



Overhaul regulation of professions

In the stock markets, rule-making, enforcement and adjudication improved after independent professionals were put in charge

There are many regulated professions: doctors, lawyers, chartered accountants, company secretaries, etc. While regulation of professional conduct is often required, the mechanisms adopted in India for all these have failed. Discontent has bubbled to the fore with doctors and lawyers. There is one success story: the regulation of stock brokers. This model was adopted by the Bankruptcy Legislative Reforms Commission (BLRC) for insolvency professionals.

In the India of old, many regulated professions were setup through organisations such as the Medical Council of India (MCI), Bar Council of India (BCI), Institute of Company Secretaries of India (ICSI), etc. They failed, for four reasons.

The first problem lay in the regulation of a profession by its own. In India, it is very hard for a doctor to enforce against a doctor. The rule of law does not come easily to humans: we are deeply wired to be nice to our friends and family. Our instinct favours reciprocity: you favour my friends and vice versa. All too often, office bearers of self-regulatory organisations have let off a fellow professional with a slap on the wrist.

The second problem lay in the lack of knowledge in India, in the past, about regulation. Regulators are mini-states, which combine legislative, executive and judicial functions. To regulate doctors is to make rules about what constitutes sound behaviour, run enforcement processes to catch those who have violated rules, and have a hearing where a neutral person hears the charges against a doctor and awards a

penalty. Each of these functions needs to be performed with sound processes and with a separation of powers. None of these processes were envisaged when building BCI, MCI, ICAI, etc.

The third problem lay in competition policy. MCI may work poorly, but it is the monopoly created by Parliament. This reduces the checks and balances that might influence its working.

The fourth problem lay in creating a statutory organisation, such as ICAI or MCI. These have suffered from the inefficiencies of government organisations.

The misdeeds of these organisations have triggered a process of change. On July 5, the Supreme Court asked the Law Commission to review the working of the legal profession. In March, the Parliamentary Standing Committee on Health and Family Welfare found glaring failures by the MCI. On May 2, the apex court asked the government to solve the problems of MCI, and until this is done, to take control of its working. These are important and healthy developments.

How should we regulate professions? First, poachers should not be gamekeepers. The second element lies in writing Parliamentary law that separates legislative, executive and judicial functions, and defines sound processes for each of these. The third element is replacing statutory monopolies with an open and competitive framework. The fourth element lies in ensuring that regulation of professions is done outside the government.

However, there is the success story of the regula-

tion of stock brokers. In the BSE of old, brokers were regulated by brokers. There was a lack of clarity about legislative, executive and judicial processes. BSE was a monopoly. This brought out the worst behaviour by brokers. Brokers organised themselves to lobby for perpetuation of their bad ways.

Through the 1990s, fundamental change was achieved, first at NSE and then at BSE. BSE is now a limited liability company, and has a shareholding that is dominated by persons who are not its members. It is managed by professionals who are not brokers. Rule-making, enforcement and adjudication processes have improved. BSE is no longer a monopoly: if it fails in its regulatory functions and loses confidence of customers, business can shift to NSE. This helps keep both NSE and BSE honest.

The reforms have worked well for brokers. In 1992, on a good day, the BSE did turnover of ₹500 crore in a day. Today, on a good day, NSE and BSE together achieve turnover of ₹2 lakh crore. Reducing the pervasive mistrust of brokers was good for brokers.

The draft Indian Financial Code further strengthens this arrangement by establishing rule of law provisions for the working of Financial Market Infrastructure Institutions (FMII). This would check the arbitrary exercise of regulatory power by such institutions.

The regulation of brokers by NSE and BSE was India's first success story of regulating a profession. These ideas can be applied in many other areas. As an example, a critical component of the bankruptcy reform is a new "insolvency profession". The insolvency professional (IP) plays a critical role once a firm defaults, either in its 'Insolvency Resolution Process' (IRP) or in its 'Liquidation'. The insolvency professional is central to the working of the bankruptcy code, and subtle flaws in the regulation of this profession would derail the entire bankruptcy reform.

In what ways do we need to constrain the IP? The IP can take a bribe from promoters or creditors, and allow them to grab an unfair share. The IP can misrepresent the possibilities available in the IRP to the creditors. The IP can be lazy. To control these problems, this must be a regulated profession.

The BLRC understood the failure of self-regulation. Poachers were not asked to be gamekeepers right at the outset: the constitution of the commission by the ministry of finance was carefully done so that only three members had an interest in being IPs. BLRC proposals are, hence, not shaped by the profit objectives of would-be IPs.

The BLRC proposal avoids the problem of monopoly by envisaging multiple private 'Insolvency Professional Agencies' (IPAs) that would regulate IPs. This creates competition: if one IPA did a bad job of regulation, then customers would use IPs from another IPA. The BLRC proposal envisages sound processes for legislative, executive and quasi-judicial functions of IPAs, and imposes transparency requirements on all IPAs so that malfeasance would be detected in the public domain. The lessons of NSE and BSE should similarly guide the reforms of MCI, BCI, ICAI, ICSI, etc.



SNAKES & LADDERS

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