criteria. The definition would emerge from these criteria. While discussing this aspect the focus has to be on the following issues:-

(i) to identify the generic criteria/principles which could determine what would constitute an office of profit and what would not, leading to its definition ; (ii) how this definition could be used uniformly; (iii) what criteria be employed for granting exemptions from disqualification; (iv) exploring the possibility of having one to one correspondence between the offices/posts at the Centre and in different States for exemptions.

12. There is general agreement over the fact that the office of profit disqualification sought to maintain two constitutional principles (i) the separation of power between the legislature and the executive and (ii) the prevention of the possibility of a conflict between duty and interest of an individual who had to perform the role of the legislator and a member of the executive.

13. The essential feature of an 'office' is that it must exist independent of its holder. An important expression that occurs in article 102(1)(a) of the Constitution is 'under the Government'. The expression 'office of profit' occurs in various Articles viz. 18(3), 18(4), 58(2), 66(4), 102(1), 158(2) and 191(1). The expression has been used in different contexts in different Articles except for 102(1) and 191(1) and nowhere it has been defined. The courts have enunciated [(in the Shivamurthy Swamy Inamdar etc. Vs. Agadi Sanganna Andapa (1971) 3 SCC 870] certain broad criteria for determining whether a particular office could be termed as an office of profit under the Government for the purposes of Article 102(1)(a) and Article 191(1)(a) of the Constitution. These are as follows:-

- (a) Whether Government made the appointment;
- (b) Whether Government had a right to remove or dismiss the holder of office;
- (c) Whether the Government paid the remuneration;
- (d) What were the functions of the holder of office; and
- (e) Did the Government exercise any control over the performance of those functions.

14. Whether an office in order to be characterized as an office of profit under the Government should satisfy these tests or whether any one or more of them might be decisive of its true nature and even what weightage was to be assigned to each factor had been the subject matter of several cases decided by the Supreme Court. But no decision appeared to lay down conclusively the character of an office of profit under the Government although the court had no doubt determined in each case whether a particular office involved in the case before it was or was not an office of profit under the Government.

15. A perusal of Parliament (Prevention of Disqualification) Act, 1959 and other State Governments Acts revealed that in granting exemption from disqualification no specific criteria had been followed except for remuneration in few cases. The Committee noted that there were number of posts bearing the same name with same duties. But while some Boards/Corporations/Bodies like Fishery Boards, Haj Committee etc. have been given exemptions in some States, similar bodies have not been given exemptions in other States.

16. A propensity of the Government has been seen, be it the Union or the States, to include an ever increasing number of offices under the exemption list. The Committee observe that the Constitution (Ninety First) Amendment Act, 2003 has placed a ceiling on Council of Ministers in the Union and the States [Articles 75(1A) and 164 (1A)] and prohibited members being disqualified on grounds of defection from holding any "remunerative political post" till they got re-elected (Article 361 B). Here the Committee would endorse the sentiments of a legal expert that the very purpose of the amendment would be defeated if one were to liberally interpret the concept of "office of profit" so as to comprehend within its scope for giving exemption to a very large number of offices from disqualification under Articles 102 (1)(a) and 191(1)(a), circumventing the provisions of those Articles.

17. Also according to this expert any definition of 'office of profit' could be introduced only through an amendment of Article 366 of the Constitution, which defined the phrases and words used in various provisions of the Constitution.

18. Again according to the National Law School University, Bangalore some aspects viz. compulsion of coalition Governments both at Centre as well as in the States, various local factors/conditions which varied from State to State and private interests of legislators should be taken into account while evolving definition/generic criteria on office of profit.

19. On the issue of principles, which were to be followed in the matter of office of profit, a former Chief Justice was also of the view that the difficulty arose because of the ambiguity created by the latter part of sub-clause (a) of clause (1) of Art. 102—'other than an office declared by Parliament by law not to disqualify its holder'. The provision while empowering the Parliament to create exceptions to the disqualification prescribed in the first part, did not specify the principle to be applied in creating exceptions to the general rule. That being so, the principle governing the exercise of power by the Parliament had to be deduced on the basis of general rules of interpretation, reading the provision as a whole and bearing in mind the avowed object. Any interpretation, which rendered the provision otiose by the second part neutralizing the first part, had to be rejected. An interpretation, which empowered the Parliament to destroy the disqualification relating to a basic feature, had to be rejected. If the amending power of the Parliament under Art. 368 could not destroy a basic feature of the Constitution; it could not be so done by a law enacted under Art. 102(1) (a), he opined.

20. The Committee agree with this view in principle.

21. Further some of the experts had opined that the explanation to Clause 1 of Art. 102, which exempted the Ministers from disqualification was relevant as an aid to construction of any law thereunder. The National Law School University, Bangalore were of the view that no definition was necessary and Parliament might by law include only such offices, which were ministerial in character but not in nomenclature.

22. This would perhaps mean that the categories of offices which would not be deemed to be offices of profit should be identified on the lines of existing provision of the Constitution.

23. A legal expert stated that the power of exemption must have followed a rigorous procedure to ensure that it was not misused. Any appointment must be for the public interest, and under conditions of transparency and accountability. He proposed that:-

- (a) the system be operated so that appointments were made only in the public interest;
- (b) the appointments be approved by the Cabinet;
- (c) A public statement needed to be made that such an appointment was in the public interest with an explanation (a) giving the reasons for such an appointment; and (b) full disclosure of the perks and emoluments;
- (d) The public statement must be simultaneously placed before the House concerned;
- (e) The appointment was to be for the term of that Parliament;
- (f) All efforts should be made to make the appointments on a voluntary and *pro bono* basis.

24. Further, the Committee noted that there was a Joint Committee on Offices of Profit (JCOP) in Parliament, which was constituted at the beginning of each Lok Sabha. That Committee examined the composition and character of Government bodies from office of profit angle and made suitable recommendations in the matter. The JCOP generally applied two tests in deciding whether a member of a body ought to have been exempted from disqualification *i.e.* (a) the emoluments and allowances attached to the members; and (b) the nature and function of the body. If a member of a body got only compensatory allowance and the body exercised merely an advisory function, then no disqualification would arise. But if the allowances given were more than compensatory allowance and/or the body exercised executive and financial powers and was in a position to wield influence and patronage, then its membership would not be exempted from disqualification. Based on the recommendations of the JCOP, exemptions had been made by adding certain offices to the list from time to time. There was, however, no such mechanism in place in any State legislatures, the Committee noted.

25. The Joint Committee on Offices of Profit (JCOP) in their report (9th Report 7th LS) were of the view that if the real spirit of Articles 102 and 191 of the Constitution was to be maintained sacrosanct, the exemption enabling provision should have been kept within its bounds and restricted in its scope both in regard to the areas of operation and legislative competence. Otherwise, the object of the imposition of the disqualifications as envisaged would become frustrated. In the wake of recommendations of the JCOP an exercise of inviting comments/views of the States on evolving common principles/criteria for uniform application was undertaken by the Ministry of Law and Justice. However, the Ministry of Law and Justice apparently did not pursue the matter due to lack of consensus among the States/UTs.

26. As was found in the past, the current exercise undertaken by this Committee also received almost similar reactions from the various State Governments. While some of the States were amenable to the idea of evolving a common criteria based on certain principles which could be made applicable to all the States, *albeit* by bringing out constitutional amendment, a large number of States were against any such move citing diverse needs based on cultural/socio-economic and political ethos of each State/region. Here the compulsion of coalition politics, which was very common at the prevailing time, was also a determining factor. Yet some of the States were in favour of having general guidelines, which might be followed by them instead of fixed definition/common criteria for identifying offices of profit without any legal binding. Mostly it was felt that there should be some guiding principles, which could be suggestive in nature for declaring a particular post, or office to be an office of profit but it should be left open ultimately to the legislature to decide on the matter. One of the views given by Ministry of Law and Justice (Legislative Department), which found many takers, was that if at all the common criteria had to be evolved, that could be enforced only through constitutional amendment. Here the State Government of Nagaland had sounded a discordant note. According to them such uniform principles could be evolved by Parliament only for members of Parliament and not for the members of the State Legislature as Parliament did not have the legislative competency in view of provisions in article 191(1) of the Constitution. Subsequently, however, on a specific query whether the Parliament had the competency under Article 368 to amend the article 191(1), the State Government of Nagaland stated that it was possible but having a uniform definition would be difficult.

27. Again the Ministry of Law and Justice (Legislative Department) were of the opinion that evolving common criteria would lead to several disputes because the determination of the fact as to whether the holder of any particular office other than the office of profit would fall within the guidelines or principles, would itself be a point of dispute or form part of that dispute. Moreover, there would be an increase in the number of references under Article 103 of the Constitution virtually leading to an enormous rise in the election petitions to be decided by the President and Election Commission.

28. On the question of generic criteria it was apparent that only JCOP were employing parameters other than the pecuniary aspect *viz.* functions, powers, patronage attached with a particular post/office to determine whether or not it was an office of profit. The text of the definition provided by the Ministry of Law and Justice, Government of India for consideration by the Committee which read as under was based on these parameters:-

"In Article 102 of the Constitution, in clause (1) for the Explanation, the following Explanations shall be substituted, namely:-

Explanation 1. For the purpose of this clause-

(1) "Office of profit" means-

Any office-

(i) under the control of the Government of India, or the Government of a State, as the case may be, whether the salary or remuneration for such office is paid out of the public revenue of the Government of India or of the Government of State; or

iii) under a body, which is wholly or partially owned by the Government of India or the Government of any State and the salary or remuneration is paid by such body; and

(A) the holder of office under sub-clause (i) is capable of exercising legislative, judicial or quasi-judicial power;

(B) the holder of office under sub-clause (ii) is capable of exercising powers by means of disbursement of funds, allotment of lands, issuing of licenses and permits or making of public appointments or granting of such other favours of substantial nature.

(11) A person shall not be deemed to hold an office of profit under the Government of India or the Government of any State by reason only that he is a Minister either for the Union or for such a State."

Explanation II. For the purposes of this clause the expression—

(a) "office" means the permanent substantive position which exists independently of the holder of the office;

(b) "remuneration" means any pecuniary gain commensurate with the status and responsibilities attached to the office;

(c) "salary" means salary or pay scale attached to the office whether or not the holder of such an office draws such salary.

After Clause (1), the following clause shall be inserted, namely :—

"(1A) Notwithstanding anything contained in sub-clause (a) of clause (1) if a member of either House of Parliament has become subject to any disqualification mentioned in that sub clause he shall not be so disqualified unless he has not resigned from such office which is the subject to disqualification."

29. The Committee note that the above definition does not specifically address the issue of profit arising out of pecuniary gain. Rather it dwells on the functions, power, patronage etc. The aspect of pecuniary gain, perhaps, also needs to be addressed while evolving a definition.

30. On the other hand, some of the top legal experts, the National Law School University, Bangalore and majority of the State Governments were veering to the idea that the remuneration/pecuniary aspect should be the major criterion in determining an office of profit as it was the only parameter which could be quantified. All other parameters were more or less subjective in nature. In this regard the Government of Nagaland were of the view that there was no office in the executive realms, which did not involve exercise of power or influence. Again according to a legal expert, perception of conflict arose not because of the nature of the powers one exercised. This perception arose because one was earning an income, a profit or gain from the Government; it did not matter what powers one exercised. An eminent lawyer went to the extent of recommending insertion of a specific provision in the Constitution to the effect that a person should not be disqualified for being chosen as, or for being a Member of either House of Parliament or of a State Legislature, only because that person held an office under the Government of India or the Government of any State, whether it be an office of profit or not, so long as that

person did not in fact receive or enjoy any benefit, whatsoever, monetary or otherwise, in connection with the holding of that office. Further he stated that it should also be clarified in a sub-clause inserted in article 103 (and a corresponding provision in Article 192) that where a person held any office (whether an office of profit or otherwise) under the Government of India or the Government of any State, and a question arose as to whether that person had or had not received, or had or had not enjoyed a benefit (monetary or otherwise) in connection with the holding of that office, the burden of proving that he or she had not received or enjoyed any benefit with reference to that office should be on the person who held that office. This should be in addition to the existing prevention of disqualification law as enacted and as amended.

31. On the issue of onus of burden of proof, the Committee feel that the matter perhaps comes under the realm of laws of evidence and/or laws of jurisprudence and accordingly should be left to the Government/Courts to decide. In any case it does not make any material difference to the subject matter being discussed and considered by the Committee.

32. A contrary view has, however, been held on the issue of remuneration by the Administrative Reforms Commission. It has held that holding of positions, in the advisory capacity, carrying certain remunerations and other perks did not make them executive offices. According to the Commission, often the crude criterion applied was whether or not the office carried remuneration. In the process, the real distinction of whether executive authority was exercised in terms of decision-making or direct involvement in deployment of public funds was often lost sight of. The Supreme Court's clarification about the appointment and removal being in the hands of the executive branch of Government did not help either, because many appointments made might be in advisory capacities. According to the report, legislators who were not Ministers often did have significant expertise from their own personal or professional background. In addition, their experience in public service gave them unique insight and understanding of public policy. Such expertise and insights would be valuable input to executive in policy making. Therefore, the Committees and Commissions of a purely advisory nature could be constituted with legislators. The Constitution recognized that holding of such offices in expert and advisory bodies did not violate separation of powers and left it to Parliament and State Legislatures to exempt such non-executive offices from disqualification. But appointment in statutory or non-statutory authorities with direct decision making powers and day to day control of field personnel, or positions on the governing boards of public sector undertakings or as Government nominees in private enterprises clearly carried direct executive responsibilities and involved decision making powers. Such appointment would undoubtedly violate separation of powers. Giving discretionary powers to legislators to sanction or approve public works was clearly an exercise of executive function, whether or not the Government appointed the legislators to a designated office. It was necessary to sharply distinguish executive functions and exercise of executive authority while defining office of profit, irrespective of whether such a role or office carried remuneration and perks. Accordingly, the Commission has made the recommendations for amendment in the Law to define office of profit based on the following principles:

- (i) All offices in purely advisory bodies where the experience, insights and expertise of a legislator would be inputs in governmental policy, should not be treated as offices of profit, irrespective of the remuneration and perks associated with such an office.

- (ii) All offices involving executive decision making and control of public funds, including positions on the governing boards of public undertakings and statutory and non-statutory authorities directly deciding policy or managing institutions or authorizing or approving expenditure should be treated as offices of profit, and no legislator should hold such offices.
- (iii) If a serving Minister, by virtue of office, was a member or head of certain organizations like the Planning Commission, where close coordination and integration between the Council of Ministers and the organization or authority or committee was vital for the day to day functioning of government, it should not be treated as office of profit.

33. The Committee note that the Administrative Reforms Commission do not recommend a blanket exemption for the Ministers to hold any office of profit unlike the existing provision. It says that an office shall not be treated as an office of profit only in cases where a Minister, by virtue of his being a Minister is a member or head of certain organization which is vital for day to day functioning of the Government. This is a new concept in as much as it seeks to curb the hitherto unrestricted access to offices of profit enjoyed by the Ministers, ostensibly to cater to the Westminster model in which executive (Council of Ministers) is drawn from the legislature. However, the Committee feel that incorporating it in the definition, disturbing the status quo, would create serious imbalance in the overall scheme of things as it stands today.

34. The Bhargava Committee appointed in 1955 had also echoed almost the same sentiments. As per Bhargava Committee (report presented in Nov. 1955), Members of Parliament should be encouraged to serve on such Committees, which were of an advisory character and represent the local or popular point of view, in a manner, which would effectively influence the official point of view. Members of Parliament by virtue of their membership were in a position to say and represent certain matters with some authority and confidence, and their views were likely to go a long way in influencing the view point of officials. But at the same time, it felt that consistent with the above view expressed, Members of Parliament should not be permitted to serve on committees, commissions etc. which jeopardized their independence or which would place them in a position of power or influence or in a position where they received some patronage from Government or were themselves in a position to distribute patronage.

35. On the issue of identifying an office of profit one of the suggestions given by a Senior Advocate was to classify the agencies and bodies into the following four categories keeping in view the nature of functions and activities being performed by them:-

- (i) Directly under the Government;
- (ii) Statutory authorities or Corporations in which Government have the power either to appoint or remove or both;
- (iii) Public Sector Undertakings owned wholly or partly by the Government where the Government have the power to appoint or remove;
- (iv) 'Other bodies' significantly funded by the Government where the Government have pervasive control.

36. So far as the first three of the above categories of offices are concerned, the import of the suggestion was that legislators should not hold these offices. As regards the fourth category of bodies, exemption from disqualification etc. should be made on the basis of recommendations of a designated Committee following due procedure.

37. For the purpose of office of profit, yet another two categories of offices of different genre had been identified by an eminent lawyer which are as follows:-

- (i) Offices in the judiciary; and
- (ii) Legislators of some other legislative body or Panchayat.

38. On the question of definition of office of profit, a new concept was introduced by State Government of Nagaland, which envisaged rewording of Article 102 on the pattern of Article 361B which dealt with 'remunerative political post'.

39. The State Government of Nagaland were of the view that the proposed definition given by the Ministry of Law and Justice (Legislative Department) did not define the 'Office of Profit' comprehensively. According to them, the definition of 'Office of Profit' in the proposed Article was same as the definition of 'remunerative political post' provided in Article 361B.

40. The Committee feel that although the idea propounded by Government of Nagaland seems to be bit interesting, there does not appear to be overwhelming reasons for making or even perceiving that Article 102(1)(a) or 191(1)(a) are almost analogous to Article 361B, which otherwise, embody entirely two different concepts, philosophy and ideals. The canvas for 'office of profit' is much larger than the 'remunerative political post', it is felt.

41. After analyzing the issue threadbare, the Committee feel that any definition of office of profit has to be the sum total of every conceivable ideas/opinions including court judgments reduced in terms of parameters/criteria such as salary, remuneration, functions, patronage, powers including that of disbursement of funds, issue of licenses etc. as it is not known as to which element in terms of weightage would precisely render an office into an office of profit in a given circumstance under legal scrutiny. At the same time the Committee can not be oblivious of the observations made by the Ministry of Law and Justice (Legislative Department) according to which any comprehensive definition of the term "office of profit" which cast the net so wide that all our citizens with specialties and know-how offering some voluntary services in para-official, statutory or like projects run or directed by Government or controlled by the State are inhibited from entering elected organs of public administration may be detrimental to the democracy itself. Accordingly, the Committee strongly feel that while defining an office of profit, it is also essential to identify the generic criteria of the offices/posts which would not constitute offices of profit or in other words which would not be deemed as offices of profit. And this aspect has to be the part of the definition itself. Accordingly, the Committee have identified the following three categories of offices which should not be deemed to be offices of profit:-

- (1) Minister for the Union or for States;
- (2) Office in Parliament or State Legislatures;
- (3) Advisory offices in Union or States.

42. The rationale for identifying the above three categories is dealt with in the succeeding paragraphs.

(1) Minister for the Union or for States

43. This is as per existing provision of the Constitution *i.e.* to account for the Westminster model in which the executive (Council of Ministers) is drawn from the legislature.

(2) Office in Parliament or State Legislatures and Advisory offices in Union or States

44. These generic criteria have been identified to account for the very spirit and soul (sanctum sanctorum) of the provisions of Article 102(1) (a) which, it is felt, need to be bracketed under a separate category, as in case of item (1) under paragraph 41 above, through positive assertions of the lofty ideals, philosophy on which the article is based in so far as evolving the generic criteria for keeping outside the purview of office of profit is concerned. This would also impart clarity and teeth to the definition of the office of profit sought to be inserted in the article.

45. Many experts and National Law School of India University, Bangalore are of the opinion that the explanation to clause 1 of Article 102 which exempts the Ministers from disqualification is relevant as an aid to construction of any law made thereunder and Parliament may by law include such offices which are ministerial in character but not in nomenclature.

46. Also there appears to be a clear consensus, as brought out in the reports of Joint Committee on Office of Profit (JCOP), Administrative Reforms Commission, among experts and cognoscenti that in a parliamentary democracy services of the representatives of the people having proven expertise, skill, vision, perspicacity etc. in various spheres of public importance should be utilized in the nation building process, policy formulation and governance, besides law making activities, by associating them in various government bodies, committees etc. in advisory and honorary capacity utilizing their core competence.

47. Again for vibrant and smooth functioning of parliamentary democracy certain posts/offices directly connected with the Parliament/State Legislatures such as office of Leader of Opposition in Parliament, office of Leader and Deputy Leader of Party and recognized Parties/groups in Parliament, the Chief Whips, Deputy Chief Whips or Whips in Parliament/State Legislature etc. are needed to be kept outside the purview of the office of profit. From perusal of 1959 Act as amended till date it can be seen that these categories of offices are already included in it. Given the lofty ideals behind the provisions of Article 102 (1)(a), these exemptions perfectly fit into the scheme of things.

48. Other exemptions suggested in the Act, although may fall under some generic nature, do not seem to fit into 'not be deemed to hold an office of profit' category going by above yardsticks and may be dealt under office declared by Parliament by law not to disqualify its holder'.

49. In view of the above, the Committee suggest the definition of office of profit as follows:-

"Office of profit" means any office—

- (i) under the control of the Government of India, or the Government of a State, as the case may be, whether or not the salary or remuneration for such office is paid out of the public revenue of the Government of India or of the Government of State; or*

(ii) under a body, which is wholly or partially owned by the Government of India or the Government of any State and the salary or remuneration is paid by such body; and

(A) the holder of which is capable of exercising executive powers delegated by the Government including disbursement of funds, allotment of lands, issuing of licenses and permits or making of public appointments or granting of such other favours of substantial nature; or legislative, judicial or quasi-judicial functions; and/or

(B) the holder under (i) or (ii) is entitled to draw salary or remuneration irrespective of whether he actually receives it.

A person shall not be deemed to hold an office of profit under the Government of India or the Government of any State by reasons only that—

(i) he is a Minister for the Union or for such a State;

(ii) he is holding an office in Parliament or such a State Legislature;

(iii) he is holding an advisory office for the Union or for such a State.

Explanation

(a) "offices in Parliament and State Legislature" means the offices which are directly connected with the discharge of legislative functions in Parliament or in a State Legislature e.g. office of Leader of Opposition in Parliament, office of Leader and Deputy Leader of Party and recognized Parties/groups in Parliament, the Chief Whips, Deputy Chief Whips or Whips in Parliament/State Legislature etc.;

(b) "salary" means salary or pay scale attached to the office whether or not the holder of such an office draws such salary;

(c) "remuneration" means any pecuniary gain commensurate with the status and responsibilities attached to the office, but shall not include the expenditure incurred on staff and infrastructure for running office;

(d) "compensatory allowance" means any sum of money payable to the holder of an office by way of daily allowance (such allowance not exceeding the amount of daily allowance to which a member of Parliament is entitled under the [Salaries and Allowances and Pensions of Members of Parliament Act, 1954 (30 of 1954)] any conveyance allowance, house rent allowance or travelling allowance for the purpose of enabling him to recoup any expenditure incurred by him in performing the functions of that office;

(e) "Advisory office" means any office (by whatever name called) which is associated with purely giving counsel or recommendation on any particular subject/policy, in respect of any matter of public importance/interest and no salary or remuneration except for compensatory allowance is attached with it.

50. The general principle that emerges from the above definition is that virtually all offices under Government are offices of profit until stated otherwise. The Committee feel that this would amply clarify the concept of office of profit without much ambiguity.

Exceptions from disqualification

51. In regard to creating exceptions from disqualification declared by law which is quite distinct from exceptions made in the definition under the 'not to be deemed as office of profit' category, the Committee feel that the pecuniary aspect could be one of the criteria. In fact this criteria has been the mainstay of the Union and most of the State Acts.

(iii) Opportunity for Resignation

52. As regards incorporation of an enabling provision in the Constitution for an elected member of Parliament to exercise an option to resign from an office in the event of the office he was holding being determined as an "office of profit" under the Government without losing his membership of the House, the majority of the State Governments were in favour of such a provision subject to modification in the definition incorporating such a clause proposed by the Ministry of Law and Justice (Legislative Department), Government of India which read as under:—

"(1)(A) Notwithstanding anything contained in sub-clause (a) of clause (1) if a member of either House of Parliament has become subject to any disqualification mentioned in that sub-clause he shall not be so disqualified unless he has not resigned from such office which is the subject to disqualification."

53. It has been the opinion of many of the State Governments that the manner in which such a clause has been drafted, it has the effect of giving unrestricted discretion to the legislator to continue in office notwithstanding occurrence of disqualification if he did not resign.

54. It was felt that the issue of resignation clause needed to be dealt with in the light of opinion expressed by a few experts and National Law School, Bangalore that there should not be any retrospective exemption from disqualification from certain offices of profit by legislation. For having proper appreciation and correct perspective of the matter, the views expressed by one of these experts in this regard (on resignation) could be summoned here. The thrust of his argument was that it made perfect sense to have such a clause, as after having done all the hard work in getting elected to Parliament or State Legislature the members should not find themselves on the wrong side of the law simply on account of holding some office/post which otherwise were perfectly alright until they got elected but subsequently turned out to be office of profit under the intense glare of legal scrutiny rendering them disqualified from being chosen as or being a member of the legislature. And they could not do anything about it. In this connection the Committee also wondered why only membership had to be sacrificed, especially when they had been elected by the people, and not the office/post which was the root cause of the problem.

55. The National Law School University, Bangalore, however, thought otherwise. According to them such a clause in the proposed definition would defeat the constitutional purpose of punishing holder of office of profit. Alternatively, they had given a suggestion that a 2-month moratorium might be allowed after constitution of the new House to the elected members holding office of profit to resign those offices, which would ensure avoidance of unnecessary disqualification.

56. Further, an expert has introduced a concept whereby a distinction was made between 'being chosen as' and 'for being' a member of the legislature. According to this view currently, articles 102 and 191 envisaged an absolute disqualification, i.e. all offices of profit must be given up before the election. However, this absolute disqualification was too wide and unnecessary.

According to him there was a distinction between two fundamental principles as to why the 'office of profit' concept was created. Broadly, these prohibitions applied to legislators (a) to prevent undue influence during elections; and (b) to avoid a conflict of interest after elections. For this reason, he had proposed that (i) the question of undue influence be dealt with under the applicable electoral law on the basis of which 'office of profit' holders must resign all their posts before filing their candidacy nominations for elections; and (ii) avoiding the problems posed by conflict of interest could be resolved by an elected legislator resigning his remaining offices of profit after the elections. On the basis of this distinction there might be:

(a) offices that must be given up before an election;

[such persons (civil servant under Articles 310 and 311 and members of Judiciary), must resign their office before becoming candidate in an election. This was in order to ensure that (1) undue advantage in the electoral process is avoided; and (2) conflict of interest was eliminated in so far as process of election was concerned]

and

(b) offices (Article 12 institutions or bodies and legislators or members of some other legislative body or Panchayat) that must be given up after an election but before taking oath as a member of the legislature.

57. For this purpose Articles 102 and 191 would require to be amended to categorize disqualifications into those for 'being chosen as' and for 'being' a Member of the Legislature. The question of a uniform approach to the States was resolved if amendments were made to corresponding Articles in the Constitution, for both the Centre and the States. Statutorily this would mean that Sections 9A and 10 of the Representation of People Act, 1951 (which provides an absolute disqualification for persons holding Government contracts or an officer of a Government company), would have to be repealed. However, the parliamentary scrutiny was necessary which could be achieved in the following two ways:

(i) At the beginning of every Parliament, a full declaration must be made by all MPs/MLAs. The list of offices held by MPs/MLAs could then be scrutinized by the Joint Parliamentary Committee on the basis of the criteria mentioned above, after which it could determine whether Parliament should validate those offices;

(ii) Thereafter, if the Government made any appointment of a legislator to an office, it must be referred to the Joint Parliamentary Committee. The findings of the Committee, although recommendatory, must be taken into account in the final determination by the Election Commission if a question arose under Article 103.

58. The Committee, however, are of the view that they have been mandated to suggest a comprehensive definition of the office of profit in the context of settled interpretation of the expression in Article 102 of the Constitution. They have to take the constitutional scheme as it was. They are not authorized to interpret how Article 103 should be changed. They can not even make distinctions between pre-election disqualification and post-election disqualification because Article 102 was committed to that. The same disqualifications apply and that was the settled aspect of the matter. Any deviation on this count has to be through constitutional amendment only.

59. Coming to Article 103 the Committee note that with reference to a query whether there could be any authority other than those provided under the existing law for deciding

whether a particular office was an office of profit or not the overwhelming view among the experts and the States was that the existing scheme in this respect should not be tampered with.

60. The Committee feel that the objective behind the proposed resignation clause may have some merit. However, with the evolution of the definition of office of profit, which would clearly indicate, as to what is an office of profit and what is not deemed to be an office of profit, and also which office is exempted from disqualification under the law, clarity to a very large extent would be available before the persons intending to contest the elections. Accordingly they may make an informed choice before filing nomination papers. This clarity is presently not available. Thus, the main reason for which the resignation clause was intended to be inserted would now be addressed by the definition. On the other hand the proposed insertion of resignation clause may cause some disputes in regard to identifying the offices in the respective categories viz. the offices which are to be resigned before election and those which are to be resigned after election, even within the ambit of articles mentioned above. Moreover this move may not be consistent with the constitutional principles and may not stand judicial scrutiny. In this regard the Committee also note the apprehensions expressed in some quarters about inserting this clause as it would defeat the very purpose of provisions of disqualification on account of holding office of profit. Accordingly, the Committee feel that a resignation clause may not be necessary after having defined the office of profit.

61. Regarding appointment of a Committee for scrutiny of offices of profit, while the concept envisioned by some of the experts may be a laudable one, the proposal does not, perhaps, fit into the overall perspective of the Committee and also constitutional scheme of things vis-a-vis Article 103. In any case, the Committee feel that the existing JCOP are addressing the issue to a large extent.

(iv) Uniform application of the criteria and definition in Union and State Governments/ Union Territories

62. On perusal of Parliament (Prevention of Disqualification) Act, 1959 and other State Government Acts the Committee found that in granting exemption from disqualification no specific criteria had been followed except for, in few cases, remuneration. In not having any criteria, except for remuneration, it seemed that the States too had given exemptions on similar lines/pattern of exemptions given to certain posts/offices in the Central Act.

63. Now that a definition of office of profit has been worked out and a criterion for giving exemptions from disqualification has been identified, it is only logical that for having the desired results the Central and the State laws are brought on equal footing, as is the existing position. Accordingly the Committee suggest that the Article 102(1)(a) should be amended on the following lines:-

Article 102(1)

A person shall be disqualified far being chosen as, and for being a member of either House of Parliament

(a) If he holds any office of profit under the Government of India or the Government of any State, other than an office declared by Parliament by law not to disqualify its holder:

1. Provided that

the holder of such office should not draw any salary/remuneration except for compensatory allowance:

II. Provided further that

a person shall not be deemed to hold an office of profit under the Government of India or the Government of any State by reasons only that—

- (i) he is a Minister for the Union or for such a State;
- (ii) he is holding an office in Parliament or such a State Legislature;
- (iii) he is holding an advisory office for the Union or for such a State.

Explanation : For the purposes of this clause

(a) "Office of profit" means any office—

(i) under the control of the Government of India, or the Government of a State, as the case may be, whether or not the salary or remuneration for such office is paid out of the public revenue of the Government of India or of the Government of State; or

(ii) under a body, which is wholly or partially owned by the Government of India or the Government of any State and the salary or remuneration is paid by such body; and

(A) the holder of which is capable of exercising executive powers delegated by the government including disbursement of funds, allotment of lands, issuing of licenses and permits or making of public appointments or granting of such other favours of substantial nature; or legislative, judicial or quasi-judicial functions; and/or

(B) the holder under (i) or (ii) is entitled to draw salary or remuneration irrespective of whether he actually receives it.

(b) "offices in Parliament and State Legislature" means the offices which are directly connected with the discharge of legislative functions in Parliament or in a State Legislature e.g. office of Leader of Opposition in Parliament, office of Leader and Deputy Leader of Party and recognized Parties/groups in Parliament, the Chief Whips, Deputy Chief Whips or Whips in Parliament/State Legislature etc.

(c) "salary" means salary or pay scale attached to the office whether or not the holder of such an office draws such salary.

(d) "remuneration" means any pecuniary gain commensurate with the status and responsibilities attached to the office, but shall not include the expenditure incurred on staff and infrastructure for running office.

(e) "compensatory allowance" means any sum of money payable to the holder of an office by way of daily allowance (such allowance not exceeding the amount of daily allowance to which a member of Parliament is entitled under the [Salaries and Allowances and Pensions of Members of Parliament Act, 1954 (30 of 1954)] any conveyance allowance, house rent allowance or travelling allowance for the purpose of enabling him to recoup any expenditure incurred by him in performing the functions of that office.

(f) "Advisory office" means any office (by whatever name called) which is associated with purely giving counsel or recommendation on any particular subject/policy, in respect of any matter of public importance/interest and no salary or remuneration except for compensatory allowance is attached with it.

64. The Committee are also of the opinion that in order to maintain uniformity in the provisions of Articles 102(1)(a) and 191(1)(a), as is the position at present, Article 191(1)(a) may also be amended on the similar lines. This would in no way take away or curtail any existing legislative rights of States, as has been apprehended in some quarters. Rather this would smoothen the implementation of the provisions of the Constitution thereby imparting clarity, certainty and uniformity to a large extent in identifying offices of profit and reducing arbitrariness in its application. Thus, the States would simultaneously retain the right to legislate for seeking exemptions from disqualification of offices keeping in view the overall national perspective as well as the local factors/compulsions, keeping the federal fabric intact. For example, Manipur Government have stated that there are more than 33 different communities of tribes and more than 7 non-tribal communities speaking different languages which need to be given representation in the Government. As a natural corollary the Committee, therefore, feel that there cannot and need not be a one to one correspondence between the offices exempted from disqualification under the Union and various State laws, in absolute terms, even while agreeing on common principles/criteria.

(v) U.K. Law and revisiting 42nd Amendment

65. The Committee note that the conundrum thrown up by the existing system had necessitated in having a serious rethinking on its efficacy in dealing with the seemingly intractable problems on the issue of office of profit. This had opened up a search for an alternative method which was in the form of examining the feasibility and exploring the possibility of adoption of system of law relating to prevention of disqualification of Members of Parliament as was existing in the United Kingdom and considered by the Constitution (Forty-Second Amendment) Act, 1976. It was felt that introduction of negative list on the pattern of U.K. law could obviate the need for having a definition of 'office of profit' and evolving of uniform criteria.

66. It was observed that The House of Commons (Disqualification) Act, 1975 disqualifies a large number of public office holders. It was the single most important legal measure affecting eligibility for parliamentary candidature. It laid down six classes of office holders who were disqualified which were as under:-

- (1) Holders of certain judicial offices including High Court and Court of Appeal judges (Law Lords are disqualified already by virtue of being members of the House of Lords);
- (2) Civil servants, whether established or not, and whether full-time or part-time;
- (3) Members of the regular armed forces;
- (4) Full-time police officers;
- (5) Members of the Legislature of any country outside the Commonwealth; and
- (6) Holder of any of the offices listed in Schedules of the Act.

67. The Act also limited the number of Ministers who could sit in the House of Commons at a time. The Act enabled the government to add or vary the list from time to time by Parliamentary resolution and an order in Council. The judicial Committee of the Privy Council had jurisdiction to decide matters in relation to jurisdiction under 1975 Act provided that an election petition was not pending or that the Commons had not made an order directing that the disqualification should be disregarded.

68. Importantly, there appeared to be no criteria in the schedule for what exactly constituted an office of profit under the Crown.

69. One clear merit of the approach followed in the United Kingdom was that there was no ambiguity surrounding whether or not the holding of a particular office would result in disqualification. If an office is listed in the schedule then it would result in a disqualification, and if it is not listed then it would not.

70. There are certain basic differences between the Indian Act [Parliament (Prevention of Disqualification Act, 1959)] and the House of Commons Disqualification Act. These were (i) The House of Commons Act did not adopt the concept of compensatory allowance in the context of office of profit, whereas this allowance was a major factor in the determination of an office of profit in the Indian law. (ii) The House of Commons Act specified the disqualifying offices fairly exhaustively and declared that no other office or place of profit under the Crown should disqualify the holder for the membership of the House. The Indian law specified the offices, which disqualify as well as do not disqualify. It did not, however, contain any definitive declaration in regard to non-disqualifying offices other than those specified in the Schedule. (iii) Further, under the Indian law any office under the Government, which fetched remuneration higher than compensatory allowance, was an office of profit except the offices exempted under the Constitution. (iv) the concept of disqualification on the ground of office of profit did not seem to apply to the membership of the House of Lords, which was a House of hereditary peerage. The Indian law applied to both Houses of Indian Parliament and Article 191(1) covered the State Legislatures. The State Legislatures had also enacted laws in this regard. (v) The Constitution of India exempted all Ministers of the Union Government as well as of the States from disqualification on account of holding an office of profit. The House of Commons law put a restriction on the number of ministers who can sit and vote in the House.

71. There was, however, one similarity. The term "office of profit" had not been clearly defined either in the House of Commons Act or the Indian Act.

72. Sections 19 and 32 of the Constitution (Forty-Second Amendment) Act, 1976 aimed to reverse the basis of disqualification by providing that only those offices which were specified by law made by Parliament would disqualify the holder on the lines of the United Kingdom law, namely the House of Commons Disqualification Act, 1975.

73. The above amendment in 1976 was brought with a view that there should be an exhaustive list of offices by a Parliamentary legislation which disqualify its holder being chosen, as or for being a member of either House of Parliament or State Legislature. The power to enact law to declare offices of profit, which would attract disqualification of its holder for being chosen as or being a member of a State Legislature, was also vested in the Parliament. However, the sections 19 and 32 of the said constitutional amendment were not brought into force and the same were omitted *vide* section 49 of the Constitution (Forty-Fourth Amendment) Act, 1978. It was felt in regard to the amendment made by the Constitution (42nd Amendment), Act 1976 that it would jeopardize the independence of Members of Legislatures and would enable the Government of the day to 'pack' the legislature with persons who would hold offices of profit for continuance in which they would be dependent upon Government.

74. While many of the States were in favour of adoption of system of law relating to prevention of disqualification of members of Parliament as existing in the United Kingdom and reintroduction of provision as envisaged in Constitution (Forty-Second Amendment) Act, 1976 as it (negative list) provided certainty and clarity regarding the offices/posts holding of which would attract disqualification, some of the State Governments and prominent experts had advised against the same as according to them United Kingdom did not have a written constitution. There, the Parliament was supreme. It even exercised judicial power in England. There Courts did not have power to strike down laws of Parliament. They could only declare that these laws would not be operative until Parliament otherwise decided. Whereas in India the Constitution was Supreme. Moreover, there were stark differences between the ground realities in both the countries.

75. The Committee finds that one clear merit of the approach followed in the United Kingdom is that there is no ambiguity surrounding whether or not the holding of a particular office would result in disqualification. If an office is listed in the schedule then it would result in a disqualification, and if it is not listed then it would not.

76. Notwithstanding the advantages of having such a negative list as exists in U.K. and as attempted in Constitution 42nd Amendment Act, 1976 in so far as they give clarity and certainty in identifying an office of profit which should not be held by a legislator, the Committee feel that this may not be suitable for the Indian system as here all the laws made by Parliament are subject to judicial review whereas in U.K. the Parliament is supreme which even exercises judicial powers. In Indian system, there will be a plethora of litigations involving the left over offices/posts, which have not been included in the negative list and otherwise are available for occupancy by the legislators on which nevertheless the shadow of office of profit will always loom large as these would not be protected under any law. Further, any office under the Government of India, which fetches remuneration higher than compensatory allowance, is an office of profit except the offices exempted under the law and the concept of disqualification on the ground of office of profit does not seem to apply to the membership of the House of Lords, which is a House of hereditary peerage.

77. The Committee finds that in fact in the U.K. law the actual use of the phrase 'office of profit' is not used while placing various offices/posts in the negative list and there is no bar in holding any office outside this list. Whereas in India, Article 102 (1)(a) specifically uses the phrase 'office of profit'. The changes as proposed in the 42nd Amendment Act will also not be adequate in providing the real solution just because the offices/posts outside the negative list will still not be safe as these would be subject to the vagaries of 'office of profit' tests which will be determined and decided by the court of law on the circumstance and merit of each case.

78. In this regard, the Committee also note that the reason given by the Ministry of Law & Justice (Legislative Department) for dropping the 42nd Amendment Act, 1976 through 44th Amendment Act, 1978 in the context of office of profit was that it would jeopardize the independence of Members of Legislatures and would enable the Government of the day to 'pack' the legislature with persons who would hold office of profit for continuance in which they would be dependent upon Government.

79. Most importantly, the Committee feel that the 42nd Constitution Amendment Act sought to vest all the powers in the hands of Parliament for declaring office of profit for disqualification, both at the Centre and the States. This, according to many States is not desirable. Here, the Committee note the observation made by the Council for Political Studies, Kolkata according to which "a fully sovereign Parliament does not go with the spirit of the Constitution—the spirit that has been reinforced by the Courts' judgment on the unamendability of the basic structure."

80. The Committee, therefore, do not feel the need for adoption of the U.K. law or revisiting the 42nd constitutional amendment in the matter. This is more so as a solution has been worked out under the existing system, *albeit*, sprucing it up.

ANNEXURES

THE PARLIAMENT (PREVENTION OF DISQUALIFICATION) ACT, 1959
(20 OF 1959)

[4th April, 1959]

An Act to declare that certain offices of profit under the Government shall not disqualify the holders thereof for being chosen as, or for being, members of Parliament.

BE it enacted by Parliament in the Tenth Year of the Republic of India as follows:-

1. **Short title.** - This Act may be called the Parliament (Prevention of Disqualification) Act, 1959.

2. **Definitions.** - In this Act, unless the context otherwise requires, -

(a) "compensatory allowance" means any sum of money payable to the holder of an office by way of daily allowance [such allowance not exceeding the amount of daily allowance to which a member of Parliament is entitled under¹ [the Salary, Allowances and Pension of Members of Parliament Act, 1954 930 of 1954]], any conveyance allowance, house rent allowance or travelling allowance for the purpose of enabling him to recoup any expenditure incurred by him in performing the functions, of that office;

(b) "Statutory body" means any corporation, committee, commission, council, board or other body of persons, whether incorporated or not, established by or under any law for the time being in force;

(c) "non-statutory body" means any body of persons other than a statutory body.

3. **Certain offices of profit not to disqualify.** - It is hereby declared that none of the following offices, in so far as it is an office of profit under the Government of India or the Government of any State, shall disqualify the holder thereof for being chosen as, or for being, a member of Parliament, namely:-

(a) any office held by a Minister, Minister of State or Deputy Minister for the Union or for any State, where *ex officio* or by name;

²[(aa) the office of a Leader of the Opposition in Parliament;]

²[(ab) the office of Deputy Chairman, Planning Commission;]

²[(ac) the office of ³[each leader and deputy leader] of a recognised party and recognized group in either House of Parliament;]

(b) the office of Chief Whip, Deputy Chief Whip or Whip in Parliament or of Parliamentary Secretary;

6[(ba) the office of Chairperson of -

(i) the National Commission for Minorities constituted under section 3 of the National Commission for Minorities Act, 1992 (19 of 1992);

(ii) the National Commission for the Scheduled Castes and Scheduled Tribes constituted under clause (i) of article 333 of the Constitution;

(iii) the National Commission for Women constituted under section 3 of the National Commission for Women Act, 1990 (20 of 1990);]

(c) the office of member of any force raised or maintained under the National Cadet Corps Act, 1948 (31 of 1948), the Territorial Army Act, 1948 (56 of 1948), or the Reserve and Auxiliary Air Forces Act, 1952 (62 of 1952);

(d) the office of a member of a Home Guard constituted under any law for the time being in force in any State;

(e) the office of sheriff in the city of Bombay, Calcutta or Madras;

(f) the office of chairman or member of the syndicate, senate, executive committee, council or court of a university or any other body connected with a university;

(g) the offices of a member of any delegation or mission sent outside India by the Government for any special purpose;

1. Subs. by Act 24 of 1993, s. 2, for certain words (w.e.f. 27-8-1993).

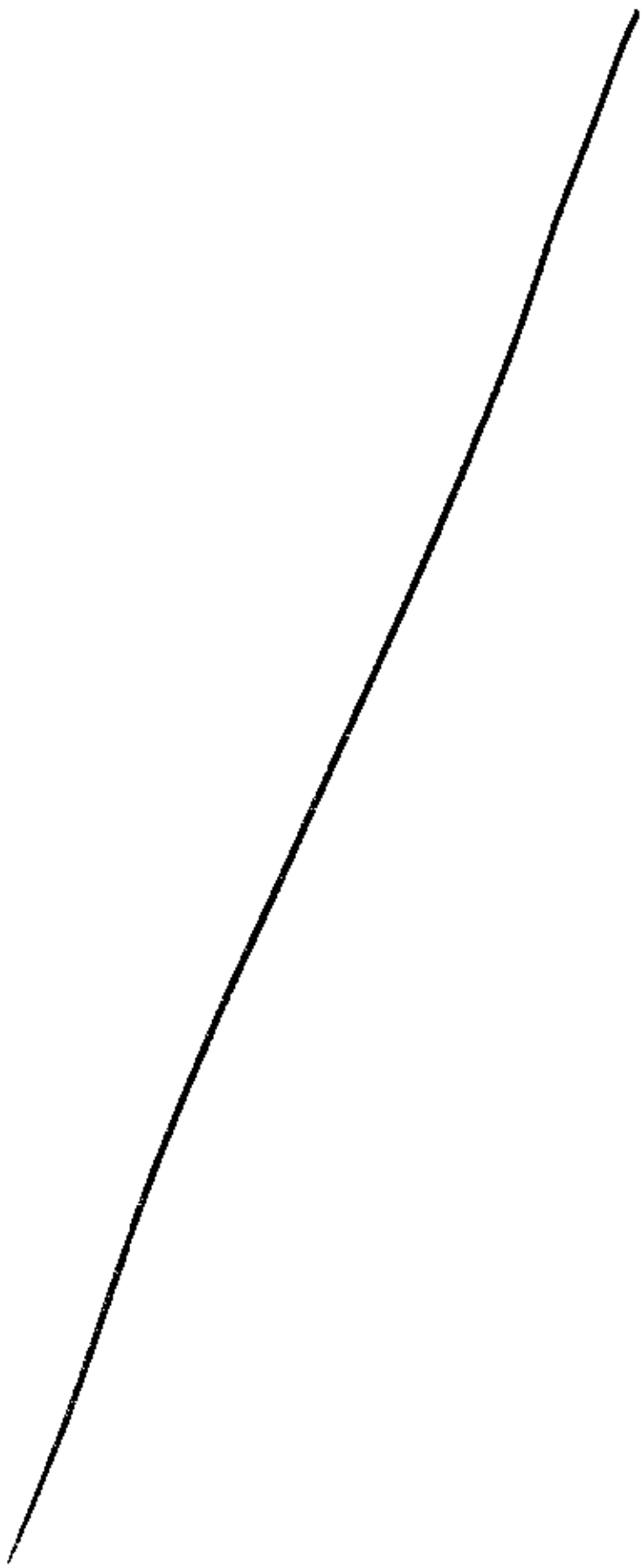
2. Ins. by Act 33 of 1977, s. 12 (w.e.f. 1-11-1977).

3. Ins. by Act 54 of 1993, s. 3 (w.e.f. 19-7-1993).

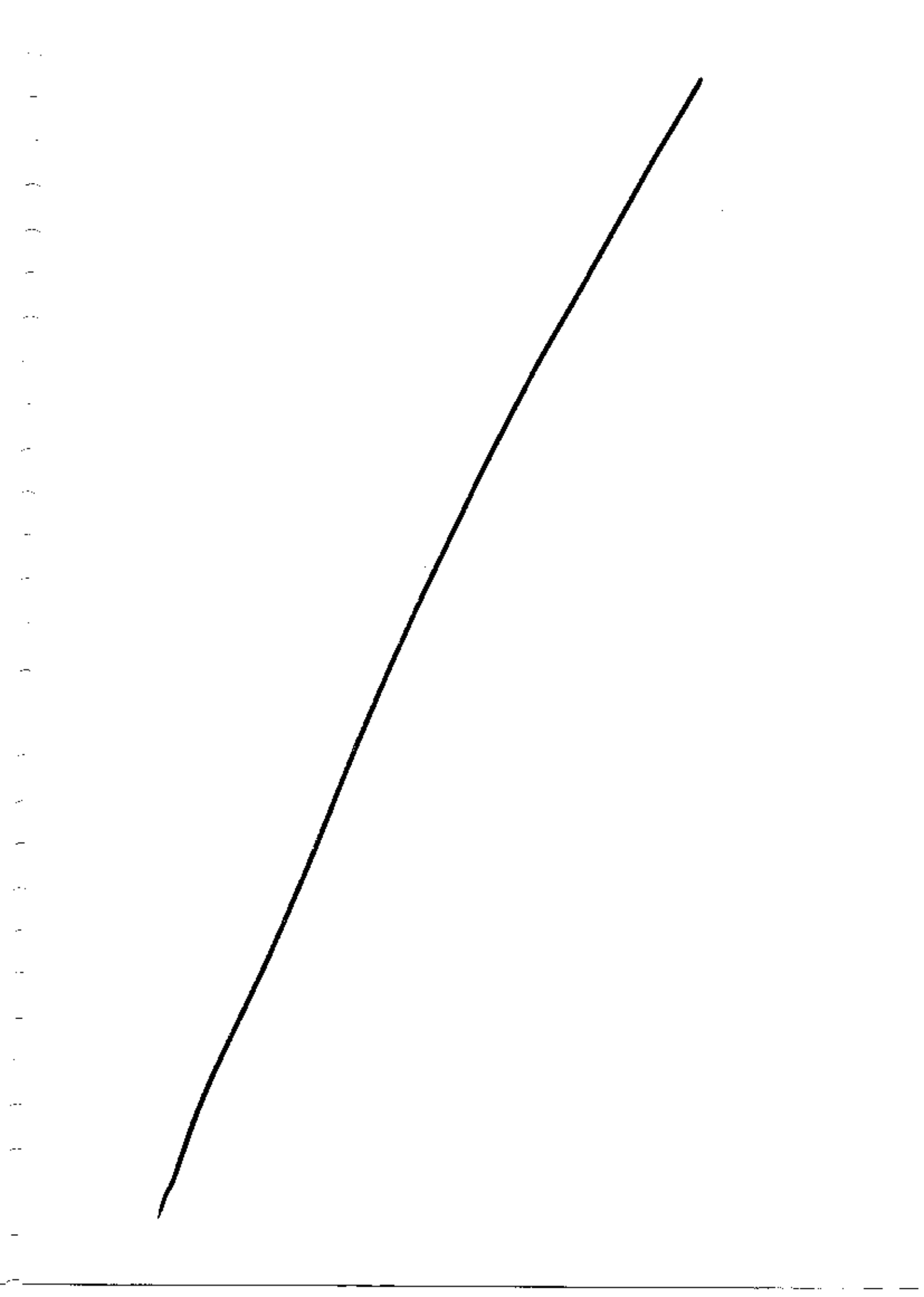
4. Ins. by Act 5 of 1999, s. 5.

5. Subs. by Act 18 of 2000, s. 5, for certain words (w.e.f. 7-6-2000).

6. Ins. by Act 54 of 1993, s. 3 (w.e.f. 27-8-1993).



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ANNEXURE I

Parliament (Prevention of Disqualification) Act, 1959
(PART IV.—Law Relating to Removal of Disqualification)

(h) the office of chairman or member of a committee (whether consisting of one or more members), set up temporarily for the purpose of advising the Government or any other authority in respect of any matter of public importance or for the purpose of making an inquiry into, or collecting statistics in respect of, any such matter, if the holder of such office is not entitled to any remuneration other than compensatory allowance;

¹[(i) the office of chairman, director or member of any statutory or non-statutory body other than any such body as is referred to in clause (h), if the holder of such office is not entitled to any remuneration other than compensatory allowance, but excluding (i) the office of chairman of any statutory or non-statutory body specified in Part I of the Schedule, (ii) the office of chairman or secretary of any statutory or non-statutory body specified in Part II of the Schedule;]

(j) the office of village revenue officer, whether called a lambardar, malguzar, patel, deshmuikh or by any other name, whose duty is to collect land revenue and who is remunerated by a share of, or commission on, the amount of land revenue collected by him, but who does not discharge any police functions.

²[*Explanation 1*].—For the purposes of this section, the office of ³[Chairman, Deputy Chairman or Secretary] shall include every office of that description by whatever name called.

⁴[*Explanation 2*].—In clause (aa), the expression "Leader of the Opposition" shall have the meaning assigned to it in the Salary and Allowances of Leaders of Opposition in Parliament Act, 1977 (33 of 1977).

⁵[*Explanation 3*].—In clause (ac), the expressions "recognised party" and "recognised group" shall have the meanings assigned to them in the Leaders and Chief Whips of Recognised Parties and Groups in Parliament (Facilities) Act, 1998 (5 of 1999).]

4. Temporary suspension of disqualification in certain case.—If a person being a member of Parliament who immediately before the commencement of this Act held an office of profit declared by any law repealed by this Act not to disqualify the holder thereof for being such member, becomes so disqualified by reason of any of the provisions contained in this Act, such office shall not, if held by such person for any period not extending beyond a period of six months from the commencement of this Act disqualify him for being a member of Parliament.

¹ Subs. by Act 54 of 1993, s. 3, for cl. (i) (w.e.f. 19.7.1993).

² *Explanation* numbered as *Explanation 1* thereof by Act 33 of 1977, s. 12 (w.e.f. 1.11.1977).

³ Subs. by Act 54 of 1993, s. 3, for certain words (w.e.f. 27.8.1993).

⁴ Ins. by Act 33 of 1977, s. 12 (w.e.f. 1.11.1977).

⁵ Ins. by Act 5 of 1999, s. 5.

5. Repeals.—The Parliament (Prevention of Disqualification) Act, 1950 (19 of 1950), the Parliament Prevention of Disqualification Act, 1951 (68 of 1951), the Prevention of Disqualification Act, 1953 (1 of 1954), and any provision in any other enactment which is inconsistent with this Act are hereby repealed.

THE SCHEDULE
[See section 3(A)]

PART I
BODIES UNDER THE CENTRAL GOVERNMENT

Air India International Corporation established under section 3 of the Air Corporations Act, 1953 (27 of 1953).

Air Transport Council constituted under section 30 of the Air Corporations Act, 1953 (27 of 1953).

Board of Directors of the Export Risks Insurance Corporation ^{1***}Limited.

Board of Directors of the Heavy Electricals ^{1***}Limited.

Board of Directors of the Hindustan Cables ^{1***}Limited.

Board of Directors of the Hindustan Insecticides ^{1***}Limited.

Board of Directors of the Hindustan Machine Tools ^{1***}Limited.

Board of Directors of the Hindustan Shipyard Limited.

Board of Directors of the ²[Hindustan Chemicals and Fertilizers Limited]

Board of Directors of the National Coal Development Corporation (Private) Limited.

Board of Directors of the National ³[Industrial] Development Corporation ^{4***} Limited.

Board of Directors of the National Instruments ^{4***} Limited.

Board of Directors of the National Small Industries Corporation ^{4***} Limited.

Board of Directors of the Neyveli Lignite Corporation (Private) Limited.

Board of Directors of the Sindri Fertilizers and Chemicals ^{4***} Limited.

Board of Directors of the State Trading Corporation of India ^{4***} Limited.

Central Warehousing Corporation established under section 17 of the Agricultural Produce (Development and Warehousing) Corporations Act, 1956 (28 of 1956).

Coal Board established under section 4 of the Coal Mines (Conservation and Safety) Act, 1952 (12 of 1952).

Coal Mines Labour Housing Board constituted under section 6 of the Coal Mines Labour Welfare Fund Act, 1947 (32 of 1947).

¹ The brackets and word "(Private)" omitted by Act 58 of 1960, s. 3 and the Second Schedule.

² Subs. by Act 58 of 1960, s. 3 and the Second Schedule, for "Nangal Fertilizers and Chemicals (Private) Limited".

³ Ins. by s. 3 and the Second Schedule, *ibid*.

⁴ The brackets and word "(Private)" omitted by s. 3 and the Second Schedule, *ibid*.

Commissioners for the Port of Calcutta.

Committee for the allotment of land in the township of Gandhidham.

Company Law Advisory Commission constituted under section 410 of the Companies Act, 1956 (1 of 1956).

Cotton Textiles Fund Committee constituted under the Textile Funds Ordinance, 1944 (Drd. 34 of 1944).

Dock Labour Board, Bombay, established under the Bombay Dock Workers (Regulation of Employment) Scheme, 1956, made under the Dock Workers (Regulation of Employment) Act, 1948 (9 of 1948).

Dock Labour Board, Calcutta, established under the Calcutta Dock Workers (Regulation of Employment) Scheme, 1956, made under the Dock Workers (Regulation of Employment) Act, 1948 (9 of 1948).

Dock Labour Board, Madras, established under the Madras Dock Workers (Regulation of Employment) Scheme, 1956, made under the Dock Workers (Regulation of Employment) Act, 1948 (9 of 1948).

Forward Markets Commission established under section 3 of the Forward Contracts (Regulation) Act, 1952 (74 of 1952).

Indian Airlines Corporation established under section 3 of the Air Corporations Act, 1953 (27 of 1953).

Industrial Finance Corporation of India established under section 3 of the Industrial Finance Corporation Act, 1948 (15 of 1948).

Licensing Committee constituted under rule 1D of the Registration and Licensing of Industrial Undertakings Rules, 1952, made under the Industries (Development and Regulation) Act, 1951 (65 of 1951).

Mining Boards constituted under section 12 of the Mines Act, 1952 (35 of 1952).

National Co-operative Development and Warehousing Board established under section 3 of the Agricultural Produce (Development and Warehousing) Corporations Act, 1956 (28 of 1956).

Rehabilitation Finance Administration constituted under section 3 of the Rehabilitation Finance Administration Act, 1948 (12 of 1948).

Tariff Commission established under section 3 of the Tariff Commission Act, 1951 (50 of 1951).

Trustees of the Port of Bombay.

Trustees of the Port of Madras.

Trustees or Commissioners of any major port as defined in the Indian Ports Act, 1908 (15 of 1908), other than the Port of Calcutta, Bombay or Madras.

BODIES UNDER STATE GOVERNMENTS

Andhra Pradesh

Agricultural Improvement Fund Committee constituted under section 3 of the Hyderabad Agricultural Improvement Act, 1952.

Co-operative Agricultural and Marketing Development Fund Committee.

Livestock purchasing Committee.

Assam

Adhi Conciliation Boards constituted under section 2A of the Assam Adhiars Protection and Regulation Act, 1948.

Assam Evacuee Property Management Committee constituted under section 12 of the Assam Evacuee Property Act, 1951.

Assam Text Book Committee.

Bihar

Mining Board for Coal Mines.

Text Book and Education Literature Committee.

Bombay

Allocation Committee (Allopathic) under the Employees' State Insurance Scheme.

Allocation Committee (Ayurvedic) under the Employees' State Insurance Scheme.

Board to conduct over-all supervision of the business and affairs, of the *Narsinggiriji Mills*, Sholapur.

Bombay Housing Board constituted under section 3 of the Bombay Housing Board Act, 1948.

Bombay State Electricity Board constituted under section 5 of the Electricity (Supply) Act, 1948 (54 of 1948).

Bombay State Electricity Consultative Council constituted under section 16 of the Electricity (Supply) Act, 1948 (54 of 1948).

Medical Service Committee under the Employees' State Insurance Scheme.

Pharmaceutical Committee under the Employees' State Insurance Scheme.

Regional Transport Authority for Ahmedabad, Aurangabad, Bombay, Nagpur, Poona, Rajkot and Thana constituted under section 44 of the Motor Vehicles Act, 1939 (4 of 1939).

Saurashtra Housing Board constituted under section 3 of the Saurashtra Housing Board Act, 1954.

State Transport Authority constituted under section 44 of the Motor Vehicles Act, 1939 (4 of 1939).

Vidarbha Housing Board constituted under section 3 of the Madhya Pradesh Housing Act, 1950.

Kerala

Board of Examiners appointed under rule 8 of the Travancore-Cochin Boiler Attendants Rules, 1954.

Panel of Assessors constituted under rule 63 of the Travancore-Cochin Boiler Attendants Rules, 1954.

Panel of Assessors constituted under the Travancore-Cochin Economiser Rules, 1956.

Madhya Pradesh

Madhya Pradesh Housing Board constituted under section 3 of the Madhya Pradesh Housing Board Act, 1950.

Mahakoshal Housing Board.

¹[Tamil Nadu]

Committee to select Books for Study for S.S.L.C. Examination.

Landing and Shipping Fees Committees for Minor Ports.

Local Committee constituted under regulation 10A of the Employees' State Insurance (General) Regulations, 1950.

Madras Board of Transport.

²[Tamil Nadu Electricity Board] constituted under section 5 of the Electricity (Supply) Act, 1948 (54 of 1948).

Madras State Electricity Consultative Council constituted under section 16 of the Electricity (Supply) Act, 1948 (54 of 1948).

Port Conservancy Boards.

Port Trust Boards of Minor Ports.

State Board of Communications.

Text Books Committee.

³[Karnataka]

Board of Management, Mysore Iron and Steel Works, Bhadravathi.

Board of Management of Industrial Concerns.

Orissa

Appeal Committee under the Board of Secondary Education.

Orissa Board of Communications and Transport.

Regional Transport Authority constituted under section 44 of the Motor Vehicles Act, 1939 (4 of 1939).

State Transport Authority constituted under section 44 of the Motor Vehicles Act, 1939 (4 of 1939).

¹ Subs. by the Madras State (Alteration of Name) (Adaptation of Laws on Union Subjects) Order, 1970, for "Madras" (*m.e.f.* 14.1.1969).

² Subs., *ibid.*, for "Madras State Electricity Board".

³ Subs. by the Mysore State (Alteration of Name) (Adaptation of Laws on Union Subjects) Order, 1974, for "Mysore" (*m.e.f.* 1.11.1973).

Punjab

Punjab State National Workers (Relief and Rehabilitation) Board.

Rajasthan

City Improvement Trust, Kota, constituted under the City of Kota Improvement Act, 1946.

Excise Appellate Board, Ajmer.

Rajasthan State Electricity Board constituted under section 5 of the Electricity (Supply) Act, 1948 (54 of 1948).

Urban Improvement Board, Jaipur.

Uttar Pradesh

Government Cement Factory Board.

Local Committees for Agra, Kanpur, Lucknow and Saharanpur appointed under section 25 of the Employees' State Insurance Act, 1948 (34 of 1948).

Sub-Committee to select books for Educational Expansion Department.

U.P. Sugar and Power Alcohol and Labour Housing Board constituted under section 10 of the U.P. Sugar and Power Alcohol Industries Labour Welfare and Development Fund Act, 1950.

West Bengal

Licensing Board constituted under the regulations made under rule 45 of the Indian Electricity Rules, 1956.

West Bengal Housing Board constituted under the West Bengal Development Corporation Act, 1954.

BODIES IN UNION TERRITORIES

Delhi Development Authority constituted under section 3 of the Delhi Development Act, 1957 (61 of 1957).

Delhi Electricity Power Control Board constituted under section 5 of the Bombay Electricity (Special Powers) Act, 1946, as applied to Delhi.

Delhi State Electricity Council constituted under section 16 of the Electricity (Supply) Act, 1948 (54 of 1948).

PART II

BODIES UNDER THE CENTRAL GOVERNMENT

Advisory Committee for the Air-India International Corporation appointed under section 41 of the Air Corporations Act, 1953 (27 of 1953).

Advisory Committee for the Indian Airlines Corporation appointed under section 41 of the Air Corporations Act, 1953 (27 of 1953).

Central Silk Board constituted under section 4 of the Central Silk Board Act, 1948 (61 of 1948).

Coffee Board constituted under section 4 of the Coffee Board Act, 1942 (7 of 1942).

Coir Board constituted under section 4 of the Coir Industry Act, 1953 (45 of 1953).

Development Council for Acids and Fertilizers established under section 6 of the Industries (Development and Regulation) Act, 1951 (65 of 1951).

Development Council for Alkalis and Allied Industries established under section 6 of the Industries (Development and Regulation) Act, 1951 (65 of 1951).

Development Council for Bicycles established under section 6 of the Industries (Development and Regulation) Act, 1951 (65 of 1951).

Development Council for Drugs, Dyes and Intermediates established under section 6 of the Industries (Development and Regulation) Act, 1951 (65 of 1951).

Development Council for Food Processing Industries established under section 6 of the Industries (Development and Regulation) Act, 1951 (65 of 1951).

Development Council for Heavy Electrical Engineering Industries established under section 6 of the Industries (Development and Regulation) Act, 1951 (65 of 1951).

Development Council for Internal Combustion Engines and Power Driven Pumps established under section 6 of the Industries (Development and Regulation) Act, 1951 (65 of 1951).

Development Council for Light Electrical Engineering Industries established under section 6 of the Industries (Development and Regulation) Act, 1951 (65 of 1951).

Development Council for Machine Tools established under section 6 of the Industries (Development and Regulation) Act, 1951 (65 of 1951).

Development Council for Non-ferrous Metals including alloys established under section 6 of the Industries (Development and Regulation) Act, 1951 (65 of 1951).

Development Council for Oil-based and Plastic Industries established under section 6 of the Industries (Development and Regulation) Act, 1951 (65 of 1951).

Development Council for Sugar Industry established under section 6 of the Industries (Development and Regulation) Act, 1951 (65 of 1951).

Development Council for Textiles made of artificial silk including artificial silk yarn established under section 6 of the Industries (Development and Regulation) Act, 1951 (65 of 1951).

Development Council for Textiles made of wool including woollen yarn, hosiery, carpets and druggest established under section 6 of the Industries (Development and Regulation) Act, 1951 (65 of 1951).

Durgah Committee, Ajmer, constituted under section 4 of the Durgah Khwaja Saheb Act, 1955 (36 of 1955).

Indian Central Arecanut Committee.

Indian Central Coconut Committee constituted under section 4 of the Indian Coconut Committee Act, 1944 (10 of 1944).

Indian Central Cotton Committee constituted under section 4 of the Indian Cotton Cess Act, 1923 (14 of 1923).

Indian Central Jute Committee.

Indian Central Oilseeds Committee constituted under section 4 of the Indian Oilseeds Committee Act, 1946 (9 of 1946).

Indian Central Sugarcane Committee.

Indian Central Tobacco Committee.

Indian Lac Cess Committee constituted under section 4 of the Indian Lac Cess Act, 1930 (24 of 1930).

Rubber Board constituted under section 4 of the Rubber Act, 1947 (24 of 1947).

Tea Board constituted under section 4 of the Tea Act, 1953 (29 of 1953).

BODIES UNDER STATE GOVERNMENTS

Andhra Pradesh

Market Committee constituted under section 4 of the Hyderabad Agricultural Market Act No. 11 of 1939 F.

Market Committee constituted under section 4A of the Madras Commercial Crops Markets Act, 1933.

Bihar

Bihar State Board of Religious Trusts.

Bihar Subai Majlis Awqaf.

Bodh Gaya Temple Advisory Committee constituted under section 15 of the Bodh Gaya Temple Act, 1949.

Bodh Gaya Temple Management Committee constituted under section 3 of the Bodh Gaya Temple Act, 1949.

Kerala

Administration Committee for Coir Purchase Scheme.

Malabar Market Committee constituted under section 4A of the Madras Commercial Crops Markets Act, 1933.

Tapioca Market Expansion Board.

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¹[Tamil Nadu]

Area Committee for Hindu Religious and Charitable Endowments constituted under section 12 of the Madras Hindu Religious and Charitable Endowments Act, 1951.

Madras State Wakf Board Constituted under Section 9 of the Wakf Act, 1954 (29 of 1954).

Punjab

State Marketing Board constituted under section 3 of the Patiala Agricultural Produce Markets Act, 2004.

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¹ Subs. by the Madras State (Alteration of Name) (Adaptation of Laws on Union Subjects) Order, 1970, for "Madras" (*w.e.f.* 14.1.1969).

² Part III omitted by Act 54 of 1993, s. 4 (*w.e.f.* 19.7.1993).

ACTS OF PARLIAMENT ON THE OFFICES OF PROFIT

Act	Year	Offices Added
1	2	3
Parliament (Prevention of Disqualification) Act	1959	<ul style="list-style-type: none">• any office held by a Minister, Minister of State or Deputy Minister for the Union or for any State, whether <i>ex-officio</i>,• or by name;• the office of Chief Whip, Deputy Chief Whip or Whip in Parliament or of a Parliamentary Secretary;• the office of member of any force raised or maintained under the National Cadet Corps Act, 1948 (31 of 1948), the Territorial Army Act, 1948 (56 of 1948), or the Reserve and Auxiliary Air Forces Act, 1952 (62 of 1952);• the office of a member of a Home Guard constituted under any law for the time being in force in any State;• the office of sheriff in the city of Bombay, Calcutta or Madras;• the office of chairman or member of the syndicate senate, executive committee, council or court of a university or any other body connected with a university;• the office of a member of any delegation or mission sent outside India by the Government for any special purpose;• the office of chairman or member of a committee (whether consisting of one or more members), set up temporarily for the purpose of advising the Government or any other authority in respect of any matter of public importance or for the purpose of making an inquiry into, or collecting statistics in respect of, any such matter, if the holder of such office is not entitled to any remuneration other than compensatory allowance;

1	2	3
Parliament (Prevention of Disqualification) Amendment Act	1977	<ul style="list-style-type: none">• the office of chairman or member of a committee (whether consisting of one or more members), set up temporarily for the purpose of advising the Government or any other authority in respect of any matter of public importance or for the purpose of making an inquiry into, or collecting statistics in respect of, any such matter, if the holder of such office is not entitled to any remuneration other than compensatory allowance;• the office of chairman, director or member of any statutory or non-statutory body other than any such body as is referred to in clause (h), if the holder of such office is not entitled to any remuneration other than compensatory allowance, but excluding (i) the office of chairman of any statutory or non-statutory body specified in Part I of the Schedule, (ii) the office of chairman or secretary of any statutory or non-statutory body specified in Part II of the Schedule;• the office of village revenue officer, whether called a lambardār, malguzar, patel, desh mukh or by any other name, whose duty is to collect land revenue and who is remunerated by a share of, or commission on, the amount of land revenue collected by him, but who does not discharge any police functions. <p>(a) the office of a Leader of the Opposition in Parliament;</p> <p>The Amendment also added the Explanation I and II to Section 3 of the Act. Explanation I says that for the purposes of this section, the office of Chairman, Deputy Chairman or Secretary shall include every office of that description by whatever name called. Explanation II says that "Leader of the Opposition" shall have the meaning assigned to it in the Salary and Allowances of Leaders of the Opposition in Parliament Act, 1977.</p>
Parliament (Prevention of Disqualification) Act	1993	<ul style="list-style-type: none">• The office of the Deputy Chairman, Planning Commission;• The office of the Chairperson of the National Commission for Minorities constituted under Section 3 of the National Commission for Minorities Act, 1992 (19 of 1992);

1	2	3
Leaders and Chief Whips of Recognised Parties and Groups in Parliament (Facilities) Act	1998	<ul style="list-style-type: none">• The office of the Chairperson of the National Commission for the Scheduled Castes and the Scheduled Tribes constituted under Clause (1) of the Article 338 of the Constitution;• The office of Chairperson the National Commission for Women constituted under Section 3 of the National Commission for Women Act, 1990 (20 of 1990)• The office of each leader and deputy leader of a recognized party and recognized group in either House of Parliament.
Parliament (Prevention of Disqualification) Amendment Act	2006	<ul style="list-style-type: none">• The office of the Chairperson of the National Advisory Council constituted by the Government of India in the Cabinet Secretariat <i>vide</i> Order No. 631/2/1/2004-Cab., dated the 31st May, 2004;• The office of Chairperson or trustee (by whatever name called) of any trust, whether public or private, not being a body specified in the Schedule;• The office of Chairman, President, Vice-President or Principal Secretary or Secretary of the Governing Body of any society registered under the Societies Registration Act, 1860 (21 of 1860) or under any other law relating to registration of societies, not being a body specified in the Schedule.• The office of Chairman, Deputy Chairman, Secretary or Member (by whatever name called) in any statutory or non-statutory body specified in the Table (Inserted by the Amendment Act);
The Table		
<ol style="list-style-type: none">1. The Tripura Khadi and Village Industries Board, a body constituted under the Tripura Khadi and Village Industries Act, 1966.2. The Uttar Pradesh Development Council.3. The Irrigation and Flood Control Commission, Uttar Pradesh.4. The Indian Statistical Institute, Calcutta.		

1	2	3
		5. The West Bengal Handicrafts Development Corporation Limited.
		6. The West Bengal Small Industries Development Corporation Limited.
		7. The West Bengal Industrial Development Corporation Limited.
		8. The Sriniketan Santiniketan Development Authority, a body constituted under the West Bengal Town and Country (Planning and Development) Act, 1979 (West Bengal Act No. 13 of 1979).
		9. The Haldia Development Authority, a body constituted under the West Bengal Town and Country (Planning and Development) Act, 1979 (West Bengal Act No. 13 of 1979).
		10. The West Bengal Minorities Development and Finance Corporation, a body constituted under the West Bengal Minorities Development and Finance Corporation Act, 1995.
		11. The Hooghly River Bridge Commissioners, constituted under the Hooghly River Bridge Act, 1969 (West Bengal Act No. 36 of 1969).
		12. The Board of Wakf, West Bengal, a body constituted under the Wakf Act, 1995 (43 of 1995).
		13. The State Fisheries Development Corporation Limited, West Bengal.
		14. The West Bengal State Haj Committee, constituted under the Haj Committee Act, 2002 (35 of 2002).
		15. The Asansol Durgapur Development Authority, West Bengal, a body constituted under the West Bengal Town and Country (Planning and Development) Act, 1979 (West Bengal Act No. 13 of 1979).
		16. The West Bengal Pharmaceutical and Phytochemical Development Corporation Limited.
		17. The West Bengal Handloom and Powerloom Development Corporation Limited.
		18. The West Bengal Khadi and Village Industry Board.

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	19.	The Society for Self-employment for Urban Youth, a society registered under the West Bengal Societies Registration Act, 1961 (West Bengal Act No. 26 of 1961).
	20.	The Tirumala Tirupathi Devasthanams Board.
	21.	The Agricultural and Processed Food Products Export Development Authority, an authority constituted under section 4 of the Agricultural and Processed Food Products Export Development Authority Act, 1985 (2 of 1986).
	22.	The National Agricultural Co-operative Marketing Federation of India Limited (NAFED).
	23.	The Indian Farmer Fertilizers Co-operative Limited (IFFCO).
	24.	The Krishak Bharati Co-operative Limited (KRISHCO).
	25.	The National Co-operative Consumers Federation of India Limited (NCCF).
	26.	The Auroville Foundation established under sub-section (1) of section 10 of the Auroville Foundation Act, 1988 (54 of 1988).
	27.	The National Commission of Enterprises in the Unorganised Sector.
	28.	The Planning Board (Asiatic Society) established under sub-section (1) of section 8 of the Asiatic Society Act, 1984 (5 of 1984).
	29.	The Delhi Rural Development Board.
	30.	The Maulana Azad Education Foundation.
	31.	The Indira Gandhi National Centre for the Arts.
	32.	Dr. Ambedkar Foundation.
	33.	The Bihar State Board of Religious Trust, a body constituted under the Bihar Hindu Religious Trust Act, 1950 (Bihar Act No. 1 of 1951).
	34.	The Research and Information System for the Non-Aligned and Other Developing Countries.

1	2	3
		35. The Indian Institute of Psychometry.
		36. The Uttar Pradesh Film Development Council.
		37. The Uttar Pradesh Provincial Co-operative Federation.
		38. The Uttar Pradesh Co-operative Federation Limited.
		39. The National Co-operative Union of India.
		40. The Uttar Pradesh Krishi and Gram Vikas Bank.
		41. The Uttar Pradesh Co-operative Bank Limited.
		42. The Indian Council for Cultural Relations.
		43. The Board of Control—A.N. Sinha Institute of Social Studies, Patna.
		44. All India Council for Sports.
		45. The Howrah Improvement Trust.
		46. The Dalit Sena, 12, Janpath, New Delhi.
		47. The Social Justice Trust, 12, Janpath, New Delhi.
		48. The Bahujan Foundation (Charitable Trust), Lucknow, Uttar Pradesh.
		49. The Bahujan Prerna Charitable Trust, Delhi.
		50. The Central Wakf Council, established under section 9 of the Wakf Act, 1995 (43 of 1995).
		51. The Nehru Memorial Museum and Library (NMML).
		52. The Jallianwala Bagh Memorial Trust.
		53. The Haj Committee of India constituted under section 3 of the Haj Committee Act, 2002 (35 of 2002).
		54. The Mallickhat Phoolbazar Parichalan Committee.
		55. The West Bengal Fisheries Corporation Limited.

ANNEXURE III

LIST OF ENACTMENTS OF STATE LEGISLATURES ON OFFICE OF PROFIT

1. The Andhra Pradesh Payment of Salaries and Pension and Removal of Disqualification Act, 1953.
2. The Arunachal Pradesh Legislature Members (Prevention of Disqualification) Act, 1977.
3. The Assam State Legislatures Members (Removal of Disqualification) Act, 1950.
4. The Bihar Legislature (Removal of Disqualification) Act, 1950.
5. The Delhi (National Capital Territory of) Members of Legislative Assembly (Removal of Disqualification) Act, 1997.
6. The Goa, Daman and Diu Members of the Legislative Assembly (Removal of Disqualification) Act, 1982.
7. The Gujarat Legislative Assembly Members (Removal of Disqualification) Act, 1960.
8. The Haryana State Legislature (Prevention of Disqualification) Act, 1974.
9. The Himachal Pradesh Legislative Assembly Members (Removal of Disqualification) Act, 1971.
10. The Jammu and Kashmir State Legislature (Prevention of Disqualification) Act, 1962.
11. The Karnataka Legislature (Prevention of Disqualification) Act, 1956.
12. The Madhya Pradesh Vidhan Mandal Sadasya Nirharta Nivaran Adhiniyam, 1967.
13. The Maharashtra Legislature Members (Removal of Disqualification) Act, 1956.
14. The Manipur Legislature (Removal of Disqualification) Act, 1972.
15. The Prevention of Disqualification (Members of the Legislative Assembly of Meghalaya) Act, 1972.
16. The Mizoram Union Territory Legislature Assembly Members (Removal of Disqualification) Act, 1975.
17. The Nagaland State Legislature Members (Removal of Disqualification) Act, 1964.
18. The Orissa Offices of Profit (Removal of Disqualification) Act, 1971.
19. The Pondicherry Member of the Legislative Assembly (Prevention of Disqualification) Act, 1994.

20. The Punjab State Legislature (Prevention of Disqualification) Act, 1952.
21. The Rajasthan Legislative Assembly Members (Removal of Disqualification) Act, 1956.
22. The Sikkim Legislative Assembly Members Removal of Disqualification Act, 1978.
23. The Tamil Nadu Legislature (Prevention of Disqualification) Act, 1967.
24. The Tripura State Legislature Members (Removal of Disqualification) Act, 1972.
25. The Uttar Pradesh State Legislature (Prevention of Disqualification) Act, 1971.
26. The West Bengal Legislature (Removal of Disqualification) Act, 1952.

COMPILATION OF DECISIONS OF THE COURTS AND TRIBUNALS ON OFFICES OF PROFIT

Sl.No.	Title of Case	Decision of Nature of Office	Test Applied	Authority/Institution
1	2	3	4	5
1.	Hansa Jeevraj Mehta v. Indubhai B. Amin & Ors. (1952 ELR; P. 171)	The office of the Vice Chancellor of University of Baroda, an honorary officer who is appointed by the Government is an office of profit under the Government.	Appointment and removal test: Whether the appointment and removal of a person to an office is vested with the Government irrespective of the fact that his salary is drawn from some source other than the Government?	Election Tribunal, Baroda
2.	Bheru Singh v. Prabhu Sayal Chaubey (1952 ELR Vol. II; p. 325)	'Patel', a person serving under the Government appointed for the performance of duties under the land revenue systems is an office of Profit under the Government.	Appointment and removal test: Whether the appointment and removal is vested with the Government?	Election Tribunal, Indore
3.	Mahendra Sahu v. Dutta Raul & Others (1953 ELR Vol. III; p. 117)	The office of Sarbarkar, i.e. the Revenue Officer, appointed by the State is not an office of profit under the State.	i. Whether the Office is heritable? ii. Whether salami is paid on every appointment? iii. Whether the interest in land granted to him is a tenancy interest enjoyed on payment of rent? iv. Whether the source from which he gets his commission is not the general revenues of the State but the collection from tenants from out of which he pays the revenue?	Election Tribunal, Cuttack
4.	Shivarama Karant v. Venkataramana Gowda & Others (1953 ELR Vol. III; p. 187)	Member of the South Kanara Area Committee appointed under the Madras Hindu Religious and Charitable Endowments Act, 1951, does not hold an office of profit, & is therefore not disqualified.	Compensatory allowance is not a profit: Reimbursement of out-of-pocket expenses does not constitute remuneration and the person receiving it is not holding an office of profit.	Election Tribunal, Bangalore, after acceptance of nomination by Returning Officer
5.	Chandernath v. Kunwar Jaswant Singh & Others (1953 ELR Vol. III, p. 147)	Member of the District Vitran Committee, Bikaner constituted by the Government of Rajasthan for the purpose of distributing the controlled	"Profit" does not necessarily mean any remuneration in cash but it certainly means some kind of advantage or gain which is tangible or which can be perceived.	Election Tribunal, Bikaner

1	2	3	4	5
		commodities such as foodgrains, sugar, cloth etc. is not an office of profit as contemplated by Article 191 of the Constitution of India and as such did not incur any disqualification.		
6.	Lahiri Singh v. Attar Singh & Others (1953 ELR Vol. III; p. 483)	Teacher in a Government School in the State of Pepsu is an office of profit and disqualified under Article 191(1)(a).	So long as the office enables the holder to make profit irrespective of whether he makes it or not, the holder will incur disqualification.	Election Tribunal
7.	Yograj Singh Shankar Singh Farihar v. Sitaram Hirachand Birla & Ors. (1953 ELR Vol. III; p. 439)	Member of the Bombay Legislative Assembly, getting a monthly salary of Rs. 150/-, though holding an office of profit is not holding it under the Government and therefore not disqualified to contest an election since legislators are not subject to the disciplinary powers of the Government.	Appointment and Removal Test: Whether the member of legislature is holding an office of profit under the Government or not should be decided according to whether he is appointed by the Government or whether he can be dismissed by the Government.	Election Tribunal, Bombay
8.	Jagannath v. Pandurang & Ors. (1953 ELR Vol. IV; p. 168)	Paté. of village Narioli appointed by an order of the Deputy Commissioner was not in accordance with rules and thus bad in law and hence no question of holding the office arises.	When there was no valid appointment there could not have been any holding of the office and hence there is no office of profit.	Election Tribunal
9.	Vindhya Pradesh Assembly Members (1953 ELR Vol. IV; p. 442)	Office of membership of the District Advisory Council appointed by the Government of Vindhya Pradesh is not an office of profit normally but it is for resident members receiving the same travel allowances and daily allowances as that of the non-members.	Whether compensatory allowance not being a profit becomes profit in the hands of resident members?	Presidential Reference to the Election Commission of India for its opinion
10.	Hari Bas v. Hira Singh Pal & Others (1953 ELR Vol. IV; p. 468)	Employee of University of Punjab is not a holder of office of profit under the Government.	Government control and administration test: Whether the Government has any hand in the administration of the University? Appointment and Removal test: The appointments and removals other than those of the Chancellor and Vice Chancellor are made by the University and not by the Government.	Election Tribunal, Himachal Pradesh
11.	Pandit Harish Chandra v. Raja Man Singh & Ors. (ELR 1953; Vol. V; p. 129)	The holder of a Government license is not an office of profit since it is no office at all.	Whether the person was holding any office and the mere fact that he received allowance is not tantamount of holding an office.	Election Tribunal

1	2	3	4	5
12.	Maharaja Anand Chand (1953 ELR Vol. V; p. 197)	Privy purse holder is not an office of profit.	A member of the House becomes subject to disqualification after he is elected as such member.	Presidential Reference to the Election Commission of India for its opinion
13.	Natwar Lal v. Bhartendra Singh and Others [ELR Vol. V; p. 405 (1953)]	An assessor of a sessions court does not hold an office of profit.	Compensatory allowance is not a source of Profit.	Election Tribunal, Kota after rejection by Returning Officer
14.	Hakikatullah v. Nathu Singh and Others (ELR Vol. V; p. 10 1953)	Chairman of a Municipality is an Office of profit.	i. Appointment and removal test, & ii. Government Control and administration test.	Election Tribunal, after rejection by Returning Officer
15.	Dholanath v. Krishna Chandra Gupta (1953 ELR Vol. VI, p. 104)	Office of a member of Legislature is not an office of profit.	i. Appointment and Removal Test ii. Disciplinary action test: Whether a member of Legislature is subject to disciplinary powers of the Government?	Election Tribunal
16.	Gulab Chand Chordia v. Thakur Narain Singh and Others (1953; ELR Vol. VI; p. 397)	An istimrardar, a holder of a perpetual farm or lease upon grant of a sanad is not an office of profit.	i. Whether he is an appointee of the State? ii. Whether the office carried emoluments payable mostly periodically? iii. Whether the office is for a limited period? iv. Whether it is terminable? v. Whether it is assignable or not? vi. Whether it is heritable or not?	Election Tribunal, Ajmer
17.	Sahi Ram v. Manphool Singh and Others (ELR 1952; Vol. VII; p. 47)	Lambardar's brother is not holding an office of profit though Lambardari is a joint family property.	It is only the holder of the office who will be disqualified under Article 191(1)(a) and not the other members of his family.	Election Tribunal, Rajasthan
18.	Isher Singh v. Manjit Inder Singh and Others (ELR 1953; Vol. VII, p. 90)	An assessor of a court is not an office of profit.	Compensatory allowance is not a source of profit.	Election Tribunal
19.	Krishnappa v. Narayan Singh and Others (ELR 1953; Vol. VIII; p. 294)	A teacher in a grant-in-aid school does not hold an office of profit.	Appointment and removal test was applied.	Election Tribunal, Nagpur

1	2	3	4	5
20.	Govind Malaviya v. Murali Manohar & Others (ELR 1953; Vol. VIII; p. 84)	A lawyer engaged by a Government, but not being paid any retaining fee is not holding an office of profit.	<ul style="list-style-type: none"> i. Whether the relationship of master and servant existed between the lawyer and the Government. ii. Whether the office is of a permanent nature, which has an existence independent of the person who filled it. 	Election Tribunal, Uttar Pradesh
21.	Mahesh Datta v. Muralidhar and Others (1953 ELR Vol. VII; p. 154)	The office of Patel is an office of profit.	Appointment and removal test was applied.	Election Tribunal, Gwalior
22.	Kishen Lal Hamror v. Madan Singh & Others (ELR X, 1954; p. 49)	Assessorship of the Railway Rates Tribunal is not an 'office' and a person who has been appointed as an Assessor is not holding any office.	Whether the person was 'holding' any office?	Election Tribunal
23.	U.O. Deshpande and Others v. State of Hyderabad & Others (ELR Vol. X; p. 2D3)	The office of a Deputy Minister is not an office of profit.	Remuneration is attached in some way or the other to an office of profit.	Hyderabad High Court
24.	Chikati Parasuram Naidu v. Vyricherla Chandran Chandramay Oev (ELR Vol. XII; p. 66)	Member of the Railway Users Consultative Committee is not an office of profit.	Out-of-pocket expenses are not profit.	Election Tribunal
25.	Maulana Abdul Shakoor's v. Rikhab Chand and Others (AIR 1958 5C 52); (Supreme Court of India- XII ELR 149)	Mohatmin (Manager) of the Madras Ourgah Khwaja Sahib Akbari is not an office of profit under the government.	Appointment and removal test was applied.	Supreme Court after rejection by Election Tribunal
26.	Dr. Deorao Lakshman Anande v. Keshav Lakshman Borkar (ELR Vol. XIII; p. 334)	Insurance Medical Practitioner, appointed under the Employees' State Insurance Act 1948 is an office of profit under the Government.	<ul style="list-style-type: none"> i. Remuneration is attached in some way or the other to an office of profit. ii. Appointment and removal test. iii. Disciplinary action test. iv. Whether the contract or agreement of service is with the Government. 	Bombay High Court after rejection by Election Tribunal
27.	G. Narayanaswamy Naidu v. C. Krishnamurthy and others (ELR vol. XIV; p. 21)	A salaried employee of the Life Insurance Corporation cannot be said to be holding an office of profit under the Government.	<ul style="list-style-type: none"> i. Appoint and removal test. ii. Source of remuneration, being distinct from the Government. 	Madras High Court after the Tribunal declared the election void & that the respondent was not holding an office of profit under the Government

1	2	3	4	5
28.	Hoti Lal v. Raj Bahadur (ELR Vol. XV; p. 55)	An Office of Oath Commissioner is an office of profit under the Government.	Government to be given widest interpretation and it includes the Executive, the Legislature and the Judiciary and an office of profit under any of these would be an office of profit under the Government.	Rajasthan High Court
29.	M. Ramappa's v. Sangappa and Others (ELR Vol. XV; p. 475)	Patels and Shanbhogs hold offices of profit under the Government.	<ul style="list-style-type: none"> i. Appointment and removal test. ii. Government Control and supervision test. iii. Remuneration paid by the Government. 	Supreme Court of India setting aside the order of the High Court and restoring the Returning Officer's order of rejection
30.	Shirur Veerabhadrapa Veerappa v. Shankara Gouda Basangouda (ELR XVII; p. 117)	Mali Patel of a Taluk is an office of profit.	Transfer of duties attached to an office of profit by the office holder to a deputy does not terminate the office of profit.	Election Tribunal
31.	Raghunath Mishra v. Kishore Chandra Deo Bhanj and Others (ELR XVII; p. 321)	The office of Sarbarkar is an office of profit under the State.	Appointment and removal test was applied as the most conclusive test.	High Court overruled the decision of the Election Tribunal
32.	Prabhunath Tiwary v. Janardhan Singh & Others (3 ELR 117)	Mukhia of a Gram Panchayat does not hold an office of profit.	<ul style="list-style-type: none"> i. Appointment and removal test was applied. ii. Gain, in order to be construed as profit, must be determined and real and attached to the office. 	Election Tribunal
33.	Ramdayal Ayodhya Prasad Gupta v. K.R. Patil and Others (ELR XVIII; p. 378 of 1958)	Member of the State Electricity Consultation Council.	The office of profit was one, which enabled him to make a profit, irrespective of whether the holder himself made profit.	Election Tribunal, Nagpur
34.	Lachman Singh v. Harprakash Kaur (ELR 19; p. 417; Punjab High Court, 1958)	Convener of Ludhiana District Project Implementing Committee is not an office of profit.	The holder of the office should receive money for personal use not connected with official work.	Punjab High Court after the Tribunal declared it an office of profit
35.	Bhairon Lal v. Doongarsidas and others (ELR 2D; p. 157; Dec. 1958)	"Meena Bara Gaon", a tenure holder rendering services to save the payment of land revenue in cash is not an office of profit.	The office of profit cannot be assignable or heritable.	Rajasthan High Court

1	2	3	4	5
36.	Karu Lall and another v. Fida Hussain and another (ELR 20)	Inspector of minor irrigation works is not an office of profit.	Allowances paid to meet out-of-pocket expenses do not make the office an office of profit.	High Court of Patna
37.	Badri Narayan Singh v. Kamdeo Prasad Singh (ELR 21; p. 64; March 1959)	Ghatwali tenure is an office of profit under the Government.	<ul style="list-style-type: none"> i. Performance of public duties, namely in the nature of police and military duties. ii. The office is not heritable or assignable. 	High Court of Patna
38.	Tikati Hargobind Prasad Singh v. Smt. Phaldani Kumari (AIR 1952 SC 38 at p. 41)	Ghatwals are persons holding offices of profit under the Government.	<ul style="list-style-type: none"> i. The Government makes appointment of successors. ii. Remuneration is attached to the office. iii. Performance of public duties, namely in the nature of police and military duties. 	Supreme Court of India
39.	Jyoti Prasad Upadhyaya v. Kalka Prasad Bhatnagar (AIR 1962 All 128)	A Vice-Chancellor of a University is not holding an office of profit under the Government.	Appointment and removal test applied in relevance with decision that the Governor appoints the Vice Chancellor in his capacity as Chancellor of the University and not in exercise of the executive power of the State.	Allahabad High Court after rejection by Election Tribunal, Uttar Pradesh
40.	Guru Govind Basu v. Shankari Prasad Ghoshal (ELR 25; p. 77; 1963)	Auditor of Life Insurance Corporation of India is an office of profit.	<ul style="list-style-type: none"> i. An office of profit does not necessitate the existence of a master-servant relationship between the Government and the office holder. ii. Appointment and removal test was also applied. 	Supreme Court of India.
41.	In Re. Shri Edouart Goubert (ELR 26; 297)	A mayor does not hold an office of profit under the Government.	<ul style="list-style-type: none"> i. Appointment and removal test. ii. Government Control and supervision test. 	Election Commission
42.	In Re. N. Mahalingam, M.L.A., Madras, (ELR Vol. 28, p. 232)	A non-official Director of a Government company is held to be an office of profit.	<ul style="list-style-type: none"> i. Appointment and removal test. ii. Government Control and supervision test. 	Election Commission
43.	Shri Ram Harbhan Mankar v. Madhusudan Amaram Virale (ELR 29; p. 171)	A Deputy Minister of a State is not an office of profit under the Government and does not incur disqualification under Article 191(1).	A Deputy Minister is construed to be exempted under Article 191(1).	Bombay High Court

1	2	3	4	5
44.	Moti Singh v. Bhaiyyalal (ELR 29; 215)	The office of Vice President of a Zilla Parishad is not an office of profit under the Government.	i. Source of remuneration test, & ii. Government control test were applied.	Bombay High Court
45.	Vishwanath v. Visheshwar Nath (ELR 29; 1967 p. 306)	The Pramukh of a Zilla Prashad is not an office of profit under the State Government.	i. Appointment and removal test is the most decisive test. ii. Government Control and supervision test.	Rajasthan High Court
46.	Ranga Rao v. Komaran Ramayya (ELR Vol. 30 of 1967, p. 52)	The post of Extra-Departmental Mail Carrier under the Postal Department of the Government of India is an office of profit under the Government.	i. Appointment and removal test. ii. Remuneration is attached to the office. iii. A resignation letter sent but not accepted has the effect of the incumbent continuing in service.	Andhra Pradesh High Court
47.	Upendra Lal v. Smt. Narainee Devi Jha (ELR Vol. 30; 1967, p. 372)	District Honorary Family Planning Leader under the Government is not an office of profit.	i. Pecuniary advantage is an essential element of office of profit, irrespective of the quantum. ii. Reimbursement of out-of-pocket expenses does not constitute remuneration and the person receiving it is not holding an office of profit.	High Court of Madhya Pradesh
48.	Niranjan Lal Sharma v. Rajkumar Agarwal & Others (ELR Vol. XXXII, p. 224)	Chairman of Janpad Sabha constituted under the Municipalities Act, 1962 is not an office of profit.	i. Appointment and removal test. ii. Government Control and Supervision test. iii. Source of Remuneration test.	High Court of Madhya Pradesh
49.	Kamta Prasad Upadhyaya v. Sarjoo Prasad Tiwari and others (ERL Vol. XXXV, p. 1)	A teacher is a Government Primary School is an office of profit.	i. A resignation letter sent but not accepted has the effect of the incumbent continuing in service. ii. The resignation could not be retrospectively accepted as to remove the disqualification already earned by the person.	High Court of Madhya Pradesh
50.	Ishwarappa Sidningappa Ghattarki v. Pampakavi Rayappa Velgali (ELR Vol. XXXIX, p. 120)	Membership of: i. Mysore State Development Council. ii. Bijapur District Development Council. iii. Jamkhandi Taluk Development Board does not constitute offices of profit under the Government.	An <i>ex-officio</i> membership by a member of the legislature is not an office of profit under the Government operating as a disqualification.	High Court of Mysore

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51.	Umrao Singh v. Darbara Singh and Others (ELR Vol. XXXIX, p. 240)	Chairman of Panchayat Samiti is not an office of profit.	Compensatory allowance in the nature of travel allowances and daily allowances is not a source of profit.	Supreme Court upheld the High Court's decision of rejecting the election petition
52.	Ghulam Hassan v. Ghulam Nabi Wani and Another (40 ELR Vol. XL p. 1)	A permanent teacher in a Government High School is holding an office of profit.	A resignation letter sent but not accepted has the effect of the incumbent continuing in service.	High Court of Jammu and Kashmir
53.	Mahadeo v. Shantibhai and Others (40 ELR Vol. XL, p. 81)	A person holding the following offices of profit: i. inclusion in the panel of lawyers prepared by the Central and Western Railway Administration. ii. President-member of a tribunal constituted under M.P. Town Improvement Trust Act, 1960. iii. Office of Professor of law in the Madhav college, Ujjain do not constitute offices of profit under the Government.	i. The office of profit was one, which enabled him to make a profit, irrespective of whether the holder himself made profit. ii. Office means a fixed position for performance duties.	Supreme Court concurred with the High Court's decision
54.	Bapurao v. Sidramappa and Others (ELR Vol. XLI, p. 83)	Chairman of Market Committee and member of Food Advisory Committee do not hold offices of profit.	i. Compensatory allowance in the nature of out-of-pocket expenses is not a source of profit. ii. The offices mentioned in Parliament (Prevention of Disqualification) Act, 1969 need not necessarily be offices of profit.	High Court of Mysore
55.	O.R. Gurushantappa v. Abdul Khuddus Anwar & Others (ELR Vol. XLI, p. 153)	Superintendent of Steel Works in the Mysore Iron and Steel Works, Ltd. is not an office of profit.	Appointment and removal test & source of remuneration test were applied.	Supreme Court upheld the High Court's decision
56.	Chandan Lal v. Ram Dass and Another (ELR Vol. XLI, p. 214)	Mere appointment of an Agricultural Assistant at the Government Agricultural farm does not amount to holding an office of profit.	A person cannot occupy an office until he enters upon the office and the entry upon that office is not necessarily simultaneous with the appointment to the office.	Supreme Court of India
57.	Umrao Singh Dhabariya v. Yashwant Singh Nahar and Others (ELR Vol. XLII, p. 126)	The office of a Zilla Pramuks is not an office of profit under the State.	i. Appointment and removal test. ii. Government Control and supervision test.	High Court of Rajasthan

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			<ul style="list-style-type: none"> iii. Source of Remuneration test. iv. Whether the holder of the office performs his functions for the government? 	
58.	Kanta Kathuria v. M. Manak Chand Khurana, (1969) 3 SCC 268	Special Government Pleader appointed to assist the Government Advocate in an Arbitration matter does not hold an office of profit.	Whether the office is of a permanent nature, which has an existence independent of the person who filled it?	Supreme Court decided in a 3:2 majority decision overruling the High Court's decision
59.	Shivamurthy Swami Inamdar v. Veerabhadra Veerappa (ELR Vol. XLIV, p. 119)	Membership of the Taluk Development Board, District Development Council, Khadi and Village Industries Board and Chairmanship of Agricultural Produce Marketing Co-operative Society do not constitute offices of profit.	<ul style="list-style-type: none"> i. Appointment and removal test. ii. Government Control and supervision test. iii. Source of Remuneration test. iv. Compensatory allowance in the nature of out-of-pocket expenses is not a source of profit. 	Supreme Court of India
60.	Gurugobinda Basu v. Shankari Prasad Ghoshal AIR 1964 SC 254	Comptroller and Auditor General was held to a holder of an office of profit under the Government of India.	<ul style="list-style-type: none"> i. Appointment and removal test. ii. Government Control and supervision test. iii. Source of Remuneration test. iv. Whether the holder of the office performs his functions for the government? 	Supreme Court of India
61.	Surya Kant Roy v. Imnul Hak Khan AIR 1975 SC 1053; (1975) 1 SCC 531	Chairman of the Mines Board of Health appointed by the State Government was not an office of profit under the State Government.	<ul style="list-style-type: none"> i. Government Control and supervision test. ii. Source of Remuneration test. 	Supreme Court of India
62.	Divya Prakash v. Kuttar Chand Rana AIR 1975 SC 1067	Chairman of the Board of School Education, Himachal Pradesh cannot be said to hold an office of profit.	In the absence of any profit accruing to the holder as a result of the holding of the office it cannot be said that he was holding an office of profit.	Supreme Court of India agreeing with the High Court dismissed the petition
63.	Madhukar G.E. Pankakar v. Jaswant Chobbildas Rajani and others (1977, 1 SCC 70)	A Medical Practitioner working as a panel doctor appointed under the Employees' State Insurance Scheme does not hold an office of profit.	Whether the office is of a permanent nature, which has an existence independent of the person who filled it?	Supreme Court
64.	Gurugobinda Basu v. Shankari Prasad Ghoshal AIR 1964 SC 254	A chartered accountant, a partner of a firm of auditors of two companies, which were owned by the Government,	<ul style="list-style-type: none"> i. Appointment and removal test. ii. Government Control and supervision test. 	Supreme Court of India

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		amounts to an office of profit under the Government.	<ul style="list-style-type: none"> iii. Source of Remuneration test. iv. Whether the holder of the office performs governmental functions? 	
65.	Ashok Kumar Bhattacharya v. Ajoy Biswas and others (1985) 1 SCC 151	Accountant-in-charge of the Agartala Municipality is not an office of profit under the Government.	<ul style="list-style-type: none"> i. Government control and supervision test. ii. Whether the holder of the office performs governmental functions? iii. Source of Remuneration test. iv. There should not be any conflict between the duties and interest of the elected member. 	Supreme Court dismissed the appeal against the Gujarat High Court.
66.	Biharilal Bobray v. Roshan Lal Bobray (1984) 1 SCC 55t	Assistant teacher of a basic primary school run by UP Board of Basic Education is an office of profit under the Government.	Appoint and removal test was applied.	Supreme Court of India.
67.	Bhagwati Prasad Dixit Ghoshal v. Rajeev Gandhi AIR 1986 SC 153	A Member of Parliament drawing salary cannot be said to hold an office of profit.	<ul style="list-style-type: none"> i. Appointment and removal test. ii. Government control and supervision test. 	Supreme Court of India.
68.	Satrucharia Chandrasekhar Raju v. Vyricherla Pradeep Kumar Oey and another AIR 1992 SC 1959	A teacher in a primary school run by the Integrated Tribal Development Agency (ITDA) does not hold an office of profit under the Government.	There should not be any conflict between the duties and interest of the elected member.	Supreme Court of India.
69.	Kethamreddi Venkata Ramana Reddi v. Government of Andhra Pradesh and other (AIR 1985 AP 73)	A Lecturer in a private college affiliated to a University receiving grant-in-aid from the State cannot be said to hold an office of profit under the Government.	<ul style="list-style-type: none"> i. Appointment and removal test. ii. Government control and supervision test. 	High Court of Andhra Pradesh.
70.	Nongthombam Ibomcha Singh v. Lesangthem Chandramani Singh and others (AIR 1977 SC 682)	Speaker of a Legislative Assembly does not hold an office of profit under the Government.	Removal of Disqualification Act, 1975 (Manipur Act 1 of 1975) with retrospective effect is valid.	Supreme Court of India.
71.	Jaineshwar Bora and others v. Returning Officer, Panchayati Raj Elections, Nowgong and others (AIR 1975 Gauhati 61)	A contractor under the Public Works Department does not hold an office of profit under the Government.	<ul style="list-style-type: none"> i. Appointment and removal test. ii. Disciplinary action test. 	High Court of Gauhati.
72.	Sivadasa Menon v. Sunni Sahib (AIR 1977 Ker. 187)	A Receiver appointed by Court is not holding an office of profit under the Government.	<ul style="list-style-type: none"> i. Whether the office is of a permanent nature, which has an 	High Court of Kerala.

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			existence independent of the person who filled it? ii. Appointment and removal text. iii. Whether the holder of the office performs public duties? iv. Source of remuneration test.	
73.	Ganga Prasad Triveni Rai and Ram Murti Anchal [71 (55 ELR 163)]	Directors of U.P. Agro Industrial Corporation Ltd. a Government company were exempted from disqualification as offices of profit under the Government by an amendment to the U.P. State Legislature (Prevention of Disqualification) Act, 1971, which was upheld by the Election Commission.	Whether the State Legislative Assembly has power to declare with retrospective effect that an office shall not disqualify its holder from being a member of the State Legislature?	Election Commission upon reference from the Governor of U.P.
74.	Divya Prakash v. Kultar Chand Rana, 1975 2 SCR 749	The post of the Chairman of the Board of School Education of the State is not an office of profit.	Whether the appointment carried any remuneration?	Supreme Court of India.
75.	Radha Krishna Visharad v. Civil Judge, Aligarh & Ors. 1964 All. L.J. 848	A person in service of a college receiving grant-in-aid from the Government is said to hold an office of profit under the Government.	Government control and supervision test was applied.	Supreme Court of India reversed the High Court's decision and affirmed the Returning Officer's decision.
76.	D.S. Awasthi and others v. Virendra Swaroop, (AIR 1976 All 26)	Chairman of U.P. Legislative Council does not hold an office of profit under the Government.	i. Appointment and removal test. ii. Government control and supervision test.	Allahabad High Court.
77.	Ramnarain v. Ramchandra, (AIR 1958 Bom. 325)	Member of the Legislative Council is not a person holding an office of profit under the Government.	Appointment and removal test was applied as the decisive test.	Bombay High Court.
78.	Rustom Satin v. Br. Sampoonanand (1959) 20 ELR 22f.	Chairman of the U.P. Legislative Council does not hold an office of profit under the Government.	Appointment and removal test was applied.	Bombay High Court.
79.	Shivamurthy Swami v. Agadi Senganna Andanappa, (1971) 3 SCC 87D	Chairman of Legislative Council does not hold an office of profit under the Government.	i. Appointment and removal test. ii. Government control and supervision test. iii. Source of Remuneration text. iv. Performance of governmental functions test.	Supreme Court of India.

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80.	Aklu Ram Mahto v. Rajendra Mahto (AIR 1999 SC 1259)	A Khalasi and a Meter Reader under the employment of the Bokaro Steel Plant belonging to the Steel Authority of India do not hold offices of profit under the Government.	i. Appointment and removal test. ii. Source of Remuneration test.	Supreme Court of India upheld the decision of the High Court.
81.	Rabinóra Kumar v. Collector, Mayurbhanj, Orissa (AIR 1999 SC 1120)	An Assistant Public Prosecutor holds an office of profit.	i. Whether the office is of a permanent nature, which has an existence independent of the person who filled it? ii. Whether income or profit accrued from that office?	Supreme Court of India.
82.	Shri Bhagavandas Sehgal v. State of Haryana & others (AIR 1974 SC 2355)	The office of Chairman of the Ambala Improvement Trust is an office of profit under the Government.	i. Appointment and removal test. ii. Source of Remuneration test.	Supreme Court of India.
83.	Pradyut Bordoloi v. Swapan Roy (AIR 2001 SC 296)	A clerk Grade-I in Tirap Colliery, North Eastern Coal Fields under the Coal India Limited is not an office of profit under the Government.	i. Appointment and removal test. ii. Disciplinary action test.	Supreme Court of India.
84.	Shibu Soren v. Dayanand Sahay & others (2001) 7 SCC 425	Chairman of Interim Jharkhand Area Autonomous Council is an office of profit under the Government.	Mere use of the word 'honorarium' cannot take the payment out of the purview of profit, if there is some pecuniary gain for the recipient.	The Supreme Court of India.
85.	M.V. Rajasekharan & others v. Vatal Nagaraj (AIR 2002 SC 742; (2002) 7 SCC 784)	The One-Man Commission appointed by the State Government to study problems of Kannadigas is held to be an office of profit under the Government.	Remuneration other than compensatory allowance is profit.	The Supreme Court overruled the High Court's decision.
86.	In Re: Disqualification of Shri R. Mohanaragam	A Special Representative holds an office of profit under the Government.	The office of profit was one, which enabled him to make a profit, irrespective of whether the holder himself made profit.	Supreme Court upon a Presidential Reference.
87.	Smt. Jaya Bachchan v. Union of India and Ors. (2006) 5 SCC 266	Chairperson of the Film Development Council is an office of profit under the Government.	i. Whether the office is of a permanent nature, which has an existence independent of the person who filled it? ii. Appointment and removal test. iii. The office of profit is one, capable of yielding a profit or pecuniary gain.	Supreme Court upheld the opinion of the Election Commission of India.
88.	Srikant v. Vasantrao and Ors. (2006) 2 SCC 682	The Government Contractor does not hold an office of profit.	Whether the State Government is different from local or other authorities under the State.	Supreme Court of India.

JOINT COMMITTEE TO EXAMINE THE CONSTITUTIONAL AND LEGAL POSITION
RELATING TO OFFICE OF PROFIT

FIRST TERM OF REFERENCE

TO EXAMINE IN THE CONTEXT OF SETTLED INTERPRETATION OF THE EXPRESSION
"OFFICE OF PROFIT" IN ARTICLE 102 OF THE CONSTITUTION AND THE
UNDERLYING CONSTITUTIONAL PRINCIPLES THEREIN, AND TO SUGGEST
A COMPREHENSIVE DEFINITION OF "OFFICE OF PROFIT"

Sl.No.	Name of State	Feasibility of definition	Definition of Office of Profit (a) State's definition of Office of Profit (b) Opinion on suggested definition**	Opportunity for resignation*
1	2	3	4	5
1.	Andhra Pradesh	in favour of defining Office of Profit.	(a) No, definition given. However, the State Government is of the view that the word 'office of Profit' be defined keeping in view the observations of the Hon'ble Supreme Court. (b) Suggested definition is comprehensive.	In favour.
2.	Arunachal Pradesh	Workable definition does not appear to be feasible.	(a) No definition suggested. (b) Suggested definition is comprehensive, just and fair for uniform application to all States/UTs.	In favour.
3.	Assam	No need for definition.	(a) No definition suggested. (b) No opinion offered (No need for such definition).	In favour.
4.	Bihar	Not in favour of defining Office of Profit.	(a) No definition suggested. (b) No need for such definition.	In favour.
5.	Chhattisgarh	in favour.	(a) No definition suggested. (b) In agreement with the suggested definition.	In favour of providing option to resign.
6.	Goa			
7.	Gujarat	No need for definition.	(a) No definition suggested. (b) Not in favour of any definition. Present scheme of the Constitution be continued.	Not in favour.
8.	Haryana	No need for definition	(a) Although no definition is given, the State Government is in favour of insertion	in favour.

1	2	3	4	5
			of following clause while evolving the definition:- "An office can be an Office of Profit based on the profit or pecuniary gain obtained from it. Word 'Honorary' should also be added in the definition of Office of Profit." (b) No comments offered.	
9.	Himachal Pradesh	In favour	(a) No comprehensive definition has been provided. (b) Suggested definition is comprehensive. However, the State Government is of the view that the proposed clause (1A) is not necessary.	Not in favour.
10.	Jammu and Kashmir			
11.	Jharkhand			
12.	Karnataka	No comprehensive definition of Office of profit is feasible	(a) No definition given. However, the State Government is of the view that any definition should incorporate the aspect of pecuniary gain. (b) No specific reply.	In favour.
13.	Kerala	In favour	(a) No definition suggested. (b) Has given opinion only on one aspect. The State Government is of the view that in order to avoid ambiguities and judicial interference, honorarium, sitting fee, daily allowances, etc. should be specifically excluded from 'remuneration'.	In favour.
14.	Madhya Pradesh			
15.	Maharashtra	Workable definition not feasible.	(a) No definition suggested. (b) Except the resignation clause (1A), the suggested definition defines Office of Profit comprehensively in context of the underlying constitutional principles.	Not in favour.
16.	Manipur	Workable definition not feasible.	(a) No definition suggested. However, State Government has desired to have its own definition under its own Act. (b) No comments offered.	In favour.
17.	Meghalaya	In favour of providing definition.	(a) State's definition—"Office of Profit means any office where pecuniary benefits or remunerations whether in the form of salary or honorarium whatever may be called, is paid for holding such office/post but will not include any office/post which will have been declared	In favour.

1	2	3	4	5
18. Mizoram	In favour of comprehensive statutory definition.	(a) State's definition—No definition offered. However, the State Government is of the opinion that definition be based on the tests formulated by Supreme Court.	not to disqualify the holder of such office/post by law made by Parliament or the Legislature of the State/Union Territories." (b) No specific reply offered but has offered their own definition.	In favour.
19. Nagaland	Have attempted a definition and suggested rewording of explanation to Articles 102(1) and 191(1) may be reworded.	(a) Article 102(1) and 191(1) may be reworded as follows:— "102. Disqualifications for membership.— (1) A person shall be disqualified for being a member of either House of Parliament,— (a) if he holds any remunerative political post; <i>Explanation:</i> (1) "remunerative political post" shall have the same meaning assigned to it in article 361B. (2) For the purposes of this clause a person shall not be deemed to hold a remunerative political post by reason only that,— (i) he is a Minister or a Parliamentary Secretary either for the Union or for such State; (ii) as a Minister or a Parliamentary Secretary, he holds any other remunerative political post in <i>ex officio</i> capacity; and (iii) he holds any office in the affairs of either House of Parliament. Provided that no remunerative political post shall be deemed as such within the meaning assigned to it under Article 361B, if the salary or remuneration, as compensatory in nature, payable in respect of	(b) The Government of Mizoram has endorsed the suggested definition and has given suggestion:— <i>"That the expression viz. a Minister either for the Union or for such a State" occurring in clause (1) of the Explanation-1 may be replaced by the expression viz. "A Minister either for the Union under article 75 or for such a State under article 164 of the Constitution", so that those have been assigned the rank or status of Minister may be kept outside."</i>	Not in favour.

1	2	3	4	5
			<p>that remunerative political post or posts together, exceeds ten per cent of the total emoluments paid to a person as a Minister or a Parliamentary Secretary or a member per month, as the case may be."</p> <p>(b) The suggested definition does not define the 'office of Profit' comprehensively. The definition of 'Office of Profit' in the proposed Article is as same as the definition of 'remunerative political post' provided in Article 361B. There is no need to define both remuneration and salary in Explanation ii. The proposed sub-clause (1A) in the proposed article will defeat the constitutional purpose of punishing holders of Office of Profit.</p>	
20.	Orissa			
21.	Punjab	Not in favour of definition.	<p>(a) Definition not feasible as each State has its own peculiar circumstances and depending on the situation the Legislature in its wisdom declares as per the provisions of the Constitution whether a particular Office is an office of Profit. By providing to the term, the freedom of the Legislature will be curtailed.</p> <p>(b) No specific reply. Not in favour of any definition.</p>	In favour.
22.	Rajasthan	in favour.	<p>(a) No definition suggested.</p> <p>(b) Suggested incorporation of various offices under Part (II) of the Explanation of suggested definition for all practical purpose seeking general exemption.</p>	In favour.
23.	Sikkim	No specific view.	<p>(a) No definition suggested.</p> <p>(b) No specific comments offered.</p>	Not in favour.
24.	Tamil Nadu	No views offered.	<p>(a) No definition suggested.</p> <p>(b) No views offered on the definition. However, the State Government is of the view that whether a person holds an Office of Profit has to be determined based on the facts of circumstances of the each case and relevant statutory provisions.</p>	In favour.
25.	Tripura	Comprehensive definition of 'Office of Profit' may be included in the Constitution. State legislature should have the authority to make its own laws.	<p>(a) State's definition-No definition suggested.</p> <p>(b) in favour of suggested definition.</p>	Not averse.

1	2	3	4	5
26.	Uttar Pradesh			
27.	Uttaranchal	In favour.	(a) No definition given. (b) The definition of the "Office of Profit" should be comprehensive. But the proposed amendment in Explanation II "After Clause (1), the following Clause...subject to of disqualification" should not be inserted otherwise the very purpose of Clause (a) of Article 102 (i) 191(1) will be defeated.	Not in favour.
28.	West Bengal	Comprehensive definition not feasible.	(a) No definition suggested. (b) Definition too restrictive...	In favour.

*Opportunity for resignation—Incorporation of an enabling provision in the Constitution for an elected Member of Parliament to exercise an option to resign from an office in the event of the office he is holding is determined to be an "Office of profit" under the Government, without losing his membership of the House.

**Suggested definition—A definition of office of profit has been attempted in some quarters which reads as under:—

"In article 102 of the Constitution, in clause (1) for the Explanation, the following Explanations shall be substituted, namely:—

Explanation I. For the purpose of this clause—

(i) "Office of profit" means any office—

(i) under the control of the Government of India, or the Government of a State, as the case may be whether the salary or remuneration for such office is paid out of the public revenue of the Government of India or of the Government of State; or

(ii) under a body, which is wholly or partially owned by the Government of India or the Government of any State and the salary or remuneration is paid by such body; and

(A) the holder of office under sub-clause (i) is capable of exercising legislative, judicial or quasi-judicial power;

(B) the holder of office under sub-clause (ii) is capable of exercising powers by means of disbursement of funds, allotment of lands, issuing of licences and permits or making of public appointments or granting of such other favours of substantial nature.

(ii) A person shall not be deemed to hold an office of profit under the Government of India or the Government of any State by reason only that he is a Minister either for the Union or for such a State."

Explanation II. For the purposes of this clause the expression—

(a) "office" means the permanent substantive position which exists independently of the holder of the office;

(b) "remuneration" means any pecuniary gain commensurate with the status and responsibilities attached to the office;

(c) "salary" means salary or pay scale attached to the office whether or not the holder of such an office draws such salary.

After clause (1), the following clause shall be inserted, namely:—

"(1A) Notwithstanding anything contained in sub-clause (a) of clause (1) if a member of either House of Parliament has become subject to any disqualification mentioned in that sub clause he shall not be so disqualified unless he has not resigned from such office which is the subject to of disqualification."

JOINT COMMITTEE TO EXAMINE THE CONSTITUTIONAL AND LEGAL POSITION
RELATING TO OFFICE OF PROFIT

SECOND TERM OF REFERENCE

TO RECOMMEND, IN RELATION TO "OFFICE OF PROFIT", THE EVOLUTION OF GENERIC AND
COMPREHENSIVE CRITERIA WHICH ARE JUST, FAIR AND REASONABLE AND CAN BE
APPLIED TO ALL STATES AND UNION TERRITORIES

Sl.No.	Name of State	Criteria followed by State Governments in granting exemption	Desirability for uniform criteria	Criteria to be adopted	Desirability of bringing constitutional amendments in Art. 102 & 191 of the Constitution
1	2	3	4	5	6
1.	Andhra Pradesh	No criteria followed while giving exemptions.	In favour.	No criteria suggested.	In favour.
2.	Arunachal Pradesh	No specific criteria has been followed.	In favour.	No criteria suggested.	In favour of amendment.
3.	Assam	No specific criteria apart from part-time clause. Exemptions given on case-to-case basis.	Not in favour.	Matter should be left to State Government as per present provisions of the Constitution.	Not in favour.
4.	Bihar	No specific criteria.	Not in favour.	Matter should be left to State Governments.	Not in favour.
5.	Chhattisgarh	No specific criteria.	In favour. However, the State Government has desired that States must be consulted before evolving such principles/criteria.	No criteria suggested.	In favour.
6.	Goa				
7.	Gujarat	No criteria followed other than pecuniary aspect in some cases.	Uniform principle not practical.	Each and every case related to Office of profit be decided on the basis of its merit and circumstances.	Not in favour.
8.	Haryana	No criteria has been followed. However, exemptions are given after due deliberation on the floor of the House.	No need to evolve uniform criteria if the concept of federalism is to be protected.	No criteria suggested.	Not in favour as it is against the concept of federalism.

1	2	3	4	5	6
9.	Himachal Pradesh	No specific criteria has been stated.	In favour.	The State Government has suggested following comprehensive criteria for constituting "Office of Profit" without compromising with the object sought to be achieved by the provisions of Article 191(1) (a) and Article 102 (1) (a):- <ul style="list-style-type: none"> • Pecuniary considerations. • The holder of the office should not wield any financial and executive power and patronage. 	In favour of amendment.
10.	Jammu and Kashmir				
11.	Jharkhand				
12.	Karnataka	No specific criteria has been stated. Exemptions are being given on the lines of Parliament Act.	In favour.	Criteria (pecuniary aspect) laid down by the Supreme Court in <i>Jaya Bachan Vs. UOI</i> can be the guiding factor.	In favour.
13.	Kerala	Remuneration is the general criteria followed for granting exemption. However, considering the importance, necessity and nature of duties and obligations, certain specific offices have also been declared exempted without considering the remuneration aspect.	In favour.	No criteria suggested.	No view offered.
14.	Madhya Pradesh				
15.	Maharashtra	General exemptions provided.	In favour.	Pecuniary gain or any kind of profit obtained by the Holder of Office of Profit.	In favour.
16.	Manipur	Ethnic and tribal interest along with the needs of other sections of the society are taken care of.	Not in favour.	Each State should determine its own criteria depending on its own needs including political aspirations and needs of the society.	No comments offered.
17.	Meghalaya	General exemptions provided.	In favour.	Criteria be decided only after indepth study as each State may have its own peculiar needs.	In favour of constitutional amendment and has desired that all provisions of Prevention of Disqualification

1	2	3	4	5	6
					{Members of Legislative Assembly of Meghalaya) Act, 1972 be included.
18. Mizoram	No other criteria other than part-time clause and not remunerated either by salary or fees has been followed while giving exemptions.	In favour.		No specific criteria suggested.	In favour of amendment.
19. Nagaland	No criteria suggested other than pecuniary aspect.	No need for uniform criteria.		No criteria suggested.	No need for constitutional amendment.
20. Orissa					
21. Punjab	Criteria followed— (i) Part-time office (ii) Office to which no regular salary is attached.	Not in favour.		There should be some guiding principles that can be suggestive in nature for declaring a particular post or office to be an office of Profit and finally it should be left open to the Legislature to decide whether any office/post is an 'Office of Profit' or not taking into consideration the available relevant facts.	Not in favour. State independence should remain.
22. Rajasthan	No criteria followed.	In favour.		No criteria suggested.	In favour of bringing constitutional amendments and has desired that general principles be laid which may be followed by the States while exempting office of profit under article 191. These principles may comprise the general elements of the offices holding of which would derogate the position or efficiency of a member as representative of people.

1	2	3	4	5	6
23. Sikkim	No specific criteria has been followed.	In favour.	In general, principles may be uniform. However, the other details of exemption or criteria be decided by State Government.	No comments offered.	
24. Tamil Nadu	No specific criteria has been followed in granting exemption from disqualification to the offices in corporations, Boards, Committees, Bodies etc. appointed by the State Government and the relevant Acts are amended accordingly.	In favour.	No particular criteria suggested.	No comments offered.	
25. Tripura	No specific criteria.	In favour.	No criteria suggested.	In favour of bringing constitutional amendments. However, State Legislatures should have authority to make laws under Article 191.	
26. Uttar Pradesh					
27. Uttaranchal	No specific criteria.	In favour.	No criteria suggested.	In favour.	
28. West Bengal	No criteria (other than restrictions on holding whole-time office and remuneration) has been followed.	In favour of uniform criteria but uniform criteria not so easy to be implemented and should be evolved only after wide deliberation.	Though it is difficult to evolve uniform criteria, however, if it is implemented local conditions be taken into account because each State forms its own legislature.	Present System of Constitution be continued.	

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ANNEXURE VII

HOUSE OF COMMONS DISQUALIFICATION ACT, 1975
(1975 Chapter 24)

[8th May, 1975]

An Act to consolidate certain enactments relating to disqualification for membership of the House of Commons.

Be it enacted by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

1. **Disqualification of holders of certain offices and places**—(1) Subject to the provisions of this Act, a person is disqualified for membership of the House of Commons who for the time being—

- (a) holds any of the judicial offices specified in Part I of Schedule 1 to this Act;
- (b) is employed in the civil service of the Crown. Whether in an established capacity or not, and whether for the whole or part of his time;
- (c) is a member of any of the regular armed forces of the Crown;
- (d) is a member of any police force maintained by a police authority;
- (e) is a member of the legislature of any country or territory outside the Commonwealth;
or
- (f) holds any office described in Part II or Part III of Schedule 1.

(2) A person who for the time being holds any office described in Part IV of Schedule 1 is disqualified for membership of the House of Commons for any constituency specified in relation to that office in the second column of Part IV.

(3) In this section—

"civil service of the Crown" includes the civil service of Northern Ireland, Her Majesty's Diplomatic Service and Her Majesty's Overseas Civil Service;

"police authority" means any police authority within the meaning of the Police Act, 1964 (1964 c.48) or the Police (Scotland) Act, 1967 (1967 c.77) or the Police Authority for Northern Ireland; and "member" in relation to a police force means a person employed as a full-time constable;

"regular armed forces of the Crown" means the Royal Navy, the regular forces as defined by section 225 of the Army Act, 1955 (1955 c.18), the regular air force as defined by section 223 of the Air Force Act, 1955 (1955 c.19), the Women's Royal Naval Service, Queen Alexandra's Royal Naval Nursing Service and Voluntary Aid Detachments serving with the Royal Navy.

(4) Except as provided by this Act, a person shall not be disqualified for membership of the House of Commons by reason of his holding an office or place of profit under the Crown or any other office or place; and a person shall not be disqualified for appointment to or for holding any office or place by reason of his being a member of that House.

2. Ministerial offices.—(1) Not more than ninety-five persons being the holders of offices specified in Schedule 2 to this Act (in this section referred to as Ministerial offices) shall be entitled to sit and vote in the House of Commons at any one time.

(2) If at any time the number of members of the House of Commons who are holders of Ministerial offices exceeds the number entitled to sit and vote in that House under sub-section (1) above, none except any who were both members of that House and holders of Ministerial offices before the excess occurred shall sit or vote therein until the number has been reduced, by death, resignation or otherwise, to the number entitled to sit and vote as aforesaid.

(3) A person holding a Ministerial office is not disqualified by this Act by reason of any office held by his *ex officio* as the holder of that Ministerial office.

3. Reserve and auxiliary forces, etc.—(1) Notwithstanding section 1(1) (c) above—

(a) a person who is an officer on the retired or emergency list of any of the regular armed forces of the Crown, or who holds an emergency commission in any of those forces, or belongs to any reserve of officers of any of those forces, is not disqualified as a member of those forces; and

(b) a naval, army, marine or air force pensioner who is recalled for service for which he is liable as such is not disqualified as a member of the regular armed forces of the Crown.

(2) A person is not disqualified under section 1(1)(c) above by reason of his being an Admiral of the fleet, a Field Marshal or a Marshal of the Royal Air Force, if he does not for the time being hold an appointment in the naval, military or air force service of the Crown.

(3) A person is not disqualified under section 1(1) (b) above by reason of his being a member of the Royal Observer Corps unless he is employed as such for the whole of his time.

4. Stewardship of Chiltern Hundreds, etc.—For the purposes of the provisions of this Act relating to the vacation of the seat of a member of the House of Commons who becomes disqualified by this Act for membership of that House, the office of steward or bailiff or Her Majesty's three Chiltern Hundreds of Stoke, Desborough and Burnham, or of the manor of Northstead, shall be treated as included among the offices described in Part III of Schedule 1 to this Act,

5. Power to amend Schedule 1.—If at any time it is resolved by the House of Commons that Schedule 1 to this Act be amended, whether by the addition or omission of any office or the removal of any office from one Part of the schedule to another, or by altering the description of any office specified therein, Her Majesty may by Order in Council amend that Schedule accordingly.

(2) A copy of this Act as from time to time amended by Order in Council under this section or by or under any other enactment shall be prepared and certified by the Clerk of the Parliaments and deposited with the rolls of Parliament; and all copies of this Act thereafter to be printed by Her Majesty's printer shall be printed in accordance with the copy so certified.

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6. Effects of disqualification and provision for relief.—(1) Subject to any order made by the House of Commons under this section,—

- (a) if any person disqualified by this Act for membership of that House, or for membership for a particular constituency, is elected as a member of that House, or as a member for that constituency, as the case may be, his election shall be void; and
- (b) if any person being a member of that House becomes disqualified by this Act for membership, or for membership for the constituency for which he is sitting, his seat shall be vacated.

(2) If, in a case falling or alleged to fall within sub-section (1) above, it appears to the House of Commons that the grounds of disqualification or alleged disqualification under this Act which subsisted or arose at the material time have been removed, and that it is otherwise proper so to do, that House may by order direct that any such disqualification incurred on those grounds at that time shall be disregarded for the purposes of this section.

(3) No order under sub-section (2) above shall affect that proceedings on any election petition or any determination of an election court, and this sub-section shall have effect subject to the provisions of section 124(5) of the Representation of the People Act, 1949 (1949 c.68) (making of an order by the House of Commons when informed of a certificate and any report of an election court).

(4) In any case where, apart from this provision, the Speaker of the House of Commons would be required to issue during a recess of that House a warrant for a new writ for election of a member, in the room of a member becoming disqualified by this Act, he may, if it appears to him that an opportunity should be given to that House to consider the making of an order under sub-section (2) above, defer the issue of his warrant pending the determination of that House.

7. Jurisdiction of Privy Council as to disqualification.—(1) Any person who claims that a person purporting to be a member of the House of Commons is disqualified by this Act, or has been so disqualified at any time since his election, may apply to Her Majesty in Council, in accordance with such rules as Her Majesty in Council may prescribe, for a declaration to that effect.

(2) Section 3 of the Judicial Committee Act, 1833 (1833 c.41) (referency to the Judicial Committee of the Privy Council of appeals to her Majesty in Council) shall apply to any application under this section as it applies to an appeal to Her Majesty in Council from a court.

(3) Upon any such application the person in respect of whom the application is made shall be the respondent; and the applicant shall give such security for the costs of the proceedings, not exceeding £ 200, as the Judicial Committee may direct.

(4) For the purpose of determining any issue of fact arising on an application under this section the Judicial Committee may direct issue to be tried—

- (a) if the constituency for which the respondent purports to be a member is in England or Wales, in the High Court;
 - (b) if that constituency is in Scotland, in the Court of Session;
 - (c) if that constituency is in Northern Ireland, in the High Court in Northern Ireland;
- and the decision of that Court shall be final.

(5) A declaration under this section may be made in respect of any person whether the grounds of the alleged disqualification subsisted at the time of his election or arose subsequently, but no such declaration shall be made—

- (a) in the case of disqualification incurred by any person on grounds which subsisted at the time of his election, if an election petition is pending or has been tried in which his disqualification on those grounds is or was in issue;
- (b) in the case of disqualification incurred by any person on any grounds, if order has been made by the House of Commons under section 6(2) above directing that any disqualification incurred by him on those grounds shall be disregarded for the purposes of that section.

8. Relaxation of obligation to accept office.—(1) No person being a member of the House of Commons, or for the time being nominated as a candidate for election to that House, shall be required to accept any office or place by virtue of which he would be disqualified by this Act for membership of that House, or for membership of that House for the constituency for which he is sitting or is a candidate.

(2) This section does not affect any obligation to serve in the armed forces of the Crown, whether imposed by an enactment or otherwise.

9. Interpretation.—(1) In this Act—“Minister of State” means a member of Her Majesty’s Government in the United Kingdom who neither has charge of any public department nor holds any other of the offices specified in Schedule 2 to this Act or any office in respect of which a salary is payable out of money provided by Parliament under section 3(1) (b) of the Ministerial and other Salaries Act, 1975 (1975 c. 27):

“Parliamentary Secretary” includes a person holding Ministerial office (however called) as assistant to a Member of Her Majesty’s Government in the United Kingdom, but no having departmental responsibilities.

10. Consequential amendment, repeals and saving.—(1) Schedule 2 to the Representation of the People Act, 1949 (1949 c. 68) which contains Parliamentary Elections Rules shall be amended by substituting, for paragraph (2) of Rule 9 of the Parliamentary Elections Rules, the following paragraph—

“(2) A candidate’s consent given under this rule shall contain a statement that he is aware of the provisions of the House of Commons Disqualification Act, 1975, and that, to the best of his knowledge and belief, he is not disqualified for membership of the House of Commons.”

(2) The enactments specified in Schedule 4 to this Act, are hereby repealed, so far as they apply in relation to disqualification for the House of Commons, to the extent specified in the third column of that Schedule.

(3) Nothing in this Act shall be construed as affecting the enactments relating to the disqualification for membership of the House of Commons, of priests in holy orders or ministers of any religious denomination.

(4) Nothing in the definition of "regular armed forces of the Crown" in section 1(3) above shall be taken to alter the law in force immediately before the passing of this Act in relation to disqualification for membership of the House of Commons.

11. **Short title and extent.**—(1) This Act may be cited as the House of Commons Disqualification Act, 1975.

(2) This Act extends to Northern Ireland.

SCHEDULES

Schedule 1

Offices Disqualifying for Membership

PART I

JUDICIAL OFFICES

Judge of the High Court of Justice or Court of Appeal.

Judge of the Court of Session.

Judge of the High Court of Justice or Court of Appeal in Northern Ireland.

Judge of the Courts-Martial Appeal Court.

Chairman of the Scottish Land Court.

Circuit Judge.

Sheriff Principal or Sheriff (other than Honorary Sheriff) appointed under the Sheriff Courts (Scotland) Act, 1907 (1907 c. 51), or Temporary Sheriff Principal or Temporary Sheriff appointed under the Sheriff Courts (Scotland) Act, 1971 (1971 c. 58).

County Court Judge or Temporary County Court Judge in Northern Ireland within the meaning of the Government of Ireland Act, 1920 (1920 c. 67), or the deputy of such a Judge.

Stipendiary Magistrate within the meaning of the Justices of the Peace Act, 1949 (1949 c. 101).

Stipendiary Magistrate in Scotland.

Resident Magistrate appointed under the Summary Jurisdiction and Criminal Justice Act (Northern Ireland), 1935 [1935 c. 13 (N.I.)] or the Magistrates' Court Act (Northern Ireland), 1964 [1964 c. 21 (N.I.)]

Chief or other National Insurance Commissioner.

Chief or other National Insurance Commissioner for Northern Ireland.

Umpire or Deputy Umpire appointed for the purposes of section 43 of the National Service Act, 1948 (1948 c. 64).

PART II

BODIES OF WHICH ALL MEMBERS ARE DISQUALIFIED

The Advisory Board for the Research Councils.

The Agreement Board.

The Appellate Tribunal constituted under the provisions of the National Service Act, 1948 relating to conscientious objectors.

An Area Electricity Board in England and Wales.

The Attendance Allowance Board.

The British Airports Authority.

The British Airways Board.

The British Film Fund Agency.

The British Gas Corporation.

The British Railways Board.

The British Steel Corporation.

The British Transport Docks Board.

The British Waterways Board.

The Central Council for Agricultural and Horticultural Co-operation.

The Central Electricity Generating Board.

The Channel Tunnel Planning Council.

The Civil Aviation Authority.

The Civil Service Arbitration Tribunal.

A Colonial Currency Board.

The Commission for Local Administration in England.

The Commission for Local Administration in Wales.

The Commission for the New Towns.

The Commonwealth Development Corporation.

The Community Relations Commission.

The Council on Tribunals.

The Covent Garden Market Authority.

The Crofters Commission.

The Crown Agents for Oversea Governments and Administrations.

The Crown Estate Commissioners.

The Development Commission established under the Development and Road Improvement Funds Act, 1909 (1909 c. 47).

A development Corporation within the meaning of the New Towns Act, 1965 (1965 c. 59) or the New Towns (Scotland) Act, 1968 (1968 c. 16).

A Development Council established under the Industrial Organisation and Development Act, 1947 (1947 c. 40).

The Eggs Authority.

The Electricity Council.

The Foreign Compensation Commission.

The Forestry Commission.

The Freight Integration Council.

The Gaming Board for Great Britain.

The General Practice Finance Corporation.

The Health and Safety Commission.

The Health and Safety Executive.

The Herring Industry Board.

The Highlands and Islands Development Board.

The Home-Grown Cereals Authority.

The Housing Corporation.

The Immigration Appeal Tribunal.

An Independent Schools Tribunal constituted under Schedule 6 to the Education Act, 1944 (1944 c. 31) or Schedule 7 to the Education (Scotland) Act, 1962 (1962 c. 47).

The Independent Broadcasting Authority.

The Industrial Arbitration Board.

An Industrial Court established in Northern Ireland.

The Industrial Estates Corporations constituted in accordance with the Local Employment Act, 1972 (1972 c. 5).

The Industrial Injuries Advisory Council.

The Intervention Board for Agricultural Produce and every committee of the Board performing functions of the Board.

A Joint Planning Inquiry Commission constituted under Part III of the Town and Country Planning (Scotland) Act, 1972 (1972 c. 52).

The Lands Tribunal.

The Lands Tribunal for Northern Ireland.

The Lands Tribunal for Scotland.

The Law Commission.

The Local Government Boundary Commission for England.

The Local Government Boundary Commission for Scotland.

The Local Government Boundary Commission for Wales.

The Location of Office Bureau.

The Manpower Services Commission.

The Maplin Development Authority.

The Meat and Livestock Commission.

A Medical Appeal Tribunal constituted for the purposes of Part III of the Social Security Act, 1975 (1975 c. 14) or Part III of the Social Security (Northern Ireland) Act, 1975 (1975 c. 15), including any panel constituted for the purposes of any such Tribunal.

A Medical Board or Pneumoconiosis Medical Board constituted for the purposes of Part III of the Social Security Act, 1975 or Part III of the Social Security (Northern Ireland) Act, 1975, including any panel constituted for the purposes of any such Board.

A Medical Practices Committee constituted under section 34 of the National Health Service Act, 1946 (1946 c. 81) or section 35 of the National Health Service (Scotland) Act, 1947 (1947 c. 27).

The Medicines Commission and any Committee established under section 4 of the Medicines Act, 1968 (1968 c. 67).

A Mental Health Review Tribunal constituted under the Mental Health Act, 1959 (1959 c. 72).

The Mental Welfare Commission for Scotland.

The Metrication Board.

The Ministry of Defence (Army Department) Teachers Selection Board.

The Monopolies and Mergers Commission.

A National Broadcasting Council.

A National Bus Company.

The National Coal Board.

The National Dock Labour Board.

The National Film Finance Corporation.

The National Freight Corporation.

The National Health Service Staff Commission.

The National Insurance Advisory Committee.

The National Ports Council.

The National Radiological Protection Board.

The National Research Development Corporation.

The North of Scotland Hydro-Electric Board.

The Northern Ireland Electricity Service.

The Occupational Pensions Board.

A Panel of Chairmen of Re-instatement Committees constituted under section 41 of the National Service Act, 1948 (1948 c. 64).

The Panel of Official Arbitrators constituted for the purposes of the Acquisition of Land (Assessment of Compensation) Act, 1919 (1919 c. 57).

The Parole Board constituted under section 59 of the Criminal Justice Act, 1967 (1967 c. 8D).

A Pensions Appeal Tribunal.

The Performing Right Tribunal.

A Planning Inquiry Commission constituted under Part III of the Town and Country Planning Act, 1971 (1971 c. 78).

A Planning Inquiry Commission constituted under Part III of the Town and Country Planning (Scotland) Act, 1972 (1972 c. 52).

The Post Office.

The Price Commission.

The Property Commission for Scotland established under section 224 of the Local Government (Scotland) Act, 1973 (1973 c. 65).

The Race Relations Board and any conciliation Committee constituted by the Board under section 14 of the Race Relations Act, 1968 (1968 c. 71).

The Red Deer Commission.

The Reserve Pension Board.

The Restrictive Practices Court.

The Review Board for Government Contracts.

A Rural Development Board.

The Scottish Committee of the Council on Tribunals.

The Scottish Land Court.

The Scottish Law Commission.

The Scottish Transport Group.

The South of Scotland Electricity Board.

The Staff Commission established under section 85(5) of the London Government Act, 1963 (1963 c. 33).

The Staff Commission for England established under section 257 of the Local Government Act, 1972 (1972 c. 70).

The Staff Commission for Scotland established under section 218 of the Local Government (Scotland) Act, 1973 (1973 c. 65).

The Staff Commission for Wales established under section 258 of the Local Government Act, 1972.

The Sugar Board.

The Supplementary Benefits Commission.

The Traffic Commissioners for any area (including the Commissioner for the Metropolitan Traffic Area).

The Transport Tribunal.

The Tribunal established under Part II of the Wireless Telegraphy Act, 1949 (1949 c. 54).

The United Kingdom Atomic Energy Authority.

The University Grants Committee.

A Value Added Tax Tribunal.

The Water Resources Board.

The Welsh National Health Service Staff Commission.

The White Fish Authority constituted in accordance with section 1 of the Sea Fish Industry Act, 1970 (1970 c. 11) and the Committee constituted in accordance with section 2 of that Act.

PART III

OTHER DISQUALIFYING OFFICES

Account of Court appointed under section 25 of the Administration of Justice (Scotland) Act, 1933 (1933 c. 41).

Adjudicator appointed for the purposes of the Immigration Act, 1971 (1971 c. 77).

Agent for Northern Ireland in Great Britain.

Ambassador representing Her Majesty's Government in the United Kingdom.

Assessor of Public Undertaking (Scotland).

Assistant Commissioner appointed under Part IV of the Local Government Act, 1972 (1972 c. 70).

Assistant Commissioner appointed under part II of the Local Government (Scotland) Act, 1973 (1973 c. 65).

Attorney General of the Duchy of Lancaster.

Auditor of the Civil List.

Auditor of the Court of Session.

Boundary Commissioner or Assistant Boundary Commissioner appointed under Part I or Part II of Schedule 1 to the House of Commons (Redistribution of Seats) Act, 1949 (1949 c. 66).

Chairman or Deputy Chairman of an Administrative Board constituted for the purposes of any scheme made, or having effect as if made, under section 2 or 5 of the Industrial Injuries and Diseases (Old Cases) Act, 1975 (1975 c. 16).

Chairman or Vice-Chairman of the Advisory Committee on Distinction Awards.

Chairman of the Advisory Committee on Distinction Awards in Northern Ireland.

Paid Chairman of an Area Transport Users Consultative Committee established under section 56 of the Transport Act, 1962 (1962 c. 46).

Chairman or Member of a Panel of Deputy-Chairmen of an Agricultural Land Tribunal.

Chairman of an Appeal Tribunal constituted under Schedule 3 to Ministry of Social Security Act, 1966 (1966 c. 20) or Schedule 3 to the Supplementary Benefits & C. Act (Northern Ireland), 1966 [1966 c. 28 (N.I.)].

Chairman or Director-General of the British Council.

Paid Chairman of the Central Tribunal Consultative Committee for Great Britain established under section 56 of the Transport Act, 1962.

Chairman of the Cinematograph Films Council.

Chairman of the Countryside Commission for Scotland and any other member of the Commission in receipt of remuneration.

Chairman or Vice-Chairman of the Dental Estimates Board or member of that Board appointed at an annual salary.

Paid Chairman of an Economic Development Committee.

Paid Chairman of a Health Board constituted under the National Health Service (Scotland) Act, 1972 (1972 c. 58).

Chairman of a Health and Social Services Board established under Article 16 of the Health and Personal Social Services (Northern Ireland) Order, 1972 [S.I. 1972/1265 (N.I. 14)].

Paid Chairman of an Industrial Training Board constituted under the Industrial Training Act, 1964 (1964 c. 16) or of a Committee appointed under that Act or paid Deputy Chairman of such a Board.

Chairman, Vice-Chairman or member of the executive Committee of the Land Settlement Association Limited appointed at a salary.

Chairman of the Local Government Staff Commission for Northern Ireland.

Chairman of a Local Tribunal constituted under section 94(2) of, and Schedule 10 to, the Social Security Act, 1975 (1975 c. 14) or under section 94(2) of, and Schedule 10 to, the Social Security (Northern Ireland) Act, 1975 (1975 c. 15).

Chairman or Deputy Chairman of a Local Tribunal constituted under the provisions of the National Service Act, 1948 (1948 c. 64) relating to conscientious objectors.

Chairman or Reserve Chairman of a Military Service (hardship) Committee constituted under Schedule 3 to the National Service Act, 1948.

Chairman of the Mining Qualifications Board.

Paid Chairman of a National Economic Development Council Working Party.

Chairman in receipt of remuneration of the National Gas Consumers' Council or any Regional Gas Consumers' Council.

Chairman or Vice-Chairman of the National Seed Development Organisation Limited.

Chairman, or other member appointed by a Minister, of the National Water Council.

Chairman of the Northern Ireland Central Services Agency for the Health and Social Services.

Chairman of the Northern Ireland Council for Nurses and Midwives.

Chairman of the Northern Ireland Staffs Council for the Health and Social Services.

Any Chairman of the Plant Varieties and Seeds Tribunal.

Chairman of the Post Offices Users' National Council.

Chairman of a Regional Economic Planning Council.

Chairman in receipt of remuneration of any Regional Health Authority, Area Health Authority or Area Health Authority (Teaching) or of any special health authority.

Chairman of a Regional Water Authority.

Chairman of the Scottish Dental Estimates Board or member of that Board appointed at an annual salary.

Chairman, Deputy Chairman or member of the Council of Management of the Scottish Special Housing Association, appointed at a salary.

Chairman of the Staff Commission for Education and Library Boards in Northern Ireland.

Chairman of the Tribunal constituted under section 463 of the Income and Corporation Taxes Act, 1970 (1970 c. 10)

Chairman of the Welsh National Water Development Authority.

Chief Electoral Officer or Deputy Electoral Officer for Northern Ireland.

Clerk of the Crown and peace in Northern Ireland.

Clerk of the Peace in Scotland.

Clerk or Assistant Clerk of Petty Session in Northern Ireland.

Assistant Commissioner appointed under Part II of the Local Government (Scotland) Act, 1973 (1973 c. 65).

Commissioner or Assistant Commissioner appointed under section 50(1) or (2) of or Schedule 4 to, the Local Government Act (Northern Ireland 1972), [(1972 c. 9 (N.I.))].

The Commissioner appointed by Her Majesty's Government in the United Kingdom under Article 3 of the Agreement confirmed by the Nauru Island Agreement Act, 1920 (1920 c. 27).

Commissioner or Assistant Commissioner of Police of the Metropolis.

Commissioner of the City of London Police.

Comptroller and Auditor General.

Comptroller and Auditor-General for Northern Ireland.

Constable, Lieutenant or Major of the Tower of London.

Correspondent appointed by the Commissioners of Customs and Excise.

Counsel to the Secretary of State under the Private Legislation Procedure (Scotland) Act, 1936 (1936 c. 52).

Crown Solicitor for Northern Ireland.

Delegate for Her Majesty's Government in the United Kingdom to the Central Rhine Commission.

Director of the Agricultural Mortgage Corporation Limited nominated by a Minister of the Crown or government department.

Director of the British Petroleum Company Limited nominated by a Minister of the Crown or government department.

Director of the British Sugar Corporation Limited appointed by the Ministers as defined by section 17 of the Sugar Act, 1956 (1956 c. 48).

Director of Cable and Wireless Limited.

Director of the Cereals Committee Limited appointed by a Minister of the Crown or government department.

Director of the Commonwealth Institute.

Director of the Compagnie Financiere de Suez et de L'Union Parisienne appointed by a Minister of the Crown or government department.

Director of any company in receipt of financial assistance under the Distribution of Industry Act, 1945 (1945 c. 36), the Distribution of Industry (Industrial Finance) Act, 1958 (1958 c. 41), The Shipbuilding Industry Act, 1967 (1967 c. 40), the Local Employment Act, 1972 (1972 c. 5) or Part II of the Industry Act, 1972 (1972 c. 63), being a Director nominated by a Minister of the Crown or government department.

Director nominated by the Secretary of State of any company in respect of which an undertaking to make advances has been given by the Secretary of State under section 2 of the Highlands and Islands Shipping Services Act, 1960 (1960 c. 31), and is for the time being in force.

Director of the Holding Company referred to in the Transport Act, 1962 (1962 c. 46).

Director appointed at a salary of Industrial Advisers to the Blind Limited.

Director of International Computers (Holdings) Limited nominated or appointed by a Minister of the Crown or government department.

Director appointed at a salary of the National Building Agency.

Director appointed at a salary of the National Institute for House-craft (Employment and Training) Limited.

Director of the Peterhead Bay (Management) Company Limited.

Director, or Deputy Director, of Public Prosecutions for Northern Ireland.

Director appointed at a salary of Remploy Limited.

Director of S.B. (Realisations) Limited nominated or appointed by a Minister of the Crown or government department.

Director of the Scottish Agricultural Securities Corporation Limited nominated by a Minister of the Crown or government department.

Director General of Fair Trading.

Distributor of Stamps appointed by the Commissioners of Inland Revenue for the Stock Exchange at Manchester or Glasgow.

Examiner or member of a board of interviews appointed by the Civil Service Commissioner.

Examiner for entrance examination to, or member of a board of interviewers for entrance to, the civil service of Northern Ireland.

General Manager or Secretary of the Scottish Special Housing Association.

Governor of the British Broadcasting Corporation.

Governor, Deputy Governor or Director of the Bank of England.

Governor, Lieutenant and Secretary, or Captain of Invalids of Chelsea Hospital.

Governor, Medical Officer or other officer or member of the staff of a prison to which the Prison Act (Northern Ireland) 1953 [(1953 c. 18 (N.I.)) applies.

Health Service Commissioner for England.

Health Service Commissioner for Scotland.

Health Service Commissioner for Wales.

High Commissioner representing Her Majesty's Government in the United Kingdom.

Industrial Assurance Commissioner or Deputy Industrial Assurance Commissioner appointed under the Industrial Assurance Act (Northern Ireland), 1924 [1924 c. 21 (N.I.)].

Judge Advocate of the Fleet.

Judge Advocate General, Vice Judge Advocate General, Assistant Judge Advocate General or Deputy Judge Advocate.

Lay observer appointed under section 45 of the Solicitors Act, 1974 (1974 c. 47).

Local government officers, the following—

Clerk or deputy clerk of a district council in Northern Ireland;

County clerk or depute county clerk of a county in Scotland;

Clerk or deputy clerk of a district council in Scotland;

Town clerk or deputy town clerk of a burgh in Scotland.

Lyon Clerk.

Lyon King of Arms.

Member of an Agricultural marketing Board appointed by the Minister under Schedule 2 to the Agricultural Marketing Act, 1958 (1958 c. 47).

Member of an Agricultural Marketing Board appointed under section 2 of the Agricultural Marketing Act (Northern Ireland), 1933 [1933 c. 22 (N.I.)] or section 3 of the Agricultural Marketing Act (Northern Ireland), 1964 (1964 c. 13 (N.I.)).

Member appointed by the Minister of Agriculture, Fisheries and Food of the Agricultural Wages Board for England and Wales committee established under the Agricultural Wages Act, 1948 (1948 c. 47), or Chairman of such a committee.

Member appointed by the Secretary of State of the Scottish Agricultural Wages Board.

Member appointed by the Head of the Department or Minister of Agriculture for Northern Ireland of the Agricultural Wages Board for Northern Ireland.

Any member of the British Library Board in receipt of remuneration.

Any member in receipt of remuneration of the British Tourist Authority, the English Tourist Board, the Scottish Tourist Board or the Wales Tourist Board.

Any member of the Countryside Commission in receipt of remuneration.

Member appointed by the Secretary of State of the Horserace Betting Levy Board.

Member of the Council of the National Computing Centre appointed at a salary by a Minister of the Crown or government department.

Any Member of the Nature Conservancy Council in receipt of remuneration.

Member of a panel of valuers appointed at an annual salary under section 4 of the Inland Revenue Regulation Act, 1890 (1890 c. 21).

Member of the permanent Joint Hops Committee appointed by a Minister of the Crown or government department.

Member of a Wages Council or Central Co-ordinating Committee appointed under paragraph 1 (a) of Schedule 2 to the Wages Councils Act, 1959 (1959 c. 69). Chairman of a Committee appointed under paragraph 1 (1) (a) of Schedule 3 to that Act or member of a Commission of Inquiry appointed under paragraph 1 (a) of Schedule 4 to that Act.

Member of a Wages Council or Central Co-ordinating Committee appointed under paragraph 1(a) of Schedule 1 to the Wages Councils Act (Northern Ireland), 1945 [1945 c. 21 (N.I.)] or Member of a Commission of Inquiry appointed under paragraph 1 (a) of Schedule 2 to that Act.

Northern Ireland Commissioner for Complaints.

Northern Ireland Parliamentary Commissioner for Administration.

Officer of the Board of Referees appointed for the purposes of section 26 of the Capital Allowances Act, 1968 (1968 c. 3).

Officer or servant employed under the Commissioner of Police of the Metropolis or the Receiver for the Metropolitan Police District.

Officer or servant of the Crown Estate Commissioners.

Officer or other member of the County Court Service within the meaning of the County Courts Act (Northern Ireland), 1959 [1959 c. 25 (N.I.)].

Officer, clerk or servant appointed or employed under section 20 of the Greenwich Hospital Act, 1865 (1865 c. 89).

Officer of the Supreme Court within the meaning of sections 115 to 120 of the Supreme Court of Judicature (Consolidation) Act, 1925 (1925 c. 49).

Officer of or attached to the Supreme Court of Northern Ireland to whom section 76 of the Supreme Court of Judicature Act (Ireland), 1877 (1877 c. 57) applies.

Parliamentary Commissioner for Administration.

President, or member of a panel of chairmen, of industrial tribunals established under section 12 of the Industrial Training Act, 1964 (1964 c. 16).

Principal Clerk of Justiciary appointed under section 25 of the Administration of Justice (Scotland) Act, 1933 (1933 c. 41).

Procurator fiscal or procurator fiscal depute appointed under the Sheriff Courts and Legal Officers (Scotland) Act, 1927 (1927 c. 35).

Public Works Loan Commissioner.

Receiver for the Metropolitan Police District.

Registrar or Assistant Registrar appointed under section 18 or section 19 of the County Courts Act, 1959 (1959 c. 22).

Registrar or Assistant Registrar of Friendly Societies.

Registrar of the Privy Council.

Registration Officer appointed under Part III of the Local Government Act, 1972 (1972 c. 70).

Sheriff Clerk or sheriff clerk depute.

Solicitor in Scotland to any department of Her Majesty's Government in the United Kingdom.

Standing Counsel to any department of Her Majesty's Government in the United Kingdom.

Substitution Officer of the Royal Air Force.

Technical Adviser to the Commissioners of Customs and Excise.

Under-Sheriff appointed under section 1 of the Sheriffs (Ireland) Act, 1920 (1920 c. 26).

PART IV

OFFICES DISQUALIFYING FOR PARTICULAR CONSTITUENCIES

<i>Office</i>	<i>Constituency</i>
Her Majesty's Commissioner of Lieutenancy in the City of London.	The Cities of London and Westminster.
Her Majesty's Lieutenant for Greater London.	Any constituency comprising any part of Greater London.
Her Majesty's Lieutenant for a County in Great Britain.	Any constituency comprising the whole or part of the area for which he is appointed.
Governor of the Isle of Wight.	The Isle of Wight.
The High Sheriff of Greater London.	Any constituency comprising any part of Greater London.
High Sheriff of a County in England and Wales.	Any constituency comprising the whole or part of the area for which he is appointed.

Schedule 2

Ministerial Offices

Prime Minister and First Lord of the Treasury.
Lord President of the Council.
Lord Privy Seal.
Chancellor of the Duchy of Lancaster.
Paymaster General.
Secretary of State.
Chancellor of the Exchequer.
Minister of Agriculture, Fisheries and Food.
President of the Board of Trade.
Minister of State.
Chief Secretary to the Treasury.
Minister in charge of a public department of Her Majesty's Government in the United Kingdom (if not within the other provision of this Schedule).
Attorney General.
Lord Advocate.
Solicitor General.

Solicitor General for Scotland.

Parliamentary Secretary to the Treasury.

Financial Secretary to the Treasury.

Parliamentary Secretary in a Government department other than the Treasury, or not in a department.

Junior Lord of the Treasury.

Treasurer of Her Majesty's Household.

Comptroller of Her Majesty's Household.

Vice-Chamberlain of Her Majesty's Household.

Assistant Government Whip.

Schedule 3

Repeals

Chapter	Short Title	Extent Repeal
1	2	3
5 & 6 Eliz. 2, c. 20	The House of Commons Disqualification Act, 1957.	The whole Act, except section 2(3).
5 & 6 Eliz. 2, c. 48	The Electricity Act, 1957.	In Schedule 4, in Part II, the entry relating to the House of Commons Disqualification Act, 1957.
6 & 7 Eliz. 2, c. 16	The Commonwealth Institute Act, 1958.	Section 7 (2).
6 & 7 Eliz. 2, c. 71	The Tribunals & Inquiries Act 1958.	The whole Act, so far as unrepealed.
6 & 7 Eliz. 2, c. 71	The Agriculture Act, 1958.	Section 8 (2). In Section 11(2), the words "except sub-section (2) of section eight thereof".
7 & 8 Eliz. 2, c. 40	The Deer (Scotland) Act, 1959.	In the section 37(2), the words from "except" to "Act, 1957". In Schedule 1, paragraph 3.
7 & 8 Eliz. 2, c. 62	The New Towns Act, 1959.	Section 2 (11). In section 14, in sub-section (2) the words from "except" to "Commons" and in sub-section (3) the words "except the said provisions". In Schedule 1, paragraph 1 (10).
7 & 8 Eliz. 2, c. 69	The Wages Councils Act, 1959.	Section 25. In section 27(3) the words "save as otherwise expressly provided".
7 & 8 Eliz. 2, c. 72	The Mental Health Act, 1959.	Section 3(5). In sections 150 and 152 the words "sub-section (5) of section three".
8 & 9 Eliz. 2, c. 18.	The Local Employment Act, 1960.	Section 11.
8 & 9 Eliz. 2, c. 58.	The Charities Act, 1960.	In section 49(2) (a) the words from "it amends" to "1957".
8 & 9 Eliz. 2, c. 61	The Mental Health (Scotland) Act, 1960.	Section 2(6) In sections 114 and 116 the words "sub-section (6) of section two".

1	2	3
9 & 10 Eliz. 2, c. 17	The Betting Levy Act, 1961,	The whole Act, so far as unrepealed.
9 & 10 Eliz. 2, c. 49	The Covent Garden Market Act, 1961.	Section 47.
10 & 11 Eliz. 2, c. 46	The Transport Act, 1962.	Section 85. In Part I of Schedule 11, the words "section eighty-five" and the words "and the House of Commons Disqualification Act, 1957".
1963 c. 33	The London Government Act, 1963.	Section 92. In section 94, in sub-section (3) the words "and section 92" and the words from "and the repeals" to "Act 1957" and in sub-section (4) the words from the beginning to "said repeals" and the words "other than this sub-section".
1963 c. 38	The Water Resources Act, 1963.	In section 137, in sub-section (2) the words "and paragraph 4 of Schedule 6 thereto" and in sub-section (3) the words "except paragraph 4 of Schedule 6)". In Schedule 6, paragraph 4.
1963 c. 40	The Commonwealth Development Act, 1963.	Section 1(4).
1964 c. 14	The Plant Varieties and Seeds Act, 1964.	In Schedule 4, paragraph 4.
1964 c. 16	The Industrial Training Act, 1964.	Section 15. In section 19 (2) the words "except section 15".
1964 c. 25	The War Damage Act, 1964.	Section 13(4).
1964 c. 40	The Harbours Act, 1964.	In section 63(2) the words "except paragraph 7 of Schedule 1." In Schedule 1, paragraph 7.
1964 c. 42	The Administration of Justice Act, 1964.	In section 41, in sub-section (6), the words from "and so" to "Act 1957" and in sub-section (7) the words from "except" to "Act 1957". In Schedule 3, in Part II, paragraph 23.
1964 c. 56	The Housing Act, 1964.	In section 108(3) the words "except paragraph 2(10) of Schedule 1". In Schedule 1, paragraph 2(10).
1964 c. 98	The Ministers of the Crown Act, 1964.	Section 3. In section 5, sub-sections (1) to (3) Schedule 2.
1965 c. 10	The Superannuation (Amendment) Act, 1965.	In Schedule 1, the entry relating to the House of Commons Disqualification Act, 1957.
1965 c. 14	The Cereals Marketing Act, 1965.	In Schedule 1, paragraph 12.
1965 c. 16	The Airports Authority Act, 1965.	In section 25(2), the words "except paragraph 5 of Schedule 1." In Schedule 1, paragraph 5.
1965 c. 22	The Law Commissions Act, 1965.	Section 6(1).
1965 c. 46	The Highlands and Islands Development (Scotland) Act, 1965.	In section 19(2) the words from "except" to "Act 1957". In Schedule 1, paragraph 6.

1	2	3
1965 c. 6	The National Insurance Act, 1966.	Section 13(2).
1966 c. 8	The National Health Service Act, 1966.	in the Schedule, paragraph 8.
1966 c. 20	The Ministry of Social Security Act, 1966.	In section 48(4) the words "the House of Commons Disqualification Act, 1957". in Schedule 1, paragraph 7. In Schedule 6, paragraph 15.
1966 c. 34	The Industrial Development Act, 1966.	in section 21(6), the words from "except" to "(disqualification)". In section 31(7), paragraph (b) and the words "and" immediately preceding it. In Schedule 3, in Part II, the entry relating to the House of Commons Disqualification Act, 1957.
1967 c. 13	The Parliamentary Commissioner Act, 1967.	Section 1 (4).
1967 c. 17	The Iron and Steel Act, 1967.	Section 1(8). in section 51(2) the words "except section 1(8) (thereof)".
1967 c. 18	The Local Government (Termination of Reviews) Act, 1967.	In section 3(2) the words from the beginning to "Act 1957".
1967 c. 22	The Agriculture Act, 1967.	Section 73.
1967 c. 80	The Criminal Justice Act, 1967.	In Schedule 2, paragraph 3.
1967 c. 86	The Countryside (Scotland) Act, 1967.	Section 1(7). In section 79(2) the words from "except" to "Act 1957".
1968 c. 24	The Commonwealth Telecommunications Act, 1968.	Section 2(d).
1968 c. 41	The Countryside Act, 1968.	Section 1(6). In section 58, sub-section (4) and in sub-section (5) the words "and (4)" and "subject to sub-section (4) above".
1968 c. 65	The Gaming Act, 1968.	Section 10(4). In section 54(2) the words "except section 18(4)".
1968 c. 67	The Medicines Act, 1968.	Section 2(6).
1968 c. 71	The Race Relations Act, 1968.	In section 29(4) the words from "except" to "Act 1957". In Schedule 1, paragraph 12. In Schedule 4, paragraph 8.
1968 c. 73	The Transport Act, 1968.	Section 155. In Schedule 17, in Part I, the words "155" and the words from "and so far" to "Part III".
1969 c. 30	The Town and Country Planning (Scotland) Act, 1969.	In section 108(3), the words from "and except" to "Act 1957".
1969 c. 35	The Transport (London) Act, 1969.	In section 47(4) the words from the beginning to "Act 1957".

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1	2	3
1969 c. 48	The Post Office Act, 1969.	Section 14(20). In Schedule 1, paragraph 6.
1969 c. 51	The Development of Tourism Act, 1969.	Section 1(4). In section 21(4) the words "except section 1(4)".
1970 c. 40	The Agriculture Act, 1970.	In Schedule 1, paragraph 12.
1970 c. 46	The Radiological Protection Act, 1970.	in Schedule 1, paragraph 6.
1970 c. 51	The National Insurance (Old persons' and widows' pensions and attendance allowance) Act, 1970.	In section 10(3), the words "I and" In Schedule 2, in Part 1, paragraph 1.
1971 c. 18	The Land Commission (Dissolution) Act, 1971.	In section 7(3) the words from "except" to "Act 1957".
1971 c. 23	The Courts Act, 1971.	Section 17(5). In section 59(5) and (6), paragraph (b).
1971 c. 58	The Sheriff Courts (Scotland) Act, 1971.	Section 21. In section 47(3) the words from "and section" to "Act 1957".
1971 c. 73	The Social Security Act, 1971.	In section 10(2), the words "I and".
1971 c. 75	The Civil Aviation Act, 1971.	Section 1(5). Section 37(5).
1971 c. 77	The Immigration Act, 1971.	In Schedule 5, paragraphs 4 and 10.
1971 c. 78	The Town and Country Planning Act, 1971.	Section 47(5). In section 29(2) the words from "relates to" to "Act 1957 or".
1972 c. 3	The Ministerial and other Salaries Act, 1972.	In section 1(6) the words from the beginning to the end of paragraph (b) and the words "and" immediately following that paragraph.
1972 c. 41	The Finance Act, 1972.	In Schedule 6, paragraph 8.
1972 c. 52	The Town and Country Planning (Scotland) Act, 1972.	Section 44(5). Section 47(5). In section 28(3) the words from "and relates" to "Act 1957".
1972 c. 54	The British Library Act, 1972.	In the Schedule, paragraph 6.
1972 c. 58	The National Health Service (Scotland) Act, 1972.	Section 42(4). In section 65 (3) and (4) the words "42(4)". In Schedule 1, paragraph 6.
1972 c. 60	The Gas Act, 1972.	In section 50(2) the words from "and the" to "Schedule 8". In Schedule 3, paragraph 4. In Schedule 6, paragraph 7.
1972 c. 62	The Agriculture (Miscellaneous Provisions) Act, 1972.	In section 27(5)(b) the words "to the House of Commons Disqualification Act, 1957".

1	2	3
1972 c. 68	The European Communities Act, 1972.	In Schedule 4, paragraph 5(6).
1972 c. 78	The Local Government Act, 1972.	Section 268. In section 274 in sub-section (2) the words "section 268 above" and the words from "and the repeals" to "that Act" and in sub-section (3) the words from the beginning to "said repeals".
1973 c. 9	The Counter-Inflation Act, 1973.	In Schedule 1, paragraph 9.
1973 c. 32	The National Health Service Reorganisation Act, 1973.	In Schedule 4, paragraph 79 and in paragraphs 147 and 148 the figures "42(4)".
1973 c. 37	The Water Act, 1973.	In section 48, in sub-section (4)(d) the figures "69" and in sub-section (5) the words "and paragraph 69 of Schedule 8" in Schedule 8, paragraph 69.
1973 c. 38	The Social Security Act, 1973.	Section 66 (3). Section 73(5). in Schedule 7, paragraph 2. In Schedule 27, paragraph 18.
1973 c. 39	The Statute Law (Repeals) Act, 1973.	In Schedule 2, paragraph 3.
1973 c. 41	The Fair Trading Act, 1973.	In Schedule 1, paragraph 4.
1973 c. 50	The Employment and Training Act, 1973.	In section 15(3), the figures "4" where it first occurs. in Schedule 3, paragraph 4.
1973 c. 54	The Nature Conservancy Act, 1973.	In section 5(3) the words "and paragraph 19 of schedule 3 also extends to Northern Ireland". In Schedule 3, paragraph 19.
1973 c. 64	The Maplin Development Act, 1973.	In Schedule 1, paragraph 5.
1973 c. 65	The Local Government (Scotland) Act, 1973.	Section 281 (5). Section 224 (5). In section 283(3) the words from "and except" to "Act 1957". In Schedule 4, paragraph 3.
1974 c. 7	The Local Government Act, 1974.	In section 43(6) the words from the beginning to "Act 1957". In Schedule 4, paragraph 12.
1974 c. 21	The Ministers of the Crown Act, 1974.	Section 2. Section 3(1).
1974 c. 24	The Prices Act, 1974.	Section 6(3).
1974 c. 37	The Health and Safety at Work etc. Act, 1974.	In section 84(1)(b), the words "2 and". In Schedule 9, paragraph 2.
1974 c. 47	The Solicitors Act, 1974.	In section 90(4)(c), the words "paragraph 5 of Schedule 3". In Schedule 3, paragraph 5.
1974 c. 48	The Railways Act, 1974.	Section 9(3).
1974 c. 52	The Trade Union and Labour Relations Act, 1974.	In section 31(5), the words "the House of Commons Disqualification Act, 1957". In Schedule 3, paragraph 6.
1957 c. 18	The Social Security (Consequential Provisions) Act, 1957.	In Schedule 2, paragraph 12.

JOINT COMMITTEE TO EXAMINE THE CONSTITUTIONAL AND
LEGAL POSITION RELATING TO OFFICE OF PROFIT

THIRD TERM OF REFERENCE

TO EXAMINE THE FEASIBILITY OF ADOPTION OF SYSTEM OF LAW RELATING TO PREVENTION OF
DISQUALIFICATION OF MEMBERS OF PARLIAMENT AS EXISTING IN THE UNITED KINGDOM AND
CONSIDERED BY THE CONSTITUTION (FORTY-SECOND AMENDMENT) ACT, 1976.

Sl.No.	Name of State	Reintroduction of disqualification provisions as in 42nd Amendment Act	Adoption of the U.K. House of Commons (Disqualification) Act, 1975
1	2	3	4
1.	Andhra Pradesh	In favour of reintroduction, however, the State Government has desired that the guidelines of the Supreme Court be incorporated in it.	Conceptually in favour.
2.	Arunachal Pradesh	No comments offered.	No comments offered.
3.	Assam	Not in favour.	No specific comments offered. However, it can be inferred that the State Government is not in favour of adoption of U.K. Law as it is against reintroduction of 42nd Amendment Act which is on the pattern of U.K. law.
4.	Bihar	Not in favour.	No specific comments. However, it can be inferred that the State Government is not in favour of U.K. Law.
5.	Chhattisgarh	In favour of reintroduction.	No specific comments. However, it can be inferred that the State Government is conceptually in favour of U.K. Law.
6.	Goa		
7.	Gujarat	Not in favour.	Not in favour.
8.	Haryana	Conceptually in favour.	Conceptually in favour.
9.	Himachal Pradesh	No specific comments offered. However, it can be inferred that the State Government is conceptually in favour of reintroduction of disqualification provisions as in 42nd Amendment Act.	In favour.

1	2	3	4
10.	Jammu and Kashmir	-	
11.	Jharkhand		
12.	Karnataka	In favour.	In favour.
13.	Kerala	In favour.	No specific comments offered. However, it can be inferred that the State Government is conceptually in favour of U.K. Law.
14.	Madhya Pradesh		
15.	Maharashtra	Not in favour.	Not required there are adequate provisions in our Constitution and Prevention of Disqualification Act.
16.	Manipur	No comments offered	No comments offered.
17.	Meghalaya	No view offered.	No view offered.
18.	Mizoram	In favour.	In favour.
19.	Nagaland	No need for reintroduction.	No need for adoption.
20.	Orissa		
21.	Punjab	Not in favour.	Not in favour.
22.	Rajasthan	Conceptually in favour.	In favour. But the power to provide exemption under Article 191 should remain with the State Legislature.
23.	Sikkim	No comments offered.	No comments offered.
24.	Tamil Nadu	In favour.	In favour.
25.	Tripura	Not in favour.	No need for adoption.
26.	Uttar Pradesh		
27.	Uttaranchal	In favour.	Conceptually in favour.
28.	West Bengal	No need for reintroduction.	Conceptually not in favour.

JOINT COMMITTEE TO EXAMINE THE CONSTITUTIONAL AND
LEGAL POSITION RELATING TO OFFICE OF PROFIT

FOURTH TERM OF REFERENCE

TO EXAMINE ANY OTHER MATTER INCIDENTAL TO THE ABOVE

Sl.No.	Name of State	Existence of any Committee in State Legislature similar to JCOP in Parliament	Need for designated authority to determine whether a particular Office is an Office of Profit	General views of State Government
1	2	3	4	5
1.	Andhra Pradesh	No such Committee in Andhra Pradesh Legislature.	In favour of having a designated authority in consultation with the Speaker of the Legislative Assembly and the Chairman of the Legislative Council.	State Government has desired to have a Joint Committee on Office of Profit on the lines of Joint Committee in the Parliament.
2.	Arunachal Pradesh	No such Committee in Arunachal Pradesh Legislature.	In favour of designated authority and has proposed constitution of a Commission like that of Election Commission headed by a retired Judge of the Supreme Court or High Court.	No specific view.
3.	Assam	No such Committee in Assam Legislature.	No need for designated authority. Such matters are decided by courts.	Exemption of "Offices of Profit" from disqualification should be left to the State Governments.
4.	Bihar	No such Committee in Bihar Legislature.	No need for designated authority.	Exemption of "Offices of Profit" from disqualification should be left to the State Governments.
5.	Chhattisgarh	No such Committee in Chhattisgarh Legislature.	No other authority required. Courts are sufficient to decide the cases.	Office of Profit must be specifically mentioned in the Schedule of exemption specifying the specific post, exempted from the purview of disqualification leaving no room for the court to interpret.
6.	Goa	-	-	-
7.	Gujarat	No such Committee in Gujarat Legislature.	No need for designated authority. The Central/State Government should consider the case and thereafter decide whether a particular office under the Government is an Office of Profit.	No specific view.

1	2	3	4	5
8. Haryana	No such Committee in Haryana Legislature.	As the Constitution has appropriate provisions in this regard, there is no need for designated authority.		The exercise of legislative powers of exemption of offices should be entirely left to the wisdom of respective Legislatures. If any deviation in law is made in this regard, then it is likely to impair the legislative competence of the Legislature. Further, it will militate against and curtail the legislative powers of the State which is against the principle of federalism in the Constitution which is basic feature of Constitution.
9. Himachal Pradesh	No such Committee.	Not in favour of creating new authority other than the existing ones.		The issue whether a person holds an Office of Profit is required to be interpreted in a realistic manner having regard to the facts and circumstances of each case and relevant statutory provisions. The expression office of profit should be interpreted with the flavour of reality bearing in mind the object for enactment of Article 102(1)(a) and 191(1)(a).
10. Jammu and Kashmir	-		-	-
11. Jharkhand	-		-	-
12. Karnataka	No such Committee in Karnataka Legislature.	No authority other than the existing ones as envisaged in the Constitution is required.		No other view suggested.
13. Kerala	No such Committee in Kerala Legislature.	No view offered.		In matters related to disqualification and scope of term of Office of Profit be restricted to Supreme Court interpretation and guidelines.
14. Madhya Pradesh	-		-	-
15. Maharashtra	No such Committee in Maharashtra Legislature.	No need for designated authority.		In favour of fair and reasonable generic and comprehensive criteria which can be made applicable to all States/UTs as laid down by Supreme Court in Jaya Bachchan's case.
16. Manipur	No such Committee in Manipur Legislature.	Governor of the State should be the designated authority.		No other view suggested.
17. Meghalaya	No such Committee in Meghalaya Legislature.	No need for any such authority as courts are sufficient to decide individual cases.		Present arrangement as in the Constitution be continued.

1	2	3	4	5
18. Mizoram	No such Committee in Mizoram Legislature.	In favour of having a designated authority in respect of post-election cases. Hon'ble Speaker of the Lok Sabha or Hon'ble Chairman of the Rajya Sabha or Hon'ble Speaker of a State Legislature, as the case may be, may be the designated authority for the purpose.	The expression viz. "Other than an office declared by Parliament by law not to disqualify its holder", as occurring in sub-clause (a) of clause (1) of article 102, could rather have been "other than an office declared by Parliament by law not to be the office of profit for the purposes of this clause". Same is for sub-clause (a) of clause (1) of article 191. In that case, the laws contemplated to be made under these articles would confine to declaring the offices which would be no longer the offices of profit irrespective of its holders. As of now, these laws list out and declare those offices which are admittedly the offices of profit but the holders thereof are declared not to be disqualified for no spelt-out reason or justifications given in such laws.	<ul style="list-style-type: none">• The idea of "Office of Profit" in Indian situation has to be abolished;• A member of a Legislature should hold his position as member of that Legislature on full time basis. Doctors, lawyers, actors and other professionals must stop their practice and every member must take a oath in this regard and violation of such oath must be punishable by a huge pecuniary penalty per day by law. The organizations that entertain the members of Legislatures practicing before, or for, them, should also be punished under law.• in place of the existing articles in the Constitution relating to office of profit which need to be scrapped, a Constitutional provision banning all members of Legislatures to take up any other office except the offices in the Legislature like, Speaker, Deputy
19. Nagaland	No such Committee in Nagaland Legislative Assembly	No authority required.		

1	2	3	4	5
				<p>Speaker, Chairman, Deputy Chairman, members of Panel of Chairman, Leader of Opposition, Leaders of Legislature parties, Chairmen of Committees etc. Any addition to this list must be by Constitutional amendment. The list should be applicable both to the members of Parliament and members of State Legislatures. The office of Ministers should, however, be exempted. Any one who holds any other office should be disqualified not for holding office of profit but for holding any other office along with the office of the Legislator that hinders devoted and full-fledged service to the constituents.</p> <ul style="list-style-type: none">• The concept of "remunerative political post" in article 361D should also be abolished along with the idea of Office of Profit.• As anti-defection law is in place which strictly organizes the House on party lines and thereby the Government, any presumption that the office of profit would act as a lure for members to cross floor is simply anachronistic. May be before the advent of the anti-defection law, the presumption would have matured into a fact. The idea of office of profit itself has thus become anachronistic warranting removal from the Constitution.
20. Orissa				
21. Punjab	No such Committee in Punjab Legislature.	If a definition to the term 'Office of Profit' is provided in the Constitution then the designated authority can be the Governor who shall obtain the opinion of the Election Commission and shall act accordingly. (This is the existing system).		Since Office of Profit has not been defined in the Constitution, the State Legislature should decide whether a particular office can be classified as Office of Profit.

1	2	3	4	5
22. Rajasthan	No such Committee in Rajasthan Legislature.	No need for designated authority. Courts are sufficient to decide the cases.	What factors will bring an office within the purview of 'office of profit' may be and should be decided by the representative of people and the decision as to whether the given factors exists in a particular office should be left to the court.	
23. Sikkim	No such Committee in Sikkim Legislature.	Courts are ultimately to decide the case. However, if any other authority is required, it could be manned by a judicial officer of the rank of District Judge at the State level either serving or retired.	Issue of Office of Profit may be governed by the laws framed by different State Governments and Union Parliament from time to time based on the requirements.	
24. Tamil Nadu	No such Committee in Tamil Nadu Legislature.	No need for designated authority as Articles 103 and 192 of the Constitution provides that it should be decided by the President/Governor based on the opinion of the Election Commission. (This is the existing provision)	No other view.	
25. Tripura	No such Committee in Tripura Legislature.	No need for designated authority.	No other view suggested.	
26. Uttar Pradesh	-	-	-	
27. Uttaranchal	No such Committee in Uttaranchal Legislature.	Not in favour of creating new authority. Courts are the best forum which can give decisive opinion.	No specific view.	
28. West Bengal	No such Committee in West Bengal Legislature.	No other authority required. Courts are best to provide decisive opinion on the matter.	No other comments.	

APPENDICES

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APPENDIX I

MOTION

(Moved in Lok Sabha on 17 August, 2006)

"That a Joint Committee of the Houses to be called the Joint Committee to examine the constitutional and legal position relating to Office of Profit be constituted consisting of fifteen members, ten members from this House to be nominated by the Speaker including the Chairperson of the Joint Committee and five members from the Rajya Sabha to be nominated by the Chairman, Rajya Sabha.

2. That the terms of reference of the Joint Committee shall be—

- (i) to examine, in the context of settled interpretation of the expression "Office of Profit" in article 102 of the Constitution and the underlying constitutional principles therein, and to suggest a comprehensive definition of "Office of Profit".
- (ii) to recommend, in relation to "Office of Profit" the evolution of generic and comprehensive criteria which are just, fair and reasonable and can be applied to all States and Union territories;
- (iii) To examine the feasibility of adoption of system of law relating to prevention of disqualification of Members of Parliament as existing in the United Kingdom and considered by the Constitution (Forty-second Amendment) Act, 1976; and
- (iv) to examine any other matter incidental to the above.

3. That in order to constitute a sitting of the Joint Committee, the quorum shall be one-third of the total number of members of the Joint Committee.

4. That the Joint Committee shall make a report to this House by the first day of the last week of the next session of Parliament.

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APPENDIX II

JOINT COMMITTEE TO EXAMINE THE CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF PROFIT

LIST OF PERSONS FROM WHOM WRITTEN MEMORANDA WERE RECEIVED

S.No.	Name/Address
1	2
1.	Shri Rustom S. Gae, Senior Advocate, Former Law Secretary to the Govt. of India, 5-B Sagar Apartments 6, Tilak Marg, New Delhi-110001
2.	Dr. R.K. Balasubramanian, Chief Executive, Bureau for Parliamentary Work, 30, Chitrakulam North, Mylapore, Madras-4
3.	Shri R.R. Singh, Retired Professor and Head (Department of Social Work), Delhi University & Former Director, Tata Institute of Social Sciences
4.	Shri Sitaram Aggrawal, 109-A, Adrash Nagar, Ajmer-305002
5.	Shri Raj Kanwar, R/O Vill. & P.O.-Kohand, Distt. Karnal, Haryana
6.	Shri Ravinder Kumar, President to Rashtriya Mukti Morcha, 37, Angad Nagar Extension, Delhi-110092.
7.	Shri Prosenjit Das Gupta, Flat G2, 206/1 N.S.C. Bose Road, Kolkata-700047

1	2
8.	Shri P. Sakthivel, Shri D. Shanmugam, Dr. S.K. Palanisamy, Shanthi Clinical Laboratory, Kandappa Mudali Lane, Opposite to Telephone Bhavan, Brough Road, Erode-638001
9.	Shri Naved Yar Khan 5182, Ballimaran, Chandni Chowk, Shahjahanabad, Delhi-110006
10.	Shri Ashoke Kr. Singhi, Dr. S.P. Mukherjee Road (Dinbuzar) P.O. & Dist. Jalpaiguri
11.	Shri Harsh Shrivastava, H-26, First Floor, Jangpura Extension, Delhi-110104
12.	Shri Bhanwar Lal Sharma, Near Ramgadiyo Dharamshala, Sujangarh-331507, Distt. Churu (Rajasthan)
13.	Shri Milap Choraria, B-5/52, Sector-7, Rohini, Delhi-110085.
14.	Shri Sudhir Kumar, D-1/115, Satya Marg, Chanakyapuri, New Delhi-110021.
15.	Shri N.H. Badlani, Flat No. 69-B; Pocket-I, Dilshad Garden, Delhi-95.
16.	Sh. N. Haridas, District Judge (Rtd.) T.C. 9/802, V J Lane, Sasthamangalam P.O., Thiruvananthapuram-10
17.	Sh. N.C. Dey, J.P. Road, Ha.udooni, Jamshedpur, Jharkhand-831002,

1	2
18.	Dr. Satyabrata Dutta, C/o Prof. (Dr). S. Sengupta, President, Council for Political Studies, 140/20 B, Soputh Sinthee Road, Kolkata-50
19.	Shri S.N. Shukla, IAS (Retd.) Advocate, General Secretary, Lok Prahari, B-7, Nirala Nagar, Lucknow-226020
20.	Dr. Sivasamy "sivasamy sivasamy" dr sivasamy@yahoo.com
21.	Shri Derrick D'souza, F-1, Jayraj Nagar, Ambadi Road, Vasai (W)-401202
22.	Shri Vidyadhar "Vidyadhar sail" <vidyadhar.sail@gmail.com>
23.	"Vijai Kumar Sahny" <vksahny@hotmail.com>
24.	"Kishen Sharma" <rm_patriotsasia2006@yahoo.co.in>
25.	"Benoy Gopal Chakraborty" <bgchakraborty@hotmail.com>
26.	Dr. (Prof.) Kalipada Basu, "Chiaruprava", 153, Joraghat Lane, Chinsurah-712101 Oistt. Hoogly, West Bengal (India)
27.	Shri Pritis Chandra Majumdar, 1/30 B Chittaranjan Colony, 2nd Floor, Kolkata-700032
28.	Prof. Subhedar Surve, President, Sadguru Sainath Ed. Society (Regd.) Sanchalak—Sai Theater Academy (Mumbai) Vatsala Tai Naik Nagar Primary School, Near Signal, Kurla (E), Mumbai-71 144/4904, Nehru Nagar, Kurla (E) Mumbai-24
29.	Shri Jagdish Prasad Aggrawal, Advocate, Grampost—Chadra, Pin-303509 Tehsil—Sikrai, Dosa Ois. Rajasthan

1	2
30.	Shri Satyanarayan Datta, Advocate, High Court and Supreme Court, 7-B, Kiron Sankar Royroad, 4th Floor, Kolkata-700001
31.	Shri Ganesh Latta, Analyst (Management), Trinetra, Parisamvad Parishad, C-21, Lal Kothi Shopping Centre, Near Laxmi Mandi Cinema, Tonk Road, Jaipur, (Rajasthan)-302015
32.	Shri Paras Singh Bhansali, 672, Sardarpura, 12/C Road, Jodhpur-342003
33.	Shri Prasanta Chouduri, P.O. & P.S.—Tamluk, Ward No. 15, Distt.—Midnapur (E), Pin-721636
34.	Shri Satyaranjan Das, C/o Krishnagopal Smail, Basantia School Bazar, P.O. Basantia, P.S. Contai, Distt. Purba Medinipur (West Bengal)
35.	Shri P. Ranjan Sandhi, Convenor, Forum for protection and promotion of articles 19 &19, St. Martin Road, Palarivattom, Cochin-682025
36.	Shri Debendra Benerji, B6/A, Nilmoni Shome St., Bhadrakali, Hooghly, West Bengal-712232
37.	Shri A. Anadam, Sreeji Appartment, H.No. 10-3-32/9/1/109/110/1, Flat No. G-3, Nehru East Marredpally, Behind Vidyasagar Primary School, Sec'bad, A.P.-500026
38.	Shri Sudha Gouranga Chakrabarti, 92, Khirkee Lane, Chinsurah, Hooghly-712101 (WB)

1	2
39.	Raja Vikram Nair, Raipur (C.G.), "Brijkishor" kishor-ryp@yahoo.com
40.	Shri Ajit Chandra Roy, 50 DD Tewari Road, Fokotalhat, P.O. Nutangani, Distt. Burdwan, West Bengal-713102
41.	Shri Manoj Kumar T., X/1258, Rajgarh Colony, Gandhi Nagar, Delhi-110031
42.	Shri Joganath Das, Puri-BSSR, Orissa
43.	Shri C. Krishnarao Laxmanrao Chinchamatpure, 290/9, Wadia Estate, Bail Bazar, Kurla, Mumbai-400070
44.	Shri Ganesh Bari
45.	Shri Ajay Mathur, Vice-President, Jan-Hit Residents Welfare Association, 1-62-A, Dilshad Garden, Delhi-110095
46.	Shri Ranjit Kumar Hazra, R.G.S. Road, Asansol-3, Vill & P.O. Ushagrani, Distt. Bhrdwar (West Bengal), Pin Code-713303
47.	Shri Kuberan G., 58, Kamarajan Nagar, Padikuppam Salai, Annanagar, West Extension, Chennai-40
48.	Shri J.K. Pathanic/Shri A.K. Gupta, President, Service Institute, Air Force Station, Agra
49.	Shri Kamata Prasad, Teacher (Physics), Village-Alipura, Post Babrai, Distt. Mahoka (Uttar Pradesh)

1	2
50.	Sh. V. Roman Joseph James, OCEANIC-A/22, 2nd Floor, Roshan Park, Naigaon (West), Vasai-401201
51.	Shri Achintya Mahanta, Rampur, Bankura, West Bengal-722101
52.	Shri Raj Kumar Ajmera, 13, Keshav Nagar, Civil Lines, Jaipur, Rajasthan
53.	Sh. S.B.S. Kushwaha, Retd. General Manager, 117, Q/611 A, Sharda Nagar, Kanpur
54.	Sh. V. Veerabhadrappe, 2133, T.G. Extn. Hosakota, Bangalore
55.	Shri Raghu Thakur, National President, Loktantrik Samajwadi Party, 27A, DDA Flats, Mata Sundri Road, New Delhi-110002
56.	Shri Ravi Kumar Mishra, House No. 10844, Gali No. 11, Kotmangal Singh Nagar, Ludhiana-141003 Punjab
57.	Shri Manoj Kumar Jha, Inspector, Central Excise and Customs AF-12/Customs & Central Excise Colony, M.O.G. Lines, Indore-452002, Madhya Pradesh

APPENDIX III

JOINT COMMITTEE TO EXAMINE THE CONSTITUTIONAL AND
LEGAL POSITION RELATING TO OFFICE OF PROFIT

(Witnesses examined)

Sl.No.	Name of Organisation/ Association/Individual	Date on which Evidence was taken	Page No.
1.	Shri Fali S. Nariman Senior Advocate Supreme Court of India and Ex-Member of Rajya Sabha	17.11.2006	
2.	Shri Rustam S. Gae Senior Advocate Supreme Court of India and former Secretary, Ministry of Law & Justice Government of India	-do-	
3.	Shri Rajeev Dhawan Senior Advocate Supreme Court of India	01.12.2006	
4.	Shri Harish N. Salve Senior Advocate Supreme Court of India	-do-	
5.	Representatives of Ministry of Home Affairs, Government of Puducherry and NCT of Delhi	20.03.2007	
6.	Representatives of State Government of Gujarat	23.08.2007	
7.	Representatives of State Governments of North Eastern States	31.10.2007	
8.	Representatives of State Government of Rajasthan	27.11.2007	
9.	Representatives of State Government of Uttar Pradesh	28.04.2008	
10.	Representatives of State Governments of Orissa	05.06.2008	
11.	Representatives of State Government of Madhya Pradesh	20.08.2008	
12.	Representatives of State Government of Kerala	09.09.2008	

APPENDIX IV

MINUTES OF THE FIRST SITTING OF THE JOINT COMMITTEE TO EXAMINE THE
CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF PROFIT

The Joint Committee sat from 1500 hrs. to 1630 hrs. on 14 September, 2006 in Committee Room No. 53, Parliament House, New Delhi.

PRESENT

Shri Iqbal Ahmed Saradgi – *Chairman*

MEMBERS

Lok Sabha

2. Shri V. Kishore Chandra S. Deo
3. Shri Santosh Gangwar
4. Shri A. Krishnaswamy
5. Shri Madhusudan Mistry
6. Shri Mohammad Salim
7. Shri Rajesh Verma

Rajya Sabha

8. Shri Virendra Bhatia
9. Shri Arun Jaitley
10. Shri Ram Jethmalani
11. Shri Sitaram Yechury

SECRETARIAT

- | | | |
|-------------------------|---|--------------------------|
| 1. Shri P.D.T. Achary | – | <i>Secretary-General</i> |
| 2. Shri J.P. Sharma | – | <i>Joint Secretary</i> |
| 3. Shri A. Louis Martin | – | <i>Director</i> |

2. The Joint Committee first held an internal meeting to discuss the programme of work of the Joint Committee. At the outset, the Chairman welcomed the Members of the Joint Committee to examine the constitutional and legal position relating to Office of profit. Then the Committee held discussion among themselves regarding the concept of office of profit.

3. Thereafter the representatives of the Ministry of Law & Justice (Legislative Department) were called in for a briefing. The following officials represented the Ministry:-

Dr. K.N. Chaturvedi	-	Secretary (Legislative Department)
Shri N.L. Meena	-	Joint Secretary and Legislative Counsel

Before the Joint Committee proceeded to hear the views of the representatives of the Ministry, the Chairman drew their attention to the provisions contained in the Direction 58 of the Directions by the Speaker.

4. Thereafter, the representatives of the Ministry briefed the Joint Committee on the subject matter under reference. The Joint Committee sought clarifications on some points and desired that the information on points, which was not readily available with them, might be furnished subsequently to the JPC for their information and use.

The witnesses then withdrew.

5. Thereafter, the Committee after some internal discussion decided that a press communique be issued in all national dailies in English and Hindi inviting memoranda from constitutional/legal experts, academicians, law institutes, Bar Councils, public bodies or individuals on the subject matter under consideration of the JPC.

6. The Committee also decided to seek the views of all the Parliamentary Parties/Groups, constitutional and legal experts and State Governments on the subject and decided to seek the approval of Hon'ble Speaker to invite information from State Governments.

A verbatim record of the proceeding of the Committee was kept.

The Committee then adjourned.

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CONFIDENTIAL

MINUTES OF THE SECOND SITTING OF THE JOINT COMMITTEE TO EXAMINE THE
CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF REPORT

The Joint Committee sat from 1130 hrs. to 1230 hrs. on 19 October, 2006, in Committee Room No. 'B', Parliament House Annexe, New Delhi.

PRESENT

Shri Iqbal Ahmed Saradgi – *Chairman*

MEMBERS

Lok Sabha

2. Shri Santosh Gangwar
3. Shri Madhusudan Mistry
4. Shri Ram Gopal Yadav

Rajya Sabha

5. Shri Ram Jethmalani

SECRETARIAT

1. Shri J.P. Sharma – *Joint Secretary*
2. Shri A. Louis Martin – *Director*

2. At the outset, the Chairman apprised the members of the action taken in pursuance of the decisions taken by the Committee at their first sitting on 14.9.2006. The Committee had decided to issue a Press Communique inviting views/suggestions from the public and also decided to seek the views of all parliamentary parties/experts and State Governments. He informed the Committee that communications were sent to the Chief Secretaries/administrators of all the States/Union Territories, 41 Parliamentary Parties and 25 legal and constitutional experts and that Press Communique was issued in 19 local (Delhi) dailies and 73 regional newspapers and was broadcast/telecast in All India Radio, Doordarshan and Lok Sabha TV Channel and also displayed on website of Lok Sabha.

3. The Chairman further informed the Committee that 56 memoranda were received from public and there were responses from 7 experts viz. (1) Sarvashri P.P. Rao, (2) The Director, Indian Law Institute, (K.N. Chandra Sekharan Pillai), (3) Mahendra Pratap Singh, (4) J.S. Verma, (former Chief Justice of India) (5) Fali S. Nariman, (6) Harish Salve, and (7) Shri Bhanu Pratap Mehta (Centre for Policy Research). There were also responses from the Union territory of Lakshdweep and three Parliamentary Parties namely RJD, NLD and Shiv Sena.

4. Copies of all the memoranda/responses received till then and replies from the Legislative Department of the Ministry of Law and Justice had been circulated to the members of the Committee.

5. The Committee authorized the Chairman to shortlist experts who might be asked to appear before the Committee for oral evidence.

6. Thereafter, the representatives of the Ministry of Law & Justice (Legislative Department) were called in. The following were present:-

Dr. K.N. Chaturvedi	-	Secretary (Legislative Department)
Shri N.L. Menna	-	Joint Secretary and Legislative Counsel

After some discussion, the Committee desired the Ministry to furnish written information on certain points which include meaning of one of the terms of references viz. "to examine in the context of settled interpretation of the expression office of profit" and State-wise list of posts of offices of profit attached with perks and facilities. The Committee directed that State-wise list of offices of profit be collected by 5th November, 2006.

Record of verbatim proceeding kept.

The Committee then adjourned.

CONFIDENTIAL

MINUTES OF THE THIRD SITTING OF THE JOINT COMMITTEE TO EXAMINE THE
CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF REPORT

The Joint Committee sat from 1500 hrs. to 1730 hrs. on Friday, 17 November, 2006 in Committee Room 'D', Parliament House Annexe, New Delhi to have personal hearing of two constitutional/legal experts.

PRESENT

Shri Iqbal Ahmed Saradgi - *Chairman*

MEMBERS

Lok Sabha

2. Shri V. Kishore Chandra S. Deo
3. Shri Santosh Gangwar
4. Dr. Satyanarayan Jatiya
5. Shri Raghunath Jha
6. Shri A. Krishnaswamy
7. Shri Madhusudan Mistry

Rajya Sabha

8. Shri Virendra Bhatia
9. Shri Arun Jaitley
10. Shri Sitaram Yechury

SECRETARIAT

- | | | |
|-------------------------|---|--------------------------|
| 1. Shri P.D.T. Achary | - | <i>Secretary-General</i> |
| 2. Shri J.P. Sharma | - | <i>Joint Secretary</i> |
| 3. Shri A. Louis Martin | - | <i>Director</i> |

2. The Committee first held the hearing of the constitutional/legal expert Shri Fati S. Nariman. At the outset, the Chairman welcomed Shri Nariman and apprised him of Direction 58 of the Directions by the Speaker. Thereafter, the Committee heard views/suggestions of Shri Nariman on the matters under reference to the Committee and held discussion.

The witness then withdrew.

3. Thereafter, Shri Rustom S. Gae, Former Law Secretary and Senior Advocate was called in. The Chairman welcomed him and apprised him of Direction 58 of the Directions by the Speaker. Thereafter, the Committee heard views/suggestions of Shri Gae on the matters under reference to the Committee and held discussions.

A verbatim record of proceedings was kept.

The Committee then adjourned.

MINUTES OF THE FOURTH SITTING OF THE JOINT COMMITTEE TO EXAMINE THE
CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF PROFIT

The Joint Committee sat from 1500 hrs. to 1655 hrs on 1 December, 2006 in Committee Room No. 63, Parliament House, New Delhi to have personal hearing of two constitutional/legal experts.

PRESENT

Shri Iqbal Ahmed Saradgi—*Chairman*

MEMBERS

Lok Sabha

2. Shri V. Kishore Chandra S. Deo
3. Shri Santosh Gangwar
4. Dr. Satyanarayan Jatiya
5. Shri Raghunath Jha

Rajya Sabha

6. Shri Virendra Bhatia
7. Shri Ram Jethmalani
8. Shri Sitaram Yechury

SECRETARIAT

1. Shri J.P. Sharma — *Joint Secretary*
2. Shri A. Louis Martin — *Director*

At the outset, the Joint Committee noted that the current session of Parliament is upto 19 December, 2006 and that the term of the Committee would expire on the first day of the last week of the current session. The Committee observed that views and suggestions were awaited from as many as 24 State Governments/U.T. Administrations and 31 parliamentary parties, whose views are necessary for the JPC to arrive at their recommendations as the criteria that might be evolved by the Committee are applicable to all States and Union Territories. It is after receipt of views from majority of State Governments and political parties, the Committee might complete oral evidences of all concerned. The Committee, therefore felt that it might not be possible for them to complete the work and present their report by the stipulated date and proposed to seek extension of time upto the first day of the last week of the Budget Session, 2007.

3. The Committee felt that the issues regarding criteria in relation to "office of profit" applicable to the States and Union Territories needed to be discussed with State Governments and Union Territories before formulating their views. The Committee, therefore, proposed that subject to extension of their term, approval of Hon'ble Speaker might be sought to undertake study visits to some States/UTs for holding informal discussion with them.

4. The Committee further noted that one of the terms of reference of the Committee is to examine the feasibility of adoption of system of law relating to prevention of disqualification of Members of Parliament as existing in the United Kingdom and considered by the Constitution (Forty-Second Amendment) Act, 1976. The Committee felt that it would be necessary to undertake a study visit to UK and Australia to study their existing laws on the subject before finalising their report.

5. Thereafter, Shri Rajeev Dhavan, Senior Advocate was called in. The Chairman welcomed Shri Rajeev Dhavan and apprised him of the Direction 58 of the Directions by the Speaker. Thereafter, the Committee heard views/suggestions of Shri Dhavan on the matters under reference to the Committee and held discussion.

The witness then withdrew.

6. Thereafter, Shri Harish N. Salve, Senior Advocate was called in. The Chairman welcomed him and apprised him of Direction 58 of the Directions by the Speaker. Then, the Committee heard views/suggestions of Shri Salve on the matters under reference to the Committee and held discussion.

A verbatim record of proceedings was kept.

The Committee then adjourned.

MINUTES OF THE FIFTH SITTING OF THE JOINT COMMITTEE TO EXAMINE THE
CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF PROFIT

The Joint Committee sat from 1500 hrs. to 1600 hrs. on 20 March, 2007 in Committee Room 'A' Parliament House Annexe, New Delhi.

PRESENT

Shri Iqbal Ahmed Saradgi — *Chairman*

MEMBERS

Lok Sabha

2. Shri Santosh Gangwar
3. Shri Raghunath Jha
4. Shri Madhusudan Mistry
5. Shri Mohammad Salim

Rajya Sabha

6. Shri Ram Jethmalani
7. Shri Sitaram Yechury

SECRETARIAT

- | | | |
|----------------------|---|-------------------------|
| 1. Shri J.P. Sharma | — | <i>Joint Secretary</i> |
| 2. Shri R.S. Mishra | — | <i>Director</i> |
| 3. Shri K. Jena | — | <i>Deputy Secretary</i> |
| 4. Shri R.D. Silawat | — | <i>Deputy Secretary</i> |

2. At the outset, the Chairman welcomed the members of the Committee and briefed them about the progress of work done by the Committee since its constitution. He informed the Committee that apart from hearing the views of some of the legal luminaries, the Committee undertook two study visits covering four States namely Maharashtra, Karnataka, West Bengal and Tamil Nadu. The Chairman emphasized the need to visit major remaining States also, as the Committee has to recommend in relation to office of profit, a generic and comprehensive criteria applicable to all States/UTs.

3. Some of the members drew the attention of the Chairman regarding one of the terms of reference of the Committee *i.e.* to examine the feasibility of adoption of system of law relating to prevention of disqualification of members of Parliament existing in the United Kingdom. The

Committee reiterated their earlier decision to undertake study visits to U.K. and Australia to study their laws on the subject in detail.

4. Thereafter, the representatives of Ministry of Home Affairs, NCT of Delhi and Union Territory of Pondicherry were called in. The following were present:

Ministry of Home Affairs

1. Shri Vinay Kumar — Additional Secretary
2. Shri B.A. Coutinho — Joint Secretary

National Capital Territory of Delhi

1. Shri Ramesh Narayanaswami — Chief Secretary
2. Shri B.S. Mathur — Pr. Secy. (Law, Justice and Legislative Affairs)
3. Smt. Shakuntala D. Gamlin — Secretary, GAD
4. Shri Ajay Chagti — Deputy Secretary
(GAD/Services)

Union Territory of Pondicherry

- Shri John Claude Pompei — Law Secretary
Mariadassou

5. The Chairman welcomed the representatives of Ministry of Home Affairs, Union Territory of Pondicherry and NCT of Delhi and drew their attention to the provisions contained in Direction 58 of the Directions by the Speaker. The Committee held discussion with them on the genesis of granting exemption to certain offices under the relevant Acts of Pondicherry and NCT of Delhi. The Committee further desired that note on certain points on which information was not available might be furnished subsequently.

A verbatim record of proceedings was kept.

The Committee then adjourned.

MINUTES OF THE SIXTH SITTING OF THE JOINT COMMITTEE TO EXAMINE THE
CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF PROFIT

The Joint Committee sat from 1500 hrs. to 1530 hrs. on 9 May, 2007 in Committee Room 'E'
Parliament House Annexe, New Delhi.

PRESENT

Shri Iqbal Ahmed Saradgi – *Chairman*

MEMBERS

Lok Sabha

2. Shri V. Kishore Chandra S. Deo
3. Shri Santosh Gangwar
4. Dr. Satyanarayan Jatiya
5. Shri Mohammad Salim

Rajya Sabha

6. Shri Virendra Bhatia

SECRETARIAT

- | | | |
|-----------------------|---|-------------------------|
| 1. Shri J.P. Sharma | – | <i>Joint Secretary</i> |
| 2. Shri R.S. Mishra | – | <i>Director</i> |
| 3. Shri K. Jena | – | <i>Deputy Secretary</i> |
| 4. Shri Kushal Sarkar | – | <i>Under Secretary</i> |

At the outset, the Hon'ble Chairman, Joint Committee to examine the constitutional and legal position relating to office of Profit welcomed the Members of the Committee to the sitting and briefed them about the progress of work done by the Committee since its constitution.

Then, the Hon'ble Chairman apprised the Members about the informal discussions the Committee had with the representatives of the respective State Governments and others during study visits to Mumbai-Bangalore and Kolkata-Chennai during the months of January and February, 2007 respectively. The Members emphasised the need to visit the other remaining major States viz. Rajasthan, Bihar, Uttar Pradesh, Gujarat, Jharkhand, Punjab, Himachal Pradesh, North-Eastern States, etc. which could not be visited by the Committee due to election in Uttar Pradesh and other inevitable reasons, to ascertain their views/suggestions on the subjects under reference besides hearing some more constitutional/legal experts.

Recalling one of the terms of reference of the Committee viz. to examine the feasibility of adoption of system of law relating to prevention of disqualification of Members of Parliament as

existing in the United Kingdom and considered by the Constitution (42nd Amendment) Act, 1976, some of the members desired that the relevant material on the subject might be obtained from Canada, Australia and other countries where parliamentary system of government exist through the Ministry of External Affairs. The Committee also reiterated that the feasibility of visiting U.K. in order to have wide discussion/interaction with House of Commons on the subject may be explored.

In view of the aforementioned voluminous task involved before finalizing their report, the Committee felt that it might not be possible for them to complete the work and present their report by the stipulated date *i.e.* by the first day of the last week of Budget Session, 2007. The Committee, therefore, proposed to seek extension of time for presentation of their report up to the first day of the last week of Monsoon Session, 2007.

The Committee then adjourned.

MINUTES OF THE SEVENTH SITTING OF THE JOINT COMMITTEE TO EXAMINE THE
CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF PROFIT

The Joint Committee sat from 1500 hrs. to 1610 hrs. on 23 August, 2007 in Committee Room
No. 63, Parliament House, New Delhi.

PRESENT

Shri Iqbal Ahmed Saradgi—*Chairman*

MEMBERS

Lok Sabha

2. Shri V. Kishore Chandra S. Deo
3. Shri Santosh Gangwar
4. Shri Madhusudan Mistry
5. Shri Mohammad Salim
6. Prof. Ram Gopal Yadav

Rajya Sabha

7. Shri Virendra Bhatia
8. Shri Arun Jaitley
9. Shri Ram Jethmalani
10. Shri Sitaram Yechury

SECRETARIAT

- | | | |
|-----------------------|---|-------------------------|
| 1. Shri P.K. Grover | — | <i>Joint Secretary</i> |
| 2. Shri R.S. Mishra | — | <i>Director</i> |
| 3. Shri K. Jena | — | <i>Deputy Secretary</i> |
| 4. Shri Kushal Sarkar | — | <i>Under Secretary</i> |

Representatives of State Government of Gujarat

- | | | |
|---------------------|---|---|
| 1. Shri H.D. Vyas | — | Secretary
Department of Legislative and
Parliamentary Affairs |
| 2. Shri I.A. Parmar | — | Joint Secretary
Department of Legislative and
Parliamentary Affairs |

Representatives of Ministry of Law and Justice
(Legislative Department)

- | | | |
|---------------------|---|---|
| 1. Dr. B.A. Agarwal | — | Additional Secretary |
| 2. Shri N.L. Meena | — | Joint Secretary and Legislative Counsel |

2. At the outset, the Chairman welcomed the members of the Joint Committee to examine the constitutional and legal position relating to Office of Profit and apprised them in brief about the work done by the Committee since its constitution. The members thereupon, discussed among themselves on the terms of reference of the Committee and other related issues. The Committee also felt the need to undertake an on-the-spot study visit to North Eastern States to elicit their views on the subject under reference of the JPC.

3. Thereafter the representatives of State Government of Gujarat and the Ministry of Law and Justice (Legislative Department) were called in. Hon'ble Chairman welcomed the representatives to the sitting of the Committee and drew their attention to the provisions contained in Direction 58 of the Directions by the Speaker.

4. Thereafter, the Joint Committee held informal discussions with the representatives of the State Government of Gujarat. The Joint Committee sought clarifications on some points and desired that the information on the points, which were not readily available with them, might be furnished subsequently in writing to the Committee for their information and use.

The witnesses then withdrew.

A verbatim record of the proceedings of the Committee has been kept.

The Committee then adjourned.

MINUTES OF THE EIGHTH SITTING OF THE JOINT COMMITTEE TO EXAMINE THE
CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF PROFIT

The Joint Committee sat from 1500 hrs. to 1530 hrs. on 5 September, 2007 in Committee Room No. 62, Parliament House, New Delhi.

PRESENT

Shri Iqbal Ahmed Saradgi - *Chairman*

MEMBERS

Lok Sabha

2. Shri V. Kishore Chandra S. Deo
3. Shri Santosh Gangwar
4. Shri Raghunath Jha
5. Shri Madhusudan Mistry
6. Prof. Ram Gopal Yadav

Rajya Sabha

7. Shri Virendra Bhatia
8. Shri Arun Jaitley
9. Shri Ram Jethmalani
10. Shri Sitaram Yechury

SECRETARIAT

- | | | |
|-----------------------|---|-------------------------|
| 1. Shri P.K. Grover | - | <i>Joint Secretary</i> |
| 2. Shri R.S. Mishra | - | <i>Director</i> |
| 3. Shri K. Jena | - | <i>Deputy Secretary</i> |
| 4. Shri Kushal Sarkar | - | <i>Under Secretary</i> |

At the outset, the Hon'ble Chairman, Joint Committee to examine the constitutional and legal position relating to Office of Profit welcomed the Members of the Committee to the sitting and briefed them about the progress of work done by the Committee since its constitution. Thereafter, the Committee deliberated over the work done by the Committee particularly the views obtained from constitutional and legal luminaries and suggestions obtained from various States on the terms of reference of the Committee. The Committee desired to visit North-Eastern States and Uttar Pradesh from 25 to 27 October, 2007 to ascertain their views on the terms of reference of the Committee. Some members also emphasized the need to have a sub-Committee for drafting the Report and further deliberation on it.

In view of the aforementioned task involved before finalizing their report, the Committee felt that it might not be possible to complete the work and present the report by the stipulated date i.e. by the first day of the last week of the Monsoon Session, 2007. The Committee, therefore, proposed to seek extension of time for presentation of their report upto last day of Winter Session, 2007.

The Committee then adjourned.

MINUTES OF THE NINTH SITTING OF THE JOINT COMMITTEE TO EXAMINE THE
CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF PROFIT

The Joint Committee sat from 1140 hrs. to 1315 hrs. on 31 October, 2007 in Committee Room 'D' Parliament House Annexe, New Delhi.

PRESENT

Shri Iqbal Ahmed Saradgi—*Chairman*

MEMBERS

Lok Sabha

2. Shri V. Kishore Chandra S. Deo
3. Shri Santosh Gangwar
4. Shri Raghunath Jha
5. Shri Madhusudan Mistry
6. Shri Rajesh Verma
7. Shri Ram Gopal Yadav

Rajya Sabha

8. Shri Ram Jethmalani
9. Shri Sitaram Yechury

SECRETARIAT

1. Shri P.K. Grover — *Joint Secretary*
2. Shri R.S. Mishra — *Director*
3. Shri Kushal Sarkar — *Deputy Secretary*

Representatives of Ministry of Law and Justice (Legislative Department)

1. Shri K.N. Chaturvedi — *Secretary*
2. Shri N.L. Meena — *Joint Secretary*

Representatives of North Eastern State Governments

TRIPURA

- Shri Swapan Chandra Bose — *Law Secretary*

MIZDRAM

- Shri P. Chakraborty — *Secretary,
Parliamentary Affairs Department*

ARUNACHAL PRADESH		
1. Shri K.K. Sharma	-	Chief Secretary
2. Shri C.P. Mansai	-	Secretary (Law and Parliamentary Affairs)
ASSAM		
1. Shri P.C. Sharma	-	Chief Secretary
2. Shri P.K. Chaudhary	-	Principal Secretary Parliamentary Affairs Department
NAGALAND		
Shri R. Kothandaraman	-	Secretary, Parliamentary Affairs Department
MANIPUR		
Shri Saichhuana	-	Additional Chief Secretary
SIKKIM		
Shri R.K. Purukayastha	-	Secretary, Parliamentary Affairs Department
MEGHALAYA		
Shri L.M. Sangam	-	Joint Secretary, Parliamentary Affairs Department

At the outset, the Chairman, JPC welcomed the members of the Joint Committee to examine the constitutional and legal position relating to office of profit and apprised them about the reasons for postponement of the study visit of the JPC to Guwahati fixed for 25 and 26 October, 2007. Further, the Committee reiterated the need to visit some of the States viz. Uttar Pradesh, Madhya Pradesh and Bihar etc., to obtain their views and suggestion on the terms of reference of the Committee before finalizing their report. The Committee also deliberated among themselves the need to draw and discuss threadbare terms of reference-wise views/suggestions received from various quarters to arrive at their conclusions. In view of the above task involved before finalizing their report, the Committee felt that it might not be possible for them to complete the work and present their report by the stipulated date i.e. by the last day of winter Session, 2007 keeping in view the fact that the ensuing Winter Session, 2007 may be for a short duration. The Committee, therefore, proposed to seek another extension of time for presentation of their report upto the first day of the last week of Budget Session, 2008.

Thereafter, the representatives of the North Eastern State Governments were called in. Before the Joint Committee proceeded to hear the views of the representatives of the North Eastern State Governments, the Chairman drew their attention to the provisions contained in Direction S8 of the Directions by the Speaker.

Thereafter, the Committee heard the views of the representatives of the North Eastern State Governments and sought clarifications on some points and desired that the information on points, which was not readily available with them, might be furnished subsequently to the JPC for their information and use.

The witnesses then withdrew.

Verbatim proceeding of the sitting have been kept on record.

The Committee then adjourned.

MINUTES OF THE TENTH SITTING OF THE JOINT COMMITTEE TO EXAMINE THE
CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF PROFIT

The Joint Committee sat from 1505 hrs. to 1535 hrs. on 27 November, 2007 in Committee Room 'O', Parliament House Annexe, New Delhi.

PRESENT

Shri Iqbal Ahmed Saradgi – *Chairman*

MEMBERS

Lok Sabha

2. Shri Santosh Gangwar

Rajya Sabha

3. Shri Ram Jethmalani

4. Shri Sitaram Yechury

SECRETARIAT

- | | | |
|-----------------------|---|-------------------------|
| 1. Shri P.K. Grover | – | <i>Joint Secretary</i> |
| 2. Shri R.S. Mishra | – | <i>Director</i> |
| 3. Shri K. Jena | – | <i>Deputy Secretary</i> |
| 4. Shri Kushal Sarkar | – | <i>Deputy Secretary</i> |

Representatives of Ministry of Law and Justice
(Legislative Department)

- | | | |
|-------------------------|---|-----------------|
| 1. Shri K.N. Chaturvedi | – | Secretary |
| 2. Shri N.L. Meena | – | Joint Secretary |

Representatives of Government of Rajasthan

- | | | |
|-------------------------|---|----------------------------|
| 1. Shri A.K. Pande | – | Additional Chief Secretary |
| 2. Shri Mahesh Bhagwati | – | Law Secretary |

At the outset, the Chairman, Joint Committee to examine the constitutional and legal position relating to Office of Profit welcomed the members to the sitting of the JPC. Thereafter, the representatives of the Government of Rajasthan were called in. Before the Joint Committee proceeded to hear the views of the representatives of the State Government of Rajasthan, the Chairman drew their attention to the provisions contained in Direction 58 of the Directions by the Speaker.

Then, the Committee heard the views of the representatives of the State Government of Rajasthan and sought clarifications on some points and desired that the information on points, which was not readily available with them, might be furnished subsequently to the JPC for their information and use.

The witnesses then withdrew.

Verbatim proceedings of the sitting have been kept on record.

The Committee then adjourned.

MINUTES OF THE ELEVENTH SITTING OF THE JOINT COMMITTEE TO EXAMINE THE
CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF PROFIT

The Joint Committee sat from 1510 hrs. to 1615 hrs. on 28 April, 2008, in Committee Room 'C', Parliament House Annexe, New Delhi.

PRESENT

Shri Iqbal Ahmed Saradgi—*Chairman*

MEMBERS

Lok Sabha

2. Shri V. Kishore Chandra S. Deo
3. Shri Santosh Gangwar
4. Shri Madhusudan Mistry
5. Shri Mohammad Salim

SECRETARIAT

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|-----------------------|---|-------------------------|
| 1. Shri P.K. Grover | — | <i>Joint Secretary</i> |
| 2. Shri R.S. Mishra | — | <i>Director</i> |
| 3. Shri Kushal Sarkar | — | <i>Deputy Secretary</i> |

Representatives of Ministry of Law and Justice (Legislative Department)

- | | | |
|-----------------|---|-----------------------------|
| Shri N.L. Meena | — | <i>Additional Secretary</i> |
|-----------------|---|-----------------------------|

Representatives of State Government of Uttar Pradesh

- | | | |
|--------------------------|---|---|
| 1. Shri P.K. Mishra | — | <i>Chief Secretary</i> |
| 2. Shri Pradeep Dubey | — | <i>Secretary, Parliamentary Affairs</i> |
| 3. Shri Atul Kumar Gupta | — | <i>Commissioner, Industrial Development</i> |

2. At the outset, the Chairman, Joint Committee to examine the constitutional and legal position relating to Office of Profit welcomed the members to the sitting of the JPC. Thereafter, the representatives of the Government of Uttar Pradesh were called in. Before the Joint Committee proceeded to hear the views of the representatives of the State Government of Uttar Pradesh, the Chairman drew their attention to the provisions contained in Direction 58 of the Directions by the Speaker.

3. Then, the Committee heard the views of the representatives of the State Government of Uttar Pradesh and sought clarifications on some points. The main points discussed during the

meeting were the desirability of evolving a uniform criteria and definition for the 'office of profit' applicable uniformly to all States; the criteria followed for exempting certain offices from the purview of 'office of profit' in the State of U.P.; the need for the public representatives to be associated with the developmental process. The Committee desired that the information on points, which was not readily available with the witnesses, might be furnished subsequently to the JPC for their information and use.

4. The witnesses then withdrew.

5. Verbatim proceedings of the sitting have been kept on record.

6. Thereafter, the Committee held discussion among themselves. Hon'ble Chairman apprised the Committee that replies from most of the States/UT Governments have been received. However, out of 41 political parties/groups which were asked to give their considered views on the reference of the Committee, replies from only 14 parties/groups had been received. The Committee felt that it is after receipt of views from the remaining States and Political Parties that the Committee would be able to complete their examination of the subject. Thereafter, the Committee would hold discussion with the administrative Ministry i.e. Ministry of Law and Justice (Legislative Department) to elicit their views/clarifications on the various points raised by the States/U.T. Governments and others. Thereafter, the Committee would hold sittings to have detailed discussion among themselves on the views so received from various quarters to arrive at their conclusions.

7. In view of the above, the Committee felt that it would not be possible for them to complete the task before them and present the Report by the stipulated time i.e. last day of the Budget Session, 2008. The Committee, therefore, decided to seek extension of time for presentation of the report upto the last day of the Monsoon Session, 2008.

The Committee then adjourned.

**MINUTES OF THE TWELFTH SITTING OF THE JOINT COMMITTEE TO EXAMINE THE
CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF PROFIT**

The Joint Committee sat from 1110 hrs. to 1245 hrs. on 5 June, 2008 in Committee Room No. 62, Parliament House, New Delhi.

PRESENT

Shri Iqbal Ahmed Saradgi—Chairman

MEMBERS

Lok Sabha

2. Shri V. Kishore Chandra S. Deo

Rajya Sabha

3. Shri Abhishek Manu Singhvi

SECRETARIAT

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|----------------------|---|-------------------------|
| 1. Shri R.S. Misra | — | <i>Director</i> |
| 2. Shri Kusal Sarkar | — | <i>Deputy Secretary</i> |

Representatives of Ministry of Law & Justice (Legislative Department)

- | | | |
|--------------------|---|-----------------------------|
| 1. Shri K.D. Singh | — | <i>Secretary</i> |
| 2. Shri N.L. Meena | — | <i>Additional Secretary</i> |

Representatives of State Government of Chhattisgarh

- | | | |
|------------------------|---|----------------------------|
| 1. Shri R.S. Sharma | — | <i>Law Secretary</i> |
| 2. Shri A.K. Samantray | — | <i>Addl. Law Secretary</i> |

Representatives of State Government of Orissa

- | | | |
|--------------------|---|--|
| 1. Shri B.K. Nayak | — | <i>Principal Law Secretary</i> |
| 2. Shri K.C. Patra | — | <i>Joint Secretary, Party. Affairs</i> |
| 3. Shri S.K. Panda | — | <i>Joint Resident Commissioner</i> |

2. At the outset, the Chairman, Joint Committee to examine the constitutional and legal position relating to Office of Profit welcomed the members to the sitting of the JPC. Thereafter, the representatives of the Government of Chhattisgarh were called in. Before the Joint Committee proceeded to hear the views of the representatives of the State Government of Chhattisgarh, the Chairman drew their attention to the provisions contained in Direction 58 of the Directions by the Speaker.

3. Then, the Committee heard the views of the representatives of the State Government of Chhattisgarh and sought clarifications on some points. The main points discussed during the meeting were the desirability of evolving a uniform criteria in relation to office of profit which can be applied to all States and Union Territories; feasibility of adoption of system of law as existing in United Kingdom; definition of 'office of profit' and the criteria followed for exempting certain offices from the purview of office of profit in the State of Chhattisgarh. The Committee desired that the information on points, which was not readily available with the witnesses might be furnished subsequently to the JPC for their information and use.

4. The witnesses then withdrew.

5. Thereafter, the representatives of Government of Orissa were called in. The Joint Committee held informal discussions with the representatives of the State Governments of Orissa on matters under reference of the JPC. The main points on which the JPC sought views of the officials of the State Government of Orissa were the need to evolve generic and comprehensive criteria applicable to all States and Union Territories; the need for public representatives to be associated with the developmental activities; the need to evolve suggestive general guidelines/principles to declare an office/post to be an 'office of profit'; the feasibility of adoption of United Kingdom law on the subject; conflict between duty and interest of members holding two offices simultaneously. The Committee sought clarifications on some points and desired that the information on the points, which were not readily available with the witnesses, might be furnished subsequently in writing to the Committee for their information and use.

The witnesses then withdrew.

Verbatim proceedings of the sitting have been kept on record.

6. Thereafter, the Committee held discussions among themselves. The Committee felt the need to visit Dehradun in the month of June, 08 to hold discussion with the officials of the State Government of Uttarakhand to ascertain their views on matters under reference of the JPC.

The Committee then adjourned.

MINUTES OF THE THIRTEENTH SITTING OF THE JOINT COMMITTEE TO EXAMINE THE
CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF PROFIT

The Joint Committee sat from 1500 hrs. to 1545 hrs. on 20 August, 2008 in Committee Room 'D', Parliament House Annexe, New Delhi.

PRESENT

Shri Iqbal Ahmed Saradgi—*Chairman*

MEMBERS

Lok Sabha

2. Shri Santosh Gangwar
3. Shri A. Krishnaswamy
4. Shri Madhusudan Mistry
5. Shri Mohammad Salim

Rajya Sabha

6. Shri Sitaram Yechury

SECRETARIAT

1. Shri P.K. Grover — *Joint Secretary*
2. Shri Kusal Sarkar — *Deputy Secretary-II*

Representatives of Ministry of Law & Justice
(Legislative Department)

- Shri K.D. Singh — Secretary
Shri N.L. Meena — Additional Secretary

Representatives of State Government of Madhya Pradesh

- Shri Rakesh Sahni — Chief Secretary
Shri Dilip Mehra — Principal Secretary, Parliamentary Affairs Department
Shri Naresh Kumar Gupta — Principal Secretary, Law & Legislative Affairs Department

2. At the outset, the Chairman, Joint Committee to examine the constitutional and legal position relating to Office of Profit welcomed the members to the sitting of the JPC. Thereafter, the representatives of the Government of Madhya Pradesh were called in. Before the

Joint Committee proceeded to hear the views of the representatives of the State Government of Madhya Pradesh, the Chairman drew their attention to the provisions contained in Direction 58 of the Directions by the Speaker.

3. Then, the Committee heard the views of the representatives of the State Government of Madhya Pradesh and sought clarifications on some points. The main points discussed during the meeting were the feasibility of definition of 'offices of profit' and the Criteria followed for exempting certain offices from the purview of 'office of profit' in the State of Madhya Pradesh; feasibility of adoption of system of law as existing in United Kingdom; desirability of evolving a uniform criteria in relation to office of profit which can be applied to all States and Union Territories; The Committee desired that the information on points, which was not readily available with the witnesses, might be furnished subsequently to the JPC for their information and use.

The witnesses then withdrew.

Verbatim proceedings of the sitting have been kept on record.

The Committee then adjourned.

MINUTES OF THE FOURTEENTH SITTING OF THE JOINT COMMITTEE TO EXAMINE THE
CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF PROFIT

The Joint Committee sat from 1500 hrs. to 1530 hrs. on 9 September, 2008 in Committee Room '8' Parliament House Annexe, New Delhi.

MEMBERS

Shri V. Kishore Chandra S. Deo—*Acting Chairman*

Lok Sabha

2. Shri Ganesh Prasad Yadav
3. Shri Madhusudan Mistry
4. Shri Rajesh Verma

Rajya Sabha

5. Shri Sitaram Yechury

SECRETARIAT

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|----------------------|---|----------------------------|
| 1. Shri P.K. Grover | — | <i>Joint Secretary</i> |
| 2. Shri R.S. Mishra | — | <i>Director</i> |
| 3. Shri Kusal Sarkar | — | <i>Deputy Secretary-II</i> |

Representatives of Ministry of Law & Justice
(Legislative Department)

- | | | |
|------------------------|---|---------------------------------------|
| Shri T.K. Vishwanathan | — | Secretary |
| Shri S.R. Dhaleta | — | Joint Secretary & Legislative Counsel |

Representatives of State Government of Kerala

- | | | |
|------------------------|---|---|
| Smt. Neela Gangadharan | — | Additional Chief Secretary, Parliamentary Affairs
Department, Government of Kerala |
| Shri B.R. Mohan Kumar | — | Law Officer |

2. In the absence of the Chairman, the Committee chose Shri V. Kishore Chandra S. Deo, to act as Chairman under rule 258(3) of the Rules of Procedure and Conduct of Business in Lok Sabha.

3. At the outset, the Chairman welcomed the members to the sitting of the JPC. Thereafter, the representatives of the State Government of Kerala were called in. Before the Joint Committee proceeded to hear the views of the representatives of the State Government of Kerala, the

Chairman drew their attention to the provisions contained in Direction 58 of the Directions by the Speaker.

4. Then, the Committee heard the views of the representatives of the State Government of Kerala and sought clarifications on some points.

5. The main points discussed during the meeting were the criterion being followed for granting exemption from disqualification and the factors other than remuneration being considered for giving exemptions by the State Government of Kerala; need for evolving a uniform criteria in relation to office of profit which can be applied to all States/UTs; feasibility of definition of office of profit; and providing for an enabling provision in the Constitution for exercising an option by an elected member to resign from an office in the event of the office he is holding being determined to be an office of profit. The information on some of the points was not available with the witnesses. The Committee, therefore, desired that the information as asked for during the discussion might be furnished subsequently by the State Government of Kerala to the JPC for their information and use.

The witnesses then withdrew.

Verbatim proceedings of the sitting have been kept on record.

The Committee then adjourned.

MINUTES OF THE FIFTEENTH SITTING OF THE JOINT COMMITTEE TO EXAMINE THE
CONSTITUTIONAL AND LEGAL POSITION RELATING TO OFFICE OF PROFIT

The Joint Committee sat from 1510 hrs. to 1600 hrs. on 16 December, 2008 in Committee Room No. '62' Parliament House, New Delhi.

Shri Iqbal Ahmed Saradgi - *Chairman*

MEMBERS

Lok Sabha

2. Shri V. Kishore Chandra S. Oeo
3. Shri Santosh Gangwar
4. Dr. Satyanarayan Jatiya
5. Shri Ganesh Prasad Singh
6. Shri Madhusudan Mistry
7. Shri Mohammad Salim

Rajya Sabha

8. Shri Virendra Bhatia
9. Shri Arun Jaitley
10. Shri Ram Jethmalani
11. Shri Sitaram Yechury

SECRETARIAT

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|----------------------|---|----------------------------|
| 1. Shri P.K. Grover | - | <i>Joint Secretary</i> |
| 2. Shri R.S. Mishra | - | <i>Director</i> |
| 3. Shri Kusal Sarkar | - | <i>Deputy Secretary-II</i> |

2. At the outset, the Hon'ble Chairman, welcomed the members of the Joint Committee to examine the constitutional and legal position relating to office of profit to the sitting.

3. The Committee then considered and adopted the draft report with minor modifications.

4. The Committee authorized the Chairman to present the report and lay the record of evidence on the Table of the House.

5. The Committee decided that two sets of memoranda containing comments/suggestions received by the Committee might be placed in Parliamentary Library, after the Report has been presented, for reference by the Members of Parliament.

6. The Committee also placed on record their deep appreciation of the hard work done and valuable assistance rendered by the officers and staff of the Lok Sabha Secretariat to facilitate the work of the Committee.

7. The Chairman while associating himself in thanking the above mentioned officers, also thanked the members of the Committee for extending their full cooperation to him in conducting the proceedings of the Committee in a most congenial atmosphere.

8. The members of the Committee also placed on record their high appreciation and thanks to the Chairman (Shri Iqbal Ahmed Saradgi) for very ably and impartially conducting the proceedings of the Committee and guiding their deliberations.

The Committee then adjourned.

CORRIGENDA

Page No.	Para	for	read
26 (line 14 from above)	1.72	rewarded	rewarded
68 (line 10 from below)	48	Other exemptions suggested in the Act	Other exemptions suggested in the Parliament (Prevention of Disqualification) Act, 1959

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Thirteenth Finance Commission

2010-2015

Volume I: Report



December 2009

CHAPTER 1

Summary of Recommendations

Finances of Union and States

1. The Ministry of Finance (MoF) should ensure that the finance accounts fully reflect the collections under cesses and surcharges as per the relevant heads, so that there are no inconsistencies between the amounts released to states in any year and the respective percentage shares in net central taxes recommended by the Finance Commission for that year.

(Para 4.33)

2. The states need to address the problem of losses in the power sector in a time-bound manner.

(Para 4.38)

3. Initiatives should be taken to reduce the number of Centrally Sponsored Schemes (CSS) and to restore the predominance of formula-based plan transfers.

(Para 4.56)

4. A calibrated exit strategy from the expansionary fiscal stance of 2008-09 and 2009-10 should be the main agenda of the Centre.

(Para 4.62)

Goods and Services Tax

5. Both the Centre and the states should conclude a 'Grand Bargain' to implement the Model GST. The Grand Bargain comprises six elements:

- i) The design of the Model GST is suggested in paras 5.25 to 5.35.

- ii) The operational modalities are outlined in paras 5.36 to 5.41.

- iii) The proposed agreement between the Centre and states, with contingencies for changes, is in paras 5.49 to 5.51.

- iv) The disincentives for non-compliance are described in Para 5.52.

- v) The implementation schedule is described in paras 5.57 to 5.59.

- vi) The procedure for claiming compensation is in Para 5.60.

(Para 5.48)

6. Any GST model adopted must be consistent with all the elements of the Grand Bargain. To incentivise implementation of the Grand Bargain, this Commission recommends sanction of a grant of Rs. 50,000 crore. The grant would be used to meet the compensation claims of State Governments for revenue losses on account of implementation of GST between 2010-11 and 2014-15, consistent with the Grand Bargain. Unspent balances in this pool would be distributed amongst all the states, as per the devolution formula, on 1 January 2015.

(paras 5.54 and 5.55)

7. The Empowered Committee of State Finance Ministers (EC) should be transformed into a statutory council. The compensation should be disbursed in quarterly instalments on the basis of the recommendations by a three-member Compensation Committee comprising of the Secretary, Department of

Thirteenth Finance Commission

Revenue, Government of India; Secretary to the RC and chaired by an eminent person with experience in public finance.

(Para 5.60)

8. In the unlikely event that a consensus with regard to implementing all the elements of the Grand Bargain cannot be achieved and the GST mechanism finally adopted is different from the Model GST suggested by us, this Commission recommends that this amount of Rs. 50,000 crore shall not be disbursed.

(Para 5.62)

9. The states should take steps to reduce the transit time of cargo vehicles crossing their borders by combining checkpoints with adjoining states and adopting user-friendly options like electronically issued passes for transit traffic.

(Para 5.47)

Union Finances

10. The policy regarding use of proceeds from disinvestment needs to be liberalised to also include capital expenditure on critical infrastructure and the environment.

(Para 6.46)

11. Records of landholdings of PSUs need to be properly maintained to ensure that this scarce resource is put to productive use, or made available for other public projects, or else, sold.

(Para 6.48)

State Finances

12. The practice of diverting plan assistance to meet non-plan needs of special category states should be discontinued.

(Para 7.79)

13. With reference to public sector undertakings:

- i) All states should endeavour to ensure clearance of the accounts of all their Public Sector Undertakings (PSUs).

(Para 7.95)

- ii) The states should use the flexibility provided by the Comptroller and Auditor General (C&AG) to clear the backlog of PSU accounts.

(Para 7.95)

- iii) All states need to draw up a roadmap for closure of non-working PSUs by March 2011. Divestment and privatisation of PSUs should be considered and actively pursued.

(paras 7.95 and 7.97)

- iv) The Ministry of Corporate Affairs should closely monitor the compliance of state and central PSUs with their statutory obligations.

(Para 7.95)

- v) A task force may be constituted to design a suitable strategy for disinvestment/privatisation and oversee the process. A Standing Committee on restructuring may be constituted under the chairmanship of the Chief Secretary to operationalise the recommendations of the task force. An independent technical secretariat may be set up to advise the finance departments in states on restructuring/disinvestment proposals.

(Para 7.98)

14. With reference to the power sector:

- i) Reduction of Transmission and Distribution (T&D) losses should be attempted through metering, feeder separation, introduction of High Voltage Distribution Systems (HVDS), metering of distribution transformers and strict anti-theft measures. Distribution franchising and Electricity Services Company (ESCO)-based structures should be considered for efficiency improvement.

(Para 7.114)

- ii) Unbundling needs to be carried out on priority basis and open access to transmission strengthened. Governance should be improved through State Load

Chapter 1: Summary of Recommendations

- Dispatch Centres (SLDCs) and this function should eventually be made autonomous.
(Para 7.116)
- iii) Proper systems should be put in place to avoid delays in completion of hydro projects.
(Para 7.117)
- iv) Instead of putting up thermal power plants in locations remote from sources of coal, states should consider joint ventures (JVs) in or near the coal-rich states.
(Para 7.119)
- v) Case 1 bid process should be extensively used to avoid vulnerability to high-cost purchases during peak demand periods.
(Para 7.120)
- vi) Regulatory institutions should be strengthened through capacity building, consumer education and tariff reforms like Multi Year Tariff (MYT). Best practices of corporate governance should be introduced in power utilities.
(Para 7.121)
15. Migration to the New Pension Scheme needs to be completed at the earliest.
(Para 7.122)
16. States with large cash balances should make efforts towards utilising these before resorting to fresh borrowings.
(Para 7.127)
17. With reference to accounting reforms:
- i) The Government of India (GoI) should ensure uniformity in the budgetary classification code across all states. The list of appendices to the finance accounts of states also needs to be standardised.
(paras 7.129 and 7.134)
- ii) Details of contra-entries as well as the summary of transactions between the public account and the consolidated fund should be provided as a separate annex to the finance accounts of the states.
(Para 7.131)
- iii) Public expenditure through creation of funds outside the consolidated fund of the states needs to be discouraged. Expenditure through such funds and from civil deposits should be brought under the audit jurisdiction of the C&AG.
(paras 7.132 and 7.133)
- iv) The following statements need to be provided with the finance accounts of states:
- a) Comprehensive data on all subsidies.
(Para 7.135)
- b) Consolidated information on the number of employees at each level, along with the commitment on salary. This statement should also include information on employees and their salary where such expenditure is shown as grants or booked under other expenditure.
(Para 7.136 & 7.137)
- c) Details of maintenance expenditure.
(Para 7.138)

Sharing of Union Tax Revenues

18. The share of states in net proceeds of shareable central taxes shall be 32 per cent in each of the financial years from 2010-11 to 2014-15. Under the Additional Duties of Excise (Goods of Special Importance) Act, 1957, all goods were exempted from payment of duty from 1 March 2006. Following this, the Centre had adjusted the basic duties of excise on sugar and tobacco products. In view of these developments, the states' share in the net proceeds of shareable central taxes shall remain unchanged at 32 per cent, even in the event of states levying sales tax (or

Thirteenth Finance Commission

Value Added Tax (VAT) on these commodities.

(paras 8.17 and 8.18)

19. In the event of notification of the 88th Amendment to the Constitution and enactment of any legislation following such notification, it should be ensured that the revenue accruing to a state under the legislation should not be less than the share that would accrue to it, had the entire service tax been part of the shareable pool of central taxes.
(Para 8.19)
20. The Central Government should review the levy of cesses and surcharges with a view to reducing their share in its gross tax revenue.
(Para 8.20)
21. The indicative ceiling on overall transfers to states on the revenue account may be set at 39.5 per cent of gross revenue receipts of the Centre.
(Para 8.21)
22. The share of each state in the net proceeds of all shareable central taxes in each of the financial years from 2010-11 to 2014-15 shall be as specified in Table 1.1:
(paras 8.38 and 8.39)

Table 1.1: Inter se Shares of States

States	Share of all Shareable Taxes Excluding Service Tax (per cent)	Share of Service Tax (per cent)
Andhra Pradesh	6.937	7.047
Arunachal Pradesh	0.328	1.332
Assam	3.628	3.885
Bihar	10.917	11.084
Chhattisgarh	2.471	2.509
Goa	0.266	0.270
Gujarat	3.041	3.089
Haryana	1.043	1.064
Himachal Pradesh	0.781	0.793
Jammu & Kashmir	1.551	nil
Jharkhand	2.802	2.846
Karnataka	4.328	4.397
Kerala	2.341	2.378
Madhya Pradesh	7.121	7.232
Maharashtra	5.299	5.281
Manipur	0.451	0.458
Meghalaya	0.418	0.415
Mizoram	0.269	0.273
Nagaland	0.314	0.318
Orissa	4.779	4.855
Punjab	1.389	1.411
Rajasthan	5.853	5.945
Sikkim	0.239	0.243
Tamil Nadu	4.969	5.047
Tripura	0.311	0.314
Uttar Pradesh	19.677	19.987
Uttarakhand	1.120	1.138
West Bengal	7.264	7.374
All States	100.000	100.000

less than 25 per cent of GDP, by 2014-15.

(paras 9.29 and 9.69, Table 9.7)

Revised Roadmap for Fiscal Consolidation

23. The revenue deficit of the Centre needs to be progressively reduced and eliminated, followed by emergence of a revenue surplus by 2014-15.
(paras 9.13 and 9.31)
24. A target of 68 per cent of GDP for the combined debt of the Centre and states should be achieved by 2014-15. The fiscal consolidation path embodies steady reduction in the augmented debt stock of the Centre to 45 per cent of GDP by 2014-15, and of the states to less than 25 per cent of GDP, by 2014-15.
(paras 9.29 and 9.69, Table 9.7)
25. The Medium Term Fiscal Plan (MTFP) should be reformed and made a statement of commitment rather than a statement of intent. Tighter integration is required between the multi-year framework provided by MTFP and the annual budget exercise.
(Para 9.38)
26. The following disclosures should be made along with the annual Central Budget/MTFP:
- i) Detailed breakup of grants to states under the overall category of non-plan and plan grants.
(Para 9.41)

Chapter 1: Summary of Recommendations

- ii) Statement on tax expenditure to be systematised and the methodology to be made explicit.
(Para 9.42)
 - iii) Compliance costs of major tax proposals to be reported.
(Para 9.43)
 - iv) Revenue Consequences of Capital Expenditure (RCCE) to be projected in MTFP.
(Para 9.45)
 - v) Fiscal impact of major policy changes to be incorporated in MTFP.
(Para 9.46)
 - vi) Public Private Partnership (PPP) liabilities to be reported along with MTFP.
(paras 9.48 and 9.49)
 - vii) MTFP to make explicit the values of parameters underlying projections for receipts and expenditure and the band within which they can vary while remaining consistent with targets.
(Para 9.61)
27. Transfer of disinvestment receipts to the public account to be discontinued and all disinvestment receipts be maintained in the consolidated fund.
(Para 9.52)
28. GoI should list all public sector enterprises that yield a lower rate of return on assets than a norm to be decided by an expert committee.
(Para 9.52)
29. The FRBM Act needs to specify the nature of shocks that would require a relaxation of FRBM targets.
(Para 9.62)
30. In case of macroeconomic shocks, instead of relaxing the states' borrowing limits and letting them borrow more, the Centre should borrow and devolve the resources using the Finance Commission tax devolution formula for *inter se* distribution between states.
(Para 9.63)
31. Structural shocks such as arrears arising out of Pay Commission awards should be avoided by, in the case of arrears, making the pay award commence from the date on which it is accepted.
(Para 9.64)
32. An independent review mechanism should be set-up by the Centre to evaluate its fiscal reform process. The independent review mechanism should evolve into a fiscal council with legislative backing over time.
(paras 9.65 and 9.66)
33. Given the exceptional circumstances of 2008-09 and 2009-10, the fiscal consolidation process of the states was disrupted. It is expected that states would be able to get back to their fiscal correction path by 2011-12, allowing for a year of adjustment in 2010-11.
- i) States that incurred zero revenue deficit or achieved revenue surplus in 2007-08 should eliminate revenue deficit by 2011-12 and maintain revenue balance or attain a surplus thereafter. Other states should eliminate revenue deficit by 2014-15.
(paras 9.69 to 9.72)
 - ii) The General Category States that attained zero revenue deficit or a revenue surplus in 2007-08 should achieve a fiscal deficit of 3 per cent of Gross State Domestic Product (GSDP) by 2011-12 and maintain such thereafter. Other general category states need to achieve 3 per cent fiscal deficit by 2013-14.
(paras 9.74 to 9.76, Table 9.5)
 - iii) All special category states with basic fiscal deficit of less than 3 per cent of GSDP in 2007-08 could incur a fiscal deficit of 3 per cent in 2011-12 and

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maintain it thereafter. Manipur, Nagaland, Sikkim and Uttarakhand to reduce their fiscal deficit to 3 per cent of GSDP by 2013-14.

(paras 9.79 and 9.81)

iv) Jammu & Kashmir and Mizoram should limit their fiscal deficit to 3 per cent of GSDP by 2014-15.

(Para 9.80)

34. States should amend/enact FRBM Acts to build in the fiscal reform path worked out. State-specific grants recommended for a state should be released upon compliance.

(Para 9.82)

35. Independent review/monitoring mechanism under the FRBM Acts should be set up by states.

(Para 9.84)

36. Borrowing limits for states to be worked out by MoF using the fiscal reform path, thus acting as an enforcement mechanism for fiscal correction by states.

(Para 9.85)

37. Loans to states from National Small Savings Fund (NSSF) contracted till 2006-07 and outstanding at the end of 2009-10 to be reset at 9 per cent rate of interest, subject to conditions prescribed.

(Para 9.106)

38. National Small Savings Scheme to be reformed into a market-aligned scheme. State Governments are also required to undertake relevant reforms at their level.

(paras 9.111 and 9.112)

39. Loans from GoI to states and administered by ministries/departments other than MoF, outstanding as at the end of 2009-10, to be written off, subject to conditions prescribed.

(Para 9.114)

40. A window for borrowing from the Central Government needs to be available for fiscally

weak states that are unable to raise loans from the market.

(Para 9.114)

41. For states that have not availed the benefit of consolidation under the Debt Consolidation and Relief Facility (DCRF), the facility, limited to consolidation and interest rate reduction, should be extended, subject to enactment of the FRBM Act.

(Para 9.115)

42. The benefit of interest relief on NSSF and the write-off should be made available to states only if they bring about the necessary amendments/enactments of FRBM.

(Para 9.116)

Local Bodies

43. Article 280 (3) (b) & (c) of the Constitution should be amended such that the words 'on the basis of the recommendations of the Finance Commission of the State' are changed to 'after taking into consideration the recommendations of the Finance Commission of the State'.

(Para 10.130)

44. Article 243(1) of the Constitution should be amended to include the phrase 'or earlier' after the words 'every fifth year'.

(Para 10.125)

45. The quantum of local body grants should be provided as per Table 10.4. The general basic grant as well as the special areas basic grant should be allocated amongst states as specified. The state-wise eligibility for these grants is placed in annexes 10.15a and 10.15c.

(Para 10.159)

46. State Governments will be eligible for the general performance grant and the special areas performance grant only if they comply with the prescribed stipulations. These grants will be disbursed in the manner specified. The

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- state-wise eligibility for these grants is placed in annexes 10.15b and 10.15d.
(paras 10.161 to 10.164)
47. The states should appropriately allocate a portion of their share of the general basic grant and general performance grant, to the special areas in proportion to the population of these areas. This allocation will be in addition to the special area basic grant and special area performance grant recommended by us.
(Para 10.170)
48. State Governments should appropriately strengthen their local fund audit departments through capacity building as well as personnel augmentation.
(Para 10.167)
49. The State Governments should incentivise revenue collection by local bodies through methods such as mandating some or all local taxes as obligatory at non-zero rates of levy, by deducting deemed own revenue collection from transfer entitlements of local bodies, or through a system of matching grants.
(Para 10.173)
50. To buttress the accounting system, the finance accounts should include a separate statement indicating head-wise details of actual expenditures under the same heads as used in the budget for both Panchayati Raj Institutions (PRIs) and Urban Local Bodies (ULBs). We recommend that these changes be brought into effect from 31 March 2012.
(Para 10.177)
51. The Government of India and the State Governments should issue executive instructions so that their respective departments pay appropriate service charges to local bodies.
(Para 10.178)
52. Given the increasing income of State Governments from royalties, they should
- share a portion of this income with those local bodies in whose jurisdiction such income arises.
(Para 10.179)
53. State Governments should ensure that the recommendations of State Finance Commissions (SFCs) are implemented without delay and that the Action Taken Report (ATR) is promptly placed before the legislature.
(Para 10.129)
54. SFCs should consider adopting the template suggested in Annex 10.5 as the basis for their reports.
(Para 10.127)
55. Bodies similar to the SFC should be set up in states which are not covered by Part IX of the Constitution.
(Para 10.180)
56. Local bodies should consider implementing the identified best practices.
(Para 10.79)
57. A portion of the grants provided by us to urban local bodies be used to revamp the fire services within their jurisdiction.
(Para 10.172)
58. Local Bodies should be associated with city planning functions wherever other development authorities are mandated this function. These authorities should also share their revenues with local bodies.
(Para 10.168)
59. The development plans for civilian areas within the cantonment areas (excluding areas under the active control of the forces) should be brought before the district planning committees.
(Para 10.169)
60. State Governments should lay down guidelines for the constitution of nagar panchayats.
(Para 10.133)

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Disaster Relief

61. The National Calamity Contingency Fund (NCCF) should be merged into the National Disaster Response Fund (NDRF) and the Calamity Relief Fund (CRF) into the State Disaster Response Funds (SDRFs) of the respective states. Contribution to the SDRFs should be shared between the Centre and states in the ratio of 75:25 for general category states and 90:10 for special category states.
(paras 11.78, 11.79 and 11.82)
62. Balances as on 31 March 2010 under state CRFs and the NCCF should be transferred to the respective SDRFs and NDRF.
(paras 11.78 and 11.93)
63. Budgetary provisions for the NDRF need to be linked to expenditure of the previous year from the fund. With cesses being subsumed on introduction of the GST; alternative sources of financing need to be identified.
(Para 11.78)
64. The total size of the SDRF has been worked out as Rs. 33,581 crore, to be shared in the ratio given above, with an additional grant of Rs. 525 crore for capacity building.
(paras 11.92 and 11.102)
65. Assistance of Rs. 230 crore to be given to the National Disaster Response Force to maintain an inventory of items required for immediate relief.
(Para 11.103)
66. Provisions relating to the District Disaster Response Fund (DDRF) in the Disaster Management (DM) Act may be reviewed and setting up of these funds left to the discretion of the individual states.
(Para 11.96)
67. Mitigation and reconstruction activities should be kept out of the schemes funded through FC grants and met out of overall development plan funds of the Centre and the states.
(Para 11.83)
68. The list of disasters to be covered under the scheme financed through FC grants should remain as it exists today. However, man-made disasters of high-intensity may be considered for NDRF funding, once norms have been stipulated and the requisite additional allocations made to the NDRF.
(Para 11.100)
69. The administrative mechanism for disaster relief to be as prescribed under the DM Act, i.e., the National Disaster Management Authority (NDMA)/National Executive Council (NEC) at the Centre and the State Disaster Management Agency (SDMA)/State Executive Council (SEC) at the state level. Financial matters to be dealt with by the Ministry of Finance as per the existing practice.
(paras 11.105 and 106)
70. Prescribed accounting norms should be adhered to for the continuance of central assistance to the SDRFs.
(Para 11.95)

Grants-in-aid to States

NPRD and Performance Incentive

71. Total non-plan revenue grant of Rs. 51,800 crore is recommended over the award period for eight states (Table 12.4).
(Para 12.12)
72. A performance grant of Rs. 1500 crore is recommended for three special category states who have graduated from a Non-plan Revenue Deficit (NPRD) situation.
(Para 12.13)

Elementary Education

73. A grant of Rs. 24,068 crore is recommended for elementary education over the award period.
(Para 12.23)
74. The education grant will be an additionality to the normal expenditure of the states for elementary education. The expenditure

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(plan + non-plan) under elementary education, i.e., major head-2202, sub-major head-01, exclusive of grants recommended, should grow by at least 8 per cent annually during 2010-15.

(Para 12.23)

Environment

75. An amount of Rs. 5000 crore is recommended as forest grant for the award period.

(Para 12.46)

76. Grants for the first two years are untied but priority should be given to the preparation of working plans. Release of grants for the last three years is linked to progress in the number of approved working plans.

(Para 12.47)

77. Twenty five per cent of the grants in the last three years are for preservation of forest wealth. These grants are over and above the non-plan revenue expenditure on forestry and wildlife (major head-2406) and shall be subject to the conditionalities given in Annex 12.3. Seventy five per cent of the grants in the last three years can be used by states for development purposes.

(Para 12.47)

78. An incentive grant of Rs. 5000 crore is recommended for grid-connected renewable energy based on the states' achievement in renewable energy capacity addition from 1 April 2010 to 31 March 2014. The performance of states in this regard needs to be reviewed on the basis of data published by GoI on capacity addition by states.

(paras 12.52 and 12.53)

79. An amount of Rs. 5000 crore is recommended as water sector management grant for four years, i.e., 2011-12 to 2014-15 of the award period.

(Para 12.57)

80. Release of water sector grants would be subject to setting up of a Water Regulatory Authority

and achieving the normatively assessed state-specific recovery of water charges.

(Para 12.58)

81. Water sector grants should be an additionality to the normal maintenance expenditure to be undertaken by the states and shall be released and monitored in accordance with the conditionalities in Annex 12.8.

(Para 12.58)

Improving Outcomes

82. States should be incentivised to enroll such of their residents who participate in welfare schemes within the Unique Identification (UID) programme. A grant of Rs. 2989 crore is proposed to be given to State Governments in this regard, as indicated in Annex 12.9.

(Para 12.70)

83. States should be incentivised to reduce their Infant Mortality Rates (IMR) based upon their performance beyond 31 December 2009. A grant of Rs 5000 crore is recommended for this purpose.

(Para 12.75)

84. A grant of Rs. 5000 crore is proposed to support improvement in a number of facets in the administration of justice. These include operation of morning/evening courts, promotion of Alternate Dispute Resolution (ADR) mechanisms, enhancing support to Lok Adalats, as well as legal aid and training.

(Para 12.79)

85. A grant of Rs 20 crore is recommended for promotion of innovation by setting up a Centre for Innovation in Public Systems (CIPS) to identify, document and promote innovations in public services across states. The second grant of Rs. 1 crore per district is for the creation of a District Innovation Fund (DIF) aimed at increasing the efficiency of the capital assets already created.

(paras 12.92 and 12.96)

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86. To enhance the quality of statistical systems, we recommend a grant of Rs. 616 crore for State Governments at the rate of Rs. 1 crore for every district to fill in statistical infrastructure gaps in areas not addressed by the India Statistical Project (ISP).

(Para 12.101)

87. A grant of Rs. 10 crore will be provided to each general category state and Rs. 5 crore to each special category state to set up an employees' and pensioners' data base. We also urge GoI to initiate a parallel effort for preparing a data base for its own employees and pensioners.

(Para 12.108)

Maintenance of Roads and Bridges

88. An amount of Rs. 19,930 crore has been recommended as grant for maintenance of roads and bridges for four years (2011-12 to 2014-15) of our award period.

(Para 12.114)

89. The maintenance grants for roads and bridges will be an additionality to the normal maintenance expenditure to be incurred by the states. Release of this grant and expenditure will be subject to the conditionalities indicated in Annex 12.17.

(Para 12.114)

State-specific Needs

90. A total grant of Rs. 27,945 crore is recommended for state-specific needs (Table 12.6)

91. In addition to the stipulations described in paras 5.52 and 9.82, state-specific grants are subject to the following conditionalities:

- i) No funds from any of the state-specific grants may be used for land acquisition by the states. Wherever land is required for a project/construction, such land may be made available by the State Government.

- ii) The phasing of the state-specific grants given in Table 12.6 is only indicative; states may communicate their required phasing to the Central Government. The grant may be released in a maximum of two instalments per year.

- iii) Accounts shall be maintained and Utilisation Certificates (UCs)/ Statements of Expenditure (SOEs) provided as per General Finance Rules (GFR) 2005.

(Para 12.324)

Monitoring

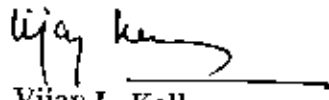
92. The High Level Monitoring Committee headed by the Chief Secretary to review the utilisation of grants and to take corrective measures, set up as per the recommendation of FC-XII, should continue.

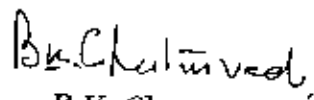
(Para 12.326)

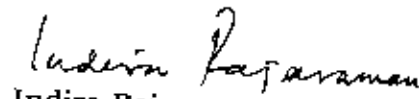
93. The total grants-in-aid recommended for the states over the award period are given in Table 1.2.

Table 1.2: Grants-in-Aid to States


	(Rs. crore)
I Local Bodies	87519
II Disaster Relief (including for capacity building)	26373
III Post-devolution Non-plan Revenue Deficit	51800
IV Performance Incentive	1500
V Elementary Education	24068
VI Environment	15000
(a) Protection of Forests	5000
(b) Renewable Energy	3000
(c) Water Sector Management	3000
VII Improving Outcomes	14446
(a) Reduction in Infant Mortality Rates	5000
(b) Improvement in Supply of Justice	5000
(c) Incentive for Issuing UTIs	2989
(d) District Innovation Fund	616
(e) Improvement of Statistical Systems at State and District Level	616
(f) Employee and Pension Data base	215
VIII Maintenance of Roads and Bridges	19930
IX State-specific	27945
X Implementation of model GST	50000
Total	310581


Vijay L. Kelkar
Chairman


B.K. Chaturvedi
Member

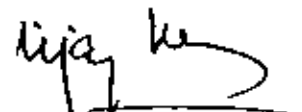

Indira Rajaraman
Member


Atul Sarma
Member


Sanjiv Misra
Member

New Delhi
29, December 2009

I wish to record my deep appreciation of the outstanding support and cooperation provided by all Members of the Commission. This report is a joint endeavour, with each Member contributing immensely with their profound knowledge and deep professional commitment. I also want to put on record the Commission's appreciation of the services rendered by Shri Sumit Bose, Secretary to the Commission. He has been a friend, philosopher and guide to this Commission. The Commission greatly owes to him for its high efficiency and meticulous work. He has been an outstanding leader of a talented team of professionals which assisted the Commission.


Vijay L. Kelkar
Chairman

New Delhi
29, December 2009

CHAPTER 5

Goods and Services Tax

Introduction

5.1. This Commission is required to consider 'the impact of the proposed implementation of Goods and Services Tax with effect from 1st April 2010 including its impact on the country's foreign trade', while formulating its recommendations. The changeover to the Goods and Service Tax (GST) will be a game-changing tax reform measure which will significantly contribute to the buoyancy of tax revenues and acceleration of growth, as well as generate many positive externalities. Three other items of consideration in our Terms of Reference (ToR), viz. (i) '...estimation of the resources of the Central and State Governments'; (ii) '... the objective of not only balancing the receipts and expenditure on the revenue account but also to generate surpluses in the capital account'; and (iii) '... to improve the tax- gross domestic product ratio of the Center and the States' will also be influenced by the GST. This Commission therefore recognised the need to holistically examine all the issues relating to the implementation of GST.

5.2. The first phase of reform of indirect taxation occurred when the Modified Value Added Tax (MODVAT) was introduced for selected commodities at the central level in 1986, and then gradually extended to all commodities through Central Value Added Tax (CENVAT). The introduction and integration of service tax into CENVAT deepened this effort. Reform at the state level occurred through introduction of Value Added Tax (VAT) by all the states in the country in a phased manner between April 2003 and January 2008. Buoyed by the success of VAT, and mindful of the need for further improvement, the Government of

India (GoI) indicated in Feb 2007 that a roadmap for introduction of destination-based GST in the country by 1 April 2010 would be prepared in consultation with the Empowered Committee (EC) of state Finance Ministers. This commitment was reiterated in February 2008 and July 2009. The origin-based Central Sales Tax (CST) was successively reduced from 4 to 3 per cent and 2 per cent during 2007 and 2008, respectively, as part of this reform process. In November 2007, a Joint Working Group consisting of representatives of the Empowered Committee and the Government of India prepared a report on the changeover to GST. This report was discussed by the EC, which then prepared 'A Model and Road Map for Goods and Service Tax in India' in April 2008. The model and roadmap, while recommending that a dual GST be put in place, also provided preliminary views on the state and central taxes to be subsumed within the GST. The model detailed the operational issues which needed to be addressed, including the number of rates, the exemptions and exclusions from GST, as well as the treatment of inter-state transactions. The roadmap outlined the legal and administrative steps which needed to be taken in order to comply with the April 2010 time line. The Government of India's response to this document formed the basis of the second round of discussions and reviews. This culminated in the release of the 'First Discussion Paper on Goods and Service Tax in India' in November 2009. This discussion paper provides details of the taxes to be subsumed, while at the same time, outlining the modalities of implementation of the tax. It also makes recommendations on a number of building blocks of the GST, including taxation of inter-state trade,

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provision of compensation, treatment of area based schemes and the additional steps required to be taken. It, however, does not provide any guidance on the Revenue Neutral Rates (RNR) which need to be adopted at the central and state level. This discussion paper is expected to spark a public debate, leading to possible modification of the design and implementation modalities of the GST.

5.3 Commendable progress has been made over the past three years in generating a national consensus on GST. Agreement on the broad framework of this tax has now been reached. GST will be a dual tax, with both central and state GST components levied on the same tax base. All goods and services, excluding the agreed upon exemptions, will be brought into this base. No distinction between goods and services will be made, with a common legislation applying to both. However, a number of issues remain to be resolved. These need to be addressed carefully. Only if a model GST is put in place, can all its potential benefits be fully exploited. Given the large positive economic and fiscal externalities of the GST reform, putting in place an incentive structure to motivate all stakeholders to design and implement such a model GST was, therefore, a prime concern of the Commission. A number of State Governments and industry associations communicated to the Commission their concerns on the design and implementation of GST. To address these and other GST related issues including the mandate in our ToR, the Commission sponsored three independent studies. One, undertaken by the National Council for Applied Economic Research (NCAER) studied the impact of GST on international trade. The second was undertaken by a task force (TF) which examined the whole gamut of GST-related issues, from design to implementation and made suitable recommendations. Both these studies have been published on the website of the Finance Commission.¹ We review below their main findings and recommendations after briefly highlighting the concerns expressed by the State Governments.

Views of State Governments

5.4 The State Governments expressed their views on the structure of GST as well as its implementation modalities to the Commission during our state visits. Nine State Governments gave their views in their respective memoranda and some expressed their views through letters to the Commission. While all the states broadly supported the introduction of GST, the major concerns expressed by them are detailed hereunder.

5.5 *Determination of the tax base:* Some State Governments pointed to the importance of accurately assessing the tax base that would be available to them under GST. They noted that with regard to service tax, figures presently available were those pertaining to the point of collection, rather than to the point of incidence. Also, the rules of supply for services have not yet been finalised. States which presently have a high tax effort apprehended that the RNR finally agreed upon would not be favourable to them. Manufacturing states would suffer additionally due to the abolition of CST. They suggested that the GST rates should, therefore, be used as a floor rate.

5.6 Low income states argued that as their consumption base was low, and they had increased their tax effort significantly after implementing VAT, there was little scope for them to increase their revenues under the proposed GST regime.

5.7 *Vertical imbalance:* It was apprehended that the GST could possibly accentuate the vertical imbalance in favour of the Centre through a proportionally larger Central Goods and Services Tax (CGST) rate and access to a larger consumption base, hitherto unavailable to the Centre.

5.8 *State autonomy:* The GST requires a commitment to a stable rate structure. This will compromise the fiscal autonomy of State Governments and deprive them of the only lever of macro-economic policy available to them.

5.9 *Single rate:* A single GST tax rate would be regressive, with the tax levied on items of common

¹ The final report of the third study was awaited at the time of writing. It will also be put on the FC website after receipt.

consumption increasing, while providing needless relief to the higher taxed luxury goods.

5.10 Compensation mechanism: Some states currently having a high tax effort noted the possibility of suffering losses upon implementation of GST. They requested that an objective compensation mechanism to support such losses be put in place. Compensation on loss of CST should also be part of this package.

5.11 Small enterprises: Small enterprises manufacturing specified goods with an annual turnover of less than Rs. 1.5 crore are presently exempt from excise. The GST will bring them into the tax net, rendering them uncompetitive and enhancing their compliance cost.

5.12 Cesses and surcharges: All cesses and surcharges levied by both the Centre and the states should be subsumed into the GST.

5.13 Taxes to be excluded from GST: Electricity duties; purchase tax; and taxes on crude oil, motor spirit (MS), high speed diesel (HSD), alcohol and tobacco should be excluded from the purview of GST.

5.14 Compliance mechanism: The GST law should be subject to rigorous compliance and deviations should not be permitted. Changes should be made only with the consent of all the states.

5.15 Selective rollout: States should be given the option to adopt GST at their convenience and the possibility of implementation of GST in only some states should be incorporated in the design.

5.16 Dispute Resolution: An independent dispute resolution mechanism should be put in place.

5.17 Implementation modalities: All tax returns, assessment and audit procedures should be harmonised across the country. A comprehensive information technology (IT) based infrastructure should be put in place to track inter-state transactions.

5.18 Adequate preparation for the changeover, rather than an arbitrary fixed schedule, should be the sole criterion for deciding the timing for introduction of GST.

5.19. The CST Act should be abrogated such that the provision for notifying declared goods is not available to the Centre.

5.20. The rules of supply for inter-state sales should be finalised expeditiously, in an objective manner. Further, the modalities for levying GST on imports, textiles and sugar should be agreed upon.

Views of the Central Government

5.21. During our consultations with the Central Government, they expressed concerns about the following issues:

- i) The recommendation in the Discussion Paper that GSI maintain the CGST threshold at Rs. 1.5 crore, while the State Goods and Services Tax (SGST) composition threshold would be Rs. 40 lakh.
- ii) The importance of agreeing upon a uniform and limited list of exempted items for the Centre and for all the states.
- iii) The criticality of promoting the power sector and the importance of subsuming electricity duty into GST.
- iv) The need to subsume purchase tax into GST to ensure that it remains a consumption-based tax and is not exported across tax jurisdictions.

Impact of GST on Foreign Trade

5.22. A NCAER study, commissioned by us, evaluates the possible impact of GST on India's international trade in a Computable General Equilibrium (CGE) framework. It notes that the differential multiple tax regimes across sectors of production are leading to distortions in the allocation of resources as well as production inefficiencies. Complete offsets of taxes are not being provided to exports, thus affecting their competitiveness. It estimates that implementation of a comprehensive GST across goods and services will enhance the nation's Gross Domestic Product (GDP) by between 0.9 and 1.7 per cent. This works out to between Rs. 52,600 crore and Rs. 99,450 crore on the basis of GDP figures for 2009-10. Such

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benefits would accrue every year. It would also lead to efficient allocation of the factors of production, with a fall in the overall price level. The report identifies a number of sectors which would directly benefit from the implementation of GST. The study estimates the gain in exports to vary between 3.2 and 6.3 per cent. Imports are expected to gain between 2.4 per cent and 4.7 per cent, thus improving the trade balance.

5.23. The study estimates the revenue-neutral GST rate across goods and services to be between 6.2 and 9.2 per cent, depending upon the assumptions made. This value was conservatively arrived at, ignoring the existence of tax thresholds and composition limits. The study assumes that the GST adopted will be a truly consumption based tax which will: (i) eliminate all origin based taxes; (ii) subsume all the other presently levied indirect taxes on goods and services (excluding customs) and (iii) will not be exported across tax jurisdictions. To exploit the benefits of GST fully, we also need to ensure that tax compliance costs are low and tax credits are available seamlessly across tax jurisdictions. Apart from uniform tax rates, this will also require harmonisation of procedures for levy, assessment, appropriation and even audit, between the states and the Centre, as well as amongst the states themselves. This is best done through a model GST, the characteristics of which are outlined in Para 5.25.

Report of the FC -XIII Task Force

5.24. The task force, appointed by this Commission, comprehensively analyzed all GST related issues and made a number of recommendations. The Task Force Report is available on the Commission's website. The key points are summarised below:

- i) Following the present VAT, the GST should be levied on consumption and computed on the basis of the invoice credit method.
- ii) All major indirect taxes (excluding customs) and all cesses and surcharges should be subsumed into the central and state GST.

Specifically, stamp duty, taxes on vehicles, taxes on goods and passengers and taxes and duties on electricity should be subsumed into the GST.

- iii) Transmission fuels, High Speed Diesel (HSD), Motor Spirit (MS) and Aviation Turbine Fuel (ATF) should be brought under a dual levy, of GST and an additional levy, with no input tax credit available on the additional levy. This would protect the existing revenues from these sources. However, all other petroleum products should be brought within the ambit of the GST, as should natural gas.
- iv) The sumptuary goods of tobacco and alcohol should be taxed through GST as well as an additional levy, with no input tax credit being provided on the additional levy.
- v) The entire transportation sector should be included in the GST base, and taxes on vehicles, goods and passengers should be subsumed into the GST. Similarly, the power sector should be included in the tax base and electricity duty subsumed.
- vi) The real estate sector (both residential and commercial) should be included in the tax base and stamp duty levied by State Governments should be subsumed into GST. A threshold of Rs. 10 lakh in this regard will permit exemption of small residential and business properties.
- vii) The entire financial services sector should be brought under the GST tax base.
- viii) Capital goods should be treated like all other goods and services, with no restrictions on avadment of input tax credit at purchase, and a corresponding liability for GST on subsequent sale.
- ix) No exemptions should be allowed, except for a common list applicable to all states as well as the Centre, which should only comprise : (a) unprocessed food items; (b) public services provided by all governments

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5.27. The SGST portion would subsume the following taxes:

- i) Value Added Tax
- ii) Central Sales Tax
- iii) Entry Tax, whether *in lieu* of octroi or otherwise
- iv) Luxury Tax
- v) Taxes on lottery, betting and gambling
- vi) Entertainment Tax
- vii) Purchase Tax
- viii) State Excise Duties
- ix) Stamp Duty
- x) Taxes on vehicles
- xi) Tax on goods and passengers
- xii) Taxes and duties on electricity
- xiii) All state cesses and surcharges

Special Provisions for Certain Goods

5.28 The taxation of petroleum products and natural gas would be rationalised by including them in the tax base. HSD, MS, and ATF could be charged GST and an additional levy by both the Central and State Governments. No input credit would be available against either CGST or SGST on the additional levy. A similar treatment would be provided to alcohol and tobacco. Such an arrangement would ensure protection of existing revenues while taking care of environmental concerns.

Exemptions

5.29 No exemptions should be allowed other than a common list applicable to all states as well as the Centre, which should only comprise: (i) unprocessed food items; (ii) public services provided by all governments excluding railways, communications and public sector enterprises and (iii) service transactions between an employer and employee (iv) health and education services.

5.30 A threshold of Rs. 10 lakh and a composition limit of Rs. 40 lakh have been agreed upon by the FC for SGST in the first discussion draft. It is

desirable that these limits be applied to CGST as well. Sales of goods of local importance will fall within these threshold limits, thus keeping them out of the ambit of GST.

5.31 Dealers with turnover below Rs 1.5 crore were previously exempt from CENVAT. As thresholds need to be consistent across SGST and CGST, such exemptions should not continue. Under the GST regime, dealers with turnovers between Rs. 10 lakh and Rs. 40 lakh will have to pay both CGST and SGST. Their compliance burden will increase. This issue can be addressed if both CGST and SGST are levied and collected from such dealers by a single agency, viz. the State Government, which would then remit the CGST portion to the Central Government. State Government will be responsible for assessment, levy, collection and audit, with Central Government retaining its right to exercise these functions in respect of CGST in specific cases. State Governments could be reimbursed the collection charges for this effort. Wherever the additional levy is likely to cause hardship, a scheme for reimbursement to economically vulnerable dealers could be considered by the government.

5.32 The present area-based exemption schemes are not consistent across the states where they are applicable. They differ in the admissibility of CENVAT credit as well as the sunset clause. Since it would be difficult to subsume these schemes into the GST structure, it is recommended that they be terminated. The existing schemes should not be grandfathered. Alternative options like refunding taxes paid by industries in these locations could be considered.

Treatment of Inter-state Sales

5.33 All transactions across tax jurisdictions should be free from tax. While exports will be zero rated, inter-state transactions should be effectively zero-rated so as to ensure that the tax is collected by the consuming state consistent with the destination principle. Therefore, any model adopted must allow accurate determination and efficient transfer of input tax credit across tax jurisdictions. Further, the model should not impose any undue restrictions on tax credit set-off or increase in compliance costs.

Formulation of Rules of Supply

5.34 The 'place of supply' rules for services need to be carefully framed to ensure consistency and credibility. It should be based on international best practice.

GST on Imports

5.35 Imports from outside the country would be subject to GST on the destination principle. This will require that proof of consumption at a pre-determined destination state should be provided. The procedure for collection and appropriation of this tax needs to be put in place. Rules for transferring this tax burden in the case of importers who sell to a consumer in a third state after the import is made, need to be clarified.

Operational Modalities

5.36 To reduce compliance costs and increase collection efficiency, all state GST laws should be harmonised. All stages of the taxation chain, from levy of the tax to its assessment, collection and appropriation, should be similar across states. This would involve similar rules across states, dealing not only with assessments, audit and refunds, but also with more basic issues like registration, filing of returns, treatment of transportation of goods, etc.

5.37 While CST will be reduced to zero, the necessity of stipulating documentation for inter-state trade needs to be carefully examined. The model for taxing inter-state sales finally adopted should provide clarity on the jurisdiction of states while facilitating inter-state trade and stock transfers. Given the volume of such transactions, this system necessarily has to be IT-based. Such an IT network should enable the sharing of information between states and assist in the plugging of revenue leakages. A system to facilitate inter-state verification of dealers and transactions is also necessary. The present system, via Tax Information Exchange System (TINXSYS), does not appear to be fully operational across all states. There are asymmetric benefits to states in putting in place such infrastructure and this appears to be affecting their incentives to do so. A system which will

uniformly incentivise all states to participate in and contribute to the verification system needs to be put in place. Alternately, one central agency could be charged with maintaining this system. The existing TINXSYS infrastructure should be updated and strengthened.

Dispute Resolution and Advance Ruling Mechanism

5.38 An effective, efficient and uniform system for redressal of anomalies in the legislation should be put in place. This could be an independent and quasi-judicial authority with full powers to look into all disputes related to GST implementation, both at the Centre and state level. Such an authority could issue guidelines, administer and enforce agreement between states and the Centre, and between the states themselves. A common Advance Ruling Authority for both the Centre and the states should also be put in place.

Refunds

5.39 Prompt refunds form the core of an effective GST framework, especially as cross-utilisation of input tax credit across CGST and SGST, are not envisaged. Delayed payment of refunds enhances the cost of dealer operations and reduces the efficiency of the tax system. The experience with refunds under the VAT regime is not reassuring, even though VAT laws in a number of states mandate payment of interest for delay. State Governments must adopt a more effective refund system. They could consider an electronic system where refunds are directly credited to the eligible dealer's bank account.

Selective Rollout

5.40 VAT was introduced in a phased manner by State Governments over a period of nearly three years, between April 2003 and January 2005. VAT dealt purely with the treatment of intra-state sales and states were not explicitly disadvantaged if they did not implement VAT. Transactions between VAT and non-VAT states did not warrant special treatment. However, GST changes the rules of the game. It requires inter-state trade to be zero rated.

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It empowers states by including services as well as the manufacturing stage in their tax base. It thus creates an uneven balance between states which implement GST and those which do not. Goods and services sold between complying and non-complying states would thus require to be treated differently in the wake of selective implementation of GST. If CST were to continue to apply in non-complying states, inter-state sales would become further complex. Goods passing through a non-complying state, to be finally sold in a complying state, would be burdened by a cascading tax which would adversely affect the price to the final consumer. The seamless flow of Input Tax Credit (ITC) on inter-state transactions would be interrupted. Further, rate mismatches may encourage trade diversion and cost of compliance would become extremely high for inter-state dealers. This would discourage economies of scale. We, therefore, feel that the model GST should be implemented by all states and the Centre at one time, and not be partially implemented in some states. It is for this reason that we recommend that proper preparation for the GST and generating of a consensus amongst all states is a greater priority than complying with the 2010 deadline. However, as has been suggested in some quarters, it is possible for the Centre alone to transform the CENVAT into a GST at the manufacturing stage at any time. It could unify the CENVAT rates and impose a general tax on all services, while adopting a common threshold. As mentioned earlier, a dual tax on petroleum products, tobacco and alcohol could be levied—a GST component and an additional levy component with no input credit being provided on the latter.

Transition Provisions

5.41 A number of transitional issues will arise. Provisions to address such issues must be consistent with the model GST.

Benefits from Supporting the Model GST

5.42 This Commission supports the implementation of a model GST for the following reasons:

- i) The NCAER study computed the present value of GST-reform induced gains in GDP as the present value of additional income stream based on the discount rate of 3 per cent representing the long-term real rate of interest. The present value of total gain in GDP is estimated as between Rs. 14.69 lakh crore and Rs. 28.81 lakh crore. The corresponding dollar values are US \$325 billion and \$637 billion. This represents between 25 and 50 per cent of the 2009-10 GDP gained through this major tax reform. The all-government tax revenue will also increase by about 0.20 per cent of GDP, a significant increment to revenues through implementation of the model GST.
- ii) The Task Force report estimated that such a GST would have a tax base of around Rs. 31,00,000 crore. It further estimated that this would require a revenue-neutral rate of only 12 per cent (5 per cent for the Central GST and 7 per cent for the State GST). This is a substantial decrease from the present 20.5 per cent (8 per cent for CENVAT and 12.5 per cent for VAT). This should be the target.
- iii) Adoption of such a model GST would make India a dynamic common market and also result in generation of positive externalities. Despite lower levels of taxes, the revenue of the Union and the states will be buoyant. Subsumation of all major indirect taxes will result in removal of inefficient taxes. Our manufactures will become more competitive and consequently exports will grow. Provision of seamless input tax credit across all transactions will avoid tax cascading, eliminate double taxation and improve resource allocation. It will foster a common market across the country, reorient supply chains and remove the present bias towards backward integration. Further, it will also inhibit tax induced migration of investment. It will, thus, support the growth of lagging but resource-rich regions. A single rate across all goods and services will eliminate

classification disputes and make tax assessment more predictable. The harmonisation of tax assessment, levy and collection procedures across states proposed under the GST will reduce compliance costs, limit evasion, enhance transparency and improve collection efficiency.

- iv) Successful implementation of GST also offers the possibility of strengthening the revenue base of local bodies that form the third tier of government.
- v) The inclusion of real estate in the GST tax base will constrain the parallel economy with consequent positive spillovers into governance and the development of land markets.
- vi) The NCAER model suggests that GST could lead to better environmental outcomes.

Concerns of State Governments

5.43 We address below the principal concerns of states relating to revenue from certain products, loss of autonomy in a GST framework, possibilities of states entering GST in a phased manner and treatment of small enterprises.

Revenue from Certain Products

5.44 The model GST will accommodate the concerns of governments with regard to maintenance of their revenues from transmission fuels and sumptuary goods by allowing the imposition of an additional levy over and above the GST.

Dilution of Fiscal Autonomy of States

5.45 Concerns have been expressed by some state governments that the GST regime will constrict their fiscal autonomy and further tilt the vertical imbalance. However, this argument should be viewed in the following perspective:

- i) While the states will normally not be able to deviate from the nationally agreed model for the GST, such constraints will apply to the Centre as well. Further, the states still have

fiscal headroom available. They can impose an additional levy on transmission fuels as well as sumptuary goods and the authority to levy temporary cesses and surcharges in case of emergencies, remains. They can also continue to levy user charges for services provided to citizens. Expenditure policy will continue to remain as a powerful fiscal instrument. Further, the strengthening of their fiscal base will improve their access to capital markets, enhancing their borrowing capacity.

- ii) The tax base of State Governments will significantly increase with the inclusion of the tax on services as well as the tax on manufacture. The tax base of the Centre, on the other hand, will increase only to the extent of tax on sales. Thus, it cannot be said that the vertical imbalance will increase in favour of the Centre.
- iii) States will benefit from the abolition of the cesses and surcharges presently being levied by the Centre, as the size of the divisible pool will rise. Presently this amounts to about 15 per cent of the divisible pool.
- iv) Tax policy is tax administration, and significant scope exists for improving tax collection efficiency through implementation of GST.
- v) The GST grant recommended by this Commission compensates for the seeming limitation in fiscal autonomy by enhancing expenditure autonomy through compensation payments and additional formulaic transfers.
- vi) The GST will be a landmark effort by the states and the Union to further co-operative federalism with all stakeholders contributing to national welfare by accepting its framework.

Compensation Mechanism

5.46 An objective compensation mechanism incorporated in the 'Grand Bargain' will provide

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reassurance to both the Central and State Governments. This has been proposed in Para 5.60.

Checkposts

5.47 Most states have put in place a system of checkposts on their border roads. There are a number of reasons for putting in place such physical barriers to trade. These include (i) enforcement of state excise, market cess, forest and vehicle fitness regulations (ii) applicability of lower taxes on inter-state trade than on intra-state trade (iii) there being no tax on stock transfers (iv) levy of entry tax on specified goods (v) levy of octroi by some municipalities and (vi) internal security. The onset of GST will not obviate all these reasons, and therefore, check posts on state borders may remain. However, it must be recognised that such checkposts, by the very nature of their operations, generate enormous delays in road traffic. The arrangement also encourages rent-seeking behaviour. It may be difficult to eliminate checkposts, given the valid concerns of State Governments. But what appears to be egregious is that the same vehicle has to pass through two checkposts—the exporting state's checkpost and the importing state's checkpost—while crossing one border. Both these checkposts are often located within a couple of kilometres of each other and a transport vehicle has to spend considerable time at both. Perhaps, it may be possible for both states to put up a combined checkpost. Officials of both states could sit together and conduct their verifications in a single checkpost. Alternately, one state could handle traffic in one direction and the other state in the other direction, essentially ensuring that there would be only one check per border for a goods vehicle. Such an arrangement would significantly reduce travel time and we recommend it for consideration. There is an overwhelming rationale for minimising delays and thus reducing transaction costs. States could be encouraged to consider user-friendly options like electronically issued passes for transit traffic in order to reduce truck transit time through their states.

The Grand Bargain

5.48 We propose that both the Centre and the states conclude a 'Grand Bargain' to implement the

model GST. Keeping the experience of the implementation of VAT in mind, we suggest that the six elements of the Grand Bargain comprise: (i) the design of the GST; (ii) its operational modalities; (iii) binding agreement between Centre and states with contingencies for change in rates and procedures; (iv) disincentives for non compliance; (v) the implementation schedule and (vi) the procedure for states to claim compensation. The design of the model GST is suggested in paras 5.25 to 5.35. The operational modalities are outlined in paras 5.36 to 5.41. The proposed agreement between the Centre and states, with contingencies for changes in the agreement, is described in paras 5.49 to 5.51. The disincentives for non-compliance are described in paras 5.52. The implementation schedule is described in paras 5.57 to 5.59. The procedure for claiming compensation is at Para 5.60.

Binding Agreement between Centre and States

5.49 Compliance of states with the previously agreed upon guidelines for VAT has not been very uniform. A number of states have deviated from the three-tier VAT rates, thus indicating the need to put in place an enforcement mechanism. States are equally apprehensive that the Centre may unilaterally raise tax rates without consulting them. The Constitution does not envisage sharing of tax bases. Taxation powers are listed either in the State List or in the Central List, but not in the Concurrent List. For the first time since the Constitution was enacted, a tax base is proposed to be shared between the Centre and the states. It is, thus, necessary that a firm arrangement be put in place for implementing the GST to prevent deviations from the agreed upon model by either the Centre or the states.

5.50 One option is the possibility of a Constitutional provision to facilitate a tax agreement between the Centre and the states on the lines of the erstwhile Article 278. One suggestion is that the new Article 278 could read: 'Notwithstanding anything in this Constitution, the Government of a state may enter into an agreement with the government of any other state or the union

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GST compensation and incentive provided the model GST is implemented before 31.3.2013. Unspent grants at the end of a year will be carried forward to the next year if GST is implemented before 31.3.2013. If GST is implemented during 2013-14, the grant will be restricted to Rs 40,000 crore. If GST is implemented during 2014-15, the grant will be restricted to Rs 30,000 crore.

5.56 To be eligible to draw down this grant, all the elements of the Grand Bargain outlined in Para 5.48 will need to be adopted. If the GST framework adopted is not consistent with this, then this Commission recommends that this grant of Rs. 50,000 crore not be disbursed. Thus, if the Grand Bargain is not concluded, this grant will not mean any net fiscal outgo. If a model GST is implemented and the grant is disbursed, then the resultant increase in GDP and tax revenue will fully finance it. If the Grand Bargain is not put in place, then the grant lapses. There are, thus, no fiscal risks with this grant—only advantages.

Implementation schedule of the Model GST

5.57 We recognise that building consensus on implementing the model GST may be an involved process but equally appreciate that the requirement of a good design is paramount and should not be subordinated to a deadline. International experience tells us that flaws in design are extremely difficult to correct subsequently. We therefore recommend that marginal rescheduling of the timetable for implementation should be acceptable if the design adopted is consistent with the model GST.

5.58 The objective of the model GST is to optimise tax collection with minimal economic distortions. The Model GST should, inter alia, comprise of (i) a uniform rate for goods and services (ii) a uniform rate across states (iii) a zero rate for exports and (iv) for all other goods and services a single rate, excluding the rate for precious metals. There could be two possible approaches to the implementation of the Model GST: the 'big-bang' approach and the 'incremental' approach. The introduction of the GST is the last mile in the reform of the indirect tax

system of this country initiated in 1986 with the introduction of the MODVAT. All stakeholders stand to gain from a swift comprehensive changeover to the GST. To the extent the switchover is staggered, the potential gains from the comprehensive GST outlined in Para 5.42 would remain unrealised. Therefore, we recommend that all the elements of the model GST should be implemented comprehensively at one instance.

5.59 However, we are aware that two essential elements of the model have not yet been formally discussed by the states and consensus needs to be built before they are adopted. These are the inclusion of stamp duty in the GST tax base to enable the taxation of real estate and the use of a single rate in the GST framework. More time may be required for these elements to be included in the GST framework. Given that the terminal year of the period covered by our recommendations is 2014-15, we propose as follows. If found necessary, the GST may be initially implemented without these two elements provided that

- i) At the time of its implementation, the road map for their inclusion in the framework before 31 December 2014 is announced.
- ii) The GST is introduced with not more than two rates.
- iii) Properties other than individually owned residential properties are brought into the ambit of GST within two years of its implementation.

This contingency does not preclude the possibility of the Centre implementing GST at an accelerated pace.

Modalities for Disbursing Compensation

5.60 As mentioned in Para 5.10, states had requested that an objective compensation mechanism to support possible revenue losses after implementing GST be put in place. We recommend the following:

- i. The present Empowered Committee be transformed into a statutory Council of Finance Ministers with representation from

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5.64 The model, the modalities as well as the timing of implementation of the GST have not yet been finalised. Making projections over a five-year period, assuming the implementation of the GST during this period, would, be a hazardous exercise. This Commission has, thus, for the purpose of our financial projections, assumed that the impact of GST will be revenue-neutral and that the gross revenues of the Centre and states will not be lower than those projected even after GST is implemented.

Summary of Recommendations

5.65 Both the Centre and the states should conclude a Grand Bargain to implement the model GST. The Grand Bargain comprises five elements: (i) the design of the model GST is suggested in paras 5.25 to 5.35; (ii) the operational modalities are outlined in paras 5.36 to 5.41; (iii) the proposed agreement between the Centre and states, with contingencies for changes is at paras 5.49 to 5.51; (iv) the disincentives for non-compliance are described in paras 5.52 (v) the implementation schedule is described in paras 5.57 to 5.59. (vi) the procedure for claiming compensation is at Para 5.60 (Para 5.48).

5.66 Any GST model adopted must be consistent with all the elements of the Grand Bargain. To incentivise implementation of the Grand Bargain this Commission recommends the sanction of a grant of

Rs. 50,000 crore which will taper down to Rs. 40,000 crore and Rs. 30,000 crore if GST is implemented after 1.4.2013 and 1.4.2014 respectively. The grant would be used for meeting the compensation claims of State Governments for revenue losses on account of GST implemented, consistent with the Grand Bargain, between 2010-11 and 2014-15. Unspent balances in this pool would be distributed on 1 January 2015 amongst all the states as per the devolution formula (paras 5.54 and 5.55).

5.67 The EC should be given formal authority. The compensation should be disbursed in quarterly instalments on the basis of the recommendations by a three-member Compensation Committee comprising of the Secretary, Department of Revenue, Government of India; Secretary to the EC and chaired by an eminent person with experience in public finance to be appointed by the Central Government (Para 5.60).

5.68 In the unlikely event that a consensus to implement all the elements of the Grand Bargain cannot be achieved and the GST mechanism finally adopted is different from the model GST suggested by us, this grant of Rs. 50, 000 crore shall not be disbursed. (Para 5.62).

5.69 States should take steps to reduce the transit time of cargo vehicles crossing its borders by combining checkposts with adjoining states and adopting user friendly options like electronically issued passes for transit traffic (Para 5.47).

the Centre and states. A GST Compensation Fund should be created under the administrative control of this Council.

- ii. The Central Government shall transfer to the GST Compensation Fund amounts as indicated in Table 5.2 and subject to the conditionalities indicated in paras 5.55 and 5.56.
- iii. The amounts in the Fund should be used for compensating states for any revenue loss on account of adoption of the model GST and the Grand Bargain as indicated above. The balance, if any, remaining on 1 January 2015, will be distributed amongst the states on the basis of the devolution formula indicated in Chapter 8 of our report, used for distributing resources in the divisible pool amongst states.
- iv. The amount will be disbursed in quarterly instalments on the basis of the recommendations made by a three-member Compensation Committee comprising of the Secretary, Department of Revenue, Government of India; Secretary to the EC and chaired by an eminent person with experience in public finance. This person would be appointed by the Union Government.

The Way Forward

5.61 A number of legal and administrative steps need to be taken prior to the implementation of GST. These include stakeholder consultations, amendments to the Constitution and state laws, administrative reorganisation, preparation of GST registration, assessment and audit manuals, staff training and conduct of awareness campaigns amongst stakeholders. We have not touched upon these milestones in our discussion, but are aware that these processes may take substantial time. This is also a reason why we have earlier recommended that the putting in place an excellent design and operational framework for the GST should be given priority, even if this implies rescheduling the previously announced implementation timetable.

5.62 We recognise that the process of generating a consensus to implement the Grand Bargain as outlined by us may be difficult and involved. However, we believe that such a consensus can, and should be, generated to fully exploit the potential of GST and reap the benefits of its positive externalities. While we would like to support this model GST, which is fully consumption based, has provision for seamless credit and imposes low compliance cost, we must allow for the possibility that political economy considerations may will otherwise. In the unlikely event that such a consensus cannot be achieved and the GST framework finally adopted is different from the Grand Bargain suggested by us, this Commission recommends that the grant amount of Rs. 50,000 crore shall not be disbursed.

Impact of GST on Projections made by the Finance Commission

5.63 Though GST requires that all cesses and surcharges be abolished, and this Commission recommends that GST be implemented as early as possible, we have, in our projections, assumed continuing revenue for the Central Government from cesses for the period 2010-15. This has been done for the following reasons.

- i. Ignoring the positive externalities of GST, the Commission has conservatively assumed that GST will be revenue-neutral. Thus, income from cesses and surcharges will be included in the computation of RNR. In the scenario when GST is implemented, the aggregate revenue figures in our projections will remain unchanged, though the accounting heads under which they are reported may change. Since the catalysing effect of GST on the economy has not been factored in our projections, they can be seen as conservative.
- ii. A number of critical sectors, including roads, education, and calamity relief, are being funded from the proceeds of cesses levied by the Government of India. The transition plan to the GST must ensure that budget provisions are made to support such initiatives.

government with respect to the levy and collection of any tax or duty leviable by them, and during the period such agreement is in force, the power of such states and union as the case may be, to make laws to impose any tax shall be subject to the terms of such agreement.' It has been argued that such a provision will eliminate the need to amend the taxing powers entrusted to the Union and the states through Schedule VII of the Constitution.

5.51 Such an agreement (between the 28 states and the Centre as parties) could specify the tax rates adopted as well as the conditions under which the agreed tax rates can be changed. The agreement can be made part of Goods and Service Tax laws which the Centre and all the states will separately enact. The agreement will, amongst other things, specify the rates to be adopted in these enactments and the implementation schedule. For amending the rates subsequently, it is proposed that all states would need to agree to a proposal to decrease rates. Only three quarters of the number of states would need to agree if the rates have to be increased. The Centre would have a veto power. All amendments to the agreement should be consistent with (i) maintaining the integrity of the GST base; (ii) providing for administrative simplicity and (c) minimising compliance costs for taxpayers. The agreement will need to be monitored by the Empowered Committee which could be transformed after the implementation of GST into a Council of Finance Ministers with statutory backing.

Disincentives for Non Compliance

5.52 Keeping in mind the experience under VAT it may become necessary to deter violations of agreement by visiting a penalty on non-complying states. We recommend that Finance Commission's state specific grants and the state's share of the GST incentive grant be withheld for the period during which a state is in violation of the agreement. If a state is in violation for only part of a year, its grant should be reduced to a proportionate extent.

Compensation/Incentive Grants

5.53 This Commission is aware that the tenor of the ongoing discussions on the GST model and

implementation modalities does not include some of the major elements of the model GST outlined above. In our view, any major deviation from the concept of the model GST would dilute its positive externalities, significantly reduce its benefits and reduce the incentive to switch over. For the reasons outlined in Para 5.42, this Commission strongly urges that any GST model adopted be consistent with the Grand Bargain described in Para 5.48. To incentivise implementation of such a Grand Bargain between the states and the Centre, this Commission recommends the sanction of a grant of Rs. 50,000 crore to be provided to all states in the aggregate, subject to the GST framework adopted being consistent with the Grand Bargain. We recognise that while GST on the whole will be revenue neutral, there may be some winners and losers during the initial years of implementation. This grant will accommodate claims for compensation from the adversely affected states and balance will be distributed amongst states as per the devolution formula.

5.54 The grant of Rs. 50,000 crore would be used for meeting the compensation claims of State Governments between 2010-11 and 2014-15. Unspent balances in this pool would be distributed amongst all the states as per the devolution formula, on 1 January 2015. To allow for the possibility of implementation of GST during 2010-11, we propose that the grant be initially allocated as given in Table 5.2:

Table 5.2- Scheduling of GST Grant

2010-11	Rs. 5000 crore
2011-12	Rs. 11250 crore
2012-13	Rs. 11250 crore
2013-14	Rs. 11250 crore
2014-15	Rs. 11250 crore

5.55 We see this allocation as substantial for two reasons. First, the Task Force estimation of RNR provides assurance that such a level of compensation may not be required. Second, the amount of compensation required will depend upon the year in which GST is implemented. The total amount of Rs. 50,000 crore may be earmarked for

- excluding railways, communications, public sector enterprises; (e) service transactions between an employer and employee and (d) health and education services.
- x) 'Place of supply' rules for goods and services should be based on international best practice, and be carefully framed to ensure consistency, credibility and relevance.
 - xi) An exemption threshold of Rs. 10 lakh should be adopted, with a composition limit of Rs. 40 lakh, above which GST would be mandatorily applicable. The present excise exemption upto Rs. 1.5 crore should be withdrawn. However, in the case of certain high value goods comprising: (i) gold, silver and platinum ornaments; (ii) precious stones and (iii) bullion, the dealers may, subject to the threshold limit of Rs. 10 lakh but without the ceiling of Rs. 40 lakh, also be allowed to opt for the composition scheme.
 - xii) Area-based exemptions should be withdrawn and the tax paid reimbursed wherever considered necessary.
 - xiii) Inter-state transactions should be treated through a mechanism which permits sellers in one state to charge SGST from buyers in another state. The seller shall furnish the transaction related information and composite payment of tax in respect of both intra and inter state transactions, to nodal bank. This SGST should then be immediately credited to the consuming state by the bank where such payment is made.
 - xiv) Harmonisation should be ensured in registration, return filing, assessment, and audit across states.
 - xv) The GST tax base has been estimated at Rs. 31,25,325 crore. This is the average of five different estimations of the tax base obtained by following as many approaches. These estimates are given in Table 5.1.
 - xvi) The consequent Revenue-Neutral Rate works out to 11 per cent (5 per cent for CGST

Table 5.1: Estimates of the Tax Base of GST by Different Approaches

	(Rs. crore)
1. Subtraction Method	30,73,037
2. Consumption Method	
a. Task Force Method	37,43,977
b. NCAER Method	30,77,952
3. Shome Index Method	27,82,809
4. Revenue Method	29,49,748
Average	31,25,325

and 6 per cent for SGST). This excludes the additional levies which would be imposed on petroleum and sumptuary goods. The task force has recommended that all goods and services should be subject to tax at the single positive GST rate of 12 per cent (that is, 5 per cent for CGST and 7 per cent for SGST) other than exports.

The Model GST

Outline of the Model GST

5.25. Keeping in mind the recommendations of the task force, we outline the design and modalities of a model GST law. Such a model GST would not distinguish between goods and services. It should be levied at a single positive rate on all goods and services. Exports should be zero-rated. Tax compliance costs should be low and tax credits should be available seamlessly across tax jurisdictions. The other design and operational modalities of a model GST are outlined below.

Taxes to be Subsumed

5.26. For the GST to be purely consumption based, all related indirect taxes and cesses should be subsumed into it. Thus, the Central GST portion would subsume the following taxes:

- i) Central excise duty and additional excise duties
- ii) Service Tax
- iii) Additional Customs Duty (Countervailing Duty)
- iv) All surcharges and cesses

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5.27. The SGST portion would subsume the following taxes:

- i) Value Added Tax
- ii) Central Sales Tax
- iii) Entry Tax, whether in lieu of octroi or otherwise
- iv) Luxury Tax
- v) Taxes on lottery, betting and gambling
- vi) Entertainment Tax
- vii) Purchase Tax
- viii) State Excise Duties
- ix) Stamp Duty
- x) Taxes on vehicles
- xi) Tax on goods and passengers
- xii) Taxes and duties on electricity
- xiii) All state cesses and surcharges

Special Provisions for Certain Goods

5.28. The taxation of petroleum products and natural gas would be rationalised by including them in the tax base. HSD, MS, and ATF could be charged GST and an additional levy by both the Central and State Governments. No input credit would be available against either CGST or SGST on the additional levy. A similar treatment would be provided to alcohol and tobacco. Such an arrangement would ensure protection of existing revenues while taking care of environmental concerns.

Exemptions

5.29. No exemptions should be allowed other than a common list applicable to all states as well as the Centre, which should only comprise: (i) unprocessed food items; (ii) public services provided by all governments excluding railways, communications and public sector enterprises and (iii) service transactions between an employer and employee (iv) health and education services.

5.30. A threshold of Rs. 10 lakh and a composition limit of Rs. 40 lakh have been agreed upon by the EC for SGST in the first discussion draft. It is

desirable that these limits be applied to CGST as well. Sales of goods of local importance will fall within these threshold limits, thus keeping them out of the ambit of GST.

5.31. Dealers with turnover below Rs 1.5 crore were previously exempt from CENVAT. As thresholds need to be consistent across SGST and CGST, such exemptions should not continue. Under the GST regime, dealers with turnovers between Rs. 10 lakh and Rs. 40 lakh will have to pay both CGST and SGST. Their compliance burden will increase. This issue can be addressed if both CGST and SGST are levied and collected from such dealers by a single agency, viz. the State Government, which would then remit the CGST portion to the Central Government. State Government will be responsible for assessment, levy, collection and audit, with Central Government retaining it right to exercise these functions in respect of CGST in specific cases. State Governments could be reimbursed the collection charges for this effort. Wherever the additional levy is likely to cause hardship, a scheme for reimbursement to economically vulnerable dealers could be considered by the government.

5.32. The present area-based exemption schemes are not consistent across the states where they are applicable. They differ in the admissibility of CENVAT credit as well as the sunset clause. Since it would be difficult to subsume these schemes into the GST structure, it is recommended that they be terminated. The existing schemes should not be grandfathered. Alternative options like refunding taxes paid by industries in these locations could be considered.

Treatment of Inter-state Sales

5.33. All transactions across tax jurisdictions should be free from tax. While exports will be zero rated, inter-state transactions should be effectively zero-rated so as to ensure that the tax is collected by the consuming state consistent with the destination principle. Therefore, any model adopted must allow accurate determination and efficient transfer of input tax credit across tax jurisdictions. Further, the model should not impose any undue restrictions on tax credit set-off or increase in compliance costs.

Formulation of Rules of Supply

5.34 The 'place of supply' rules for services need to be carefully framed to ensure consistency and credibility. It should be based on international best practice.

GST on Imports

5.35 Imports from outside the country would be subject to GST on the destination principle. This will require that proof of consumption at a pre-determined destination state should be provided. The procedure for collection and appropriation of this tax needs to be put in place. Rules for transferring this tax burden in the case of importers who sell to a consumer in a third state after the import is made, need to be clarified.

Operational Modalities

5.36 To reduce compliance costs and increase collection efficiency, all state GST laws should be harmonised. All stages of the taxation chain, from levy of the tax to its assessment, collection and appropriation, should be similar across states. This would involve similar rules across states, dealing not only with assessments, audit and refunds, but also with more basic issues like registration, filing of returns, treatment of transportation of goods, etc.

5.37 While CST will be reduced to zero, the necessity of stipulating documentation for inter-state trade needs to be carefully examined. The model for taxing inter-state sales finally adopted should provide clarity on the jurisdiction of states while facilitating inter-state trade and stock transfers. Given the volume of such transactions, this system necessarily has to be IT-based. Such an IT network should enable the sharing of information between states and assist in the plugging of revenue leakages. A system to facilitate inter-state verification of dealers and transactions is also necessary. The present system, viz. Tax Information Exchange System (TINXSYS), does not appear to be fully operational across all states. There are asymmetric benefits to states in putting in place such infrastructure and this appears to be affecting their incentives to do so. A system which will

uniformly incentivise all states to participate in and contribute to the verification system needs to be put in place. Alternately, one central agency could be charged with maintaining this system. The existing TINXSYS infrastructure should be updated and strengthened.

Dispute Resolution and Advance Ruling Mechanism

5.38 An effective, efficient and uniform system for redressal of anomalies in the legislation should be put in place. This could be an independent and quasi-judicial authority with full powers to look into all disputes related to GST implementation, both at the Centre and state level. Such an authority could issue guidelines, administer and enforce agreement between states and the Centre, and between the states themselves. A common Advance Ruling Authority for both the Centre and the states should also be put in place.

Refunds

5.39 Prompt refunds form the core of an effective GST framework, especially as cross-utilisation of input tax credit across CGST and SGST, are not envisaged. Delayed payment of refunds enhances the cost of dealer operations and reduces the efficiency of the tax system. The experience with refunds under the VAT regime is not reassuring, even though VAT laws in a number of states mandate payment of interest for delay. State Governments must adopt a more effective refund system. They could consider an electronic system where refunds are directly credited to the eligible dealer's bank account.

Selective Rollout

5.40 VAT was introduced in a phased manner by State Governments over a period of nearly three years, between April 2003 and January 2008. VAT dealt purely with the treatment of intra-state sales and states were not explicitly disadvantaged if they did not implement VAT. Transactions between VAT and non-VAT states did not warrant special treatment. However, GST changes the rules of the game. It requires inter-state trade to be zero rated.

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It empowers states by including services as well as the manufacturing stage in their tax base. It thus creates an uneven balance between states which implement GST and those which do not. Goods and services sold between complying and non-complying states would thus require to be treated differently in the wake of selective implementation of GST. If CST were to continue to apply in non-complying states, inter-state sales would become further complex. Goods passing through a non-complying state, to be finally sold in a complying state, would be burdened by a cascading tax which would adversely affect the price to the final consumer. The seamless flow of Input Tax Credit (ITC) on inter-state transactions would be interrupted. Further, rate mismatches may encourage trade diversion and cost of compliance would become extremely high for inter-state dealers. This would discourage economies of scale. We, therefore, feel that the model GST should be implemented by all states and the Centre at one time, and not be partially implemented in some states. It is for this reason that we recommend that proper preparation for the GST and generating of a consensus amongst all states is a greater priority than complying with the 2010 deadline. However, as has been suggested in some quarters, it is possible for the Centre alone to transform the CENVAT into a GST at the manufacturing stage at any time. It could unify the CENVAT rates and impose a general tax on all services, while adopting a common threshold. As mentioned earlier, a dual tax on petroleum products, tobacco and alcohol could be levied—a GST component and an additional levy component with no input credit being provided on the latter.

Transition Provisions

5.41 A number of transitional issues will arise. Provisions to address such issues must be consistent with the model GST.

Benefits from Supporting the Model GST

5.42 This Commission supports the implementation of a model GST for the following reasons:

- i) The NCAER study computed the present value of GST-reform induced gains in GDP as the present value of additional income stream based on the discount rate of 3 per cent representing the long-term real rate of interest. The present value of total gain in GDP is estimated as between Rs. 14.69 lakh crore and Rs. 28.81 lakh crore. The corresponding dollar values are US \$325 billion and \$637 billion. This represents between 25 and 50 per cent of the 2009-10 GDP gained through this major tax reform. The all-government tax revenue will also increase by about 0.20 per cent of GDP, a significant increment to revenues through implementation of the model GST.
- ii) The Task Force report estimated that such a GST would have a tax base of around Rs. 31,00,000 crore. It further estimated that this would require a revenue-neutral rate of only 12 per cent (5 per cent for the Central GST and 7 per cent for the State GST). This is a substantial decrease from the present 20.5 per cent (8 per cent for CENVAT and 12.5 per cent for VAT). This should be the target.
- iii) Adoption of such a model GST would make India a dynamic common market and also result in generation of positive externalities. Despite lower levels of taxes, the revenue of the Union and the states will be buoyant. Subsumation of all major indirect taxes will result in removal of inefficient taxes. Our manufactures will become more competitive and consequently exports will grow. Provision of seamless input tax credit across all transactions will avoid tax cascading, eliminate double taxation and improve resource allocation. It will foster a common market across the country, reorient supply chains and remove the present bias towards backward integration. Further, it will also inhibit tax induced migration of investment. It will, thus, support the growth of lagging but resource-rich regions. A single rate across all goods and services will eliminate

classification disputes and make tax assessment more predictable. The harmonisation of tax assessment, levy and collection procedures across states proposed under the GST will reduce compliance costs, limit evasion, enhance transparency and improve collection efficiency.

- iv) Successful implementation of GST also offers the possibility of strengthening the revenue base of local bodies that form the third tier of government.
- v) The inclusion of real estate in the GST tax base will constrain the parallel economy with consequent positive spillovers into governance and the development of land markets.
- vi) The NCAER model suggests that GST could lead to better environmental outcomes.

Concerns of State Governments

5.43 We address below the principal concerns of states relating to revenue from certain products, loss of autonomy in a GST framework, possibilities of states entering GST in a phased manner and treatment of small enterprises.

Revenue from Certain Products

5.44 The model GST will accommodate the concerns of governments with regard to maintenance of their revenues from transmission fuels and sumptuary goods by allowing the imposition of an additional levy over and above the GST.

Dilution of Fiscal Autonomy of States

5.45 Concerns have been expressed by some state governments that the GST regime will constrict their fiscal autonomy and further tilt the vertical imbalance. However, this argument should be viewed in the following perspective:

- i) While the states will normally not be able to deviate from the nationally agreed model for the GST, such constraints will apply to the Centre as well. Further, the states still have

fiscal headroom available. They can impose an additional levy on transmission fuels as well as sumptuary goods and the authority to levy temporary cesses and surcharges in case of emergencies, remains. They can also continue to levy user charges for services provided to citizens. Expenditure policy will continue to remain as a powerful fiscal instrument. Further, the strengthening of their fiscal base will improve their access to capital markets, enhancing their borrowing capacity.

- ii) The tax base of State Governments will significantly increase with the inclusion of the tax on services as well as the tax on manufacture. The tax base of the Centre, on the other hand, will increase only to the extent of tax on sales. Thus, it cannot be said that the vertical imbalance will increase in favour of the Centre.
- iii) States will benefit from the abolition of the cesses and surcharges presently being levied by the Centre, as the size of the divisible pool will rise. Presently this amounts to about 15 per cent of the divisible pool.
- iv) Tax policy is tax administration, and significant scope exists for improving tax collection efficiency through implementation of GST.
- v) The GST grant recommended by this Commission compensates for the seeming limitation in fiscal autonomy by enhancing expenditure autonomy through compensation payments and additional formulaic transfers.
- vi) The GST will be a landmark effort by the states and the Union to further co-operative federalism with all stakeholders contributing to national welfare by accepting its framework.

Compensation Mechanism

5.46 An objective compensation mechanism incorporated in the 'Grand Bargain' will provide

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reassurance to both the Central and State Governments. This has been proposed in Para 5.6n.

Checkposts

5.47 Most states have put in place a system of checkposts on their border roads. There are a number of reasons for putting in place such physical barriers to trade. These include (i) enforcement of state excise, market cess, forest and vehicle fitness regulations (ii) applicability of lower taxes on inter-state trade than on intra-state trade (iii) there being no tax on stock transfers (iv) levy of entry tax on specified goods (v) levy of octroi by some municipalities and (vi) internal security. The onset of GST will not obviate all these reasons, and therefore, check posts on state borders may remain. However, it must be recognised that such checkposts, by the very nature of their operations, generate enormous delays in road traffic. The arrangement also encourages rent-seeking behaviour. It may be difficult to eliminate checkposts, given the valid concerns of State Governments. But what appears to be egregious is that the same vehicle has to pass through two checkposts—the exporting state's checkpost and the importing state's checkpost—while crossing one border. Both these checkposts are often located within a couple of kilometres of each other and a transport vehicle has to spend considerable time at both. Perhaps, it may be possible for both states to put up a combined checkpost. Officials of both states could sit together and conduct their verifications in a single check post. Alternately, one state could handle traffic in one direction and the other state in the other direction, essentially ensuring that there would be only one check per border for a goods vehicle. Such an arrangement would significantly reduce travel time and we recommend it for consideration. There is an overwhelming rationale for minimising delays and thus reducing transaction costs. States could be encouraged to consider user-friendly options like electronically issued passes for transit traffic in order to reduce truck transit time through their states.

The Grand Bargain

5.48 We propose that both the Centre and the states conclude a 'Grand Bargain' to implement the

model GST. Keeping the experience of the implementation of VAT in mind, we suggest that the six elements of the Grand Bargain comprise: (i) the design of the GST; (ii) its operational modalities; (iii) binding agreement between Centre and states with contingencies for change in rates and procedures; (iv) disincentives for non-compliance; (v) the implementation schedule and (vi) the procedure for states to claim compensation. The design of the model GST is suggested in paras 5.25 to 5.35. The operational modalities are outlined in paras 5.36 to 5.41. The proposed agreement between the Centre and states, with contingencies for changes in the agreement, is described in paras 5.49 to 5.51. The disincentives for non-compliance are described in paras 5.52. The implementation schedule is described in paras 5.57 to 5.59. The procedure for claiming compensation is at Para 5.60.

Binding Agreement between Centre and States

5.49 Compliance of states with the previously agreed upon guidelines for VAT has not been very uniform. A number of states have deviated from the three-tier VAT rates, thus indicating the need to put in place an enforcement mechanism. States are equally apprehensive that the Centre may unilaterally raise tax rates without consulting them. The Constitution does not envisage sharing of tax bases. Taxation powers are listed either in the State List or in the Central List, but not in the Concurrent List. For the first time since the Constitution was enacted, a tax base is proposed to be shared between the Centre and the states. It is, thus, necessary that a firm arrangement be put in place for implementing the GST to prevent deviations from the agreed upon model by either the Centre or the states.

5.50 One option is the possibility of a Constitutional provision to facilitate a tax agreement between the Centre and the states on the lines of the erstwhile Article 278. One suggestion is that the new Article 278 could read: 'Notwithstanding anything in this Constitution, the Government of a state may enter into an agreement with the government of any other state or the union

government with respect to the levy and collection of any tax or duty leviable by them, and during the period such agreement is in force, the power of such states and union as the case may be, to make laws to impose any tax shall be subject to the terms of such agreement.' It has been argued that such a provision will eliminate the need to amend the taxing powers entrusted to the Union and the states through Schedule VII of the Constitution.

5.51 Such an agreement (between the 28 states and the Centre as parties) could specify the tax rates adopted as well as the conditions under which the agreed tax rates can be changed. The agreement can be made part of Goods and Service Tax laws which the Centre and all the states will separately enact. The agreement will, amongst other things, specify the rates to be adopted in these enactments and the implementation schedule. For amending the rates subsequently, it is proposed that all states would need to agree to a proposal to decrease rates. Only three quarters of the number of states would need to agree if the rates have to be increased. The Centre would have a veto power. All amendments to the agreement should be consistent with (i) maintaining the integrity of the GST base; (ii) providing for administrative simplicity and (c) minimising compliance costs for taxpayers. The agreement will need to be monitored by the Empowered Committee which could be transformed after the implementation of GST into a Council of Finance Ministers with statutory backing.

Disincentives for Non Compliance

5.52 Keeping in mind the experience under VAT it may become necessary to deter violations of agreement by visiting a penalty on non-complying states. We recommend that Finance Commission's state specific grants and the state's share of the GST incentive grant be withheld for the period during which a state is in violation of the agreement. If a state is in violation for only part of a year, its grant should be reduced to a proportionate extent.

Compensation/Incentive Grants

5.53 This Commission is aware that the tenor of the ongoing discussions on the GST model and

implementation modalities does not include some of the major elements of the model GST outlined above. In our view, any major deviation from the concept of the model GST would dilute its positive externalities, significantly reduce its benefits and reduce the incentive to switch over. For the reasons outlined in Para 5.42, this Commission strongly urges that any GST model adopted be consistent with the Grand Bargain described in Para 5.48. To incentivise implementation of such a Grand Bargain between the states and the Centre, this Commission recommends the sanction of a grant of Rs. 50,000 crore to be provided to all states in the aggregate, subject to the GST framework adopted being consistent with the Grand Bargain. We recognise that while GST on the whole will be revenue neutral, there may be some winners and losers during the initial years of implementation. This grant will accommodate claims for compensation from the adversely affected states and balance will be distributed amongst states as per the devolution formula.

5.54 The grant of Rs. 50,000 crore would be used for meeting the compensation claims of State Governments between 2010-11 and 2014-15. Unspent balances in this pool would be distributed amongst all the states as per the devolution formula, on 1 January 2015. To allow for the possibility of implementation of GST during 2010-11, we propose that the grant be initially allocated as given in Table 5.2:

Table 5.2- Scheduling of GST Grant

2010-11	Rs. 5000 crore
2011-12	Rs. 11250 crore
2012-13	Rs. 11250 crore
2013-14	Rs. 11250 crore
2014-15	Rs. 11250 crore

5.55 We see this allocation as substantial for two reasons. First, the Task Force estimation of RNR provides assurance that such a level of compensation may not be required. Second, the amount of compensation required will depend upon the year in which GST is implemented. The total amount of Rs. 50,000 crore may be earmarked for

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GST compensation and incentive provided the model GST is implemented before 31.3.2013. Unspent grants at the end of a year will be carried forward to the next year if GST is implemented before 31.3.2013. If GST is implemented during 2013-14, the grant will be restricted to Rs 40,000 crore. If GST is implemented during 2014-15, the grant will be restricted to Rs 30,000 crore.

5.56 To be eligible to draw down this grant, all the elements of the Grand Bargain outlined in Para 5.48 will need to be adopted. If the GST framework adopted is not consistent with this, then this Commission recommends that this grant of Rs. 50,000 crore not be disbursed. Thus, if the Grand Bargain is not concluded, this grant will not mean any net fiscal outgo. If a model GST is implemented and the grant is disbursed, then the resultant increase in GDP and tax revenue will fully finance it. If the Grand Bargain is not put in place, then the grant lapses. There are, thus, no fiscal risks with this grant—only advantages.

Implementation schedule of the Model GST

5.57 We recognise that building consensus on implementing the model GST may be an involved process but equally appreciate that the requirement of a good design is paramount and should not be subordinated to a deadline. International experience tells us that flaws in design are extremely difficult to correct subsequently. We therefore recommend that marginal rescheduling of the timetable for implementation should be acceptable if the design adopted is consistent with the model GST.

5.58 The objective of the model GST is to optimise tax collection with minimal economic distortions. The Model GST should, inter alia, comprise of (i) a uniform rate for goods and services (ii) a uniform rate across states (iii) a zero rate for exports and (iv) for all other goods and services a single rate, excluding the rate for precious metals. There could be two possible approaches to the implementation of the Model GST: the 'big-bang' approach and the 'incremental' approach. The introduction of the GST is the last mile in the reform of the indirect tax

system of this country initiated in 1986 with the introduction of the MODVAT. All stakeholders stand to gain from a swift comprehensive changover to the GST. To the extent the switchover is staggered, the potential gains from the comprehensive GST outlined in Para 5.42 would remain unrealised. Therefore, we recommend that all the elements of the model GST should be implemented comprehensively at one instance.

5.59 However, we are aware that two essential elements of the model have not yet been formally discussed by the states and consensus needs to be built before they are adopted. These are the inclusion of stamp duty in the GST tax base to enable the taxation of real estate and the use of a single rate in the GST framework. More time may be required for these elements to be included in the GST framework. Given that the terminal year of the period covered by our recommendations is 2014-15, we propose as follows. If found necessary, the GST may be initially implemented without these two elements provided that

- i) At the time of its implementation, the road map for their inclusion in the framework before 31 December 2014 is announced.
- ii) The GST is introduced with not more than two rates.
- iii) Properties other than individually owned residential properties are brought into the ambit of GST within two years of its implementation.

This contingency does not preclude the possibility of the Centre implementing GST at an accelerated pace.

Modalities for Disbursing Compensation

5.60 As mentioned in Para 5.10, states had requested that an objective compensation mechanism to support possible revenue losses after implementing GST be put in place. We recommend the following:

- i. The present Empowered Committee be transformed into a statutory Council of Finance Ministers with representation from

- the Centre and states. A GST Compensation Fund should be created under the administrative control of this Council.
- ii. The Central Government shall transfer to the GST Compensation Fund amounts as indicated in Table 5.2 and subject to the conditionalities indicated in paras 5.55 and 5.56.
 - iii. The amounts in the Fund should be used for compensating states for any revenue loss on account of adoption of the model GST and the Grand Bargain as indicated above. The balance, if any, remaining on 1 January 2015, will be distributed amongst the states on the basis of the devolution formula indicated in Chapter 8 of our report, used for distributing resources in the divisible pool amongst states.
 - iv. The amount will be disbursed in quarterly instalments on the basis of the recommendations made by a three-member Compensation Committee comprising of the Secretary, Department of Revenue, Government of India; Secretary to the EC and chaired by an eminent person with experience in public finance. This person would be appointed by the Union Government.

The Way Forward

5.61 A number of legal and administrative steps need to be taken prior to the implementation of GST. These include stakeholder consultations, amendments to the Constitution and state laws, administrative reorganisation, preparation of GST registration, assessment and audit manuals, staff training and conduct of awareness campaigns amongst stakeholders. We have not touched upon these milestones in our discussion, but are aware that these processes may take substantial time. This is also a reason why we have earlier recommended that the putting in place an excellent design and operational framework for the GST should be given priority, even if this implies rescheduling the previously announced implementation timetable.

5.62 We recognise that the process of generating a consensus to implement the Grand Bargain as outlined by us may be difficult and involved. However, we believe that such a consensus can, and should be, generated to fully exploit the potential of GST and reap the benefits of its positive externalities. While we would like to support this model GST, which is fully consumption based, has provision for seamless credit and imposes low compliance cost, we must allow for the possibility that political economy considerations may will otherwise. In the unlikely event that such a consensus cannot be achieved and the GST framework finally adopted is different from the Grand Bargain suggested by us, this Commission recommends that the grant amount of Rs. 50,000 crore shall not be disbursed.

Impact of GST on Projections made by the Finance Commission

5.63 Though GST requires that all cesses and surcharges be abolished, and this Commission recommends that GST be implemented as early as possible, we have, in our projections, assumed continuing revenue for the Central Government from cesses for the period 2010-15. This has been done for the following reasons.

- i. Ignoring the positive externalities of GST, the Commission has conservatively assumed that GST will be revenue-neutral. Thus, income from cesses and surcharges will be included in the computation of RNR. In the scenario when GST is implemented, the aggregate revenue figures in our projections will remain unchanged, though the accounting heads under which they are reported may change. Since the catalysing effect of GST on the economy has not been factored in our projections, they can be seen as conservative.
- ii. A number of critical sectors, including roads, education, and calamity relief, are being funded from the proceeds of cesses levied by the Government of India. The transition plan to the GST must ensure that budget provisions are made to support such initiatives.

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5.64 The model, the modalities as well as the timing of implementation of the GST have not yet been finalised. Making projections over a five-year period, assuming the implementation of the GST during this period, would be a hazardous exercise. This Commission has, thus, for the purpose of our financial projections, assumed that the impact of GST will be revenue-neutral and that the gross revenues of the Centre and states will not be lower than those projected even after GST is implemented.

Summary of Recommendations

5.65 Both the Centre and the states should conclude a Grand Bargain to implement the model GST. The Grand Bargain comprises five elements: (i) the design of the model GST is suggested in paras 5.25 to 5.35; (ii) the operational modalities are outlined in paras 5.36 to 5.41; (iii) the proposed agreement between the Centre and states, with contingencies for changes is at paras 5.49 to 5.51; (iv) the disincentives for non-compliance are described in paras 5.52 (v) the implementation schedule is described in paras 5.57 to 5.59. (vi) the procedure for claiming compensation is at Para 5.60 (Para 5.48).

5.66 Any GST model adopted must be consistent with all the elements of the Grand Bargain. To incentivise implementation of the Grand Bargain this Commission recommends the sanction of a grant of

Rs. 50,000 crore which will taper down to Rs. 40,000 crore and Rs. 30,000 crore if GST is implemented after 1.4.2013 and 1.4.2014 respectively. The grant would be used for meeting the compensation claims of State Governments for revenue losses on account of GST implemented, consistent with the Grand Bargain, between 2014-11 and 2014-15. Unspent balances in this pool would be distributed on 1 January 2015 amongst all the states as per the devolution formula (paras 5.54 and 5.55).

5.67 The EC should be given formal authority. The compensation should be disbursed in quarterly instalments on the basis of the recommendations by a three-member Compensation Committee comprising of the Secretary, Department of Revenue, Government of India; Secretary to the EC and chaired by an eminent person with experience in public finance to be appointed by the Central Government (Para 5.60).

5.68 In the unlikely event that a consensus to implement all the elements of the Grand Bargain cannot be achieved and the GST mechanism finally adopted is different from the model GST suggested by us, this grant of Rs. 50,000 crore shall not be disbursed. (Para 5.62).

5.69 States should take steps to reduce the transit time of cargo vehicles crossing its borders by combining checkpoints with adjoining states and adopting user friendly options like electronically issued passes for transit traffic (Para 5.47).



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वित्त मंत्रालय

(आर्थिक कार्य विभाग)

अधिसूचना

नई दिल्ली, 2 जनवरी, 2013

क्र.आ. 31(अ)— राष्ट्रपति द्वारा किया गया निम्नलिखित आदेश सर्वसाधारण की जानकारी के लिए प्रकाशित किया जाता है :-

आदेश

राष्ट्रपति, वित्त आयोग प्रकीर्ण उपबंध) अधिनियम, 1951 (1951 का 33) के उपबंधों के साथ पठित संविधान के अनुच्छेद 280 के खंड (1) के अनुसरण में एक वित्त आयोग का गठन करते हैं जिसमें डा. वाई.वी. रेड्डी, भारतीय रिजर्व बैंक के पूर्व गवर्नर, अध्यक्ष के रूप में और निम्नलिखित चार सदस्य सम्मिलित होंगे, अर्थात :

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|----|---|----------------------|
| 1. | प्रो. अभिजीत सेन
सदस्य योजना आयोग | सदस्य
(अंश कालिक) |
| 2. | सुश्री सुब्रता माथ
पूर्व केंद्रीय वित्त सचिव | सदस्य |
| 3. | डा. एम. गोविन्दा राव
निदेशक, राष्ट्रीय लोक वित्त
एवं नीति संस्थान,
नई दिल्ली | सदस्य |

4. डा. सुदीप्तो मुंडले सदस्य
पूर्व कार्यकारी अध्यक्ष,
राष्ट्रीय सांख्यिकीय आयोग
2. श्री अजय नारायण झा आयोग के सचिव होंगे।
3. आयोग के अध्यक्ष और अन्य सदस्य उस तारीख से, जिसको वे अपना-अपना पद ग्रहण करते हैं, 31 अक्टूबर, 2014 तक पद धारण करेंगे।
4. आयोग निम्नलिखित विषयों के बारे में सिफारिशें करेगा, अर्थात्:-
 - (i) संघ और राज्यों के बीच करों के शुद्ध आगमों का, जो संविधान के भाग 12 के अध्याय 1, अधीन उनमें विभाजित किए जाने हैं या किए जाएं, वितरण और राज्यों के बीच ऐसे आगमों के तत्संबंधी भाग का आबंटन;
 - (ii) भारत की संचित निधि में से राज्यों के राजस्व में सहायता अनुदान को शासित करने वाले सिद्धांत और उन राज्यों को, जिन्हें संविधान के अनुच्छेद 275 के अधीन उनके राजस्वों में सहायता अनुदान के रूप में उस अनुच्छेद के खंड (1) के परंतुक में विनिर्दिष्ट प्रयोजनों से भिन्न प्रयोजनों के लिए सहायता की आवश्यकता है, संदत्त की जाने वाली धनराशियां; और
 - (iii) राज्य के विस्तार आयोग द्वारा की गई सिफारिशों के आधार पर राज्य में पंचायतों और नगरपालिकाओं के संसाधनों की अनुपूर्ति के लिए किसी राज्य की संचित निधि के संवर्धन के लिए आवश्यक अध्युपाय।
5. आयोग, विशेष रूप से, तेरहवें विस्तार आयोग द्वारा सिफारिश की गई राजवित्तीय समेकन रूपरेखा को ध्यान में रखते हुए, संघ और राज्यों की वित्तीय स्थिति, घाटे और ऋण स्तरों का पुनर्विलोकन और वर्तमान में प्रवृत्त राजवित्तीय उत्तरदायित्व बजट प्रबंध अधिनियमों में संशोधन के सुझावों सहित समग्र वृद्धि से संगत स्थिर और पोषणीय राजवित्तीय वातावरण बनाए रखने के लिए उपायों का सुझाव देगा और ऐसा करते समय, आयोग, घाटे के संबंध में पूंजी आस्तियों के सृजन हेतु अनुदानों के रूप में प्राप्तियों और व्यय के प्रभाव पर विचार कर सकेगा; और आयोग, राजवित्तीय उत्तरदायित्व बजट प्रबंध अधिनियमों में अधिकथित बाधकताओं का पालन करने हेतु राज्यों के लिए प्रोत्साहनों और हतोत्साहनों पर भी विचार करेगा और उनकी सिफारिश भी करेगा।
6. आयोग अपनी सिफारिशें करते समय, अन्य बातों के साथ, निम्नलिखित को ध्यान में रखेगा:-
 - ... वर्ष 2014-15 के दौरान पूरा किए जाने वाले कराधान और गैर-कर राजस्वों के

संभावित स्तरों के आधार पर, 1 अप्रैल, 2015 को आरंभ होने वाले पांच वर्षों के लिए केंद्रीय सरकार के संसाधन;

- (ii) केंद्रीय सरकार के संसाधनों, विशेष रूप से सिविल प्रशासन, रक्षा, आंतरिक और सीमा सुरक्षा, ऋण सेवा और अन्य प्रतिबद्ध व्यय तथा दायित्वों संबंधी मांग;
- (iii) वर्ष 2014-15 के दौरान पूरा किए जाने वाले कराधान और गैर-कर राजस्वों के संभावित स्तरों के आधार पर, 1 अप्रैल, 2015 को आरंभ होने वाले पांच वर्षों के लिए, राज्य सरकारों के संसाधन और विभिन्न शीर्षों के अधीन ऐसे संसाधनों पर मांग, जिसके अंतर्गत ऋण प्रतिबलित राज्यों में उपलब्ध संसाधन पर ऋण स्तरों का समायात भी है;
- (iv) सभी राज्यों और संघ के राजस्व खाते पर प्राप्तियों और व्यय को न केवल संतुलित करने, अपितु पूंजी निवेश के लिए अधिशेष उद्भूत करने का भी उद्देश्य;
- (v) केंद्रीय सरकार और प्रत्येक राज्य सरकार के कराधान संबंधी प्रयास और संघ की दशा में कर-सकल घरेलू उत्पाद अनुपात और राज्यों की दशा में कर-सकल राज्य घरेलू उत्पाद अनुपात में सुधार करने के लिए अतिरिक्त संसाधन जुटाने की क्षमता;
- (vi) पोषणीय और समावेशित विकास, और केंद्रीय सरकार और राज्य सरकारों के बीच साहचिकियों के समान विभाजन की आवश्यकता को ध्यान में रखते हुए, अपेक्षित साहचिकियों का स्तर;
- (vii) पूंजीगत आस्तियों के रख-रखाव और अनुरक्षण के गैर-वेतन घटक संबंधी व्यय और 31 मार्च, 2015 तक पूरी की जाने वाली आयोजना स्कीमों पर गैर-मजूदरी संबंधी रख-रखाव व्यय तथा ऐसे मानदण्ड, जिनके आधार पर पूंजीगत आस्तियों के रख-रखाव के लिए विनिर्दिष्ट धनराशियों की सिफारिश की जाती है, तथा ऐसे व्यय को मानीटर करने की रीति;
- (viii) पेयजल, सिंचाई, विद्युत और सार्वजनिक परिवहन जैसी जनोपयोगी सेवाओं के मूल्यनिर्धारण को कानूनी उपबंधों के माफत नीतिगत उतार-चढ़ावों से अलग रखने की आवश्यकता;
- (ix) पब्लिक सेक्टर उद्यमों को प्रतिस्पर्धी और बाजारोन्मुखी बनाने, सूचीबद्ध और विनिवेश और गैर-प्राथमिकता वाले उद्यमों को छोड़ने की आवश्यकता;
- (x) सतत आर्थिक विकास के अनुरूप पारिस्थितिकी, पर्यावरण और जलवायु परिवर्तन के संतुलित प्रबंध की आवश्यकता; और
- (xi) केंद्र और राज्यों के वित्तीय-साधनों पर प्रस्तावित माल और सेवा कर का प्रभाव और किसी राजस्व हानि की दशा में क्षतिपूर्ति के लिए तंत्र।

7. आयोग, विभिन्न विषयों पर अपनी सिफारिशें करते समय, उन सभी मामलों में, जहाँ करों और शुल्कों तथा सहायता अनुदानों के अंतरण को अवधारित करने के लिए जनसंख्या एक कारक है, वर्ष 1971 की जनसंख्या के आंकड़ों को, सामान्यतया, आधार के रूप में लेगा; तथापि, आयोग, उन जनसांख्यिकीय बदलावों को भी ध्यान में रख सकेगा जो 1971 के बाद में हुए हैं।

8. आयोग, बजटीय और लेखाकरण मानकों तथा परंपराओं सहित, विद्यमान में लागू लोक व्यव प्रबंध प्रणालियों, प्राप्तियों और व्यय के वर्गीकरण की विद्यमान प्रणाली; परिवर्तनों को उत्पादन और परिणाम से जोड़ने; देश में और विदेशों में प्रचलित सर्वोत्तम परंपराओं का पुनर्विलोकन कर सकेगा और उनके संबंध में उपयुक्त सिफारिशें कर सकेगा।

9. आयोग, आपदा प्रबंध अधिनियम, 2005 (2005 का 53) के अधीन गठित निधियों के प्रतिनिर्देश से आपदा प्रबंध के वित्तपोषण के संबंध में विद्यमान व्यवस्थाओं पुनर्विलोकन कर सकेगा और उनके संबंध में उपयुक्त सिफारिशें कर सकेगा।

10. आयोग उन आधारों को बताएगा, जिनके आधार पर वह अपने निष्कर्षों पर पहुंचा है और प्राप्तियों और व्यय के राज्य-वार अनुमान उपलब्ध कराएगा।

11. आयोग, 1 अप्रैल, 2015 से प्रारंभ होने वाली पांच वर्ष की अवधि को समाविष्ट करते हुए, 31 अक्टूबर, 2014 तक अपनी रिपोर्ट उपलब्ध कराएगा।

नई दिल्ली, तारीख 1 जनवरी, 2013

ह/-
प्रणव मुखर्जी
राष्ट्रपति

[फा. सं. 10(2)-बी (एस)/2012]
डॉ. रजत भार्गव, संयुक्त सचिव (बजट)

MINISTRY OF FINANCE
(Department of Economic Affairs)
NOTIFICATION
New Delhi, the 2nd January, 2013

S.O. 31(E).— The following order made by the President is published for general information:-

ORDER

In pursuance of clause (1) of article 280 of the Constitution, read with the provisions of the Finance Commission (Miscellaneous Provisions) Act, 1951 (33 of 1951), the President is pleased to constitute a Finance Commission consisting of Dr. Y.V.Reddy, former Governor Reserve Bank of India, as the Chairman and the following four other members, namely: -

- | | |
|---|-----------------------|
| 1. Prof Abhijit Sen
Member, Planning Commission | Member
(Part Time) |
| 2. Ms.Sushma Nath
Former Union Finance Secretary | Member |
| 3. Dr.M.Govinda Rao
Director, National Institute for Public
Finance and Policy, New Delhi | Member |
| 4. Dr.Sudipto Mundie
Former Acting Chairman,
National Statistical Commission | Member |

2. Shri Ajay Narayan Jha shall be the Secretary to the Commission.

3. The Chairman and the other members of the Commission shall hold office from the date on which they respectively assume office upto the 31st day of October, 2014.

4. The Commission shall make recommendations as to the following matters, namely:-

- (i) the distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them under Chapter I, Part XII of the Constitution and the allocation between the States of the respective shares of such proceeds;

(ii) the principles which should govern the grants-in-aid of the revenues of the States out of the Consolidated Fund of India and the sums to be paid to the States which are in need of assistance by way of grants-in-aid of their revenues under article 275 of the Constitution for purposes other than those specified in the provisos to clause (1) of that article; and

(iii) the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State.

5. The Commission shall review the state of the finances, deficit and debt levels of the Union and the States, keeping in view, in particular, the fiscal consolidation roadmap recommended by the Thirteenth Finance Commission, and suggest measures for maintaining a stable and sustainable fiscal environment consistent with equitable growth including suggestions to amend the Fiscal Responsibility Budget Management Acts currently in force and while doing so, the Commission may consider the effect of the receipts and expenditure in the form of grants for creation of capital assets on the deficits; and the Commission shall also consider and recommend incentives and disincentives for States for observing the obligations laid down in the Fiscal Responsibility Budget Management Acts.

6. In making its recommendations, the Commission shall have regard, among other considerations, to —

- (i) the resources of the Central Government, for five years commencing on 1st April 2015, on the basis of levels of taxation and non-tax revenues likely to be reached during 2014-15;
- (ii) the demands on the resources of the Central Government, in particular, on account of the expenditure on civil administration, defence, internal and border security, debt-servicing and other committed expenditure and liabilities;
- (iii) the resources of the State Governments and the demands on such resources under different heads, including the impact of debt levels on resource availability in debt stressed states, for the five years commencing on 1st April 2015, on the basis of levels of taxation and non-tax revenues likely to be reached during 2014-15;
- (iv) the objective of not only balancing the receipts and expenditure on revenue account of all the States and the Union, but also generating surpluses for capital investment;

- (v) the taxation efforts of the Central Government and each State Government and the potential for additional resource mobilisation to improve the tax-Gross Domestic Product ratio in the case of the Union and tax-Gross State Domestic Product ratio in the case of the States;
- (vi) the level of subsidies that are required, having regard to the need for sustainable and inclusive growth, and equitable sharing of subsidies between the Central Government and State Governments;
- (vii) the expenditure on the non-salary component of maintenance and upkeep of capital assets and the non-wage related maintenance expenditure on plan schemes to be completed by 31st March, 2015 and the norms on the basis of which specific amounts are recommended for the maintenance of the capital assets and the manner of monitoring such expenditure;
- (viii) the need for insulating the pricing of public utility services like drinking water, irrigation, power and public transport from policy fluctuations through statutory provisions;
- (ix) the need for making the public sector enterprises competitive and market oriented; listing and disinvestment; and relinquishing of non-priority enterprises;
- (x) the need to balance management of ecology, environment and climate change consistent with sustainable economic development; and
- (xi) the impact of the proposed Goods and Services Tax on the finances of Centre and States and the mechanism for compensation in case of any revenue loss.

7. In making its recommendations on various matters, the Commission shall generally take the base of population figures as of 1971 in all cases where population is a factor for determination of devolution of taxes and duties and grants-in-aid; however, the Commission may also take into account the demographic changes that have taken place subsequent to 1971.

8. The Commission may review the present Public Expenditure Management systems in place including the budgeting and accounting standards and practices; the existing system of classification of receipts and expenditure; linking outlays to outputs and outcomes; best practices within the country and internationally, and make appropriate recommendations thereon.

9. The Commission may review the present arrangements as regards financing of Disaster Management with reference to the funds constituted under the Disaster Management Act, 2005(53 of 2005), and make appropriate recommendations thereon.

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10. The Commission shall indicate the basis on which it has arrived at its findings and make available the State-wise estimates of receipts and expenditure.

11. The Commission shall make its report available by the 31st October, 2014, covering a period of five years commencing on the 1st April, 2015.

New Delhi, Dated the 1st January, 2013

Sd/-
SHRI PRANAB MUKHERJEE
President

[F. No. 10(2)-B(S)/2012]
Dr. RAJAT BHARGAVA, Jt. Secy. (Budget)

मंत्रि: वरुण
उप मंत्रि

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AS INTRODUCED IN LOK SABHA

1 MAR 2006

Bill No. 21 of 2006

THE DRUGS (CONTROL) REPEAL BILL, 2006

A

BILL

to repeal the Drugs (Control) Act, 1950.

BE it enacted by Parliament in the Fifty-seventh Year of the Republic of India as follows:—

1. This Act may be called the Drugs (Control) Repeal Act, 2006.
2. The Drugs (Control) Act, 1950 is hereby repealed.

Short title.

Repeal of Act
26 of 1950.

STATEMENT OF OBJECTS AND REASONS

The Drugs (Control) Act, 1950 was enacted by Parliament in order to ensure that certain essential imported drugs and medicines were sold at reasonable prices in the Chief Commissioner's Provinces.

2. After the enactment of the Essential Commodities Act, 1955 (10 of 1955) (EC Act) and the 'drugs' having been declared as an Essential Commodity under the EC Act, the Drugs (Price Control) Orders are being issued from time to time since 1970, under section 3 of the EC Act. Prior to this, price orders were issued in 1963, 1966 and 1968 under the Defence of India Act. Presently, the Drugs (Price Control) Order, 1995 (DPCO), is in force. Thus, prices of some of the drugs are being controlled uniformly for the entire country. The National Pharmaceutical Pricing Authority (NPPA) was constituted in September, 1997 to fix and control prices of the drugs under the provisions of DPCO, 1995.

3. Since price control is being done under the Essential Commodities Act, the Drugs (Control) Act, 1950 has become redundant and, therefore, it has been decided to repeal the same.

4. The Bill seeks to achieve the aforesaid object.

NEW DELHI
The 27th February, 2006.

RAM VILAS PASWAN.

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LOK SABHA

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BILL

to repeal the Drugs (Control) Act, 1950.

*(Shri Ram Vilas Paswan, Minister of Chemicals and Fertilizers
and Minister of Steel)*

MGIPMRND—6039LS(S-5)—06.03.2006.