

# Regulators too need evaluation

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A key differentiator among nations is the quality of their institutions. Regulators occupy a centrestage in the institutional edifice of a nation. They carry out governance on behalf of the government in accordance with a statutory contract. There are significant advantages of governance through regulators, as well as concerns.

We make out a case for the statutory contract to provide for regulators' performance evaluation, to minimise such concerns while harnessing the advantages an independent regulator brings along.

Generally, the society has a love-hate relationship with regulators. In normal times, regulators are criticised for 'over-regulation', and a "hands-off" approach is urged. In unusual times, they are questioned for under-regulation, and charged with allegations of sleeping on the wheel.

There is a tendency to use one untoward event to evaluate the performance of a regulator, ignoring its good work in possibly preventing such events in the past.

For want of a statutory requirement of an evaluation, which can factor in both achievements and failures, event specific evaluations have become the norm. Such evaluations do more harm than good, as they result in a blame game and knee jerk reactions, often yielding bad solutions.

An objective, formal and periodic performance evaluation of regulators has been engaging the attention of the reformers. The Second Administrative Reforms Commission (2009), in its 13th Report, had recommended that once in five years, a body of reputed experts should propose guidelines for such evaluation.

Based on these guidelines, the government, in consultation with the Parliamentary Committees and the regulator concerned, should finalise the parameters for annual evaluation.

Annual reports of the regulators should include progress on pre-agreed evaluation parameters and should be discussed in the Parliamentary Committees.

The Commission had further recommended that each statute creating a regulator should include a provision for periodic impact assessment by an external agency. The then government had accepted these recommendations

The Financial Sector Legislative Reforms Commission (2013) recommended a formal mechanism to evaluate regulators' compliance systems, through a review committee comprising only non-executive members of the regulators' governing board.

This recommendation was included in the International Financial Services Centres Authority Act, 2019 which requires the authority to constitute a Performance Review Committee to review its performance annually.

The Damodaran Committee on Reforming the Regulatory Environment for Doing Business in India (2013) recommended that each regulator should undertake self-evaluation once in three years, and place its conclusions in the public domain for informed discussion and debate.

The Annual Report Rules relating to the Insolvency and Bankruptcy Board of India (IBBI) has included this suggestion. The Rules require the IBBI to carry out an assessment of its effectiveness and efficiency in terms of its objectives and mandate, keeping in view its resources, duties and powers, and an assessment of performance of its Governing Board. IBBI makes these self-assessments and publishes them in its annual reports.

There is a growing literature on the rationale of performance evaluation of regulators indicating that such an exercise, on a regular basis, engenders good regulatory decisions, minimises bad decisions, avoids repetition of mistakes, and stimulates prompt course corrections.

It helps a regulator to remain on track, pursuing its objectives, making the best possible use of its resources, and driving improvements. It also helps to build credibility and legitimacy and establishes continued regulatory relevance.

## **Global practices**

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Internationally, several frameworks are available for performance evaluation. The most prominent among them is probably OECD's 'Measuring Regulatory Performance'. Some jurisdictions have tailor-made evaluation frameworks such as UK's 'Performance Measurement by Regulators' and Australia's 'Regulator Performance Framework'.

A few jurisdictions, including the US and South Africa have statutory obligations on the regulators to undertake performance evaluation.

Such performance evaluation can be quite complex. It is because regulators generally do not have much direct output; their services are inputs to outputs of the regulated entities and markets.

Their performance is affected by several external factors, many of which are beyond their control, and their efforts may take years to have visible outcomes. Data required to make evaluation may not be easily available.

Even the ecosystem may not have capacity to evaluate regulators operating in the high end, sophisticated markets.

It is difficult to envisage a standard framework for evaluation for every regulator given that statutory design of every regulator and the nature of market it supervises are unique.

Yet a typical evaluation may factor in three sets of parameters, namely, governance, process, and outcomes.

## **Three parameters**

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Governance may cover elements of quality of governance such as organisation design to address concerns arising from integration of quasi-legislative, executive and quasi-judicial powers with the regulator; compliance with statutory provisions in exercise of powers; transparency and responsiveness in discharge of its responsibilities; accountability of responsibility centres, etc.

The second set of parameters may include appropriateness and strength of processes followed in carrying out regulatory functions, such as quality of public consultation while making regulations; adherence to principles of natural justice in adjudication; extent of business disturbance while conducting inspections and investigations; systems for monitoring compliances, processing times for regulatory approvals or enforcement actions, etc.

The third set of parameters may cover quality of regulation, regulatory impact assessment, adjudication orders, and services of regulated entities; market efficiency and integrity; cost of transactions; effectiveness of grievance redressal mechanism, and cost of regulations.

The evaluation may be supplemented with feedback from relevant stakeholders and a comparison with peer regulators nationally and internationally. It may end with identification of areas for improvement.

With three decades of experience with regulatory architecture, a comprehensive review of India's regulatory architecture is perhaps an imperative. Performance evaluation should be a key element of this review. The respective statutes should provide for an annual, internal and external evaluation of performance of the regulator, in relation to its objectives, resources, powers, and duties, and the nature of market it is responsible for.

The regulator should facilitate such evaluation, particularly by generating relevant data and making it available. The results of the evaluation exercise should be disclosed.

While statute takes time to change, regulators should voluntarily undertake assessment, in sync with their respective objectives, in the interest of credibility. The ecosystem should develop capacity to carry out such evaluation.

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