



NSE-IGIDR International Conference on Corporate Governance

Edited Transcript
of

Chief Guest's Address and Panel Discussions

Mumbai, July 10, 2014

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Preface

While the onus of maintaining and raising governance standards in any jurisdiction lies with all the stakeholders, stock exchanges worldwide play a particularly key role, given their traditional mandate to monitor their listed companies' compliance with listing and disclosure requirements. In this respect, NSE has been no exception. Indeed, to improve governance standards, NSE has gone beyond these regular channels and taken initiatives to influence policy debates by involving regulators, practitioners and academics.

Toward this end, NSE jointly with the Indira Gandhi Institute of Development Research (IGIDR) has taken a research initiative, whose aim is to provide a platform for industry and academia to complement each other and to give research support for effective policy making. As part of this initiative, an international conference on corporate governance was held on July 10 and 11, 2014 in Mumbai. The conference *inter alia* involved a speech by Chief Guest Shri U. K. Sinha, Chairman, SEBI and panel discussions on two important topics, namely, (a) 'comply or explain' as a regulatory approach to corporate governance, and (b) corporate governance in financial institutions.

Chief Guest, Shri Sinha focused on the regulator's perspective, while emphasizing that corporate governance is high on SEBI's agenda. He drew attention to the rapidly diminishing tolerance to mis-governance in different parts of the world in post 2008 financial crisis and how the regulators worldwide, including SEBI in India, have responded to this.

The discussion on 'Comply or explain' as a regulatory approach was perhaps the first in the country. 'Comply or explain' has emerged as an alternative approach to the traditional 'mandatory' approach to corporate governance. This alternative, which questions the one-size-fits-all approach, has become popular in some countries mainly because of its inherent flexibility. Since India has had only limited success with the mandatory approach, the possibility of transiting to this alternative approach was considered worth exploring. To set the stage for an effective debate on this, a Quarterly Briefing was produced in January 2014 on this subject under the aegis of NSE Centre for Excellence in Corporate Governance (NSE CECG). The panel discussion on this topic was a logical next step.

The second panel discussion was on the governance of financial institutions. The high systemic risk entailed by poorly governed financial institutions and the devastating consequences that follow when those risks materialize, are now widely recognized. The discussion at the conference, which drew attention to some core issues, was particularly timely, as it took place just a couple of months after the RBI brought out the report of an expert committee set up to review the governance of Indian Banks.

I would like to thank all the panellists for their valuable contribution. I am also grateful to Mr. Nawshir Mirza and Prof. Subrata Sarkar for playing wonderfully the role of moderators in the panel discussions. The deliberations of both the panels have been captured in this edited transcript and we believe that the transcript would be useful for industry participants, academics and policy makers.

Nirmal Mohanty
Head, Department of Economic Policy and Research
National Stock Exchange of India Ltd.

Chief Guest's Address by Shri U. K. Sinha (Chairman, SEBI)

Since the subject of the conference is corporate governance – on which a wide variety of sessions ranging from comply or explain, role of the audit committee, performance of the firms to ownership structure has been conducted – so what I will try and do is to confine myself to the perspective of the regulators. I will attempt to explain the regulatory perspectives and how and why we undertake these regulations.

In matters of corporate governance, there is a legal and an ethical aspect. You cannot define by law as to what the ethical or moral behavior could be. So, a regulator or the government has to follow certain principles. In India, like in other parts of the world, we mainly follow the principles of equity and fair play. There should be considerations of equity and fair play in whatever regime we are trying to enforce. Further, we try to follow the principles of transparency in information dissemination, the principles of integrity in the financial reporting system and the principles of having a predictable legal environment while dealing with violations.

In India and in many other parts of the world, either in a muted or in an open way, it has become very common to call the regulators as activists. Some people have also started calling us as dragons. I do not know in what context those words are being used. I would like to give you the background and a perspective of our functions. I will begin by exploring the social and political context. As we move from Brazil to Cairo to Turkey to New Delhi, we find huge amounts of protest expressing anguish, distrust and suspicion on matters of governance. The level of tolerance for mis-governance has declined not only in India but also in the rest of the world in an accelerated fashion post-2008 financial crisis. And the people who are protesting are not the unemployed youth or students who could be mobilized by a political party at a very short-notice. They are educated, employed individuals who are willing to come out in hoards to register their protests.

Earlier, if you were appointed to a particular public office you were assured of your tenure. However, that is no longer the case now. For example, in India, starting from the residents' welfare associations to mass protests at the India Gate, people are expressing their anguish, clamoring for regime change, right to recall, right to reject and continuous and comprehensive evaluation. People are no longer willing to remain silent spectators. Instead, they are aggressive, wanting their voices to be heard. No longer is there an inherent trust in you, if you are holding a public office. If this is happening in the wider society, the corporate sector can hardly afford to remain insulated from these trends.

Currently, the old Indian style of conducting multiple annual general meetings in a span of half an hour is no longer prevalent. This had happened due to the conduct of some of the CEOs and Boards. If I start from the USA on this issue, the Enquiry Commission of USA --in its report submitted in 2011 -- has acknowledged that there was a dramatic failure of corporate governance and risk management during the financial crisis. They have also identified this failure as one of the principal causes of the crisis. Further, we have events where for example, billions of dollars of fraud are committed and the CEO calls it a tempest in a tea cup. It is a different matter that down the line, the same company has to go for a settlement of more than USD 10 billion.

Consider another example of a large corporate firm where a USD 40 billion plus position taken in derivatives market is described by the CEO as something not overly exciting to him. Moreover, the CEO says that undertaking the aforesaid action would not take more than a small fraction of his time. If this sort of attitude is being observed in or outside India, then people should be ready for the associated consequences. In India, we have seen misrepresentation of accounts in one particular big company for years together and when we finally blew this up, it hurt a large number of investors both within and outside the country. Interestingly, people in India have raised billions of dollars for goat farming and emu farming schemes and have got away with it. In one particular case, more than USD 4 billion were raised from 30 million investors and it was still being claimed as a private placement.

In SEBI, we have examples of companies getting shareholders' approval for selling some of the company assets for redemption of foreign currency convertible bonds. However, post the approval and sale of the asset, the asset was utilized entirely for buying property in the name of the promoter of the company. We further have examples of a company buying another private company which was owned by the promoter at a valuation more than 100 times the actual valuation of the company. There was also an incidence of a company selling its IT division to foreign parent at a valuation several times lower than the actual valuation and there was no due diligence. The shareholders of the board simply passed a resolution without showing any active due diligence.

In SEBI, we have a complaint management system in place. Anybody would imagine that if there exists a complaint management system in SEBI, majority of the complaints should be against SEBI's own intermediaries such as investment bankers, merchant bankers, broker dealers etc. You will be surprised to know, however, that more than 50 per cent of the complaints are against companies.

The Financial Report Council in UK has recently come out with a discussion paper and they intend to implement it from October 1st this year. They have a huge agenda for change in corporate governance norms in the areas of directors' remuneration, risk management, internal controls and the basis of accounting. These are the areas in which significant changes are proposed in the UK. The focus is on designing a remuneration policy keeping in mind the long term success of the company. Provisions for claw back of variable pay, disclosure of the methods of engagement of the shareholders, approach of the company towards engaging the shareholders, disclosure of the principal risk of the company and methods which the company is going to follow in order to mitigate those risks should be clearly specified.

In the European Union, the Shareholder Rights Directive (SRD) is almost equivalent to the UK Stewardship code. So whether it is the case of USA, UK or European Union, you can see that there are certain common thought processes which are in place.

In Canada, the Institute of Chartered Accountants asserts that shareholders can seek private meeting with the board to express their concerns. Companies in Canada have shown their willingness to ask Directors to resign if the number of votes against them exceeds the number of votes in their favor.

Something similar has been provided in Australia as well. In South Africa, you are aware about the Third King Report on Corporate Governance. So there are examples from several countries on the thought process behind the regulatory responses.

What has been the outcome of these responses? The awareness that has been created as a result of these regulatory responses is leading to some very surprising outcomes which could not have been imagined earlier. In May this year, 20 per cent of the shareholders voted against the remuneration policy of a large U.K. company. The policy included a potential bonus to the chairman. The shareholders were able to induce the company to reduce the chairman's bonus to less than half of what was recommended. There are examples of very large pharma companies and companies in the consumer goods sector where similar developments have taken place in 2014.

There was another Fortune-500 company where in 2012, the compensation request for the chairman was turned down by the shareholders and chairman as well as CEO of the company had to resign. Several companies in Europe and other parts of the world are facing similar challenges. Besides the resolutions which are being challenged, the regulatory action is also showing a particular trend of the past where you would discover a number of companies having settlements with the regulator.

There are several developments which have taken place on the regulatory front. Firstly, in India, now we have got a mechanism where we have categorized the offenses into two components: serious and not so serious. The serious offences are not allowed to be settled; they cannot be consented; they are non-consultable. If a company or its executives have committed a serious offence, they will have to suffer regulatory action. The second development is that, earlier the penalties used to be against the companies, which in many cases was considered as an additional cost of doing business. However, if you look at Hong Kong, USA and UK data in the last three or four years, you will find that the penalties are now increasingly being imposed against the executives and the key management people. They are being held responsible and are being penalized by the regulators.

The developments in India can be better appreciated if we consider the larger perspective of what is happening outside the country. There are people who allege that SEBI has become an activist, a dragon and they even threaten that they will take their business out of India. I wonder what jurisdiction they have in mind to go to, because I have recounted earlier that more or less similar regulatory responses are prevailing in all the evolved jurisdictions.

The Companies Act in India was evolving for almost 10 years. In 2004 in a different job, I remember, I was -- in a certain manner -- associated with the drafting of regulations. Huge amount of consultations had taken place and finally the Act came into existence in 2013. When it came into existence, everybody appreciated this initiative; but within less than a year of its enactment, people have started discovering serious flaws in the Act.

About two years back, we in SEBI had prescribed certain requirements to be followed when two companies merge or there are certain schemes of arrangement between two companies. Note that, the requirement of periodic disclosures to the stock exchanges as per the listing agreements have been in existence for a very long time, but on one stock exchange there were more than 1,000

companies which had failed to file their disclosures and reports. If SEBI as a regulator takes note of this and provides for a standing operating procedure that if companies do not file their annual or quarterly reports then they will have to suffer the due list of consequences, would it be proper for you to blame SEBI regarding this?

While formulating the regulations, SEBI has been very careful that the consequences of such action by the management are not faced by the small retail shareholders. Earlier we used to blindly say that the trading of the companies which had not disclosed their reports to the stock exchanges should be suspended. But now we have got a series of actions which are directed mainly against the directors, promoters and the management people and the first step is to halt their economic interests rather than punish the minority shareholders who have no say in the running of the affairs of that particular company.

You will acknowledge that for any listed company, the market needs to know whether there has been any change in the shareholding pattern of the promoters. We have an option for that but it was not being followed. The pledging of shares by the promoters was not getting reported in spite of SEBI mandating the same. Ignoring SEBI's prescription, people have come out with a legal instrument called Non-disposal Undertaking (NDU). We came to know of this much later and so we had to provide for dealing with NDU by making it compulsory to disclose it. We had discovered that in a number of instances, people were filing for buybacks and very exalted ideas were propagated about SEBI wanting to return the money to the shareholders. SEBI supported it but our analysis of data for the last three-four years showed that in majority of the cases, these buybacks are being used for managing the stability of share prices, rather than for actually delivering the money. So we have come out with our new regulations where we have mandated that certain amount of shares must be bought back. Further, the time frame and all other details regarding buyback of shares have been prescribed.

In April this year, we have come out with a new set of guidelines for effective corporate governance. The discussion paper on that has been in public domain for more than a year and we have had serious discussions with various groups of people including those from chambers of commerce and industry. It is a different matter that when SEBI calls these associations, many of them feel that there is no need for senior office bearers to go and attend those meetings, so they can send anybody there. Perhaps they want to reserve their right to criticize the decisions which SEBI is ultimately going to take.

In matters of abusive related party transactions, SEBI as a regulator cannot keep silent. The roles of audit committee, remuneration committee and certain other actions have been clearly outlined. Taking cue from SEBI's own experience and the global developments, we have put a ceiling on the number of companies in which one can become an independent director. This is being criticized very severely stating that we do not have enough number of independent directors in this country. This country has a population of 120 crores, every year we produce hundreds and thousands of engineers, chartered accountants, bankers and other qualified professionals. We require directors for only about 5,000 listed companies. If somebody has a case that for 5000 companies in the country, we do not have enough independent directors, then I think that we need to reconsider our claims of being a large global economy.

In the beginning, I talked about how people want to remain involved in decision making whether it is in the social or political or corporate sphere. But we have had examples, consider any large company in India and your first reaction would be that their headquarter is registered in Mumbai or Delhi but many of them are registered in places away from these metros and to expect that all the shareholders holding 100 or 1,000 shares would be attending the AGMs by physically visiting those places, could be expecting too much from them.

SEBI is being criticized for providing electronic voting facility for these shareholders. Should we then leave it to the old system where you have a Performa meeting in which the resolutions are expected to be passed in 5 to 10 minutes and then get away with it? I am happy that there is a good development by way of the recent growth of the proxy advisory firms in this country who are expressing their opinion on various matters. SEBI has also desired that institutional investors like mutual funds should have a say in the corporate board resolutions. SEBI has prescribed that each mutual fund must have a voting policy and the policy should be put up on its website. The mutual fund's track record of voting should also be disclosed on their websites. We have talked to our counterpart, the insurance regulator requesting them to make similar provisions for insurance companies.

Despite these developments, our mindset goes back to a system where these developments are being challenged. We are perhaps forgetting that today's India is not the same India which existed 20 or 30 years ago. People are now more demanding, more aware and more educated. If we want India to remain a trustworthy investment destination, there should not be a dispute or battle between the regulator and the companies. In fact, I would expect that companies should adopt the regulations willingly and in a spirit of cooperation because it is in their own interest to follow the corporate governance norms. This is because increasing number of analysts and advisory firms are rating the companies not only on their financial performance but also on the basis of their score on corporate governance.

I would like to assure all of you that we do believe in building safeguards and we have had a series of extensive consultations on every regulation that we have prescribed. When we recently came out with research analyst regulations, a question was raised before us as to how we can avoid the potential conflict of interest when proxy advisory firms give their opinions. Our research analyst regulations have mandated that a proxy advisory firm has to make required disclosures in order to avoid conflict of interest. Further, there will be restrictions on trading during a certain period. The same has also been provided by us for people who express their opinions in media on various scrips.

The fear that we are not mindful of the genuine concerns of the corporates is not true. We are willing to build adequate number of safeguards as and when required, but corporate India also has to change its mindset of treating corporate governance norms as an undue burden. They should understand that if they take care of the needs of all the stakeholders, it is in the interest of the long-term growth of their own companies.

Thank you very much.

Panel Discussion I: Regulatory Approach to Corporate Governance: Comply or Explain

- Panellists:** **V. S. Sundaresan**, Chief General Manager, SEBI
Deborah Gilshan, Corporate Governance Counsel, RPMI Railpen Investments, UK
John Roberts, Professor, University of Sydney
Cyril Shroff, Managing Partner, Amarchand & Mangaldas & Suresh A. Shroff & Co.
- Moderator:** **Nawshir Mirza**, Professional Independent Director

Nawshir Mirza: Corporate governance is all about how do you make companies behave responsibly to their various stakeholders. When you talk of companies, you talk of the board and senior management, and you talk of in general how do you make companies behave responsibly? When you reflect upon it today, we have billions of experiments of the uses of 'comply or explain'. Even today, I would guess there are about 2 billion experiments operating on this earth and they have been operating for a long time. Consider, for example, the institution of marriage in which 'comply or explain' is the principle that makes each one of those who are parties to a marriage, suppress their more natural instincts to apply a veneer over what their natural urges lead them to do. When you go away from here, reflect upon: (a) what accounts for the success of 'comply or explain' in the institution of marriage? and (b) what has made it such a success?

There are perhaps millions of cases where this principle has not worked and hence marriages have not worked. On the positive side, however, there are billions of other examples where this principle has worked successfully. This has induced us to reflect on what are the attributes that has made 'comply or explain' principle such a success in the institution of marriage and do those attributes prevail in our corporate environment.

What did we have before 'comply or explain' in the institution of marriage? If I am to believe in the cartoons that I see, before that you had "I club you and drag you into my cave by your hair if you do not comply" and you will see that there are still some juvenile societies, such as the USA, that do not use 'comply or explain' and instead use 'comply or else' which might explain the crew cuts a common fashion in the USA.

India is not a juvenile society and we are proud to have a 5000-year old culture

and society but we have had to resort to 'comply or explain' principle. We had a lighter rule when Clause 49 was not there. Now it has all been written into the law and severe penalties have been attached to non-compliance with the law. So we have indeed imported the USA system of "comply or I club you over the head" into our own country.

The 'comply or explain' principle has been mentioned as first being used in corporate governance through the Cadbury Report. My own reading of this, however, is that its first use in the world of business was in the UK when they introduced accounting standards. In those days, they were called "statements of standard accounting practice" and the rule then and still now is that the true and fair override. This rule is there in SEBI's new corporate governance code that will be effective from October 1, 2014.

More specifically, as per the rule, the Board of Directors are obliged to comply with the standards of accounting practice but they must examine whether by not complying with them and by using a different method, they would achieve a set of financial statements that is as true and fair as before. So it induced the boards to not only comply with the accounting standards but also to ensure that if by applying the accounting standards you are not achieving a true and fair result, you are not obliged to comply with the standards. So you were obliged to apply an alternative method and explain which is exactly what 'comply and explain' is. Adrian Cadbury used that idea and that is what we are going to discuss here.

V. S. Sundaresan:

Though I represent the Securities Exchange Board of India, let me make the usual disclaimer that the views are personal and my employer may or may not subscribe to my views.

On whether we can adopt 'comply or explain' principle for corporate governance in India, I do agree with Nawshir that it brings out well understood benefits which have been demonstrated in UK, Germany, and Netherlands among others. A lot of empirical studies have shown that the extent of compliance standards have actually gone up in these countries. The Securities Market regulator in Canada has come out with a discussion paper on having 'mandatory women representation' on the board and the regulator has said that it will follow the principle of 'comply or explain' to these women directors on the boards. So, several countries are moving towards this concept of 'comply or explain', more particularly, in the area of corporate governance. The moot question is, they have adopted this concept because 'one size fits all' is not an accepted practice. If you apply the principle that 'one size does not fit all', my first observation is that 'comply

or explain' being adopted elsewhere may or may not fit into our system.

The second point is that for this 'comply or explain' concept to be successful, two ingredients have to be fulfilled. The first one is that the entity i.e., the corporate or its board, which is required to comply or explain, has to be responsible, transparent and should also have an inherent interest in complying; and if it is not complying, it must be in a position to explain the rationale for non-compliance. Similarly the investor community should also be equally responsible and demonstrate it by questioning the compliance standards adopted by the corporate and judge whether the explanation given by the corporate is adequate or not.

I can divide the general compliance into the following three parts: (a) apparent compliance, (b) adequate compliance, and (c) absolute compliance. To reiterate, the investment community should be in a position to question the explanations that have been provided. Can we apply this concept of 'comply or explain' in the Indian securities market? My first reaction is no. Neither the corporate entity is as transparent as the regulator expects it to be nor the investor community is as responsible to question the performance of the companies.

Having said that, this 'comply or explain' concept has been tried out in some instances. Say for example, two or three clauses of the listing agreement already provides for this 'comply or explain' concept. One, which pertains to the disclosure of material information to the public and across the stock exchanges, the discretion of what is material resting on the corporate. If you do not disclose, you have to tell the reason when you are questioned about it.

Nawshir Mirza: Mr. Sundaresan, it also says 10% is material and then it goes on to say both. So which one is required?

V. S. Sundaresan: I will speak about few instances where the disclosure has been made and in my view, neither that company is transparent in compliance nor the investor community is responsible enough to question that. So this type of imbalance in the system can hinder the successful adoption of the 'comply or explain' concept. Since that balance does not exist in the Indian securities market at this point of time, my initial reaction is that it may not be appropriate for India to adopt 'comply or explain' for the time being.

Deborah Gilshan: We represent long-term shareholders, i.e. pension funds. So, I guess we are the ultimate example of patient capital. I think one of the advantages of a 'comply or explain' approach is that it is a market solution; but it means that

all of us have responsibilities: as shareholders, companies and their directors. Also there has to be some sort of regulatory underpinning that encourages the framework to work. I think there has been a lot of debate on corporate governance structures and independent directors and I understand that a lot of Indian companies are promoter led companies where often the promoters are the majority owners and founders. Ultimately, however, when we look at the corporate governance structures of the companies and the markets that we invest in, we must be mindful of the fact that we are investing our beneficiaries' money. The reason why corporate governance structures are necessary is because of the separation of ownership and control; and the fact that there should be some sort of privilege attached to access to the public capital whether a company is a majority owned company or there is disperse ownership across the shareholder base.

I think public market integrity is very important regardless of the jurisdiction that you invest in. I do agree that perhaps for Indian companies, 'comply or explain' principle may not be appropriate at this time for the reasons discussed earlier.

For all jurisdictions, there is onus on compliance but we do also have relationships with our companies and specifically with the independent directors of the companies we invest in. I think a 'comply or explain' framework does encourage the relationship between shareholders and directors of companies and often we are happy or willing to accept deviations from these principles in the short term if we have a trustful long term relationship with the companies which we invest in. We understand that these long term relationships help us to move towards a governance structure that will better protect our investment.

So I think it is one thing to have a code framework, but it is quite another thing of how it actually works in practice and it needs to involve the shareholders, companies, directors and the regulators as well. We have seen that some of the best practices have not been followed in the UK especially around executive compensation; and there has been a threat of regulation resulting in more rights for shareholders. I think it is quite interesting to note that recently in India, there was a defeat of proposals concerning executive pay in Tata Motors. I think that is very good example of a scenario where there is appetite to challenge practices that may not be in the best long term interest of shareholders.

The markets that I primarily cover are Australia, UK and USA. Both Australia and UK are very similar because there is a code of governance that is 'comply

or explain'. In both these markets, we have a healthy relationship between shareholders and companies, including the independent board of directors, that allows proper challenges and debates to take place. When you look at USA -- where there is no code of best practice and where everything on corporate governance is through regulation -- it really has led to quite an adversarial relationship between shareholders, companies and the directors. I do not think it is a healthy way for governance to evolve. We, as foreign shareholders in USA companies, have been doing quite a lot to push forward the agenda of board accountability. Further, there is also talk from a Dutch pension fund PGGM regarding a code of governance in USA and it will be interesting to see how that evolves. I certainly think that the governance framework in developed markets like Australia and UK are a lot better than what we see in places and markets where there is no such governance code. So I will end my comments there for now but I just want to say that I think there is an opportunity for Indian companies to embrace a code whether it is on 'comply or explain' or something else.

John Roberts:

What we want from directors of big companies? Do we really want them to be compliant? I think that we do not just want compliance. We do not want them to be obedient and passive in that sense. We want them to be active in the board room and use their intelligence act rather. So the principle of 'comply or explain' is an attempt to respect the autonomy of directors, insisting that they want directors to be active and use their intelligence, even if on occasions this means departing from the letter of the Code, and this is why it is such a good principle.

However, the history of the principle in the UK has been difficult. Investors have been severely criticized throughout the life of the Code for, in practice, not allowing companies to offer explanations for non-compliance and instead just doing 'box ticking' checks on compliance. So 'comply or be damned' has been one version of this, or 'comply or perform' where investors are seen only to take corporate governance seriously when financial performance falters. The regulatory temptation was initially to attempt to address failures of governance through making the Code even more prescriptive; the original 1992 two page Code of Best Practice by 2003 had extended to some 48 pages of Principles and Provisions with associated appendices. Wisely in the UK, post the financial crisis where compliance with the Code clearly did not differentiate effectively between those banks and financial institutions that survived and those that failed, there has been a recognition that Code compliance really cannot take the place of director thought and intelligence. The regulators have since deliberately and explicitly backed

away from detailed prescription and instead re-emphasized the importance of directors' compliance with the spirit of the Code; the Code cannot take the place of director thought and intelligence.

Nawshir Mirza:

John, when you said it has run into 48 pages, I was reminded of our new Companies Act and the SEBI regulations. I have just put together a checklist of all the things that Audit Committees, Nomination and Remuneration Committees need to do and I have a list of 70 things that they need to do each year. Well, not everything needs to be done each year, but there are 70 things prescribed in these two regulations which means that all of the time is spent on compliance and very little is spent on doing something which perhaps adds value to the business.

Cyril Shroff:

Just to sort of build on what has already been said, I think that India has just started exploring and experimenting with 'comply or explain'. CSR is one such example. However, I feel that we have not gone too deeply into the theme as a regulatory strategy. But the way I look at it is that it falls significantly short of, what I would call 'name or shame'. Actually even if there is an obligation to adhere to few things or explain, it still does not rise to the level of 'name or shame'. At least as per corporates' viewpoint, there is no shame in saying I did not comply to a rule. I think, the way we have worked so far, is to really make a distinction between what are mandatory provisions and what are directory provisions and as far as I can see corporate India has just ignored the latter. So if there is no punishment, there will be no explanation and no shame. This may be partly just because of the way our society works and because of the regulatory bias that arises when companies move from being private to public. For instance, on day one of your life as a listed company, you have to identify a promoter. I am not sure how many countries in the world follow this but I think it is probably very few. You have to specify not just the promoter entity but even the person with his passport and his driving license. From the day a public company is born, you set up incentives and create a culture which treats the promoter as special. The way the promoters' mind works may be a little bit biased in favor of family control, but I think the same principle largely applies to government companies or even multinationals who have a similar sort of approach. When you start your life as a promoter, you have greater responsibilities. There is also a tradeoff that if I have greater responsibility, I probably have some greater privileges as well notwithstanding the fact that the law may consider all shareholders as equal. I think the promoter can have a superior provision in proposing ideas depending on how his business works. This is in line with the feudal system. I think the origin of

feudalism in corporate India lies in the manner you were listed in India.

Now having said that, a few more reasons why I think the governance codes in India are not working as well as one expects it to. One is of course the promoter controlling shareholder overhang. There is really no concept of an independent director. They may be technically independent but they behold an outside environment in some other way and the chances of them really confronting each other are very low unless there is a fight in the boards or something like that and they have to pick sides. I do not think boards are the source of power in a company. I think the center of power lies somewhere else. It could be the Chairman, it could be the family as a whole, or the headquarters of a multinational company. I think the real quality of governance in an Indian listed company will actually depend upon the desire of the source of power. I think that such a source of power is a minority but they want the company to be well governed, have a good reputation and not only comply with the baseline law but also go further in terms of having effective boards.

The second difference between what I see in India and in the UK and USA markets is regarding the legal system and the judiciary. The chances of you getting sued in India for something which is sort of breach of fiduciary duty and being held responsible for damages is extremely low. Although strong regulation in India is filling some of that gap but I do not think these regulatory measures really had that same impact as in developed countries. An attempt has been made to introduce a provision in our Companies Act of providing for class action suits, although the power of enforcing this regulation has actually been given to the company law tribunal instead of having been given to the courts.

I have nothing against the tribunal. I do not know what it is because it is not even formed. However, you do not give this sort of power to a quasi-judicial body. My experience of quasi-judicial and administrative tribunals in India is that they are not like courts. There are lots of parallel, informal conversations going on in these tribunals. So, you should not give class action type powers to a body that has this sort of multiple cuts as to how they operate. Time will tell whether this class action thing works or not. But I think that it has had the impact of conveying the message that in addition to compliance, there would be adverse consequences if one breaches fiduciary obligations or if there are conflicts which have not been disclosed or the manner in which one conducts oneself. This is the other difference that I see between India and other developed countries like USA and UK. I think this

has contributed a lot to western directors being more careful not only on their personal liabilities but also on their reputations.

I like 'comply or explain' because I think it provides us a middle territory between mandatory and directory provisions. I think it may be a good strategy to start building upon. At least it can be a moral force. It could potentially go to 'name or shame' depending on how you implement it.

Nawshir Mirza:

Well, Sundaresan mentioned earlier on what they have done in the SEBI regulations. They have said that they will leave it to us to determine what is material but according to them, 10% is like a fair guideline, though you are not bound to that 10%.

I think, as a society, we Indians are very cynical. I have never been to a corporate governance conference in our country but I must have been to about 100 other conferences where the speakers and audience have said that they know what really happens behind the scenes. I have never seen this attitude in any other country's conferences. So, my question to Sundaresan is should we adopt what has recently been adopted in the UK? In the UK, they have two categories of listing: premium listing and standard listing. For the premium listing, they have certain higher benchmarks of governance. Companies that do not want to achieve those standards are free to move down to a standard listing and there is a 175-year old company which has done that. The same family has run that company for 175 years and that company has given better returns than Warren Buffett has given and they have never had independent directors. All of their directors have been executive directors. So, the Chairman has written a letter to the shareholders saying we do not want a premium listing if it comes with our being poised with these independent directors.

Now one of the criticisms I have is that if SEBI allows a whole lot of people to go out and take money from the public for listing and then they tell independent directors to make sure those guys behave, my point is that do not allow these guys to list. Instead of being proud of 5,000 listed companies, let us be proud of only 500 listed companies and put all the rest out. So, do you think this device of 'comply or opt out' is perhaps a good device because whatever you all have said, none of them is going to make the tail of the dog straight. What do you think?

V. S. Sundaresan:

Yes, we are moving towards that. That is why, about a year back we have carved out a separate listing segment for SMEs and for this segment, many listing requirements which are applicable for the main board are not made applicable for them. However, the feedback which we have got is that the

threshold for that is too small which allows only very small companies to list in the SME segment. To answer your query, we have already begun thinking in that direction. Now what is the correct limit, will get determined only over a period of time.

Nawshir Mirza: Why should we have a threshold at all? Leave it to the company saying that we are not going to have independent directors; we are not going to have 70 rituals in our committees. Let shareholders not buy their shares if they have got an issue.

Cyril Shroff: I have a view and I doubt whether this will work in India because part of it is linked to social status. If you are linked to a lower form of listing, it has a big impact on your personal reputation. The chances of somebody happily saying that I am not on the big board but on the small board, are next to nil. I think there is another problem which is delisting. Part of how our regulation works is that we have the 'Hotel California' syndrome which says "You can check out any time you want, but you can never leave". So the problem is with the sheer difficulty in getting unlisted. If you can fix that problem, I think a lot of this will work. You are absolutely right that a large number of companies which never should have been listed, have been listed. Now at least, we need to create some retrace mechanism which is extremely difficult.

Deborah Gilshan: I just want to say the other point about premium listing. The privilege of being a premium listed company is that there is lot of liquidity in your shares.

V. S. Sundaresan: We have already increased the threshold and the entry norms for IPOs to get listed. I am not going by the amount raised by the listed companies. The actual number of companies which came out with public issue in the last one and half years is substantially lower than what it was 3 years back. In August 2012, we increased the threshold limit from Rs 1 of profit to Rs 15 crores of profit for 3 years out of the previous 5 years. Earlier the requirement was even if you have earned Rs 1, you are considered as a profit making company and you can come out with your public issue. Hence, many companies definitely could not fulfill the eligibility criteria. So the alternate option for them was how to raise the minimum 75 per cent of the public issue proceeds from the qualified institutional buyers which was not that easy. Therefore, many companies did not come out with the public issue at all.

Nawshir Mirza: So, you have saved a few thousand innocent lambs from the slaughter. John, the South Africans and the Dutch have this thing called 'apply or explain'. It is about accounting standards where you need to apply your mind. What is your view on this?

John Roberts: I think yes, there are people in UK who were pushing for a change to 'apply or explain' to better signify compliance, but I think that it is institutional investors' attitudes towards explanations of non-compliance that is the key. So, if the big institutions are not respecting explanations of non-compliance, then it becomes necessary for companies to comply or risk investor anger. If the investors accept that it is, on occasions, legitimate for companies to depart from Code principles then companies are happy to explain their reasons for doing so.

Nawshir Mirza: Deborah, as an outside investor, how would you be able to tell whether mere compliance or the lack of it, is the right application in a certain situation. They ought to have followed an alternative. You would not have access to that knowledge within the board room to be able to determine that.

Deborah Gilshan: No and nor should we. The shareholders are not in the board room and that is correct. That is why we also focus on meeting independent non-executive directors. Actually you can meet every criteria on paper but it is what you do in practice that counts. So we put a lot of emphasis on actually meeting with the directors of the company we invest in. I think there are lots of examples where there were good corporate governance principles on paper but actually it did not work out for long term shareholders.

Nawshir Mirza: So it is time now to open the floor to the audience.

Q & A Session:

Audience: I have a question and a comment. In 'comply or explain', who judges the sufficiency of an explanation? There are only two such avenues for giving judgment: one is the regulator and another is the market. In a country like India where we boast of about 5,000 listed companies, does the regulator have enough resources to judge whether an explanation is adequate or not; and I am not taking into account the expertise of the regulator in this. Now coming to the market, I think apart from the top 100 companies in the stock market, the rest of the companies are not highly liquid. So, market as an institution to judge the sufficiency of explanations may also not be adequate. Therefore, my question is who judges the sufficiency of an explanation?

Nawshir Mirza: So you are actually questioning the 'comply or explain' principle, being a successful user?

Audience: No, I am not questioning. If you can provide solutions then of course it is a question. In a developed economy, say for example in the UK where in some sense companies are moving towards optimal structures, instances of non-compliance are relatively less there. Therefore, it is possible to judge

whether the explanations are sufficient or not. In emerging countries like ours, one can say that our optimal structures are different so our standards are also different. Hence, the extent of non-compliance may be much more and in that case, it may be too costly to implement this 'comply or explain'.

In corporate governance you can come up with many explanations of what is an optimal structure and justify those explanations. I am talking about good companies here and I am discounting the fact that 'comply or explain' can be used as a strategic tool by some bad companies to do non-compliance.

Audience:

As far as I can recollect, I do not think there is any provision of 'comply or explain' in the corporate governance Code of SEBI; I mean it is all compliance. The only place where I have seen 'comply or explain' is in the CSR segment of the Companies Act. But the problem there is that in case I do not comply and I just explain it by saying that I could not find a project, who is going to object to that explanation? When the debate was going on here, I was told that shareholders will object. I believe that shareholders will never object because their money have been invested in the company. It should have been doled out to the society for some social projects. So the only complaint could have been from the shareholders who would not think of doing so.

Even if the media points out that this company did not spend 2 per cent of their profits on CSR activities, it does not really hurt the company in any way. So, I think 'comply or explain' principle in CSR is not going to work. Companies can comply and spend 2 per cent of their profits on CSR activities but a lot of companies are actually going to explain and get away with it.

Nawshir Mirza:

Actually I asked that whether in the AGMs, a resolution of the shareholders can be put up saying that they do not want to donate 2 per cent of their profits and no more explanation needs to be provided regarding this.

You guys are not asking questions but making statements. Please ask questions.

Audience:

I have a question. In this discussion, we have not heard a single word about the market for corporate control or the information environment. For example, one problem with family companies is that they usually have stakes that they are not willing to divest and therefore the market for corporate control's role in this is precluded. However, in the USA and some other countries, we have seen that as new generations arrive, they start looking after their own family's interests. The existence of a rich information environment which penetrates questions and answers at annual meetings along with analysts' periodic reports, cause divergences among family

members and usually lead the family to dilute its stake to the point where they are a more fairly governed company. So these are the kind of tensions that prevail and I wonder how the information environment affects the way in which capital markets can discipline the family owned companies outside India versus within India. That would be an interesting contrast, if anybody has any thoughts on that.

Cyril Shroff:

I would first like to make an observation on the previous two comments on: (a) whom do you need to give an explanation to, and (b) what constitutes a good explanation. For the first question, I do not think it can ever be the regulator; because if it is a regulator who is going to judge the adequacy of the explanation, then what you have done is carved out an exception in the section itself. So it has to be the market and what I am actually seeing is a little more heartening than what Prithvi has mentioned on CSR. I do not think companies are looking at it the way you think. A lot of companies value their reputation and do not want to be seen in a bad light in the market and they are willing to spend the required amount on CSR activities and make a special effort to keep their image up. I do not know whether 'comply or explain' principle will work differently for any other segment of corporate governance. But whatever it is, I think this principle is not currently working; but let us see, time will tell.

Now coming to the question on corporate control, I think it is going to be a while before the market for corporate control will really have an impact on disciplining the family owned companies. Let me call it majority controlled companies because this whole debate on promoters gets sort of subconsciously equated to family controls. I think multinationals and public sector are just the same and they operate on very similar lines. It is just that there are so many family companies that we implicitly talk about them.

Some other things that have emerged in the new Companies Act is the majority or minority thing including SEBI's decision to discipline the majority because their control on some important things is irrelevant and that control should actually lie with the minority. I think it is an early stage of the debate regarding whether we are going to see the development of US style jurisprudence on corporate control being a disciplining factor. I do not think this will happen till firstly, we have disbursed shareholdings and secondly, till the process of acquiring corporate control moves to a US type environment where the independent boards really are the source of power.

So, we have the Takeover Code working as a facilitator if the board is practically irrelevant. The offer is made directly by the acquirer to the

shareholder. So the boards do not really play a role in it. There is no “Revlon” type principle for instance, no fiduciary duty and no “Go Shop” or any of those kinds of fiduciary obligations. I think two things are needed to get to that kind of environment. First is declining promoter stakes and second is the role of the board in an open offer. The role that the board is required to play in a market for corporate control has to change unless the regulator really takes on that role. In such a scenario, it will get very controversial because whenever regulators have tried to interfere in market forces for corporate control, it has usually come a cropper.

Deborah Gilshan: I just wanted to mention one thing about the whole piece of majority-minority control. In the UK, most of the companies have dispersed ownership but there are a few companies which have a majority owner. There is the financial conduct authority that introduced rules in October this year to actually protect the strength of minority shareholders in controlled companies (30% of the voting rights). One of the things that they are doing is requiring the votes of minority shareholders as well as the entire shareholder base on the election of directors at the annual meeting. This is because often we have situations where the directors who are supposed to hold the majority owner accountable, are protected and elected on to the board because the majority owner votes in favor of those directors. Note that, we still have challenges in the UK regarding minority shareholder rights in majority owned or controlled companies.

Audience: Not a question just a supplement. This is in terms of the numbers on CSR for the Nifty 50 companies for 2013. So these 50 companies on Nifty 50 spent about Rs 2,700 crores on CSR which was 1 per cent of their profits as against the statutory norms of 2 per cent. However, given the fact that most of it was before the regulations kicked in, it is evident that companies are quite willing to spend on CSR irrespective of the impact which it might have on its bottom line.

Cyril Shroff: They are also stopping the private philanthropy and instead doing it in the company itself. So it is sort of a set-off.

Audience: No, the problem with CSR clause of corporate governance is that we always get confined to this top 20, 30, 40, 50 companies and we feel good about it. We do not look at the remaining 4,500 companies with regard to the standards of governance or CSR.

Cyril Shroff: Fair point. I do not think we should judge the whole ‘comply or explain’ philosophy based only on CSR. It is actually a bit of Red Herring to solely test it on that.

Audience: When we talk about corporate governance, the stakeholders are basically the companies and their shareholders. But when we look at the small shareholders who vote electronically, the percentage of them is minimal, not even 1 per cent or 0.5 per cent of the total number of shareholders. A measure was introduced to this effect but it was not explained to anybody. So, don't you think that more responsibilities should be put on the institutional investors similar to what happened in the European countries and US where they are the torch bearers of corporate governance. These investors, and not small shareholders, can influence the policies of a company.

Nawshir Mirza: Deborah represents that and she quoted the Tata Motors example here itself where the proposal to hike the remuneration of the executive directors was turned down by essentially the institutional shareholders despite the fact that 30 per cent voted against it and 70 per cent voted for because it needed 75 per cent favorable votes for it to be passed.

Mr. Sunderesan, you have any observations on that?

V. S. Sunderesan: E-voting has been made mandatory now and it is in its nascent stage. We have to wait for this trend to pick up. Recently, one of the largest companies of India came and told us that this e-voting concept has really helped them and as compared to the previous year, more people had participated in this voting scheme. Just because many people are not voting, you cannot ask the Election Commission why they are conducting the elections every five years. The moment you start something new, the response will always be lukewarm to begin with. But over a period of time, the response will be more favorable. For example, consider the way in which demat accounts has penetrated into India today. If you had asked the same question 10 years back, no one would have said that demat would be a success in India. But today no one will entertain you if you say I am holding the shares physically. If at all you want to purchase or transfer securities, you must have a demat account.

Nawshir Mirza: I agree and the proxy advisory firms are also playing a critical role in this e-voting because many shareholders are unable to comprehend certain technical issues. Now they seek advice from these firms and vote accordingly.

Audience: This framework implies that there is a threat and someone would act against you if you do not comply with the prescribed rules. Now we have seen and most people here would agree that this threat is not a credible one. So, is it not time to experiment with other regimes because we feel that the conditions for the successful implementation of this regime do not exist. There is no

reason why we should not experiment. I think CSR has provided one good opportunity to do that; but to the best of my knowledge, the sufficiency of the explanation is to be judged by the regulator in this instance rather than the investors as is done in UK or Germany. But eventually I think it would be the investors who would have to judge the sufficiency.

I think the question which Subrata had raised is the key debate of the regulator enforcing versus the market enforcing the governance norms. Now the case for such a debate is stronger in a jurisdiction where the market size is too large for the chief regulator, namely, the SEBI in our case. So that makes the case stronger for us but given the fact that the investor community, especially the institutional investors, have become more responsive. I think the experiment is well worth it. Moreover, it would be nice if more and more people shift from 'voluntary' norms to adopt 'comply or explain' norms over a period of time. Currently, we have three types of norms: (a) voluntary norms, (b) mandatory norms and (c) comply or explain norms. I think the efforts to execute the above idea are worth taking since it does not involve much risks.

Nawshir Mirza:

I think we are now reaching the end of the time allotted to us. So I must sum up the discussion. I think John in his earlier session pointed out the three pillars that Adrian Cadbury identified for good governance. These three pillars are: transparency, integrity and accountability. But he also made a very interesting statement where he spoke about the market forces as a regulatory mechanism. Those of you who have read yesterday's Economic Survey, at the end of the second chapter there is a strong case made for market regulation and moving away from the command and control economy to which we have been subjugated for close to 70 years and many people in this room would still like that old regulation system because they think that markets are incapable of regulating the economy.

As Nirmal said, do you want to trust the markets and he obviously represents the biggest market in India and the second biggest in the world. Anyone from the USA or from the Western countries would make a case for markets and I think if we want to become an international country, we should certainly take that into account.

However, the point I wish to make to all of you who are corporate leaders is that our desire to do well is more important than the market is. I think Deborah said that managements and boards should be keen on having good governance because if they are not keen, it is just not possible to have effective governance, no matter how much 'comply or explain' or 'mandatory' norms

are in place. There is a law that you must drive on the left side of the road. It is not just motorcycles, no one any longer follows that law. I have seen cars driving on the wrong side down Marine Drive in Mumbai. So we have now reached a state where people do not abide by the law and in the process, run the risk of killing people. This is something I would leave to each of you to go back and ponder about.

I will conclude with a very nice quote in support of 'comply or explain' from an article:

"A voluntary code of corporate governance provides guidance to the inexperienced, focus the ambivalent and control the adventurous."

So that's what a 'comply or explain' code ought to provide.

Thank you.

Panel Discussion II: Corporate Governance in Financial Institutions

- Panellists:** **Anand Sinha**, Ex-Deputy Governor, RBI
Krishnamurthy Subramanian, Assistant Professor, ISB
Pratip Chaudhuri, Ex-Chairman, SBI
Renee Adams, Professor, University of New South Wales, Australia
- Moderator:** **Subrata Sarkar**, Professor, IGIDR

Subrata Sarkar: Good evening ladies and gentlemen. Let me welcome you to the second panel discussion of the conference on corporate governance in financial institutions. The role of financial institutions in governance has received attention both in the academic literature as well as in various policy discourses. However, most of these debates and discussions have concentrated on the role played by these institutions in the governance of companies and not much attention has been paid to the governance structures within these institutions themselves. However, the financial crisis of 2008 has brought into focus the need for understanding and strengthening the governance structures of the financial institutions themselves, which can be paramount for promoting better governance companies and for increasing the growth of the nations.

We have a very distinguished panel consisting of members who bring with them rich experience and expertise on this subject. They come from different spheres of both policymaking as well as academics and can provide a very diverse view on this important subject. I will first request Professor Renee Adams to give her opening remarks.

Renee Adams: I will start my comments with a story. I graduated from the University of Chicago and my first job was at the Federal Reserve Bank of New York. They have a very big research department and the attraction for a Ph.D student to join at the FED is that they have lots of data which is like the Holy Grail for an individual doing research. In FED, I intended to work on corporate governance which was the area of my thesis. However, I found that the central bank had data on hundreds of variables but there was not a single corporate governance variable that regulators generally collect on banks. Obviously I was a bit disappointed because the FED had lots of data for everyone else but not for me. So, we had put in a proposal to the FED in 1999, saying that let us establish a corporate governance center where one

can actually collect the data from annual reports. We needed a bit of money to be able to collect the data. However, FED turned down our proposal. The importance of the proposal was evident during the crisis period and I think the FED now wishes that they had actually agreed to the proposal at that time.

The governance of banks is a very hot topic for regulators and academics alike. The Dodd Frank Act was enacted in the US as a response to the crisis, but note that this Act is not specific to banks. The provisions concerning governance, shareholders' say on executive compensation, their access to the ballot for the purpose of Directorate elections and independence of the compensation committee apply to all listed firms in the USA. More specific to banks is the 2013 EU Capital Directive which, amongst other things, recommends board diversity as an important requirement for banks. Banks have to set a target for board room diversity. This Directive also contains a recommendation that banks should separate the CEO and Chair positions. Moreover, there is a provision concerning compensation as well as reporting norms for risk management systems in the companies. The Deutsche Bank Act outlines the provisions for competition committee independence.

People have advocated these governance provisions already in order to prevent managerial of self-dealing. However, the focus of the governance discussion after the crisis was not self-dealing but risk. Now this is a problem because the academic literature has always focused on self-dealing; it has not focused on risk. So, we actually know nothing about the relationship between corporate governance and risk taking. How do we actually develop proper governance regulations for banks, given that firstly, we do not have good data, and secondly, banks have not been an object of great interest either to academics or to regulators.

Subrata Sarkar:

Thank you very much Renee. I now request Mr. Chaudhuri to give his opening statements.

Pratip Chaudhuri:

Thank you very much and I would go on the same path as Renee did; start with a story. The head of JP Morgan, Mr. James Dimon had once come to India and when he met us, we had asked him the question that how do you handle corporate governance? He said, I will tell you something; when the crisis broke out, the board's query was where can we see the crisis? Actually, the best place to see the crisis is to closely watch the daily operations of a company to which the board members agreed after a while. Fortunately, JP Morgan was not so strongly affected by the crisis.

I know, banking is a more technical issue unlike that of a company and I

am not downplaying the importance of governance in the corporate sector. If a company is managed badly, it can end up losing its own money or the shareholder's money whereas in a bank or a financial institution, lack of proper management can result in loss of the depositors' money as well as loss of confidence in the financial system itself. Therefore, very stringent rules and guidelines for effective governance in banks are prescribed by the regulators. In India, the regulator and Central Bank is the same.

Coming from a public sector bank where the position of CEO and Chairman of the Board are combined into one and the CEO is not selected by the shareholders but appointed by the largest shareholder, what I feel is that the Central Bank, being a highly respected organization, must use its leverage very rigorously to achieve more fruitful results. During my tenure, I have not seen many requests for Board appointment in public sector banks being entertained by the Central Government, but we did not find the same rigor being applied by the Central Bank. You have the committee reports saying the boards are not professional enough. If the boards are not professional enough, why did we not apply the 'fit and proper criteria' more effectively? I do not want to apportion the blame of unprofessional behavior in this forum. At the end of the day, banks need to have a good ROE and profit. So the board should not get into micro managing issues. In public sector, by fiat, so many issues have to be taken into account and therefore the board should think strategically for favorable positioning of the bank. However, in the board deliberations, very little of that happens and most of the discussions are on minor issues which I would say, amounts to micro management. So the discussions should move away from the issues of micro management to the larger issues of placing the bank in a good light to its customers.

The board meetings are structured in such a way that the chairman, the managing directors, the deputy directors, the functional heads and the independent directors should be present in them. Now, in case one of the directors is not there on a given day, that paper is presented by his neighbour who may not have any understanding of the issue at hand. So, treasury paper is being presented by somebody who deals with stress testing. That should not happen. In fact, the board meeting rule should mandate that if the head of the treasury who is invited to the board is not present then we must encourage the culture of the deputy and then next deputy to come and present. I think, this would give an opportunity to the independent and other directors to assess the quality and understanding of the executives. Furthermore, the executives should also get to know what it requires to have an effective board member and have proper communication of their thoughts.

Subrata Sarkar:

Let me now request Mr. Anand Sinha to express his views on corporate governance of financial institutions.

Anand Sinha:

Thank you. I broadly agree with the two previous speakers. What I would like to do is to focus a little bit on the issue of risk that has been raised in the context of corporate governance. Now, I would not define corporate governance because there are several definitions which are well understood. I would like to emphasize only one point that while corporate governance is a set of procedures, rules, methodologies etc., there is a soft element to that and if this soft element is not taken into consideration, it can lead to disaster which is exactly what happened during the crisis. The soft element is essentially about ethics, call it value judgment or ethics or whatever name you want to give. Consider the recent G-30 report 'Towards Effective governance of Financial Institution' which says that actually the question of whether the behavioral pattern is correct or not has to be judged when nobody is looking. In other words, the values i.e., ethics should be internalized.

There are two prime reasons for considering the financial sector as special, as pointed out by Mr. Chaudhuri. One is that when you enter into a financial contract, you are exposed to more risks as compared to when you go into the real sector. For example, if you buy a car and the car company fails, you do not really lose much, apart from the fact that the car's value goes on diminishing. Whereas, when you invest in a financial product, its value increases with time and how safe it is depends on the continuous, well-functioning of the financial institution where you have invested in. That is where the question of regulation, corporate governance, etc. becomes extra important. No doubt, it is important in every context but here it assumes central importance because it ensures the safe and sound functioning of that particular financial institution as well as of the entire financial system.

The second thing is leverage. Unlike companies in real sector activities, the leverage of financial sector companies, in particular banks, is very high. In fact, BCBS (Basel Committee on Banking Supervision) had done a study; I would like to quote some figures from that. As per the study conducted by the Bank for International Settlements (BIS) for the period 1995- 2009, financial institutions operated on a higher leverage as compared to non-financial institutions that had a leverage of about 3. Banks operated at a leverage of 18.3, while non-banking financial companies had a leverage of 12.1. In fact, 18.3 looks very respectable. Actually during the crisis, the leverage had gone up in some institutions, as high as 50. Even today, the

Basel Committee is experimenting with a leverage value of 33, which to my mind is not very prudent. Now, why leverage is dangerous or becomes dangerous is because you do not have enough equity but have a lot of debt and therefore once you get into bad times as in case of the recent crisis, the amount of equity which was thought to be sufficient so far, turned out to be totally inadequate.

Now obviously under Basel III, the equity has been strengthened both in terms of quality and quantity. However, in a crisis, when a herd mentality prevails in the market and when your normal distribution actually becomes extremely fat-tailed, at that time no amount of equity can protect you. Therefore it is very essential that corporate governance should prepare the institution not to get into that situation or if a crisis indeed comes, to be able to mitigate its impact. Note that, not every US institution was badly affected by the 2008 financial crisis. In fact, there is a study by a group of senior supervisors where they have examined various institutions during the crisis, particularly in Europe and US. They have come to the conclusion that institutions which used qualitative judgment while evaluating risks and devising appropriate measures rather than rely exclusively on quantitative models, did fare much better.

Now what happens when herd mentalities prevail? Let me give you some figures just to tell you what could be the dimension of the problem. You know that all risk management generally operates on the basis of normal distribution. However, we all know that the assumption of normality does not correspond to reality, particularly in a highly stressed situation. For example, the probability of 5 sigma loss that is 5 standard deviations removed from the mean of the distribution on any given day would mean that such an occurrence should happen once in about 14,000 years assuming 250 trading days in a year. This is much longer than the period of time that has elapsed since civilization evolved. During the crisis, the Wall Street journal reported that events which were predicted by models to happen only once in 10,000 years, actually happened once in 3 days. This is just one of the many such examples that I am quoting.

Although corporate governance has several components, I thought I should focus on the issue of risk and how it should be managed. This in turn leads to several other issues, that of technology, MIS, competence and skills among others. It goes without saying that Boards have to be more professional. Among the independent directors, there should be at least some people who have expertise in the required domains such as risk and if the people in the Board do not understand certain things, they should not venture into that area.

Krishnamurthy

Subramanian:

Basically, I want to connect the dots that have been provided to me by my esteemed panelists and try and set the agenda for a debate on corporate governance in financial institutions in India and elsewhere. As you know, Pratip mentioned that governance in financial institutions is very important. That's absolutely true because a healthy financial sector creates positive externalities or benefits for the real sector. At the same time, as we learnt during the financial crisis, a distressed financial sector can have adverse side effects on the real economy because of lending not flowing into the real sector. So governance in financial sector is of paramount importance. However, this does not mean that governance elsewhere is not important. When you ask a question about corporate governance, you think about boards, incentives for management, etc. But then you have to step back and ask the question: what is the objective that the management is trying to pursue? When you ask that question for industrial firms, you would get the obvious answer that they should be maximizing shareholder value. But the answer is not so obvious when you think about financial institutions. They are very highly leveraged. Furthermore, the risk of financial institutions can change overnight. Management really has a lot of discretion to undertake treasury operations. For example, you can move into risky assets as had happened during the financial crisis when people switched to securitized assets which were difficult to understand for someone who is outside the sector; such securities were difficult for even directors on the board to understand. So risk can change very quickly in treasury operations in a way that outsiders may not be able to keep track of. Similarly, only after lending to a particular client, the lender understands his operations well; others do not understand the client's operations as much. As a result, when you combine the fact that you have a highly leveraged institution that is vulnerable to shocks and there's significant uncertainty and information asymmetry, then governance becomes very important.

Equity value maximization is not necessarily right in the context of a financial institution. This is because when you have a highly leveraged institution, if managers are asked to maximize equity value, it can lead to incentives for taking a lot of risk. Therefore, equity value maximization is not necessarily the correct objective to pursue in financial institutions.

Further, we also have the moral hazard that is created because of deposit insurance, which most financial institutions have. Consider a thought experiment where you have a big bank in India which is under distress. Will it be allowed to fail like Lehmann was allowed to fail? Of course not!

Apart from this moral hazard problem, there are also the perverse incentives created by the “too big to fail” syndrome, which need to be taken into account. What’s the moral hazard? I know very well that even if I am in distress, the government as the lender of last resort will come and help me out and therefore, I don’t have to worry as such. When you have an institution that is highly leveraged together with the fact that risks can change very quickly, internalizing these risks either through capital or other requirements is not very easy and therefore the board’s expertise at handling these risks becomes very critical.

Now when you think about governance there are two main pillars: the board of course and secondly, the incentives that are created for employees. In both these cases, the objective function that has to be specified should be well thought off. So, either you could internalize those externalities by pricing them but pricing on a dynamic sense is not very easy because the risk component can change very quickly, which compounds the regulator’s problem.

Now I want to specifically talk about boards because as part of the P J Nayak Committee, we carefully examined the deliberations of boards of all the big banks in India. The RBI was very helpful in giving us actual minutes of the boards and as Pratip has mentioned earlier, we observed the fact that the quality of deliberations is not very high. Consider the analogy between a bank and a car. In a car, the accelerator and the brake are equally important. Similarly, in a bank, the strategy acts as the accelerator while risk acts as is the brake. So you need to use them together optimally. Still, you find that in most Indian banks, be it private sector or public sector banks, close to 65 per cent to 70 per cent of the attention is devoted to compliance. The visit by the Finance Minister or the lecture that the Chairman of the bank gave in a particular college gets as much attention as issues concerning risks or strategies. That is the reality of the quality of deliberations that we have in India. The decision of whether or not there should be an ATM created in a particular area or whether there should be housing premises created in Bhopal gets as much attention as matters pertaining to risk. The quality of people that we are recruiting needs some thought and that’s where the difference lies between public sector banks and private sector banks.

Subrata Sarkar:

Let me thank all the panelists for very detailed opening statements which cover a lot of issues. One important takeaway from their comments is that it is not easy to translate the objectives and standards of corporate governance of non-financial companies mechanically into governance of financial

companies. One principal difficulty is that while profit maximization is an accepted objective function for non-financial companies, the objective function for financial companies cannot be easily identified. In case of financial companies, the objective function has to incorporate social and developmental goals with the government playing the dual roles of investor and the sovereign. I think this is a very important distinction since the governance structures of financial companies must be designed in a way that it can balance the various objectives and not just profit maximization.

I am going to ask two questions on corporate governance structures in financial institutions and I want each of you to give your quick comments on them. The first question that I want to ask is, what do you think about governance in public sector banks? Second, what do you have to say on the notion of CEO duality where the chairman and managing directors is the same person and we have just heard in the previous session that sometimes it might make sense to have these two posts held by different persons. I ask this question particularly because it is not clear that we should do for financial companies what we do for non-financial companies.

Pratip Chaudhuri:

This has been discussed by the very eminent specialists in the area. Since private sector banks do not have an experience of this, it might be a good idea to experiment with separation of the positions of CEO and chairman of banks. I think one thing would improve the corporate governance is listing of companies because when you come under scrutiny not only from the boards but also from shareholders, the quality of governance improves. If we look at last 15 years, any failure of a financial institution which has involved payment from the exchequer, that was the Unit Trust of India. The Unit Trust of India was not listed. Perhaps it's a moot question but if it had been listed, may be it would have been subject to a greater scrutiny. On empirical basis I can say that in public sector banks, the quality of governance and the quality of questioning has significantly increased after they have become listed. My worry is regarding the non-listing of Life Insurance Corporation. The Life Insurance Corporation of India (LIC) which holds as much financial assets as the largest bank in the country, is very opaque in its transactions. It is not subject to shareholders' scrutiny. I believe that the level of governance and scrutiny would greatly improve by getting LIC listed in the exchanges. In India, I think the overall quality of governance has definitely improved in proportion to the activism of the Right to Information Act. Similarly, I think listing enhances the level of RTI in any organization. So, I would strongly recommend all financial institutions which are accepting savings of the public to get listed.

Renee Adams: My question is what's the point of separating it? Why do people say they want to separate it?

Subrata Sarkar: Usual argument is that you get reduced oversight if the same person holds both posts. However, the other side of the argument is that if the same person holds both the jobs, decision making is faster. As I understand from the views of most panelists, the implications of failure in non-financial companies are very different from the implications in a bank. So therefore, I think that separating the positions of chairman and CEO which is probably good for nonfinancial companies cannot be mechanically implemented in banks.

Renee Adams: I don't think there is any evidence that it makes any difference whatsoever for nonfinancial companies. This is one thing that I find puzzling as an academic. In spite of so much debate on the issue of separation of the positions, I think probably the impact is truly irrelevant. It depends on the chairman's role which in turn depends on the company that he/ she is associated with. Many listed large banks in the US actually have both positions combined because their internal promotion is most likely to go to the CEO position and then the chairman position. So the role is important for succession. It really depends on what the role is and how the company actually uses the Chairman's position.

**Krishnamurthy
Subramanian:**

Arguments have been put forward that when you combine the Chairman and the CEO positions together one person might find it difficult to handle this complex role in financial institutions. I think in the Indian context, particularly in case of public sector banks, you also have to take into account the following flip side. Suppose you separate these roles, you can have a situation where the Chairman's post is held by a politician, may be even worse a failed politician who has lost the elections. Hence, I think that the current practice of having the Chairman and the CEO positions being held by someone who is actually expert in that area acts as a very good governance mechanism. If you have someone who is actually coming up with objectives which are very different from the health of the institution, that can be a recipe for disaster, which is why our committee delved into this issue and we felt that progress on this front was not possible till there was political interference by the government. Consider for example that the Ministry of Finance over the last five years has issued several circulars saying that ALM and micro management of banks have to be done in a particular way. When you have such interference then it may not be optimal to separate the two roles.

Anand Sinha: Ultimately the question is that if the political interference is not there, then what is the model to be accepted? I would strongly advocate separation of the two, though I fully agree with Renee that in any situation whatever system you produce, you have to look at the balance of advantages. In reality, you cannot predict how it will function. It depends on the people who are there. So even if you have a separation or a non-separation, ultimately the effectiveness of corporate governance will be the result of the efforts of the people manning these posts. I think, the advantage of separating the two positions is that it frees the managing director to concentrate on the operational tasks and he has somebody else to assist him or guide him in policy formulation. But at no cost should we have political appointees neither now nor ever.

**Krishnamurthy
Subramanian:**

But I think to add what Renee was saying that the evidence is tenuous on whether or not the Chairman and CEO roles should be separated. Even ignoring politicization, whether separating these positions improves governance is not so obvious.

Anand Sinha:

I would agree with you on this point and this is similar to the debate as to whether regulation and supervision should be done by the Central Bank or someone outside of it. There is no clear evidence regarding this. One can say that both systems have performed equally well at some times and equally badly at other times. That's why I believe that ultimately what matters is how you operate the system. For example, several post- crisis studies have shown that there is nothing wrong with the corporate governance codes; what is wrong is the manner of implementation of those codes. That is why you won't find the OECD Corporate Governance norms being revised because they have come to the conclusion that the norms are correct, the fault lies in their implementation. My view is that the success of any system ultimately depends on how it is put to use rather than too much on its structure *per se*. But if one thinks along the lines that you could have good people at some point of time, and not so good people at other points of time, then I would think that the balance of advantage would lie in separating the two roles.

Pratip Chaudhuri:

I want to make a comment, regarding this implementation thing. My father used to work for Planning Commission and I think his job was the easiest because if anything flung in the 2nd Five Year Plan or 3rd Five Year Plan, you say I planned it right but the implementation was not carried out properly. But I would like to see whether the planners can step into the shoes of implementers and produce better results.

Subrata Sarkar: Yes, but I think that though in theory it is a good suggestion, yet empirically to get this counterfactual is very costly. Hence, we cannot afford to get a bad outcome by undertaking the counterfactual.

Krishnamurthy

Subramanian: I just want to point out one thing that has happened with this crisis of governance. The evidence suggests that box-ticking kind of corporate governance leads to bad outcomes; there should be something in spirit that enables better governance.

Subrata Sarkar: I want to touch upon yet another important aspect which is specific to public sector banks in India, namely the tenure of the CMD. As we all know that many CMDs get appointed late in their careers and do not have sufficient time to take a bank forward. So Mr. Chaudhuri, what is your view on having minimum tenure: say 5 or 10 years?

Pratip Chaudhuri: No, I think 3 years is good enough because if it is 5 years, I personally think that in the first 2 years you tend to relax. Then you say that I will make it up in the next 3 years. So, 3 years gives you urgency and in case of SBI, it is better because normally the CMD or the Chairman is an internal candidate, so he/ she pretty much knows the capabilities, the interests and the ability to deliver of the top 40 executives. On the contrary, in other public sector banks you come from a bank based in South, suddenly you get transferred to a much larger bank in North or in the East. Then, you first have to come to terms with the names of the people and then the overall personality of the people which becomes a problem because India is a culturally and ethnically diverse country. So I think 3 years is good enough a term but in other public sector banks, if a person becomes the Executive Director, he/ she should continue as the CMD and then Director, because spending 2 years here and then moving on to something else is not very easy.

Subrata Sarkar: Does the P J Nayak Committee have something to say about this?

Krishnamurthy

Subramanian: We have actually recommended 5 years but we also feel that while tenure is important, I think the incentives are even more important. The elephant in the room is really the incentives. Tenure can of course make a difference, but unless you have proper incentives, it will be difficult to achieve good governance. The reason I am harping on this is that, consider for example, Pratip's comment that if the tenure is 5 years, in the first 2 years the CMD might relax. When you look at private sector banks, it does not happen. You have CEOs who actually are there for may be even longer than 3 or 5 years and yet they do not relax. This is because their incentives are such that they

are actually motivated to work hard. So, unless you have the right incentives to deliver good performance, you will not be motivated to do so. Further, appropriate incentives will also ensure that people will not relax for the first 2 years. So, both incentives and tenure have to be seen as complementary. The government has to think about this.

Subrata Sarkar:

I want to touch upon one last question namely the importance of having sufficient number of independent directors on boards of financial institutions. One of the major arguments advanced by corporate against having too many independent directors on corporate boards is that many of these directors are not accustomed to the business of the company. Adequate emphasis is not placed on the fact that independent directors also have another responsibility namely their fiduciary responsibility to the shareholders. However, banking is a very specialize business where the requirement of domain knowledge is very strong. The P. J. Nayak Committee has suggested that banks should be incorporated in the Companies Act and all requirements of Clause 49 relating to having minimum percentage of independent directors should be also applicable to banking companies.

What is your take on this issue especially regarding the appointment of independent directors by the government for short tenures and who may not have specific domain knowledge? Do you think it is a good idea to apply Clause 49 regulations on all listed companies, including banks?

Pratip Chaudhuri:

I think it is like the constitution of the country. No matter how well it is drafted, no matter how well intentioned it is, it is only as good as the people who are running it and using it. Similarly, even this concept of having an independent director is good but it remains to be seen how well it will be applied. It should not be that tomorrow a retrograde management appoints these independent directors and havoc is created. Moreover, in Indian banks, individual credit proposals are to be approved by the boards beyond their threshold levels. I think that threshold should be higher. There have been instances, not in SBI but in other banks, that these board members harass the customer by saying that 'Okay, unless you do this for me, I will block your proposal in the board'. So, that moral hazard would remain and I think that at least in case of credit proposals, independent directors, should not be eligible.

Anand Sinha:

On the question of specialized knowledge of independent directors, we have several acts, the Banking Regulation (BR) Act, SBI Act among others which prescribe specialization. It is not that specialization is not prescribed; the issue again is of the man behind the machine. Specialization is there, but how do you define it and how do you select a real specialist? So, again

we come back to the question of the manner of implementation and that is the crux of the issue. What Mr. Chaudhuri said regarding interference from Directors, etc., he would know better about this. Selection of the board members on the lines of the recommendation of the committee does assume importance because if the bigger private sector banks can have high quality professionals, why can the public sector banks not have so, when it is already prescribed as law? The solution lies in changing the process, changing the way you select people.

Pratip Chaudhuri: In SBI there is one problem. There is a rule that if you are a director in SBI, you cannot be a director in any of the companies that are being financially assisted by SBI. In India we have many successful professionals who would have done great justice to their functions, if they were on the board of SBI. But they simply cannot, for one directorship disengage themselves from 20 other companies with whom they have been very closely associated.

Anand Sinha: This is not a problem with SBI; this is actually prescribed in section 20 of the BR Act. So, it is applicable across the system.

Pratip Chaudhuri: With the corporate houses owning the banks, I think these functions would become more acute.

**Krishnamurthy
Subramanian:**

I just wanted to touch on the spirit of, why we actually felt that banks and the bank investment company should be a part of the New Companies Act. Remember that the Banking Regulation Act was enacted when banks were nationalized. At that time, the government owned 100 per cent stake in the banks and essentially the employees were going to run the bank. So the spirit, under which the BR Act was enacted, was very different from what we have now. Now you have banks which are actually listed in the stock markets and have minority private investors as well.

The other important point is expropriation of minority investors by the government as a majority investor and this is something that should be thought about. You have a Companies Act which is actually state of the art and you also have the Clause 49 listing guidelines. There are specific director categories, like CA directors and we got to know that some of these directors come with their own agendas. So, my point is why live on something that is anachronistic now when a state of the art piece of legislation is in place and can be used? That was the spirit behind having banks and the bank holding company incorporated under the Companies Act.

Anand Sinha: This has been a long standing debate and in fact, there has been a lot of

support for having one Act to deal with all the banks.

Subrata Sarkar: Thank you all for your very much insightful comments. I will open the floor for questions.

Q&A Session:

Audience: There has been much debate about the importance of independent directors and Prof. Subramanian called 'incentives' as the elephant in the room. Why would anybody join the board of a bank if he cannot be remunerated? My question to Mr. Chaudhuri is therefore, what is the quid-pro-quo that the banks are earning, from these independent directors' inputs? Why do you have this rule that you cannot get any remuneration for being on the board of a bank?

Pratip Chaudhuri: No, you get remuneration but it is not substantive.

Deborah Gilshan: Just wanted to quickly make a comment about the separation of Chairman and CEO's positions. It is actually about the Chairman being independent and it is not just about separation of the roles of the two posts. It is about the fact that the ultimate role of the board is to hire and fire the CEO. I think we get caught in this debate about separation, when actually it is about the role of the boards. I spent a lot of time in the US and we spoke to companies about this specifically. Our Chairman said he never understood the difference between the two until he became an independent chairman after which he realized what the debate was about. So the main point we have to be careful about is regarding the Chairman's independence and no unfretted power being vested in one individual.

**Krishnamurthy
Subramanian:**

I think Renee will agree with me that what you have highlighted is clearly important. There is of course a trade-off where you have a Chairman who is a non-executive and he necessarily does not understand the detailed operations of the company. See basically, when there is the question of having an executive versus a non-executive, there is a trade-off in terms of information. I think there is no clear answer which can be applied to all situations. That's why, while I quite understand the fact that having a non-executive on board might bring more oversight, it does not come without the flip side.

Renee Adams: I want to go back to this point of director compensation. This is true in the USA also that bank directors receive substantially lower compensation as compared to directors of non-financial firms. In this whole debate about governance and expertise, what nobody has talked about is what they

should actually get paid to be directors of these institutions. I mean it is just unbelievable when everybody talks about bank directors being overpaid. So in the current climate, regulators will obviously never get a push for more compensation for bank directors, but I think that is really important.

Audience: Yes, who is really an independent director in a public sector bank? Most of them are appointed by the government, and only few are appointed by the shareholders.

Krishnamurthy

Subramanian: If the directors are appointed by the government, they should qualify as 'promoter directors'. This is because the government is equivalent to a promoter and the government is appointing these directors. Thus, you do not have independent directors currently on boards of public sector banks.

Audience: They say that they are complying with the independent director norms. The P J Nayak Committee Report also somewhat mentions about this.

Krishnamurthy

Subramanian: But another thing you have to take into consideration is that public sector companies have been exempted from adhering to clause 49 regulations. If they are exempted, then necessarily you cannot require them to comply with independent director norms. What is happening currently is that the public sector companies including public sector banks are not complying with Clause 49.

Audience: I think I will add one critical factor to the point of governance in banking, which is the intensity of Regulatory and Supervisory oversight which to a considerable extent lowers the necessity of governance. Generally, be it a private or public sector firm, once you get a fairly a good chit from the Reserve Bank inspection report, a comfort feeling occurs that they are absolutely well managed. So, the main issue is that how do you go about complying with the RBI directions. The second factor is that banks deal in other people's money. Hence protection of depositors should be their primary objective. Shareholders' value maximization is a secondary concern for everyone. Even if your ROA drops slightly, there will always be some credible borrowers. If your confidence is shaken at any point of time however big you are, you are bound to fail. Last but not the least: is the prevailing view that banks can never fail. This is a philosophy that has been adopted in the developing countries. Today, all countries, including developed ones, experience bank bailouts becoming a rule rather than an exception. These things cumulatively impact the governance. In state owned banks, there is a typical pattern so far as directors are concerned. State Bank of India is

an exception. It has been fortunate to get a fairly good choice of their own directors but when it comes to other state owned banks, the directors are not chosen by the banks themselves. In a lighter vein I would say, you need a managing director to manage the directors and you also need a managing director to manage the bank. Ultimately, it is the CEO's integrity, competence, and leadership that determine the style of governance. You may combine the roles of the chairman and the CEO as long as a chairman remembers that he is not the CEO and has the humility to accept a 'no' from the board.

Audience:

Recently we have seen that in a large number of banks, whenever there is a change of the CEO, there is an increased amount of write-off taking place in the accounts immediately. Given this is happening, what do you perceive about the role of the board and more specifically, the role of the audit committee? Also in that context, what do you think about the extreme oversight which RBI is exercising through its inspection? Should it not be flagged a little bit earlier rather than wait for the CEO to change?

Pratip Chaudhuri:

I think I would respond to this. See we have so much to learn in this area, particularly from the bad loans in the US because we have relatively smaller operations there. However, what is happening in India is that one account is standard with one bank, while substandard with another. So it depends on the leverage of the auditors or the CEO. But in the USA, where there are 200 nationally accredited accounts, the regulator comes in and takes a hard look at the asset and if it finds it to be substandard or doubtful, it prescribes uniform provisioning for that. So, even if that account is there in 20 banks, all banks will have to do provisioning of 15 per cent, or 20 per cent or 40 per cent, whatever the prevailing rate is. One single step by RBI in this direction can clear a lot of clutter.

Regarding the question of, "too big to fail" institutions, if you look at Basel III capital requirements, most of the international banks are allocated 80 per cent of the capital to credit, except Bearings Bank which failed because of operational issues. If we add one more disclosure norm to Basel III, i.e. what percentage of your assets are AAA, AA+, A, B and as per the external credit rating of the asset and that would lay bare the internal health of the bank.

Subrata Sarkar:

Thank you everybody. The governance of financial institutions is a very involving topic with a number of important issues which we cannot possibly address in a short time but we still got a number of valuable insights. I think that one major takeaway from this discussion is that banks are not same as companies as the objective functions of these two entities are quite different. The objective function of a bank encompasses many aspects which

are difficult to aggregate. So we have a problem at the beginning itself namely, what should a bank maximize? One possible way out is to design an improved governance structure for banks and then repose our faith in that structure and the people embedded in them to define the important objectives and to take appropriate steps for achieving those objectives.

Empowering bank-boards becomes paramount in this context. I think in India, especially in public sector banks, the board should be empowered so that they can take decisions which are in the best interests of not only the shareholders but also the employees/ clients. With this, let me thank all the panel members and the audience and let me bring to a close this exciting discussion.

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