excellence enablers CORPORATE GOVERNANCE SPECIALISTS
(AN M. DAMODARAN INITIATIVE)

Expert Expressions
Corporate Governance Demystified

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Clarity and continuity of law and regulation is a *sine qua non* of an orderly society. What happens then, when there is no clarity on which regulator should be responsible for a function or activity? While tigers mark their territory, should regulators tread on each other's toes?

Editor

Gaps, Overlaps, Traps and Mishaps

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*Mere angne main tumhara kya kaam hai…*is a question that has been asked in the regulatory space on quite a few occasions. Replace *"mere"* with *"uske"* and it will be seen that the recent order of the Securities Appellate Tribunal (SAT), setting aside Securities and Exchange Board of India (SEBI)'s findings in the matter of some entities and some partners of the Price Waterhouse Group, poses exactly this question. SAT has held that the Institute of Chartered Accountants of India (ICAI), and not SEBI, can, and should, regulate the profession of Chartered Accountants and the practice of auditing. Does this render SEBI toothless when it comes to dealing with suspected negligence, or worse, while seeking to ensure that the accounts of regulated entities present a true and fair picture?

Turf battles between regulators are not new. More than a decade ago, and consequent on an announcement in the budget regarding the setting up of Gold Exchange Traded Funds (GETFs), SEBI constituted a committee to give effect to this decision. Objections were raised at the threshold. It was contended on behalf of the Reserve Bank of India (RBI) that gold being a surrogate for currency, the RBI should take the initiative in the setting up of such funds. The Forward Markets Commission (FMC) (since merged with SEBI) expressed the view that gold being a commodity, it should be left to the commodities regulator, namely the FMC, to act on this matter. SEBI's contention was that the announcement was regarding a fund, the units of which will be traded in the market and therefore it was for the securities market regulator to enable the setting up of such funds.

A few years later, there was a standoff between SEBI and the Insurance Regulatory and Development Authority of India (IRDAI) on the regulation of the Unit Linked Scheme. It was SEBI's view that the nature of the activity lent itself to regulation only by SEBI. On the other hand, the IRDAI held that the entities offering these products were insurance companies, which were regulated by the IRDAI, and hence, by extension, IRDAI should regulate these products. The matter remaining unresolved, the Ministry of Finance (MoF) got into the act and set up the Financial Stability and Development Council (FSDC) to provide *inter alia* for inter-regulatory coordination. Questioned on the necessity of setting up such a body, the then Finance Minister stated in Parliament that if two regulatory bodies were fighting like children, the MoF could not stand aside and watch. In some ways, it was a timely reminder of the story of the two cats and the monkey.

Outside the public glare, there is the difference of opinion, to put it mildly, between the RBI and SEBI on some matters relating to the regulation of the debt market. Yet another disagreement is on whether institutions that are functioning as exchanges can remain outside the regulatory ambit of SEBI.

If perceived regulatory overlaps were not enough, there has been at least one significant instance of regulatory gap. Between 1996 and 1998, a number of unincorporated bodies raised money from unsuspecting retail investors, by promising extraordinary returns. The most prominent of these were tree plantation schemes which were launched to persuade the common man that money could grow on trees. There were several other similar shared ownership schemes which promised a bounty after a few years. These schemes proliferated since there was no clarity on who would regulate them. This regulatory gap was exploited by several unscrupulous persons and entities, and predictably, many investors came to grief. When it was finally decided in 1998 that such schemes should be treated as collective investment schemes, and should be regulated by SEBI, there were no applicants for registration. From then till now, SEBI is dealing with the pre-1998 cases, and trying to recover the money raised fraudulently by these entities.

Post the coming into force of the Companies Act, 2013, questions arose as to the manner in which inconsistencies between the Statute and Clause 49 (since replaced by SEBI (Listing Obligations and Disclosure Requirements) Regulations (LODR)) should be tackled. The commonsense view, which has stabilised after a few years, is that while the Ministry of Corporate Affairs (MCA) would have jurisdiction over the entire universe of corporate entities, SEBI would be well within its rights to prescribe higher standards of governance for the much smaller universe of listed entities.

The story will be incomplete without referring to the recent measures announced by the Government of India, ostensibly in public interest. Relevant to our purpose is the reported decision of the Government that banks would not classify Micro, Small and Medium Enterprises' (MSME) accounts as non-performing assets (NPAs) till 31st March, 2020. Ever since the income recognition and asset classification (IRAC) norms were given effect to in the early 1990s, and even before that, it was the Central Bank that had the responsibility for prescribing when, and on what basis, an account ought to be treated as an NPA. Is the present announcement an aberration and are we likely to see RBI gently reminding the Government of the inappropriateness of the announcement? Will Mint Street stand up and be counted or will it sit back and watch?

Underlying these standoffs is one common question. Is it the entity that is proposed to be regulated or is it the function or activity that should be the focus of regulation? For example, in the standoff between SEBI and IRDAI on the Unit-Linked Insurance Plans (ULIPs), would it not have been appropriate to hold that it was the function that was sought to be regulated, and therefore it fell within SEBI's domain, while the entities, namely the insurance companies, would continue to be regulated by IRDAI in its role as the entity regulator. To put the matter differently, is it the structure that is sought to be regulated, or is it the function? If both of these are to be regulated, can they not be regulated by two regulators, without stepping on each other's toes? To give an extreme, and hopefully a theoretical, example, if a player commits premeditated murder in a football field, should the basic crime be dealt with by the police or by the Football Association? The Association as entity regulator would be well within its rights to ban the player for life and even to impose penalties on the club to which she/he belongs; but dealing with the offence of culpable homicide will be the function of the police.

There are innumerable examples of crimes remaining unresolved because police stations were protesting the absence of jurisdiction, while the criminals made good their escape. Regulatory gaps, if unattended to, will play out in the same fashion.

Before the next turf dispute emerges among regulatory entities, the FSDC should think through all possible gaps and overlaps, and address them appropriately. "If it ain't broke, don't fix it" won't work if potential problems are ignored. The SEBI-SAT standoff is expected to end up in the Supreme Court. My unsolicited advice is simply this: Let ICAI regulate the profession of Chartered Accountants, and leave it to SEBI to discipline auditors who negligently, or otherwise, aid in the publication of accounts, that are neither true nor fair.

READERSPEAK - A Tale of Two Boards

TN Manoharan, Member, Govt appointed Satyam board, Chairman, Canara Bank, and Past President, ICAI
"The incisive analysis bringing out the similarities and differences between the Satyam and IL&FS and the take away in the form of right lessons is comprehensive and meaningful. Having been part of the Government nominated Board of Satyam, I can vouch that the advantages we derived in terms of diversity of expertise among the Board members, support drawn from second line of Management and the absolute freedom of operation were instrumental in turning around and resurrecting the Company."

BS Raghavan, IAS (Retd), GoI
"Brilliant, Damodaran....the comparative analysis of how both situations were handled is full of penetrating insights."

B. P. Vijayendra, Former Principal CGM, RBI
"The comparison between the Satyam and IL&FS events, separated by a decade, is extremely interesting. The relevance of CA and Lawyer on the Board and significance of the middle level functionaries in the rehabilitation efforts are important lessons to be learnt."

S Hajara, Former CMD, Shipping Corporation of India
"I totally concur with you that for an entity like ILFS, involved with such diversified business segments, a multi disciplinarian composition of the Board was the best suited approach. Today somehow diversity in the corporate sector has fashionably become synonymous with gender diversity but diversity in knowledge, experience and wisdom is a far more important issue. Legal and financial acumen and knowledge should form the pillars of any corporate revival."

Gen (Retd) Ved Malik, Former Chief of Army Staff, GoI
"Enjoyed reading this column with very sane advice, especially on the QR for Independent Directors."

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