CORPORATE GOVERNANCE IN INDIAN BANKS

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Abstract: ***Corporate governance has been widely recognized for the success of corporations in the business environment. This has been in limelight when the number of scandals, such as Enron, Parmalat, WorldCom or Lehman Brothers, came into picture and significant essence has been felt worldwide for effective corporate governance. Corporate governance practices need to be constantly evaluated against the backdrop of an increasingly uncertain and complex business environment. Globally, there has been much debate on 'what constitutes good governance?' Governance norms have primarily focused on the higher responsibilities, tighter regulation for the board of directors and the increase in shareholder activism. The Indian corporate governance is controlled by different Acts and guidelines. If we consider the Indian banking sector , there are specific and different set of guidelines. The aim of this paper if to provide an insight into the existing corporate governance practices in Indian banks. The present paper highlights the major corporate governance guidelines provided by SEBI and RBI and provisions of the Companies Act, 2013.***

Index Terms - Corporate governance, Board, Board Committees, Bank

I. INTRODUCTION

The banking and financial institutions are the strong backbone of any economy. The healthy economic condition of a country positively correlates with sound functioning of its banking sector. Functioning of banking and financial institutions differs with other corporate entities in many ways that makes corporate governance of banks very different and critical too. So, if a corporate fails on corporate governance front, the fall outs can be restricted to the stakeholders, but on the other hand, if a banking or financial institution fails, the impact can spread rapidly through other banks and financial institutions, which ultimately have serious implication on financial system at large.

II. OBJECTIVES OF CORPORATE GOVERNANCE

Good governance is integral to the very existence of a company. It inspires and strengthens the investor's confidence by ensuring company's commitment to the higher level of growth and profits. It seeks to achieve following objectives:

- A properly structured Board capable of taking independent and objective decisions is in place at the helm of affairs;
- The Board adopts transparent procedures and practices and arrives at decisions on the strength of adequate information;
- The Board effectively and regularly monitors the functioning of the management team; and
- The Board has an effective mechanism to serve the concerns of stakeholders;
- The Board is balanced as regards the representation of adequate number of non-executive and independent directors who will take care of the interests and well-being of all the stakeholders;
- The Board keeps the shareholders informed of relevant developments impacting the company;
- The Board remains in effective control of the affairs of the company at all times.

III. WHY IS CORPORATE GOVERNANCE IMPORTANT?

- It enhances higher possibilities in delivering sustainable good business performance.
- It ensures that a well governed company is accountable and transparent towards its shareholders and other stakeholders.
- It ensures that the business environment is fair and transparent enough for companies that one may be held accountable for their actions.
- It has emerged as new way to manage modern joint stock corporations, which are equally significant in cooperatives, state-owned enterprises and family businesses.

IV. KEY COMPONENTS OF GOOD CORPORATE GOVERNANCE

The Board, which is a main functionary is primary responsible to ensure the value creation for its stakeholders. In the absence of clarity on designated role and powers of the Board, it weakens the accountability mechanism that subsequently, threatens the achievement of organizational goals. Therefore, the key requirement of good governance is the clarity on part of identification of powers, responsibilities, roles and accountability of top position holders, including the Board, the Chairman of the Board and the CEO. In such cases, role of the Board should be clearly documented in a Board Charter, which can be followed throughout. To elaborate the above discussion, following are the essential elements of good corporate governance:

- A well-structured Audit Committee setup is required to work as liaison with the management, internal and statutory auditors. Importance of such is to review the adequacy of internal control and compliance with significant policies and procedures, reporting to the Board on the key issues.
- Accountability towards the stakeholders with an objective to serve the stakeholders through strong and sustained communication processes at a regular interval.
- Clear documentation of company's objectives as a part of long-term corporate strategy including an annual business plan together with achievable and measurable performance targets.

❖ Effective whistle blower policy is another element, whereby the employees may report to the top management about any suspected frauds, unethical behavior or violation of company's code of conduct. Appropriate mechanism should be in place for adequate safeguard to such employees.

❖ Emphasis on healthy management environment, which includes appropriate ethical framework, clear objectives, establishing due processes, clear enunciation of responsibility and accountability, sound business planning, establishing performance evaluation measures.

❖ Fair and unambiguous legislation and regulations.

❖ Fairness to all stakeholders.

❖ Focus on social, regulatory and environmental concerns

❖ Identification and analyzing risk is an important element of corporate functioning and governance, which should be appropriately taken into consideration as remedial measures. This can be well settled by formulating a mechanism of periodic reviews of internal and external risks.

❖ To be specific on norms of ethical practices and code of conduct that is required to be communicated to all the stakeholders.

❖ Transparency and independence in the functioning of the Board, where Board should provide effective leadership for achieving sustained prosperity for all stakeholders, which can be possible by providing independent judgment in achieving the company's objectives.

V. BENEFITS OF CORPORATE GOVERNANCE

Corporate governance has a unique and important place for the companies and different stakeholders. The corporate governance codes benefits the owners and managers of companies and increases transparency and disclosure enhancing access to capital and financial markets. Corporate governance thereby leads to a greater accountability, better system of internal control and better profit margins for the company. It also provides higher potential for future diversification, excessive growth, attracting equity investors (nationally and abroad), and reduction in the cost of credit for corporations.

Corporate governance can provide mechanism that matches the objectives of the company and the shareholders. It ensures greater security to the investment of the shareholders, creditors and various stakeholders. It creates an environment, where shareholders are sufficiently informed on decisions concerning fundamental. From various empirical researches, it has been found that majority of global institutional investors are willing to pay a premium for the shares of a well-governed company over the other poorly governed companies, which have an impressive and comparable financial record.

VI. INDIAN SCENARIO OF CORPORATE GOVERNANCE

The fiscal crisis in 1991, had pushed the Indian government to take serious measures by adopting reformative actions for economic stabilization. These reforms were part of macro strategy of building industrial capabilities. Such reforms also involved a wide range of institutional and corporate level initiatives, which have reflected a good sign of corporate responsiveness and transparency in subsequent years. As a liberalization measure, the Government amended the Companies Act, 1956 many times including in 1999, 2000, 2002 , 2003 and 2017. Several measures have been adopted by the government, which includes empowering the stock market regulator - Securities and Exchange Board of India (SEBI) and also by improving specific measures for more disclosures and enhancing transparency. Some of the major corporate governance initiatives taken since 1990s by the corporate bodies and the Government of India are listed below.

- THE CONFEDERATION OF INDIAN INDUSTRY (CII) CODE (1998)
- THE KUMAR MANGALAM BIRLA COMMITTEE (2000)
- THE REPORT OF TASK FORCE ON CORPORATE EXCELLENCE (2000)
- RBI ADVISORY GROUP ON CORPORATE GOVERNANCE (2001)
- RBI CONSULTATIVE GROUP OF DIRECTORS OF BANKS/ FINANCIAL INSTITUTIONS (2002)
- THE NARESH CHANDRA COMMITTEE (2002)
- THE NARAYANA MURTHY COMMITTEE (2003)
- THE J.J. IRANI COMMITTEE (2005)
- CENTRAL COORDINATION AND MONITORING COMMITTEE
- ICSI RECOMMENDATIONS TO STRENGTHEN CORPORATE GOVERNANCE FRAMEWORK (2010)
- SHRI ADI GODREJ COMMITTEE (2012)
- THE COMPANIES ACT, 2013
    - ENABLING TRANSPARENCY (SEC. 120)
    - CORPORATE SOCIAL RESPONSIBILITY (SEC. 135)
    - APPOINTMENT OF AUDITORS, SEC. 139 AND NOT TO RENDER CERTAIN SERVICES (SEC. 144)
    - STRUCTURE OF BOARD OF DIRECTORS (SEC. 149)
    - DUTIES OF DIRECTOR (SEC. 166)
    - CODE FOR INDEPENDENT DIRECTORS (SCHEDULE IV)
    - STRUCTURE OF AUDIT COMMITTEE AND ITS FUNCTION (SEC. 177)
    - PROHIBITION ON INSIDER TRADING OF SECURITIES (SEC. 195)
    - APPOINTMENT OF KEY MANAGERIAL PERSONNEL (KMP) (SEC. 203)
    - SECRETARIAL AUDIT FOR BIGGER COMPANIES (SEC. 204)
    - DEFINED FUNCTIONS OF COMPANY SECRETARY (SEC. 205)
    - ESTABLISHMENT OF SERIOUS FRAUD INVESTIGATION OFFICE (SEC. 211 AND 212)

- SEBI GUIDELINES, 2014
- SECURITIES AND EXCHANGE BOARD OF INDIA (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015
  - BOARD COMPOSITION
  - AUDIT COMMITTEE
  - NOMINATION AND REMUNERATION COMMITTEE

VII. EVOLUTION OF CORPORATE GOVERNANCE IN INDIAN BANKING SYSTEM

Considering the changing role of corporate governance, various advisory groups and consultative groups were formed to deeply study baking sector in the light of effective corporate governance. To name a few, an advisory group on corporate governance was formed under the chairmanship of Dr. R. H. Patil, in March 2001.Subsequently, another consultative group was formed in November 2001 under the Chairmanship of Dr. A.S. Ganguly, with an objective to strengthen the internal supervisory role of the Boards in banks. In continuation, an advisory group on banking supervision was initiated under the Chairmanship of Shri M.S.Verma. Based on the recommendations of these advisory groups and considering the global corporate governance experience, RBI had undertaken several measures to strengthen the corporate governance in the Indian banking sector. Various areas, which were potentially important and needed attention, were emphasized. It included defined role of supervisors, ensuring an environment supportive to the sound corporate governance, effective organizational structure to have responsible board of directors, etc. Considering the fact that Indian banking sector is dominated by the government-managed banks (including public sector banks, nationalized banks and rural banks, etc.), these issues were further examined. In this phenomenon, corporate governance issue was important for public sector banks, especially because they constitute major share of business in the banking sector. *(See Figure 1 below for the Structure of Indian Banking System).*

The Reserve Bank of India (RBI) and the Securities and Exchange Board of India (SEBI) established in 1992 are two important statutory bodies empowered to regulate and maintain the standard required for the effective corporate governance. Another global initiative in 1999 of the Basel Committee also brought important principles on corporate governance for banks. Additionally, Banking Regulation Act, 1949, Foreign Exchange Management Act (FEMA), 1999, Payment and Settlement Systems Act, 2007, New Companies Act, 2013 and other directives/ regulations/ guidelines/ instructions issued by RBI and SEBI from time to time have created a positive environment and future scope for enhancing corporate governance. This evolution phase of corporate governance and banking industry experiences created long way of development and setting global standards for corporate governance, which make it more robust and sophisticated in today's time frame.

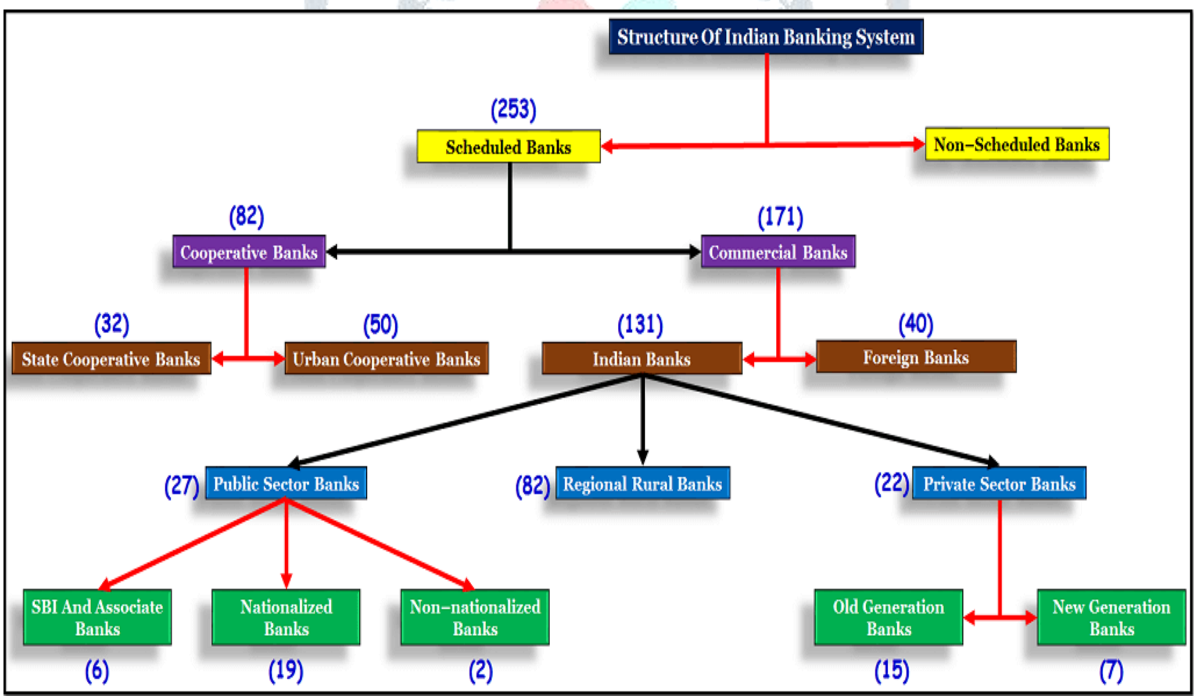

Figure-1: Structure of Indian Banking System

VIII. NEED OF EFFECTIVE GOVERNANCE IN BANKS

There are various parameters, which refer the crucial need of corporate governance in banking sector. It cannot be denied that banking sector plays important role of managing funds and its circulation. They have access to capital market as well to maintain the statutory requirement of having sound capital adequacy ratio (CAR). This way they also have open-ended investors from the capital market as well as major shareholders. Investors believe that a bank with good governance will provide them a safe place for investment and also give better returns.

In an growing economy like India banks are always in need of funds for lending and maintaining adequate CAR, in view of this good corporate governance is important factor in retaining existing investors and attracting new investors. Another aspect of greater transparency and fairness motivate its investors, customers, employees and vendors to maintaining long-term relationship with the bank. Important practices in good corporate governance such as assessment of credit risks pertaining to lending process has an encouragement for the corporate sector, as in turn it will improve their internal corporate governance practices and standards. At any point of time, any imbalance within the effective corporate governance framework will led to corporate failure. In the light of above, the need of corporate governance in banking sector is essentially required in order:

- to establish a capable, effective and reliable board of directors and their composition
- to have an effective and operating audit committee, compensation committee and nominating/ corporate governance committee
- to establish corporate governance procedures in order to enhance shareholder's value
- to establish a corporate code of ethics
- to disclose the information in an transparent manner
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IX. RBI'S ROLE IN ENSURING CORPORATE GOVERNANCE IN BANKS

RBI, being the central bank and banking sector regulator in India has major role in formulating, implementing and promoting the standards of corporate governance for India's banking sector. Originally, RBI had task to regulate issue of currency, maintaining forex reserve, financing five-year plan, establishing specialized institutions to promote saving and to fulfill needs of priority sector. Afterwards post librelisation phase, it also started focusing on facilitation of efficient functioning of capital and money market, fixing interest rates, providing necessary operational framework to banks for setting various transparency and disclosures norms. It also focuses on stabilizing the financial system. Apart from main functions of RBI, it also has supervisory and regulatory powers for public sector banks, private sector banks, regional rural banks, foreign banks, non-banking financing companies (NBFC), Small Industries Development Bank of India (SIDBI), cooperative banks and various institutions formed under special acts (including SBI Act, IDBI Act, Industrial Finance Corporation, NABARD Act, Deposit Insurance and Credit Guarantee Corporation Act and National Housing Bank Act).

RBI also follows the important functions guided by the Board of Financial Supervision (BFS), which inspects and monitor the banks through its CAMELS approach (capital adequacy, asset quality, management, earnings, liquidity, and systems & control). Here primary objective of BFS is to undertake consolidated supervision of the financial sector. It also look after the Department of banking Supervision, Department of Non Banking Supervision and the Financial Institution Division, in terms of issuing necessary directions for important regulatory matters. Within the supervision and regulatory powers, RBI has discretion over bank licensing, asset liquidity, branch expansion and methods of amalgamation and liquidation, etc., which further empower RBI to play leading role of formulating and implementation of effective corporate governance mechanism for the institutions within banking sector.

RBI follows three important parameters in maintaining and managing effective corporate governance, namely, prompt disclosure and transparency norms, off-site surveillance and timely appropriate corrective action. These parameters and their sequencing are pictorially presented below in *Figure 2*.

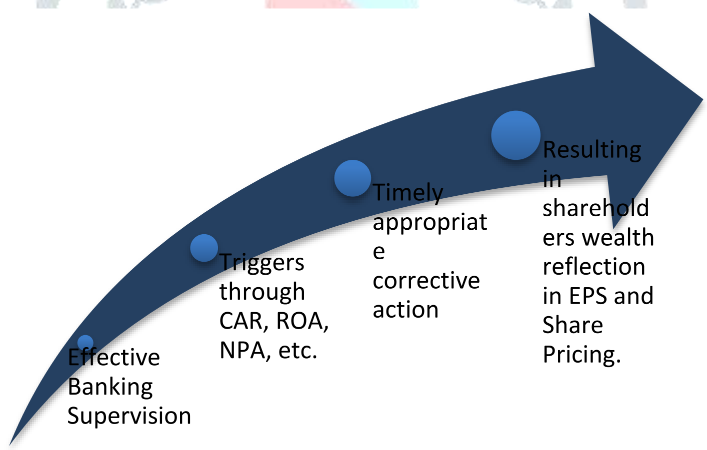

Figure - 2: RBI's Key Parameters for Maintaining Corporate Governance

X. IMPORTANT COMMITTEES OF BOARD

Most of the guidelines are based on SEBI guidelines, New Companies Act 2013, Norms set by the RBI or by the Ministry of Corporate Affair. Some of the important guidelines are referred below:

Board Composition

Some of the important regulatory provisions framed by RBI for banks already discussed above. Additionally, NBFC, listed banks and other financial intermediaries come under the ambit of SEBI. In effective corporate governance, it is encouraged to have higher the number of non-executive director or independent director over the executive director. As per SEBI (LODR) Regulations 2015, an optimum combination of executive and non-executive directors is required with at least one woman director in board and majority of directors need to be from Non-Executive (i.e., 50% or more). In case the Chairman of the board is a Non-executive director then at least 33% of the board of directors shall comprise of Independent Directors. On the other hand when the Chairman is not a regular Non-executive Director, then at least 50% of the board of directors shall comprise of Independent Directors. Although in cases where the regular Non-executive chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the level of board of director or at one level below the board of directors, then at least 50% of the board of directors of the listed entity shall consist of Independent Directors.

An Audit Committee

As per the Sec. 177 of New Companies Act 2013, every listed company is required to constitute an Audit Committee comprising minimum 3 Directors, with Independent Directors in majority. An audit committee is one of the important board committee to oversee financial reporting process and disclosure. It ensures the correct, sufficient and credible financial statement of the company. Committee needs to meet at least four times in a year.

The Remuneration and Nomination Committee

The Committee should consists more than 2 Non-Executive Directors, and include minimum 50%, as the Independent Directors in the composition. It can have chairperson of the company (whether executive or non-executive) as the member of the Committee, but cannot become the Chairman of such Committee. The Remuneration Committee has prime function to identify persons who are qualified to become directors and can be appointed in senior management in accordance with the pre defined criteria. This committee formulates the criteria for determining qualifications, positive attributes and independence of a director and also empowered to authorize the remuneration, business and other benefits to directors, key managerial personnel and other employees.

Risk Management Committee

It is another important committee, with an objective to assist the Board in fulfilling its corporate governance oversight responsibilities with regard to the identification, evaluation and mitigation of strategic, operational, and external risks.

Stakeholders Relationship Committee

Role of the Stakeholders Relationship Committee (Earlier referred as the Shareholders'/ Investors' Grievance and Administrative Committee) is very important in terms of approving, transferring and transmission of shares, *etc*. It also reviews the queries/complaints received from the shareholders.

Corporate Social Responsibility Committee

In order to have company's contribution to the social sector development, CSR has been mandatory for companies, which have net worth of Rs. 500 crore or more, or turnover of Rs.1000 crore or more or a net profit of Rs.5 crore or more during any financial year. Such companies need to have CSR Committee of the board, which can articulate the scope of CSR activities, by ensuring compliance with the CSR policy of the banks in accordance to the Companies Act 2013. Key functions of the committee include review of CSR initiatives, formulation of CSR policy, monitoring the CSR activities, implementation of and compliance with the CSR Policy and reviewing and implementing.

XI. IMPORTANT GUIDELINES OF RBI ON CORPORATE GOVERNANCE

RBI issues important guidelines from time to time to the banks, NBFC and other financial institutions, which comes under its supervisory control. Some of the key guidelines are discussed below:

Guidelines for Licensing of 'Payments Banks'

The RBI through its recent guideline dated November 27, 2014for Licensing of Payments Banks, emphasized that the Board of the banks should have a majority of independent Directors as well as banks are required to comply with the corporate governance guidelines issued from time to time by the RBI, SEBI, etc.

Corporate Governance Directions for Non-Banking Financial Companies (NBFCs)

RBI *vide* its Master Circular no. RBI/2015-16/12 DNBR (PD) CC.No.053/03.10.119/2015-16 dated July 1, 2015 directed the NBFCs to frame internal guidelines on corporate governance which is to be approved by its Board of Directors. Through this circular, NFC's are required to have three Board committees on mandatory basis including, Audit Committee, Nomination Committee and Risk Management Committee.

Fit & Proper Criteria for Directors

NBFC's are required to have in place a Board approved policy on 'Fit and Proper Criteria for Directors'. Through which, company obtains necessary disclosures from Directors from time to time. The companies are required to ensure in furnishing to the RBI, statement on change of directors and a certificate confirming that fit and proper criteria in selection of the directors has been followed.

XII. BASEL COMMITTEE ON CORPORATE GOVERNANCE PRINCIPLES FOR BANKS

The Basel Committee on banking supervision was setup in 1975 by the Central Bank Governors of the G10 developed countries. It is empowered as the banking supervisory authority. Since its inception, it has introduced the Basel Capital Accord in, the New Basel Capital Accord in 2003. BIS (2015) have come out with guidelines on corporate governance principles for banks with an objective of promoting the adoption of sound corporate governance practices by banks in worldwide. It has given 13 principles of corporate governance for banks, which are shown in *Figure.3* below.

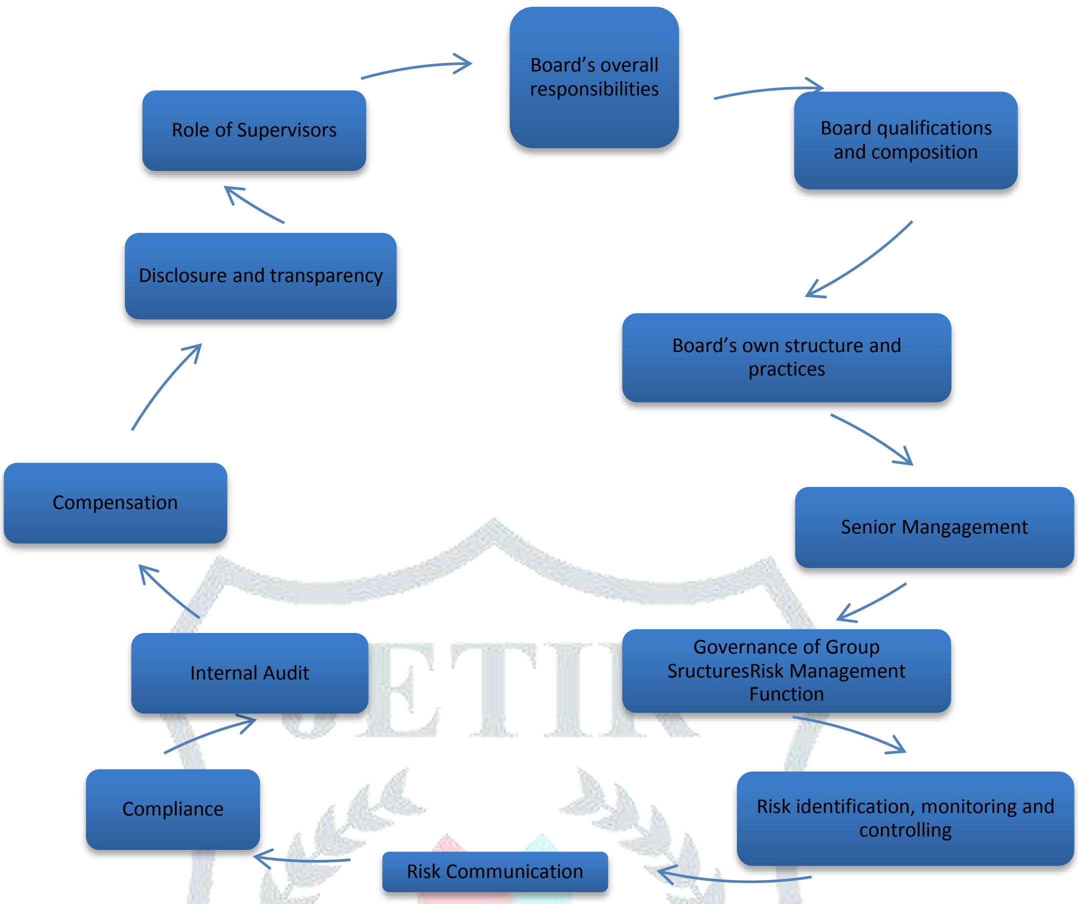

Figure-3: Corporate Governance Principles for Banks

XIII. CONCLUSION

Thus, corporate governance has equal importance in case of banks and financial institutions as well. In Indian market, the concept of corporate governance is emphasized considering the liberalization, privatization and globalization phase, whereby institutionalization of financial markets, foreign institutional investors (FIIs) became dominant players in the stock markets. This phase also left private sector companies with a realization that 'investors keep invested in those corporate, which create values for their investors'. Thus, in this way, corporate essentially requires to adhere with the honest, fair and transparent corporate procedures and practices. As a liberalization measure, the Government amended the Companies Act, 1956 many times including in 1999, 2000, 2002 and 2003. Several measures have been adopted by the government, which includes empowering the stock market regulator - Securities and Exchange Board of India (SEBI) and also by improving specific measures for more disclosures and enhancing transparency. Provisions of the Companies Act, 2013 , the guidelines of RBI and SEBI with respect to corporate governance play an important role in shaping and maintaining the corporate governance practices of Indian banks.

XIV. ACKNOWLEDGEMENT

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