
CORPORATE GOVERNANCE AS EFFECTIVE TOOL TO CURB MISCONDUCT IN CONCENTRATED OWNERSHIP STRUCTURE IN THE BANKING INDUSTRY

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ABSTRACT

The Banking system in the country has seen a drastic change during the last 10 – 15 years, due to various policy, governance, and other direct and indirect factors. These changes are the consequence of the authority's efforts to alter the country's banking system's structure in order to ensure stability, minimal involvement in banking operations, and maximum governance. Even before independence, our country's banking system faced significant obstacles. After independence, during the 1950's and 60's the banking system in the country which consisted of scheduled private and non-private banks and cooperative banks had miserably failed, due to which the Union government decided to nationalize the banks and keep it under strict vigil as well have a social control over it, since these failed in achieving social goals.

However, recent governance trends reflect the government's desire to disinvest and wash its hands of the banking industry, limiting itself to a regulatory role and allowing corporations and large industrial houses to invest and fill the void left by the government. This paper deals with the proposal of the RBI to grant banking license to Corporates and large industrial houses and evaluate its viability.

The primary purpose of this paper is to evaluate the guidelines relating corporate governance issued by RBI in their recent circular to understand how best it suits to block ownership structure in banking industry. That apart, this paper also tries to understand banking system in other countries, where there is presence of corporate ownership/block ownership so as to understand its viability and to explore any regulatory benchmarks.

INTRODUCTION

The banking industry is a key component of any economy, it not only contributes to financial stability but also to the achievement of social goals that uplift the society. Thus, the general approach has been that either the state provides these services or in cases where it is private, the ownership structure should be diversified to mitigate risks. In India, the state has made sure that the banking system of the country strives to achieve the social goals of the country. This is evident from the chain of events that have taken place in the post-independence era in India i.e., the episodes of bank nationalisation and thereafter the strict vigil by the sector specific regulator hindering the entry of large corporate/industrial houses, to wholly own or operate banks as they predominantly follow concentrated/block ownership structure. The main rationale behind such restriction was to keep the ownership pattern diversified. The banking license guidelines issued at various intervals had created checks on eligibility of promoters, which has ensured that such entities would not be able to have a controlling stake in banks. However, the recent proposal by the Internal Working Group of RBI¹ which proposed to grant banking license to large industrial Houses/Corporate Houses has caught the eyes of the entire financial sector.

BACKGROUND

RBI's review on Ownership structure

The Reserve Bank of India on June 12, 2020 constituted an Internal Working Group (IWG) to review the existing Ownership Guidelines and Corporate Structure for Indian Private Sector Banks, which had made certain recommendations. One such recommendation was to grant banking license to Large Industrial Houses/ Corporate Houses by making necessary amendments to the Banking Regulation Act, 1949.

In this context a large corporate/industrial/business house means “a group having total assets of ₹ 5000 crore or more, where the non-financial business of the group accounts for more than 40 per cent in terms of total assets or gross income.”² It is also pertinent to note that such organizations follow an ownership structure where the majority control is within the hands of

¹ RBI, Report of the Internal Working Group to Review Extant Ownership Guidelines and Corporate Structure for Indian Private Sector Banks, (October 2020), <
<https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1160#CP54> > accessed 24th May 2022.

² Ibid pp 52

single individual/ family, who act in concert manner. Such type of ownership structure is called as Block Ownership/Concentrated Ownership, where a firm or a company in which the family has a strong influence on the day to day running of the business.³ Some of the prominent large industrial houses and corporate houses in India are the Tata group, JSW group, L& T group, Jaypee group, Wipro, Adani etc.

Critics have pointed out that granting of banking licenses to such entities shall result in conflict of interest and may lead to connected lending and associated problems. It has also been argued that intra-group lending had helped inflame the 1997 Asian Financial crisis. And fear that same chain of events may repeat had RBI gone ahead with its plan.

Although the said proposal has been turned down, this paper tries to analyze as to how corporate governance measures identified by RBI in its discussion paper on 'Governance in commercial Banks in India'⁴ can play a vital role in ensuring such ownership structure in banking industry can be successful and analyzing what changes needs to be brought about to ensure best corporate governance is in place.

As per the IWG report the main reason as to why large corporate/industrial houses should not be allowed to promote a bank is as follows:

- Existing corporate governance practices in corporate houses is not up to the international standard therefore it will be challenging to ring fence the promoters' non-financial activities from that of the bank.
- The strain in non-financial activity of the promoters might spill over to the banks operations.
- The corporate houses may favour lending to their close business associates or provide their own enterprises undue credit.

³ A. Narayanan, Book Reviews: Sudipt Dutta, Family Business in India, New Delhi: Response Books, 1997, pp. 267, 6 The Journal of Entrepreneurship 256-258 (1997)

⁴ Reserve bank of India, 'Discussion Paper on governance in Commercial Banks in India' (RBI - PRESS RELEASES, June 11, 2020) <<https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR2485B5760C1A541540BBBA3FC460635F60C0.PDF>> accessed 2 August 2022

- They may influence lending by the bank, to finance the supply and distribution chains and customers of the group's non-financial businesses, thereby creating unreported risk to the bank. Regulations on connected lending can be circumvented in a number of ways, and it is challenging to monitor the distribution of money to group concerns because of complicated entity structures and crossholding of capital.⁵

In this regard it is pertinent to carry out the research to look out for best and efficient corporate governance practices that are required to be adopted by banking companies which intends to have block ownership structure or concentrated ownership. As management and operational inefficiencies by such entities will cost us dearer and therefore, we need to have certain checks and balances to tackle the same.

CHAPTER OVERVIEW

This dissertation is divided into three parts. The first chapter is titled 'Banking Industry in India, which discusses the current landscape of the banking industry in India and the latest developments. The chapter also discusses the concept of corporate governance in the banking industry.

The second chapter is titled 'An Examination of The Directions Issued by RBI On Corporate Governance'. This chapter mainly analyses the steps taken by the RBI to enhance the corporate governance practices and provides for certain steps that can be incorporated to suit the guidelines to block ownership patterns in the banking industry.

The final chapter is titled as 'Conclusion', which mainly discuss the importance of having such corporate governance measures and what ought to be the future trend if such measures are to be successful in the practical world, especially in cases of banks operating in block ownership/ Concentrated ownership structure.

RESEARCH QUESTIONS

1. To identify the best corporate governance practices that suits block ownership/ Concentrated ownership structure in banking business? And controls that needs to be

⁵ RBI, Report of the Internal Working Group to Review Extant Ownership Guidelines and Corporate Structure for Indian Private Sector Banks, (October 2020), < <https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1160#CP54> > accessed 24th May 2022

imposed to avoid such commercial prospects from being abused.

2. Evaluating the merits and demerits of the suggestions made by the IWG of RBI on practices to be followed by banks, which intend to have block ownership structure.

CHAPTER 1

BANKING INDUSTRY IN INDIA

1.1. THE CURRENT LANDSCAPE

The banking industry is a vital component to the financial stability of any economy. Unlike the banking system prevalent earlier, the banking institutions in the country today has evolved to not only function as an institution accepting and lending funds but carry out the function of transmission of monetary benefits, achieve better financial inclusion, provide easier access to credit etc The RBI originally had pursued a banking-led strategy to promote greater financial inclusion, but it has since switched to a multi-stakeholder strategy as Fin-Tech firms and telecom service providers have become significant players in the effort to promote inclusive growth⁶. In a way this change can be credited to the development of technology and innovation. As banks today not only recognised for carrying out primary functions but also other functions like providing business credit, cost effective transfer of funds virtually (IMPS, NEFT, UPI), asset management services, investment management etc. This is achieved by the banking industry by operating in an efficient manner by deploying the necessary technology, innovation, and process in place. Today the competition to banking industry is not limited to the counterparts in the industry, but has gone beyond to unknown players dominated by fintech start-ups and other business involved in services relating financial instruments like insurance, investments etc.⁷

The Future of banking will seem entirely different from what it does now due to various evolutionary changes. It is safe to state that "Digital" is the way of the future for banking.⁸ As

⁶ Reserve bank of India, Approach paper on 'National Strategy for Financial Inclusion (NSFI): 2019-2024' [10 Jan 2020] RBI reports <<https://rbidocs.rbi.org.in/rdocs//PublicationReport/Pdfs/NSFIREPORT100119FF91DAA6B73B497A923CC11E0811776D.PDF>> accessed 2 August 2022

⁷ Mrutyunjay mahapatra, 'Leaders must adapt to tomorrow's banking ' (The Economic Times, Mar 18, 2020) <<https://economictimes.indiatimes.com/markets/stocks/news/leaders-must-adapt-to-tomorrows-banking/articleshow/74683777.cms>> accessed 29 July 2022

⁸ Sanjay doshi, 'Future of banking is a digital business model ' (The Economic Times, 15.02.2021)

pointed out by the IWG of RBI in its report there are higher expectations for the banking industry to develop in order to have a bigger role in the global financial system, which is in line with the goal outlined for the country's economic growth to become a \$5 trillion economy.⁹ The Reserve Bank of India began the process for a thorough review of the current standards on licencing and ownership for private sector banks in order to take advantage of these changes for fostering competition and inducing energetic leadership to make use of the novel and efficient banking eco-system via the admission of new players.¹⁰ This has been one of the major reasons as to why large industrial houses/ corporate houses were considered for granting of banking licenses.

1.2. CORPORATE GOVERNANCE

Corporate governance includes those rules and practices by which an organization is led by its leadership in achievement of objectives. Sir Adrian Cadbury has defined corporate governance as “the system by which companies are directed and controlled.”¹¹ It essentially means and includes the system and by-laws of an establishment by which its functions are carried out on daily basis. The primary objective of such a mechanism is to ensure the existence of a preventative system to secure the company assets from misuse for personal gain or in any other manner, thereby making sure that the human resources of the company contribute effectively to the achievement of the company's goals in a transparent manner and act in a manner responsible to the stakeholders of the company.

Any organization that follows good corporate governance practices has the capability to not only withstand domestic financial crises but also to showcase better corporate efficiency by creating a competent management¹². In this connection it is important to be mindful of the fact that enactment of good corporate governance practice perhaps is crucial when weighed against

<<https://economictimes.indiatimes.com/industry/banking/finance/banking/future-of-banking-is-a-digital-business-model/articleshow/80923490.cms>> accessed 1st August 2022

⁹ RBI, Report of the Internal Working Group to Review Extant Ownership Guidelines and Corporate Structure for Indian Private Sector Banks, (October 2020), < <https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1160#CP54> > accessed 24th May 2022 pp 8 (para 1.3)

¹⁰ Ibid

¹¹ Cadbury, A., Comm. Fin. Aspects Corp. Governance, Report of The Committee on The Financial Aspects of Corporate Governance (1992), < <https://ecgi.global/sites/default/files//codes/documents/cadbury.pdf>> accessed on 25th July 2022

¹² Varun Bhat, 'Corporate Governance in India: Past, Present, and Suggestions for the Future' (2007) 92 Iowa L Rev 1429

ownership disputes, succession issues and stakeholder disputes.¹³

Further, as rightly pointed out by Benjamin Franklin “an ounce of prevention is worth a pound of cure”.¹⁴, the need for such an irreplaceable mechanism cannot be more stressed at a time when the inefficiencies and mismanagement in the banking sector has proved to be costly due to the increase in NPA’s and recent episodes like that of YES Bank and Lakshmi Vilas Bank, where it was pointed out that absence of governance measures in place was one of the important reasons for failures¹⁵. Therefore, it is imperative that time has come for right corporate governance practices to be put in place to ensure checks and balances for management and operations of banking industry regardless of its ownership structure.

1.3. CORPORATE GOVERNANCE IN BANKING INDUSTRY

RBI being the regulatory authority has issued a standard framework of governance practices to be followed by banks in its day-to-day operations along with the statutory requirements warranted by the Banking Regulation Act, 1949 and the Companies Act, 2013 and relevant rules there under. The current corporate governance practices followed by banks were due for an overall enhancement. In this regard RBI after due deliberation has issued a circular dated 26.04.2021 titled ‘Corporate Governance in Banks - Appointment of Directors and Constitution of Committees of the Board’ which provides for directions applicable to all privately held commercial and small financial banks on requirement for appointment of directors as well as for setting up of committees.

The key changes suggested by the RBI in the above-mentioned circular are as follows:

- a. The chair of the BOD shall be an independent director. And in absence of the chair of the board, the meetings shall be presided over an independent director. Further, at least half of the directors shall be independent directors.
- b. RBI states that the following committees shall be constituted

¹³ Zisha Rizvi, 'Corporate Governance' (2014) 1 Ct Uncourt 10

¹⁴ Merriam-webster dictionary, 'An ounce of prevention is worth a pound of cure' (Merriam- Webster.com) <<https://www.merriam-webster.com/dictionary/an%20ounce%20of%20prevention%20is%20worth%20a%20pound%20of%20cure>> accessed 2 August 2022

¹⁵ Shakeb akhtar and others, 'YES Bank Fiasco: Arrogance or Negligence' [2021] Vol 3(Issue 2) Emerging Economies Cases Journal <<https://doi.org/10.1177/25166042211061003>> accessed 15 September 2022

- Audit Committee of the Board (ACB) – It shall consist of only non-executive directors (NEDs). RBI has made sure that ACB shall have utmost independence in its working as well as have the capability to have form a professional opinion on its own.
 - Risk Management Committee of the Board (RMCB) – it is mandated that RMCB shall be constituted with at least half of the members attending the meeting being independent directors. The CRO (Chief Risk Officer) shall be the secretary to the RMCB.
 - Nomination and Remuneration Committee (NRC) shall be constituted with only Non-Executive Directors being the members of the committee. The main purpose of the committee being to decide the remuneration of the key managerial personal.
- c. RBI has capped the upper age limit for appointment of non-Executive directors at 75 years, and has mandated that no person shall serve as NED or on the board of the bank for 8 years. And a person can be considered for re-appointment only after a gap of 3 years. RBI capped the remuneration of non-Executive directors at 20 Lakh per annum.
- d. RBI has brought about certain restrictions on the tenure of Managing director, Chief Executive Officer and Whole Time Director and capped their tenure at 15 years. And if such person is a promoter/ major shareholder, they cannot hold these posts for more than 12 years.
- e. Further the above-mentioned appointments are also subjected to statutory approvals. Such personal are eligible for reappointment only after a cooling off period of 3 years, during which they are prohibited from being associated with the bank or its group affiliates in any manner. The upper age limits of persons identified to be appointed as MD, CEO or WTD is capped at 70 years.¹⁶

From bare perusal of the above it becomes clear that although RBI has made bonafide efforts to tackle the issue and certain forthcoming obstacles, the problem yet remains unsolved. In the

¹⁶ RBI circular on 'Corporate Governance in Banks - Appointment of Directors and Constitution of Committees of the Board', 26th April, 2021 < <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/24CORPORATE68CA91B159A2408DB3EBC479471DD2B4.PDF>> accessed 2nd August 2022

next chapter we shall understand the practical challenges in implementing the said guidelines of RBI.

CHAPTER 2

AN EXAMINATION OF THE DIRECTIONS ISSUED BY RBI ON CORPORATE GOVERNANCE

2.1. ANALYSIS AND SUGGESTIONS

At the outset, the guidelines issued by RBI and the contents of the discussion paper¹⁷ are applicable to all the Private Sector Banks including Small Finance Banks (SFB)s regardless of the ownership pattern in one size fits all fashion. In other words, the proposed corporate governance directions have been prepared in a manner, not taking the ownership structure into account and therefore is not entirely suitable as standard guideline to all the banks due variations in management style, talent acquisition, Human resource management because of their ownership structure.

Given the fact that a master circular on corporate governance practices is yet to be released by RBI, the contents of the discussion paper¹⁸, which RBI intends to convert as guidelines on corporate governance as well the directions issued via circular mentioned above are being considered for analysing the limitations, which are as follows:

2.1.1. Independence of the Independent Directors

RBI as well as other statutes governing the banking companies have always pointed out the need for efficient Independent Directors at the board. The Supreme court in the case of Tata Consultancy Services Ltd. v. Cyrus Investments (P) Ltd.,¹⁹ has also pointed out the statutory mandates with regards to independent directors contemplated by the Companies Act,2013 and emphasizes on how it helps in corporate governance.

However, it is pertinent to note that there is no solid mechanism to through which such independent directors can be identified and appointed in a transparent and effective manner

¹⁷ Ibid

¹⁸ Ibid

¹⁹ Tata Consultancy Services Ltd. v. Cyrus Investments (P) Ltd. (2021) 9 SCC 449

especially in cases of private companies.

In this context “Independent directors are directors who apart from receiving director’s remuneration do not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in the judgement of the board may affect their independence of judgement”²⁰ There can be true independence in the advices or decisions rendered by independent directors only when their appointment, remuneration and removal are carried out in an independent and transparent manner. Another major cause of concern in such appointments is the availability of independent director. Currently the process of identification and appointment of independent directors is carried out with the help of Indian Institute of Corporate Affairs that empanels and provides necessary assistance to the companies to find independent directors. However, this procedure is only mandated in case of public companies dealing with listed securities as per Companies (Appointment and Qualification of Directors) Rules, 2014. Therefore, to address the issue of finding appropriate personal for appointment as independent director, it is desirable that RBI identifies the necessary qualification and eligibility criteria that must be complied before such persons can empanel with the Indian Institute of Corporate Affairs (authorised agency) for the purposes of becoming independent directors at banks. And banks must be directed to appoint independent directors only from such pool of candidates. Thus, ensuring that neither the board nor any interested person interferes in the appointment process.

An earlier practice mandated RBI to recommend a director to the board of scheduled commercial bank. Thus, gaining the trust of the public, however the same has been stopped due conflict of interest, where in it was pointed out that RBI was acting as the sector regulator as well as part of the team involved in operations of the business. The implementation of the above mechanism would ensure that there are no issues of conflict of interest on the other hand can also help in ensuring that appointment of independent directors is impartial

2.1.2. Scope of Risk Management Committee of the Board (RMCB)

The RBI’s decision to set up a Risk Management Committee is welcoming and a step in the right direction that is based on the Basel committee’s report²¹. However, it has failed to list

²⁰ Securities and Exchange Board of India, Clause 49 - Corporate Governance, revised in 2014, <https://www.sebi.gov.in/sebi_data/commondocs/cir2803an1_p.pdf> accessed 2nd August 2022

²¹ Bank for international settlements, 'Guidelines Corporate governance principles for banks' [2015] Basel Committee on Banking Supervision <<https://www.bis.org/bcbs/publ/d328.pdf>> accessed 3 August 2022

down the appropriate functions and responsibilities of such a committee.

The circular issued by RBI makes no mention of the roles and responsibilities of risk management committee, in this regard the guidelines laid down in the discussion paper on 'Governance in Commercial Banks in India' that was reiterated by the National Company Law Appellate tribunal in the case of *Deloitte Haskins and Sells LLP and Ors. vs. Union of India and Ors*²² may be used as the benchmark. The tribunal has identified the following to be the responsibilities of the Risk Management Committee of the Board, (RMCB)

- i. Periodically evaluating the adequacy of the operational processes and risk management framework created for new enterprises and products
- ii. providing advice on how to enhance risk management strategies to address new national and international market and regulatory trends;
- iii. approval of overall restrictions on the supervision of market, liquidity, and credit risks;
- iv. reviewing asset liability management reports and providing recommendations on policy guidelines for liquidity and interest rate risk;
- v. assessment of the Company's capital adequacy requirements and presentation of recommendations for the Board's consideration about the criteria to be taken into account in this respect;
- vi. an assessment of the company's compliance programme,
- vii. monitoring the status of enquiries, investigations, or other disciplinary measures undertaken by the RBI, SEBI, or other regulatory organisations²³

2.1.3. Additionally, it is also desirable that following may incorporated as the responsibilities of RMCB in cases where block ownership structure is followed

²² *Deloitte Haskins and Sells LLP and Ors. vs. Union of India and Ors.* (04.03.2020 - NCLAT) : MANU/NL/0162/2020

²³ *Ibid* (Deloitte Haskins Vs.U.O. I)

viii. disclosure of merger or acquisition by the shareholder having controlling stake to the risk committee, to point out red flags or future threats.

ix. To deal with the problem of intra group lending, it is desirable to make it mandatory to have Effective risk identification and measurement approaches as a corporate governance measure in at least in those group companies which deals with financial assets to ensure there is firewall in place to stop the pilferage from such organizations into banks owned by the group.

2.1.4. The core assets of a bank are the loans and advances it provides. In this connection a cause of concern that affects the economic stability of banks are the quality of its assets²⁴, which ought to provide return on investments. However, if such loans are not repaid to the bank in time, it becomes difficult for the bank to repay its customers on time, therefore making it a necessary norm to classify such assets as NPA. A Non-performing Asset (NPA) 'means any asset or account receivable of a borrower that has been categorized as substandard, dubious, etc. by banks or financial institutions in accordance with the RBI Guidelines.'²⁵

The lack of a reliable system for credit assessment, insufficient post-credit disbursal supervision, and ineffective recovery measures have been identified as the main causes of the banking industry's underlying weakness²⁶. The foregoing factors also had a significant influence on the steadily rising NPAs on bank balance sheets.

However, things turn out from bad to worse when such assets are not classified or identified in accordance with statutory norms. Although circulars by RBI have made it clear that declaring a wilful defaulter and NPA is a banker's obligation that is to be carried out through an internal procedure. The banks have always tried to showcase a rosy picture of the quality of its assets (proportion of NPA against loans disbursed) keeping the business perspective in mind. Further, citing the said circulars the Delhi HC has also reiterated the same holding that 'the decision to declare an asset a non-performing asset (NPA) is based on RBI rules rather than the whims and desires of banks and financial institutions. Furthermore, the Court made it clear that the Banks must follow RBI directives and guidelines because they have a statutory flavour and will help

²⁴ Shakeb Akhtar and others, 'EXAMINE THE KEY DRIVERS AFFECTING BOTTOM LINE: A PANEL ESTIMATION STUDY OF INDIAN COMMERCIAL BANK' [2020] Vol 7, (Issue 9) Journal of Critical Reviews 1114

²⁵ ICICI Bank Limited v. Official Liquidator of APS Star Industries Limited, (2010) 10 SCC 1

²⁶ Ishani Narain and Garima, A New Perspective on Dealing with Stressed Assets in India: An Insight into RBI's Role in Stressed Assets Management Post 2014, (2017) 2.2 JCLG 69

to raise the standard of the Banks' assets. As a result, following the 90-day default period, the Banks are required to identify bad loans as NPAs²⁷.

In this regard to ensure that the asset quality of the banks is frequently monitored in a manner comparable to how the financials are examined by the auditors, it is imperative that a system be put in place. The need for similar mechanism has also been stressed by RBI as well²⁸. In this regard a process like that of the AQR (Asset Quality Review) that aims to identify and classify assets as stressed or sustainable to a gain clearer understanding of the proportion of bad debts,²⁹ may be adopted. Its effectiveness was evident when it was used by RBI in 2016 to bring out the true numbers in relation to NPA. As a result of carrying out the AQR it shall evade the possibility of related party transaction, risk appetite, thereby ensuring better financial stability of the bank.

2.1.5. To address the issue gaining the trust of the public especially in cases where banks have block ownership structure, it is advisable there exist rating system based on appropriate criteria. Such mechanism is prevalent in jurisdictions like USA, where the financial institutions overall condition is given a rating based on a system known as CAMELS rating System. The main factors considered for such a rating are capital adequacy, assets, management capability, earnings, liquidity, sensitivity. In the Indian context a similar rating exercise may be undertaken either by the RBI or such other institutions identified based on the criteria laid down by the RBI and may be published to enable the public to judge the financial strength and weakness of the bank.

2.1.6. Fairness and transparency are core tenets of corporate governance. And in pursuance of this, an important aspect to be complied is information dissemination. Banking industry being one such unique one which may be considered as the material resources of the community since it is utilised as a vehicle to achieve social objectives in an economy. Regardless of the ownership structure it is important to bear in mind that banks are vital ingredients of an economy. Therefore, the sector specific regulator 'RBI' which collects information from banks needs to make such information available to the public. The information collected includes data

²⁷ *Holystar Natural Resources Pvt. Ltd. v. Union of India*, 2014 SCC OnLine Del 230

²⁸ RBI, 'Annual Report 2020-2021' (Reserve Bank of India, 24th May 2021) <https://rbidocs.rbi.org.in/rdocs/AnnualReport/PDFs/0RBIAR202021_F49F9833694E84C16AAD01BE48F53F6A2.PDF> accessed 15 September 2022

²⁹ Shani Narain and Garima, A New Perspective on Dealing with Stressed Assets in India: An Insight into RBI's Role in Stressed Assets Management Post 2014, (2017) 2.2 JCLG 69

regarding top defaulters, outstanding loans, investigations and audit reports regarding the bank, investigations relating to any of its KMP/senior executives etc.

Such a measure from the corporate governance perspective, where such information is made available to the public through due process helps in determining the banks operational as well as financial condition thereby ensuring that the banks need to have competitive mindset rather than a compliance mindset. However, the same shall be subject to the fact that the said information being provided is factually correct.

The Apex court in the case of Reserve Bank of India v. Jayantilal N. Mistry,³⁰ has categorically held that in a case where information is sought from RBI under right to information about the working or financial health of a bank dealing with the public money, although it included information about the top defaulters of the bank, the particular procedures and process that has been adopted, penalties imposed, outstanding loans and its details etc, RBI is liable to provide the same. The Court reiterated the same in a subsequent decision between the same parties.³¹

The aforementioned measures address the issues of accountability, transparency, and independence and may be regarded as credible solutions to the problems that are currently causing concern to the stakeholders in the industry, even though they aren't the de facto solutions to all of the problems within the industry.

CHAPTER 3

CONCLUSION

Banks are considered as institutions that have a social character, regardless of their ownership structure or size as they deal with public money and therefore a duty arises to ensure that stakeholder interest is not siphoned off. Further, when such banks carry out business with concentrated ownership structure, where the majority stake with respect to ownership rests with a set of individuals who are close or act in concert manner or are connected by relationships, it becomes more complicated and therefore it is necessary to ensure that there are certain policy measures adopted to keep abuse or misuse of such business prospect in check.

³⁰ RBI v. Jayantilal N. Mistry, (2016) 3 SCC 525

³¹ RBI vs. Jayantilal N. Mistry & Anr LL 2020 SC 233

Although necessary policies, guidelines have been adopted when deemed fit by the banks in general, such policies were in nature of damage control rather than being preventive in nature or were an update to an earlier statutory guidelines etc. However, such measures were always aimed at banks that were either state controlled or commercial banks that had diversified ownership rather than a single person or a company holding the majority stake.

Corporate governance was first conceptualised and studied for private listed companies. This was because of stock exchanges and other private institutions' self-regulatory efforts, which either had admission requirements or established recommendations for good corporate governance, typically with corporate governance codes, and occasionally with the assistance of the comply or explain-principle established by legislators³²

One such code which is in nature of self-regulation measure is the Dutch banking code that extends to all activities carried out in the Netherlands by banks that have been issued a banking licence under the Financial Supervision Act. It uses the 'comply or explain' principle, which covers aspects like Sound and ethical conduct of business, guidelines pertaining to supervisory and management board, risk policy, remuneration policy and Audit policy.³³

As a result, banks following the said code have enacted policies pertaining to - "(1) Code of Conduct (2) Bankers Oath (3) Conflict of Interest Policy (4). Personal Account Dealing Policy (5) Outside Business Interests Policy (6) Competition Policy (7) Complaints Policy (8) Incident Reporting Policy (9) Handling of Material Non-Public Information (MNPI) and Confidential Information Handling Policy. (10) Whistleblowing Policy"³⁴. And therefore, is considered as an aspirational benchmark and has been recommended by institutions such as the EBA³⁵, Basel

³² (Klaus J. Hopt, 'Corporate Governance of Banks and Financial Institutions: Economic Theory, Supervisory Practice, Evidence and Policy' [2021] 22(0) European Business Organization Law Review <<https://doi.org/10.1007/s40804-020-00201-z>> accessed 9 September 2022)

³³ Netherlands bankers' association, 'Codes of Conduct' (*Netherlands Bankers' Association website*, 2010) <<https://www.nvb.nl/english/codes-of-conduct/>> accessed 10 August 2022

³⁴ MUFG bank (Europe) NV, 'Implementation status as per April 2020' (Dutch Banking Code, April 2020) <<https://www.nl.bk.mufg.jp/media/1211/180329-dutch-banking-code-website-version.pdf>> accessed 15 September 2022

³⁵ European banking authority, 'FINAL REPORT ON GUIDELINES ON INTERNAL GOVERNANCE UNDER DIRECTIVE 2013/36/EU' [2017] European Banking Authority <<https://www.eba.europa.eu/regulation-and-policy/internal-governance/guidelines-on-internal-governance-revised->> accessed 3 August 2022

Committee³⁶ and the FSB³⁷.

In this context the usage of corporate governance as an effective tool may turn out to be a viable option in ensuring zero tolerance against mismanagement in case of concentrated ownership structure. Corporate governance measures play a pivotal role in ensuring that an establishment functions smoothly in a procedural manner to make good to all the stakeholders involved as it provides a sense of direction as well control over the subject matter that it intends to govern. Corporate governance today has matured to a level where it is considered as the most efficient solution to ensure effective management and operation within enterprises, due to the fact that it provides operational level clarity and guidance, if implemented in the right manner.

As most of the corporate governance measures are considered as internal controls that are based on the standards prescribed by the regulations, a startling feature of corporate governance is that they provide a framework of standards and etiquette within which the enterprise shall operate and thus can be adaptable to the changing needs in a more flexible manner in case amendments are necessary, as opposed to statutory norms or regulations, as there is a necessity for such changes to be brainstormed and then approved by the regulator, making it a time consuming process.

Further, 'due to its function in preventing unfair business practises by companies and so maintaining their long-term sustainability, corporate governance is becoming increasingly important in management'.³⁸ 'Clean corporate governance structures enable monitoring of supervisory and administrative movements and, as a result, mitigate corporate risks that may be the outcome from the malfeasance of employees.'³⁹

In the context of block ownership structure corporate governance measures shall be more reliable due to the fact that the challenges and obstacles pitch in from different directions (e.g.,

³⁶ Bank for international settlements 2015, 'Guidelines Corporate governance principles for banks' [2015] Basel Committee on Banking Supervision p5 <<https://www.bis.org/bcbs/publ/d328.pdf>> accessed 3 August 2022

³⁷ Financial stability board, 'Thematic Review on Corporate Governance' [2017] FSB- Peer Review Reports <<https://www.fsb.org/wp-content/uploads/Thematic-Review-on-Corporate-Governance.pdf>> accessed 3 August 2022

³⁸ Wasdani, K. P., Vijaygopal, A., Manimala, M. J., & Verghese, A. K. 'Impact of Corporate Governance on Organisational Performance of Indian Firms' (2021). Vol 14(2), Indian Journal of Corporate Governance,180. <<https://doi.org/10.1177/09746862211047396>> accessed 15 September 2022

³⁹ Vivek Malhotra & Rohan Aniraj, 'Corporate Governance Failures in India' (2021) 4 Int'l JL Mgmt & Human 4176

succession planning, maintaining business etiquettes within the group companies etc) which needs adaptive and out of the box solutions.

As previously stated, connected lending, conflict of interest are larger concerns that needs to be addressed. Although the actions listed above are not comprehensive, they do help to alleviate the concerns that have surfaced. Corporate governance is critical for developing a corporate culture of transparency, accountability, and disclosure.⁴⁰ A strong Board of Directors comprising the necessary number of independent directors, measures such as disclosure of information to ensure transparency and accountability shall have far reaching effect if followed ritually.

Thus, corporate governance practices, needs to be looked into, reviewed, and revised as when required, so as to ensure objective of implementing the same is achieved. In this regard any practice that are in accordance with the 'principles of corporate governance namely, Transparency, Accountability, and Independence'⁴¹ can be considered appropriate.

When corporate governance is employed as a tool to address any issue, it is always pertinent to bear in mind that the end result of corporate governance measures should ensure accountability to the stakeholders they serve in order for such a control mechanism to survive.

⁴⁰ Ibid

⁴¹ Anjali Singh, 'Corporate Governance Regime in India: An Exigency for Reform' (2022) 5 Int'l JL Mgmt & Human 929