

## REGULATORY IMPACT ASSESSMENT (RIA) – A “CUTS” NOTE

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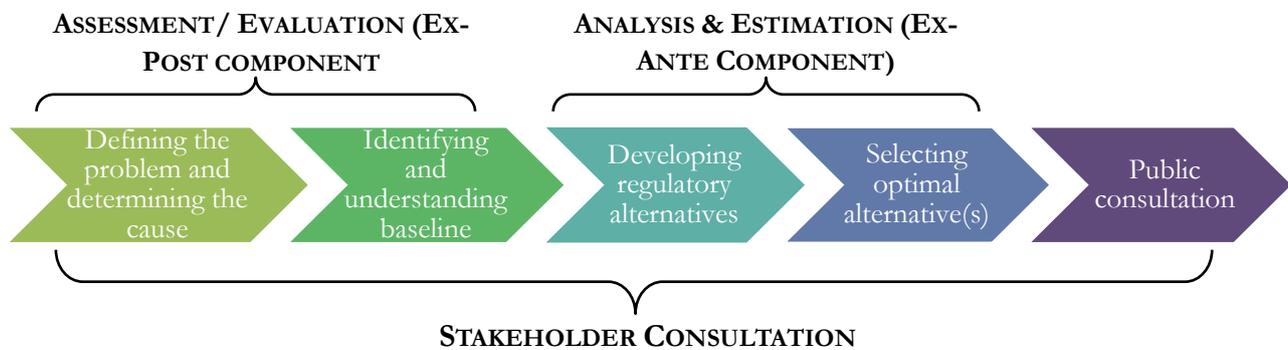
### INTRODUCTION

Regulatory instruments such as policies, legislations, rules, and regulations etc (regulations) have widespread impacts, which affect multiple stakeholders in different ways. Regulations tend to change behaviour of stakeholders, and thus impose additional costs. Consequently, only such regulations must be adopted which can achieve intended objectives with least possible distortions. Moreover, sub-optimal regulations have the potential to impose superfluous costs on stakeholders, raise complexity and uncertainty associated with obligations, which must be avoided. Therefore, it is important to understand impacts of proposed and existing regulations to formulate most optimal design.

One of the systematic approaches to critically assess the impacts of proposed and existing regulations is Regulatory Impact Assessment (RIA). It is an important element of an evidence-based approach to policy making, as it essentially comprises stakeholder engagement in policy making and review. Impacts of regulatory options are compared with ‘as is’ scenario on the basis of scientifically developed tools such as cost-benefits analysis, cost-effective analysis etc. and thus best possible regulatory intervention is selected.

Both developed and developing countries have increasingly realised benefits of RIA over the years. A study of 15 RIAs by the US Environmental Protection Agency showed that three (out of total 15) RIAs increased net benefits to society from recommended improvements in regulations, by \$10 billion. Similarly, removing numerous regulatory barriers in South Korea was estimated to boost FDI by \$26 billion over 5 years. Moreover, The One-in, Two-out Policy of UK, which mandates removal of £2 of costs for imposition of £1 of costs via state-led intervention, has resulted in net reduction £836 million in costs to business between 2010 and 2013

### PROCESS OF UNDERTAKING RIA



Steps	Description	Examples	
		Banking	Insurance
<b>Defining the problem and objective</b>	The first step in performing RIA is to clearly define the problem that the proposed regulatory intervention or amendment to existing regulation is intended to address. Problem definition sets out the objective and scope of	<i>Problem:</i> Slow and low recovery of debts due to banks and financial institutions  <i>Objective:</i> Improving the debt recovery process  <i>Stakeholders:</i> Banks, Financial Institutions, Ministry of Finance, RBI, DRTs, DRATs, legal practitioners, etc.	<i>Problem:</i> Low investments in and inadequate access in insurance sector  <i>Objective:</i> Facilitating investments and enabling access  <i>Stakeholders:</i> Insurance companies (Private and Public Sector), legal practitioners and consultants, insurance intermediaries, agencies

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	RIA exercise, and helps in identification of stakeholders		government, regulatory bodies and sector experts.
<b>Identifying and understanding the baseline</b>	<p>This steps involves identification and selection of relevant existing regulations/ legislations (based on the pre-defined indicators), identification of issues, understanding the costs and benefits of the as-is/ baseline scenario.</p> <p>In-depth literature review, <b>stakeholder interaction</b>, and analysis of relevant regulatory provisions aid in this exercise</p>	<p><i>Regulations/ Legislations:</i> DRT Act and SARFAESI Act (selected based on indicators like time required for compliance, procedures/authorities involved, cost of compliance, debt recovery rate, focus on debt recovery, etc.)</p> <p><i>Issues identified:</i></p> <ul style="list-style-type: none"> <li>• Sub-optimal provisions in relation to staffing and operation of recovery tribunals</li> <li>• Lack of performance review and accountability provisions</li> <li>• Absence of provisions in relation to adequate number of recovery tribunals</li> <li>• Sub-optimal provisions in relation to taking over of assets</li> <li>• No guidance on determination of correct value of mortgaged security</li> </ul> <p><i>Estimation of Costs:</i></p> <ul style="list-style-type: none"> <li>• Opportunity cost due to delay in recovery (<i>up to four years</i>) has been estimated up to Rs. 35,000 cr. (DRT Act and SARFAESI Act)</li> <li>• Low debt recovery has resulted in credit risk premium of around 300 basis points, resulting in high cost of funds</li> <li>• Social cost of the amount of loans written off by commercial banks in last five years (i.e., Rs. 1,61,018 cr.) would have allowed 1.5 million of the children to get a full university degree</li> </ul>	<p><i>Regulations/ Legislations:</i></p> <ul style="list-style-type: none"> <li>• Insurance Act, 1938, and Insurance Laws (Amendment) Act, 2015</li> <li>• Insurance Rules, 1939</li> <li>• IRDA (Linked Insurance Product) Regulations, 2013</li> <li>• IRDA (Non-linked Insurance Product) Regulations, 2013</li> <li>• IRDA Guidelines on Persistency</li> <li>• IRDA Master Circular on preparation of financial statements and filing returns of life insurance business, 2013</li> </ul> <p><i>Issues identified:</i></p> <ul style="list-style-type: none"> <li>• Unreasonable regulatory restrictions for investments</li> <li>• Regulatory cap on allowable expenditure by insurers</li> <li>• Lack of incentives for customer retention</li> </ul> <p><i>Estimation of Costs:</i></p> <ul style="list-style-type: none"> <li>• Investments of more than Rs. 50,000 crore stuck in the sector</li> <li>• Front loading of costs resulting in entry barriers</li> <li>• Misaligned incentives promoting customer acquisition much more than customer retention</li> <li>• Persistency in more than 50% of insurers of less than 50%.</li> </ul>
<b>Developing regulatory alternatives</b>	Multiple alternatives intending to achieve desired change in the baseline scenario are developed. Alternatives could be no-regulation, co-regulation, direct regulation, etc. Further, costs and benefits of the alternatives on relevant	<p><i>Regulatory alternatives and their respective costs:</i></p> <ul style="list-style-type: none"> <li>• Establishment of additional DRT/ DRAT – Rs. 63 cr. for setting up 24 additional DRTs in addition to one time infrastructure cost</li> <li>• Appointment of technical members in DRTs/ DRATs – Rs. 6.60 cr. per annum</li> </ul>	<p><i>Regulatory alternatives and their respective costs:</i></p> <p><b>Regulating expenditure by insurance companies:</b></p> <ul style="list-style-type: none"> <li>• Regulatory suggestion: Capping the expenditure</li> <li>• Disclosure of comparative costs to consumer</li> <li>• Checking surrender and</li> </ul>

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	stakeholders, including government, are estimated	<ul style="list-style-type: none"> <li>• Constitution of independent advisory body to recommend candidates for appointments – Rs. 20.40 lakhs per annum</li> </ul> <p><i>Benefits:</i></p> <ul style="list-style-type: none"> <li>• Improved recovery rate</li> <li>• Improved performance of recovery tribunals</li> <li>• Prevention of benefits foregone</li> </ul>	<p>misselling</p> <ul style="list-style-type: none"> <li>• Disallowing high upfront commissions</li> </ul> <p><b>Promoting customer retention:</b></p> <ul style="list-style-type: none"> <li>• Commission claw-backs</li> <li>• Enforcing suitability requirements</li> <li>• Incentivising industry led initiative for customer retention</li> </ul> <p><i>Costs of alternatives:</i></p> <ul style="list-style-type: none"> <li>• Increase in cost of doing business for insurers</li> <li>• Increased monitoring and supervision burden on regulator</li> <li>• Reduction in high upfront commission for intermediaries</li> <li>• Increase in the cost of law making for policy makers</li> </ul> <p><i>Benefits:</i></p> <ul style="list-style-type: none"> <li>• Reduction in information asymmetry</li> <li>• Increase in sale of suitable products to consumers</li> <li>• Enabling access to insurance products and facilitating investments</li> </ul>
<b>Selection of optimal alternative</b>	The alternatives are compared inter-se and with the baseline scenario using appropriate tool for selection of the alternative having the potential to result in greatest net benefit.	<p><i>Selection of alternatives:</i></p> <ul style="list-style-type: none"> <li>• Establishment of additional alternatives</li> <li>• Appointments of technical members</li> <li>• Providing statutory timelines to DM/CMM to dispose of the case</li> </ul>	<p><i>Selection of alternatives:</i></p> <ul style="list-style-type: none"> <li>• Improving the law making process</li> <li>• Checking surrender and mis-selling</li> <li>• Enforcing suitability requirements</li> </ul>

### Benefits of RIA

Implementation of RIA improves overall regulatory quality, by factoring all the relevant expectations of stakeholders. Rigorous and transparent assessment of costs and benefits also increases the acceptability of regulation among stakeholders. As a result, there is greater clarity and predictability in regulatory process. This is evident from experience of the other jurisdictions (as mentioned earlier) from adoption of RIA.

Taking a cue from other jurisdictions, RIA has been recommended for India by several expert committees. These include the erstwhile Planning Commission's Working Group on Business Regulatory Framework (to which CUTS acted as a Knowledge Partner), Financial Sector Legislative Reforms Commission, Damodaran Committee Report and the Tax Administration Reform Commission. The Pre-Legislative Consultation Policy of the Government of India, introduced in 2014, also requires government departments to conduct partial RIA of proposed legislations. Recently, the Expert Committee on Prior Permission and Regulatory Mechanism recommended adoption of RIA in India by central and state governments.

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