

CUTS International
Comments on the revised draft of the Indian Financial Code

1. Background

CUTS International is an economic policy research and advocacy institution, leading reform initiatives in the areas of regulation, competition, consumer protection, governance and trade, for more than three decades. It has also undertaken several initiatives in the areas of financial regulation and financial consumer protection.¹

CUTS shared its suggestions on the approach paper² and report³ of the Financial Sector Legislative Reforms Commission, including the Initial draft of the Indian Financial Code (Code). In terms of notification dated 23 July 2015, Ministry of Finance issued revised draft of the Code for public comments.

CUTS' comments on revised draft of the Indian Financial Code are as follows:

S. no	Section	Issue	Suggestion	Rationale
1	106	Principle of appropriateness in financial consumer protection chapter	Reinstate the principle of appropriateness of financial product or financial service for different classes of consumers	The principle of appropriateness or suitability is significant in financial consumer protection, owing to the inherent complex nature of financial sector products and services. This is clearly highlighted in the Sergeant Review of Simple Financial Products in UK, amongst other expert committee reports. Consequently, it must be taken into account by regulators while discharging their functions.
2	109(5)	Restriction on determining substantially non-negotiable	Delete the restriction	The provision implies that if the provisions which define financial product/ service or set out price are not negotiated between the consumer and financial service provider, the contract will still be presumed to be negotiated. While at present price and scope

¹ www.cuts-international.org

² [www.cuts-ccier.org/pdf/CUTS-](http://www.cuts-ccier.org/pdf/CUTS-Comments_on_the_Approach_Paper_of_the_Financial_Sector_Legislative_Reforms_Commission.pdf)

[Comments_on_the_Approach_Paper_of_the_Financial_Sector_Legislative_Reforms_Commission.pdf](http://www.cuts-ccier.org/pdf/CUTS-Comments_on_the_Approach_Paper_of_the_Financial_Sector_Legislative_Reforms_Commission.pdf)

³ [http://www.cuts-ccier.org/pdf/CUTS-](http://www.cuts-ccier.org/pdf/CUTS-Comments_on_the_recommendations_of_Financial_Sector_Legislative_Reforms_Commission.pdf)

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				of services might not be negotiated between service providers and consumers, such restriction provides unfair advantage to the financial service providers and could prevent development of negotiation culture on price and scope of financial service products, in the country.
3	146(2)	Scope of financial awareness	<p>The scope of financial awareness must be expanded to include duties of consumers, benefits of financial planning, comparing different financial products.</p> <p>Also, the regulator must be authorised to provide financial and technical support to other entities and bodies, such as non-government institutions and civil society organisations, engaged in financial awareness activities.</p>	<p>The scope of financial awareness is not limited to rights and protections available to consumers, but is much wider, and the same must be accordingly included in the code.</p> <p>In addition, it would be practically impossible for the regulators to conduct financial awareness by themselves across the country and thus they should be authorised to aid other institutions and organisations involved in conducting financial awareness across the country.</p>
4	154(2)	Scope of 'provide a financial service'	Add 'and providing financial service from India to a consumers.'	The provision does not cover situations when financial service providers in India are providing financial services to consumers outside India. Such financial service providers should come within the jurisdiction of the regulator, as they are operating from India.
5	158	Cancellation, suspension or modification of authorization	Add the following sub-section (6) to section 158: 158(6) While taking a decision on cancellation, suspension or modification or	Any action of regulator on financial service provider will ultimately impact the consumers and other financial service providers operating in the market.

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			authorization, a Regulator must consider the impact on, and the need to further the interests of competition and consumers.	Consequently, it is pertinent to take into account the impact of regulator's action on competition and consumers, specifically consumers being serviced by the financial service provider in question.
6	164 (1)	Power of regulator to specify conditions for encumbrances on assets of consumers	Delete "or the assets of its consumers".	<p>The regulated persons must not be allowed to create encumbrances (and consequently specify encumbrances) on assets of a consumer, as a matter of principle. Such assets must be kept separate all times, from the reach of regulated entity.</p> <p>The original version of the Code (s. 161(1)(b)) authorised the regulators to specify restrictions on creation of encumbrances, which has a completely different import when compared to the current language, which provide for powers to create encumbrances.</p>
7	197(3)	Process of making bye-laws	<p>Add the following provision in section 197(3):</p> <p>197(3)(b) a summary analysis of costs and benefits of the proposed bye-law.</p> <p>Consequent changes to be made in section 197(5)</p>	The estimation of costs and benefits must not be limited to regulations made by the regulators but should be extended to bye-laws of infrastructure institutions. More often than not, bye-laws affect operations of market players and consumers more than primary or secondary laws, and consequently, care needs to be taken in their formulation.
8	227(c)	Definition of 'insider'	<p>Add the following sub-clause:</p> <p>227(c)(iv) by receipt of such information directly or indirectly from a person referred to in sub-clause (iii),</p>	The existing scenario does not provides as a situation when a third party receives insider information from a person not associated with the issuer in any mann

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			where the recipient of such information could be reasonably expected to know that communicator of such information has received such information, directly or indirectly, from a person referred to in sub-clause (iii).	The proposed change is to close this loop.
9	Chapter 56	Defenses to market abuse (228(2), 229 (2) etc.)	A provision should be inserted that burden on proof of denying market abuse would rest on person claiming so.	While defenses to market abuse are necessary, often, enforcing agencies find it difficult to prove market abuse, on account of such defenses. Consequently, burden on proof must shift to a person denying market abuse.
10	241(2)(b)	Process of making rules relating to capital controls	Delete the words “except the requirements contained in section 58(1)(f) and 58(4)(b)	<p>It is necessary that rules made by government also pass the test of publicly scrutinized cost-benefit analysis.</p> <p>The argument that since the rules are made by government, which is accountable to electorate, and hence there is no need to conduct cost benefit analysis, is weak as the electorate tends to vote on varied issues, often not including, imposition of rules. Further, the rules made by government are not subject to detailed legislative scrutiny (certainly not more than for regulations made by regulators). In addition, the international best practice includes conduct of regulatory impact assessment (one of the modes of which is cost-benefit analysis) and stakeholder engagement through publication of findings, on primary and secondary legislations, including rules and</p>

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				regulations.
11	256(2)	Composition of the monetary policy committee	Replace “four” by “three” in s. 256(2)(d)	<p>While it is important to have independent expert views, it is also necessary that the Reserve Bank has adequate tools to achieve its objective on monetary policy function.</p> <p>Under the draft Code, it is objective of Reserve Bank to formulate and implement monetary policy objective. However, on case the four external members do not agree with Reserve Bank members, the Reserve Bank would have to go ahead with the decision of external members and implement policy rate which it does not agree to. In such situation the casting vote of the Chairperson will not help as there is no tie of votes.</p> <p>Consequently, it is important to have equal number of external and internal members. This would result in equal weightage to internal and independent view, and hopefully a balanced decision.</p>
12	377(4)	Additional condition on ‘experience in determining quasi-judicial matters’ for appointment as Tribunal member	Delete the additional condition	The condition for experience in determining quasi-judicial matters would exclude experts from academia, professionals etc in finance, who might otherwise be well suited for functioning as Tribunal member
13	383	Jurisdiction of tribunal	Restore the power of tribunal to review regulations issued by regulators under the Code	The tribunal must be given power to test validity of regulations on the touchstone of the code, for the following reasons:

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				<p>1. Tribunal is a specialised agency equipped with expertise in financial sector and better equipped than other authorities to test the regulations.</p> <p>2. Tribunal is manned by retired high court chief justice/ supreme court judges, and would be as equipped other authorities. Even the salary is same as judge of supreme court.</p> <p>3. The appeal from the tribunal lies to the supreme court, and only on question of law. Thus, they are established to reduce burden of high courts.</p> <p>4. In any case, high courts retain writ jurisdiction and can test the regulations on touchstone of constitution.</p>
14	384	Bar on jurisdiction of civil court	<p>Add following provision to section 384:</p> <p>384(3) No person will approach a civil court in respect of any matter which the Tribunal is empowered by or under this Act to determine</p> <p>384(4) If any person approaches a civil court, resulting in violation of sections 384(3), the Tribunal can impose penalty on such person.</p>	<p>Experience suggests that simple provisions to bar jurisdiction of civil court, like those existing in current draft, do not bar interested persons in approaching such forums and seeking remedy.</p> <p>Consequently, the tribunal must be empowered to impose penalties on such persons who try to delay the process at tribunal.</p>
15	393	Procedure committee of the Tribunal	<p>Addition of following sub-section in section 393 (2)</p> <p>393 (2) The Procedure Committee must</p>	<p>Not only the rules and practice directions issued by the government on functioning of tribunal impact the tribunal, but other rules, regulations and guidelines issued by</p>

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			periodically.... (d) undertake judicial impact assessment of other rules and regulations issued by regulatory agencies and other bodies in the country, which might impact the functioning of the tribunal and submit periodic reports to the government	government and other regulatory agencies might impact the functioning of tribunal. Thus, it is necessary to conduct impact assessment of such rules and guidelines as well
16	402(2)	Annual report of tribunal	Addition of “along with reasons for same and measures adopted to prevent such delay in future”, after eighty days in s. 402(2)(e)	Mere pointing out delay in disposing of applications will not help and the tribunal must be required to set out reasons for the same, and the measures taken for preventing delays in disposing of matters
17		Interaction between Regulators and other regulatory agencies	Provide for interaction between Regulators and other regulatory agencies, including telecom regulator	While the revised draft provides details instructions with respect to interaction between Competition Commission of India and financial regulators, there is no provision to provide for facilitation and coordination of interaction between financial and non-financial regulators (especially telecom regulators). In increasingly complicated world and interlinkages of finance with other sectors, this is of paramount importance.
