

Do Codes of Conduct Matter? 18th September, 2019 Mumbai

SUMMARY OF DISCUSSIONS

Rationale

Corporate Governance in public sector banks has been a subject of much discussion and debate. There are some who believe that government ownership necessarily leads to good governance and no prescriptive arrangement for ensuring Corporate Governance is required in public sector entities. At the same time, there are some that believe that no matter what systems, procedures, checks and balances are put in place, majority ownership by the government will be a stumbling block in an attempt to promote good Corporate Governance. The discussions at the Roundtable are expected to lead to suggestions on how a pragmatic, implementable and meaningful Corporate Governance framework can be put in place in public sector banks.

DISCUSSIONS

- Government is the majority owner of all Public Sector Banks (PSBs). In addition, it continuously tries to actively manage the banks. A clear understanding of the fact that ownership need not necessarily translate to management does not seem to exist.
- Further, what might have passed muster when the banks were wholly owned by the government, fails the test of good corporate governance when as majority owner, as distinct from sole owner, government unilaterally takes decisions, without consulting, or keeping in mind, the views and concerns of other shareholders.
- This does not mean that government's majority ownership is the only reason for under-performance by banks.
- Keeping an eye on return on capital, is not something that PSBs are found to be doing. This is especially important since PSBs also have socio-economic priorities, derived from policy interventions of the majority owner. The question arises whether there can be a carve out for initiatives that are driven by the socio-economic needs of stakeholders, as distinct from the purely commercial operations of PSBs.
- It is unfair to expect PSBs to compete with private sector banks while expecting them to shoulder socio-economic burdens.
- All PSBs are listed. However, there is no alignment with some provisions of the Companies Act, 2013 and SEBI's Listing Obligation and Disclosure Requirements (LODR) Regulations. This should be addressed by bringing all PSBs fully under the Companies Act, 2013, and regulating their functions under the Banking Regulations Act. The need for the Banking Companies (Acquisition and Transfer of Undertakings) Act, the State Bank of India Act, and other Acts and Rules which carve out a special place for PSBs, should be re-examined and, if possible, they should be repealed.
- The question whether workmen representatives and non-workmen representatives should be on Boards, should be re-examined. While there is a view that they add value, there is an opposite view that some of them are a disruptive presence in the boardroom. The government seems to have adopted a half way house of not filling these vacancies without doing away with the statutory provisions
- There is a view that the PSBs are not focussing as much on technology as private sector banks. While this might not be entirely correct, it is useful for PSBs which are laggards in the space to take a leaf out of State Bank of India's book.
- There are a number of deficiencies in the way the Board and the committees are constituted.
 1. The Reserve Bank of India (RBI) being the banking regulator should not be represented on the Board of the PSBs which are regulated entities since there is an obvious conflict of interest.
 2. Government nominees should not be on the more operational committees such as the ones that take credit decisions.
 3. No Executive Director (ED) should be a member of the Audit Committee (AC). EDs can be invited to the AC meetings depending on need.

- The Chief Risk Officer reporting to the Managing Director (MD) is not a healthy proposition.
- The recently announced code of conduct for Directors on the Boards of PSBs seems to be one more effort to tick the box. A number of provisions have been extracted from Schedule IV of the Companies Act, 2013, which itself is far from an ideal code.
- A view has been expressed that the Department of Financial Services (DFS) and the RBI should have professionals. This is a questionable view since in the case of the RBI, most senior positions are held by career central bankers. As for the DFS, it would be helpful if persons appointed in senior positions in the DFS have some background of banking and the financial sector, and have reasonably long terms of office to get familiar with banking and to contribute better.
- Moving persons from one PSB to another on account of promotion as ED and thereafter, on account of promotion as MD, is often disruptive since the size as well as the culture of the bank in which the person is appointed, might be very different from those of the bank from which she is moving out.
- Since in many cases the MD or ED is an outsider to the bank, it takes a while for her to stabilise and to become a part of the formal and informal system.
- The utility of Banks Board Bureau (BBB) in the timely filling of vacancies is limited, since it is only a recommendatory body.
- The BBB's recommendations on corporate governance in PSBs are on its website. There is no clarity on how many of them have been implemented.
- Boards of PSBs are not seen as exercising any of the powers which Boards should normally exercise. For example, when MDs are moved out of banks, neither the Chairperson nor the Board is consulted or even kept informed prior to the change being made. Resultantly, the MD sees himself as being answerable only to the Ministry and not to the Board. This strikes at the root of corporate governance in so called Board-managed entities.
- In the last many years, it has become a practice for Finance Ministers to hold regular meetings with MDs of PSBs. At these meetings, they are told what the banks are required to do going forward. While the government is within its rights to articulate policies and action plans, it would be appropriate for the Board to decide in what manner the implementation should take place.
- Even though all PSBs have government nominees, instructions are directly communicated by the Ministry to the management (as distinct from the Board) of the PSBs. It is not understood why the majority shareholder cannot communicate its thoughts through its nominees on the Boards.
- A view has been expressed that some junior persons are appointed as nominee Directors and they are unable to contribute satisfactorily. This problem presumably arises from the large number of PSBs on whose Boards government has to have a nominee Director, as also the fact that the law provides that no Director should be on the Board of more than one bank. This problem will hopefully get addressed partially when the proposed bank mergers take place, and lesser number of nominees are required.
- The attendance record of nominee directors is in most cases dismal. Some of them have attended less than 20% of the meetings of the Board.
- Rotation of Directors, such as shareholder directors, once every 6 months, is disruptive and does not add any value.
- Independent Directors and other Non-Executive Directors, such as shareholder directors, should not be on committees which are required to meet once a week, since it could result in the transgression of Board members into the area of management.
- Boards are unproductive partly because the agenda is voluminous and contains a number of items which ordinarily should be dealt with by management. A part of the problem is the routine manner in which the RBI keeps on adding to the list of items which ought to be brought to the Board. This has the undesirable effect of Directors not reading the agenda notes and the Board often taking it as read, without saying so.
- The separation of the roles of the Chairperson and the MD was perceived as a salutary step since it is consistent with the corporate governance dictum that the management is answerable to the Board. In practice, the experience has been varied. There are non-executive Chairpersons who are often present in the bank's headquarters and are therefore seen as being involved in all matters, including

operational matters. There are others, who being textbook Chairpersons, go to the bank only on days of Board or committee meetings.

- When Chairpersons were appointed, it was felt that they would, on behalf of the bank, absorb, or deal with, the pressures from the majority owner. In practice, this does not seem to have worked since whenever pressure is exerted, the Chairperson is kept out of the conversation. Further, the practice has not yet evolved of the MDs seeking the support of the Chairpersons to resist the pressures from the government.
- Since it would be idle to pretend that the Ministry will either reduce or stop the number of meeting with the MDs of PSB, it is necessary for the bank leadership to ensure that its agenda is also discussed at these meetings. These meetings should not become one sided conversations in which the bank managements are told what is required to be done. It is understood that banks managements do not suggest agenda items for discussions in such meetings.
- The Indian Banks' Association is a representative body for all banks in the country. Nevertheless, there is a perception in some quarters that its membership is confined to PSBs. In the process, the IBA sometimes becomes the instrumentality through which directions, derived from policies, are sought to be passed on to PSBs.

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