Article

Global Crisis, Regulatory Reform and International Policy Coordination

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Abstract

The recent global crisis has brought the following issues to the forefront of macro-policy analysis: (a) procyclicality of bank capital regulation, (b) role of asset bubbles, (c) high social costs of financial failures and (d) high leverage of financial institutions (FIs). It has been realized by the global community that tackling these problems calls for a coordinated approach in which the following agencies will have to play a vital role:

1. National regulatory and supervisory (R&S) authorities
2. International Monetary Fund (IMF)
3. Financial Stability Forum (FSF)
4. International standard setting bodies—Basel Committee on Banking Supervision (BCBS), International Organization of Securities Commissions (IOSCO), etc.
5. Influential groups like G-20

For purposes of this article, we focus on the role of national R&S authorities and find that this role revolves around seven key policy areas, namely (a) making monetary policy respond to asset prices, (b) strengthening and expanding the scope of regulation and supervision, (c) controlling leverage of FIs, (d) dampening procyclicality of capital requirements,

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(e) reducing costs of financial failures, (f) devising market incentives for prudent behaviour and (g) a shift from micro-prudential to macro-prudential regulation. We examine to what extent the official financial supervisory and regulatory authorities in India have fulfilled this role successfully.

Keywords

Global crisis, policy coordination, monetary policy, macro-prudential stability, IMF Reforms, Role of G20

JEL Classification: E6, F4, F5

Introduction

The recent global crisis has thrown into turmoil both the theoretical perceptions about how the macroeconomy works as well as several of the well-entrenched notions about how a policy (especially monetary policy) should be conducted with the objective of steering the economy towards specific goals. It has also highlighted the fact that coordinated efforts are needed at the global level, if not to avert, then at least to attenuate the consequences of a crisis of similar dimensions. The main partners in such a coordinated approach are envisaged to be:

1. National regulatory and supervisory (R&S) authorities.
2. International Monetary Fund (IMF).
3. Financial Stability Forum (FSF)/Financial Stability Board (FSB).
4. International standard setting bodies like the Basel Committee on Banking Supervision (BCBS) of Bank of International Settlements (BIS) and International Organization of Securities Commissions (IOSCO).
5. Globally influential organizations like G-20.

We will restrict our focus in this article to the first of these aspects only, though as all the issues are interconnected. For the sake of completeness, we will be including brief discussions on the other aspects also.

A Paradigm Shift in Macroeconomics

The 'New Consensus Macroeconomics' (NCM), which gradually established itself in the 1980s and 1990s as the dominant mainstream view of

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the macroeconomics profession, essentially represented an amalgam of the 'new classical school' (Lucas, 1972; Sargent, 1979) based on the twin pillars of the rational expectations hypothesis (REH) and the efficient markets hypothesis (EMH) and the neo-Keynesian view (Mankiw, 1989; Phelps, 1968; Taylor, 1980) of imperfect markets, adjustment costs and sticky prices and wages. The NCM also supplied the intellectual basis for the wave of financial liberalization that surged in the 1990s throughout the developing world.

The policy matrix emanating from the NCM theoretical framework comprised five basic tenets, namely (a) elevation of monetary policy and downgrading of fiscal policy, (b) inflation targeting, (c) Taylor rule, (d) the Jackson Hole consensus and (e) advocacy of financialization.[2]

The global crisis posed a very serious challenge to the NCM, partly because the NCM failed to anticipate the extent and severity of the crisis and partly because solutions proposed within its framework met with limited success. While there are several competing theories of what triggered the global crisis in the US (Brunnermeier, 2009); Brunnermeier & Oehmke., 2012; Giovanni & Spaventa, 2008; Gorton, 2010; Reddy, 2009) a common strand running through all explanations emphasizes three factors: (a) inadequate attention to the build-up of asset price (especially in real estate) bubbles in the formulation of monetary policy, (b) an implicit over-belief in the self-tuning properties of the financial sector and (c) insufficient appreciation of the potential threats to financial stability posed by financial deregulation, financial liberalization and financial innovation. Largely flowing from such a perspective, there was a serious questioning of the NCM from four major alternative schools, namely the post-Keynesian, the Austrian, the structuralist and the Marxist. Of these critiques, the post-Keynesian has been the most consistent one with important policy implications, many of these latter having already gained substantial ground among policy circles globally. In line with this revision in academic thinking, it was but natural that the contours of central banking policy (a broad term to include monetary policy as well as financial sector regulation and supervision) were redrawn with added emphasis on the role of national R&S authorities

[2] The NCM attitude to financial markets was that they posed no grave dangers of instability being generally self-equilibrating and further that through several channels, financial development could play a defining role in promoting real growth (see, e.g., Aghion, Howitt, & Mayer-Foulkes, 2004). As a natural consequence, financialization became an important ingredient of the standard IMF prescription of neoliberalism for the many countries that faced structural macroeconomic crises in the 1980s and early 1990s.

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in crisis prevention and crisis management. The new thinking in the immediate aftermath of the crisis is encapsulated in two detailed reports, namely those of the de Larosiere Group (2009) in the European Union and the 'Working Group 1' of the G-20 (2009). Soon enough, a broad implicit agreement seems to have emerged among central bankers globally on the following 'seven-point agenda':

1. A thorough overhaul of monetary policy
2. Strengthening and expanding the scope of regulation and supervision
3. Improved prudential standards for financial institutions (FIs)
4. Special attention to non-performing assets (NPAs)
5. Reducing costs of financial failures
6. Devising market incentives for prudent behaviour
7. A shift from micro-prudential to macro-prudential regulation

We discuss each of these aspects in some details below.

A New Look at Monetary Policy

Jackson Hole Consensus (JHC): Prior to the crisis, the thinking on monetary policy was relatively clear-cut and reflected in what was termed as the 'Jackson Hole consensus' (following Issing, 2009). The major dimensions of the JHC were:

1. that commodity inflation control should be the overriding (if not exclusive) objective of monetary policy (inflation targeting),
2. that asset price bubbles are better left alone as attempts to control (or worse 'prick') such bubbles could lead the economy into dangerous territory and
3. if, and when, asset prices burst, central banks should 'mop up the mess', that is, go into the 'lender of last resort' act (see Blinder & Reis, 2005; Greenspan, 2004; Mishkin, 2007).

The intellectual roots of the JHC are based in a conventional Friedmanian argument that 'financial instability' is the outcome of 'unexpected shocks' to the inflation level, mainly arising from overenthusiastic central banks trying to stimulate the economy beyond its 'natural' rate (see Friedman & Schwartz, 1963; Schwartz, 1998). Bernanke and Gertler

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(1999) cryptically summarize this viewpoint as 'central banks should view price stability and financial stability as highly complementary and mutually consistent objectives'.

As is now universal knowledge, the global crisis brought out the fatal flaw in this consensus.

Monetary Policy and Asset Prices: Perhaps the biggest flaw in the JHC framework was its neglect of 'balance sheet disorders' arising in the current environment of deregulated financial markets and financial innovation. Even before the global crisis, a strong empirical evidence was building up to the effect that even prolonged episodes of price stability could conceal severe imbalances building up in the financial sector through asset price bubbles. Thus, 'monetary stability' could not only coexist with 'financial instability', but there could also occasionally be a causal nexus from the former to the latter (see, e.g., Borio & Lowe, 2003; Laeven & Valencia, 2008 for empirical illustrations). This can eventuate because periods of monetary stability (such as the so-called Great Moderation spanning the decade and a half from 1990 to 2005) are often accompanied by output growth and correspondingly bullish expectations of future prospects, which, in turn, lay the foundations for booms, especially in equity markets and real estate. Demand for credit soars, especially for investment in highly profitable rising asset markets. Central banks (exclusively focused on commodity market inflation) may keep interest rates low, which can enhance the 'disaster myopia' psychology of speculative investors (see Rajan, 2005). This sets the stage for the kind of asset price booms which have preceded many crisis episodes (in the US), including those of 1893, 1907, the Great Depression (1929–33) and, of course, the current global crisis beginning with the Lehman collapse of 2007.

With the benefit of hindsight, it is now clear that central banks cannot afford to play the combined role of a 'bystander' while an asset boom is in progress and a 'good Samaritan' once the boom goes bust of its own accord. In short, the facts argue for a more proactive role for central banks in asset markets (see Bean, Panstian, Penalver, & Taylor, 2010; Buiter, 2008). In practice, central banks' intervention could assume either of three forms (including combinations).

1. Firstly, monetary policy could be made responsive to asset price developments, either by using asset prices as explicit 'targets' (as originally suggested by Goodhart, 1995) or minimally as 'indicators'.

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2. Secondly, a stricter system of controls on capital requirements in banks and other FIs could be instituted.
3. Thirdly, restrictions could be imposed on certain types of trades in asset markets (see Friedman, 2010).

Turning now to the situation in India, in recognition of the need to revisit the conduct of monetary policy, an expert committee was appointed (Urjit Patel Committee; UPC) in 2013. However, in a rather surprising twist, the approach adopted by the committee (see RBI, 2014a) does not seem to be in consonance with the revised thinking on monetary policy set out above. Instead, as the opening sentence[3] of Box II.1 of the committee makes it amply clear, the theoretical framework of this report closely follows that of its antecedents, namely the Percy Mistry Committee report and the Raghuram Rajan Committee report. This theoretical framework, rooted in the twin hypotheses of rational expectations and continuously clearing efficient markets, is precisely the NCM approach, which in our view, stands largely discredited in the post-crisis era (see, e.g., Allington, McCombie, & Pike, 2011; Arestis & Sawyer, 2012; Nachane, 2013).

Even though the finely balanced opening remarks of the UPC almost lead one to expect that it would favour a monetary policy moving away from a 'narrow focus on inflation towards a multiple targets–multiple indicators approach' (see Para II.3), the theoretical framework (NCM) espoused by the UPC drives it inexorably to a 'flexible inflation targeting framework' (i.e., one where the inflation target is expected to be maintained on the average over the business cycle). By and large, the empirical evidence does indicate that inflation targeting regimes are successful in their avowed purpose of moderating 'commodity' inflation and tempering its volatility (see Agenor & da Silva, 2013, pp. 32–34, Box 3, for a summary of the latest evidence in this regard). But this, of itself, does not constitute an unqualified criterion for success. There is an abundant theoretical literature supported by adequate econometric evidence that such regimes could unfavourably impact several other macroeconomic dimensions of direct/indirect significance for social welfare (see Akram & Eitrheim, 2008; Blanchard, 2005; Lo, 2010; Nachane, 2014).

[3] 'The New Keynesian (NK) research programme is one of the most influential and prolific areas of research in monetary policy analysis'.

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Strengthening and Expanding the Scope of Regulation and Supervision

There is an increasing awareness in the global community that crisis prevention and management require a considerable strengthening of the national financial R&S framework. This would essentially involve a three-pronged approach:

1. Entrusting a special regulatory authority (either an existing one or a newly constituted one) with an explicit financial stability mandate.
2. Ensuring coordination between different regulatory authorities.
3. Expanding the scope of regulation to include credit rating agencies and private pools of capital (including hedge funds) via a system of registration, disclosure requirements and oversight.

Special Regulatory Authority: On the first two of the above aspects, the Indian authorities have been particularly active. The Board for Financial Supervision (BFS) had already been established as early as November 1994, and the Reserve Bank of India (RBI) carries out its financial stability mandate under the general guidance of the BFS. The Financial Stability Assessment Update (FSAU) of the IMF (2013), while expressing overall satisfaction with the R&S process in India, highlighted several important lacunae in this regard (IMF, 2013, pp. 24–32). As regards the banking sector, for example, the FSAU felt that (a) Indian banks operating in overseas jurisdictions display a considerable lack of communication with the overseas supervisory authorities, (b) legal provisions of the Banking Regulation Act limit the de jure independence of the RBI from the central government and (c) similarly, while deposit taking non-banking financial companies (NBFCs) had been brought under the ambit of prudential regulation, regulatory gaps and latent arbitrage opportunities were present in the interconnected operations of non-deposit taking NBFCs, which could pose systemic risks to the financial sector.

Coordination among Regulators: Any modern economy is characterized by a diversity of FIs, each under a possibly different R&S authority. In India, the R&S mandate for the financial sector is vested in several different bodies with reasonably well delineated domains. The apex R&S bodies along with their main domains are (a) RBI (banks, NBFCs and microfinance institutions; MFIs), (b) Securities and Exchange Board of India (SEBI; securities markets), (c) Insurance Regulatory Development

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Authority (IRDA; insurance sector), (d) Forward Markets Commission (FMC; forward commodity markets) and (e) Pension Fund Regulatory and Development Authority (PFRDA; pension funds). In addition to these apex bodies, there are a number of Tier 2 bodies performing certain R&S functions under the overall directions of an apex body such as the National Bank for Agriculture and Rural Development (NABARD), Deposit Insurance and Credit Guarantee Corporation (DICGC), National Housing Bank (NHB), etc. The Ministry of Finance is also a key player in the finance sector, being responsible for financial planning and legislation.[4]

Until the establishment of the Financial Stability and Development Council (FSDC), coordination between the three major regulators—RBI, SEBI and IRDA—was weak, and potentiality for conflicts was not ruled out. The rise of hybrid products in recent years has considerably raised the possibility of 'turf wars' or interregulatory conflicts in a multiple regulatory system.[5] Keeping these considerations in mind, the Indian government established the FSDC as an apex level body in December 2010. The FSDC is chaired by the finance minister and its members include the heads of all the five apex R&S institutions mentioned above in addition to the finance secretary and the chief economic advisor. Most of the operational matters of the FSDC are handled by a subcommittee, chaired by the RBI governor. In addition, there are several working groups focused on special issues such as the Interregulatory Technical Group (IR-TG), the Interregulatory Forum for Monitoring Financial Conglomerates (IRF-FC), the Macrofinancial and Monitoring Group (MFMG), etc.

Expanding the Scope of R&S: The defining feature that sets the current crisis apart from other crises of comparable intensity in the past is the

[4] Of the five apex regulatory bodies listed above, three have been established as statutory bodies via parliamentary enactments, namely the RBI (via the RBI Act 1934), SEBI (via the SEBI Act 1992) and IRDA (via the IRDA Act 1999), while the remaining two are part of Government of India ministries. The FMC falls within the purview of the Ministry of Consumer Affairs, Food & Public Distribution, while the PFRDA is under the Ministry of Finance.

[5] An important case in point is the recent controversy in India over unit linked insurance plans (ULIPs), which are similar to mutual funds with an added insurance component. In August 2009, a turf war erupted between the SEBI and IRDA over an order issued by SEBI banning 14 insurance companies from issuing ULIPs, with the IRDA countermanding this order. The matter was ultimately decided in favour of the IRDA through government intervention in June 2010.

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critical role played by the 'shadow' banking sector. In the last three decades or so, there has been a proliferation of non-deposit taking financial intermediaries, which engage in lending but (in the absence of access to public deposits or central bank funding) rely on funding via 'asset-backed commercial paper' or in the repo market against collateral. The institutions typically constituting the 'shadow' banking sector are hedge funds, money market mutual funds, private pension funds, special purpose vehicles (SPVs), etc. The growth of such institutions is attributable to several factors, including the emergence of securitization and new financial products (such as credit derivatives, collateralized debt obligations; CDOs, etc.) as well as the proliferation of the 'universal banking' syndrome (see Gorton & Souleles, 2006). In times of liquidity panics, such asset-backed commercial paper markets are prone to collapse (as happened in the US financial crisis of 2008; see Brunnermeier & Pedersen, 2009). As such, it is critical for financial stability to bring the shadow banking sector under the regulatory pale. The large number of institutions in the shadow banking sector and the opacity of their operations pose formidable obstacles in the way of placing them on a regulatory par with traditional depository institutions.

In India, regulation and supervision of the shadow banking sector is weak and riddled with loopholes. The only effective restriction is that imposed on members of the Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) to maintain several types of margins with these exchanges including most prominently daily margins, mark-to-market margins, carry forward margins, ad hoc margins, etc. The FSAU (IMF, 2013, p. 27) has highlighted several basic shortcomings so far as the non-banking financial sector is concerned such as (a) loose supervision of mutual funds and other fund managers (especially hedge funds), (b) frequent non-compliance of security issuers with reporting and disclosure requirements, (c) accounting and auditing standards need upgradation, (d) weak enforcement of criminal procedures, (e) sanctions are unusually light etc. The New Companies Act 2013 is designed to address many of these lacunae, but it is too early to comment on the degree of its success.

Prudential Standards

Improving the Quality of Bank Capital: 'Common equity' (defined as 'common' shares plus retained earnings minus 'goodwill') is generally

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regarded as higher quality capital than 'preferred' equity. Hence, given the objective of helping banks recapitalize quickly in the event of stress, it may be desirable to increase the share of common equity in bank capital. Reflecting this logic, the Basel III proposals have increased the ratio of Tier 1 capital to total risk-weighted assets from 6 per cent under Basel II to 8.5 per cent while simultaneously putting in place a staggered system of restrictions on distribution of earnings if the ratio of common equity in Tier 1 (to risk weighted assets) falls short of the minimum of 7 per cent. Additionally, Tier 2 capital has been strengthened, while Tier 3 capital has been dropped altogether. The RBI has already agreed to move to a Basel III framework on the internationally agreed timeline.

Procyclicality of Capital Requirements: That the capital standards imposed under Basel I and II tend to be procyclical has been well known to economists for quite some time (see Borio., 2011 for an early critique of this feature). They can, hence, be a possible accentuating factor in any crisis by leading to shrinkage in the size of bank balance sheets. As the current crisis runs its course, there is a greater realization among central bankers globally that ways had to be found to counter this procyclicality. At least three operational suggestions have been made in this context: (a) requiring FIs to build up 'capital buffers' during economic expansions, (which could then be unwound in times of recession; Ghosh & Nachane, 2003; Gordy & Howells, 2006), (b) 'capital insurance' wherein a bank insures against a capital shortfall via a collateralized (insurance) policy (see Kashyap, Rajan, & Stein, 2008 for a detailed exposition of this concept) and (c) introducing so-called 'contingent convertibles' (securities that are issued as debt by a bank but are automatically convertible into equity, if regulatory capital of the bank falls below a certain threshold; see Flannery, 2005; French et al., 2010, Hanson, Kashyap, & Stein, 2011).

Leverage of FIs: An important amplification factor for the recent crisis has been not only the high degree of leveraging of many FIs, but also the fact that this leveraging has very often been quite opaque (see Kalemli-Ozcan, Sorensen, & Yesiltas, 2011). Reflecting the need for more accurate measures of balance sheet exposures, the following suggestions have emerged: (a) A stronger focus by regulators on loan-to-value (LTV) ratios. The RBI, for example, now insists on a cap of 75 per cent on the LTV ratio, with risk weights on exposures varied according to the LTV ratio. (b) Limits on leverage ratios (LRs) of banks. In tune with this thinking, Basel III proposes to introduce a minimum

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Tier 1 LR of 3 per cent defined as ratio of Tier 1 capital to total exposure (on and off balance sheet). It is interesting to note that as of March 2014, this ratio stood at 6.1 per cent for scheduled commercial banks in India, while it stood considerably lower at 5.2 per cent for public sector banks.

Other Prudential Measures: Several other prudential measures have also been suggested and discussed in detail in the literature. An indicative list would comprise:

1. Higher loan loss provisioning norms (Saurina, 2009). In India, for example, loan loss provisioning has been steeply raised by the RBI in the wake of the crisis (it currently stands at 70 per cent).
2. Imposing higher capital requirements on 'systemically important' FIs (see Bullard, Neely, & Wheelock, 2009; Pennacchi, 2010). Once again referring to the Indian case, systemically important non-bank financial intermediaries are subject to a higher capital to risk-weighted assets ratio (CRAR) of between 12 per cent and 15 per cent, as opposed to the regularly applicable CRAR of 9 per cent for banks.
3. Stress testing exercises to be conducted periodically to monitor leveraging on an ongoing basis (Lopez, 2005; Matsakh, Altintas, & Callender, 2010). In India, stress testing for banks is being done regularly by the RBI since 2007. The tests are designed to test the resilience of the banking system against macroeconomic shocks. Two adverse scenarios are considered (medium and severe) around a baseline scenario involving 10 year historical data. The macro-variables included are the GDP, inflation, interest rate and merchandise exports (to GDP) ratio, with the two adverse scenarios being based respectively on 1 per cent and 2 per cent standard deviations around the baseline. The stress variables examined are the credit risk, foreign exchange risk, interest rate risk, liquidity risk and market (equity price) risk. The exercise is done separately for scheduled commercial banks, urban cooperative banks and NBFCs.
4. Disclosure requirements for complex structured products and reducing procyclicality of accounting standards (Borio & Tsatsaronis, 2005; Novoa, Scarlata, & Sole, 2009). Accounting standards in India for financial entities are aligned with those of the Institute of Chartered Accountants of India (ICAI). Unfortunately, these are not widely accepted internationally. Convergence to international standards [International Financial

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Reporting Standards (IFRS)] has commenced from April 2013, and in the interim, the RBI has been periodically issuing prudential guidelines on asset classification, income recognition, provisioning and investment valuation. The RBI also lacks access to external auditors' working papers and the power to rescind auditors' appointments. These can and often do impose effective limits on the RBI's supervisory powers.

5. Risk concentration limits involving ceilings on growth of particular types of exposures (BIS, 2006; Bonti, Kalkbrener, Lotz, & Stahl, 2006). As was pointed out by the FSAU of the IMF (2013), the current exposure limit (in India) for large loans of 55 per cent of a banking group's capital is far in excess of global practices of 10 per cent to 25 per cent and should be brought down in stages. The report also observed (IMF, 2013, p. 49) that the issue of 'connected exposures' was not getting enough attention in the case of the Indian financial system. More specifically, 'cross guarantees' between financial entities should be sufficiently highlighted as these result in financial interdependency and commensurate concentration of risk.
6. The establishment of clearing houses in over the counter (OTC) derivatives markets (see Norman, 2011; Pirrong, 2011). About 75 per cent of the OTC derivative contracts in India are routed through a centralized exchange, namely the Clearing Corporation of India Ltd. (CCIL).

Special Attention to Non-performing Assets (NPAs)

NPAs constitute an important dimension of financial stability, apart from affecting the overall efficiency and profitability of the banking system. In India, the problem of NPAs, which had lain dormant in the high growth phase of the last decade, seems to have resurfaced since the global crisis of 2008–09. Two trends are particularly worrisome—firstly, the fact that the problem has not subsided with the tapering off of the global crisis but instead accentuated especially in 2011–13; secondly, India is among the few countries in Asia to display such a trend, most other countries showing a moderation in NPAs over 2009–12.

As per the extant guidelines of the RBI, a loan/advance slips into the NPA category if the interest and/or instalment of principal repayment

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thereof remain overdue for a period exceeding 90 days. NPAs are further classified as: (a) 'substandard' (an asset with NPA status of up to 12 months), (b) 'doubtful' (an asset of more than 12 months' status as 'substandard') and (c) 'loss asset' (an asset on which loss has been identified by the bank, its auditors or an RBI inspection team).

Several issues come to the fore as soon as an asset is qualified as an NPA: (a) The first issue pertains to the accounting norms for recognizing any income that may occur from the NPA either pre- or post-restructuring (income recognition). (b) Since an NPA represents a potential (partial/total) loss asset, the accounts of the bank should be adjusted to take cognizance of this possible loss (provisioning). (c) The third and easily the most contentious issue pertains to the 'restructuring' of an account, specifically under what circumstances an asset has claims to be so restructured and what should be its accounting status post such restructuring (restructuring). (d) Banks are always engaged in the recovery efforts on NPAs. These can either be through legal recourse or market-based sell-offs (recovery). (e) Finally, banks need to take a decision on the write-off of NPAs which have been overdue for long, with a view to save provisioning costs and economize on regulatory capital requirements (write-offs).

In recent months, NPAs have emerged as an active area of concern for the RBI. In a recent report, the RBI (2012) has proposed a slew of measures to confront the various problems involved in NPA management. Briefly these may be classified as:

1. **Early Recognition of Stressed Assets:** A new asset category has been introduced, namely special mention accounts (SMAs) with three sub-categories: (a) SMA-1 (principal/interest payment overdue between 31–60 days), (b) SMA-2 (principal/interest payment overdue between 61–90 days) and (c) SMA-NF (accounts which signal certain non-financial signs of stress, e.g., delays in submission of stock statements, devolvement of deferred payment guarantees, shortfalls in projected sales/profits, etc.). Additionally, a new entity called Central Repository of Information on Large Credits (CRILC) will be established to collect/disseminate data relating to large borrowers (exposures exceeding ₹ 50 million). Any account slipping into the SMA category will be immediately reported to CRILC by the concerned bank, setting in motion the formation of Joint Lenders' Forum (JLF) among the creditors (including banks as well as systematically important NBFCs). The JLF will work out a Corrective Action Plan (CAP) and decide

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on the appropriate course of action, namely rescheduling, restructuring, recovery or write-off.

2. **Modification of Restructuring Process:** Among the important new features being suggested for restructuring, the following features may be noted: (a) The corporate debt restructuring (CDR) mechanism to be made accessible also to non-members on a transaction to transaction basis. (b) Time lags involved at various stages in the CDR decision-making process to be drastically shortened. (c) Restructuring of accounts with exposure exceeding ₹ 5 billion to be evaluated by an Independent Evaluation Committee (IEC), comprising experts fulfilling certain eligibility conditions. (d) Greater emphasis than currently prevails on promoters either infusing fresh equity into the stressed company or transferring a part of their equity to creditors. (e) Possibility of ushering in a shift in management control, if favoured by a majority of lenders.
3. **Accelerated Provisioning Requirements:** With a view to forestall the abuse of the asset restructuring facility by borrowers/creditors, 'accelerated' provisioning norms are proposed to be applied where banks/FIs do not intimate the SMA status of problem accounts to CRILC in a timely fashion. Creditors who renege on the terms of an agreed CAP or retreat from agreements already negotiated under inter-creditor agreements (ICAs) or debtor–creditor agreements (DCAs) could also invite accelerated provisioning on their NPA exposures to the concerned borrowers.
4. **Greater Accountability of Directors/Promoters/Auditors:** Accelerated provisioning norms will also apply to exposures to companies whose directors/promoters figure more than once in the list of wilful defaulters. Similar treatment will apply to exposures to borrowers classified as 'non-cooperative'. RBI will compile a list of such directors/promoters/borrowers to be disseminated to all lenders. Company auditors involved in falsification of accounts/miscertification of stock statements will be reported to ICAI for disciplinary action, while their identity will be made public to all banks.

Contrary to a popular misconception, it is not the priority sector in which the NPA problem is rooted. Even though the Gross Non-Performing Assets (GNPA) ratio stands uniformly higher for the priority sector as compared to the non-priority sector, a closer look at the totality of

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'impaired' assets indicates that the problem lies elsewhere. In particular, big-ticket loans to highly leveraged corporates account for a large share of distressed assets. In recent years, both borrowers and creditors are taking increasing recourse to restructuring under the CDR mechanism. While not denying the case for genuine restructuring in times of distress conditions beyond the control of the borrower, evidence seems to be mounting that some large borrowers might be actively engaged in attempts at evergreening of loans with the active connivance of the creditors. Recovery of NPAs through asset sales to asset reconstruction companies/securitization companies (ARCs/SCs) is becoming increasingly popular in recent years, though the market in distressed asset sales is not really well developed. Write-offs are proving increasingly popular as a cosmetic device for cleansing balance sheets, though they impose the moral hazard of slackening the efforts at recovery. The silver lining, of course, is provided by the fact that the RBI is being seriously seized of the problem and engaged in working out a series of effective measures aimed at addressing both the micro- and macro-dimensions of the NPA problem. However, these efforts may fall short of the mark unless banks/FIs as creditors respond with a greater sense of responsibility towards credit appraisal, credit monitoring, credit risk management and better information systems to quickly identify assets under stress and initiate remedial actions.

Reducing Costs of Financial Failures

The welfare costs of financial crises are generally severe and fall disproportionately on disadvantaged groups in any society, and the current crisis is hardly an exception (see Nachane, 2009). With a view to reducing such costs, the following two major suggestions have been proposed at various international policy forums:

Early Warning Diagnostic System: Early warning systems purport to detect underlying financial fragilities well in advance of a crisis, permitting central bankers to initiate pre-emptive action (see Bussiere & Fratzscher, 2006). The RBI introduced the Prompt Corrective Action (PCA) scheme in December 2002, under which, the central bank would initiate 'structured' as well as 'discretionary' actions in respect of banks, which have hit certain trigger points (defined in terms of CRAR, net NPAs and return on assets; ROA).

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Orderly Closure Rules: The instituting of orderly closure rules for important FIs, as prevalent in the US for banks under the Federal Deposit Insurance Corporation (FDIC) Improvement Act & Competitive Equality Banking Act. Under this act, apart from capital-based triggers, there are stipulations ensuring that banks are closed before it is too late (i.e., before they go into negative worth territory). The brunt of the loss is borne by shareholders and the FDIC becomes the receiver. A temporary bridge bank is set up to pay off depositors and creditors and organize the 'fire sale' of assets. In India, to date, no such provision exists—failing banks are either merged with another stronger (public or private) bank or there is capital infusion from the government. Both the courses have obvious drawbacks (see Goldstein, 2008). Pending the initiation of such closure rules, suggestions have been made in the Indian context to raise the limits for deposit insurance (Nachane, 2009) and to replace the existing flat premium with a risk-sensitive premium (see GOI, 2009).

In the Indian context, with the huge hangover of NPAs in the banking system, the recouping of bank losses lends an additional dimension to the financial failure problem.

Recouping of Bank Losses Due to NPAs: As per the existing arrangements in India, recovery of losses on problematic loans can proceed via three channels, namely (a) sale of assets to SCs/ARCs (established under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act 2002), (b) debt recovery tribunals (DRTs) and (c) Lok Adalats.

Sale to SCs/ARCs: Under the SARFAESI Act, banks/FIs can sell NPAs to SCs/ARCs (and even standard assets under certain stipulated conditions). The sale can be on mutually agreed terms, though the selling banks/FIs have to show any shortfall in sale price below the net book value (NBW[6]) in their Profit & Loss account.

DRTs: The DRTs have been established under an act of Parliament (Act 51 of 1993), with a view to provide an avenue for banks and FIs to salvage a part of their losses on assets through a process of expeditious adjudication and recovery. Currently, there are about 33 DRTs across the country. Additionally, the DRTs can also function as a court of appeal for creditors seeking redress for sales of assets under the SARFAESI Act.

[6] NBW of an asset is its book value minus the provisions held against it.

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Lok Adalats: These were established under the Legal Services Authorities Act, 1987, and are basically designed to settle outstanding debt issues via arbitration between small borrowers[7] in distress and banks/FIs. Such borrowers are also entitled to receive legal services, provided that the concerned authority is satisfied that there is a prima facie case to prosecute or to defend. The system is a multi-tiered one, comprising the National Legal Services Authority at the apex, and state, district and taluk legal services authorities at the lower rungs of the hierarchy. Lok Adalats within a taluk are organized by the respective Taluk Legal Services Committee.

The dominant role in NPAs recovery is played by the SARFAESI channel (see RBI, 2014c, p. 69). Further, the share of this channel in total NPAs recovery increased from 70 per cent in 2011–12 to 79 per cent in 2012–13. The importance of this route is likely to increase even more in the future with the increase in popularization of the securitization route. Given their very nature, the Lok Adalats deal with a large number of cases involving small amounts. But their role is essentially seen as supportive of the overall objective of financial inclusion. One modification which suggests itself is a more liberal regulatory treatment of asset sales to ARCs/SCs, with a view to encourage banks/FIs to recover losses on NPAs via this route. Some progress in this direction is already evident. The RBI has promised to allow lenders to spread losses on such asset sales over two years (instead of one year as at present). Leveraged buyouts will be permitted for acquisition of stressed assets. Further, greater leeway is proposed for private equity firms in the distressed asset sales market. Finally, the finance ministry has already raised the foreign investment limit in ARCs to 74 per cent (from 49 per cent earlier) in August 2013, and now intends to ease the norms for nominee directors in ARCs.

Devising Market Incentives for Prudent Behaviour

The issue of market 'discipline' was brought into the forefront of debates on sound regulatory practices by the great emphasis laid on it by Basel II

[7] This category includes (a) a member of a scheduled caste or scheduled tribe, (b) a victim of trafficking in human beings or beggar as referred to in Article 23 of the Constitution, (c) a woman or a child, (d) a mentally ill or otherwise disabled person, (e) in receipt of annual income less than ₹ 9000, etc.

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as one of its three pillars (Pillar III) of sound prudential regulation. 'Market discipline' is a generic term referring to the monitoring of FIs by market participants and in the Basel II schemata, it is sought to be achieved by imposing various kinds of disclosure requirements on FIs (most particularly banks), relating to their capital, assets, credit risk, market risk, operational risk, etc. The rationale for disclosures is to provide adequate information to enable counterparties (mainly depositors, shareholders and occasionally, junior/subordinated debt holders) to assess whether the available capital is sufficient to meet measured and non-measured risks. To the extent that such disclosures are comprehensive and objective, it is expected to assist market participants in judging how a bank's management of its capital adequacy relates to its other risk management processes and its ability to withstand future volatility. The BIS has elaborated considerably on the recommendations of the accord concerning the nature of information which should be disclosed under this pillar. The salient components of this information (for a bank) comprise (a) the structure and components of bank capital, (b) the terms and main features of its capital instruments, (c) the accounting policies used in the valuation of assets and liabilities and for provisioning and income recognition, (d) qualitative and quantitative information about risk exposures and strategies for risk management, (e) its capital ratio and other data related to its capital adequacy on a consolidated basis and (f) a breakdown of its risk exposures. The information needs to be supplemented by an analysis of factors affecting the banks' capital position. Moreover, banks are encouraged to disclose ways in which they allocate capital among their different activities. The disclosures envisaged under this pillar need to be made on a semi-annual basis.

Since Basel II Pillar III has gone into implementation in India in March 2009, the disclosure component of market discipline seems to be fairly in place. But it has to be remembered that while disclosures do contribute to greater transparency in financial sector operations, and to that extent to better monitoring by all counterparties, they constitute only a necessary condition for market discipline.

Monitoring of banks and FIs by depositors in India is weak, primarily because of the prevalent 'flat rate deposit insurance premium', which imposes a uniform premium on deposit insurance for all banks, irrespective of the riskiness of their respective loan and investment portfolios. Such a system subsidizes high-risk, poorly run institutions at the cost of well-run institutions. An ideal deposit insurance premium pricing system would involve (a) banks paying premium indexed to their own levels of risks and (b) a premium level that ensures a continually solvent

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insurance fund (see, e.g., Demirguc-Kunt & Huizinga, 2004). However, it is difficult to assess individual banks' risks accurately ex ante*,* that is, before problems emerge. Thus, risk-based premium (RBP) systems should be viewed as a complement to, rather than a substitute for, other methods of checking excessive risk taking like risk-based capital requirement prescriptions, strong supervision and direct restraints on risky activities. There is an increasing move towards RBP systems across the globe, and moving towards an RBP system could be an important move in the direction of strengthening market discipline in India.

Monitoring of banks by shareholders traditionally occurs via responses of equity values to changes in the perceived risks of banks. If market discipline is effective in improving bank governance, then we must have publicly listed banks (with constantly available market signals from their equity and bond prices), assuming less risk than similarly placed non-publicly traded banks. There have been several empirical tests of this and similar hypotheses as well (see, e.g., Baumann & Nier, 2006; Park & Peristiani, 2007); Stephanou, 2010). While the empirical conclusions vary somewhat, nevertheless there seems to be a fairly broad consensus around two propositions, namely (a) lack of a significant difference in the risk profile between publicly traded and non-traded banks and (b) publicly traded banks often tend to have worse supervisory ratings than non-publicly traded banks. Little econometric evidence seems to be available in India in this regard, though bank's stock indices do show a significant response to declaration of bank's quarterly results. However, this effect is in most cases transitory, and overall shareholder apathy is widely prevalent. It is highly doubtful whether shareholder discipline can operate in improving bank risk profiles in the Indian context.

An interesting additional way to strengthen market discipline is via the so-called Chicago Fed Plan (see Keehn, 1989), which proposes the inclusion of a mandatory 'subordinated debt' (i.e., debt that is unsecured and has lower order of claims than other debts in the event of closure) component in bank capital requirements (see also, Calomiris & Powell, 2000; Evanoff & Wall, 2000). Interestingly, subordinated debt can act as an important market disciplining factor, since as perceived risks of a bank increase, holders of subordinated liabilities will require a higher return to compensate for the extra perceived risk. Several studies (Evanoff & Wall, 2002; Jagtiani & Lemieux, 2001; Sironi, 2003) have noted that issuance and secondary market risk premiums on traded subordinated debt are correlated positively with risk measures such as asset portfolio composition, credit ratings, probability of undercapitalization and/or failure, etc. In India, as in other South Asian countries, as of now,

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there is no mandatory requirement for subordinate debt, and it is a suggestion worth careful consideration as to whether such a mandatory requirement be imposed in the interests of market discipline.

Basel III more or less reiterates the Basel II approach to market discipline but emphasizes more the regulators' role. On balance, such an assessment seems appropriate in a country like India, where financial markets are riddled with too much inefficiency, and where excessive reliance on market discipline may prove of limited value.

A Shift from Micro-prudential to Macro-prudential Regulation

Financial stability as an explicit concern of central banks certainly antedates the recent global crisis in most advanced countries and several Emerging Market Economies (EMEs), including India. The crisis, however, has brought it into a much sharper focus. Even more importantly, the crisis brought about a shift of emphasis from 'micro-prudential regulation' (essentially centred on a partial equilibrium approach to regulation aimed at preventing the costly failure of individual FIs) to 'macro-prudential regulation' (constituting a general equilibrium approach to regulation aimed at safeguarding the financial system as a whole). The string of successive failures of FIs in the US and Europe, subsequent to the Lehman collapse, highlighted the inadequateness of a microprudential regulatory structure, geared to address 'idiosyncratic' risks specific to individual FIs. Instead, it was becoming increasingly clear that financial crises tend to be typically characterized by a 'Domino' scenario in which the collapse of a few key FIs is followed by a general collapse of the financial system, and that only an R&S framework designed to address 'systemic risk'[8] provides a measure of insurance against a general 'Minsky moment' (Cassidy, 2009; Minsky, 1986). Inter-institutional linkages, accompanied by low capitalization and an excessive reliance on

[8] There are several (closely related) definitions of systemic risk, and we mention here the two most commonly used ones. The G-10 (2001) define systemic risk as 'the risk that an event will trigger a loss of economic value or confidence in, and attendant increases in uncertainty about, a substantial portion of the financial system that is serious enough to quite probably have adverse effects on the real economy', whereas the IMF–BIS–FSB (2009) definition runs somewhat parallel as 'a risk of disruption to financial services that is (i) caused by an impairment of all or parts of the financial system and (ii) has the potential to have serious negative consequences for the real economy'.

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short-term sources of funding (maturity mismatch), often lead to general rollover problems, thus creating a potential for financial crises. As noted by Whelan (2009), systemic risk can often arise even with individual institutions having good risk management systems in place. Further, such systemic episodes can be triggered by relatively minor impulses. It is often generated by individual institutions taking decisions in the interest of their own prudent risk management.

The Basel II framework (2004) did play an important role in putting (globally active) individual FIs (especially banks) on a sound footing, but with its emphasis on micro-prudential regulation, it fell short of forestalling the global financial crisis of 2007–08. The proposed Basel III framework seeks to steer financial regulatory (and supervisory) structures towards macro-prudential regulation, but several critiques have stressed its limitations. Acharya (2011, pp. 17–19), for example, has indicated four pitfalls: (a) firstly, the approach tends to be focused on individual FIs; (b) secondly, reduction of institution-specific risk can aggravate systemic risk, as in their attempts to diversify away 'idiosyncratic' risk, the portfolio holdings of FIs tend to get increasingly correlated; (c) thirdly, Basel III ignores the dynamic evolution of endogenous risks of FI portfolios, as asset quality can deteriorate by the very fact of increased holding of the asset class across various institutions and (d) finally, overleveraging on the favoured asset class could aggravate systemic liquidity risk, if and when the risk on this class turns adverse.[9]

In India, without awaiting cues from Basel III, the RBI in collaboration with the subcommittee of the FSDC has been seriously engaged in identifying, anticipating and attempting to moderate systemic financial risks since 2011. This is being done at three levels:

1. Firstly, a systemic risk survey is conducted six-monthly (the ninth in this series being concluded in October 2015), involving experts' and market participants' assessment of systemic risk spanning five dimensions—global risks, macroeconomic risks, market risks, institutional risks and general risks (natural disasters, social unrest, etc.).
2. Secondly, stability maps are constructed for the macroeconomy, the corporate sector and banking sector. The indices used are as follows: macroeconomy (global output growth, domestic output growth, inflation, current account deficit/GDP ratio and fiscal

[9] Acharya (2011) also illustrates these possibilities with several examples.

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and primary deficits), corporate sector (profitability, leverage, interest coverage ratio, liquidity and turnover) and banking sector (CRAR, net NPAs/total assets, net interest margin, liquidity and efficiency; RBI, 2014b, pp. 61–63).

3. Systemic risk posed by the interconnectedness of the financial system is sought to be ascertained via two approaches, namely 'solvency contagion analysis' and 'liquidity contagion analysis'. In the first approach, the gross loss to the banking system owing to the domino effect of a bank failure is assessed, whereas in the second one, the corresponding loss is calculated in the event of the failure of a net lender. A sophisticated network analysis methodology is employed in both the approaches.

Overview of the Role of Select Multilateral Institutions in Financial Stability

Our article has discussed at length the role of the national R&S authorities in ensuring financial stability in a world dominated by an overarching financial superstructure. In the globally integrated world of today, emergent distress in one country can easily transmit itself to other countries, often with amplificatory effects. The role of global multilateral institutions becomes particularly relevant in containing such contagion. Of late, many of these institutions have also been active in striving for adoption of harmonized 'best' global practices by national regulators. However, the rights of national authorities to adapt and modify these practices in consonance with their specific national circumstances have often not been taken into consideration. As the oldest and also the most influential multilateral organization, the role of the IMF is particularly crucial and to this we now turn.

Reforming the IMF: There has been a general feeling of dissatisfaction among LDCs (Less Developed Countries) and EMEs with the role of the IMF in handling financial crises. It has long been felt that the IMF plays an asymmetric role in handling crises, being more interested in protecting the interests of international lenders/bankers and imposing conditionalities on crisis-afflicted countries, which very often draw them into long-term structural problems (Devlin & Ffrench-Davis, 1995; Komisar, 2011). This has led to a general dissatisfaction among LDCs and EMEs about inadequate representation of their point of view. The main demands of these countries are threefold:

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1. Radical changes in access, pricing and conditionality for IMF borrowers. In particular, the introduction of 'flexible credit lines' (FCLs).
2. Raising quotas/votes of EMEs and LDCs as a group.
3. Negating the US veto on crucial IMF decisions.

The Committee on IMF Governance Reform (under the chairmanship of Trevor Manuel), which submitted its report on 24 March 2009, makes an honest effort to address several of these concerns, though in what form these will be finally incorporated in the IMF charter is as yet unclear. Among the major recommendations of the report are the following:

1. Radical changes in access, pricing and conditionality for IMF borrowers (FCLs).
2. By recommending the lowering of threshold on critical decisions from 85 per cent to 70–75 per cent, the US veto is proposed to be annulled (as the US has 17 per cent voting power).
3. Doubling of quotas and shifting of 6 per cent of voting power to dynamic EMEs.
4. A proposed tripling of 'basic' votes (number of votes every country has qua member) which would increase developing country votes from 32.3 per cent to 34.4 per cent (the corresponding World Bank figure is 42.6 per cent, proposed to be raised to 43.8 per cent).
5. Some countries have also argued for the adoption of a 'double majority voting' process for major IMF decisions. Double majority implies a majority of both weighted votes (as currently) and country votes. The system prevails at the Inter-American Development Bank, African Development Bank (ADB), etc. in crucial matters such as the election of a new president/head (see Birdsall, 2009).

At its 2010 Seoul Meeting, the G-20 pledged to implement an IMF governance reform, centred on the following three-point agenda:

1. Shifts in quota shares of over 6 per cent to dynamic EMEs and LDCs.
2. A doubling of quotas (the financial resources of the IMF) and a review of the quota formula by January 2014.
3. Greater representation for EMEs and LDCs at the executive board by reducing the number of advanced European chairs by two. Further, moving to an all-elected board with a commitment to maintain the board size at 24 chairs.

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However, the Euro crisis distracted policy-makers from the IMF governance agenda to more pressing intra-Eurozone issues. A complicating factor impeding progress on the IMF reforms is that in most IMF member countries, many of the proposed changes require parliamentary approval, which can be a very slow process. Currently, only about half of the G-20 members have taken action on the approval process.

At the 14th general review of quotas (December 2010), while the above three-point agenda was approved, three conditionalities were imposed before the provisions could become operational, namely (a) the quota increases must have the consent of members with an aggregate quota holding of at least 70 per cent of the total quotas, (b) the 2008 amendment on voice and participation must have entered into force and (c) the acceptance of the amendment to reform the executive board by three-fifths of the members with more than 85 per cent of the total voting power.

As of April 2013, 149 members holding 77.42 per cent of IMF quotas had consented to the quota increases, while the 2008 amendment on voice and participation entered into force in March 2011 (see IMF, 2013). Thus, of the three listed conditionalities, only the last conditionality remains to be fulfilled.

FSF/FSB: The FSF is a group consisting of major national financial authorities such as finance ministries, central bankers and international financial bodies. The forum was founded in 1999 to promote international financial stability. The forum facilitates discussion and cooperation in supervision and surveillance of FIs, transactions and events.

FSF includes about a dozen industrialized nations (USA, Japan, Germany, UK, France, etc.) who participate through their central banks, financial ministries and departments and securities regulators. It also includes several international economic organizations. The 2009 G-20 London summit decided to establish a successor to the FSF, the FSB, with the explicit mandate to address global vulnerabilities and to develop and implement strong regulatory, supervisory and other policies in the interest of financial stability. In this role, the FSB should alert international standard setting bodies about loopholes and structural deficiencies identified in existing national regulatory structures. The standard setting bodies like BCBS, IOSCO, etc. can then devise specific operational guidelines for incorporation into national regulatory and surveillance frameworks. The FSB is also empowered to issue general warnings on emergent systemic risks in specific zones (Brunnermeier, Crockett, Goodhart, Persaud, & Shin, 2009). As pointed out by Ocampo and Griffith-Jones (2010), the FSB suffers from several limitations, of which,

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the most prominent ones seem to be (a) the total absence of representation of small and medium sized economies, (b) the ad hoc nature of the arrangement and the lack of a formal secretariat and (c) the absence of accountability to a representative political body.

International Standard Setting Bodies: International standard setting bodies have also been fairly active in promoting financial stability around the globe and in redesigning the global financial architecture in response to specific episodes of global turbulence. The BCBS of BIS has been particularly active in promoting good governance in the financial sector, especially the banking sector. In the aftermath of the recent global crisis, it put forth a new blueprint for bank regulation, supervision and governance, namely Basel III, which goes considerably beyond its predecessors, Basel I & II. The central feature of Basel III is its focus on 'systemic risk' which was largely neglected in the earlier Basel accords. This is sought to be accomplished through several important measures including:

1. Improvement of the 'quality of capital' (insisting that Tier 1 capital should include a mandatory 'common equity' component).
2. Raising the 'minimum capital' ratio (from the current level of 8 per cent under Basel II to 10.5 per cent). The additional minimum capital of 2.5 per cent constitutes the so-called 'capital conservation buffer'.
3. Additional capital requirements for systematically important financial institutions (SIFIs) via the issuance of 'contingent capital'.
4. Reduction of procyclicality of capital requirements by introducing (in addition to the minimum capital ratio) a 'counter-cyclical buffer' of between 0–2.5 per cent (at discretion of national regulator) of risk-weighted assets composed of Tier 1 capital.
5. Introduction of a minimum LR of 3 per cent. LR = Tier 1 capital/Total exposure (on and off balance sheet).
6. In addition, a liquidity coverage ratio (LCR) of 100 per cent is introduced. LCR = Stock of high-quality liquid assets/Total net cash outflows expected over next 30 calendar days.

G-20 and Its Role: The Group of 20 was formed in 1999 and comprises 19 individual nations and the European Union. There is a general agreement that its initiatives played a key role in coordinating national stimuli measures in the wake of the post-Lehman crisis situation. Since then, it has sought to transform itself from a 'crisis management forum' to an

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effective 'global governance steering forum' (see Jorgensen, 2013). At the London summit of the G-20 in April 2009, an ambitious agenda was adopted to rejuvenate the global trading and investment system while maintaining financial stability and moderating global imbalances. The main components of this agenda were:

1. A substantial increase in IMF resources [$750 billion + $250 billion Special Drawing Rights (SDR) allocation] as also of the Multilateral Development Banks (MDBS) [$100 billion].
2. Greater flexibility in IMF support programmes (FCLs).
3. Strengthening financial supervision and regulation (regulatory oversight of credit rating agencies, action against non-cooperative jurisdictions and tax havens, improvement in accounting standards, establishment of a new FSB, etc.).
4. Supporting growth in EMEs and LDCs by helping to finance counter-cyclical spending, bank recapitalization, infrastructure, etc.
5. Countering rising protectionism in response to the post-Lehman crisis.
6. Reaffirmation of millennium development goals.
7. The establishment of an effective mechanism to monitor the impact of the crisis on the poorest and the most vulnerable.

Assessments of the G-20 show considerable variation. There seems to be a general agreement that the Mutual Assessment Process (MAP) initiated under the G-20 auspices at its Pittsburg summit (2009) by ensuring greater cooperation among members on key post-crisis issues (such as fiscal stimulus, financial reform, etc.) prevented the world sliding into a repeat of the Great Depression. Similarly, the G-20 deserves credit for its repeated emphasis on inadequate supervision of 'shadow banking' activities as the primary cause of the recent crisis. This set in train important improvements in the financial regulatory landscape such as Basel III and the Dodd-Frank Act. Additionally, the continual rhetoric at the G-20 against a renewal of protectionism fended off the kind of tariff conflicts witnessed in the post-depression era. However, the G-20 has not been able to make much headway in certain key dimensions of global stability such as (a) the design of an equitable and credible international debt resolution mechanism, (b) striking a proper balance between fiscal consolidation and the need to use fiscal policy as a component of counter-cyclical macroeconomic policies, (c) reducing the global dependence on US macroeconomic policies stemming from the use of the US dollar as a reserve currency, (d) recognition of the threats to financial stability

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of the LDCs posed by procyclical cross-border capital flows and (e) removal of major impediments to international movement of labour.

Conclusion

'This time is different' is a common refrain in discussions following every major crisis and is also the title of an interesting book written in response to the current one (see Reinhart & Rogoff, 2009). However, in one essential regard, this crisis is indeed different from its predecessors, namely that for the first time, nations have come together to chalk out a coordinated global effort to fight the crisis, instead of each country attempting to build walls of insulation around its own domestic economy. In the immediate wake of the crisis, certain things emerged with stark clarity—in particular, the inconsistencies in regulatory systems across countries and clear conflicts of interests between regulators across borders as well as between regulators and financial markets. The need was quite evident for a new era of global financial coordination to deal with global systemic risk. The major issues that seemed to call for inclusion in the agenda of such an endeavour were:

1. Regulation of domestic financial markets and the coordination of regulations across jurisdictions to avoid 'regulatory arbitrage'.
2. Regulation of cross-border capital flows.
3. To device global 'lenders of last resort' mechanisms to supplement emergency liquidity financing of national central banks.
4. To ensure adequate global debt resolution mechanisms.
5. To ensure coordination of debt resolution tools as well as coordination in depositor and investor protection.
6. To provide frameworks for enhanced information sharing among regulators.
7. To work towards an international financial architecture that addresses international stability considerations in a fair and forthcoming manner, with special attention to EMEs and LDCs.

The global coordination process was envisaged as involving the five major partners listed in the opening paragraph of this article. This article has gone into an extended discussion of the range of tasks confronting each of these partners in the conduct of the overall mandate of global stability. Difficulties abound but significant signs of progress are also discernible. While it is premature to prognosticate on the likely success

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of this ambitious endeavour, one cannot but welcome the overall efforts at facilitating consensus building among the comity of nations.

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