THE HINDU BusinessLine
TUESDAY, OCTOBER 22, 2019

Mind the gaps

The SEBI diktat on auditor resignations is welcome, but auditors' lapses need to be fixed

Implementing its proposals from its July discussion paper, the Securities Exchange Board of India (SEBI) has issued a circular that aims to discourage auditors of listed companies from abandoning their posts midway, when faced with the task of revealing uncomfortable truths about the financials they are auditing. Auditors of listed firms who put in their papers mid-term will now have to ensure that they present an audit opinion either for the preceding or forthcoming quarter (depending on the time of their resignation). Where they're unable to continue owing to uncooperative management, the company's audit committee is expected to intervene. SEBI has also mandated detailed disclosures from resigning auditors on the exact nature of the missing information and its materiality to the finances. These steps will help ensure that stakeholders in listed companies aren't left groping in the dark when statutory auditors abruptly quit.

Scan & Share

While these new rules address situations where investors in listed firms face an information vacuum after auditor resignations, a remedy is yet to be found for the many errors of commission and omission that statutory auditors commit during their continued engagement with both listed and unlisted companies. Business failures that have rocked the financial system in the last couple of years have shone a harsh light on statutory auditors failing to uncover glaring holes in financials — whether it was the gold-plating of assets at IL&FS or concentrated lending in violation of RBI norms at PMC Bank. Several mid-sized listed companies are under a cloud for cooking up their headline numbers. While the Ministry of Corporate Affairs has been quite tardy at following up such cases, SEBI has been more proactive, cracking the whip on auditors found negligent in cases such as Satyam Computers. But SEBI's efforts recently received a significant setback after the Securities Appellate Tribunal (SAT) overturned its embargo on PwC in the Satyam case. Taking the controversial view that SEBI can act against auditors of listed firms only if it unearthed evidence of deliberate intent to defraud, it questioned SEBI's jurisdiction in cases that merely involved negligence. This has lobbed the ball to ICAI (Institute of Chartered Accountants of India) — a professional body that has tended to be quite soft on its erring members.

The Centre's move last year to operationalise the National Financial Reporting Authority (NFRA) as an umbrella regulatory agency for the auditing profession, amid stiff opposition from the ICAI, is a welcome move. The NFRA is presently tasked with overseeing audit quality for listed companies and large unlisted firms alone. If it proves more effective than the ICAI in reforming the profession, its oversight should be extended to other unlisted firms as well. Given the number and complexity of issues it is likely to be called to handle, it needs to be equipped with adequate infrastructure, resources and technical expertise at the earliest.

For a private market in deposit insurance

Depositors' claims can be settled faster if the DICGC acted only as a re-insurer and private/public sector players offer protection

D SAMPATH KUMAR

It is nearly four weeks since the RBI froze the banking operations of Punjab and Maharashtra Cooperative Bank (PMC) Bank including restrictions on the quantum of withdrawal by depositors of monies deposited in that bank. The RBI has claimed that with the hike in the quantum of withdrawal to ₹40,000 announced on October 14, around 77 per cent of the depositors would be able to withdraw their entire savings in the bank. But there still remains a question mark over the fate of the monies held by the balance 23 per cent of the customers of the bank. They are left to agitate in front of the RBI premises on Mint Street in Mumbai or pour their tale of woe before 24/7 television news channels. Yet it need not have been reduced to all this.

Think of an alternative scenario. The RBI issues a direction under Section 35A of the Banking Regulation Act against a particular bank which puts a question mark over the safety of a customer's deposit in that bank. Far from rushing the next day morning to the bank branch, the customer leisurely walks up to the nearest branch of an ICICI Lombard or a HDFC ERGO from whom he/she has taken out a policy deposit insurance against the defaulting bank and lodge a claim for the sum assured on the ground that a direction by the RBI under Section 35A constitutes a claim event.

The case for a private market in deposit insurance stems primarily from the fact that the present system of settling deposit insurance claims under the Deposit Insurance and Credit Guarantee Corporation Act is slow and cumbersome as this newspaper had argued in a recent article on the subject (*BusinessLine*, October 19). The structural reason as to why the settlement process is so time consuming is that the RBI does not segregate the process of settlement of deposit insurance claims from the process of preserving the value of the troubled bank's assets. That the insurance liability falls on its wholly-owned subsidiary, the Deposit Insurance and Credit Corporation (DICGC), doesn't help matters either.

Ideally, the banking regulator (RBI) should not also be in the business of deposit insurance protection.

Also, the DICGC bundles the role of primary insurance protection and reinsurance operation into a composite whole. This goes against the fundamental principle of risk mitigation in the insurance industry where the functions of insurance and reinsurance are usually separate depending on the size of risk exposure in individual policyholder or types of policies. If the DICGC were to act only as a re-insurer with a large number of private and public sector insurance companies offering deposit insurance protection, the process of settlement of insurance claims would be inherently faster.

Scan & Share

There is another problem which is even more serious. The vast army of private savers in the country's banking system simply do not enjoy total insurance protection for their bank deposits. The deposit insurance which is currently pegged at ₹1 lakh is substantially below the average size of deposits in the banking system which as of March 2019, stood at roughly ₹5 lakh. In absolute terms, around ₹85 lakh crore worth of public savings in the Indian banking system is currently uninsured. This is spread over 17.4 crore bank accounts (DICGC Annual Report 2018-19). Granted that many savers typically tend to bank with more than one institution, the number of individuals/corporates or unincorporated entities whose deposits are marginally or substantially bereft of any insurance cover is bound to be a large portion of the 17.4 crore number mentioned above.

Time ordinary investors had protection for their entire savings ISTOCK

Hike insurance cover?

The obvious solution is to hike the insurance cover. But this is something that the government is unable to do. The government's reasoning goes something like this. The banking system in most market-driven economies is highly interlinked with one another. A crisis in one institution willy-nilly ends up becoming the crisis of the entire banking industry as a whole. Should the banking industry be integrated in a greater measure with financial institutions across the globe, a distress in one with its 'contagion' effect of consequences becomes even global in nature.

In such a situation, it is beyond the capacity of any insurance institution or for that matter, even the sovereign to bail out banks across the world. The only way things can be brought back on an even keel is for the community of savers to forgo a portion of what these institutions owe to them — what the financial services industry calls a 'haircut'.

This is what the government tried to do with its Bill on Financial Resolution and Deposit Insurance of 2017. Since it would be politically suicidal to confess upfront, that there is no way out of forcing the depositors into taking a 'haircut' on the monies deposited, the legal draft on the issue was delightfully left vague while throwing in a crumb to the public in the form of a hike in deposit protection from ₹1 lakh to ₹3 lakh. But of course, the public were not fooled and the resultant furore led to the government withdrawing the Bill itself!

We thus have a situation where the government seems daunted by the prospect of having to underwrite a humongous sum of money on the implicit assumption that a failure in one bank will inevitably lead to a collapse of the entire banking industry. Since that price tag for that is currently put at ₹85 lakh crore, the government has come to the conclusion that it doesn't have the fiscal capacity for the same and has thus chosen the expedient way — kicking the can down the road to be confronted at a future date.

But the government is clearly misreading the lessons of the Global Financial Crisis of 2008. The crisis in the financial institutions of the West, back then, was due to non-ring-fencing of primary banking business from purely speculative bets on the value of financial assets whose connection to some real assets was so far removed as to make it almost illusory. This is not the case in India.

The use of derivative products by banks is not extensive and, in any case, can be ring-fenced from traditional activities of deposit taking and lending undertaken by a bank. The inter-bank assets and liabilities taken together, account for a tiny fraction (around 4 per cent) of the banking system's assets (loans and investments) that lie outside the banking sector (*RBI Weekly Statistical Supplement*: September 27, 2019).

Uninsured deposits

The other misconception about uninsured deposits is that a claim against such deposits will materialise all at the same time. How realistic is that? This is like asserting that all the 'Life' policies underwritten by LIC would result in death claims against the insurance company at one instantaneous point of time.

The phenomenon of uninsured deposits in the banking system is not without an element of irony. Both the RBI and the insurance industry regulator (IRDAI) currently permit regulated institutions to cover their assets against risk of default through the mechanism of Credit Default Swaps. But ordinary investors have no protection for the entirety of their savings in the banking system because the public agency tasked with offering such protection is either incapable of or otherwise unwilling to secure them in its entirety. Need one say more?

The writer is a former Editor of BusinessLine

The limitations of Abhijit Banerjee's methods

Randomised control trials can be useful as an objective evaluation of policies. But their results can vary across space and time

NARENDAR PANI

CITYZEN

As we continue to struggle with using evidence-based research for urban policy there is bound to be some interest in whether the answer lies in the method suggested by Abhijit Banerjee. The Nobel prize is a confirmation of its intellectual rigour. An affirmation of its value has come from the man who implemented the most fundamental economic reforms in India — Manmohan Singh. The true value, and difficulties, of this method, however, emerge when we take it to the challenge of Indian urban policy. The method does help highlight some of the serious lacunae in urban policy, even as the experience points to limitations of the method.

The support for the method is best understood when we place it in the context of the larger challenges to economic thinking. If the ideal of a completely free market was confronted by the Great Depression in the first half of the twentieth century, the collapse of communism ensured scepticism over all ideological theories. The resultant rise of pragmatism meant that policymakers could take virtually any step on the expectation that it would work. Since the success or failure of a policy was only known after implementation, there was no way of knowing beforehand whether it would work. We could never be certain policymakers were not pursuing policies due to vested interests, while all the while claiming they would be beneficial. And if the policies did not work, we could never be sure whether it was the result of corruption or due to more legitimate causes. As the line between genuine failure and corrupt practices blurred, we tended to tar all failures with the same brush of corruption. This made the honest policymaker averse to the risks of taking a decision, and hence contributed to policy paralysis.

Scan & Share

It is here that the method proposed by Abhijit Banerjee, and others like him, became attractive. In this method, specific policy options are tested under experimental conditions. Using randomised control trials (RCT), not unlike the ones used to test drugs, the method throws up results that are objectively arrived at. This rules out the possibility of individual policymakers only doing what they find expedient.

Can't experiment with urban policy

In an urban policy environment in India where decisions are based on anything from popular beliefs to the fancies of individual policymakers, any movement towards objective evidence is undoubtedly a good thing. Apart from keeping out expediency and its contribution to corruption, the evidence generated by this method provides a better view of what actually works. And this could include several unexpected results. Valuable as this method could be in increasing evidence-based research in urban policy-making, it falls well short of providing an effective policy framework. Its focus is entirely on testing specific policy options. It tells us little or nothing about how to arrive at the options that are to be tested. There could easily be policy options that fall outside the purview of current beliefs and hence slip under the radar. These include not just entirely new options but also previously prominent ones. Would anyone spend the money required for these trials to find out whether nationalisation was an effective urban policy option today?

Much also depends on when a policy is believed to work. An experiment in an urban school could show that teachers in one that requires them to swipe a card when they enter tend to be more on time than those in a school that has no such requirement.

But a mother who is a teacher in the school where they are forced to come on time may do so by cutting the time she spends on the preschool learning of her young daughter at home. An enforcement of this policy could then result in the more sensitive mothers, and teachers, dropping out of the workforce. Is there any objective way of judging the overall impact of such a policy, of when we can say it works?

Even if we arrive at a consensus on what works, there are other difficulties. What do we do when the results of an experiment at one place and time contradict those of another done elsewhere at another time? Banerjee's suggestion would be to do more experiments for each local situation. But policy cannot always wait endlessly for experiments to be done in a way that suits academic rigour. As another Nobel laureate, Angus Deaton, has pointed out, RCT is neither necessary nor sufficient for evidence-based policy-making.

Urban policymakers should thank Abjijit Banerjee for his much-needed reminder of the importance of evidence-based approaches, but they should refuse to be shackled by the narrowness of randomised control trials.

The writer is a professor at the School of Social Science, National Institute of Advanced Studies, Bengaluru

OTHER VOICES

GULF NEWS

Arab land is not America's to gift

The idea that one individual can unilaterally decide the fate of a population 10,000 km away on a whim and, worse, surrender even an inch of a state's sovereign territory to a third entity is illegal, immoral and downright dangerous. America's puppeteer play in Syria has echoes of Sykes and Picot who in 1916 carved-up the Middle East in a back room of Britain's House of Commons into spheres of British and French interests. DUBAI, OCTOBER 21

GLOBAL TIMES

US' piercing words don't hurt Huawei's growth

Under unprecedented relentless assault of the US government, Huawei has proved to the world that it will not cave in to a bully, and that the Chinese technology flag-bearer is not to be beaten by any force, even it is a superpower with piercing teeth. Ren Zhengfei, the 75-year-old founder of Huawei, is now gaining waves of cyberspace stardom for his thinking and clear vision in leading his company. BEIJING, OCTOBER 20

ALL THE NEWS WITHOUT FEAR OR FAVOR
The Japan Times

Brexit drags on

Despite pronouncing that he would rather be "dead in a ditch" than ask the European Union to delay the Oct. 31 deadline for Britain's departure from the EU, British Prime Minister Boris Johnson last weekend informed the EU Council that he would in fact need additional time to win parliamentary support for his new plan. His humiliation is the product of his own behaviour, the toxic legacy of a lack of seriousness and commitment to any plan or principle. TOKYO, OCTOBER 21

LETTERS TO THE EDITOR

Send your letters by email to bleditor@thehindu.co.in or by post to 'Letters to the Editor', The Hindu Business Line, Kasturi Buildings, 859-860, Anna Salai, Chennai 600002.

Resolving bad loans

This has reference to the editorial 'Saving the IBC' (October 21). The twists and turns in the resolution process of Bhushan Power and Steel, no doubt, poignantly reflect the labyrinthine ways of our legal system. However, before putting the ED in the dock one needs to be tempered by a larger issue involved. The premise that an asset, the acquisition and management of which involved some legal infringement, once transferred, should remain beyond the reach of law enforcement agencies in the name of well-being of the economy is fraught with moral hazard and may encourage defaulters to deliberately transfer assets before arms of law or creditors catch up with them.

Exasperation over delay should not blind one to the potential negative fallouts.

Manohar Alembath
Kannur

Recovery of NPAs

Public sector and scheduled commercial banks are reeling under high volume of NPAs (non-performing assets) and after experimenting with different schemes like CDR, S4A, etc., the IBC was found to be the effective route for recovery of delinquent loans, though with some delay.

At this juncture, it is unfortunate that the statutory agencies like NCLAT and the Enforcement Directorate are entering into a tussle to claim properties owned by Bhushan Power and Steel which may ultimately delay the recovery process.

When the issue for distribution of assets between financial and operational creditors has barely been settled, the fresh controversy raising its head now is bound to further affect the recovery process. The Enforcement Directorate primarily deals with two laws — the Foreign Exchange Management Act and the Prevention of Money Laundering Act — which are primarily specific to individuals. On the other hand, banks being secured creditors have wider claim against the properties of the defaulting firms. As such the chairman of NCLAT is right in his assessment. The fulcrum for rekindling economic growth through credit revival lies in speedy recovery of NPAs.

As such it is imperative and inevitable that the agencies involved understand the problems and predicaments and work towards a common goal which helps in the revival of the economy.

Srinivasan Velamur
Chennai

Monetary policy

Apropos 'The 'beggar thy neighbour' policy contagion' (October 21). Indeed the adoption of unconventional monetary policy by developed countries is resulting in low rates of interest. It may increase liquidity but there will be a mismatch between savings and investment and, correspondingly, there will be no increase in production and employment and the liquidity trap that follows with slowdown.

Nevertheless, there are structural problems that are causing supply shocks and stagflation. The tariff war between major powers is increasing the cost of goods. The 'beggar thy neighbour' policy is affecting developing economies like India. The global slowdown is caused by not only a lack of demand but also supply shocks.

NR Nagarjan
Sivakasi

Single-use plastic

This refers to 'Banning single-use plastic' (October 21). Though the government has postponed the ban on single-use plastic till 2022, it is a clear case of not thinking deeply before announcing a big decision like that. Given that as much as 50 per cent of our plastic waste remains uncollected or littered, the government cannot put the the issue on the back-burner for long. Multiple industries will be directly benefited from this decision as bags made of jute, cloth or paper would gain currency. What is critical here is the clear message to small-scale industries and people in general on which all products will be allowed to be carried in plastic and which ones will not.

Without any doubt promoting alternative eco-friendly packaging materials/products will provide a huge boost to local artisans across the country. As responsible citizens we need to change our behaviour gradually for the larger interest of the environment and society.

Bal Govind
Noida

Published by N. Ravi at Kasturi Buildings, 859 & 860, Anna Salai, Chennai-600002 on behalf of THG PUBLISHING PVT LTD., and Printed by D. Rajkumar at Plot B-6 & B-7, CMDA Industrial Complex, Maraimalai Nagar, Chengleput Taluk, Kancheepuram Dist., Pin: 603209. Editor: Raghavan Srinivasan (Editor responsible for selection of news under the PRB Act). ISSN 0971 - 7528