OPEN BOOK EXAMINATION

341

Roll No.....................................

Time allowed : 3 hours ***Maximum marks : 100***

Total number of questions : 6 ***Total number of printed pages : 8***

NOTE : *Answer **ALL** Questions.*

1. Corporate Governance is an integral part of the Management Control System (MCS) which directly reflects in maintaining the image and the reputation of the company and its strategy because of global competition. Banks in the light of global image and reputation are to be very careful in ensuring their integrity in dealing with the financial aspects of their Constituents. The efforts in the field of Corporate Governance in vague since 1992 when the set of guidelines were provided by Cadbury Committee and thereafter by many other committees on the issues of Corporate Governance.

(A) **Corporate Governance Issues in Banks :**

In today's fast growing economies, the reputation of an organisation has much important as its market value. Added to the financial crisis, the organizations are facing governance issues which are creating reputational and other risks. To overcome these, the Corporate sector is focusing on a new concept called "Corporate Governance". Business ethics, Corporate Governance and Corporate Social Responsibility have become not only an integral part of the present globalised business environment, but also have changed the business model of banks and they are also enforcing such issues.

People have many rights and an attempt by any person to violate any of these right is considered unethical. Right to privacy is violated in many ways. The personal data available with researchers have led to give rise to various junk spam mails, telemarketing calls and so on. In practical situations, it is not always easy to determine whether a particular issue is ethical or unethical. However, on certain perceptions and depending upon the situations, it can be referred to as ethical or unethical. Value is the factor that distinguish an action as ethical or unethical. There are many reasons for an individual or group of individuals or corporate and others to follow ethical or unethical practices. Ethical practices would ensure better and conducive climate in workplace. We come across, unethical practices prevailing in many areas such as HR management, Marketing management, Financial management, Risk management, Production management and so on. These are the basic issues which the banks are facing in global trade now a days.

(B) **Corporate Governance in Banks :**

Banks play an important role in the economic development of a nation as an intermediaries in the financial sector. Banks also act as the trustees of the funds of the depositors. Thus, for efficient functioning and control in banks, an effective Corporate Governance practices should be an integral part of bank management. Banks should have good Corporate Governance in force which should be much more than complying with legal and regulatory requirements. The objectives of corporate governance in the banks must cover broadly :

(1) To protect and enhance shareholders value.

(2) To protect the interest of all other stakeholders consisting of customers, employees and society at large.

(3) To ensure transparency and integrity in communication and to make available full, accurate, clear information to all concerned whether public or the government or any other.

(4) To ensure accountability of the employees for work performance and in giving customer services and to achieve excellence at all the levels of their work and services.

The role of the Board of directors, Chairman and/or CEO and Committees of the board is not only important but crucial in governance matters. The Bank's Board of directors should meet regularly and to provide effective leadership and insight in business and functional areas. They also should monitor bank's performance of business. The Chairman and/or CEO have the responsibility for all aspects of executive management and is accountable to the Board for the ultimate performance of the bank and for implementation of the policies laid down by the Board. A senior executive is made responsible in respect of compliance issues. Board level committees are also formed, to assist the Board of directors in working and to function effectively. These committees provide effective professional support in the conduct of Board level business in key areas and also provide inputs for taking major decisions.

The banks should ensure compliance with the provisions of corporate governance as per SEBI (LODR) Regulations, 2015 as applicable. The bank needs to disclose certain important information as per SEBI (LODR), Regulations, 2015 to the extent that the requirements do not violate the provisions of the Rules and Regulations made thereunder and as per guidelines/directives/orders issued by the Reserve Bank of India (RBI).

The Basel committee guidance provides a foundation for sound corporate governance practices for various banking system across the countries. The guidance is divided into four major sections (*i*) overview of corporate governance in banks (*ii*) sound corporate governance principles, (*iii*) role of supervisor (*iv*) promotion of an environment to support sound corporate governance. According to the Basel guidance, bank's good corporate governance practices would entail banks for better operational efficiency, greater opportunities to get low cost funds, and a good reputation and increased market value.

(C) **Reserve Bank of India and Corporate Governance in the Banking Sector :** The special nature of banking institutions necessitates a broad view of corporate governance where regulation of banking activities is required to protect depositors. Corporate governance in the banking sector is not just a formality but a dire need of society. In almost every country in the world, there is a watchdog like Reserve Bank of India (RBI) in India which monitors all the transactions and activities undertaken by the banks and regulate the business of the bank by making them to submit regular reports on various aspects related to the business undertaken and dealt. Corporate governance is needed for the bank to protect depositors interest, keep a check on money laundering, financial immoral and criminal acts and transaction of money with the terrorists.

RBI in India plays leading and vital role in formulating and implementing corporate governance. The corporate governance mechanism as followed by Reserve Bank of India is based on three categories (*i*) disclosure and transparency, (*ii*) off site surveillance (*iii*) prompt corrective action.

Disclosure and Transparency : If the banks are not disclosing their transactions to the RBI than they can operate at their whims and fancies and may play with the lifelong investments and savings of the people entrusted to them.

Off Site Surveillance : In addition to performing an annual on site inspection of the records of the banks, the RBI had initiated off site surveillance functions for operations of banks. The main focus of the off-site surveillance is to monitor the financial health of banks between two on-site inspections. Identifying banks which show financial deterioration, lacking in services, engaged in unethical matters requiring attention. The offsite surveillance is conducted through filing of periodic returns by banks enabling the RBI to take timely remedial action before things get out of control.

Prompt Corrective Action : RBI while promoting corporate governance in banks in India has set various trigger points on the basis of CRAR, NPA and ROA. On the basis of triggers so set by RBI, the banks have to follow 'structured action plan' which are also called mandatory action plans. Besides mandatory action plan RBI has discretionary action plans too. The main reason for classifying the risk-based action points into mandatory and discretionary is that some of the actions are essential to re-store the financial health of banks while other actions will be taken at the discreation of RBI depending upon the profile of each bank and quantum of business.

All commercial banks in India are regulated by the RBI under the Banking Regulation (BR) Act of 1949. Additionally, all public sector banks are regulated by the Government of India (GOI) under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, the Bank Nationalisation Act, 1980 and the State Bank of India Act, 1955. Section 51 of the amended BR Act explicitely states which provisions of the BR Act apply to the PSBs. It is the demand since a long time that dual control of Public Sector Banks (PSBs) should end and PSBs should be either converted into companies of which control should be with the Reserve Bank of India (RBI), or it should entirely be under the control of Government. These are two aspects of the regulation and supervision of banks governance and of prudential regulation.

The RBI regulates both the governance aspect and the prudential aspect of private sector banks. In the case of PSBs, the government exercises all powers relating to governance, leaving prudential regulation to the RBI. This has been identified as the problem of dual control which according to banks is providing way for frauds.

It is being noted that the appropriate values on fitness and propriety and internal governance structure are in place with respect to private and foreign banks. Nevertheless, the influence which the RBI may exercise on bank's governance through section 21 of the BR Act, by placement of RBI representatives on banks' boards, with limited authority under the Banking Acts, as well as the practice to hold the PSB board accountable has become problematic. Under the law and according to custom, the RBI cannot hold PSB board accountable for assessing and—when necessary—replacing weak and non-performing senior management and government—appointed board members.

The experience gained over the years and the recent incidents reveal that the Indian banks need to improve their risk management, and to maintain strong governance processes, practices and systems.

Some of India's leading private sector lenders are in the spot light for over the role of their leaders. Some bank faces allegations of conflict of interest over grant of loans to a corporate group. While the bank's board has offered full support to the leadership team. The allegations against the management prove to be true, they could hit the banks reputation and expose it to legal and financial risks. Number of banks in India confront serious governance and risk issues. The 'tone at the top' is crucial relating to Rating of bank; Management's ability and expertise to grow the business sustainability which are being assessed always. The governance and transparency in Indian banking is viewed as a negative factor. This is similar to many other emerging markets. The smooth transition and continuity in management in all the banks in trouble will be an important issue.

However, too much pressure on the banks must not be imposed in the name of corporate governance so that they feel harassed which is having impact on the efficiency leading slowdown of financial transactions. Additionally internal governance must be increased which must be formulated in a way that the efficiency of banks is not eroded and deteriorated and be capable to have check on the collusion of employees with constituents and others.

In this backdrop you are required to give answers in the context of prevailing banking practices and regulations to the following :

(*a*) Should a good Corporate Governance much more than complying with legal and regulatory requirements be applied by the banks ?

(*5 marks*)

(*b*) Elaborate the role of the Board of directors, Chairman and/or CEO and Committees of the Board in governance matters. List some of the important committees of the Board constituted in bank for the purpose of compliance of governance.

(*10 marks*)

(*c*) (*i*) State the responsibility of the senior executives of the bank in respect of compliance related issues in banks.

(*2 marks*)

(*ii*) What are the mandatory requirements of SEBI (LODR) Regulations, 2015 relating to the Corporate governance ?

(*3 marks*)

(*d*) State the sound corporate governance principles as outlined by the Basel Committee and also being approved by Reserve Bank of India (RBI).

(*8 marks*)

(*e*) Describe the corporate governance mechanism as followed by Reserve Bank of India (RBI) for governing the banks operating in India.

(*7 marks*)

(*f*) Dual control of Public Sector Banks (PSBs) should end. Banking Regulatory Powers in India are not ownership neutral. Elucidate.

(*10 marks*)

(*g*) State some of the ways to address the governance issues in Indian banks.

(*5 marks*)

2. Chirping Birding Limited approached their bankers for working capital requirement. The bank has agreed to sanction the same by retaining margins as under :

Raw materials	18%
Work-in-progress	30%
Finished goods	20%
Debtors	10%

The bank has also acceded to the request of the company to add 10% to the estimated figure of working capital to cover the contingencies. Following projections are being made available to bank by the company :

Estimates	**Amount** (in ₹)
Annual sales	18,00,000
Cost of production	14,40,000
Raw materials purchased	9,35,000
Monthly expenditure	50,000
Anticipated opening stock of raw materials	1,80,000
Anticipated closing stock of raw materials	1,55,000
Inventory Norms	
Raw material	2 months
Work-in-progress	15 days
Finished goods	1 month

The company enjoys a credit of 15 days on its purchases and allows one month credit on the goods sold.

Company has received advance of ₹ 2,50,000 against the sales orders.

Given the above and stating assumptions, if any so taken :

(*a*) Calculate the working capital required by the company Chirping Birding Ltd. (*12 marks*)

(*b*) Work out and state the working capital limits likely to be approved by the banker to the company on the basis of the provided projections. (*8 marks*)

(*c*) State in which forms the working capital finance may be granted by the bank. (*5 marks*)

(*d*) Describe the factors determining the margin. (*5 marks*)

3. Comment on the following in the context of the prevailing banking practices and the statutory provisions :

(*a*) In a lien there should be a right of possession.

(*2 marks*)

(*b*) Banker possesses right of set-off and not a lien on the money deposited.

(*3 marks*)

4. What are the popular types of mortgages obtained by a banker ? How the mortgage(s) is/are enforced by the bank ?

Answer be given on the basis of relevant provisions and the prevailing banking practices.

(*5 marks*)

5. Explain "SWIFT" and describe the salient features of 'SWIFT' system. State further in which ways it is being useful to banks.

(*5 marks*)

6. Leverage ratio framework under Basel-III is calibrated to act as a credible supplementary measure to risk based capital requirements. Elaborate its objective in context of report of the committee on Basel-III.

(*5 marks*)

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