

Financial Stability and Development Council (FSDC)
(18 January, 2022)

With a view to strengthening and institutionalizing the mechanism for maintaining **financial stability, enhancing inter-regulatory coordination, and promoting financial sector development**, the Financial Stability and Development Council (FSDC) was set up by the Government as the apex level forum in December 2010.

- The **Chairman of the FSDC is the Finance Minister** and its members include the **heads of financial sector Regulators (RBI, SEBI, PFRDA, IRDA & FMC)** Finance Secretary and/or Secretary, Department of Economic Affairs, Secretary, Department of Financial Services, and Chief Economic Adviser.
- The Council can invite experts to its meeting if required.
- Without prejudice to the autonomy of regulators, the **Council monitors macro-prudential supervision of the economy**, including the functioning of large financial conglomerates, and **addresses inter-regulatory coordination** and financial sector development issues.
- It also **focuses on financial literacy and financial inclusion**.

What is Macroprudential policy?

- **Macroprudential policy** is a novel way of looking into financial regulation. It **aims to prevent the build-up of risk** (resulting from external factors and market failures); **make the financial sector more resilient and limit contagion effects** and create a perspective to create the right set of incentives.

What is Financial Stability?

UPSC GS Study Notes

- **Monetary stability** (say maintaining low and stable inflation) **leads to financial stability**. Monetary stability is an important precondition for financial stability. Contextually, financial stability in India means
 1. ensuring **uninterrupted settlements** of financial transactions (both internal and external),
 2. maintenance of a **level of confidence** in the financial system amongst all the participants and stakeholders and
 3. **absence of excess volatility** that unduly and adversely affects real economic activity.
- Forces affecting financial stability, include:
 1. **The boom in credit to the private sector**, both investment and consumption, A particular form of boom and bust cycle is generated by the end of hyperinflation episodes.
 2. **highly regulated systems** have also suffered crises.
 3. Direct effects of **fiscal difficulties and crises** in one country have a direct effect on economic conditions.
 4. Terms of **trade shocks** and movements in **real exchange rates**.
 5. **Political instability, unrest, civil conflict**.
 6. **Policy-induced distortions**, government influence over public sector banks.

About Financial Stability and Development Council (FSDC)

- The idea to create such a super regulatory body was first mooted by the **Raghuram Rajan Committee in 2008**.
- Finally, in 2010, the then Finance Minister of India, Pranab Mukherjee, decided to set up such an **autonomous body dealing with macro-prudential and financial regularities** in the entire financial sector of India.
- It was set up as a **non-statutory organization in 2010**. To maintain financial stability and enhancing inter-regulatory coordination.
- The **Chairman of the FSDC is the Finance Minister** and its members include the heads of the financial sector regulatory authorities (i.e, **SEBI, IRDA, RBI, PFRDA, and FMC**), Finance Secretaries, and the Chief Economic Adviser.
- FMC was added in 2013. It would monitor macro-prudential supervision of the economy, including the functioning of large financial conglomerates.
- It will address inter-regulatory coordination issues.
- It will also focus on financial literacy and financial inclusion. Prior to the financial stability & development council, it was an objective of monetary policy.
- The recent global economic meltdown has put pressure on governments and institutions across the globe to regulate their economic assets.
- This council is seen as India's initiative to be better conditioned to prevent such incidents in the future.
- The new body envisages strengthening and institutionalize the mechanism of

UPSC GS Study Notes

maintaining financial stability, financial sector development, inter-regulatory coordination along with monitoring macro-prudential regulation of the economy.

- No funds are separately allocated to the council for undertaking its activities.

Composition of FSDC

- **Chairperson: The Union Finance Minister of India**
- Governor Reserve Bank of India (RBI),
- Finance Secretary and/ or Secretary, Department of Economic Affairs (DEA),
- Secretary, Department of Financial Services (DFS),
- Secretary, Ministry of Corporate Affairs,
- Secretary, Ministry of Electronics and Information Technology,
- Chief Economic Advisor, Ministry of Finance,
- Chairman, Securities and Exchange Board of India (SEBI),
- Chairman, Insurance Regulatory and Development Authority (IRDA),
- Chairman, Pension Fund Regulatory and Development Authority (PFRDA),
- Chairman, Insolvency and Bankruptcy Board of India (IBBI),
- Additional Secretary, Ministry of Finance, DEA, will be the Secretary of the Council,
- The Chairperson may invite any person whose presence is deemed necessary for any of its meetings.

Responsibilities of FSDC

- Financial Stability
- Financial Sector Development
- Inter-Regulatory Coordination
- Financial Literacy
- Financial Inclusion
- Macroprudential supervision of the economy including the functioning of large financial conglomerates.
- Coordinating India's international interface with financial sector bodies like the Financial Action Task Force (FATF), Financial Stability Board (FSB), and any such body as may be decided by the Finance Minister from time to time.

The institutional structure for India's Financial Inclusion/ Literacy programme is unique as it has an apex body in the Financial Stability and Development Council (FSDC), headed by the Finance Minister of Government of India, mandated, inter alia, to focus on attaining financial inclusion/ literacy goals.

Structural and Functional changes

- To Entrust it with the tasks of existing regulators i.e. RBI, IRDA, SEBI, PFRDA.
- The Council shall have a sub-committee headed by the Governor, RBI. The sub-committee will replace the existing High-Level Coordination Committee on Financial Markets.

UPSC GS Study Notes

- Sectoral regulators' autonomy to be protected.
- Guidelines prepared on the functioning of the Financial Stability and Development Council, a high-level body set up to sort out inter-regulatory issues, will define the role of the finance ministry and how member regulators' autonomy is not compromised.
- FSDC was formed to bring greater coordination among financial market regulators. The council is headed by the finance minister and has the Reserve Bank of India (RBI) governor and chairpersons of the Securities and Exchange Board of India, Insurance Regulatory and Development Authority, and Pension Fund Regulatory and Development Authority as other members along with the finance ministry officials.
- RBI and other regulators had earlier feared that their autonomy was at stake as the financial stability & development council was headed by the finance minister herself. After the assurance of FM, this fear was set to rest but functional guidelines were supposed to address this issue.

Financial Sector Legislative Reforms Commission (FSLRC- 2013)

- **Financial Sector Legislative Reforms Commission (FSLRC- 2013)** had thoroughly redefined the role of FSDC. It recommended
 1. It recommended **making the financial stability & development council a statutory body** to perform the mandate of financial stability/systemic risk management.
 2. It also suggested a data center called **Financial Data Management Center (FDMC)** to work with FSDC.

Financial Data Management Center (FDMC)

- **Budget 2016-17 set up FDMC** under FSDC to facilitate integrated data aggregation and analysis in the financial sector.
- The financial stability & development council presently works in a two-tier structure.
- While the financial stability & development council functions under Finance Minister, its Sub-Committee (FSDC-SC) operates as an executive arm of the main Council under the chairmanship of Governor, RBI.
- Although India has institutionalized financial stability mechanism, an explicit macroprudential policy framework is yet to develop.

Financial Stability Board

1. It was established in **2009 under G20** by bringing together national authorities, standard setting bodies and international financial institutions.
2. For addressing vulnerabilities and developing and implementing strong policies for **financial stability**.
3. India is an active member having 3 seats.



UPSC GS Study Notes

ASPIRE IAS