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Corporate Governance In Banks

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ABSTRACT

Banks constitute the largest financial intermediaries around the world and possess stupendous power of leverage. Unlike in the Corporate World, authorities like RBI and the government play a direct role in bank governance through bank regulation and supervision. This role is justified by the need to ensure systemic Stability, Financial stability and deposit insurance liability considerations. Banks enjoy the benefit of high leverage with the downside protection of deposit insurance which weakens their incentives for strong management monitoring. While a ubiquitous form of corporate control and concentrated ownership will raise new barrier to effective corporate governance, large investors may manipulate the Firm contrary to the broad interests of the banks and other stakeholders.

Keywords : Stakeholders, Financial Intermediaries

Corporate Governance and Co-operative banks

The literature on corporate governance in its wider connotation covers a range of issues such as protection of 'shareholders rights, enhancing shareholders' value, Board issues including its composition and role, disclosure requirements, integrity of accounting practices, the control systems, in particular internal control systems. Corporate governance especially in the o-operative sector has come into sharp focus because more and more co-operative banks in India, both in urban and rural areas, have experienced grave problems in recent times which has in a way threatened the profile and identity of the entire co-operative system. These problems include mismanagements, financial impropriety, poor investment decisions and the growing distance between members and their co-operative society.

The purpose and objectives of co-operatives provide the framework for co-operative corporate governance co-operatives are organised groups of people and jointly managed and democratically controlled enterprises. They exist to serve their members and depositors and produce benefits for them. Co-operative corporate governance is therefore about ensuring co-operative relevance and performance by connecting members management and the employees to the policy, Strategy and decision making processes.

The special place of Banking :-

Banking as a sector has been unique and the interests of other Stake holders appear more important to it than in the case of non-banking and non-finance organisation. In the case of traditional manufacturing corporations, the issue has been that of safeguarding and maximising the shareholders' value. in the case of banking, the risk involved for depositors and the possibility of contagion assumes greater importance than that of consumers of manufactured products. Further, the involvement of government is discemibly higher in banks due to importance of stability of financial system and the larger interests of the public. Since the market control is not sufficient to ensure proper governance in banks, the government does see reason in regulating and controlling the nature of activities, the structure of bonds, the ownership pattern, capital adequacy norms, liquidity ratios, etc.

Reasons for high degree of oversight :-

There are there reasons for degree of government oversight in this sector.

- Firstly, it is believed that the depositors, particularly retail depositors, can not effectively protect them selves as they do not have adequate information, nor are they in a position to coordinate with each other.
- Secondly, Bank assets are unusually opaque and lack transparency as well as liquidity. This condition arises due to the fact that most bank loans, unlike other products and services, are usually customised and privately negotiated.
- Thirdly, it is believed that there could be a contagion effect resulting from the instability of one bank. Which would affect a Class of banks or even the entire financial system and the economy. As one bank becomes unstable. There may be a heightened perception of risk among depositors for the entire class of such banks, resulting in a run on the deposits and putting the entire financial system in jeopardy.

Role of the Government and Regulator

Regulators are external pressure points for good corporate governance. Mere compliance with regulatory requirements is not however an ideal situation in itself. In fact, mere compliance with regulatory is a minimum requirement of good corporate governance and what are required are internal pressures, Peer pressures and market pressures to reach higher than minimum standards prescribed by regulatory agencies. RBI' s. approach to regulation in recent times has some features that would enhance the need for and usefulness of good corporate governance in the co-operative sector. The Transparency aspect has been emphasised by expanding the coverage of information and timeliness of such information and analytical content. Importantly, deregulation and operational freedom must go hand in hand with operational transparency. In fact, the RBI has made it clear that with the abolition of minimum lending rates for Co-operative banks, it will be incumbent on these banks to make the interest rates charged by them transparent and known to all customers. Banks have therefore been to polished the minimum and maximum interest rates Charged by them and display this information in every branch. Disclosure and transparency are thus key pillars of a corporate governance framework because they provide all the stakeholders with the information necessary to judge whether their interests are being taken care of. We in RBI see transparency and disclosure as an important adjunct to the supervisory process as they facilitate market discipline of banks.

Another area which requires focused attention is greater transparency in the balance sheets of co-operative Banks. The commercial banks in India are now required to disclose accounting ratios relating too operating profit, Return on assets, Business per employee, NPAs, etc. As also maturity profile of loans, advances, investments, borrowings and deposits. The issue before us now is how to adapt similar disclosures suitably to be captured in the audit reports of co-operative banks. RBI had advised Registrants of co-operative Societies of the state Governments in 1996 that the balance sheet and profit & loss account should be prepared based on prudential norms introduced as a sequel to financial Sector Reforms and that the statutory/departmental auditors of co-operative banks should look into the compliance with these norms. Auditors are therefore expected to be well-versed with all aspects of the new guidelines issued by RBI and ensure that the profit & loss account and balance sheet of cooperative banks are prepared in a transparent manner and refect the true state of affairs. Auditors should also ensure that other necessary statutory provisions and appropriations out of profits are made as required in terms of co-operative Societies Act/Rules of the state concerned and the bye-laws of the respective institution.

Measures taken by banks towards implementation of best practices.

Prudential Norms:- In terms of income recognition Assets classification and capital adequacy have been well assimilated by the Indian banking system. In keeping with the international best practice, starting 31st March 2004, Banks have adopted 90 day norm for classification of NPAs. Also norms governing provisioning requirements in respect of doubtful Assets have been made more stringent in a phased manner. Beginning 2005, banks will be required to set aside capital change for market risk on their trading portfolio of government investments, which was earlier virtually exempt virtually exempt form market risk requirement.

On the Income Recognition Front:- There is complete uniformity now in the banking industry and the system therefore ensures responsibility and accountability on the part of the management in proper accounting of income as well as loan impairment.

Asset Liability Management and Risk Management Practices:- At the initiative of the regulators, banks were quickly required to address the need for Assets Liability Management followed by risk management practices. Both these are critical areas for an effective oversight by the board and the senior management which are implemented by the Indian Banking system on a tight time frame and the implementation review by RBI.

Measures taken by regulator towards corporate governance:-

Reserve Bank of India has taken various furthering corporate governance in the Indian banking system. These can broadly be classified into the following there categories.

- ✓ Transparency
- ✓ off- site Surveillance
- ✓ Prompt corrective action

Transparency and disclosure standards are also important constituents of a sound corporate governance mechanism. Transparency and accounting standards in India have been enhanced to align with international best practices. However, there are many gaps in the disclosures in India vis-a-vis the international standards, particularly in the area of risk management strategies and risk parameters, Risk concentrations, Performance measures component of capital structure, etc. Hence, the disclosure standards need to be further broad-based in consonance with improvements in the capability of market players to analyse the information objectively.

The Off-Site surveillance mechanism is also active in monitoring the movement of assets, its impact on capital adequacy and overall efficiency and adequacy of managerial. Practices in banks. RBI also brings out the periodic data on "Peer Group comparison" on critical ratios to maintain peer pressure for better performance and governances.

Prompt Corrective Action has been adopted by RBI as a part of core principles for effective banking supervision. As against a single trigger point based on capital adequacy normally adopted by many countries. Reserve bank in keeping with Indian conditions have set two more trigger points namely Non-performing Assets (NPA) and Return on Assists (ROA) as proxies for asset quality and profitability. These trigger points will enable the intervention of regulator through a set of mandatory action to stem further deterioration in the health of banks showing sings of weakness.

Conclusion

The Indian financial system will grow not only in size but also in complexity as the forces of competition gain further momentum and financial markets acquire greater depth. The Policy environment will remain supportive of healthy growth and development with accent on more operational flexibility as well as greater prudential regulation and supervision. The real success of our financial sector reforms will however depend primarily on the organizational effectiveness of the banks, including cooperative banks, for which initiatives will have to come from the banks themselves. It is for the co-operatives banks themselves to build on the synergy inherent in the cooperative structure and stand up for their unique qualities. with elements of good corporate governance, sound investment policy, appropriate internal control systems, better credit risk management, focus on newly-emerging business areas like micro finance, Commitment to better customer service, adequate automation and proactive policies on house-keeping issues, co-operative banks will definitely be able to grapple with these challenges and convert them into opportunities.

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