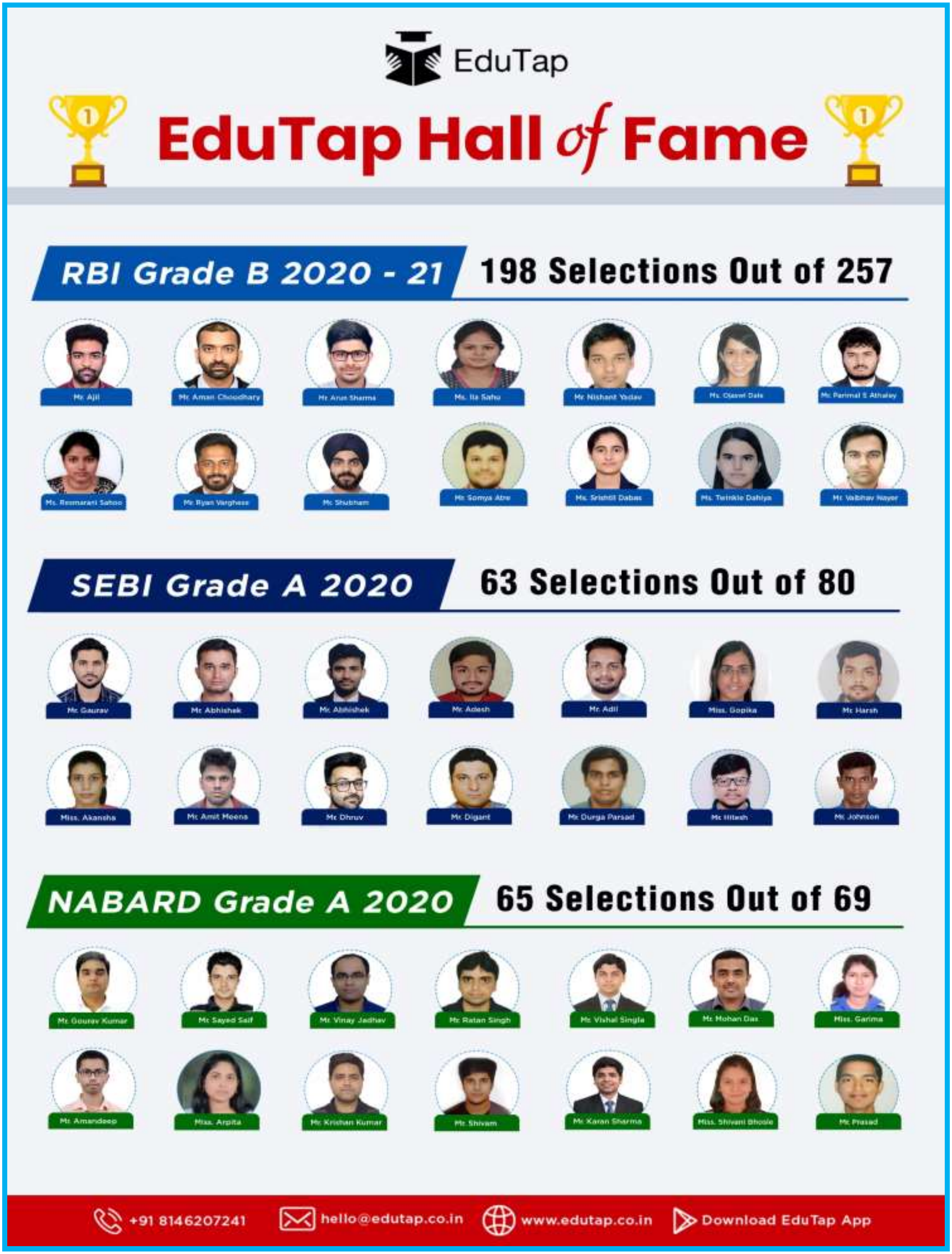
EduTap

SUMMARY SHEET

Corporate Governance in Banking Sector



EduTap
EduTap Hall of Fame
RBI Grade B 2020 - 21
198 Selections Out of 257
Mr. Ajil
Mr. Aman Choodhary
Mr. Arun Sharma
Ms. Ila Sahu
Mr. Nishant Yadav
Ms. Ojaswi Dala
Mr. Parimal S Athaley
Ms. Resmarani Sahoo
Mr. Ryan Varghese
Mr. Shubham
Mr. Somya Atre
Ms. Srishti Dabas
Ms. Twinkle Dahiya
Mr. Vaibhav Nayer
SEBI Grade A 2020
63 Selections Out of 80
Mr. Gaurav
Mr. Abhishek
Mr. Abhishek
Mr. Adesh
Mr. Adil
Miss. Gopika
Mr. Harsh
Miss. Akansha
Mr. Amit Meena
Mr. Dhruv
Mr. Digant
Mr. Durga Parsad
Mr. Hitesh
Mr. Johnson
NABARD Grade A 2020
65 Selections Out of 69
Mr. Gourav Kumar
Mr. Sayed Saif
Mr. Vinay Jadhav
Mr. Ratan Singh
Mr. Vishal Singla
Mr. Mohan Das
Miss. Garima
Mr. Amandeep
Miss. Arpita
Mr. Krishan Kumar
Mr. Shivam
Mr. Karan Sharma
Miss. Shivani Bhosle
Mr. Prasad
+91 8146207241
hello@edutap.co.in
www.edutap.co.in
Download EduTap App

Important Points

1. This Summary Sheet shall only be used for Quick Revision after you have read the Complete Notes

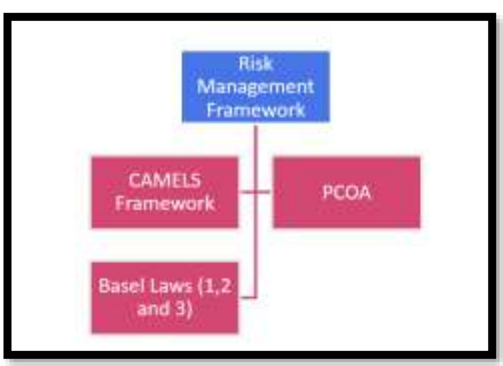
2. For Building Concepts along with examples/concept checks you should rely only on Complete Notes

3. It would be useful to go through this Summary sheet just before the exam or before any Mock Test

4. Questions in the exam are concept based and reading only summary sheets shall not be sufficient to answer all the questions

1 Summary Points

- **Importance of Corporate Governance in Banks:**
    1. Banks lubricate the **wheels of the real economy**, act as conduits of monetary policy transmission and constitute the economy's payment and settlement system
    2. **Failing of Banks** can pose serious consequences for the entire financial system and the macro economy
    3. Banks are **highly leveraged** as they accept large amounts of uncollateralized public funds as deposits and further leverage those funds through credit creation
- **Mechanisms of Corporate Governance in Banks**
    1. **Managing Risk**
    2. **Managing Governance Aspects**
- Risk Management is done through below mentioned processes: This will be discussed in detail in Risk Management chapter.



- **Laws addressing Governance aspects of Banks:**

Banking Regulation Act,1949

↓

Companies Act, 2013

↓

SEBI Clause 49

- **Corporate Governance Clauses in Banking Regulation Act,1949**
  1. **Clause 10 A:** Minimum **51%** of directors should have special knowledge or practical experience in respective fields and out of this **minimum 2 directors** should have knowledge in agriculture and rural economy, co-operation or small-scale industry
     - Directors should not have exceeding **5 Lakh or 10%** of paid up capital of the company
     - Director can hold office for **maximum tenure 8 years,** except Chairman
  2. **Clause 10 B:** Banking company must have whole time Chairman else RBI approval required for part-time basis
  3. **Clause 10BB:** If position of Chairman is vacant then RBI can appoint a person to be the Chairman in depositor's interest
  4. **Clause 10 C:** Chairman and certain directors cannot hold **qualification shares**
  5. **Clause 10 D:** Any appointment or removal of a Director shall not be entitled to claim any compensation for the loss or termination of office
  6. **Clause 16:** Banking company cannot have any of its director to be in the board of directors of other banking company and it should not have any such 3 directors who are holding more than 20% voting rights
  7. **Clause 36AA:** In the depositor's interest, RBI can remove Chairman, chief executive officer or any person of the banking company
  8. **Clause 36AB:** In the depositor's interest, RBI can appoint additional directors in the banking company
  9. **Clause 36AC:** Provisions of **36AA and 36AB overrides** any other contrary provision in the Companies Act, 1956 or any other law operating at that time

- **Corporate Governance through Companies Act, 2013** -> The company's bill 2012 got the approval from President in 2013 and hence it became a **Companies Act, 2013**. For Corporate governance details as per Companies Act, 2013 please refer to our Unit of "**Corporate Governance**' in the Management Section.

- **Corporate Governance through Clause 49 of SEBI**: Clause 49 of the SEBI listing agreement was the mainstay of Corporate Governance guidelines before Companies Act, 2013 came into picture. But post companies Act, 2013 SEBI is trying to make changes in the clause 49 to be in line with the Companies Act, 2013 and as result SEBI has come up with LODR regulations

  For Details on the clause 49/LODR Regulations, you can read the '**Corporate Governance**' unit in the Management Section.

- **Ganguly Committee Recommendations (2002):**
  1. **Responsibilities of Board of Directors:** Corporate Board is expected to follow 4 major roles of overseeing and managing **risk profile (Bank), integrity of business, control mechanisms and maximizing interests of stakeholders**
     - Also, required that directors need to get acquainted before getting inducted into BOD about functioning of bank
  2. **Training Facilities for Board of Directors:** To ensure that the directors discharge their duties to the best of their abilities, frequent trainings must be arranged for them to acquaint them with emerging changes in the banking sector
  3. **Establishment of various Committees on the Board:**
     - **Shareholders' Redressal Committee:** Banks which have issued shares, debentures to public under the chairmanship of a non-executive director
     - **Risk Management Committee:** Every banking organization is required to set up
     - **Supervisory Committee:** To monitor the exposures (both credit and investment) of the bank, adequacy review, ensuring compliance, etc.
     - **Nomination Committee**: To nominate and see fitment of the people to become directors on the board of the company
     - **Compensation Committee**: Evaluates performance of CMD and ED's

- **PJ Nayak Committee on Banking Reforms**

  The P J Nayak Committee or officially the Committee to Review Governance of Boards of Banks in India was set up by the Reserve Bank of India (RBI) to review the governance of the board of banks in India. The Committee was set up in January 2014. The Committee was chaired by P J Nayak, the former CEO and Chairman of Axis Bank

  Recommendations by the committee:

  1. Repeal the Bank Nationalization Act (1970, 1980), the SBI Act and the SBI Subsidiaries Act. This is because these acts require the government to have above 50% share in the banks
  2. After the above acts are repealed, the government should set up a Bank Investment Company (BIC) as a holding company or a core investment company.
  3. The government to transfer its share in the banks to this BIC. Thus, the BIC would become the parent holding company of all these national banks, which would become subsidiaries. As a result of this, all the PSBs (public sector banks) would become 'limited' banks. BIC will be autonomous and have the power to appoint the Board of Directors and make other policy decisions.
  4. Until the BIC is formed, a temporary body called the Bank Boards Bureau (BBB) will be formed to do the functions of the BIC. Once BIC is formed, the BBB will be dissolved.

5. The BBB will advise on appointments to the board, banks' chairman and other executive directors.

Set up of Banks Board Bureau

As a result of recommendations made by PJ Nayak Committee, the Banks Board Bureau was constituted on February 28, 2016. BBB works as an autonomous body. It recommends selection of chiefs of government owned banks and financial institutions and to help banks in developing strategies and capital raising plans

It is housed in RBI's Central Office in Mumbai

- **Corporate Governance in Banks – Guidelines by RBI**

- **Fit and Proper criteria for the Board of Directors in the Private Banks:**
  - For nominating/co-opting directors, certain broad 'fit and proper' norms should be formed
  - A person can be rejected if he does not fulfil fit and proper criteria
  - Criteria for nominating independent/ non-executive directors:
    - Candidate should normally be a **graduate** (exception categories of farmers, depositors, artisans, etc)
    - Between **35 and 65 years of age**
    - **Should not** be a Member of Parliament / Member of Legislative Assembly/ Member of Legislative Council
  - After amendments in the Section 9(3)(i) of the **Banking Companies (Acquisition and Transfer of Undertakings) Act 1970/1980** and **State bank of India Act 1959** to include the 'Fit and Proper Criteria'
    - **Nomination committee** need to determine fit and proper' status of the existing elected directors/proposed candidates based on qualification, track record and integrity

- Nomination committee: **Minimum three directors** (all independent and non-executive)
- **4 whole- time directors**
- Nomination of **up to 3 shareholder directors** on basis of percentage of shareholding
- RBI can appoint one or more additional directors

- **Fit and Proper criteria for the Board of Directors in the Public Banks as Per RBI Directions issued in 2019:**
  - **Educational qualification –** The candidate should at least be a graduate.
  - **Tenure**: An elected director shall hold office for **three years** and shall be eligible for re-election: Provided that no such director shall hold office for a period **exceeding six years**, whether served continuously or intermittently.
  - **Experience**: have special knowledge or experience in respect of one or more of the following areas, namely:--

    (i) agriculture and rural economy,

    (ii) banking,

    (iii) co-operation,

    (iv) economics,

    (v) finance,

    (vi) law,

    (vii) small-scale industry,

    (viii) IT, Risk Management, Human resources, Payment and Settlement and Business Management

    (viii) any other area the special knowledge of, and experience in, which in the opinion of the Reserve Bank shall be useful to the bank

  - The candidate should not be a member of the Board of any bank or the Reserve Bank or a Financial Institution (FI) or an Insurance Company or a NOFHC holding any other bank
  - A person connected with hire purchase, financing, money lending, investment, leasing and other para banking activities shall not be considered for appointment as elected director on the board of a PSB. However, investors of such entities would not be disqualified for appointment as directors if they do not enjoy any managerial control in them.

  - No person may be elected/ re-elected on the Board of a bank if he/she has served as director in the past on the board of any bank1/FI/RBI/Insurance Company under any category for six years, whether continuously or intermittently.

- The candidate should not be engaging in the business of stock broking.
- The candidate should not be holding the position of a Member of Parliament or State Legislature or Municipal Corporation or Municipality or other local bodies

➢ Guidelines for Appointment of Directors and Constitution of Committees of the Board

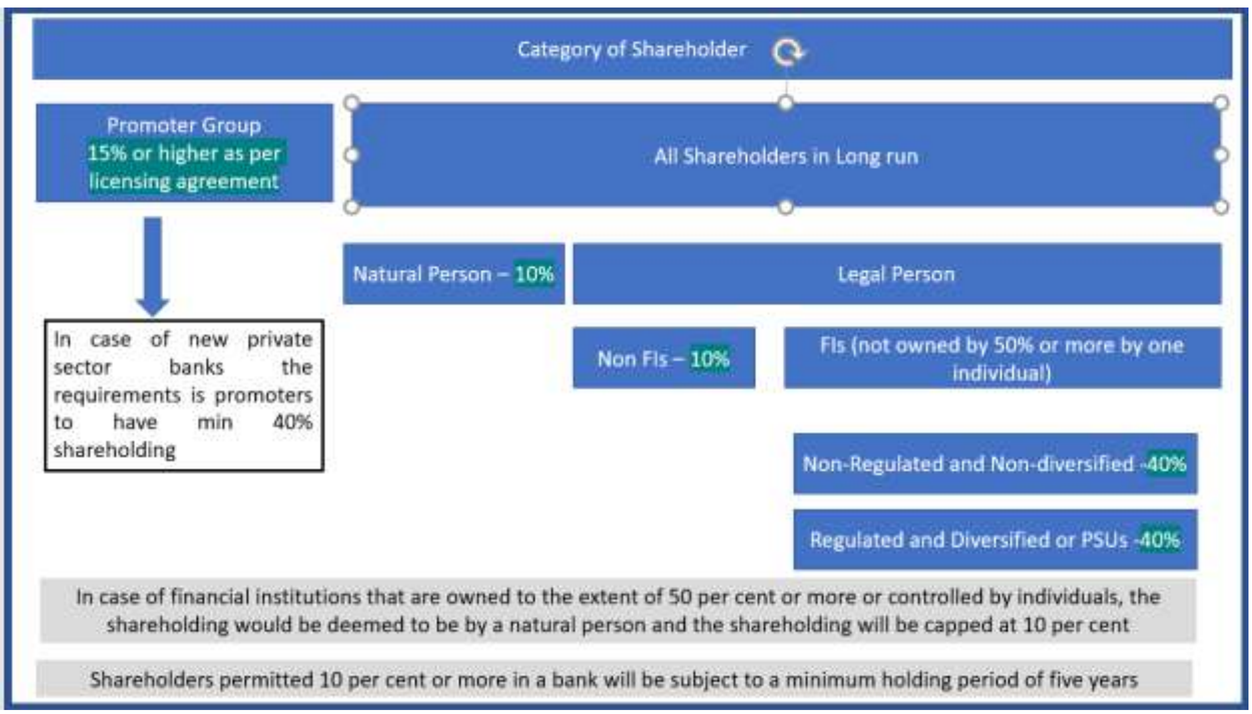
Applicability	The revised instructions would be applicable to all the **Private Sector Banks including Small Finance Banks (SFBs) and wholly owned subsidiaries of Foreign Banks**. In respect of **State Bank of India and Nationalized Banks**, these guidelines would **apply to the extent the stipulations are not inconsistent with provisions of specific statutes** applicable to these banks or instructions issued under the statutes The circular **will not be applicable in the case of foreign banks operating as branches in India**. The applicability to other commercial banks viz**., Local Area Banks, Payments Banks and Regional Rural Banks will be notified separately**.
Chair and Quorum of Meetings of the Board	The **Chair of the board shall be an independent director**. In the absence of the Chair of the board, the meetings of the board shall be chaired by an independent director. The **quorum** for the board meetings shall be **one-third of the total strength of the board or three directors**, whichever is higher. **At least half of the directors attending the meetings** of the board shall be **independent directors**
Committees on the Board	**Audit Committee of the Board (ACB):** 1. The ACB shall be constituted with **only non-executive directors** (NEDs). The Chair of the board shall not be a member of the ACB. The Chair of the ACB shall not be a member of any committee of the board which has a mandate of sanctioning credit exposures 2. The ACB shall meet with a **quorum of three members**. **At least two-thirds of the members attending the meeting** of the ACB **shall be independent directors**. 3. The **meetings** of the ACB shall be **chaired by an independent director** who shall not chair any other committee of the Board 4. The ACB shall **meet at least once in a quarter**. 5. All members should have the ability to understand all financial statements as well as the notes/ reports attached thereto and at least one member shall have requisite professional expertise/ qualification in financial accounting or financial management

	Risk Management Committee of the Board (RMCB) **1.** The board shall constitute an RMCB with a **majority of NEDs.** 2. The RMCB shall meet with a **quorum of three members**. 3. **At least half of the members attending the meeting** of the RMCB **shall be independent directors** of which at least one member shall have professional expertise/ qualification in risk management 4. **Meetings of RMCB shall be chaired by an independent director** who shall not be a Chair of the board or any other committee of the board. The Chair of the board may be a member of the RMCB only if he/she has the requisite risk management expertise. 5. The RMCB shall **meet at least once in each quarter**. **Nomination and Remuneration Committee (NRC)** 1. The board shall constitute an NRC **made up of only NEDs**. The Chair of the board shall not chair the NRC 2. The NRC shall meet with a **quorum of three members**. 3. **At least half of the members attending the meeting** of the NRC shall be **independent directors**, of which one shall be a member of the RMCB. 4. The **meetings** of the NRC shall be **chaired by an independent director**. 5. The meeting of NRC may be held as and when required
Age and tenure of NEDs	**1.** The **upper age limit for NEDs, including the Chair of the board**, shall be **75 years** and after attaining the age of 75 years no person can continue in these positions **2.** The total tenure of an NED, continuously or otherwise, on the board of a bank, **shall not exceed eight years** **3.** **After completing eight years** on the board of a bank the person may be considered for **re-appointment only after a minimum gap of three years**
Remuneration of NEDs	The remuneration to NED shall consist of 2 components 1. Sitting Fee (Fee for attending a meeting) 2. Fixed Remuneration in line with responsibility. However, such fixed remuneration for an NED, other than the Chair of the board, **shall not exceed ₹20 lakh per annum**
Age and Tenure of MD&CEO and Whole time Directors	1. No person can continue as MD&CEO or WTD **beyond the age of 70 years in private sector banks** 2. The post of the MD&CEO or WTD **cannot be held by the same incumbent for more than 15 years**. After completing 15 years, the same person can be **re-appointed** after a **min gap of three years**

	provided that during these 3 years, he/she is not associated with the bank or its group entities in any capacity, either directly or indirectly. 3. MD&CEO or WTD who is also a promoter/ major shareholder, cannot hold these posts for more than **12 years**. However, in extraordinary circumstances, at the sole discretion of the Reserve Bank such MD&CEO or WTDs **may be allowed to continue up to 15 years**. While examining the matter of re-appointment of such MD&CEOs or WTDs within the 12/15 years period, the level of progress and adherence to the milestones for dilution of promoters' shareholding in the bank shall also be factored in by the Reserve Bank.

- **RBI Guidelines for Ownership in Private Banks**

In 2016, RBI Issued guidelines on Ownership in Private Banks which came to be known as Reserve Bank of India (Ownership in Private Sector Banks) Directions, 2016. As per these guidelines the ownership of various categories of shareholders is shown below



1. Any acquisition of shareholding / voting rights of 5 per cent or more of the paid-up capital of the bank or total voting rights of the bank shall be subject to obtaining prior approval from the Reserve Bank of India

2. Acquisition of shareholding in a private sector bank shall be subject to the extant Foreign Direct Investment (FDI) policy. As of now the foreign investment in private sector banks from all sources

(Foreign Direct Investment, Foreign Institutional Investors, Non-Resident Indians) shall not exceed **74 per cent** of paid-up capital of the bank. **(Just for you Information, FDI in PSBs is 20%)**

3. Cross holding limits: Banks (including foreign banks having branch presence in India) shall not acquire any fresh stake in a bank's equity shares, if by such acquisition, the investing bank's holding is 10 per cent or more of the investee bank's equity capital

4. Higher Shareholding Limits: RBI may permit higher shareholding than permitted where in the opinion of the RBI, a change in the ownership / management of the bank is necessary in the interests of the depositors of the bank / public interest. However, such shareholding should be bought back to normal levels within 12 years from the date of such higher shareholding being permitted.

Proposed amendments, with respect to Ownership in Private Banks

RBI has constituted an Internal Working Group (IWG) to review the extant guidelines on ownership and corporate structure for Indian private sector banks, **under the chairmanship of Dr. Prasanna Kumar Mohanty**.

One of the key recommendations of the committee are as follows –

- The cap on promoters' group stake may be raised from the current level of "**15 per cent to 26 per cent of the paid-up voting equity share capital of the bank".**

Note – Although RBI has accepted the above-mentioned recommendations, however neither RBI has released any official notification, nor does RBI have amended any of its master circular.

- **Corporate Governance Principles by Basel Committee (1974):**
  1. **Principle 1:** The **board has overall responsibility for the bank**, including approving and overseeing management's implementation of the bank's strategic objectives, governance framework and corporate culture
     - The board may delegate some of its functions but not its responsibilities to board committees
     - *Few Responsibilities of Board:*
       - Establish the bank's risk appetite along with senior management and CRO
       - Oversee the implementation bank's capital adequacy assessment process, capital and liquidity plans, compliance policies and obligations, and the internal control system
       - Approve the annual financial statements
       - Approve the selection and oversee the performance of the ceo, key members of senior management and heads of the control functions
       - oversee the bank's approach to compensation, including monitoring and reviewing executive compensation

2. **Principle 2: Board members** should be and remain **qualified, individually and collectively**, for their positions. They should understand their oversight and corporate governance role and be able to exercise sound, objective judgment about the affairs of the bank.
    - ***Board Composition:*** Sufficient number of independent directors with balance of skills, diversity and expertise
    - Well-defined selection process for board members
    - Board members should not have conflict of interest with the bank
    - Should have Nomination Committee in place
3. **Principle 3:** The **board should define appropriate governance structures and practices for its own work**, and put in place the means for such practices to be followed and periodically reviewed for ongoing effectiveness
    - *Organization and assessment of the board:* Periodically review its structure, size and composition as well as committees' structures. Assess the ongoing suitability of each board member periodically and maintain appropriate records of its discussions & decisions
    - Various Board Committees need to be established:
        - *Audit Committee:* Independent chair responsible for internal audit and financial reporting and Appointment, remuneration and dismissal or external auditors
        - *Risk Management Committee:* Independent chair having experience in Risk management and can advise the board on the bank's overall current and future risk appetite
        - *Compensation Committee:* For overseeing the remuneration system's design and operation and ensuring that remuneration is appropriate
        - *Nomination Committee:* Recommending to the board for new board members and members of senior management
        - *Ethics Committee:* Ensuring appropriate means for promoting proper decision-making
4. **Principle 4:** Under the direction and oversight of the board, **senior management should carry out and manage the bank's activities** in a manner consistent with the business strategy, risk appetite, remuneration and other policies approved by the board
    - Senior management consists of a core group of individuals for day-to-day management of the bank
    - Decision-making of senior management should be clear and transparent
    - Senior management is responsible for delegating duties to staff

5. **Principle 5:** In a **group structure**, the **board of the parent company has the overall responsibility for the group** and for ensuring the establishment and operation of a clear governance framework among the child companies of the parent company
6. **Principle 6:** Banks should have an effective independent **risk management function**, under the direction of a chief risk officer (CRO), with sufficient stature, independence, resources and access to the board
7. ***Principle 7:*** **Risks should be identified, monitored and controlled** on an ongoing bank-wide and individual entity basis. The sophistication of the bank's risk management and internal control infrastructure should keep pace with changes to the bank's risk profile, to the external risk landscape and in industry practice
8. **Principle 8:** An effective risk governance framework requires **robust communication within the bank about risk**, both across the organization and through reporting to the board and senior management
9. **Principle 9:** The **internal audit function** should provide **independent assurance** to the board and should support board and senior management in promoting an effective governance process and the long-term soundness of the bank.
10. **Principle 10:** The **governance of the bank should be adequately transparent** to its shareholders, depositors, other relevant stakeholders and market participants