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RBI Discussion Paper: Bank Boards And Their Burdens

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There are some reports on reading which one wishes that they had not been written. The discussion paper on “Governance in Commercial Banks in India” is one such report.

The frequent failures in the banking sector have prompted the RBI to think of a revised prescriptive regime, which is indicative of the tendency of regulators to micro manage regulated entities. To describe the RBI’s discussion paper on governance, as a curate’s egg, good in parts, is to be charitable.

The discussion paper suffers from an identity crisis. It starts out as a discussion paper, with a background, and promptly seeks to convert itself into the first draft of a proposed regulation, complete with provisions for “Interpretation”, “Transition” and “Repeal”.

But that is hardly its biggest flaw. These are…

1. Not Uniformly Applicable

The first problem, and the fundamental problem at that, is in relation to the “Applicability” of the provisions contained in the discussion paper.

In paragraph 2.1.(ii), it has been mentioned that these provisions would have applicability to the extent that they are not inconsistent with the provisions of specific statutes applicable to the State Bank of India, nationalised banks and regional rural banks. So far so good. The sting is in the tail. The provisions will not apply “in case where the major shareholder/ promoter viz., Government of India retains its instructions”. Stated differently, it would mean that instructions issued from time to time by the Government of India will override any of the provisions of the regulations, which would be crafted based on this discussion paper, and the feedback received thereon.

This strikes at the root of corporate governance. The mindset that instructions issued owing to the exercise of ownership functions by the Government of India, override regulations on corporate governance, should be done away with, sooner rather than later.

2. Corporate Governance Is A Set Of Relationships?

There are a number of definitions in paragraph 3 of the Paper. While many of them call for critical comment, considerations of time and space require that the focus of this article is only on a few of them.

The first is **corporate governance.** In a long and elaborate definition, it has been stated that corporate governance means a set of relationships. This definition is completely unacceptable. Corporate governance is a philosophy that translates to practices and processes put in place to ensure that the affairs of a company are conducted in a manner consistent with the interest of all categories of stakeholders.

The next definition which needs to be addressed is that of **non-executive director**. An NED has been defined as "a member of the board who does not have responsibilities within the bank". Considering that the board is a part of the bank, as its highest decision-making authority, it would be incorrect to say that an NED does not have responsibilities. If the intention is to state that NEDs have no executive responsibilities, it must be stated clearly.

There are nine definitions associated with different aspects of risk. Some definitions partake of the character of explanations. For example, the definition of **risk appetite framework** contains the following sentences – "The RAF shall consider risks to the bank, as well to its reputation vis-à-vis depositors, investors and customers. The RAF must be in alignment with the bank's strategy."

3. Duties Of A Director

The paper seems to experience recurring difficulty in stating what directors do. Paragraph 4.6 sets out the "Duties of a Director". Among the 31 duties that are listed, the following attract a special notice. Point 4.6.(xxiv) states that a director should "not interfere in the WTDs and other management functionaries performance of duties". The fact that a whole-time director is a director, seems to have been lost sight of. Similarly, there is a provision which requires the directors to "not interfere in the day-to-day functioning of the bank". This too overlooks the fact that WTDs, who are also directors, have to be involved in the functioning of the bank. If the intention was to list the duties of independent directors or NEDs, the heading of Paragraph 4.6 ought to have been appropriately worded.

4. Board Committees

Paragraph 5.1.1 relates to the **audit committee of the board** (ACB). It provides *inter alia* that the meetings of the ACB will be chaired by an ID, who shall not chair any other committee of the Board. This is a sound proposition.

It further provides that the committee shall normally meet without the presence of executives or senior management functionaries, except for the secretary, and goes on to state that at its discretion, and as and when needed, any of the WTDs, or heads of finance, vigilance, risk, etc. shall be invited to be present. The absence of executives on a regular basis will adversely impact the functioning of the ACB, since the secretary of the board will be in no position to provide information or clarifications that the committee might need during its meeting. It is a good practice to invite a WTD and/or the chief financial officer, whether the latter is a board-level functionary or not, to the meetings so that the committee's work is not hampered by absence of information.

Paragraph 5.1.2 relates to the **risk management committee of the board**. It has been suggested that the RMCB should be made up only of NEDs. Notwithstanding the wisdom and expertise that NEDs bring to the board and to the committees, it will be far fetched to claim that they would have all the information required for the committee to address all manner or risks, including operational and financial risks. This committee would benefit considerably if the chief executive officer is made a member of the committee. The direction that the chairperson of the board shall not be a member of the RMC is also of dubious merit, since chairpersons in most banks are NEDs, with considerable knowledge and experience of several sectors. To deny the RMCB the advantage of the inputs of the chairperson of the board, is not a value adding proposition.

Paragraph 5.1.3 relates to the **nomination and remuneration committee**. It has been provided that one of the IDs, who is a member of the NRC, should also be a member of the RMCB. Surprisingly, no such commonality of membership has been expressly stipulated in the case of the ACB and the RMCB. The role of the NRC inter alia includes reviewing whether board candidates have the knowledge, skills and experience, and particularly, in the case of NEDs, independence of mind. This has been stated to be a part of the induction process. Clearly, these questions should have been asked, and answered, prior to getting the Director on board and waiting for the induction/ orientation process.

Yet another responsibility of the NRC is to determine whether each director falls within the "fit and proper" description. This too has to be an activity undertaken prior to getting a person on board. The NRC has also been tasked to conduct an annual evaluation of the board, its committees, the chair of the board, the chair of the committees, board members, other directors, senior management functionaries and other employees. It should not be the responsibility of the NRC to conduct annual evaluation of persons other than directors and key managerial personnel, since that is a legitimate function of the human resources department.

The mandatory **stakeholders relationship committee** has been disposed off in one sentence in paragraph 5.1.4. Unlike the portions of the paper relating to other committees, this has no mention of the composition of the committee. While expanding the scope of work of the committee, which is a desirable step, it would have been worthwhile to specifically mention that both transactional and systemic aspects of grievances ought to be addressed.

Paragraph 5.1.5 relates to the "Committees of the Board performing management function". This is dangerous territory. The board and its committees are to provide superintendence, direction and control. They are not expected to manage the company. The board's responsibility, and also the responsibility of the committees, is to ensure that the management discharges its duties in the best interests of all stakeholders. Therefore, to talk about separating the supervisory functions of the board from the management functions of the board, strikes at the root of corporate governance theory, and should not be countenanced. This paragraph also states that – "Should the Board constitute/have constituted committee(s) such as Management Committee and/or Executive Committee and/or Credit Committee and/or Investment Committee or any other committee by whatever name called which has a mandate to assume risks, then it shall consist of Directors who are not part of either ACB, RMCB or NRC." This recommendation would presume that the board has an unlimited supply of directors to man all committees.

5. CEO Is Not Company Secretary

There are howlers such as "the CEO shall make the following disclosures on - communicate outcome of Board deliberations to Directors/ concerned personnel…" Since directors are present at board meetings, they do not need the CEO to communicate to them the outcome of board deliberations. In any event, the deliberations at the board are captured in the minutes, and do not require separate communications from the CEO.

The CEO has also been tasked with preparing and circulating to the directors, in a timely manner, the agenda of the meeting, as well as the minutes of the previous meetings. This is a responsibility of the company secretary.

> **The paper does not seem to attach adequate importance to the position of company secretary, who is one of the 3 KMPs in the company. The paper provides for separate secretaries for each of the committees.**

For example, the chief risk officer is the secretary of the RMCB, the head of HR of the NRC, and the head of internal audit of the ACB. This is incorrect for two reasons.

1. The company secretary should be the secretary for all board committees on account of compliance requirements as well as commonalities in procedures. Further, making the head of IA the secretary of the ACB would give the impression that the ACB deals only with IA.

2. It has also been recommended that the company secretary shall report to the chair of the board, and her assessment shall be undertaken by the NRC based on the feedback provided by the chair of the board.

Both these propositions are inadvisable.

The company secretary is a secretary to the board, and not to the chairperson. To ensure unity of command and control, it is necessary to also factor in the assessment by the CEO, as head of management.

Even at this stage, it is preferable to substitute this paper with a report that addresses the extant instructions, and indicates the changes proposed to be made, and the reasons for proposing those changes. In the process, provisions that exist in the Companies Act, 2013, the SEBI LODR Regulations, 2015 and the Secretarial Standards could be referred to, without being set out in avoidable detail. The fundamentals of corporate governance, which commence with a clear understanding of the roles and responsibilities of the board and the management, and the interface between the two, should not be lost sight of. Loading the board with management functions, and creating a situation in which part-time functionaries, who are board members, become liable for acts and omissions that belong in the realm of management, is a problem that needs to be frontally addressed. It is time for the masterful to be masterly in its prescription.

Good corporate governance is an aid to the conduct of business. A regulatory regime that obstructs the business function of a corporate entity serves no one's purpose.

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