EVENT REPORT

SEMINAR ON COMPETITION AND REGULATORY REFORMS IN INDIAN FINANCIAL SECTOR

MUMBAI, MAHARASHTRA, DECEMBER 16, 2013

Background

CUTS Centre for Competition, Investment & Economic Regulation (CCIER) organised a seminar on competition and regulatory reforms in the Indian financial sector in Mumbai, Maharashtra, on December 16, 2013. The seminar was part of the outreach events being organised by CUTS CCIER for the project on India Competition and Regulation Report, 2013 (ICRR IV).

ICRR is a biennial project which conducts assessment of competition and regulation scenario in the country. This is desirable in light of India's embracing of market-oriented economic and the prevailing distortions in economic management of the country that impede realisation of competitive outcomes. The project is supported by the Ministry of Foreign Affairs through the Royal Norwegian Embassy in New Delhi.

Three ICRR reports (2007, 2009, and 2011) have been released until now and the ICRR IV focuses on competition and regulation in select sectors (coal, finance, private healthcare and railways) and certain cross-cutting issues (regulatory overlaps and regulatory independence). In addition, stakeholder perception surveys about the state of competition and regulation in the economy in general and also for the select sectors have been conducted, to support the analysis and findings of the secondary research.

The findings of the paper developed on financial sector for the ICRR IV project were presented by Amol Kulkarni, Policy Analyst, CUTS. This was followed by a panel discussion amongst the sector experts about the regulation and competition issues in the Indian financial sector, and the reforms required. The floor was then opened for a question and answer session. The agenda for the seminar is available at: *www.cuts-ccier.org/pdf/Agenda-Seminar_on_Reforms_in_Financial_Sector_in_India.pdf*.

The panellists for the seminar were:

- Charan Singh, Reserve Bank of India Chair Professor of Economics, Indian Institute of Management, Bangalore
- Somasekhar Sundaresan, Partner, J. Sagar Associates
- Sucheta Dalal, Managing Editor, Moneylife
- Prithvi Haldea, Chairman & Managing Director, Prime Database

The panel was chaired by Pradeep S Mehta, Secretary General, CUTS.

The audience comprised a mix of financial sector practitioners, lawyers, economists, academia, representatives from regulatory bodies, civil society, including Nishith Desai, a Leading Taxation Lawyer, Founder and Managing Partner, Nishith Desai Associates.

Welcome Address

Pradeep S Mehta welcomed the panellists and the audience for the seminar. He provided an introduction about CUTS, its programmatic areas, and CUTS CCIER. Financial sector interventions made by CUTS, in India and abroad, were also briefly highlighted by Mehta. These included interventions in relation to the fiscal management regime, the foreign direct investment and portfolio investment policy, the insider trading regulations, amongst others. Some of the financial sector interventions made by CUTS are available at: *www.cuts-ccier.org/Advocacy.htm*.

He mentioned that while India has embraced market-oriented economic reforms, there is, as yet, no periodic review to assess functioning of markets in the country. This is desirable given the existence of distortions in economic management of the country that impede realisation of competitive outcomes. Considering the important role of market forces in a liberalised economic regime, there is a need to do periodic assessment of competition and regulation scenario in the country. The ICRR project is an attempt to fill this vacuum.

Commenting on the diverse backgrounds of the panellists, he mentioned that this would help in bringing in fore divergent and refreshing point of views in relation to the subject. He also thanked JSA for its assistance to organise the seminar and to the Royal Norwegian Embassy for the financial support.

Presentation

The presentation began with a brief about the methodology adopted by CUTS to develop the financial sector paper and its scope. The paper focused on the regulatory, competition and consumer protection issues in the banking, non-banking financial companies (NBFCs) and insurance sub-sectors of the Indian financial sector. The paper has been developed with the background of financial crisis, five years post which lot of dust has settled and regulators across the world are taking measures to prevent repetition of crisis.

The methodology involved developing a draft paper based on secondary research guided by the National Reference Group, a group of sector experts who set the contours for the paper and research. The draft paper was shared with sector experts and expert inputs and findings of stakeholder perception surveys were included in it. Stakeholder perception surveys involve administration of dedicated questionnaires to elicit responses from various stakeholders, such as business, academia, regulators, consumers etc. During the course of the presentation, some of the findings of the perception surveys and expert inputs were also shared.

It was highlighted that Indian regulations consist of excessive entry and performance conditions that intend to regulate risk taking of market players and hence micro-manage their business. Such micro management was also practiced prior to financial crisis but did not result in preventing the same. It was questioned if this was the correct manner to regulate a sector or there could be an alternative method. It was further mentioned that the regulators have unfettered discretion to impose additional conditions and reject application and a lack of adequate grievance redressal mechanism exacerbates the concerns in Indian financial sector.

With regard to competition in the financial sector, public sector enterprises have been given statutory preferential treatment. The general corporate laws, such as winding up and bankruptcy, are not applicable to public sector. In addition, public sector benefits from explicit and implicit guarantees and unlimited access to public funds. In spite of such preferences, the public sector suffers from high non-performance assets and low return on assets when compared with private sector. Further, NBFCs and banks, carrying on substantially similar activities on the assets side, are differentially treated. There is a case for similar treatment of banks and NBFCs.

It was further pointed out that there have been various regulatory conflicts amongst financial sector regulators, and between the Competition Commission of India and the financial sector regulators. The regulators rarely consult each other on critical areas and the Financial Stability and Development Council (FSDC) has not been used as an effective platform to manage regulatory co-ordination, systemic regulation, and resolve conflicts. More than 60 percent of the stakeholder survey respondents felt that FSDC was the right platform for managing inter-regulatory conflicts.

Further, the financial sector is marred with unfair business practices, such as product bundling and tying, mis-selling of products, unreasonable charges and fraudulent entities. Comparisons of products are not available, even after regulatory directions, know your customer requirements remain complex and the Ombudsmen have remained ineffective.

The presentation further reviewed the regulatory developments in India and abroad post-crises, and queried the kind of reforms India needed in light of its expanding needs and that the fact that the global financial sector is going back to basics of making banking simple and boring.

Panel Discussion

Each of the panellists was given around 10 minutes to react to the presentation, which was followed by the panel discussion and audience interaction.

Charan Singh

Singh pointed out that lack of domestic research and studies based in the country, and probably an over emphasis on foreign research, results in lack of effective policy making. In addition, he highlighted that there is a need for clarity between evaluation of path and destination of reforms. The path followed for reforms need to be tracked (changes in 1992, 2002, 2012) and then way forward could be suggested. In order to evaluate the destination, the state today, and the deficiencies therein must be analysed to suggest the way forward.

Singh further mentioned that greater discussion is needed on India's stance on critical financial sector issues, such as capital account convertibility, banking regulation and inflation targeting. It needs to be evaluated if the world is recognising and appreciating India's stance on these issues and veering around to India's view point. Once it is decided as to what is the right or the alternate policy, there needs to be a law in place, which brings in the role of regulation and supervision. He stressed on the need for balanced evaluation wherein an evaluator should accept what is good, identify where the policy is lacking, and then suggest alternatives. Only then a policy dent can be achieved.

Sucheta Dalal

Dalal stressed that consumers are being taken for granted in the Indian financial sector and regulators were not taking into account concerns of consumers while formulating policies. She deplored the regulatory understanding of consumer protection issues and measures proposed by regulators to deal with such issues. She also mentioned that financial sector Ombudsmen have not been effective, and there is low level of awareness about the Ombudsman mechanism in the country.

In addition, she raised the concern that the regulators were not being held accountable in spite of ineffective supervision and failure of timely action against UBPs and fraudulent entities operating in the Indian financial sector. The regulators are not answerable to consumers and consumer organisations. She also raised issues of inefficient regulation and lack of regulation in certain critical segments of financial sector.

Prithvi Haldea

Haldea mentioned that lack of adequate data collection, analysis, and interpretation mechanism that could feed in policy and regulation making is resulting in sub-optimal regulation. He mentioned that most of laws/regulations in the financial sector are superficial in nature and do not take into account the ground realities. As a result, investors do not trust the disclosures, corporate governance and accounts of companies.

He was concerned that while disclosure standards in order to list a company are high, such requirements fall dramatically post-listing. He also emphasised on the lack of regulatory predictability, lack of inter-regulatory coordination, and focus on quantitative in place of qualitative norms, being areas of concern in financial regulation. One of the examples that were cited was absence of qualitative criteria for appointment of independent directors.

Somasekhar Sundaresan

Issues of regulatory arbitrage and multiplicity of regulators, including regulation of similar products (such as mutual funds and pension funds) by separate regulators, were raised by Sundaresan. He emphasised that similar products must be regulated by single regulator to prevent regulatory cracks and arbitrage issues. Also, like service providers must be treated in like manner and disproportionate skewness in the market must be reduced.

He mentioned that the financial redress agencies, as suggested by the Financial Sector Legislative Reforms Commission (FSLRC), could assist in increasing the reach of regulators and ensuring adequate grievance redressal in financial sector. In addition, check and balance mechanism in form of a common appellate body, i.e. the Financial Sector Appellate Tribunal, as suggested by FSLRC is crucial for efficient functioning of financial markets. He was also of the opinion that conflict resolution mechanism between regulators need to be improved and there should be clarity in regulatory policy before writing of regulations.

Pradeep S Mehta

Mehta pointed out that primary reason for regulatory conflicts was absence of co-ordination between heads of regulatory agencies. Lack of co-ordination persists amongst financial regulators as well as between financial regulators and the CCI.

As the regulatory agencies are manned by retired civil servants, the differences in individual thought processes result in regulatory non-cooperation and conflicts. This regulatory capture by the institution of post-retirement sinecures was identified as one of the reasons for regulatory turf wars and inappropriate regulation.

Audience Interaction

While interacting with the audience, the panel emphasised that the product-based regulation as opposed to activity based regulation is resulting in regulatory cracks in the financial system and regulation by a unified regulator of similar products, as suggested by the FSLRC, could be the apt solution to deal with the problem. The issues of excessive regulation of the sector resulting in harm to genuine market players were also discussed during the interactive session.

Query in relation to financial contract being a bilateral contract and the regulatory locus to interfere in the same was raised. The panel argued that unless a contract is comprehensible by the customer, it should not be construed as a valid contract, as suggested by FSLRC and the regulator must have the jurisdiction to interfere on such ground. It was also highlighted that Indian regulators are reactive by nature, and they should be aware of the global developments, and ensure clarity in their understanding of innovations in the financial sector.

Closing Remarks

The central theme that emerged from the seminar was that there is a need to focus on the consumer as the core purpose of all financial sector regulation.

This was emphasised by Mehta, who delivered the closing remarks for the seminar. He also highlighted the practice that regulators are beholden to the line ministries and not to the Parliament, a culture that needs to change. Suggestion on similar lines has been made by CUTS to the recent draft of the Regulatory Reform Bill.

He also emphasised on the need for democratisation of the regulatory appointment process and ensuring proper credentials for appointees and validation of appointments by the Parliament.

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