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Expert Expressions
Corporate Governance Demystified

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UNEASY LIES THE HEAD THAT....

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It is cliched, but the truth of the saying does not go away. Every crisis presents an opportunity. Corporates must learn from the NSE fiasco, and take remedial action to prevent something similar in their backyard.

The shenanigans that have surfaced in recent times in regard to the National Stock Exchange (NSE), have consumed several column centimetres of newsprint, and a large number of sound-bytes. Not surprisingly, much of the attention has been focused on matters that are peripheral, but are capable of being sensationalised.

NSE is not merely a systemically important institution, but also a prime indicator of the functioning of the economy. Over the 25 years of its existence, it has conquered several peaks, including that of being the largest exchange in the world for derivatives transactions. The urgent task on hand therefore is to restore its credibility, and to put in place the checks and balances, required to enable it to function as a healthy institution, rather than as an instrument of the illegitimate pursuits of ill-intentioned individuals. This is also an opportunity to look at issues that either have, or are likely to have, adverse impact on the functioning of large corporate entities.

The first issue which stares one in the face is that the same two persons have been a part of the decision-making process of this market infrastructure intermediary for the last 25 years. During this period, they have doubtless played a role in bringing the Exchange to its present position of size and strength. In the process, with excessive dependence on two individuals, organisational stability in the long term has fallen off the radar. Institutions are expected to outlive individuals, and therefore, exclusive reliance on two persons over two and a half decades was clearly a recipe for disaster.

There are some fatal flaws in the structural arrangements put in place in the Exchange. The foremost of this is that of the previous Managing Director (MD) and Chief Executive Officer (CEO) being accommodated on the Board of Directors as the non-executive Vice Chairman of the company. Having the immediate previous CEO on the Board can give rise to one of two possibilities. The first is that the previous CEO, while participating in Board

deliberations, would find it difficult to suppress the tendency of saying what he/she had done when a similar problem had to be tackled, or a similar situation addressed in the past. Some of this would translate to circumscribing the freedom of the current CEO to chart his/her course of action for the company. The second possibility, and one that we are confronting now, is the situation that can arise when the present incumbent and the immediate predecessor have a sharedagenda. The presence of the latter in the boardroom could significantly influence boardroom conversations, as also help to obstruct the free flow of information that the rest of theBoard needs to have on important matters. The past and the present holders of the top management position, acting in concert, is as big a risk factor, as any, that companies have to recognise and neutralise.

The composition ofany Board of Directors must have contextual relevance. Before getting onto the Board,persons who have distinguished themselves in their chosen spheres of activities, it is necessary to remind ourselves of the warning of the Mutual Fund industry that past performance is no guarantee of future returns. Having on Board persons that "grace the Board with their name and reputation" is often the best way to mislead investors that the Board is well equipped to discharge its onerous responsibility. The related question, at least in the NSE's context, is whether these Directors on the Board were chosen, keeping in mind NSE's requirements, or whether these were names that the NSE's top management was comfortable with. In the latter case, the constructive tension that ought to exist between the Board and the management, is more a hope than an expectation.

Public Interest Directors (PIDs), as the name signifies, are expected to act in public interest. The distinguished PIDs, then on the Board of the NSE, clearly did not measure up to expectations. It is worth ascertaining whether these distinguished individuals that SEBI appointed as PIDs, were identified by SEBI, having regard to their experience and expertise, or were persons recommended by the NSE's top management to SEBI, albeit informally, for appointment as PIDs. The not so benign neglect manifested by the Board would strengthen the possibility that these names were suggested by the NSE top management.

For the Board to function properly, it is necessary that the adequacy and the timeliness of the information is ensured. When the Board lulls itself into the belief that the fiercely competent management can do no wrong, the seeking of information tends to recede into the background. Given the circumstances of the instant case, it shouldnot surprise anyone that there might not have been worthwhile conversations in the boardroom or in the meetings of the Nomination and Remuneration Committee (NRC) regarding succession planning for the top management positions.

Concentration of power, without having in place adequate checks and balances, will sooner, rather than later, lead to inappropriate decisions, whether it is the induction of unqualified persons, being brought into senior positions, or enabling the flow of confidential information to unauthorised persons. It cannot be anyone's case that all of this could happen in a large institution without anyone in the Board coming to know of it. What is worse is the possibility that the Board and the appropriate committee had knowledge, but did not act in time and effectively.

Whatgives rise to the unfortunate conclusion in the preceding paragraph is that a number of communications from the Regulator remained unresponded to. Even reminders were happily ignored. Clearly, there either was no system put in place to ensure prompt responses, or,what is worse, the existence of a system did not prevent those incharge

from responding promptly. While top management might have their reasons (completely invalid) to delay or to deny information to the Regulator, the Board should not have played along, and encouraged a culture of non-compliance. Not responding to communications froma Regulator, in the context of an allegation received by the latter, should be treated as a separate punishable offence. If that approach is followed, many, if not all, members of the Board, would have much to answer for.

SEBI's inability to get the responses/ clarifications in time, points to a serious weakness that needs to be addressed. Regulatory organisations should not place themselves in the position of issuers of routine reminders, in the expectation that someday the requisite information would be received. This was clearly a failing, contributed in part by the belief that this organisation, with blessings from senior functionaries in the political ecosystem, should not be pushed beyond a point.

On the issue of whether a person, who was effectively the number two in the management, and was given an extraordinary compensation, should not be designated as a KMP, it has been noticed that the Secretarial Auditor pointed to this omission. The purpose of any audit, including secretarial audit, is defeated when the auditee summarily brushes aside a finding or a recommendation of the Auditor concerned.

Any organisation, with multiple departments, should have a system of annual inspections, which are sufficiently robust. Even if this is not done by an external entity, it could be given effect to by selecting persons from different departments to inspect other departments. Ordinarily, this is an exercise that the Inspection department can, and should, implement. However, given the specifics of the NSE, as revealed in the SEBI order, nothing would have prevented convenient persons being identified for this exercise, even if it was contemplated.

Internal audit has an important role in uncovering whether there have been serious transgressions in the practices adopted by different departments. Why internal audit could not identify some of these issues, should itself be a matter of separate enquiry.

The nature of operations of the NSE calls for a very robust,impenetrable security system, with no overrides being ordinarily contemplated. For the persons in-charge of the security system to create a gap in the firewalls, to enable emails from an unauthorised outside entity to flow into the system, or emails to flow to him, was a majorlydelinquent act, which needs to be gone into, and the perpetrators of which need to be punished. That sucha step was taken on the directions of the CEO is equivalent to placing the individual above the institution.

Public sector banks have, for long, had a praiseworthy practice of having a Chief Vigilance Officer (CVO), not belonging to the organisation, but brought on deputation from some other bank. What this ensured was that the individual concerned, not being obliged to look for career progression within that bank, was in a position to not pull his/her punches, and to bring to the attention of the Board, transgressions that had taken place or were taking place. It is time for organisations as large and as important as the NSE to immediately induct a CVO from another organisation to ensure the purity of vigilance interventions.

The whistleblower mechanism is another aspect that needs to be gone into carefully. When things were going wrong, as clearly they were, there would have been persons from within the organisationwhose unhappiness would have prompted them to send in

whistleblower complaints. It is worth examining whether such complaints were received, and if so, how they were dealt with. The law envisages that serious whistleblower complaints can be addressed to the Chair of the Audit Committee (AC), so that the management is not in a position to keep it under wraps. It needs to be gone into whether such complaints were received by the Chair of the AC, and how they were acted upon. Protecting the anonymity of the complainant is the pillar on which the whistleblower mechanism is erected. It thereforeneeds to be examined whether the larger-than-life presence of the then-MD, and her predecessor, discouraged persons from addressing complaints to appropriate persons within the organisation. The fact that SEBI received whistleblower complaint(s), and the NSE did not act on any whistleblower complaints that it might have received,gives rise to uncomfortable conclusions.

The Exchange had a Company Secretary, who was of the rank of the President. It either did not occur to him, or did not seem important to him, to point out that significant matters discussed in Board meetings, ought to be captured in the minutes. The explanation trotted out on behalf of the Board, that the matter was too confidential to be captured in the minutes, does not hold water.

The role of the Compliance Officer requires very serious examination. The only task, that he had, was to ensure,as a Compliance Officer,compliance. It would seem that even that task was not accomplished to any degree of satisfaction. The fact that this individual was also the Chief Regulatory Officer, begs the question whether there was any responsibility whatsoever, attached to that post.

There were several occasions on which, and several officials who could have brought the irregular goings-on to SEBI's attention. That none of them appeared to have chosen to do so at the earliest opportunity, points to a culture of complicity, which seems to have overtaken the organisation. This needs to be gone into, and signals sent to all functionaries across the board, that being remiss in discharging one's duties relating to compliance, and sharing of information, will no longer be countenanced.

Finally, persons on “power-packed Boards” should exercise “power” in the boardroom. Absent this, the Boards might be seen as “packed Boards”.