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Many a Slip: Enforcing Regulation

India Inc needs a strong enforcement mechanism to go with a well-defined regulatory structure

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Successive corporate scams have prompted governments around the world, including in India, to develop a stronger legal and regulatory framework that governs and regulates business and corporate transactions. Some of the central issues, while regulating the working of corporations, include the clarity of laws, rules and regulations; roles, responsibilities and jurisdictions of regulatory institutions and coordination among regulatory bodies.

First, let us look at the clarity of laws. The purpose of a regulatory mechanism is to ensure proper conduct of business transactions without undermining efficiency and productivity. With inconsistent interpretation and enforcement of laws and retrospective regulatory amendments, it is becoming increasingly difficult for investors to plan their strategy to invest in India. For example, the income-tax department's approach in the recent Vodafone and Aditya Birla Nuvo cases questioning the established market practice of foreign investors investing in India through a Mauritius subsidiary to save on capital-gains tax at the time of exit from the investment has created uncertainty in the investment climate in India.

Nearly 60% of foreign investment in India has been made through Mauritius for over a decade. The income-tax department orders have left both Indian corporates and foreign investors struggling to understand what is an acceptable form of tax structuring under law for investment in India. Similarly, recently, the RBI has sent notices to a few companies noting that put options in favour of foreign investors, where the investor has the right to sell his shares to the investee at a pre-determined price, are considered external commercial borrowings and, as such, not permitted under the Fema. These options have been widely used by foreign investors while investing in India. Such a reinterpretation of existing market standards can lead to loss of confidence in the legal and regulatory structure, which may have a direct effect on foreign direct investment coming into India. According to the World Investment Report, 2011, by Unctad, FDI has shrunk by more than 31% in India in 2010.

Moving to the second issue of responsibilities of regulatory institutions, India fared well in the recent global economic crisis largely due to robust regulatory oversight of the Indian financial sector by our regulators. Indian regulators did not permit complex over-the-counter derivative transactions and subprime mortgages, the two main causes for the crisis on Wall Street. But on the flip side, right now when India is well poised to become a safe haven for FDI, largely due to its good performance during the global financial crisis, lack of clarity of roles and responsibilities of various regulators and their jurisdiction has become a cause for concern and uncertainty.

Instances of conflict over jurisdiction among regulators and possible overreach of regulators into areas traditionally not covered by them include Sebi and the Insurance Regulatory Development Authority (Irda) sparring over jurisdiction, and Sebi claiming jurisdiction on the issue of optionally fully-convertible debentures by an unlisted entity. Significant effort is required on the part of policymakers to define the powers of various regulators clearly and on the part of regulators to understand and stay within their jurisdiction.

> **While the Sebi and CCI have appellate bodies where the former's decisions can be challenged, the RBI does not have such a body**

The recent Competition Commission of India's (CCI) order against DLF, wherein the CCI chose to demonstrate regulatory self-restraint in not expanding its scope and jurisdiction to cover irregularities committed by DLF that were not 'anti competitive' is a welcome trend, particularly when it could have used the argument of the 'interests of the consumer', which is statutorily provided to CCI more widely.

Lastly, coordination and interaction among regulatory bodies is also vital, given the overlapping jurisdiction of various regulators. There are sectors where such coordination has worked smoothly. To obtain a non-banking finance company registration from RBI, a financial firm will need clearance from any other regulator that regulates it. This clearance is secured by the RBI from various regulators and the applicant does not have to go to multiple regulators to obtain approval.

However, there are other instances of overlap of jurisdiction and lack of coordination among regulators, which makes an investor run from pillar to post to get necessary approvals. For instance, the department of industrial policy and promotion, which comes under the purview of the ministry of commerce and industry, is mandated to formulate policy for FDI. However, the implementation and approvals for investment are the mandate of FIPB, which comes under the purview of ministry of finance. So, if there is a clarification required on an aspect of FDI policy, there is lack of clarity on who should be approached. To complicate matters, since FDI policies overlap with Fema, the FIPB as a practice more often than not would pass a query to RBI for their view.

Going ahead, there is a clear need for rationalisation of jurisdictional authority of corporate regulations. It is imperative for any well-developed financial system to have a robust, transparent and accountable regulatory mechanism. In India, our primary securities regulator, Sebi, and the CCI have appellate bodies where the decisions made by these bodies can be challenged.

However, the RBI does not have such an appellate body, in which case the aggrieved party has to rely on the discretionary reliefs through writ petitions. A well-defined regulatory structure with a strong and predictable enforcement mechanism is the need of the hour for Indian financial markets.

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