

The role of referees came in for considerable comment during the recently concluded Football World Cup. With the hangover still impacting his world view, our Chairperson, a football fanatic, takes a look at the referees in the regulatory space.

Non-statutory warning – Past experience is no guarantee against future observations.

Editor

REFEREES IN THE REGULATORY SPACE



M. Damodaran

*Chairperson, Excellence Enablers
Former Chairman, SEBI, UTI and
IDBI*

Decades ago, when intellectual discourse yielded place to ideology-derived belligerence, and worse, in Indian universities, Professor V.V. John, an eminent Vice Chancellor, made a profound observation. He stated that outside the gates of heaven, there was one long queue and one short queue. The persons in the longer queue were required to first serve a term in purgatory or hell, before they gained admission to heaven. The second queue was meant for Vice Chancellors who had already served in Indian universities.

Unconfirmed reports emanating from above would seem to suggest that persons who have served in regulatory organisations would also be entitled to join the shorter queue. Clearly, the price that is required to be paid while on earth is that of steering the ship, through stormy seas, to safe shores, in an effort to promote orderly conduct in the regulated universe.

The life of a Regulator, especially in the emerging markets, is as exciting as it is challenging. One securities market Regulator of a relatively small jurisdiction once mentioned that when the stock market indices were going up, no one knew of his existence; but when they came down, everyone knew his telephone number and residential address.

A Regulator's role is a combination of the roles of FIFA and of the football match referee. The Regulator lays down the rules, and also enforces them on the field of play. What lends credibility to this role is an attempt to make the rules and regulations clear, and to give them reasonable continuity of existence, so that the players are aware of what is fair, and what is not, on the playground. Domain familiarity is clearly a necessary requirement. What is more critical is equanimity and poise and a sense of justice and fair play, treating all regulated entities alike. In the process, those that need to be rapped on their knuckles should be dealt with in a manner significantly different from those that need to be hanged for material system-destroying offences.

The need for regulatory organisations arises when it is recognised that smaller entities, with a disadvantage of limitation of size and scale, are unable to stand up and be counted on their own strength. This is best illustrated in the preamble to the SEBI Act which states that the objective of the statute is to protect the interest of investors and to provide for the development and the regulation of markets. It follows that a Regulator's role is not only that of a policeman pulling up persons for real or perceived offences, but also one that creates a large universe in which more and more persons can take part in the process of wealth creation. (One regulator who years ago made a statement that regulation was his only objective, may be forgiven for not reading the Preamble!).

How is this role discharged? Rules and regulation can at best provide the enabling framework. What is essential is that all contending parties involved in any transaction are given a fair hearing, and thereafter, a reasoned order is passed in order to do justice to the party that has been adversely affected. "Audi alteram partem" is a pillar of natural justice, not a comment on an automobile of choice.

The requirements of impartiality and fairness are often explained in terms of the demand for “independence” of Regulators. Regulatory independence is a misconceived notion. What is required is functional autonomy to operate within an ecosystem in which there are multiple participants.

Functional autonomy, without any accountability, would be the perfect recipe for disaster. Accountability however should not mean being responsive on a continuing basis to the demands that government functionaries or the political executive might make in regard to individual transactions. Further, in a country as vast as India, with a significant public sector presence, it is not unusual for Regulators to be requested to grant exemptions, with extension of time being the fallback option. Responding positively to such requests weakens the regulatory system since exemptions and carve-outs based on ownership can be disruptive to discipline in the regulatory environment.

As far as accountability is concerned, the best option is to provide for every Regulator to appear before an appropriate Committee of Parliament once a year to explain what that regulatory body set out to do in the year gone by, what thereof was accomplished, and the reasons for falling short of the identified objectives. It is equally important for the Regulator to explain to a Parliamentary Committee what the state of the regulated universe is, and what major issues are proposed to be addressed in the forthcoming year. The necessity for giving evidence annually to a Parliamentary Committee derives from the clear understanding that regulation is subordinate legislation, and that Parliament, as the supreme lawmaker in the country, is entitled to know how subordinate legislation is being conceived and implemented. To see such rendering of evidence as interference by Parliament is to close one's eyes to the representative form of government that we have chosen for India.

The functioning of Regulators in recent times has often raised eyebrows. As corporate skeletons tumbled out of cupboards in rapid succession, the inadequacy of the regulatory organisations in the US manifested itself. The position was no better in other developed jurisdictions. Nearer home, we have an example of the banking Regulator stating that it is not adequately empowered to deal with public sector banks, and that it has powers to discipline only private sector banks. The question whether such powers are being exercised with respect to private sector banks need not detain us here. What is more significant is the admission of absence of powers over public sector banks, when everyone, including the Government, believed that the Regulator was adequately empowered. Statements of this kind are destabilising for the credibility of the organisation. Recently, we have seen the insurance Regulator clear a proposal by a government owned insurance company for investment in a bank to the extent of 51% of the share capital, when the statutory limit is 15%. It is not unlikely that the larger public interest, which the Regulator perceived, merited such a decision. It would have however helped the optics, if the decision was not seen as taken immediately on receipt of the application by the insurance company. The related question whether the Board of the insurance company was fully in the picture, or was cajoled or coerced into taking this decision is a tale which will be told another day. Suffice it to say that the announcement of the decision of the Board to the public was made by a senior government official, and not by any executive of the insurance company. It remains to be seen whether the regulatory system looks into these aspects, and investigates them to decide whether the Board has done what it needs to do as the custodian of Corporate Governance.

Reports seem to indicate that in-principle approval was obtained from the banking Regulator before application was made to the insurance Regulator. Other regulated entities are entitled to ask when the informal in-principle approval system came into being.

Strengthening of regulatory organisations is clearly a high priority. Unless this is done, ownership-derived preferential treatment, for the mere asking, is likely to be the order of the day. Regulatory organisations must also be financially self-sufficient, so that their existence does not owe itself to handouts from the government. Handouts, as is well known, come with strings attached, and regulatory organisations cannot afford to pay that price.

Debates and discussions on the structure of regulatory organisations are meaningless, unless the business of regulation is taken seriously by the creators of regulatory organisations and by the leaders of those organisations. Failing this, one will have to fall back on Alexander Pope's contextually amended observation –

*For forms of regulation, let the fools contest.
Whatever is best regulated is best.*

READERSPEAK - Auditors' Dilemma – To Sign or To Resign?

"TV Mohandas Pai, Chairman, Manipal Global Education Services "
"Agree with you fully, running away is not an option!"

"Pradeep Dinodia, presently ID on listed entities and Managing Partner, SR Dinodia & Co. LLP"

"An excellent piece of incisive writing..... They are doing risk management of their auditing practice rather than that of the Auditee. The suggestion that their concerns be shared with the Audit committee is one of the best I have seen in a long time. The Auditing firms should also appoint ombudsman in their own firms to deal with unreasonable audit partner demands on the Auditee."

"Nawshir Mirza, presently ID on listed entities and former Partner, S.R. Batliboi & Co."

"From my four decades as an auditor and near two decades as an independent director, I would say that the auditors that resigned have failed to fulfil their part of their contract of appointment. A quiet resignation is nothing but connivance between the auditor and the stewards of the business to allow the latter an easier escape. Action should also be brought against the directors on the audit committees of the concerned companies for not only failing in their responsibilities for ensuring full information to auditors but for failing to inform the shareholders of the reasons for their auditors' resignations, the auditors having failed to do so."

"Siddharth Shriram, former CMD, Mawana Sugars "

"There is a further dilemma that auditors face and that is their own conflict of interest. Also, their own qualifying note that they always write 'we have relied on the information provided' is a cop out because they must delve deep into the audit. They take on too many audits and then cannot do a thorough job; consulting practices are often the rich fruit of audit practices."

"Suresh Talwar, Founder Partner, Talwar Thakore & Associates (TTA)"

"Brilliant. Brief yet very comprehensive. It covers every aspect of the subject."

"Debashish Mohanty, President and Country Head, UTI AMC"

"Can we think of a solution where a pool of funds will be created under a third party or under the supervision of the ministry of corporate affairs which will remunerate all the auditors of the registered companies? This will ensure neutrality and fairness of reporting."

Do let us know of any specific issues you would like to see addressed in subsequent issues.

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