

Report of the Consultative Group
of Directors
of Banks / Financial Institutions



Reserve Bank of India
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Executive Summary:

1. The Consultative Group of Directors of banks and financial institutions was set up by the Reserve Bank to review the supervisory role of Boards of banks and financial institutions and to obtain feedback on the functioning of the Boards vis-à-vis compliance, transparency, disclosures, audit committees etc. and make recommendations for making the role of Board of Directors more effective with a view to minimising risks and over-exposure.
2. The Group has produced a list of recommendations after a comprehensive review of the existing legal framework governing constitution of the Boards of banks and financial institutions, interaction with various interested groups, organisations, etc. and benchmarked its recommendations with international best practices as enunciated by the Basel Committee on Banking Supervision, as well as of other committees and advisory bodies, to the extent applicable in the Indian environment.

Recommendations of the Group:

3. Due diligence of the directors of all banks - be they in public or private sector, should be done in regard to their suitability for the post by way of qualifications and technical expertise. Involvement of Nomination Committee of the Board in such an exercise should be seriously considered as a formal process.
4. The Government while nominating directors on the Boards of public sector banks should be guided by certain broad "fit and proper" norms for the Directors. The criteria suggested by the BIS may be suitably adopted for considering 'fit and proper' test for bank directors.
5. For assessing integrity and suitability, factors such as criminal records, financial position, civil actions undertaken to pursue personal debts, refusal of admission to, or expulsion from professional bodies, sanctions applied by regulators or similar bodies, and previous questionable business practices, etc. should be considered.
6. The appointment / nomination of independent / non-executive directors to the Boards of banks (both public sector and private sector) should be from a

pool of professional and talented people to be prepared and maintained by Reserve Bank of India. Any deviation from this procedure by any bank should be with the prior approval of RBI.

7. In the present context of banking becoming more complex and knowledge-based, there is an urgent need for making the Boards of banks more contemporarily professional by inducting technical and specially qualified individuals.
8. While continuing regulation based representation of sectors like agriculture, SSI, cooperation, etc, efforts should be aimed at combining it with the need-based representation of skills such as marketing, technology & systems, risk management, strategic planning, treasury operations, credit recovery, etc., Further, the Boards of banks should also have representation in the areas such as finance, information technology, human resources development, economics and persons with good track record of experience in managing / advising industrial enterprises.
9. The independent / non-executive directors should raise in the meetings of the Board, critical questions relating to business strategy, including loans & recovery policy, housekeeping and internal control systems, record of exposure to various sectors / industries by way of both credit and investment, risk management systems, internal audit, accounting policy, senior management development, other important aspects of the functioning of the bank and investor relations. The good corporate governance in banks will be sustained by a knowledgeable, skillful and well informed Board of Directors with a proper blend of expertise / professionalism, independence and involvement.
10. In the case of private sector banks where promoter directors may act in concert, the independent / non-executive directors should provide effective checks and balances ensuring that the bank does not build up exposures to entities connected with the promoters or their associates. The independent / non-executive directors should provide effective checks and balances particularly, in widely held and closely controlled banking organisations.

11. Directors on the boards of NBFCs may be permitted to become Independent / non-executive directors on the boards of banks, subject to certain conditions.
12. Every Director should be given a brief on the functioning of the bank, before his appointment / induction, covering various aspects of structure / functioning of the bank.
13. The Board should formulate policies relating to credit dispensation, particularly in regard to exposure to various productive sectors, geographical areas, investments, exposures to sensitive sectors such as capital market, strategies for recovery of loans and status of progress with respect to investments, risk management, etc.
14. The directors could be made more responsible to their organisation by exposing them to need-based training programmes / seminars / workshops to acquaint them with emerging developments / challenges facing the banking sector. Reserve Bank as the Regulator, could take the initiative to organizing such seminars.
15. The whole-time directors should have sufficiently long tenure to enable them to leave a mark of their leadership and business acumen on the bank's performance.
16. Reserve Bank may bring out an updated charter indicating clear-cut, specific guidelines on the role expected and the responsibilities of the individual directors.
17. As a step towards effective corporate governance, it would be desirable to take an undertaking from every director to the effect that they have gone through the guidelines defining the role and responsibilities of directors, and understood what is expected of them and enter into a covenant to discharge their responsibilities to the best of their abilities, individually and collectively.
18. The existing level of remuneration paid (by way of sitting fees, etc.) to directors of banks and financial institutions is grossly inadequate, by

contemporary standards, to attract qualified professional people to their boards, and expect them to discharge their duties as per the mutually agreed covenants. In order to attract quality professionals, the level of remuneration payable to the directors should be commensurate with the time required to be devoted to the bank's work as well as to signal the appropriateness of remuneration to the quality of inputs expected from a member. The remuneration of the directors may also include the form of stock option.

19. It would be desirable to separate the office of Chairman and Managing Director in respect of large sized public sector banks. This functional separation will bring about more focus on strategy and vision as also the needed thrust in the operational functioning of the top management of the bank.
20. The statutory prohibition under section 20 of the Banking Regulation Act, 1949 on lending to companies in which the director is interested, severely constricts availability of quality professional directors on to the Boards of banks. Internationally, however, banks are permitted to extend credit facilities to companies in which the directors are interested subject to full disclosure and appropriate covenants. This would require a change in the existing legal framework. We need to move towards this goal.
21. The information furnished to the Board should be wholesome, complete and adequate to take meaningful decisions. A distinction needs to be made between statutory items and strategic issues in order to make the material for directors 'manageable'. The manner in which the Board proceedings are recorded and followed up in public sector banks leaves much scope for improvement. The Reviews dealing with various performance areas could be put up to the Supervisory Committee of Board and a summary of each such review could be put up to the Main Board. The Board's focus should be devoted more on strategy issues, risk profile, internal control systems, overall performance of the bank, etc.
22. The procedure followed for recording of the minutes of the board meetings in banks and financial institutions should be uniform and formalised. Banks

and financial institutions may adopt two methods for recording the proceedings viz., a summary of key observations and a more detailed recording of the proceedings. In every meeting, the board should review the status of the action taken on the points arising from earlier meetings and till action is completed to its satisfaction; the pending items should continue to be put up before the board.

23. It would be desirable if the exposures of a bank to stockbrokers and market-makers as a group, as also exposures to other sensitive sectors, viz., real estate etc. are reported to the Board regularly. The disclosures in respect of the progress made in putting in place a progressive risk management system, the risk management policy, strategy followed by the bank, exposures to related entities, the asset classification of such lendings / investments etc. conformity with Corporate Governance Standards etc., be made by banks to the Board of Directors at regular intervals as prescribed.
24. All banks should consider appointing qualified Company Secretary as the Secretary to the Board and have a Compliance Officer (reporting to the Secretary) for monitoring and reporting compliance with various regulatory / accounting requirements.
25. There could be a Supervisory Committee of the Board in all banks, be they public or private sector, which will work on collective trust and at the same time, without diluting the overall responsibility of the Board. Their role and responsibilities could include monitoring of the exposures (credit and investment) review of the adequacy of risk management process & upgradation thereof, internal control systems and ensuring compliance with the statutory / regulatory framework.
26. The Audit Committee should, ideally be constituted with independent / non-executive directors and the Executive Director should only be a permanent invitee. However, in respect of public sector banks, the existing arrangement of including the Executive Director and nominee directors of Government and RBI in the Audit Committee may continue.
27. The Chairman of Audit Committee need not be confined to the Chartered

accountant profession but can be a person with knowledge on 'finance' or 'banking' so as to provide directions and guidance to the Audit Committee, since the Committee not only looks at accounting issues, but also the overall management of the bank.

28. It is desirable to have a Nomination Committee for appointing independent / non-executive directors of banks. In the context of a number of public sector banks issuing capital to the public, a Nomination Committee of the Board may be formed for nomination of directors. representing shareholders.
29. With a view to building up credibility among the investor class, the Group recommends that a Committee of the Board may be set up to look into the grievances of investors and shareholders, with the Company Secretary as a nodal point.
30. The formation and operationalisation of the Risk Management Committees in pursuance of the guidelines issued by the RBI should be speeded up and their role further strengthened.
31. The banks could be asked to come up with a strategy and plan for implementation of the governance standards recommended and submit progress of implementation, for review after twelve months and thereafter half yearly or annually, as deemed appropriate.

Chapter 1.

Introduction

Background

- 1.1. The recent developments provide ample evidence that inadequate corporate governance standards in certain banks and financial institutions could contribute to their financial fragility. The developments in the South - East Asian countries in 1997-98 bring out clearly the need for formal governance standards in the corporate and financial sectors. The inadequate governance standards in the corporate sector raises the risk profile of companies and expose the relevant banks and other lending institutions to greater potential default. The adherence to formal (or mandated) corporate governance practices are particularly crucial for banks as weak or inadequate corporate governance standards invariably result in ineffective risk management and ultimately to financial instability. In the case of banks, the developments in one bank may trigger systemic consequences. The essence of formal corporate governance in banking institutions are, therefore, the responsibility of the Board and its independent Committees for providing adequate checks and balances, transparency and disclosures, robust risk management systems, risk containment procedures, early warning systems and prompt corrective actions to avoid default.

- 1.2. The recent developments in the country have brought to the fore the need for Boards of banks and financial institutions to ensure appropriate organisational mechanisms regarding the functioning of banks and other financial institutions. The Mid-term Review of Monetary and Credit Policy for the year 2001-02 announced on October 22, 2001 noted that although as part of the on-going financial sector reforms, much greater autonomy and powers have been entrusted to the Boards of banks and financial institutions to lay down effective internal guidelines and procedures to enhance transparency, disclosure, risk and asset-liability management ; yet, it has been noticed that in some cases, the policy laid

down by the Boards was either flouted with impunity, or the Board itself had failed to formally lay down appropriate internal guidelines for minimising risks and over-lending to certain entities, without adequate security. The Mid-term Review, therefore, noted that if problems of the type which have surfaced, recently, are to be avoided in the future, within the framework of a growing deregulated and liberal financial system, the role of Boards becomes crucial. In the above backdrop, the Consultative Group of Directors of banks and financial institutions was set up by the Reserve Bank in consultation with IBA, with the following terms of reference:

- (a) To review the supervisory role of Boards of banks and financial institutions and to obtain feedback on the functioning of the Boards vis-à-vis compliance, transparency, disclosures, audit committees, etc.
- (b) To study the system prevalent in banks / financial institutions for monitoring by the Board, the implementation of the policies laid down by it.
- (c) To make recommendations for making the role of Board of Directors more effective with a view to minimising risks and over-exposure.
- (d) Any other matter relevant to the subject.

The details of the constitution of the Group are furnished in [Annexure 1](#).

Methodology

- 1.3. The specific mandate given to the Group was to review and to recommend measures to make the supervisory role of the Boards of banks and financial institutions more effective. Given the mandate, the methodology followed by the Group was to examine the legal framework governing the constitution and functioning of the Boards of banks, the international best practices on corporate governance and to explore the feasibility of adapting desirable practices so as to make the supervisory role of the Boards of banks more effective.

1.4. The Group reviewed the existing legal framework governing constitution of the Boards of banks and financial institutions such as, appointment of the Chairmen and Managing Directors of banks, appointment of independent directors and of auditors, etc. The Group looked into the functioning of the Boards of banks, the quality of information flow to the Boards, the system prevailing in banks for the follow up of the action taken on the earlier decisions of the Board, compliance with legal and regulatory requirements, secretarial practices relating to Board matters, etc. The Group also reviewed the contemporary literature on the subject and the international best practices such as those enunciated by the Basel Committee on Banking Supervision, the OECD, the guidelines issued by the Hong Kong Monetary Authority, the recommendations of the Kumar Mangalam Birla Committee appointed by the SEBI, recommendations of the Advisory Groups set up by RBI on Corporate Governance (under the chairmanship of Dr. R.H. Patil) and on Banking Supervision (under the chairmanship of Shri M.S. Verma). A note indicating the principles / recommendations (as applicable to banks) arising out of the best practices as also of the reports of the aforesaid Groups was circulated among the banks for their comments. The comments received from banks and financial institutions were considered by the Group and taken into account to the extent relevant to the terms of reference while formulating its recommendations.

1.5. With a view to getting certain expert opinion in the areas of its study, the Group discussed the various issues with specialists in the field. The experts / professional bodies who held discussions / made presentations before the Group were the following:

- (i) Institute of Company Secretaries of India, New Delhi
- (ii) Dr. Y.R.K. Reddy of Yaga Consulting Pvt. Ltd., Hyderabad
- (iii) Consindia HR Services Pvt Ltd., Mumbai

The Group held four meetings, including for the presentations by expert groups. It also met a representative group of banks in a separate meeting on 18th March 2002 to elicit feedback on the draft recommendations of the Group.

Acknowledgement

- 1.6. The Group expresses its sincere gratitude to the bankers, experts and the professional bodies who spared their valuable time in presenting their views on the areas of study of the Group as also to the Chairmen of banks who had submitted their comments / observations. The Group places on record its deep appreciation of the contributions made by Shri M.R.Srinivasan, Member Secretary, whose untiring efforts made it possible for the Group to finalise its recommendations within the shortest time possible. The Group also thanks the secretarial services provided by the staff of the Department of Banking Operations and Development, viz., S/Shri K.V.Rajan, S.G.Bapat, Abhay Kumar and N. Badri Prasad.

Chapter 2

Existing Practices and Legal Framework

Legal frame work governing banks

2.1. The Group noted that banks in India are governed by separate statutes as under:

- ? The Banking Regulation Act, 1949 is applicable to all banks,
- ? The public sector banks are in addition governed by the statutes under which they were incorporated, viz.,
 - ✍ State Bank of India under State Bank of India Act, 1955
 - ✍ The Associate Banks of SBI under the State Bank of India (Associate Banks) Act, 1959
 - ✍ Nationalised banks under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/'80.

The public sector banks are exempted from some of the provisions of the Banking Regulation Act in view of the separate statutes governing them.

Constitution of the Boards of banks

2.2. The statutes governing banks provide for constitution of the Board of Directors, appointment of the Chairmen and Managing Directors, audit of books and accounts, appointment of statutory auditors, publication of the balance sheets, etc. The Banking Regulation Act, 1949 provides that not less than 51% of the total number of members of the Board of Directors of a banking company shall consist of persons who shall have special knowledge or practical experience in respect of one or more of the following areas: viz., Accountancy, Agriculture and Rural Economy, Banking, Co-operation, Economics, Finance, Law, Small Scale Industry or any other matter the special knowledge or practical experience in, which would, in the opinion of Reserve Bank, be useful to the banking company. Out of the aforesaid 51% of directors, not less than 2 directors shall have special knowledge or practical experience in respect

of agriculture and rural economy, co-operation or small-scale industry. The directors representing the aforesaid sectors shall also not have substantial interest in or be connected with whether as employee, Manager or Managing Agent in any company (other than a Section 25 company) or a firm which carries on any trade, commerce and industry and which is not a small scale industry concern. The statutes governing the public sector banks also provide for election of shareholder nominees in proportion to the shares issued to public, subject to a maximum of six nominees in respect of banks which have issued capital to public up to 40% of the bank's paid-up capital.

- 2.3. The Boards of private sector banks are constituted by the promoters / shareholders keeping in view the requirements of the Banking Regulation Act as indicated above. The appointment of the Chief Executive Officers of the private sector banks, however, requires the prior approval of the RBI as per the provisions of the Banking Regulation Act, 1949.
- 2.4. The Banking Companies (Acquisition and Transfer of Undertakings) Acts, 1970/'80, do not provide for any explicit representation from the aforesaid sectors of the economy. However, the six directors nominated to the Boards of nationalised banks by the Central Government or elected by the shareholders (of banks which have issued capital to the public) shall have special knowledge or practical experience in respect of one or more of the above fields.
- 2.5. The Boards of nationalised banks and State Bank of India are constituted by the Central Government. The Nationalisation Acts and the SBI Act vest powers with the Central Government to appoint the Chairmen and Managing Directors of the banks in consultation with the Reserve Bank. The majority of the directors in the case of public sector banks are also appointed by the Central Government. In the case of development finance institutions (viz., IDBI, NABARD, NHB, etc.) the Central Government is empowered as per the statutes governing them,

to constitute the Board with the majority of the directors representing the owner, viz., the Central Government.

- 2.6. The Group noted that the corporate governance structure of banks in India thus, has the elements of both the "outsider" model of the U.S. and the U.K. where there is separation of ownership and management as in the case of public sector banks, and the "insider" model with families, inter-connected entities or promoters running management as in the case of some of the private sector banks.

International best practices

- 2.7. The BIS Paper on *Enhancing Corporate Governance in Banking Organisations* (September, 1999), reports of Dr. Patil Advisory Group as also of the Verma Group enumerate the best practices in corporate governance for banking organisations. The Hong Kong Monetary Authority had also issued guidelines on corporate governance to the domestic banking organisations. The most important elements of these best practices emphasised by the BIS Principles and other expert Committees are the following:

(i) Constitution of the Board and related aspects:

- ? Ensure that the Board members are qualified for their positions, have a clear understanding of their role in corporate governance and are not subject to undue influence from management or outside interests.
- ? The Board should appoint as a Chief Executive, a person with integrity, technical competence and experience in banking.
- ? Clearly stated assignment of responsibilities / accountabilities and establish a mechanism for interaction and cooperation among Board members.
- ? Ensure that the organisation has a mechanism for oversight as under:

- ✍ Oversight by the Board
- ✍ Oversight by independent committees of the Board
- ✍ Oversight by independent Board members not involved in day-to-day running of the business.

- ? Monitoring of risk exposures as also exposures where conflicts of interest are likely, including business relationships with parties connected with the bank, large shareholders, senior management, etc.

ii) Internal control and independent committees of the Board for -

- ? Risk management and independent audit
- ? Strong internal control system including internal and external audit functions
- ? Independent Audit Committee comprising non-executive directors.

iii) Disclosure and transparency

- ? Appropriate information flow internally and to the public
- ? Public disclosures in regard to organisational structure, incentive structure, transactions with related parties, etc.

2.8. The three crucial ingredients of good corporate governance standards as could be observed from the above, are thus:

- (i) Clear division of responsibility throughout the organization.
- (ii) Checks and balances, incorporating "four eyes" principles, and
- (iii) Disclosures and transparency.

Chapter 3

Approach of the Group

- 3.1. The Group notes that the best governance practices suggested for banks in the BIS paper and other documents which are implementable within the existing legal framework, have been implemented by the Reserve Bank. The banks have set up Board level Committees in areas like risk management (both for credit risk and market risk) and audit. The role and responsibilities of the Audit Committee of the Board have been further enhanced to ensure monitoring of exposure to connected parties, sensitive sectors, etc. The disclosure requirements of banks have been enhanced and banks are now required to disclose besides critical financial parameters, investment in equity shares and debentures, advances against shares and debentures, exposure to stock brokers, etc., as part of 'Notes on Accounts', to their balance sheet.
- 3.2. The Group deliberated upon the legal framework governing the banking sector, the public ownership, the management control of the Government in the case of the public sector banks, and other related issues. In the case of private sector banks, although there are no legal impediments to introducing internationally accepted corporate governance standards, particularly in regard to constitution of the Board and defining its fiduciary responsibilities, etc., in practice, in several instances and in spite of RBI directives, however, there is in practice, no check on the Chief Executive Officer, who is generally closely linked to the promoters. Furthermore, there is little or no formal accountability on the Boards or the internal audit systems are weak.
- 3.3. Considering the legal framework governing the PSBs and the existing governance practices in banks, the Group noted that the manner of appointment of directors have led to certain inadequacies over a period of time and needed to be remedied. The Group is of the view that in

order to introduce effective corporate governance standards as enunciated in the BIS Paper or those suggested in the reports of the Patil Group or Verma Group, it would be necessary to effect amendments to the various statutes governing the banks. In the meantime, the corporate governance standards for banks have to be defined within the given legal framework. Therefore, taking into account the existing legal framework, the Group's attempt was to define, both "desirable" and "do-able" practices for enhancing the supervisory role and effectiveness of the Boards of banks in order to significantly improve the corporate governance standards in banks and financial institutions. The major conclusions and the views of the Group thereon are given in the following Chapter (4).

Chapter 4

Observations and Recommendations of the Group

Board of Directors

Constitution of the Board

- 4.1. The Board of Directors has important fiduciary responsibilities to the shareholders of the company. The Board is responsible for the overall management and effective functioning of the bank. The banks, being a corporate entity, the Board of a bank is responsible to the shareholders. Further, banks being important participants in the payment systems, it is enjoined upon the Boards to safeguard the interests of the depositors and other stakeholders. The Board, however, cannot be expected to supervise the day-to-day operations of the bank and it, therefore, delegates and entrusts appropriate authority to the various functionaries, via the whole - time directors of the Board such as, Chairman, Managing Director and Executive Directors. This makes each whole-time director, individually, and the Board, collectively, responsible for the performance of the bank.
- 4.2. The challenge facing the Indian banking has been getting the board of directors to shape strategy and monitor performance without encroaching on management terrain or becoming too involved in the bank's day-to-day operations.
- 4.3. The Group notes that the statutes governing public sector banks vest powers with the Central Government to appoint whole-time directors as also majority of the independent / non-executive directors. The Boards of public sector banks (barring State Bank of India) comprise presently, two whole-time directors (one Chairman & Managing Director and one Executive Director). Considering the fact that banking is becoming more complex, the Group is of the view that one more whole-time director should be appointed on the Boards of large-sized nationalised banks, who could provide undivided attention to critical areas like risk management systems, human resource management, etc.

4.4. The eligibility criteria normally followed for nomination of independent directors to the Boards of public sector banks are the following:

- ? The candidate should normally be a graduate (which can be relaxed while selecting directors for the categories of farmers, depositors, artisans, etc.)
- ? He / she would 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

The Group is of the view that the above criteria needs to be revised in view of challenges facing the banking sector.

4.5. Presently, the due diligence is done, to a limited extent, by the Reserve Bank of India for the candidates considered for independent / non-executive directorship in public sector banks. The due diligence by RBI is, however, confined to verifying whether the names forwarded by the Government of India figure in the Defaulters' List or not. This due diligence process does not assess either the ability, professional qualification or the technical competence of the candidates being considered for directorship to fulfil the fiduciary responsibilities expected of them.

4.6. In the case of independent / non-executive directors of private sector banks, since they are appointed by the Board, the due diligence exercise is not done by RBI. Such directors are appointed by the Board keeping in view the requirement of giving representation to the specified sectors, as enshrined in the Banking Regulation Act, 1949.

4.7. The Group recommends that the criteria followed by the Government of India for nominating directors to the Boards of public sector banks and the due diligence followed for them should be made applicable to independent / non-executive directors of other banks as well.

4.8. The Group is of the view that due diligence of the directors of all banks - be they in public sector or private sector should be done in regard to their suitability for the post by way of qualifications and technical expertise. The Group strongly feels that involvement of Nomination Committee of the Board in such an exercise should be seriously considered as a formal process. The final decision in respect of appointment of independent / non-executive directors should be that of the Board with the Nomination Committee presenting its recommendations highlighting both positive and negative aspects of each recommended candidate, for consideration of the Board.

4.9. While the desirable international practice of the Board members being nominated by the Nomination Committee from a list of qualified, experienced professionals would require amendments to the banking laws, the Group recommends that the Government while nominating directors on the Boards of public sector banks should be guided by certain broad "fit and proper" norms for the directors. The Group recommends the criteria suggested by the BIS to consider 'fit and proper' for bank directors:

- ? Competence of the individual directors as assessed in terms of formal qualifications, previous experience and track record.
- ? Integrity of the candidates.

For assessing integrity and suitability, the features like criminal records, financial position, civil actions undertaken to pursue personal debts, refusal of admission to, or expulsion from professional bodies, sanctions applied by regulators or similar bodies, and previous questionable business practices, etc. should be considered. (*cf*, "*Supervision of Financial Conglomerates*", 1998, BCBS). The Group recommends that these criteria should also be made applicable to nomination of independent directors of private sector banks.

4.10. The Group recommends that a pool of professional and talented people should be built up for consideration of nomination as independent / non-executive directors to the Board of banks and financial institutions. The

list of such eligible directors should be assembled by RBI from independent sources after proper due diligence and such a list should be put on the RBI's website for access by all concerned. The Group is of the view that appointment / nomination of independent / non-executive directors to the Boards of banks (both public sector and private sector) should be from this list. Any deviation from this procedure by any bank, according to the Group, should be with the prior approval of RBI. RBI may also establish procedures for regularly updating the list through additions and deletions from time to time.

Composition of the Board

4.11. The Group examined the structure and the composition of the Boards of banks. It is noted that composition of the Boards of banks is more regulation-based rather than need-based. As noted in paragraph 2.2 above, as per the regulation applicable to banks, the Board of Directors of a bank is required to have representation from specific sectors like agriculture and rural economy, co-operation, SSI, law, etc., The Group is of the view that in the context of banking becoming more complex and competitive, the composition of the Board should be left to the business needs of banks. Composition of the Board (by way of representation of various sectors) should be so as to reflect the business strategy and its vision for the future.

4.12. The Group is of the view that in the present context when banking is becoming more complex and knowledge-based, there is an urgent need for making the Boards of banks more contemporarily professional, by inducting technical and specially qualified personnel. The earlier requirement of ensuring representation on the Boards of banks for areas like agricultural sector, law, co-operation, small-scale industry, etc. which were relevant in the immediate post-nationalisation era, in the Group's view, have now to be supplemented by other emerging priorities. The Group feels that instead of attempting to wholly change sectoral representation, efforts should be aimed at bringing about a blend of

'historical skills' set (that is, regulation-based representation of sectors like agriculture, SSI, co-operation, etc.) and the **'new skills'** set (that is, need-based representation of skills such as, marketing, technology and systems, risk management, strategic planning, treasury operations, credit recovery, etc.).

4.13. It was recognised that agriculture still contributes a significant share of GDP and representation to agriculture and SSI, etc., sectors have to be continued. With increased de-regulation and the structural changes that have taken place in the economy and in the banking sector, the Group is of the view that the Boards of banks should have representation in the following areas:

- ? Finance
- ? Information Technology
- ? Human Resources Development
- ? Persons with good track record of experience in managing / advising industrial enterprises
- ? Economics

Independent / non-executive directors

4.14. The independent / non-executive directors in any organization have a constructive role to play both on-and-off-the Board because of their knowledge and professional objectivity. Within the existing legal framework, the Group is of the view that the independent / non-executive directors must play a more pro-active role by exercising their independence of judgement, practical experience, specialised knowledge, etc. to the deliberations of the Board. The independent / non-executive directors have a prominent role in introducing and sustaining a pro-active governance framework in banks and financial institutions. The independent / non-executive directors, according to the Group, should provide constructive inputs regarding the business strategy, performance of the bank, etc. They should act as the catalyst for focussed discussions on issues brought to the Board and subjects of critical importance to the bank during the meetings of the Board. These directors, being independent, are expected to be free from any organisational affiliation and

should seek all information which are relevant to monitor the performance of the bank, the overall risk profile of its credit and investment portfolios, cases of over-exposure to one or a particular group of borrowers or entities related / associated with the promoter directors, etc. According to the Group, the independent / non-executive directors should raise in the meetings of the Board, critical questions relating to -

- ✍ business strategy, including loans and recovery policy,
- ✍ house keeping and internal control system,
- ✍ record of exposure to various sectors / industries by way of both credit and investments, etc.
- ✍ risk management systems,
- ✍ internal audit,
- ✍ accounting policy,
- ✍ senior management development,
- ✍ other aspects of the functioning of the bank, and
- ✍ investor relations.

The independent / non -executive directors need to ensure that the vital issues raised by them are addressed by the bank to the full satisfaction of the Board. While making the above recommendations, the Group is guided by the fact that good corporate governance in banks will be sustained by a knowledgeable, skilful and well informed Board of Directors with a correct blend of expertise / professionalism, independence and involvement.

4.15. In the case of private sector banks where promoter directors may act in concert, the independent / non-executive directors should provide effective checks and balances ensuring that the bank does not build up exposures to entities connected with the promoters or their associates. They should also seek through the Board, all information relating to critical areas like connected lending, investments, exposure to entities / associates related to the promoters/ large shareholders. The independent / non-executive

directors should provide effective checks and balances, particularly, in widely held and closely controlled banking organisations.

Commonality of directors of banks and NBFCs

4.16. In regard to the existing regulatory prohibition on directors of NBFCs becoming independent / non-executive directors on the boards of banks, the Group is of the view that it would not be proper to debar a professional director on the board of an NBFC from becoming a director on the board of a bank. It needs to be noted that as per the existing policy, NBFCs satisfying certain criteria (such as, AAA rating, minimum net worth of Rs. 200 crore, CRAR of not less than 12%, net NPA not more than 5%, etc.) are allowed to be converted to a bank. In view of the above policy stance, the Group feels that it would not be fair to debar directors on the boards of NBFCs becoming independent / non-executive directors on the boards of banks. In order to avoid any likely conflict of interest, the Group recommends that a director on the board of a NBFC could be considered for appointment as director on the board of a bank if -

- (i) He/she is not the owner of the NBFC, [i.e., holdings (single or jointly with relatives, associates, etc.) exceeding 50%] or
- (ii) He/she is not related to the promoter of the NBFC, or
- (iii) He/she is not full-time employee in the NBFC.

In regard to full-time employees of NBFCs, the Group feels that the Reserve Bank of India as the regulator, should have the discretion for considering such person for directorship in a bank, keeping in view the specific circumstances, merits , etc. of each case.

Responsibilities of directors

4.17. A strong corporate board performs four major roles: over-seeing the risk profile of a company, monitoring the integrity of its business and control mechanisms, ensuring that expert management is in place and maximising the interests of its stakeholders. Such board has regular and

close contact with the organisation and can detect and correct any abnormal behaviour quickly. Such a board is also able to play a crucial role in hiring and retaining sound managers. The Group is of the view that banks being pivotal for the country's financial system, the boards of banks should fulfil all these four roles.

4.18. The Board of Directors of banks and financial institutions have, besides fiduciary obligations, as above, important social responsibilities, and the responsibilities to ensure compliance with the regulatory framework. These would include compliance with the directions / policy of the Government etc. In their fiduciary capacity, the Boards of directors should receive regular reports from their management committees, auditors and audit committee, formulate clear written policies in regard to various business strategies and policies (credit, investments, etc.), performance parameters for the bank and ensure that the bank's affairs are conducted in accordance with the stated policies / regulatory requirements. The Board should formulate policies relating to credit dispensation particularly in regard to exposures to various productive sectors, geographical areas, investments, exposures to sensitive sectors such as capital market, strategies for recovery of loans and status of progress with respect to investments, risk management, etc.

4.19. The need for clear lines of responsibilities in any organisation cannot be overemphasised. In the case of banks, the Group notes that the responsibilities are well defined for the managerial functionaries. Powers are delegated to the various functionaries of the bank for sanctioning of loans and advances, investments, incurring authorised level of expenditure, etc. The managerial functionaries are also made accountable and their performance is monitored vis-à-vis the performance targets agreed to by the Board, judicious exercise of discretionary powers, etc.

4.20. The Group recommends that every director should be given a brief on the functioning of the bank, before his appointment / induction, covering the following:

- ✍ Delegation of various authorities by the Board
- ✍ Strategic Plan of the bank
- ✍ Organisational Structure
- ✍ Financial and other controls and systems
- ✍ Economic features of the market and competitive environment,
and
- ✍ Meeting with key management team after briefing.

Training to directors

4.21. The Group is of the view that the directors could be made more responsible to their organisations by exposing them to need-based training programmes / seminars / workshops to acquaint them with the emerging developments / challenges facing the banking sector. The directors could be exposed to the latest management techniques, technological developments, innovations in financial markets, risk management and other areas of interest to the organisation to discharge their duties to the best of their abilities. The Group is of the view that such investment would be of great value to the financial system. Ideally, in the Group's view, the Reserve Bank of India as the Regulator, could take the initiative in organising such seminars for the directors of banks and financial institutions.

4.22. The Group notes that broad guidelines have been issued both by the Government of India and the Reserve Bank in regard to the role expected of their nominees on the Boards of banks. These guidelines emphasise the following points:

- ? The director is expected to regularly attend board meetings and take an active part in its deliberations.
- ? Members of the Board do not exercise any executive authority individually, but are collectively responsible for the superintendence, direction and management of the bank.

- ? While directors can delegate certain powers to any committees, executives or other officers, they cannot absolve themselves of their responsibility of ensuring that the bank operates on sound and prudent lines.
- ? They are responsible for safeguarding the interests of the depositors and owners through efficient and well informed administration of the bank.
- ? Directors are expected to critically and thoroughly study agenda papers.
- ? They should pay adequate attention to the state of non-performing assets, recovery performance and write-off of large debts (say Rs. 1 crore or more).

Based on the meetings attended by them, the nominee directors are required to submit reports to the Government (in the case of its nominees of the Boards of public sector banks) and to Reserve Bank of India (in respect of its nominees on the Boards of all banks).

4.23. Presently, there is no mechanism to make the directors on the Boards of banks and financial institutions accountable for the performance of their organisation. The Group is of the view that the lack of clearly documented responsibility and accountability of directors on the Board stems from the manner in which the Board is constituted. In the case of public sector banks, majority of the Board comprises nominees of the Central Government and the individual directors are, therefore, mainly accountable to the political institution of the land. The Group is of the view that while a change in the manner in which the Boards are constituted is essential in order to make the Board and its individual members more accountable, this would necessitate a change in the statutes governing the banking sector. According to the Group, the role of CEOs - their track record, competence and leadership qualities provides the pivot for good governance practices in a banking company. The process of selection of the CEO, therefore, assumes crucial importance in the endeavour to introduce modern corporate governance standards in banks.

- 4.24. The Group is of the view that it would be desirable to separate the office of Chairman and Managing Director in respect of large sized banks. Keeping in view the balance sheet size, sophistication of business transactions and complexity of the bank, the office of Chairman and Managing Director could be bifurcated into two : the Chairman who is the Chairman of the board and the Managing Director who could function as the Chief Executive responsible for day-to-day management of the bank. The Group is of the view that this functional separation will bring about more focus and vision as also the needed thrust in the functioning of the top management of the bank.
- 4.25. The Group notes that many Expert Committees (including the Committee on Banking Sector Reforms under Chairmanship of Shri M.Narasimham) had recommended in favour of a reasonably long tenure of services for the whole-time directors. The Group recommends that the whole-time directors should have sufficiently long tenure so as to enable them to leave a mark of their leadership and business acumen on the bank's performance.
- 4.26. While the responsibilities of nominee directors have been clearly laid down, the responsibilities of the Board of Directors as a whole has not been delineated. Furthermore, there is no practice of advising the directors (other than nominee directors) of banks their responsibilities, role, etc. in the organisation. The Reserve Bank of India had circulated in 1984 among the private sector banks, guidelines on the role and functions of independent / non-executive directors on the Boards of private sector banks. These guidelines were in the nature of operational guidelines bringing home to them the fact that the directors should not interfere in day-to-day affairs of the bank or otherwise intervene in credit / investment / personnel / other operational matters. The guidelines highlight the need for the independent / non-executive directors to take interest in the banks' work concerning their own fields of specialisation / activity and also deliberate on all matters of general policy affecting the bank's functioning.

The guidelines exhort that every director should function in a manner most conducive to the interests of the depositors, of the shareholders and of the nation as a whole. The Reserve Bank of India had also circulated in 1992 a list of "do's" and "don'ts" to the private sector banks, with a view to sensitising the directors on their role and responsibilities. A similar list had also been given by the Government to the directors of public sector banks. The Group recommends that these instructions may be reviewed and updated where required, and the roles and responsibilities of independent / non-executive directors be clearly stated.

4.27. Keeping in view the recent developments and the changes witnessed in the banks' operations, as also the technical developments, the Group suggests that Reserve Bank may bring out an updated charter indicating clear-cut, specific guidelines on the role expected and the responsibilities of the individual directors. The responsibilities of the directors according to the Group, should illustratively include the following:

- ? Deliberating and approving the objectives, business strategies and annual business plans
- ? Deliberating and approving the management succession policy of the institution, and assessing senior management's performance on an on-going basis,
- ? Clearly defining the authorities and responsibilities of both executive directors and relevant senior management,
- ? Developing and providing a list of checks and balances for use by senior management,
- ? Formulating policies on vital areas of bank's functioning (viz., loan and recovery policy, investment policy, risk management policy, exposure to sensitive sector including capital market, etc.)
- ? Guidance on risk management particularly investment assessment, the fixation of risk limits, exposure ceiling both individual and group – borrower ceilings, etc.,
- ? Approve the policy on introduction of technology to the bank's various facets of working with a view to provide better service in a

most cost effective manner as measured by targets of productivity and profitability

- ? Maintaining and recording appropriate levels of checks and balances with regard to the influence of the management and/or large shareholder(s).
- ? Monitoring on an on-going basis the bank's performance, build up of exposure to various categories of borrowers, industries, sectors, etc against targets of the annual operating plan.
- ? Discussing the reports submitted by the Audit Committee, monitoring the follow up action taken to rectify the deficiencies observed, etc.
- ? Ensuring compliance with all legal / regulatory requirements, etc.

4.28. As a step towards effective corporate governance, the Group is of the view that it would be desirable to take an undertaking from every director to the effect that they have gone through the guidelines defining the role and responsibilities of directors, and understood what is expected of them and enter into a covenant to discharge their responsibilities to the best of their abilities, individually and collectively. In this connection, the Group would recommend that before appointment of a director, a questionnaire on the lines of the one used by the FSA of UK, modified keeping in view of our requirements could be used as a model ([Annexure 2](#)) for obtaining relevant information regarding background of the potential appointee.

4.29. The Group is of view that in consonance with transparency in regard to responsibility of directors, an appropriate covenant should be obtained from each of the directors, whether they are independent / non-executive directors / nominees of Government / RBI / other institutions having sizable shareholding in banking organisations. The Group accordingly has devised a covenant for adoption by all the banks. A copy of the format is given in [Annexure3](#).

Remuneration to directors

4.30. The Group is of the view that the existing level of remuneration paid (by way of sitting fees, etc.) to directors of banks and financial institutions is grossly inadequate, by contemporary standards, to attract qualified professional people to their Boards, and expect them to discharge their duties as per the mutually agreed covenants. A few of the banks / FIs have modified their compensation plans to include a base salary, performance bonus and options to their directors. In order to get quality professional people, the level of remuneration payable to the directors should be commensurate with the time required to be devoted to the bank's work and also to signal the appropriateness of remuneration to the quality of inputs expected from a member. The remuneration of the directors may also include the form of stock option.

Prohibitions flowing from Section 20 of the B.R. Act, 1949

4.31. The Group is of the view that the statutory prohibition under section 20 of the Banking Regulation Act, 1949 on lending to companies in which a director is interested, severely constricts availability of quality professional directors on to the Boards of banks. The Group notes that internationally, however, banks are permitted to extend credit facilities to companies in which the directors are interested subject to full disclosure and appropriate covenants. The Group is aware that any change in the existing legal framework would require an amendment to the Banking Regulation Act. The Group recommends that we move towards that goal.

Information flow to / from the Board

4.32. The Group notes that the effectiveness of the Boards largely depends upon the flow of information to and from the Board. The information furnished to the Board should be wholesome and complete and should be adequate to take meaningful decisions. A distinction needs to be made between statutory items and strategic issues in order to make the material for directors 'manageable'. In this context, the Group reviewed the

practices of banks and financial institutions in regard to preparation of the agenda notes, recording of the proceedings of the meeting of the Board, follow up of various action points arising from the decision taken at the meetings, etc. The Group noted that the manner in which the proceedings are recorded and followed up in public sector banks leave much scope for improvement.

- 4.33. An issue that was brought to the notice of the Group was the number of reviews put up to the Board as per the Calendar of Reviews prescribed by the Reserve Bank of India. It is pointed out that the large number of reviews put up to the Board leaves little time to the Board for fruitful discussions on future business strategies and policies. The Group recommends that the Reviews dealing with various performance areas could be put to the Supervisory Committee of Board and a summary on each of the reviews could be put up to the Main Board. The Board's focus should be more on strategy issues, risk profile, internal control systems, overall performance of the bank, etc.
- 4.34. The Group is of the view that the procedure followed for recording of the minutes of the Board meetings in banks and financial institutions should be uniform and formalised. The Group would suggest that banks and financial institutions may adopt two methods for recording the proceedings: A summary of key observations made which should be submitted to the next Board meeting and a more detailed recording of the proceedings which will clearly bring out the observations, dissents, etc. made by the individual directors could be forwarded to them for their confirmation.
- 4.35. The Group is of the view that 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. If a director fails to respond within the time specified, it should be taken that he / she has no comments to offer.

4.36. In every Board meeting, the Board should review the status of the action taken on the points arising from the earlier meetings and till action is completed to the satisfaction of the Board, any pending item should continue to be put up before the Board.

Company Secretary

4.37. The Group noted that the public sector banks do not have a qualified Company Secretary on their rolls. A 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.

4.38. The Public Sector banks historically had no qualified Company Secretary. In the context of a number of banks in the public sector accessing the capital market, the Group is of the view that there is now a need to have a qualified Company Secretary in order to ensure that the bank is in compliance at all times with the company law related issues as also to be instrumental in redressing grievances of the investors. A qualified Company Secretary, according to the Group, would also fulfil the earlier recommendation in regard to recordings of the proceedings of the meetings of the Board and its Committees. The Group recommends that all banks should 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. Further, the Institute of Company Secretaries of India may be required to include appropriate inputs in their curriculum as part of the professional examination.

Committees of the Board

(1) Supervisory Committee

4.39. An issue raised during the deliberations of the Group was whether an additional tier by way of Supervisory Board could be considered for banks,

a practice which is followed by banks in Germany. The Supervisory Boards of banks in Germany mainly function as "Executive Committees" of the Board. The public sector banks in India have constituted "Executive Committee" or "Management Committee" which meet more frequently than the full Board do. The Group is of the view that instead of creating another tier by way of a Supervisory Board, there could be a **Supervisory Committee** of the Board in all banks - be they public or private sector, which will work on collective trust and at the same time, without diluting the overall responsibility of the Board. The role and responsibilities of the Supervisory Committee of the Board could include monitoring of the exposures (both credit and investment) by the banks, review of the adequacy of the risk management process and upgradation thereof, internal control systems and ensuring compliance with the statutory / regulatory framework.

(2) Audit Committee of the Board

4.40. The Group notes that banks have set up as required in terms of the RBI guidelines, independent Audit Committees. The Audit Committee comprises a majority of the independent / non-executive directors with the Executive Director of the bank as one of the members. The Group notes that a Chartered Accountant, wherever available on the board, is a member of the Audit Committee.

4.41. The international best practice in this regard is to constitute Audit Committees with only independent / non-executive directors. As regards the composition of the Audit Committee, the Basel Committee has suggested that in order to ensure its independence, the Audit Committee of the Board should be constituted with external Board members who have banking or financial expertise. (*cf Enhancing Corporate Governance for Banking Organisations*, Basel, September 1999). The Group is of the view that ideally the Audit Committee should be constituted with independent / non-executive directors and the Executive Director should only be a permanent invitee. However, keeping in view that the present circumstances, the existing arrangements where the Executive Director is

one of the members may continue; and may include the Executive Director and official directors i.e., nominee of Government of India and RBI in respect of public sector banks.

4.42. The Group is of view that the Chairman of Audit Committee need not be confined to the Chartered accountant profession but can be a person with knowledge of 'finance' or 'banking' so as to provide directions and guidance to the Audit Committee since the Committee not only looks at accounting role but also the overall management audit etc. of the bank.

(3) Nomination Committee

4.43. As already discussed in the paragraph 4.8, the Group is of the view that it is desirable to have a Nomination Committee for appointing independent / non-executive directors of banks that should scrutinise the nominations received for nomination of independent / non-executive directors with reference to their qualifications, experience and other criteria proposed above. The Group recognises that in the case of public sector banks, the nomination committees may be of not immediate relevance, since the independent / non-executive directors (except shareholder nominees in the case of banks which have issued capital to the public) are appointed by the Central Government. The Group is of the view that in the context of a number of public sector banks issuing capital to the public, a Nomination Committee of the Board may be formed for nomination of directors representing shareholders.

(4) Shareholders' Redressal Committee

4.44. Since banks are increasingly accessing capital market, there is a need for an effective machinery for redressal of investor grievances in banks. The Group notes that as of now, the matters relating to investor complaints, etc. are looked after by the line staff. With a view to building up credibility among the investor class, the Group recommends that a Committee of the Board may be set up to look into the grievances of investors and shareholders, with the Company Secretary as a nodal point.

(5) Risk Management Committee

4.45. The Group notes that in pursuance of the Guidelines issued by the Reserve Bank of India, every banking organisation is required to set up Risk Management Committees (for management of both credit risk and market risk) with Board level representation to manage effectively the risk profile of the bank. The management of risk particularly arising from over exposure to interconnected entities, came to the fore in the recent past in respect of a few banks. The Group, therefore, recommends that the formation and operationalisation of the Risk Management Committees should be speeded up and their role further strengthened.

Disclosure and Transparency

4.46. The Group notes that disclosure requirements for banks have been substantially enhanced in the recent period. Banks are now required to disclose in the 'Notes on Accounts', exposure to sensitive sectors as also exposure to capital market by way of (a) direct investment in shares and debentures, (b) advances against shares and debentures and (c) guarantees issued on behalf of stockbrokers. The Group suggests that it would be desirable if the exposure of a bank to stockbrokers and market makers as a group, as also exposure to other sensitive sectors (viz., real estate), exposure to various sectors, etc. are reported to the Board regularly.

4.47. The Group recommends that the following disclosures be made by banks to the board of directors at regular intervals as may be prescribed by the board from time to time:

- (i) The progress made in putting in place a progressive risk management system, the risk management policy and strategy followed by the bank.

- (ii) Exposure to related entities, viz., details of lending to / investment in subsidiaries, the asset classification of such lendings / investment, etc.
- (iii) Conformity with Corporate Governance standards - structure, various committees, etc.

Review of implementation

4.48. For implementation of the recommendations made above, the Group suggests the following approach for adoption: The banks could be asked to come up with a strategy for implementation of the governance standards recommended. Once the strategy is received from all banks, the progress of implementation could be reviewed after a period of twelve months. Thereafter, the position could be reviewed half-yearly or annually, as deemed appropriate.

sd/

 (Dr. A.S.Ganguly)
 Chairman

sd/

 (J.L.Saha)

sd/

 (Tarun Das)

sd/

 (Janki Vallabh)

sd/

 (D.Satwalekar)

sd/

 (S.C.Wadhwa)

sd/

 (P.V.Indiresan)

sd/

 (Shailendra Swarup)

sd/

 (P.R.Khanna)

sd/

 (S.K.Munjaj)

sd/

 (K.L.Khetrapaul)

sd/

 (M.R.Srinivasan)
 Member Secretary.

Constitution of the Group

Deputy Governor

Reserve Bank of India
Central Office
Shaheed Bhagat Singh Road
Mumbai - 400 001. India

Memorandum

As part of its review of the impact of recent developments on long-term objective of financial sector reforms, the Mid-Term Review of Monetary and Credit Policy for the year 2001-2002 announced on October 22, 2001 had, inter alia observed as follows:

"Recent events have also brought to the fore the need for Boards of banks and financial institutions to exercise proper vigilance and supervision over the functioning of commercial banking and other financial institutions. In recent years, as part of on-going financial sector reforms, much greater autonomy and powers have been entrusted to their Boards, to lay down effective internal guidelines and procedures for transparency, disclosure, risk and asset-liability management. Yet, it has been noticed that in some cases, the policy laid down by the Boards was either flouted with impunity or the Board itself had failed to lay down appropriate internal guidelines for minimizing risks and over-lending a certain entities without adequate security. If problems of the type which have surfaced recently are to be avoided in the future, within the framework of a deregulated and liberal financial system, the role of Boards become crucial. The Reserve Bank proposes to set up a consultative group of directors of a select group of commercial banks and financial institutions to suggest, for consideration by the government /RBI , measures that should be taken to strengthen the internal supervisory role of Boards" [paragraph 511]

2. Accordingly, and in consultation with the Indian Bank's Association it has been decided to constitute a Consultative Group with the following members.

i) **Chairman:** Dr. A.S.Ganguly, Director, Central Board, RBI

Members

- ii) Dr. J.L.Saha, Director IIM, Ahmedabad.
- iii) Shri Tarun Das, New Delhi, Director, (IDBI)
- iv) Shri Janki Vallabh, Chairman, State Bank of India
- v) Shri D.Satwalekar, Director, HDFC Bank Ltd
- vi) Shri S.C.Wadhwa, Director, Dena Bank
- vii) Shri P.V. Indiresan, Director, Indian Bank
- viii) Shri Shailendra Swarup, Director, Corporation Bank

- ix) Shri P.R.Khanna, Director, State Bank of India
- x) Shri S.K. Munjal, Director, Bank of India
- xi) Executive Director, RBI (in-charge of DBOD), and
- xii) CGM-in-Charge, DBOD, Member Secretary.

3. The terms of reference of the Group are as following:
 - (a) To review the supervisory role of Boards of banks and financial institutions and to obtain feedback on the functioning of the Boards vis-à-vis compliance, transparency, disclosures, audit committees, etc.
 - (b) To study the system prevalent in banks / financial institutions for monitoring by the Board, the implementation of the policies laid down by it.
 - (c) To make recommendations for making the role of Board of Directors more effective with a view to minimising risks and over-exposure.
 - (d) Any other matter relevant to the subject.
4. The Group can invite experts and Directors of Banks and other corporates to participate in one or more of their meetings as considered necessary.
5. The Group is requested to submit its report within 3 months.
6. The secretariat of the Group would be provided in the Department of Banking Operations and Development, Central Office.

sd/
(G.P.Muniappan)
Deputy Governor.

15.11.2001.

FORMAT of Questionnaire for independent / non-executive directors

Independent non-executive directors who are individuals should complete this format. This Questionnaire is not a notification or application form.

1. Name of the institution in connection with which this form is being completed ("the institution").
2. Name: FIRST _____
LASTNAME _____
 - a. Any other previous name(s) _____ alias _____
3. Any previous name(s) by which you have been known.
4. Your private Address :
5. Your previous private address(es) during the last 10 years
6. Date of Birth and Place of birth (including borough, town or city)
7. Name(s) and address(es) of your bankers within the last 10 years.
8. Your professional Qualification and year they were obtained.
9. Your occupation and employment now and during the last 10 years, including the name of the employer in each case, the nature of the business, the position held and relevant dates.
10. Of what bodies corporate (other than the institution) are you now a director?. Give relevant dates and, if you are a controller of any such bodies corporate, indicate in what sense.

11. Are you a significant shareholder of any body corporate (other than the institution), which is now authorised or has applied for authorisation under, Banking Act ? If so, give particulars.
12. Of what bodies corporate other than the institution and those listed in answer to question 11 have you been a director, at any time during the last 10 years ? Give relevant dates.
13. Do any of the bodies corporate listed in the answer to question 10 to 12 maintain a business relationship with the institution? If so, give particulars
14. Does any institution with which you are, or have been, associated as a director, hold, or has it ever held or applied for, a licence or equivalent authorisation to carry on any business activity? If so, give particulars. If any such application was refused, or was withdrawn after it was made or any authorisation revoked, give particulars.
15. Have you at any time been convicted of any offences? If so, give particulars or the court by which you were convicted, the offence and the penalty imposed and the date of conviction.
16. Have you been censured, disciplined, warned as to future conduct, or publicly criticised by, or made the subject of a court order at the instigation of, any regulatory authority (including but not limited to the Secretary of State for Trade and Industry, a recognised self-regulating organisation and the Takeover Panel.) or any professional body to which you belong or belonged, or have you ever held a practicing certificate subject to conditions? If so, give particulars.
17. Have you, or has any body corporate, partnership or unincorporated institution with which you are, or have been, associated as a director, been the subject of an investigation or at the instigation of a

government department or agency, professional association or other regulatory body ? If so, give particulars.

18. Have you been dismissed from any office or employment, subject to disciplinary proceedings by your employer or barred from entry to any profession or occupation ? If so, give particulars
19. Have you incurred a judgement debt under an order of a court or made any compromise arrangement with your creditors within last 10 years ? If so, give particulars.
20. Have you been adjudicated bankrupt by a court or has a bankruptcy petition ever been served on you? If so, give particulars.
21. Have you, in connection with the formation or management of any body corporate, partnership or unincorporated institution, been adjudged by a court, civilly liable for any fraud, misfeasance or other misconduct by you towards such a body or company or towards any members thereof? If so, give particulars.
22. Has any body corporate, partnership or unincorporated institution with which you were associated as a director been wound up, made subject to any administration order, otherwise made any compromise or arrangement with its creditors or ceased trading either which you are were associated with it or within one year after you cease to be associated with it or has anything analogous to any of these events occurred under the laws of any other jurisdiction ? If so, give particulars.
23. Have you been concerned with the management or conduct of affairs of any institution which, by reasons of any matter relating to a time when you were so concerned, has been censured, warned as to future conduct, disciplined or publicly criticised by, or made the

subject to a court order at the instigation of, any regulatory authority ?
If so, give particulars.

24. In carrying out your duties will you be acting on the directions or instructions of any other individual or institution ? If so, give particulars.
25. Do you, in your private capacity, or does any related party, under taken business with the institution? If so, give particulars.
26. How many shares in the institution (or another institution of which the institution is a subsidiary undertaking) are registered in your name or the name of a related party, If applicable, give name(s) in which registered and class of shares.
27. In how many shares in the institution or another institution of which the institution is a subsidiary undertaking (not being registered in your name or that of a related party, are you or any related party beneficially interested?
28. Do you, or does any related party, hold any shares in the institutions as trustee or nominee? if so, give particulars.
29. Are any of the shares mentioned in answer to question 31 to 33 equitably or legally charged or pledged to any party ? if so, give particulars.
30. What proportion of the voting power at any general meeting of the institution (or of another institution of which it is a subsidiary undertaking) are you or any related party, entitled to exercise or control exercise of ?
31. If the exercise of the voting power any general meeting of the institution (or another institution of which it is a subsidiary

undertaking) is or may be controlled by one or more associates (As per BR Act, 1949 and Present RBI instructions) of you or of any related party, give the proportion of the voting power so controlled in each case and the identity of each associate.

32. Are you presently, or do you expect to be, engaged in any litigation other than in a professional capacity ? If so, give particulars.

Signature

Place:

Date:

Note : The questionnaire is on the lines of the one used by the FSA of UK, modified keeping in view of our requirements, could be used as a model.

FORM OF DEED OF COVENANTS WITH A DIRECTOR

THIS DEED OF COVENANTS is made this _____ day of _____ Two thousand _____ BETWEEN _____, having its registered office at _____ (hereinafter called the ‘Bank’) of the one part and Mr/Ms _____ of _____ (hereinafter called the “Director”) of the other part.

WHEREAS

- A. The director has been appointed as a director on the Board of Directors of the Bank (hereinafter called “the Board”) and is required as a term of his/her appointment to enter into a Deed of Covenants with the Bank.
- B. The director has agreed to enter into this Deed of Covenants, which has been approved by the Board, pursuant to his said terms of appointment.

NOW IT IS HEREBY AGREED AND THIS DEED OF COVENANTS WITNESSETH AS FOLLOWS:

- 1. The director acknowledges that his/her appointment as director on the Board of the Bank is subject to applicable laws and regulations including the Memorandum and Articles of Association of the Bank and the provisions of this Deed of Covenants.
- 2. The director covenants with the Bank that:
 - (i) The director shall disclose to the Board the nature of his/her interest, direct or indirect, if he/she has any interest in or is concerned with a contract or arrangement or any proposed contract or arrangement entered into or to be entered into between the Bank and any other person, immediately upon becoming aware of the same or at meeting of the Board at which the question of entering into such contract or arrangement is taken into consideration or if the director was not at

the date of that meeting concerned or interested in such proposed contract or arrangement, then at the first meeting of the Board held after he/she becomes so concerned or interested and in case of any other contract or arrangement, the required disclosure shall be made at the first meeting of the Board held after the director becomes concerned or interested in the contract or arrangement.

- (ii) The director shall disclose by general notice to the Board his/her other directorships, his/her memberships of bodies corporate, his/her interest in other entities and his/her interest as a partner or proprietor of firms and shall keep the Board apprised of all changes therein.
- (iii) The director shall provide to the Bank a list of his/her relatives as defined in the Companies Act, 1956 and to the extent the director is aware directorships and interests of such relatives in other bodies corporate, firms and other entities.
- (iv) The director shall in carrying on his/her duties as director of the Bank:
 - (a) use such degree of skill as may be reasonable to expect from a person with his/her knowledge or experience;
 - (b) in the performance of his/her duties take such care as he/she might be reasonably expected to take on his/her own behalf and exercise any power vested in him/her in good faith and in the interests of the Bank;
 - (c) shall keep himself/herself informed about the business, activities and financial status of the Bank to the extent disclosed to him/her;
 - (d) attend meetings of the Board and Committees thereof (collectively for the sake of brevity hereinafter referred to as "Board") with fair regularity and conscientiously fulfil his/her obligations as director of the Bank;

- (e) shall not seek to influence any decision of the Board for any consideration other than in the interests of the Bank;
 - (f) shall bring independent judgement to bear on all matters affecting the Bank brought before the Board including but not limited to statutory compliances, performance reviews, compliances with internal control systems and procedures, key executive appointments and standards of conduct;
 - (g) shall in exercise of his/her judgement in matters brought before the Board or entrusted to him/her by the Board be free from any business or other relationship which could materially interfere with the exercise of his/her independent judgement; and
 - (h) shall express his/her views and opinions at Board meetings without any fear or favour and without any influence on exercise of his/her independent judgement;
- (v) The director shall have:
- (a) fiduciary duty to act in good faith and in the interests of the Bank and not for any collateral purpose;
 - (b) duty to act only within the powers as laid down by the Bank's Memorandum and Articles of Association and by applicable laws and regulations; and
 - (c) duty to acquire proper understanding of the business of the Bank.
- (vi) The director shall:
- (a) not evade responsibility in regard to matters entrusted to him/her by the Board;

- (b) not interfere in the performance of their duties by the whole-time directors and other officers of the Bank and wherever the director has reasons to believe otherwise, he/she shall forthwith disclose his/her concerns to the Board; and
 - (c) not make improper use of information disclosed to him/her as a member of the Board for his/her or someone else's advantage or benefit and shall use the information disclosed to him/her by the Bank in his/her capacity as director of the Bank only for the purposes of performance of his/her duties as a director and not for any other purpose.
3. The Bank covenants with the director that:
- (i) the Bank shall apprise the director about:
 - (a) Board procedures including identification of legal and other duties of Director and required compliances with statutory obligations;
 - (b) control systems and procedures;
 - (c) voting rights at Board meetings including matters in which Director should not participate because of his/her interest, direct or indirect therein;
 - (d) qualification requirements and provide copies of Memorandum and Articles of Association;
 - (e) corporate policies and procedures;
 - (f) insider dealing restrictions;
 - (g) constitution of, delegation of authority to and terms of reference of various committees constituted by the Board;
 - (h) appointments of Senior Executives and their authority;

- (i) remuneration policy,
 - (j) deliberations of committees of the Board, and
 - (k) communicate any changes in policies, procedures, control systems, applicable regulations including Memorandum and Articles of Association of the Bank, delegation of authority, Senior Executives, etc. and appoint the compliance officer who shall be responsible for all statutory and legal compliance.
- (ii) the Bank shall disclose and provide to the Board including the director all information which is reasonably required for them to carry out their functions and duties as a directors of the Bank and to take informed decisions in respect of matters brought before the Board for its consideration or entrusted to the director by the Board or any committee thereof;
- (iii) the disclosures to be made by the Bank to the directors shall include but not be limited to the following:
- (a) all relevant information for taking informed decisions in respect of matters brought before the Board;
 - (b) Bank's strategic and business plans and forecasts;
 - (c) organisational structure of the Bank and delegation of authority,
 - (d) corporate and management controls and systems including procedures;
 - (e) economic features and marketing environment,
 - (f) information and updates as appropriate on Bank's products;
 - (g) information and updates on major expenditure;
 - (h) periodic reviews of performance of the Bank; and

- (i) report periodically about implementation of strategic initiatives and plans;
 - (iv) the Bank shall communicate outcome of Board deliberations to directors and concerned personnel and prepare and circulate minutes of the meeting of Board to directors in a timely manner and to the extent possible within two business days of the date of conclusion of the Board meeting; and
 - (v) advise the director about the levels of authority delegated in matters placed before the Board.
- 4. The Bank shall provide to the director periodic reports on the functioning of internal control system including effectiveness thereof.
- 5. The Bank shall appoint a compliance officer who shall be a Senior executive reporting to the Board and be responsible for setting forth policies and procedures and shall monitor adherence to the applicable laws and regulations and policies and procedures including but not limited to directions of Reserve Bank of India and other concerned statutory and governmental authorities.
- 6. The director shall not assign, transfer, sublet or encumber his/her office and his/her rights and obligations as director of the Bank to any third party provided that nothing herein contained shall be construed to prohibit delegation of any authority, power, function or delegation by the Board or any committee thereof subject to applicable laws and regulations including Memorandum and Articles of Association of the Bank.
- 7. The failure on the part of either party hereto to perform, discharge, observe or comply with any obligation or duty shall not be deemed to be a waiver thereof nor shall it operate as a bar to the performance, observance, discharge or compliance thereof at any time or times thereafter.

8. Any and all amendments and/or supplements and/or alterations to this Deed of Covenants shall be valid and effectual only if in writing and signed by the director and the duly authorised representative of the Bank.
9. This Deed of Covenants has been executed in duplicate and both the copies shall be deemed to be originals.

IN WITNESS WHEREOF THE PARTIES HAVE DULY EXECUTED THIS AGREEMENT ON THE DAY, MONTH AND YEAR FIRST ABOVE WRITTEN.

For the Bank
By
Name:
Title:

Director
.....
Name:

In the presence of:

1.

2.

Appendix 1

List of individuals / organisations making presentation before the Group.

| Sl. No | Representative | Organisation | Subject |
|--------|--|--|---|
| 1 | 1. Shri Pradip K Pain, Director 2. Dr. (Ms.) Bindi Mehta, Director (Research) | The Institute of Company Secretaries of India - Centre for Corporate Research & Training | Corporate Governance in Banks & FIs - Role of Boards |
| 2 | Dr. Y.R.K. Reddy | M/s. Yaga Consulting Pvt. Ltd, Hyderabad | The First principles of Corporate Governance for Public Enterprises in India - Supervisory role of Board of Directors |
| 3 | 1. Shri T Sen Gupta 2. Shri. Shankar Naskar | M/s. CONSINDIA HR SERVICES PVT. LTD. | Independent Directors for Banks |

Appendix 2

List of persons / banks consulted by the Group for views/ suggestions

| Sl. No. | Name | Designation- | Organisation |
|----------------|-----------------------|------------------------------------|-------------------------------|
| 1 | Shri David Neilson | Chief Executive Officer | Deutsche Bank |
| 2 | Shri K.K.Rai | Executive Director | Allahabad Bank |
| 3 | Shri B.Vasanthan | The Chairman and Managing Director | Andhra Bank |
| 4 | Shri A.K. Khandelwal | Executive Director | Bank of Baroda |
| 5 | Shri S.S.Kohli (*) | The Chairman and Managing Director | Punjab National Bank |
| 6 | Dr. P.J.Nayak | The Chairman and Managing Director | UTI Bank Ltd. |
| 7 | Shri K.M.Bhattacharya | Managing Director | Bank of Rajasthan Ltd. |
| 8 | Shri Manoj Bhalla | Executive Director | Development Credit Bank Ltd., |

(*) Though did not personally participate in the Meeting, Shri Kohli had sent his comments / views.