Report of the Consultative Group of Directors of Banks / Financial Institutions (Dr. Ganguly Group) - Implementation of recommendations

June 20, 2002

DBOD. No.BC. 116 / 08.139.001/2001-02

The Chairman & Managing Directors / Managing Directors
of all scheduled commercial banks (excluding foreign banks,
regional rural banks and local area banks)

Dear Sir,

Report of the Consultative Group of Directors of Banks / Financial Institutions (Dr. Ganguly Group) - Implementation of recommendations

The Consultative Group of Directors of banks and FIs set up by Reserve Bank of India to review the supervisory role of Boards had submitted its report in April 2002 and the same was put in our website (**www.rbi.org.in**) for wider dissemination and comments from banks and other experts (A copy of the report is enclosed for ready reference).

We have examined the recommendations of the Group. In view of the importance of the recommendations made by the Group for effective functioning of banks, we would request you to place the Report as well as the list of recommendations enclosed as Annexure before the Board of Directors of your bank. Based on the decision taken by the Board, these recommendations can be adopted and implemented in your bank.

Incidentally, certain recommendations of the Group require the approval of the Government or legislative amendments and hence they have been referred to Government for consideration.

You may please keep us informed of the action taken by you in this regard.

2. Please acknowledge receipt.

Yours faithfully,
(C.R. Muralidharan)
Chief General Manager
Encls: As above

Annexure

List of recommendations of the Consultative Group of Directors on banks and financial institutions which may be considered by banks for adoption and implementation

A. <u>Recommendations which may be implemented by all banks</u>

(i) Responsibilities of the Board of Directors

(a) A strong corporate board should fulfil the following four major roles viz. overseeing the risk profile of the bank, monitoring the integrity of its business and control mechanisms, ensuring the expert management, and maximising the interests of its stakeholders.

(b) The Board of Directors should ensure that responsibilities of directors are well-defined and every director should be familiarised on the functioning of the bank before his induction, covering the following essential areas:

- ? delegation of powers to various authorities by the Board,
- ? strategic plan of the institution
- ? organisational structure
- ? financial and other controls and systems
- ? economic features of the market and competitive environment.

(ii) Role and responsibility of independent and non-executive directors

(a) The independent / non-executive directors have a prominent role in inducting and sustaining a pro-active governance framework in banks.

(b) In order to familiarise the independent /non-executive directors with the environment of the bank, banks may circulate among the new directors a brief note on the profile of the bank, the sub committees of the Board, their role, details on delegation of powers, the profiles of the top executives etc.

(c) It would be desirable for the banks to take an undertaking from each independent and non-executive director to the effect that he/she has gone through the guidelines defining the role and responsibilities and enter into covenant to discharge his/her responsibilities to the best of their abilities, individually and collectively. A model form of “deed of covenants with a director” is provided in Annexure 3 to the Consultative Group’s Report.

(iii) Training facilities for directors

(a) Need-based training programmes / seminars/ workshops may be designed by banks to acquaint their directors with emerging developments/challenges facing the banking sector and participation in such programmes could make the directors more sensitive to their role.

(b) The Board should ensure that the directors are exposed to the latest managerial techniques, technological developments in banks, and financial markets, risk management systems etc. so as to discharge their duties to the best of their abilities.

(c) While RBI can offer certain training programmes/seminars in this regard at its training establishments, large banks may conduct such programmes in their own training centres.

(iv) Submission of routine information to the Board

Reviews dealing with various performance areas may be put up to the Management Committee of the Board and only a summary on each of the reviews may be put up to the Board of directors at periodic intervals. This will provide the Board more time to concentrate on more strategic issues such as risk profile, internal control systems, overall performance of the bank. etc.

(v) Agenda and minutes of the board meeting

(a) The draft minutes of the meeting should be forwarded to the directors, preferably via the electronic media, within 48 hours of the meeting and ratification obtained from the directors within a definite time frame. The directors may be provided with necessary technology assistance towards this end.

(b) The Board should review the status of the action taken on points arising from the earlier meetings till action is completed to the satisfaction of the Board, and any pending item should be continued to be put up as part of the agenda items before the Board.

(vi) Committees of the Board

(a) Shareholders' Redressal Committee

As communicated to banks in our circular DBOD No.111/08.138.001/2001-02 dated June 4, 2002 on SEBI Committee on Corporate Governance , the banks which have issued shares,/debentures to public may form a committee under the chairmanship of a non-executive director to look into redressal of shareholders' complaints.

(b) Risk Management Committee

In pursuance of the Risk Management Guidelines issued by the Reserve Bank of India in October 1999, every banking organisation is required to set up Risk Management Committee. The formation and operationalisation of such committee should be speeded up and their role further strengthened.

(c) Supervisory Committee

The role and responsibilities of the Supervisory Committee as envisaged by the Group viz., monitoring of the exposures (both credit and investment) of the bank, review of the adequacy of the risk management process and upgradation thereof, internal control system, ensuring compliance with the statutory / regulatory framework etc., may be assigned to the Management Committee./ Executive Committee of the Board.

(vii) Disclosure and transparency

The following disclosures should be made by banks to the Board of Directors at regular intervals as may be prescribed by the Board in this regard.

? progress made in putting in place a progressive risk management system, and risk management policy and strategy followed by the bank.

? exposures to related entities of the bank, viz. details of lending to/investment in subsidiaries, the asset classification of such lending/investment, etc.

? conformity with corporate governance standards viz. in composition of various committees, their role and functions, periodicity of the meetings and compliance with coverage and review functions etc.

B. Recommendations applicable only to public sector banks

(i) Information flow

In order to improve manner in which the proceedings are recorded and followed up in public sector banks, they may initiate measures to provide the following information to the board:

? A summary of key observations made by the directors which should be submitted in the next board meeting.

? A more detailed recording of the proceedings which will clearly bring out the observations, dissents, etc. by the individual directors which could be forwarded to them for their confirmation.

(ii) Company Secretary

The Company Secretary has important fiduciary and Company Law responsibilities. The Company Secretary is the nodal point for the Board to get feedback on the status of compliance by the organisation in regard to provisions of the Company Law, listing agreements, SEBI regulations, shareholder grievances, etc. In view of the important role performed by the Company Secretary vis-à-vis the functioning of the Boards of the banks, as also in the context of some of the public sector banks having made public issue it may be necessary to have Company Secretary for these banks also. Banks should therefore consider appointing qualified Company Secretary as the Secretary to the Board and have a Compliance Officer (reporting to the Secretary) for ensuring compliance with various regulatory / accounting requirements.

C. Recommendations applicable only to private sector banks

(i) Eligibility criteria and ‘ fit and proper’ norms for nomination of directors.

(a) The Board of Directors of the banks while nominating/ co-opting directors should be guided by certain broad 'fit and proper' norms for directors, viz. formal qualification, experience, track record, integrity etc. For assessing integrity and suitability features like criminal records, financial position, civil actions initiated to pursue personal debts, refusal of admission to or expulsion from professional bodies, sanctions applied by regulators or similar bodies, previous questionable business practices etc should be considered. The Board of Directors may, therefore, evolve appropriate systems for ensuring ‘fit and proper’ norms for directors, which may include calling for information by way of self-declaration, verification reports from market, etc.

(b) The following criteria, which is in vogue in respect of nomination to the boards of public sector banks, may also be followed for nominating independent/ non-executive directors on private sector banks:

- The candidate should normally be a graduate (which can be relaxed while selecting directors for the categories of farmers, depositors, artisans, etc.)
- He / she should be between 35 and 65 years of age.
- He / she should not be a Member of Parliament / Member of Legislative Assembly/ Member of Legislative Council.

(ii) Commonality of directors of banks and non banking finance companies (NBFC)

In case, a director on the board of an NBFC is to be considered for appointment as director on the board of the bank, the following conditions must be followed:

- He/she is not the owner of the NBFC, [i.e., share holdings (single or jointly with relatives, associates, etc.) should not exceed 50%] ,
- He/she is not related to the promoter of the NBFC,
- He/she is not a full-time employee in the NBFC.
- The concerned NBFC is not a borrower of the bank.

(iii) Composition of the Board

In the context of banking becoming more complex and competitive, the composition of the Board should be commensurate with the business needs of the banks. There is an urgent need for making the Boards of banks more contemporarily professional by inducting technical and specially qualified personnel. Efforts should be aimed at bringing about a blend of 'historical skills' set, i.e. regulation based representation of sectors like agriculture, SSI, cooperation etc. and the 'new skills' set, i.e. need based representation of skills such as, marketing, technology and systems, risk management, strategic planning, treasury operations, credit recovery etc. The above suggestions may be kept in view while electing / co-opting directors to their boards.