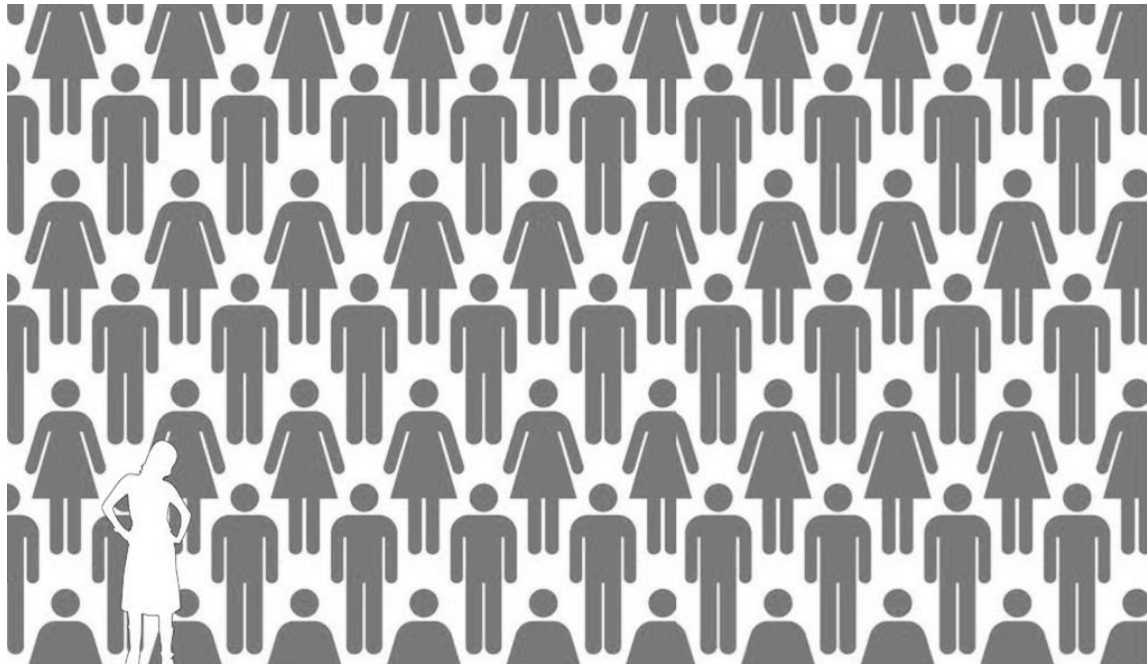


The new world of public interest directors

In his twin interactions with bank directors, RBI's governor did not ask them to maximize profits or focus on shareholder value. He asked that their judgements prioritize the stability and growth of the financial system.



Copyright infringement unintentional

For companies the best time to borrow money is when they don't need to. For banks the best time to accumulate capital is when they don't need to. For banks the best time to strengthen processes is when times are good. It is this thinking that prompted Reserve Bank of India's Governor [Shaktikanta Das to hold twin interactions](#) on governance in banks. The first of these was with the boards of public sector banks and a week later, with the boards of private sector banks. He reminded the boards that "risks often get overlooked or forgotten when things are going well." Banks currently have a capital adequacy ratio of 16.1%, the highest in a long while, with gross and net non-performing assets or NPAs at 4.41% and 1.16% respectively, the lowest in a long while. This then is the best time to focus on and strengthen the governance process and structures.

The Governor drew out a 10-point charter to ensure the safety and stability of the banking system. He emphasized that the quality of governance and management is critical to a bank's success. He went on to list seven critical items that should be on the board's agenda. These are business strategy, financial reports and their integrity, risk, compliance, customer protection, financial inclusion and human resources.

Speaking about the independence and skills of the independent directors, the Governor stressed that the larger purpose of the Board is to provide clear and consistent direction to the bank and oversight over the senior management. Additionally, the board is also tasked with overseeing the Bank's corporate values. Setting the correct tone at the top will help build a conducive corporate and risk culture as well as ethical behavior among the employees.

As the customer deals with the bank, the board should ensure that the bank's practices are fair practices, the customer is paramount, grievance redress is quick and effective. RBI expects agreements with third parties to ensure that the primary responsibility remains that of the banks and not with the third parties.

There is far more to unpack in the speech than I have listed above. Those on company boards and those hoping to join one – and not just a banks board, must read the full text of the speech as well as the two by two of the [Deputy Governors](#), including the headline grabbing one by [MR Rao](#). He asked boards to hold managements “accountable for their actions” and take “suitable action, including replacing the management, to improve the bank's governance and risk management.”

What is noteworthy in the speeches is the glossing over of the responsibilities of the directors, including shareholder directors, in the very narrow sense. There is no call to maximize profits or return money to shareholders. Reading between the lines the Governor is suggesting that board members must view themselves as Public Interest Director (PID) and not as shareholder directors.

PIDs are appointed to the board to represent the broader public interest rather than just the interests of shareholders. Their primary responsibility is to ensure that the organization operates in a manner that serves the best interests of the public.

PIDs are not new to India. They are routinely appointed on the boards of Market Infrastructure Institutions (MIIs) like stock exchanges or clearing corporations. SEBI has been recalibrating the role PIDs. The board composition of MIIs too reflects this, with the chair of an MII and the majority of directors being PIDs. Further proposals put to the board are approved only if a majority of PIDs support them. Over the years, SEBI has conflated independent directors of MIIs with PIDs.

The legal imprimatur to this shift has been provided by the Companies Act 2013. The Act prioritizes the primacy of stakeholders - employees, customers, suppliers, and communities in which businesses operate, over those of

shareholders. This thinking gained more heft after the sustainable development goals or SDGs were rolled out in 2015. The SDGs linked corporate purpose with social and green objectives. Further, the various RBI circulars and court judgements including that of the [Supreme Court in 2016](#), which interpreted the law to include officers of a private bank under the definition of a "*public servant*" as defined under Prevention of Corruption Act, 1988.

**Streamlining the process of appointing independent directors in
government owned banks**

The current process for appointing shareholder-directors in government owned banks involves the bank inviting nominations from the public shareholders through the AGM/EGM notice. The nominations received are then scrutinized by the bank under RBIs 'Fit and proper criteria'. In case the number of candidates is more than the vacancies, the bank announces the 'approved' names through a newspaper advertisement, which is when shareholders get to vote. If the vacancies exceed or match the number of candidates, the meeting is cancelled.

The process needs change with banks first seeking nominations for shareholder-directors, through newspaper advertisements (- and not shareholder notice), and only then send the AGM/EGM notice with the names and profiles of the candidates seeking appointment. Further, even if the number of candidates equals or is less than the vacancies, they should not be automatically elected, but put to shareholders to vote in the AGM/EGM.

Clearly, the role of the bank boards has changed since the financial crisis. Today's banks need to be robust to support what will soon be a US\$5 trillion plus economy. And in line with this, a bank director's judgements will need to prioritise the stability and growth of the financial system. Silently, the bank's boards have stepped into a new world of public interest directors.



A modified version of this blog was published in Business Standard on 28 June 2023. Subscribers can access the blog by clicking this [link](https://www.business-standard.com/opinion/columns/the-new-world-of-public-interest-directors-123062701077_1.html) or typing the following in your url: https://www.business-standard.com/opinion/columns/the-new-world-of-public-interest-directors-123062701077_1.html

Disclaimer

This document has been prepared by Institutional Investor Advisory Services India Limited (IiAS). The information contained herein is solely derived from publicly available data, but we do not represent that it is accurate or complete and it should not be relied on as such. IiAS shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. This document is provided for assistance only and is not intended to be and must not be taken as the basis for any voting or investment decision and/or construed as legal opinion/advice. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigation as it deems necessary to arrive at an independent evaluation of information referred to in this document (including the merits and risks involved) and exercise due diligence while using this report. The discussions or views expressed may not be suitable for all investors. The information given in this document is as of the date of this report and there can be no assurance that future results or events will be consistent with this information. This information is subject to change without any prior notice. IiAS reserves the right to make modifications and alterations to this document as may be required from time to time; however, IiAS is under no obligation to update or keep the information current. Nevertheless, IiAS would be happy to provide any information in response to specific queries. No copyright infringement is intended in the preparation of this document. Neither IiAS nor any of its affiliates, group companies, directors, employees, agents or representatives shall be liable for any damages whether direct, indirect, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of this information. This report may cover listed companies (the 'subject companies'); IiAS may hold a nominal number of shares in some of the subject companies to the extent disclosed on its website and/or these companies might have subscribed to IiAS' services or might be shareholders of IiAS. IiAS and its research analyst(s) do not have any financial interest in any of the subject companies except to the extent disclosed on its website.

Confidentiality

This information is strictly confidential and is being furnished to you solely for your information. This information should not be reproduced or redistributed or passed on directly or indirectly in any form to any other person or published, copied, in whole or in part, for any purpose without the written permission of IiAS. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject IiAS to any registration or licensing requirements within such jurisdiction. The distribution of this document in certain jurisdictions may be restricted by law, and persons in whose possession this document comes, should inform themselves about and observe, any such restrictions. The information provided in these reports remains, unless otherwise stated, the copyright of IiAS. All layout, design, original artwork, concepts and other Intellectual Properties, remains the property and copyright of IiAS and may not be used in any form or for any purpose whatsoever by any party without the express written permission of the copyright holders.

Other Disclosures

IiAS is a SEBI registered entity (proxy advisor registration number: INH000000024) dedicated to providing participants in the Indian market with independent opinions, research and data on corporate governance issues as well as voting recommendations on shareholder resolutions of about 800 listed Indian companies (<https://www.iiasadvisory.com/iias-coverage-list>). Our products and services include voting advisory reports, standardized services under the Indian Corporate Governance Scorecard, and databases (www.iiasadrian.com and www.iiascompayre.com). There are no significant or material orders passed against the company by any of the Regulators or Courts/Tribunals.

This article is a commentary on general trends and developments in the securities market.

About IiAS

Institutional Investor Advisory Services India Limited (IiAS) is an advisory firm, dedicated to providing participants in the Indian market with independent opinions, research and data on corporate governance issues as well as voting recommendations on shareholder resolutions for over 950 companies that account for over 96% of market capitalization.

IiAS provides bespoke research and assists institutions in their engagement with company managements and their boards. It runs two cloud-based platforms, SMART to help investors with reporting on their stewardship activities and ADRIAN, a repository of resolutions and institutional voting pattern.

IiAS with the International Finance Corporation (IFC) and BSE Limited, has developed a Corporate Governance Scorecard for India to evaluate company's governance practices and market benchmarks. More recently, IiAS has extended its analysis to ESG and is also empanelled with AMFI as an ESG Rating Provider.

IiAS has equity participation by Aditya Birla Sunlife AMC Limited, Axis Bank Limited, Fitch Group Inc., HDFC Investments Limited, ICICI Prudential Life Insurance Company Limited, Kotak Mahindra Bank Limited, RBL Bank Limited, Tata Investment Corporation Limited, UTI Asset Management Company Limited and Yes Bank Limited.

IiAS is a SEBI registered entity (proxy advisor registration number: INH000000024).