RBI plans to overhaul corporate governance structure of banks

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The Reserve Bank of India plans to overhaul the corporate governance structure of Indian banking system, limiting the terms of directors and chief executive officers and placing more responsibility on the board of directors for a bank's culture and compensation.

Board of directors would be responsible for the remuneration and the outcome or performance and would be accountable for the risk a bank takes. Related party transactions and conflict of interest between various entities of a group to which the bank belongs also dominate the latest set of governance rules that the regulator is proposing.

``To build a robust culture of sound governance practice, professional management of banks and to adopt the principle of separating ownership from management, it is desirable to limit the tenure of the WTDs (Whole Time Directors) or CEOs,'' the paper said. ``Therefore, it is felt that 10 years is an adequate time limit for a promoter / major shareholder of a bank as WTD or CEO of the bank to stabilise its operations and to transition the managerial leadership to a professional management.''

The regulator's latest round of governance norms comes in the wake of the collapse of Yes Bank which faced governance issues and the RBI had to step in with a bailout package through the State Bank of India. Furthermore, charges of poor governance practices and conflict of interest also saw Chanda Kochhar getting terminated as the CEO of ICICI Bank.

CEO of a bank for 15 consecutive years,'' the paper said. ``Thereafter, the individual shall be eligible for re-appointment as WTD or CEO only after the expiration of three years.''

If these proposals are implemented from next fiscal, the chances of a long run like that of Aditya Puri at HDFC Bank or Uday Kotak at Kotak Mahindra Bank may no longer be a reality. These two bankers have been credited with building these two institutions.

Among other things, the new guidelines put the burden of outcomes vis-à-vis the compensation on the board.

``The board, through its NRC, is responsible for oversight of management's implementation of compensation system for the entire bank,'' the paper said. ``In addition, the board, through its NRC, shall regularly monitor and review outcomes to assess whether the bank-wide compensation system is creating desired incentives. The NRC shall review the compensation plans, processes and outcomes at least annually.''

In the past, the lack of governance systems, have led to undesirable results with some segment of stakeholders being left out.

``In the context where management plays the role of an agent of a board and the board in turn plays the role of an agent of shareholders, governance failures have brought to fore the impact of quality of governance on efficiency in allocation of resources, protection of depositors' interest as well as maintaining financial stability,'' it said.

These guidelines would be effective likely next fiscal year.