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ETHICS AND CORPORATE GOVERNANCE IN BANKS

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Abstract

The literature on corporate governance covers a range of issues such as protection of shareholders' rights, enhancing shareholders' value, Board issues including practices, the control systems, in particular internal control systems. Banks have some unique features that make their corporate governance different from, and more complicated than, that of other firms. For e.g., their balance sheets are not very transparent, they are highly leveraged, they typically have short-term liabilities and longer-term assets, they are heavily regulated and have access to government safety nets, and they are systemically very critical organizations. This paper seeks to identify the major issues in corporate governance in banks in India and to provide suggestions for possible action by the Reserve Bank of India as banking regulator. These issues relate to the composition of the Board of Directors and the duties of members, the functions of the board, the committees of the board, preventing abusive related party transactions and disclosures. The paper makes me suggestions as to the role of the Reserve Bank of Indiain strengthening corporate governance in Indian banks in the public as well as the private sector.

Keywords: Corporate governance in banks, financial crisis, Reserve Bank of India

I Introduction

In the present scenario, 'Ethics' and 'Corporate Governance' have become key words for any successful organization, especially in the financial sector where large amount of monetary transactions are involved. The corporate governance in the financial sector, mainly in banks, clearly has severe implications for the stability of the economy. 'Ethics are rules of behaviour

used by individuals or professionals to decide what is right and wrong in the normal course of life or of business whereas corporate governance is the rules and practice that govern the relationship among all the stakeholders of the organization. Corporate governance is a voluntary ethical code of business of companies/organizations, by which companies/organizations are directed and controlled. It comprises a set of various processes and systems aimed at ensuring that the company is keen in managing best interests of all stakeholders.During the end of 20th century, public confidence in corporate governance came down due to a number of scandals in companies/organisations. This prompted the government of United States to enact the Public Company Accounting Reforms and Investor Protection Act. The act is popularly known as the Sarbanes-Oxley Act of 2002. It laid out certain legal obligations for privately held and publicly traded corporations, with an aim to improve accountability. Canada followed this act with Bill C-198 which is identical in principle, but with a few variations in accountability and execution.In 1991, the London Stock Exchange set up a Committee under the chairmanship of Sir Adrian Cadbury to help raise the standards of corporate governance and the level of confidence in financial reporting and auditing.The Cadbury Committee Report has since become the basic document for corporate governance all over the world. This report suggests an ethical alignment of individuals, corporations, and the economic system, which is captured in the definition of corporate governance offered by Cadbury and adopted by the World Bank. A strong work ethics is vital to any organization in achieving goals. It energizes every staff member to face the challenges head-on, to be the best and keep themselves at the top place. Any adverse incident or news will affect the business, bottom line and most importantly the reputation. Thus, the solution is to foster and maintain a strong work ethics. When ethics and corporate governance go hand in hand, the success of an organization is inevitable. As far as banks are concerned, under corporate governance, the board of directors are responsible for a range of issues such as protection of shareholders' rights, enhancing shareholders' value, board issues including practices, the control systems, particularly internal control systems and business & organizational decisions. Corporategovernance in banks, however, is different and more complex than the corporate governance in other firms.

Literature Review

Significance of corporate governance in banks:

As in any organization, good corporate governance in banks regulates the relationship between banks' stakeholders, their boards and their management. It prevents the misuse of power and self-serving conduct, restricts indiscreet and high risk behavior by bank officials, and resolves conflicts of interest between managers and board members on theone hand and shareholders and depositors on the other. Corporate governance deals with how a corporate is governed. Corporate governance promotes three main pillars of any ethical organization, i.e. corporatefairness, transparency and accountability. Some of the objectives of corporate governance are – attaining disclosure and transparency in the way corporate is governed, fixing accountability of controllers and managers towards other stakeholders, fixing corporate responsibility, integrity and probity in financial reports, etc. Corporate governance becomes imperative in today's globalized world where corporations need to access global pools of capital, need to attract and retain the best human capital from various parts of the world and to live in harmony with the community. The concept of corporate governance in India is fairly recent, where the Confederation of Indian Industry (CII) set up a task force under Rahul Bajaj in 1995. On the basis of this, CII released a voluntary code called "Desirable Corporate Governance" in 1998. SEBI also established a few committees towards corporate governance of which the notable are:Kumarmanlagam Birla report (2000), Naresh Chandra Committee (2002) and Narayana Murthy Committee (2002). While the Kumarmangalam Birla committee suggested mandatory and no mandatory requirements, Naresh Chandra committee extensively covered the auditor company relationship, rotation of statutory audit firms/partners, procedure for appointment of auditors and determination of audit fees and true and fair statement of financial affairs of companies. Further, the Narayan Murthy Committee focused on responsibilities of the audit committee, quality of financial disclosure, requiring boards to assess and disclose business risks in the company's annual reports. The Kotak Committee on corporate governance was constituted on June 2, 2017 under the Chairmanship of Uday Kotak. Based on their recommendations, SEBI introduced a comprehensive set of

corporate governance principles which are expected to improve upon the existing governance regime for listed companies including banks. The concept of business responsibility reporting for top 500 listed companies is being introduced to bring out the corporates' ideology in dealing with various stakeholders. Further, Risk Committees are being mandated to ensure that they appropriately identify the risks associated with business. Related party transactions for making any payments require approval of a majority of public shareholders. Banks are key role holders in the economy and play unifying and intermediary role with depositors, investors and borrowers. While working with the principles of profitability and productivity, banks are obliged to follow ethical corporate governance. They are required to regulate or maintain their relationship with other banks, other institutes, government bodies, customers, employees, etc., in compliance with certain ethical principles. Under corporate governance, banks fulfil their social responsibilities, environmental awareness through various Corporate Social Responsibilities (CSR) activities. After the Satyam Scandal, SEBI became stricter towards disclosure norms and implementation of Clause 49 provisions to bring about a sea change in the transparency and accountability in companies. The Companies Act gave these norms a proper statutory backing. The Clause 49 now serves as a standard of corporate governance in India. The clause stipulates that half the directors on a listed company's board must be IndependentDirectors. In the same clause, SEBI put forward the responsibilities of the Audit committee, which was to have majority Independent Directors. Clause 49 of the Listing Agreement is applicable to companies which wish to get themselves listed in the stock exchanges. This clause has both mandatory and non-mandatory provisions. Key mandatory provisions are as follows:

- Composition of Board and its procedure frequency of meeting, number of independent directors, code of conduct for Board of directors and senior management;

- Audit Committee, its composition, and role

- Provision relating to Subsidiary Companies

- Disclosure to Audit committee, Board and the Shareholders

• CEO/CFO certification

• Quarterly report on corporate governance

• Annual compliance certificate Key Non-mandatory provisions include the following:

• Constitution of Remuneration Committee

• Training of Board members

• Peer evaluation of Board members

• Whistle Blower policy in 2014, the clause 49 was amended to include Whistle blower policy as mandatory provision. Other major provisions under Clause 49 connected to Companies Act 2013 are as under

Appointment of ED, NED and ID: There are two kinds of directors in the companies' vizExecutive Directors (ED) and Non-executive Directors (NED). The Non-Executive Directors are divided into two categories viz. Independent Directors (ID) and others. Thus, every listed company has Executive Directors, Nonexecutive Directors and Independent Directors on its board.

III. Methodology

Appointment of Women Directors:

The Companies Act 2013 provides that every listed company has to appoint at least one woman director. Appointment of women directors was earlier voluntary but it is made mandatory in Companies Act to have more talented woman on the boards of their companies.

Related Party Transactions (RPTs):

To enhance the transparency, certain rules are set in respect of RPTs. These rules make sure that in all material dealings by company promoters, business decisions will be at arm's length level and are not against the interests of small and minority shareholders.

Top Level remuneration:

To check the tendency of fixing unreasonably high compensations for promoters and top-level executives, constitution of a nomination and remuneration committee with an independent chairman is mandatory. All companies need to follow enhanced disclosure norms on remuneration.

Audit Committee and whistle blower mechanism:

There are rules and norms which expand the role of audit committee in listed firms and direct them to adopt a compulsory whistle blower mechanism to curb unfair business practices and protect the interest of minority stakeholders. There are few general principles of ethical corporate governance as under:

a. Integrity: Banks while performing their various activities with the customers or other parties, consider the principles ofintegrity in their relations with all these individuals as well as organizations/ bodies.

b. Impartiality: Successful banks believe in extending due respect to the people while dealing without any discrimination and without any prejudice behavior.

c. Reliability: While giving any services or doing any transactions, banks serve the customers in a mutual confidence, and provide their customers with accurate and transparent information and render timely services.

d. Sincerity: The bankers must perform their duties sincerely in all circumstances not only to satisfy customers' needs and expectations but also with a view to help the economy.

e. Trustworthiness: Banking is the business of trust and confidence. Banks should ensure against breach of trust with the customers as well as other stakeholders. It may lead to reputation loss to the bank. Banks should not do anything which will create any suspicion in the minds of people with whom the bank deals.

f. Legitimacy: It goes without saying that all the dealings of the bank should be legitimate. It should neither jeopardize the interest of the stakeholders nor thesociety at large. Going out of the way to favor or disfavor somebody will also amount to illegitimacy.

g. Professional competence and due diligence: Due diligence is the key word in banking sector, and it is one of the indicators of professional competence. For achieving desired results, it is essential that the bankers acquire human, technical, and conceptual skills properly for performing the duties with proper due diligence.

h. Transparency: Our Bank has adopted 'Transparency' as one of the values in Vision, Mission and Values. Bank should inform the customers their rights and obligations, benefits and risks in simple, understandable manner without hiding anything. Transparency and trust always go hand in hand which banks need to understand while dealing with any parties.

Finally, corporate governance and ethics help banks in various ways like coping with money laundering, resolving HR issues, meeting competition, building trust in the minds of all

stakeholders, handling customer complaints, recruiting and promotion policy, career development and above all inimprovingservice quality by creating a healthy work environment.

Conclusion

The four pillars of corporate governance which are accountability, independence, fairness and transparency cannot be deleted from financial reports of business organizations. The financial reports when they contain reliable facts and faithfulness in contents, it proves that the business organization is presenting a sustainable performance that will attract investors and relevant stakeholders. Trust and confidence have been identified over time as the key blocks for laying the foundation of survival and profitability in the banking industry. To talk of trust and confidence however is to talk of ethics (Egwuonwa, 1997).With the adoption of International Financial Reporting Standard by countries all over the global village which helps to produce harmonized financial reports, Financial Reporting Council of Nigeria will need to ensure full compliance of all the relevant standards for quality, reliable and faithful financial reports. The Nigerian regulatory authorities need to enhance the level of supervision of Nigerian banks in view of the enhanced capital base and the global connection of economies where financial reports are considered as very important financial documents that will aid foreign direct investment into an economy.

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