

# **Financial sector regulation for growth equity and stability, and role of DFIs**

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# Structure of presentation

- **Background**
- **Growth**
- **Equity**
- **Stability**
- **Linkages with macro economic policy and international financial architecture**
- **Conclusion**

# Background

- **Global banking changes since 1980s**
- **Deregulation became focus and encouraging innovation –markets know best**
- **Excess Financialisation**
- **Financial sector source of instability –passed on to the fiscal space- economic crisis**
- **Focus on stability and through stability growth and equity**

# Finance and growth

- **Positive relationship ?**
- **Finance supported growth of world trade investment and output**
- **Quality of growth in the period since 2004- mostly in the financial sector**
- **Excess leverage, innovation, credit supported spending ,crisis**
- **Impact of Basel 3 on growth**

# **Impact of Basel 3 on growth**

- **Studies show small impact- overall benefits of stable growth outweighs cost**
- **EMEs- contagion effect beneficial but some stress for trade credit , infrastructure and SME**
- **Quality of growth and quality of supervision**
- **Problems of implementation of Basel 2/3**
- **Financial sector should serve real sector**

# Finance and Equity

- **Equity - specific objective of regulation ?**
- **Safety net in downturns and calamities- insurance and guarantees**
- **Diversification benefit**
- **Time horizons- regulatory and accounting norms, performance parameters**
- **Good innovation- ICT, branchless banking- proportional regulation-credit records , identity**
- **Finance supplemented by other policies**
- **Local community based institutions**

# Finance and Stability

- **Systemic crisis because of leverage externalities , TBTF, interconnectedness**
- **Importance of macro economic policies for stability**
- **Macro prudential policies- indicators of stress, policy tools, institutional and governance issues**
- **Capital flows and capital controls for stability**

# **Regulation and links with macro policy and global architecture**

- **Links with monetary and fiscal policy**
- **Reserve Currency and imbalances**
- **Global lender of last resort**
- **Credit rating agencies and the market micro structure participants**
- **Global banks and national regulators**
- **Political aspects of regulation**



# **Panchsheel – 5 principles for good regulation**

- **State or markets –the golden mean**
- **Courage**
- **Communication**
- **Bio diversity**
- **Cooperation and coordination**

# Role of development financial institutions

- Development finance has long term benefits that can't be measured through profits . Commercial banks are oriented towards annual profits , ROA , ROC
- Development finance needs long term funds – commercial banks dependent on shorter term funds
- Development finance supports in time of distress
- Development finance has to be affordable
- Development needs infrastructure –physical , payments systems, credit information, rating
- Development finance must provide risk mitigants
- Catalytic role – venture capital, asset reconstruction

# Role of DFIs

- Routing of subsidies for credit
- Build capacities and enhance professional skills
- Non credit interventions
- Facilitating access to markets
- Creating awareness
- Countercyclical role
- Sustainability – green technology, energy efficiency
- Micro finance

# Regulation and supervision of DFIs

- Performance audit
- Efficiency –productivity
- Transparency
- Regulatory norms adherence
- Oversight on linked institutions