

# Changing Legal Landscape in the World of Finance

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## *Introduction*

The business of financing must be one of the oldest in human history. This business has undergone changes in its form and delivery mechanism from time to time. Such changes are necessitated by the contemporary business needs. Though this business has helped progress and economic development, it is one of the riskiest businesses. The financial crisis of 2008 triggered reforms in the financial sector in many countries. Replacement of Financial Services authority in UK with Financial Conduct Authority and Prudential Regulation Authority, Dodd Frank Act of USA, European Market Infrastructure Regulation (EMIR), enactment of Financial Services Act, 2013<sup>2</sup> and the Central Bank of Malaysia Act, 2009 are some examples. I don't propose to go into the intricacies of these developments that have taken place abroad. I propose to restrict myself to some of the developments at home and underscore the growing importance of delegated legislation and compliance.

2. The world of finance in India is both diversified and dynamic. It is diversified because it has to cater to small businesses as well as large ones spreading across different jurisdictions and dynamic because it has to adapt itself to the changing needs. The functions of the legal landscape include protecting the interests of both the financier and the financed in all forms of financing, big and small and providing for a suitable mechanism for regulation and supervision.

## *A change in the approach of laws*

3. Traditionally, law has been biased in favour of the borrower on account of his financial weakness and the inability to fight the powerful and rich financier. The reference here is to the Moneylenders' Acts<sup>3</sup>, law of mortgages under Transfer of Property Act, 1882 and the recovery procedure under the Civil Procedure Code, 1908, to name a few. We have seen that

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<sup>2</sup> Malaysia

<sup>3</sup> State laws

too much leeway to the borrowers has its own challenges. The legal landscape had to undergo change in favour of banks and financial institutions. The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (DRT Act) and The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) were enacted to provide some support to banks and financial institutions.

### *Upgrading laws*

4. Regulators and the regulatory mechanisms also need to be upgraded from time to time to address newer forms of financing and to tackle the risks arising out of innovation in the field of financing. This has seen the birth of new regulators<sup>4</sup> or the enhancement of the powers of the regulators. The amendments<sup>5</sup> to PSS Act which define “legal entity identifier”<sup>6</sup> and “trade repository”<sup>7</sup> and bring them under the regulatory jurisdiction of RBI are recent examples.

5. Collection of money from the members of the public by making tall promises never intended to be fulfilled necessitated the enactment of depositor protection laws by various states. These State Acts provide for punishing the very collection of money by making unviable promises as also for attachment and sale of assets before the operators vanish with the money collected. Supreme Court has since upheld<sup>8</sup> the Constitutional validity of those laws. Collection of money from the members of the public in the name of multi level marketing schemes<sup>9</sup> is another menace. Risks involved in peer to peer financing needs to be examined in great detail to provide a legal or regulatory framework.

### *Legislative reforms*

6. Those fraudulent activities apart, there is a felt need for the revamp of the legal framework to regulate modern day financial activities. Financial Sector Legislative Reforms Commission (FSLRC)<sup>10</sup> has suggested a large scale overhauling of the financial system and the regulatory framework. We all know when FSLRC was constituted<sup>11</sup> and what political combinations were running the government when it submitted<sup>12</sup> the report. We also know what political

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<sup>4</sup> Insurance Regulatory and Development Authority Act, 1999, The Pension Fund Regulatory and Development Authority Act, 2013

<sup>5</sup> The Payment and Settlement Systems (Amendment) Act, 2015

<sup>6</sup> Section 2(db) *ibid.*

<sup>7</sup> Section 2(r) *ibid.*

<sup>8</sup> *K.K.Baskaran v. Tamilnadu*, (2011) 3 SCC 793, *State of Maharashtra v Vijay C Puljal* – (2012) 10 SCC 599

<sup>9</sup> Please see Money circulation schemes under Prize Chits and Money Circulation Schemes (Banning) Act, 1978.

<sup>10</sup> Headed by Justice Srikrishna, former Judge of the Supreme Court

<sup>11</sup> March 24, 2011

<sup>12</sup> March 22, 2013

combinations are running the government now<sup>13</sup>. Though there is a change in the political set up, the recommendations made by FSLRC are reportedly in various stages of implementation, notwithstanding the concerns which some regulators have, on some issues. There appears to be a political consensus on the need for some legislative reforms to address the current challenges in the world of finance. This drives home the point that change in the legal landscape in the world of finance is a natural process resulting from the changes that take place in the world of finance itself and is largely agnostic to the political set up.

7. In addition to the laws that directly deal with financial matters and the regulation of financial institutions, other laws also impact the financial world. The delays in settlement of commercial disputes between the constituents of banks and financial institutions could affect the interests of banks and financial institutions indirectly. Introduction of the Bill<sup>14</sup> to set up commercial courts and Benches is a significant development to watch. Amendments<sup>15</sup> made recently to Arbitration Act<sup>16</sup> to ensure speedy disposal of commercial arbitration will also impact the financial world.

#### *New tools to expedite*

8. Newer laws are employing newer tactics to ensure speedy disposal. Timelines fixed in statutes for disposal of cases have been observed more in breach than in adherence. This is our experience under DRT Act and elsewhere. The new amendments to Arbitration Act are designed to ensure timely disposal of arbitration by relating the fee of arbitrators to the timeliness of disposal<sup>17</sup>. We have to see the results before we can comment on its efficacy in ensuring quick and reasonable disposal.

9. Insolvency and bankruptcy has been another area of concern. Bankruptcy Code<sup>18</sup> again has timelines for every step. Timely resolution or liquidation is sought to be achieved through a new breed of professionals<sup>19</sup>. Quick resolution will free up the capital and labour for a more

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<sup>13</sup> Post 2014 General Elections.

<sup>14</sup> The Commercial Courts, Commercial Division and Commercial Appellate Division of High Courts Bill, 2015 introduced in the Rajyasabha on April 29, 2015

<sup>15</sup> The Arbitration and Conciliation (Amendment) Act, 2015 which has received Presidential assent on 31 December 2015.

<sup>16</sup> Arbitration and Conciliation Act, 1996

<sup>17</sup> Section 29A Ibid. Provision for payment of additional fee for disposal in time (12 months) if parties agree and reduction of fee for extension of time.

<sup>18</sup> The Insolvency and Bankruptcy Code, 2016

<sup>19</sup> Insolvency Professional – sections 3(19), 206 and 207, Insolvency Professional Agency - sections 3(20) and 201, Insolvency and Bankruptcy Board of India – [section 3(1)] established under sub-section (1) of section 188, *ibid*. Resolution Professional – section 3(27) *ibid*.

productive use. The impact of prolonged sickness of the borrower on the banks and financial institutions may be expected to be mitigated. One thing for banks and financial institutions to cheer about in this Code is the priority<sup>20</sup> given to secured creditor over state dues.

### *Separate resolution regime for financial service providers*

10. The Bankruptcy code does not apply to the bankruptcy of financial service providers<sup>21</sup>. On the lines of the recommendations of FSLRC and another expert group<sup>22</sup> work is said to be going on for providing a separate legal framework for quick and efficient resolution of financial service providers.

### *Challenges posed by technology*

11. Innovations in technology have contributed to changing the face of financial services. The improvement in efficiency has not come without a cost. It has thrown up challenges in the form of technology driven frauds. Laws that govern the use of information technology<sup>23</sup> and the laws made to deal with money laundering<sup>24</sup> also impact the financial world and those laws also form a part of the legal landscape for the world of finance.

### *Delegated Legislation*

12. One could go on and on with any number of examples of laws newly enacted or amended that change the legal landscape of the world of finance. Even then, these statutes would only represent the tip of the iceberg. Legal landscape is provided not only by statutes but also by regulations made by regulators. The case law generated by courts also contributes to the legal framework in a big way. The courts decide only individual disputes relating to the rights and liabilities of the parties. They have precedent value for future guidance. However, the policy framework flows from statutes only. It takes a very long time to enact laws. The world of finance requires swift measures. The regulators are therefore vested with the power under their respective statutes to make regulations having the force of law and the regulated entities are bound to comply with the same.

### *Importance of compliance*

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<sup>20</sup> Sections 53 and 178 *ibid* regarding priority of payments.

<sup>21</sup> Section 3(7) *ibid* under which financial service providers are not included in the definition of corporate person

<sup>22</sup> Report of the High Level Working Group on Resolution Regime for Financial Institutions, available at <[https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/RWG020514\\_FL.pdf](https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/RWG020514_FL.pdf)>

<sup>23</sup> Information technology Act, 2000

<sup>24</sup> Prevention of Money Laundering act, 2002

13. Compliance is very important. Primarily because, the regulations these days, are based on international best practices keeping in mind the domestic needs. By complying with the regulations, the regulated entities will be following international best practices. Non-compliance was always being treated as a risk to the reputation as the financial penalties were insignificant. Penalties in terms of multiples of the gain made or loss averted by non-compliance could become the order of the day. When regulators start imposing such penalties, non-compliance will dent the profits also significantly.

#### *Challenges in compliance*

14. There are some practical difficulties also in compliance. The requirements are spread over a multitude of rules, regulations, notifications, circulars, guidelines, orders, etc. Some may require filing, some may require the prior permission of the regulator, some may be imposing some restrictions on the way the business is carried on, and so on. This could partly be a compilation issue. To a large extent, issue of Master Directions by RBI and RBI itself updating them from time to time has come as a great help in keeping track of the regulatory changes affecting RBI regulated entities.

15. There are other issues also in compliance. There could be genuine misunderstanding of the requirements of the regulations. Sometimes the business needs are such that there is no time for seeking clarifications from the regulators. Howsoever one may be keen on compliance, there could be gaps in the way the regulations are understood and the way they are implemented. This may not be the right forum to push the idea that a system should be put in place by each of the regulators to provide timely clarifications by way of advance rulings. Regulators have put in place some machinery for addressing consumer grievances. That is welcome. In a different format, regulators could set up multidepartment committees to meet at frequent intervals to provide clarifications on the regulatory requirements. That could improve the compliance culture in the world of finance.

#### *Conclusion*

16. The legal landscape in the world of finance changes to meet the challenges thrown up by the changes in the financial world. The world of finance is spread so far and wide that the changes in laws not directly connected with finance may also affect the world of finance. The plethora of delegated legislation or subordinate legislation issued by regulators in exercise of their statutory powers has the force of law. The compliance requirements that flow from delegated legislation are not merely submission of returns and statements on time. The

requirements are much more. Non-compliance with them now has far more serious consequences than what it had in the yester years. There could be challenges in compliance. The awareness that delegated legislation in the form of rules, regulations, notifications, circulars, guidelines, orders, etc., occupy a large space in the legal landscape in the world of finance is necessary. A positive approach to understanding this legal framework pays many dividends. The writing on the wall is loud and clear that the cost of compliance is negligible when compared to the cost of non-compliance. Thanks to the changing legal landscape in the world of finance.

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