AN ANALYSIS OF CORPORATE FINANCIAL CRISIS AND CORPORATE GOVERNANCE

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ABSTRACT

Banking as a sector has been unique and the interests of other stakeholders Appear more important to it than in the case of non-banking and non-finance Organizations. In this case, of traditional manufacturing corporations, the issue has Been that of safeguarding and maximizing the shareholders' value. In the case of Banking, the risk involved for depositors and the possibility of contagion assumes Greater importance than that of consumers of manufactured products. Further, the Involvement of government is discernibly higher in banks due to importance of Stability of financial system and the larger interests of the public. Since the market control is not sufficient to ensure proper governance in banks, the government does See reason in regulating and controlling the nature of activities, the structure of bonds, The ownership pattern, capital adequacy norms, liquidity ratios, etc. About four-fifths Of the banking business in India is under the control of public sector banks. This Phenomenon complicates the corporate governance since the effective management Vests with the government, while top management and board of banks operate merely As functionaries. It is time that the nation debates whether corporate governance is Compatible with the present form of public ownership as it makes the head of the Institution accountable to political institutions. In view of this dichotomy, even the Dilution of government holdings to below 51% cannot guarantee good corporate Governance practices, unless the government defines its very role de novo. The Joint Parliamentary Committee on Stock Market Scam observes that it is imperative for Banks to follow strategies and techniques basic to all tenets of corporate governance. From a banking industry perspective, corporate governance involves the manner in Which their boards of directors and senior management govern the business and Affairs of individual banks, affecting how banks set their corporate objectives, run Day-to-day operations, consider the interests of various Stakeholders and corporate Activities with the expectation that banks will operate in a safe and sound manner and In compliance with applicable laws and regulations and protect the interests of Depositors. Indian Banking productivity Excellence has

> perennial relevance, but is Much more relevant now, as going forward incremental growth will depend increasingly on productivity growth. India witnessed remarkable growth acceleration in the years before the crisis; many of the factors that aided this have been acknowledged. But, as it had seen before, one of the unacknowledged drivers of that growth performance has been the improvement in the quantum and quality of financial intermediation led by the commercial banking sector. It is needed to build on that achievement, and productivity improvement is by far the most vital instrument for doing so.

Corporate Governance in Indian Banking Industry

To initiate and establish Corporate Governance in banks, an Advisory Group On Corporate Governance was formed under the chairmanship of Dr. R.H. Patil. Following the recommendations of Advisory Group another Consultative Group was Constituted under the chairmanship of Dr.A.S.Ganguly. The purpose of Consultative Group was purely to strengthen the internal supervisory role of the Boards of Indian Banks. Further this move was supported by the observations of Advisory Group on Banking Supervision under the chairmanship of Shri M.S.Verma which submitted its Report in January 2003. Observing the all these recommendations with cross-country Experience, the Reserve Bank of India initiated several measures to strengthen the Mechanism of corporate governance practices in the Indian Banking Sector. Indian banking sector comprises both public and private banks having a basic Difference of government's intake and control of Reserve Bank of India upon them by and large the current regulatory framework has uniform treatment of Public and Private Sector Banks so far as the practical aspects of banks are concerned. Some of The governance aspects of Public Sector Banks on the ground of prudential matters are Exempt from the applicability of the relevant provisions of the Banking Regulation Act because they are largely regulated by their respective constitution under which Various Public Sector Banks were set up. Consequently the approach of Reserve Bank Of India has been to guarantee, to the extent possible, uniform treatment of the Public Sector Banks and the Private Sector Banks with regard to practical and technical Regulations. So far as the governance aspects of Banking are concerned the Reserve Bank of India prescribes its policy framework time to time. Reserve Bank of India Also suggests the Government of India the uniform framework and policy prescription For adoption with consistent legal imperatives in Banks.

Corporate Governance in Banks and Companies Bill 2012

Because Banks are financial institutions hence Banks don't come under the Purview of definition of Company according to the Companies Act. Banks are Particularly regulated by their respective legislations. However banks are also listed in The stock exchange hence clause 49 of listing agreement of corporate governance Automatically applies to banks also. Further all banks have boards of directors for the Management and since role of directors form the basis for effectiveness Implementation of corporate governance in banks, it is necessary a code of conduct For the Independent Directors that comes under the purview of Schedule IV [section 149(7)] as prescribed in Companies Act 2013 for the guidance to the companies. Adherence to these standards by independent directors and fulfilment of their Responsibilities in a professional and faithful manner will promote confidence of Investment community, particularly minority shareholders, regulators and companies In the institution of independent directors. The extent of companies act applies to Banks only where that doesn't violate their respective legislations. Codes of Conduct For Independent directors are following:

Guidelines of professional conduct:

An independent director shall:

1. Uphold ethical standards of integrity and probity;
2. Act objectively and constructively while exercising his duties;
3. Exercise his responsibilities in a bona fide manner in the interest of the company;
4. Devote sufficient time and attention to his professional obligations for informed and balanced decision making;
5. Not allow any extraneous considerations that will vitiate his exercise of objective Independent judgment in the paramount interest of the company as a whole, while concurring in or dissenting from the collective judgment of the Board in its Decision making;

6. Not abuse his position to the detriment of the company or its shareholders or for the purpose of gaining direct or indirect personal advantage or advantage for any Associated person;

7. Refrain from any action that would lead to loss of his independence;

8. Where circumstances arise which make an independent director lose his Independence, the independent director must immediately inform the Board accordingly;

9. Assist the company in implementing the best corporate governance practices.

II. Role and functions :

The independent directors shall:

1. Help in bringing an independent judgment to bear on the Board's deliberations Especially on issues of strategy, performance, risk management, resources, key Appointments and standards of conduct;

2. Bring an objective view in the evaluation of the performance of board and Management;

3. Scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance;

4. Satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible;

5. Safeguard the interests of all stakeholders, particularly the minority shareholders;

6. Balance the conflicting interest of the stakeholders;

7. Determine appropriate levels of remuneration of executive directors, key managerial personnel and senior management and have a prime role in appointing and where necessary recommend removal of executive directors, key

managerial personnel and senior management; 8. Moderate and arbitrate in the interest of the company as a whole, in situations of conflict between management and shareholder's interest.

III. Duties:

The independent directors shall :

1. Undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company;

2. Seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company;

3. Strive to attend all meetings of the Board of Directors and of the Board Committees of which he is a member;

4. Participate constructively and actively in the committees of the Board in which they are chairpersons or members;

5. Strive to attend the general meetings of the company;

6. Where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the minutes of the Board meeting;

7. Keep themselves well informed about the company and the external environment in which it operates;

8. Not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board;

9. Pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the Interest of the company;

10. Ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use;

11. Report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy;

12. Acting within his authority assist in protecting the legitimate interests of the company, shareholders and its employees;

13. Not disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law

Corporate Governance in Banks and Role of SEBI

The Securities and Exchange Board of India (SEBI) has circulated its corporate governance standards of clause 49 on February 21, 2000 to all stock Exchanges for implementation by listed entities. At the time of issuing of this circular Clause 49 of the listing agreement were exempted by body corporate such as public and private sector banks, financial institutions, insurance companies and those Incorporated under separate statute. Later on SEBI suggested to RBI to consider Issuing suitable guideline to banks and financial institutions so as to ensure that all Listed companies would have uniform standard of corporate governance. After SEBI Initiative followed by RBI it became mandatory to all commercial banks to comply with the Clause 49 of listing agreement.

Corporate Governance in Banks and Basel Committee

On 4 October 2010, the Basel Committee on Banking Supervision (BCBS) published a set of principle for enhancing corporate governance in banks. The Principles are intended to provide targeted supervisory guidance. BCBS published initial guidance on corporate governance practices in 1999 and revised principles in 2006. BCBS launched a public consultation in March 2010 to address deficiencies which came to light since the financial crisis. The principles should be considered in the context of the wider regulatory drive to strengthen corporate

governance and Restructure executive compensation practices for financial institutions. The main principles enunciated by the Basel Committee are as under:

- The board has overall responsibility for the bank, including approving and overseeing the implementation of the banks' strategic objectives, risk strategy, corporate governance and corporate values. The board is also responsible for providing oversight of senior management.

- Board members should be and remain qualified, including through training, for their positions. They should have a clear understanding of their role in corporate governance and be able to exercise sound and objective judgement about the affairs of the bank.

- The board should define appropriate governance practices for its own work and have in place the means to ensure that such practices were followed and periodically reviewed for ongoing improvements.

- In a group structure, the board of the present company has the overall responsibility for adequate corporate governance across the group and ensuring that there are governance policies and mechanism appropriate to the structure, business and risks of the group and its entities.

- Under the direction of the board, senior management should ensure that the Banks' activities are consistent with the business strategy, risk tolerance/ appetite and policies approved by the board.

- Banks should have an effective internal controls system and a risk management function with sufficient authority, stature, independence, resources and access to the board.

- Risks should be identified and monitored on an ongoing firm- wide and individual entity basis, and the sophistication of the banks' risk management and inter control infrastructure should keep pace with any changes to the banks' risk profile and to the external risk landscape.

- Effective risk management requires robust internal communication within the banks about risk, both across the organisation and through reporting to the board and senior

management.

- The board and senior management should effectively utilize the work conducted by internal audit functions, external auditors and internal control functions.

- The board should actively oversee the compensation system's design and operation, and should monitor and review the compensation system to ensure that it operates as intended.

- An employee's compensation should be effectively aligned with prudent risk taking: compensation should be adjusted for all types of risk; compensation outcomes should be symmetric with risk outcomes; compensation payout schedules should be sensitive to the time horizon of risks; and the mix of cash, equity and other forms of compensation should be consistent with risk alignment.

- The board and senior management should know and understand the bank's operational structural and the risks that it poses (know your structure).

- Where a bank operates through special purpose or related structure or in jurisdiction that impede transparency or do not meet international banking standards, its board and senior management should understand the purpose, structure and unique risk of these operations. They should also seek to mitigate the risk identified (understand your structure)

- The governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participations.

  Thus, for any organisation every individual has a definite role to play for ensuring the good corporate governance. Certainly the corporate governance is the collective and joint effort.

Reserve Bank's approach

The Reserve Bank initiated several measures to strengthen the corporate governance in the Indian banking sector. In June 2002, the report of the Ganguly Group was transmitted to all the banks for their consideration while simultaneously transmitting it to the Government of India

for appropriate consideration. It may be noted here that there is a basic difference between the private sector banks and public sector banks as far as the Reserve Bank's role in governance matters relevant to banking is concerned. The current regulatory framework ensures, by and large, uniform treatment of private and public sector banks by the Reserve Bank in so far as prudential aspects are concerned.

As a follow-up of the Ganguly Committee report, in Mid-Term Review the Monetary and Credit Policy in November 2003, the concept of 'tit and proper criteria for directors of banks was formally enunciated, and it included the process of collecting Information, exercising due diligence and constitution of a Nomination Committee of the Board to scrutinize the declarations made by the bank directors. In this regard, it will be useful to refer to the RBI guidelines on ownership and governance in the private sector banks released recently.

The existing legal provisions in regard to banks stipulate specific areas of background that a director should be drawn from such as accountancy, banking, economics, finance, agriculture, etc., but do not specify the extent or degree of professionalism or expertise required in regard to that area. Hence, it is left to the good faith of the shareholders to elect directors from the various specified areas with qualifications and experience that is appropriate to the bank. The position in regard to the CEOs of the private sector banks is on a different footing where the RBI is in a position to exercise its judgment on the suitability of the candidate s proposed; in as much as the approval of the Reserve Bank is required for the appointment and the RBI may seek removal also. These provisions are broadly consistent with global best practices though there is scope for enhancing effective implementation. The appointment of the CEOs in the public sector banks, as well as their removal, is also a matter to be decided only by the Government of India. There is, however, active consultation with the Reserve Bank in regard to appointment of CEOs.

The Public Accounting Reform and Investor Protection Act is the most significant piece of United States (U.S.) corporate governance law introduced in the twenty-first century. The Sarbanes-Oxley Act of 2002 (SOX) is the name given to it in most contexts. On July 30, 2002, SOX became law. It was enacted in response to the Enron, Tyco International, and WorldCom scandals, among other things. The connected companies' share values fell precipitously as a result of these scandals, which also caused investors to lose faith in the accuracy of the companies' financial statements and the stability of the American financial system.

The U.S. financial system suffers from the corporate governance norms and regulations' reactionary genesis. [1] Corporate governance needs to take a more proactive approach if it wants to lessen the impact of upcoming scandals and crises.

The most recent significant corporate governance law, SOX, contains a number of unique elements. Following the publication of each, a line of research examined the ramifications, costs, and benefits of the provision for businesses. What benefit does corporate governance have for businesses? is the main question that these research strands aim to address. The solution is still a mystery over 15 years after corporate governance laws and guidelines were reinforced. However, the direct answer to the issue is not the goal of this study. Instead, it looks at how main SOX requirements have affected American businesses as a whole and makes suggestions on how to strengthen corporate governance. These suggestions are made to assist academics and policymakers in modernising and maximising corporate governance laws and regulations. These suggestions cover the following ideas:

Creating proactive corporate governance, using corporate governance meta-analyses, grounding research in theories other than the conventional agency theory, planning for corporate governance convergence, disclosing board interlocks, and considering and embracing blockchain as a disruptive technology are just a few of the steps that should be taken.

This study makes several contributions to the literature on corporate governance. It first offers information on current governance regulations in the United States. Second, it makes policymakers, practitioners, and academics more aware of the need for further thought regarding the scope of corporate governance in order to improve the advantages of businesses' governance. Third, it expands the scant literature on corporate governance norms, rules, and world financial crises.[2]

The rest of this essay is structured as follows. The ramifications of SOX for businesses are covered in section two. The third section offers suggestions for extending the scope of corporate governance and maximising benefits to businesses. The fourth section includes a summary and last thoughts.

[1] El-Mahdy and Norman, 2010
[2] Kumar, 2013; Tarraf, 2010; Yeoh, 2010

SIGNIFICANCE OF STUDY

The Steering Group's analysis of corporate governance weaknesses in remuneration, risk management, board practices and the exercise of shareholder rights concludes that, at this stage, there is no immediate call for a revision of the OECD Principles. In general, the Principles provide for a good basis to adequately address the key concerns that have been raised. A more urgent challenge for the Steering Group is to encourage and support effective implementation of already agreed standards"

REVIEW OF LITERATURE

The present thesis is a doctrinal study dealing with a very broad issue. Utilized research tools have been coordinated in way so as to highlight and analyse the issue in the most efficient form. This study could not have been completed without exhaustive review of existing literature.

In his paper – *An analysis of financial corruption under the ambit of International Commercial Law*, Smaranika Sen (2021)[3] suggested that Corruption is a hurdle in the development of society. It disrupts the economy, financial stability, and democracy of the country. It is like a termite in the system. Once it enters the system, it goes on increasing. It is difficult to remove corruption from its roots. Corruption is practised by especially the people in authority committing dishonest or illegal acts like bribery. The practice of corruption has been prevalent for a long time. As per Corruption Perception Index Report, 2020, almost two-third of 180 countries have scored below 50, where a hundred means clean and zero means highly corrupt. This shows that a lot of countries fall under the radar of corruption.

The *UNITED NATIONS OFFICE ON DRUG AND CRIME, 2021*[4] entitled " LEGISLATIVE GUIDE FOR THE IMPLEMENTATION OF THE UNITED NATIONS CONVENTION AGAINST CORRUPTION " that conducts an In its resolution 58/4 of October 31, 2003, the General Assembly adopted the United Nations Convention against Corruption. The current practical legislative guide's purpose is to support States seeking to ratify and implement the Convention by outlining the legislative requirements, problems that may arise.

[3] http://www.oas.org/en/sla/dil/docs/inter_american_treaties_b-58_against_corruption.pdf
[4] https://www.unodc.org/pdf/corruption/CoC_LegislativeGuide.pdf