Don’t Witch Hunt Bankers: Corruption Act must be amended, else decision making will be frozen

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A cardinal principle of a justice system is that even if a thousand guilty go scot free, not one innocent should be punished inadvertently. In the current round of arrests of and chargesheets on public sector bankers, this cardinal principle stands violated.

As cases drag on for years, reputations carved with decades of diligent and sincere action stand besmirched. As several cases pertain to retired officers, the officers’ post-retirement reality is now consumed by worries about criminal action in courts and the prospect of having to run from pillar to post to extricate oneself.

The most damaging aspect of these incidents is that the genuinely corrupt and the honest who may have only deviated from procedure are clubbed together. Needless to say, this pooling must surely delight the crooks who are now in august company.

To address the issues that these incidents raise, the amendment to the Prevention of Corruption Act (PCA) needs to be taken up urgently in the forthcoming session of Parliament. To learn from best practices elsewhere, consider the US, which is among the most litigious of countries. Even in civil liability cases, where the burden of proof is weaker than in criminal cases, the “business judgment rule” governs court decisions.

The business judgment rule refers to a common law presumption that directors and officers act in the best interests of the corporation they serve. Therefore, a court will not review the substantive wisdom underlying business decisions, as otherwise decision makers

would be “frozen in inaction” if they were to be subject to legal action for decisions which in hindsight were monetarily or otherwise unsuccessful.

The rule generally requires a clear indication of fraud, gross negligence or self-benefit. Courts have also ruled that the burden of proof on fraud and gross negligence also rests on demonstrating self-benefit. Crucially, mistakes or errors in the exercise of honest business judgment do not subject decision makers to liability for negligence in the discharge of their appointed duties.

In criminal cases, the standard of proof required for a conviction is even stronger. The main burden of proof rests on demonstrating self-benefit, monetary or otherwise, which thereby demonstrates that an individual abused his loyalty to his organisation by benefiting himself. Criminal cases against individuals too typically stand or fall in courts based on whether selfbenefit is demonstrated.

The PCA needs to be changed so that economic decisions are evaluated using demonstrated self-benefit as the standard for admissible evidence. If there is no evidence of self-benefit, FIRs and chargesheets should not ordinarily be filed. The present process adopted is to scrutinise all loan cases above a threshold limit where there have been defaults and to identify procedural lapses as the basis for vigilance enforcement action, without necessarily obtaining evidence of self-benefit.

Demonstrating self-benefit is imperative because, unlike other professions, banking involves judgment exercised using soft information, which is primarily qualitative and subjective. To illustrate, the character of a borrower, which a lender must invariably assess, involves a subjective assessment that can vary from one individual to another. Similarly, assessing the future growth potential of a borrower involves subjective assumptions of the future that may seem reasonable to one individual but not to another.

As well, such assessments that may have seemed perfectly reasonable at the time when the judgment was exercised may appear unreasonable or irrationally exuberant in hindsight. For instance, renewing a loan where the bank’s exposure is less than 10% of a borrower’s overall obligation seems reasonable at the time the renewal was granted. So, the process and professional standards set by investigating agencies need to be debated if they question that decision now because the borrower turned out to be a fugitive wilful defaulter.

Such instances equate reasonable judgment, let alone bad judgment, to malafide intent. Similar questions need to be asked if the investigative agencies treat as malafide intent those lending decisions that were based on an irrationally exuberant extrapolation of high economic growth in the past into the future. If investigative agencies cannot demonstrate self-benefit, but nevertheless bring accusations of corruption against bank managers, the investigative agencies would need to subject themselves to a higher standard of professional scrutiny.

To be clear, the intention is not to understate the extent of corruption in public sector banks, which is a major public policy concern. However, the intent is to highlight that the instruments for identifying and tackling corruption in lending need to be nuanced, because the burden of evidence needs to be more demanding.

Absent this change, several adverse consequences will follow. First, bank officers become extremely reluctant to handle credit. Second, a perverse belief then develops in banks wherein those who have not 'soiled their hands with credit' find the easiest path into top management. Third, the very nature of credit appraisal then becomes mechanistic, driven solely by stipulated processes.

World over, the best credit officers use discretion innovatively and thereby often deviate from established procedures. In the best banks in the world, deviation from procedure does not imply culpability. We need to usher in a similar legal framework for investigation and vigilance enforcement so that the credit culture in the country can be genuinely improved.

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