Research Monograph 53
2021

OPERATING GOVERNANCE IN BANKS: THE ROLE OF BOARD OF DIRECTORS

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Published in November, 2021

Published by Bangladesh Institute of Bank Management (BIBM)
Plot No. 4, Main Road No. 1 (South), Section No. 2
Mirpur, Dhaka-1216, Bangladesh.
PABX : 48032091-4, 48032096-7
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Printed by Chhapaghar, 273 Elephant Road, Dhaka, Bangladesh.

Foreword

As part of the ongoing dissemination of BIBM research outputs, the present research monograph contains the findings of the research project titled “Operating Governance in Banks: The Role of Board of Directors”. The study was conducted in 2019-20 and the paper was presented in a seminar held in November 2020. The role of the board of directors in operating governance of the banks has raised questions about the efficacy of governance mechanisms relating to loan default, liquidity crisis, loan scam, failure of the banks to ensure minimum reserve requirement, and declining private sector credit growth. The loopholes in the corporate governance mechanism in the respective banks lead to such operating governance failures. The study has examined the existing operating governance mechanism of banks in Bangladesh; and assessed the role of the Board of directors in ensuring good governance in banks.

It gives me immense pleasure to publish and distribute this research output to the practitioners of the banks and financial institutions, regulatory agencies, academics and the common readers. I hope this monograph will be a valuable resource for professionals, especially for the banking community for ensuring operating governance in the banking industry in Bangladesh.

Md. Akhtaruzzaman, *Ph.D.*
Director General, BIBM

Acknowledgement

We would like to extend our gratitude to Dr. Md. Akhtaruzzaman, Honorable Director General of BIBM for his valuable guidance and suggestions to complete the study comprehensively.

The research team is grateful to Professor Barkat-e-Khuda, Ph.D., Dr. Muzaffer Ahmad Chair Professor, BIBM for his consistent guidance, as well as for his review and editing of this paper.

We would like to thank the respondents of our questionnaires and the learned discussants, who provided their valuable inputs for the successful finalization of the report. We are also thankful to all our colleagues for their cooperation and support.

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Operating Governance in Banks: The Role of Board of Directors

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Abbreviations

AC	Audit Committee
ACC	Anti-Corruption Commission
BB	Bangladesh Bank
BIBM	Bangladesh Institute of Bank Management
BASIC	Bank of Small Industries and Commerce
BoD	Board of Directors
BSEC	Bangladesh Securities & Exchange Commission
CAR	Capital Adequacy Ratio
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CG	Corporate Governance
CS	Company Secretary
FCB	Foreign Commercial Bank
FSI	Financial Service Industry
HIAC	Head of Internal Audit and Compliance
IB	Islamic Bank
ICC	Internal Control and Compliance
MD	Managing Director
MANCOM	Management Committee
NPL	Non-performing Loan
NRC	Nomination and Remuneration Committee
OECD	Organization for Economic Cooperation and Development
OG	Operating Governance
PCB	Private Commercial Bank
ROA	Return on Asset
RIT	Rationalized Input Templates
SB	Specialized Bank
SOB	State Owned Commercial Bank

Executive Summary

The role of the board of directors in operating governance (OG) of the banks has raised questions about the efficacy of governance mechanisms relating to loan default, liquidity crisis, loan scam, failure of the banks to ensure minimum reserve requirement, and declining private sector credit growth. The reasons for such distress in the financial sectors include weakness in board oversight and negligence as well as board members' involvement with day-to-day operations; weakness in the bank management and internal control mechanism, connivance of some insiders with the borrowers and third parties; nepotism and favoritism in appointment, posting, promotion, and transfer of bank officials; inaction of the respective board to handle the situation; lack of appropriate policy direction; personal greed, forgery and corrupt practice. These loopholes in the operating governance mechanism in banks lead to such failures. Thus, ensuring effective OG is critical to banks' sustainable growth.

The broad objective of this study is to examine the role of the board of directors in ensuring OG in banks. Specifically, the study objectives are to discuss the existing operating governance mechanism of banks in Bangladesh and assess the role of the board of directors in ensuring good governance in banks.

Both primary and secondary data were collected to fulfil the objectives of the study. Secondary data were collected from the annual reports of the sample banks for 5 years from 2015 to 2019. Primary data were collected through interviews and questionnaire surveys. Using Google form, a structured questionnaire survey was conducted to understand the perceptions of the bank employees regarding the existing operating governance mechanism in banks. A total of 731 responses (54%) were received out of 1351 questionnaires sent through e-mail (using google form) to the training participants from January 2020 to October 2020 of BIBM. Interviews were conducted with three Chairmen of the Board, two Directors, three Managing Directors/CEOs of the banks, and two General Managers of Bangladesh Bank to explore the operational roles of the board of directors in ensuring governance in banks. A purposive sampling method was used for selecting the interviewees. Non-performing Loans (NPLs) have been used as a proxy of bank performance (dependent variable). Board size, the proportion of independent directors, female directors, foreign directors, and institutional directors, and appointment of observer/administrator were considered as proxies for governance (independent variables). The role of the board of directors in ensuring good governance in banks has been assessed using regression model.

The summarized findings of the study are as follows. Since 1993, the Bank Companies Act (BCA) has been amended as many as eight times. Such frequent changes create an environment of a low-level of credibility on certain decisive components of the BCA, which is not conducive for the operating governance of banks. The amendments made in 2018 extending the tenure of a director from six consecutive years to nine consecutive years and increasing the number of board members from the same family from two to four have impaired the operating governance in banks. The power of the Bangladesh Bank has been restricted by Section-46 (The BCA-1991) and Bangladesh Bank cannot remove the Chairman, Director, and CEO of the state-owned banks. Despite the restrictions imposed by Bangladesh Bank, there are instances of the presence of outsiders, including employees

and borrowers in board meetings of banks. Influence of business group, family members, or politicians on the board adversely affects operating governance whereas inclusion of female directors and foreign directors on the board help ensure OG. The dummy directors, chairman, and managing directors represent the influential sponsor shareholders and thus, they cannot act independently. Likewise, the independent directors of banks are appointed based on their loyalty to and close relationships with the chairman and other directors rather than based on their competencies. Therefore, they cannot play an independent role in most of the cases. Undisclosed related-party transactions reduce the operational efficiency of banks. Findings suggest that in most of the cases, the members of the board interfere with the day-to-day activities including the loan approval process, recruitment, selection, promotion, transfer and other HR activities. Such unholy interference reduces the autonomy and independence of the bank management.

Based on the findings, the study recommends the following measures to strengthen the operating governance in Banks in Bangladesh. Banking regulations and policies should be well-thought, sustainable and long lasting as frequent policy and regulatory changes create instability and may affect operating governance in banks. The power of Bangladesh Bank should be equally applicable to all banks irrespective of their ownership. The presence of outsiders in the board meeting must not be allowed. Independent directors should be selected based on competencies rather than based on loyalty, and the selection process should be transparent. The involvement of the board members with the recruitment, selection, promotion and transfer of employees and other day to day activities should not be allowed. All the related party transactions should be audited meticulously and disclosed properly in the annual report and website to ensure transparency.

Operating Governance in Banks: The Role of Board of Directors

1. Introduction

1.1 Background

Banks are the financial intermediaries in any economy, which collect money from the surplus units (depositors) and lend it to the deficit units (borrowers). Banking is a business based on confidence. Effective operating governance (OG) is of paramount importance for maintaining public confidence and sustainable growth of the banks. OG integrates the functional and operational aspects of an organization, and thus, can be termed as a 'Nervous System' of an organization (Partner and Partner, 2015). It is like the 'Nervous System' of the human body. The overall governance system may fail if OG fails. Transparency and teamwork; training and development; employee value; trust and fair treatment, quality product and sense of involvement; empowerment and discipline; and work knowledge are critical to ensuring OG in an organization (Singh and Shukla, 2017).

The banking sector in Bangladesh experienced numerous scams[1] (e.g., Hallmark scam, Bismillah group scam, BASIC Bank scam, SB Group scam) which indicate weakness in OG in banks, however, it should not be generalized for the industry as a whole. The following cases of misappropriations may be useful in understanding the magnitude of the inefficiency of OG in banks in Bangladesh:

> **"**The Anti-Corruption Commission filed two separate cases against the owners of two business entities and five officials of a commercial bank for misappropriating more than Tk 28 crore from the bank. SB Group, in connivance with the bank officials and a surveyor, swindled Tk 28 crore from the bank showing forged documents of lands used as a mortgage, according to one of the case statements" (The Daily Star, 23 September 2013 issue).

The banking sector of Bangladesh is facing a turmoil situation due to the increasing trend of Non-Performing Loan (NPL). The defaulted loans have created a crisis in the banking sector of Bangladesh. The credit growth in the sector has come down alarmingly in recent

[1] "BASIC Bank Audit Objection (The Daily Ittefaq, 7 August 2020); MP Papul lost his directorship of NRBC (Prothom Alo, 28 June 2020); BASIC Bank caught in huge bad loans: Scam-hit three branches account for more than 78pc of total default loans (The Daily Star: Wednesday, November 27, 2013); Tk 1200 crore Embezzled from 6 Banks (Janata Bank, Jamuna Bank, Prime Bank, Premier Bank, South East Bank and Shahjalal Islami Bank): ACC moves to tighten noose around Bismillah high-ups (A Prime News Special Report, March, 2013); Embezzlement of Tk 140cr - Shahjalal bank director held (The Daily Star: Thursday, June 26, 2014); Hallmark scam: Cracks in management and monitoring systems of banks - Salehuddin Ahmed, Former Governor, Bangladesh Bank (The Daily Star: Tuesday, September 4, 2012); BASIC Bank faces BB ultimatum: The central bank asks the bank to sign a deal to improve performance, or face actions (The Daily Star: Tuesday, July 9, 2013); 5 banks swindled: Terry towel maker (Bismillah group) siphons off over Tk 1,250cr, opens businesses in Dubai (The Daily Star: Monday, July 29, 2013); TK 28 CR Scam: ACC sues SB Group owners, Bangladesh Commerce Bank officials (The Daily Star: Monday, September 23, 2013)."

years (Ahmed, 2019) along with the continuous rising trend of the defaulted loans, NPL, scams, failure to maintain minimum liquidity and capital requirement. The probable reasons for such scams and distress in the financial sectors include weakness in board oversight and negligence as well as board members' involvement with day-to-day operations; weakness in the bank management and internal control mechanism, connivance of some insiders with the borrowers and third parties; nepotism and favoritism in appointment, posting, promotion, and transfer of bank officials; inaction of the respective board to handle the situation; lack of appropriate policy direction; personal greed, forgery, and corrupt practice. These loopholes in the operating governance mechanism in banks have led to such failures and questioned the role of the board of directors. As such, it is imperative to examine the role of the board of directors in promoting OG in banks.

1.2 Objectives and Methodology

Against this backdrop, the broad objective of this study is to examine how the role of the board of directors in ensuring the OG of banks. The specific objectives are to review the existing OG mechanism of banks in Bangladesh and examine the role of the board of directors in ensuring good governance in banks.

Both primary and secondary data were collected to fulfil the objectives of the study. Secondary data were collected from the annual reports of the sample banks for 5 years from 2015 to 2019. Primary data were collected through a questionnaire survey (Appendix-A) and interviews (Appendix-B). The structured questionnaire was designed, based on prudential guidelines of Bangladesh Bank (BB), BASEL guidelines on CG (2015), Bangladesh Securities and Exchange Commission (BSEC) guidelines, the Bank Companies Act 1991, and the Companies Act 1994. A total of 731 responses were received out of 1351 questionnaires sent through e-mail (using Google form) to the training participants of BIBM from January 2020 to October 2020. Questionnaire survey response is voluntary (Demaio, 1980). The response rate of this study is 54% which is more than the usual responses rate of 52.7% (Baruch and Holtom, 2009). Interviews were conducted with three Chairmen of the Board, two Directors, three Managing Directors/CEOs of the banks, and two General Managers of Bangladesh Bank to explore the operational roles of the board of directors in ensuring governance in banks. A purposive sampling method was used for selecting the interviewees. Non-performing loans (NPLs) have been used as a proxy of bank performance (dependent variable). Board size, the proportion of independent directors, female directors, foreign directors, and institutional directors, and appointment of observer/administrator were considered as proxies for governance (independent variables). The role of the board of directors in ensuring good governance in banks has been assessed using the regression model. The study samples include 51 banks (Appendix-C) - 8 SOBs, 38 PCBs and 5 FBs (Table-1.1)

Table 1.1: Sampling Distribution

Bank Group	Population	Sample Banks	(%)
SOBs including 3 Specialized Banks	9	8 (including 2 specialized banks)	89%
PCBs (Including 8 Islami Banks)	41	38 (including 7 Islami banks)	93%
FBs	9	5	56%
Total	59	51	86%

Source: Scheduled Bank Statistics, BB (2019)

Note: The parenthesis indicates the total number of banks

Regression Models: To assess the role of the Board of directors in ensuring good governance in banks, the study used the following two regression models.

$$LnNPL_{it} = \alpha + \beta_1 Observer_{it} + \beta_2 LnBsize_{it} + \beta_3 IndD_{it} + \beta_4 FemD_{it} + \beta_5 InstD_{it} + \beta_6 ForD_{it} + \beta_7 CAR_{it} + \beta_8 LnSize_{it} + \beta_9 AGE_{it} + \varepsilon_{it} \text{ ---Model-1}$$

$$ROA_{it} = \alpha + \beta_1 Observer_{it} + \beta_2 LnBsize_{it} + \beta_3 IndD_{it} + \beta_4 FemD_{it} + \beta_5 InstD_{it} + \beta_6 ForD_{it} + \beta_7 CAR_{it} + \beta_8 LnSize_{it} + \beta_9 AGE_{it} + \varepsilon_{it} \text{ ---Model-2}$$

Here,

LnNPL = Natural Logarithm of Non-Performing Loans that explains the performance of ith bank for the year 't'

Observer = Observer/Administrator appointed by Bangladesh Bank (BB) to the commercial banks

LnBsize = Size of the board taking natural logarithm

IndD = Percentage of independent director to the total directors

FemD = Percentage of female director to the total directors

InstD = Percentage of institutional director to the total directors

ForD = Percentage of foreign director to the total directors

CAR= Total Eligible Asset to Total Risk Weighted Asset of the Banks

LnSize = the natural logarithm of total assets of the bank

AGE = Total age from the year of the commencement of the business

Variables: Bangladesh Bank appoints observers to improve ICC, RM and ensure credit discipline of the banks through strengthening supervision and monitoring (Business News, 2016). The observer is empowered to attend policy making meetings, including that of the board of directors, executive and audit committee of the bank to oversee their functions. Further, Bangladesh Bank appoints observers in banks after finding malpractices and window-dressing of NPL. The surge of NPL is positively connected with the appointment of an observer of the banks. The study considered 'observer' and board composition (independent director, female director, foreign director and institutional director) as principal variables of interest to measure the quality of governance of the banks.

There are various accounting measures to quantify the performance of an organization (Saeed *et al.*, 2014). Supportive to the earlier studies in the banking sector, this study used Non-Performing Loans (NPLs) (e.g., Hung *et al.*, 2017; Cucinelli, 2015; Musaya, 2009; Curak *et al.*, 2013). NPL is measured by the ratio of total classified loans to total loans and advances. The study considered NPLs as dependent variables. LnNPL i.e., NPL as the natural logarithm was used for the data analysis. Also, Return on Assets (ROA) was considered to check the regression result.

The study included SIZE (Total Assets) (Cooper *et al.*, 2010, Islam, 2012; 2013; Perez *et al.*, 2014, Hung *et al.*, 2017; Islam *et al.*, 2020) and AGE (Cochran and Wood, 1984; Islam, 2012; 2013; Islam *et al.*, 2020) for empirical analysis. Moreover, the Capital Adequacy Ratio (CAR) of the banks was controlled for, while checking the relationship of the role of the board and firm performance (Table-2.1).

Table 1.2: Variables Names, Acronyms and Definitions

Variable Name	Acronym	Definition
Dependent Variable: Bank Performance		
Non-Performing Loan Rate	LnNPL	LnNPL is the natural logarithm of the ratio of classified loan to total loans and advances.
Return on Assets	ROA	Return on Assets is the ratio of NPAT to total assets of the banks.
Independent Variables (Governance Factors)		
Observer	Observer	Observer/Administrator appointed by Bangladesh Bank (BB) to the commercial banks since 2015.
Board Size	LnBsize	Size of the board taking natural logarithm
Independent Director	IndD	Percentage of independent director to the total directors
Female Director	FemD	Percentage of female director to the total directors
Institutional Director	InstD	Percentage of institutional director to the total directors
Foreign Director	ForD	Percentage of foreign director to the total directors
Control Variables		
Capital Adequacy Ratio	CAR	CAR is the Total Eligible Capital to Total Risk Weighted Asset of the Banks
Total Assets	LnSize	LnSize is the natural logarithm of total assets of the bank
Age	AGE	Year of the commencement of the business

1.3 Organization of this Study

The contents of this report are organized into nine sections. Section -1 covers the background, objectives and methodology; Section-2 explains board roles in banks-guidelines by international bodies; Section-3 discusses the board roles in banks- guidelines in Bangladesh; while Section-4 compares corporate governance guidelines of selected SAARC countries. Section-5 explains the operating governance models. The findings of the study are presented in Section-6 (perception survey findings), Section-7 (interview findings), and Section-8 (empirical findings with the cases in operating governance presented in Appendix-I). Finally, Section-9 recommends some measures to strengthen OG in banks in Bangladesh.

2. Role of Board of Directors in Banks- Guidelines by International Bodies

Different international bodies such as Organization for Economic Cooperation and Development (OECD), and BASEL identified the role of the board of directors for banks as discussed below.

OECD: Chapter VI of the G20/OECD Principles of Corporate Governance 2015 delineates the board of directors' responsibilities. The principles underscore CG framework ought to confirm the strategic direction of the company as well as proper monitoring of the company management, and accountability of the board to the company's stakeholders. The principles emphasize that the BoD should and apply high ethical standards on a fully informed basis, in good faith, with due diligence and care. The BoD is also expected to take an objective independent decision on corporate affairs (Appendix-D).

BASEL guidelines: Amongst the 13 principles of CG guidelines of BASEL (2015), four principles have been stipulated on board. These are the overall responsibilities of the board (Principle-1), composition and qualifications of the board (Principle-2), structure and practices of the board itself (Principle-3) and governance of group structures (Principle-5). Moreover, Principle-5 is stated on senior management of the banks (Appendix-E).

3. Role of Board of Directors in Banks- Guidelines in Bangladesh

In Bangladesh, the different regulatory authorities such as BB, RJSCF, and BSEC identified the role of the board of directors to ensure good governance in banks.

3.1 Bangladesh Bank Prudential Guidelines

The prudential regulations of Bangladesh Bank (BB) require banks to have their boards consisting of directors that are competent and professionally skilled for formulating policies and efficiently supervising business activities of their banks and ensuring good governance. The responsibilities of a bank's board are more important than those of other companies because of the need to gain and maintain the confidence of the depositors.

Appointment of New directors: As per the BRPD Circular Number 11 of 27 October 2013, every bank, other than specialized banks, is required to submit certain documents to Bangladesh Bank, including personal information, declaration and confidentiality declaration, and CIB report of the concerned person.

Vacation of office of Director: The office of a bank director will be vacated, if he or she becomes a defaulter and not repaying the loan within 2 months (Sec. 17, The BCA-1991); supplying untrue statement; or failing to meet eligibility criteria. The vacated director shall not eligible to be a director of any bank or FIs for one year after repayment of the dues.

Moreover, directorship shall be vacated under section 108(1) of the Companies Act, 1994. BB can remove any director, including Chairman, *except SOBs*, for any activities which jeopardize depositors' interest or public interest (Sec. 46; the BCA, 1991). BB can also supersede any bank board under Section-47 of the BCA, 1991.

Removal of Directors from office: As per section 108(2) of the Companies Act, 1994, a bank director [other than SBs] can be removed from his/her office for the reason specified in its Articles of Association with the prior approval of Bangladesh Bank. The reason and grounds of the dismissal/removal and copy of the decision of the board and list of directors should be submitted to BB, and the removal in such cases will be effective from the date of BB's approval.

Responsibilities and Authorities of Board: The board shall establish policies for the bank's risk management, internal control and compliance, and ensure their implementation according to the Section 15(Kha) & (ga) of Bank Company Act, 1991 [BRPD Circular No. 11 dated 27 October 2013]. The board of the bank is responsible for work-plan and strategic management, credit and risk management, internal control and compliance, HRM and financial management

Appointment of Chief Executive Officer (CEO): To strengthen the financial health of a bank and attain the depositor's confidence, the board will appoint an honest, efficient, experienced and suitable CEO, subject to the approval of BB.

Board Meeting: Board meetings shall be held at least once every three months; however, too many meetings are discouraged.

Responsibilities of the Chairman: Any member of the board, including the Chairman, does not have any personal authority to interrupt the day-to-day activities of the bank. The Chairman may inspect any branch, call for information regarding bank operation, and share such information in the board meeting or executive committee meeting.

Restriction on Lending to Directors of Private Banks: Any credit to a bank director or his/her relatives must be approved by the board, and has to be clearly disclosed in the balance sheet. However, such a loan amount cannot be more than 50% of the paid-up stock value of the director concerned.

3.2 Evolving Role of The Bank Companies Act - 1991 to 2018

The Bank Companies Act has been amended over time to make it updated (in 1993, 1995, 1997, 2001, 2003, 2007, 2013 and 2018). Some of the important amendments that contribute to corporate governance include the inclusion of independent directors, the establishment of an audit committee, revising qualifications and experiences of the member of the board and audit committee (Siddique, 2017). The major changes in the Bank Companies Act have been summarized in Appendix-F.

Based on a Cabinet meeting held on 8 May 2017, some major amendments were done to the Bank Companies Act-1991. The first amendment related to the tenure of BoD from six years to nine years. Kollol (2017) explained that the reasons for such changes are to get benefits from longer tenure. The second amendment was s to increase the number of a family member on the board from two to four.

3.3 The Companies Act 1994

The board shall disclose important issues such as industry outlook and product-wise performance, internal and external risk factors, related party transactions, public/issues, clarification if the financial result worsens, remuneration paid to the directors, financial statement, minority shareholders last preceding 5-year summary, etc. in the Board of Director's report.

3.4 BSEC Corporate Governance Guidelines

In June 2018, BSEC issued a CG code applicable to all the companies, including banks listed with the stock markets, and is, therefore, the common document regarding CG in Bangladesh. According to BSEC (2018), a company needs a minimum of two committees — Audit Committee and the Nomination and Remuneration Committee. Pertinent codes are summarized in Appendix-G.

Regulatory and Reporting Requirements of BSEC and DSE: In addition to the regulatory requirements of Bangladesh Bank, banks listed in the stock exchange are also required to comply with the requirements of BSEC and DSE. A summary of the regulatory and reporting requirements of BSEC and DSE is shown in Appendix-H.

4. Comparison of Corporate Governance Guidelines of Selected SAARC Countries

The comparative picture of the CG guidelines of selected SAARC countries has been presented in Table 4.1. The aspect of the role of the board has been covered in Bangladesh, India, Sri Lanka, and Pakistan. Compared to the CG guidelines of the respective countries, Bangladesh CG guidelines did not specifically cover eight areas (maximum members in a committee, the maximum number of involvements in a committee as a Chairman, meeting to be held in a year and its interval between two, measuring the performance of the entire board and CEO, arranging training for the board members, performance evaluation of independent directors). There is a scope of improvement in the above mentioned eight areas in terms of strengthening the CG practices in Bangladeshi companies as well as in the banking sector.

Table 4.1: Role of Board of Directors

Subject	BANGLADESH	INDIA	SRI LANKA	PAKISTAN
The Composition of Board	Representing various categories of shareholders and independent directors.	Optimum combination of executive and non-executive directors at least one-woman director	Balance of executive and non- executive directors (including independent non-executives)	Effective representation of independent non-executive directors, including those representing minority interests.
Board size	5 to 20	Not specifically covered	Not Specifically covered	Not specifically covered
Maximum no of committee act as member	Not specifically covered	Not more than 10 committees across all companies in which he is a director	Not specifically covered	Not specifically covered
Role of Board	Covered	Covered	Covered	Covered
Maximum no of committee act as Chairman	Not specifically covered	Not more than 5 committees across all companies in which he is a director	Not specifically covered	Not specifically covered
No. of meeting in a year and the time interval between two meeting	Not specifically covered	At least 4 times a year, with a maximum time gap of 120 days between any two meetings.	At least once in every quarter of a financial year	At least once in every quarter of a financial year
Evaluation of BOD as a whole	Not specifically covered	Covered	Covered	Covered
Evaluation of CEO	Not specifically covered	Covered	Covered	Covered
Training of BOD	Not specifically covered	Covered	Covered	Covered
Committee of BOD	Audit Committee	Audit, Remuneration, and Nomination Committees	Audit, Remuneration and Nomination Committees	Audit, Human Resource and Remuneration (HR&R) Committee
Code of Conduct	Covered	Covered	Covered	Covered
Disclosure of Remuneration	Covered	Covered	Covered	Covered
The Number of Independent Directors	At least 1/10th of the total number of directors or minimum one.	at least 1/3th of the board if executive chairman, at least 1/2th of the board if executive chairman	At least 02 Non-Executive Directors or 1/3th of the total number of Directors, whichever is higher. If Chairman and CEO is the same person, comprise a majority of the Board.	At least 01 and preferably 1/3th of the total members

Table 4.1: Continued

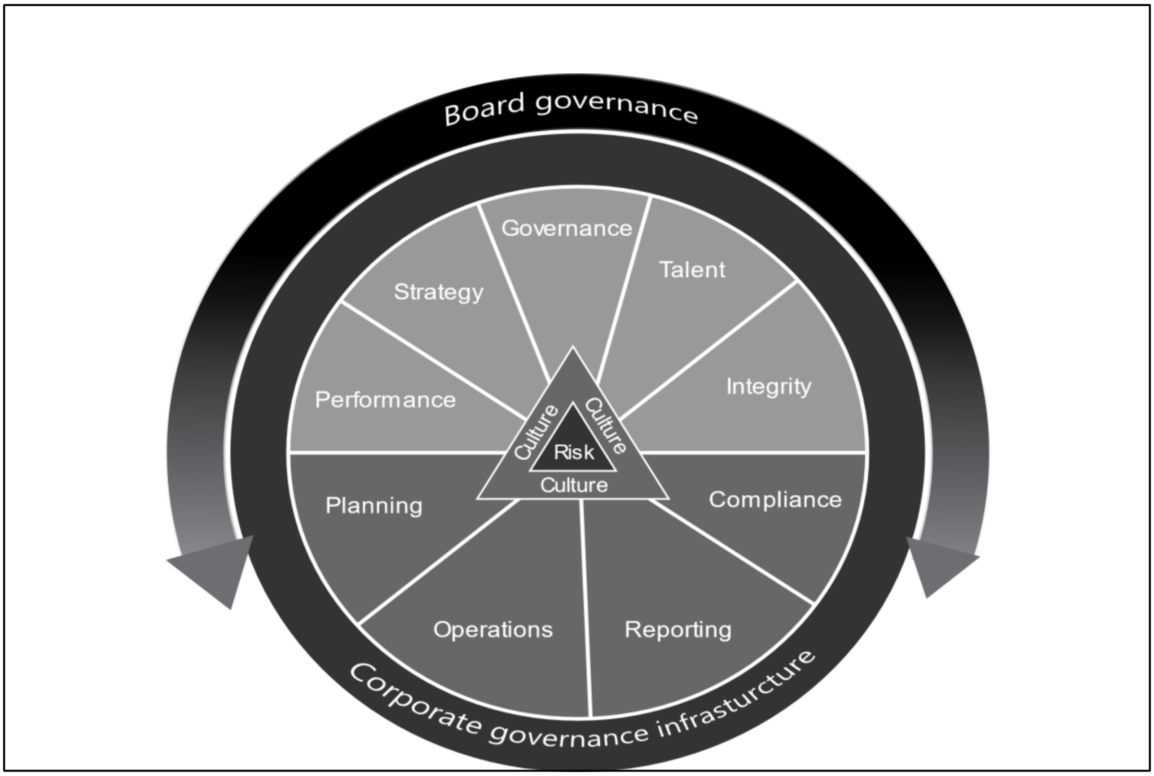
Subject	BANGLADESH	INDIA	SRI LANKA	PAKISTAN
Limit on the number of independent directorships	Not more than 3 listed companies	Not more than 7 but if whole time director in any listed company as an independent director in not more than three listed companies.	Not specifically covered	Not specifically covered
Shareholding of independent director	Not more than 1%	Not more than 2%	Not more than 5%	Not more than 10%
Maximum tenure of Independent Directors	3 years, extended for 1 term only	As per law	9 years	Three consecutive terms
Appointment to Independent Directors	Board of Directors	As per law	Nomination Committee	Not specifically covered
Performance evaluation of Independent Directors	Not specifically covered	Covered	Covered	Not specifically covered
Separate meetings of the Independent Directors	Not specifically covered	At least one meeting in a year	At least once each year	Not specifically covered
Restriction to be independent director	Sponsor, loan defaulter, stock exchange member	Pecuniary relationship with the company or subsidiary or supplier	Material relationship or close family member or significant shareholdings	Connection or family relationship with the company

Source: Das, *et al.* (2018)

5. Operating Governance Models

As part of the broader CG framework, Deloitte (2013) explained that an OG is used by the board and management to implement the CG mechanism into practice with responsibilities and accountabilities. The typical model for the Financial Service Industry (FSI) is shown in Figure-5.1.:

Figure 5.1: Typical Governance Framework of FSI



Source: Deloitte (2013)

Deloitte (2013) explained that the OG model particularly supports the board and management in taking decisions to ensure better CG infrastructure. This model enables the board and CEO to implement CG elements. Due to the absence of the right OG model, the performance of the banks suffers. Figure-5.2 shows the major components of an OG model and its associations.

Figure 5.2: Operating Governance Model

	Structure	
Organizational design and reporting structure		Committee(s) structure and charters
	Oversight Responsibilities	
Board oversight and responsibilities	Management accountability and authority	Committee(s) authorities and responsibilities
	Talent and Culture	
Performance management and incentives	Business and operating principles	Leadership development and talent programs
	Infrastructure	
Policies and procedures	Reporting and communication	Technology

Source: Deloitte (2013)

However, the step-by-step process of designing operating governance model for the financial institutions is shown in Figure-5.3:

Figure: 5.3: Process of Designing Operating Governance Model

Step-1: Define the governance operating model requirements		
Sub-step 1.1: Analyze peers at a summary level	**Sub-step 1.2:** Assess the organization's governance vis-à-vis a governance maturity model	**Sub-step 1.3:** Identify and prioritize governance needs and activities
Step-2: Design the governance operating model		
Sub-step 2.1: Detail design of governance operating model and its components	**Sub-step 2.1:** Develop matrix defining key accountabilities across the organization	**Sub-step 2.1:** Develop matrix defining decision rights and escalation paths
Step-3: Implementing the governance operating model		
Sub-step 3.1: Create an implementation plan in an electronic, visual format that enables the team to track progress on action steps and to log disposition of risks and related issues	**Sub-step 3.1:** Obtain external assistance in creating a workable plan and format and in overseeing implementation, as necessary	

Source: The Authors Adopted from Deloitte (2013)

6. Operating Governance and Role of Board: Findings from the Perception Survey

Some 731 survey responses were received where 77% of the respondents were from Officers to Senior Principal Officers (SPOs), 21% from Assistant Vice President (AVPs) to Senior Executive Vice President (SEVPs) and 2% are above SEVP position (Figure-6.1). All categories of banks, including Bangladesh Bank (BB) as the regulator were included. Just over half of the responses (52%) were received from the PCBs excluding the Islamic Banks followed by the State-Owned Banks (19%), Islamic Banks (18%), and Foreign Banks (10%) (Figure-6.2).

Figure 6.1: Range of the Participants (by Designation)

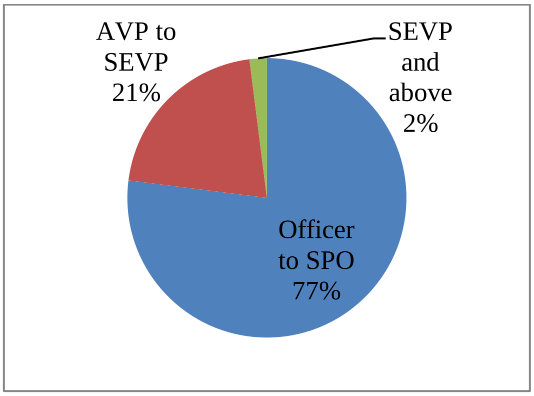
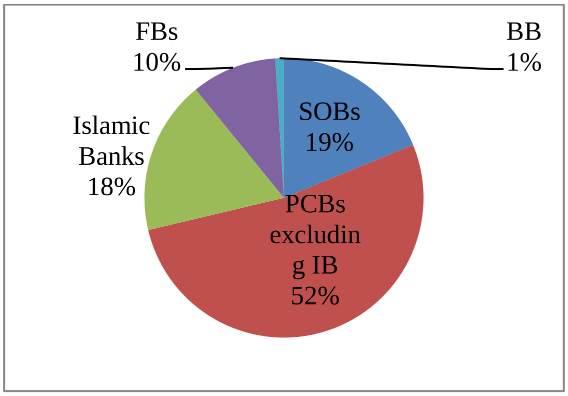
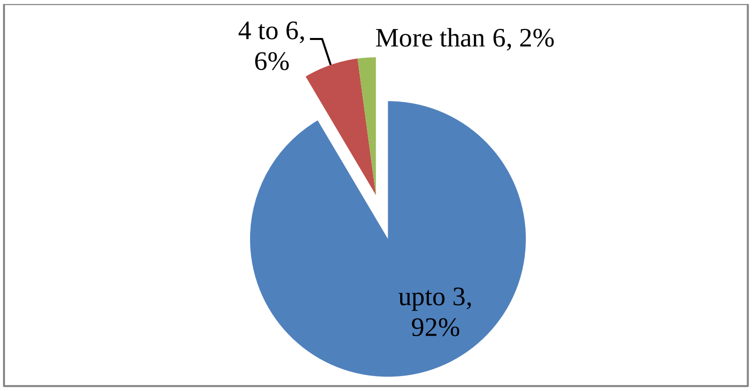


Figure 6.2: Respondents (by Bank Category)



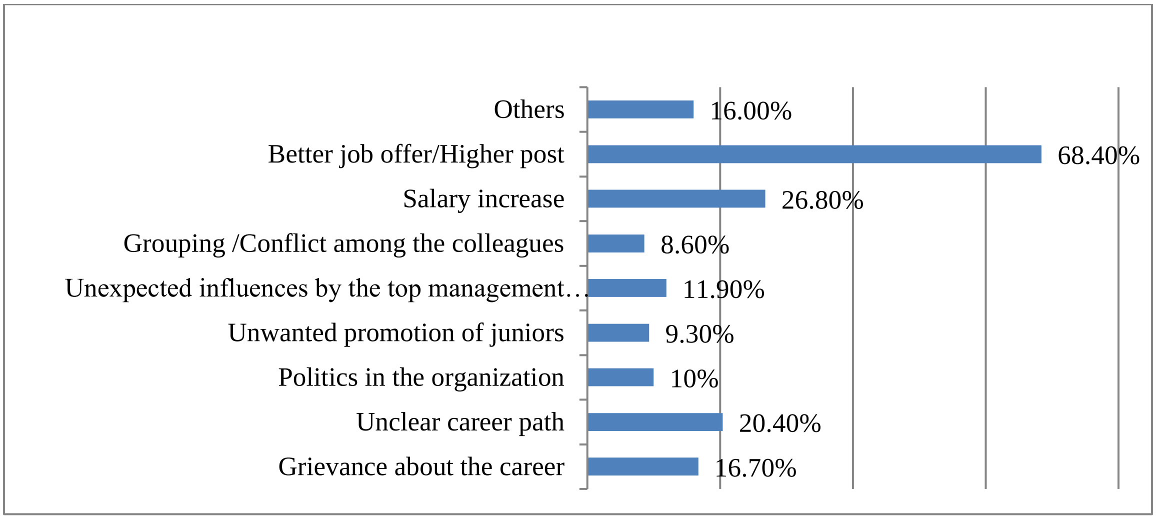
The study explored the number of banks a respondent switched from the very beginning of his/her banking career till the date of response and found that 92% of the respondents changed up to 3 banks while 2% changed more than 6 banks (Figure-6.3). Respondents switch their bank for different reasons, such as unexpected influences from the board and top management, unwanted promotion of juniors, internal politics, unclear career path, grouping/conflict among the colleagues, and grievance of the employees.

Figure 6.3: Number of Organizations a Respondent Switched



Over two-thirds (68.4%) of bankers switched their jobs for a better job offer or higher posts, followed by 26.8% for salary increases and 20.4% for lack of career path in the existing bank. Among other factors, around 12% switched their jobs due to unexpected influences by the top management and board, followed by 9.3% for unwanted promotion of juniors and 8.6% for grouping or conflict among the colleagues (Figure-6.4).

Figure 6.4: Reasons for Switching the Job



6.1 Risk Appetite System, Management Control, and Dummy Director and Related Party Transactions

The study captured the perception of the respondents about the risk appetite system and management control system, dummy directors and related party transactions of banks. About 42% of respondents opined that their banks follow a top-down approach, and 17.1% respondents opined that their banks follow a top-down approach while 40.6% of the respondents opined that the risk appetite system of their banks is the combination of both the top-down and bottom-up approaches (Figure-6.5). About 73% of the respondents claimed their banks follow a centralized management control system. (Figure-6.6). Some 51% of the respondents argued that banks have dummy directors on the board who act as an agent of the non-board members while 37% of the respondents disagreed with that (Figure-6.7). Some 605 of the respondents opined that their banks do not disclose related-party transactions (Figure-6.8).

Figure 6.5: Risk Appetite System in Banks

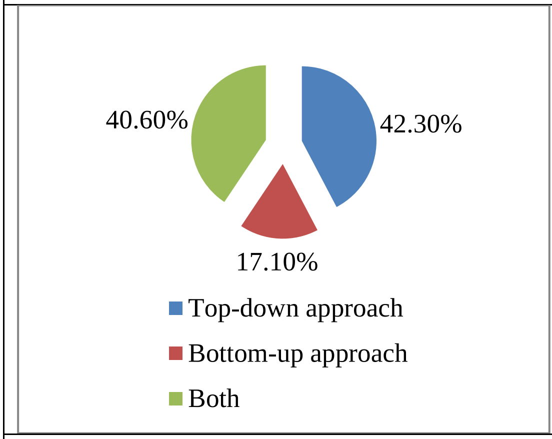


Figure 6.6: Management Control System of Bank

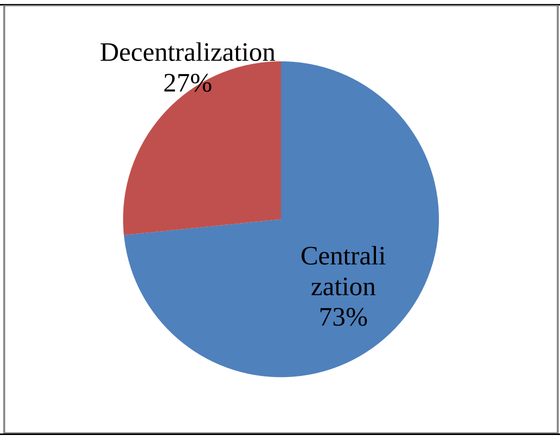


Figure 6.7: Presence of Dummy Director

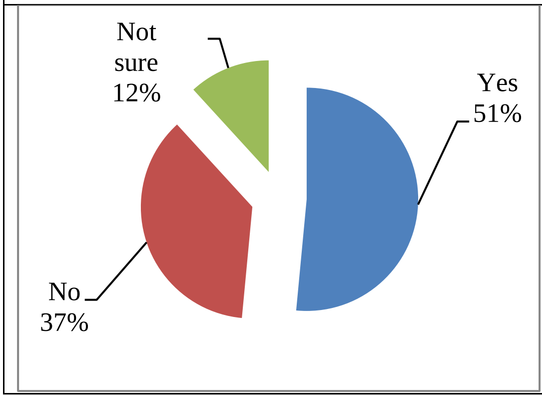
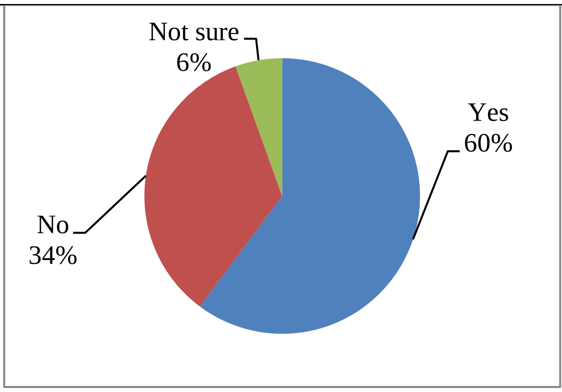


Figure 6.8: Undisclosed Related Party Transactions



6.2 Board Competency and Selection

Regarding the competency and qualifications of the board of directors, about 24% of the respondents strongly agreed that board members are competent and qualified enough to understand and oversee CG, and 46% agreed with the notion. In contrast, 11% of the respondents opined that the boards of directors of their banks are not competent and qualified (Figure-6.9). Regarding the selection of the board members, only 12% of the respondents strongly opined that the board has a clear and rigorous process for identifying, assessing and selecting board members. In contrast, 13% of the respondents strongly disagreed with the notion (Figure-6.10).

Figure 6.9: Board Competency about OG

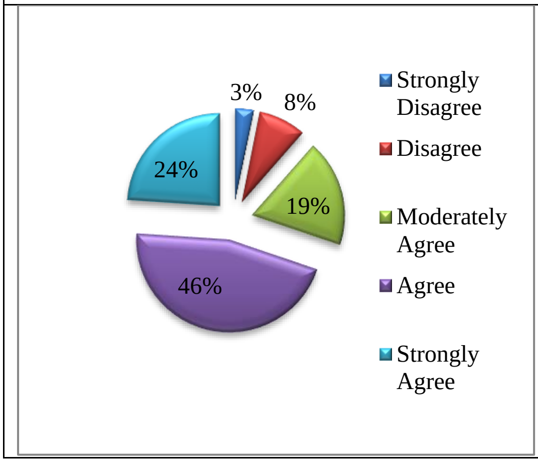


Figure 6.10: Clear and Rigorous Process in Selecting Board Members

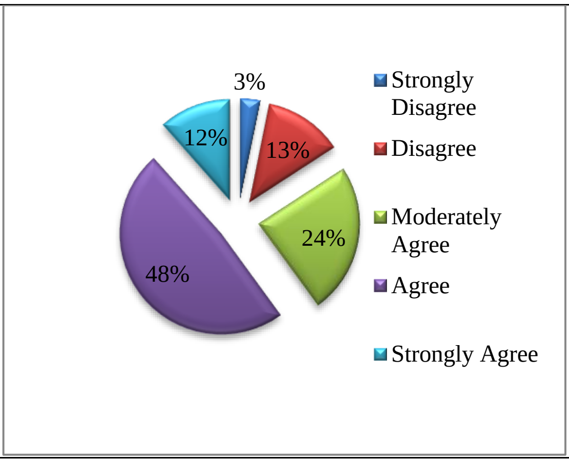


Table 6.1: Board Orientation and Independency of ICC and RM Unit

Issues	Strongly Disagree	Disagree	Moderately Agree	Agree	Strongly Agree
Board establishes long-term business target and risk exposure	3	8	19	51	16
Board does not support excessive credit risk	3	14	17	48	16
The risk management unit of the bank can work independently	5	7	20	46	20
The bank has an independent and effective internal audit function	3	3	16	46	30

Table 6.1 shows that some 86% of the respondents opined that their board establishes long-term business target, and risk exposure of the banks effectively, while 11% of the respondents did not think so. Some 81% of the respondents opined that their board does

not support excessive credit risk, while 17% of the respondents did not think so. Some 86% of the respondents opined that the risk management unit of the bank can work independently, while 12% of the respondents did not agree with the notion. Some 92% of the respondents opined that their banks have an independent and effective internal audit function, while 6% of the respondents were against the notion.

Table 6.2 shows that some 95% of the respondents opined that their board chairman is ethical and trustworthy, while 5% were against the notion. About 80% of the respondents opined that their board chairman does not interfere with any HR affairs. About 77% of the respondents opined that the board chairman does not participate in or interfere with the administrative/operational/routine affairs of the bank. Only 54% of the respondents opined that the chairman of the bank conducts an on-site inspection of branches, while 40% of the respondents were against the notion.

Table 6.2: Role of Chairman of the Board

Issues	Strongly Disagree	Disagree	Moderately Agree	Agree	Strongly Agree
Board Chairman is ethical and trustworthy	2	3	13	52	30
Board Chairman does not interfere with any HR affairs	6	11	21	43	16
Board Chairman does not participate in or interfere in the administrative/routine activities	3	14	17	48	12
Board Chairman conducts an on-site inspection of branches.	7	33	19	32	3

Table 6.3: Role of the Board

Issues	Strongly Disagree	Disagree	Moderately Agree	Agree	Strongly Agree
Board oversees the bank's approach to compensation.	2	7	26	56	9
Board maintains and periodically updates organizational rules, by-laws.	2	6	21	53	14
When a conflict of interest arises, the board members forego their own interest for the sake of the bank's interest.	3	17	24	42	10
Board assesses the audit committee reports and BB inspections	1	3	15	62	19
Board actively engages in the succession plan for the key positions	5	11	18	52	14

Table-6.3 shows that 91% of the respondents opined that their board oversees the bank's approach to compensation. Some 88% of the respondents opined that their board maintains and periodically updates organizational rules and by-laws. About 76% of the respondents opined that when a conflict of interest arises the board members forgo their own interest for the sake of the bank's interest. Some 96% of the respondents opined that Board reviews the submitted reports of the audit committee and BB inspections. About 84% of the respondents opined that the board actively engages in the succession plan for the key positions, while 16% of the respondents were against the notion.

6.3 Responsibilities of the Board

The respondents were asked about the Board responsibility in approving and overseeing the management activities. About 84% of the respondents opined that the board of the bank takes responsibility for approving and overseeing the activities of management ethically, in contrast, some 14% of the respondents were against the notion (Figure 6.11). Figure-6.12 shows that only 80% of the respondents opined that the board takes responsibility for the bank's business strategy and financial soundness as opposed to 19% of the respondents who were against the notion.

Figure 6.11: Board Responsibility in Approving and Overseeing the Management Activities

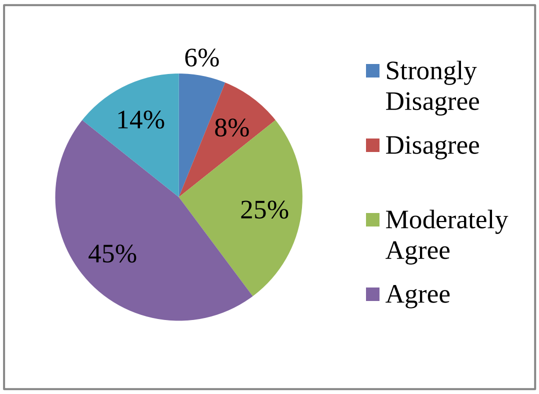
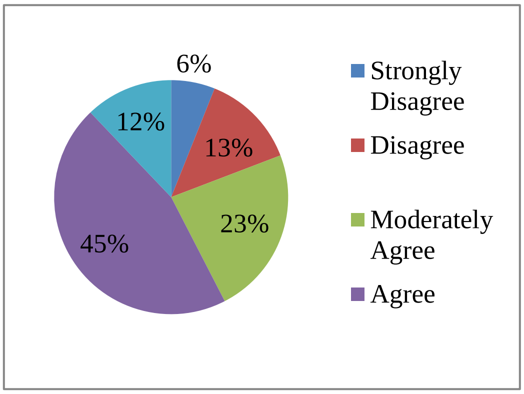


Figure 6.12: Board Responsibility for Formulating Business Strategy and Financial Soundness



6.4 Board Interference

Regarding board interference operations of the bank, 56% of the respondent opined that the board of the bank interferes with the loan approval process while only 6% of respondent strongly disagreed with the notion (Figure 6.13). Some 66% of the respondent opined that the Chairman of the bank does not involve or interfere with or influence over any HR affairs while only 6% of respondent strongly disagreed with the notion (Figure 6.14). Some 59% of respondent opined that the Directors are not included in any selection committees for employee recruitment & promotion (except MD and DMD) while only 6% of respondent strongly disagreed with the notion (Figure 6.15).

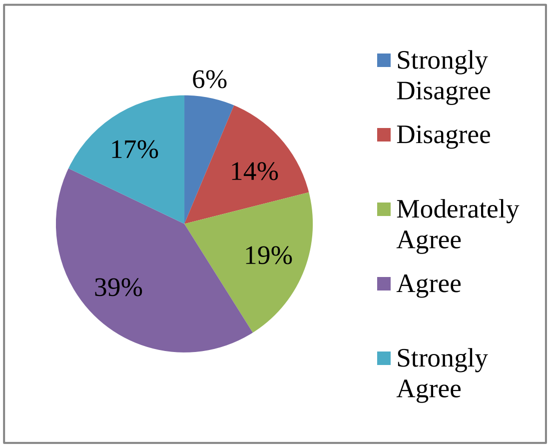
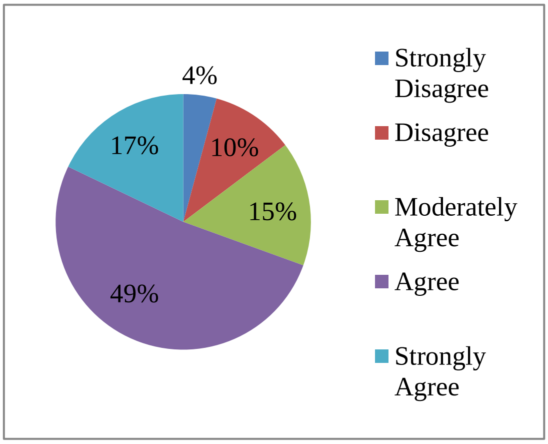
Figure 6.13: Board Interference with the Loan Approval Process	**Figure 6.14: Board Involvement in Employees Recruitment and Selection (except MD and DMD)**
	

Figure 6.15: Board Interference in HR Operations

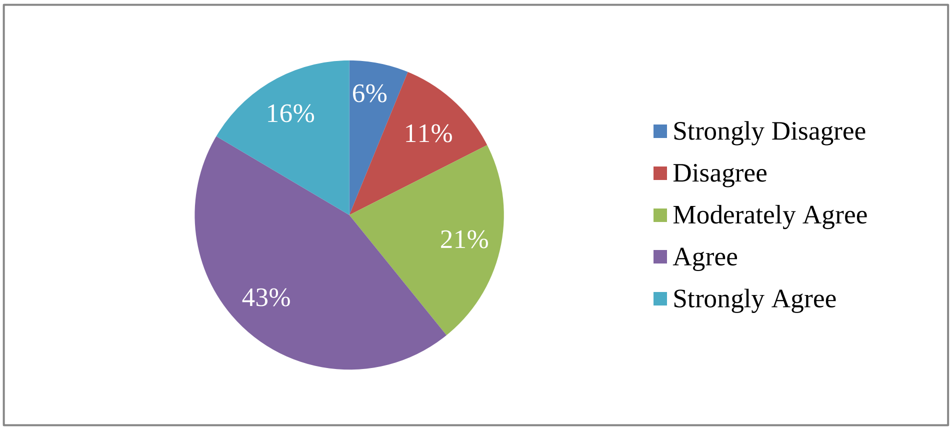


Table-6.4 depicts the findings regarding role clarification and delegation of authority by the board. It shows that only 89% of the respondents opined that their board clarifies and fixes the core responsibilities of the board, top management, risk management and ICC unit. Some 75% of the respondents opined that their board delegates some authority to lower management in contrast to 22% of the respondents who were against the notion. Some 71% of the respondents opined that Board specifically distributes the power to the CEO and lower tier to sanction of loan/investment in contrast to 10% of the respondents were against the notion.

Table 6.4: Role Clarification and Delegation of Authority by the Board

Issues	Strongly Disagree	Disagree	Moderately Agree	Agree	Strongly Agree
Board clarifies and fixes the core responsibilities of the board, top management, risk management and ICC unit	3	5	17	55	17
Board delegates some authority to lower management	5	17	18	45	12
The board specifically distributes the power to the CEO and lower tier to sanction loan/investment	3	7	17	54	17

Table 6.5: Board Role and Effect on Performance

Issues	Strongly Disagree	Disagree	Moderately Agree	Agree	Strongly Agree
The presence of Politicians as Board Member increases the performance of the bank.	26	42	15	10	2
Business Group/persons having political connection sits in the board increases the performance of the bank	20	42	19	11	2
Family directors on the board increase efficiency of the bank.	20	51	16	5	2
Having Dummy directors (Directors who have no roles) reduces board efficiency	5	12	12	40	26
Related party transactions (transactions with business or directors or their family members) reduce the operational efficiency of the bank.	5	15	18	41	16

Table-6.5 depicts 68% of the respondents opined that the presence of politicians as board member increases the performance of the bank. Similarly, 62% of the respondents disagreed that the inclusion of business group/persons having a political connection in the board increases the performance of the bank. Some 71% of the respondents opined that family director in the board increases the efficiency of the bank. Some 66% of the respondents opined that having dummy directors reduces board efficiency. Similarly, 75% of the respondents opined that related party transactions reduce the operational efficiency of the bank.

6.5 Role of Employees

Employees of the bank are expected to play important roles in promoting governance in banks. Figure 6.16 shows that 89% of the respondents agreed that employees having strong ethics increases Board efficiency. Likewise, 78 of the respondents opined that employees having strong ethics reduces board interference in operational activities (Figure-6.17).

Figure 6.16: Employees having Strong Ethics Increases Board Efficiency

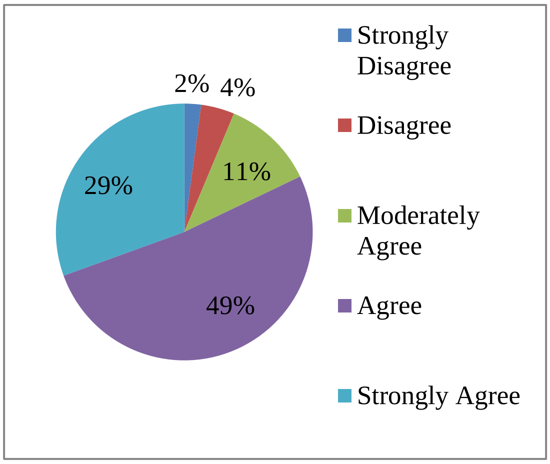
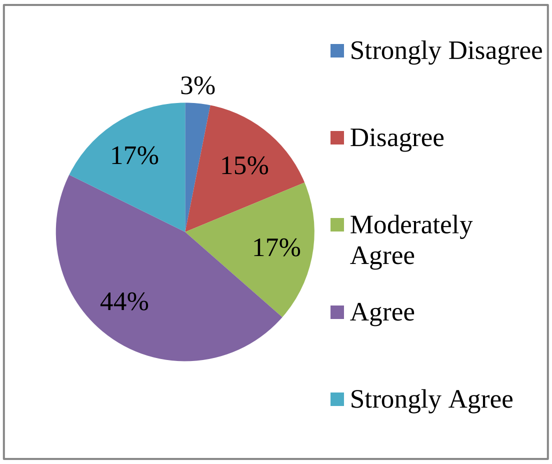


Figure 6.17: Employees having Strong Ethics Reduces Board Interference in Operational Activities



7. Role of Board of Directors – Interview Findings

The interview findings have been summarized below.

i. The interviewees were concerned about the frequent changes of the Bank Companies Act-1991. They agreed that the recent amendments (2018) in the Bank Companies Act reduces operating governance mechanism by increasing the number of family members (from 2 to 4) in the board and increasing the tenure of the director (from 6 to 9).

ii. Independent directors have been appointed, based on the Director's close friends and well-wishers.

iii. CEO/Managing Director is the Chief of the Management as well as a member of the Board. This dual role of the MD/CEO may influence the operating governance practices.

iv. MD/CEO of the banks has been promoted or appointed in the banks by regional connection or political connection of the Board; here, the MD/CEO works as a Dummy MD/CEO of the Board. The Chairman of the Board instructs the MD/CEO about the operational activities of the banks by which the MD/CEO prepare memo for the Board Meeting.

v. Eight to Nine banks are owned and managed by a business group. These business groups appoint a Dummy MD/CEO and Dummy Chairman of the Board. Although the Chairman has many supervisory and constitutional powers, he/she cannot exercise these powers as they are Dummy Chairman of the Business Group.

vi. Similarly, the same business group appoints Dummy MD/CEO of the banks. They act on behalf of the business group. Before preparing memos of the Board meetings, the Dummy MD/CEO consults with the business group rather than discussing with the Chairman or vice-versa. The Dummy Chairman of the bank merely signs the board memos as minutes.

vii. Further, Politicians dominate around 14 banks' board. The board of the State-Owned Banks has no ownership interest, while that of the private commercial banks have ownership interest which creates a conflict of interest.

viii. The Board of the Bank approves the loan and other operational activities of the banks which are against the laws. Management of the banks is the highest authority for operational activities, while the Board will formulate policies of the banks.

ix. The power of the BB has been confined by law regarding the removal of Chairman, Director or Principal Executive of the State-Owned Commercial Banks, thereby reducing the transparency of the SOBs and increasing NPL.

x. Some directors (except the Chairman) of the banks regularly maintain an office in the Bank's head office and interfere in the regular activities of the banks. In an investigation, the Bangladesh Bank team found some evidence and punished the respective directors. The directors, who were punished, gave tick mark (√) on the office files which will be approved.

xi. Although board members cannot be members of any committee for employees' recruitment, promotion, transfer and other HR activities, most of the HR activities have been performed by the Board. Chairman is not supposed to take interviews with the employees for selection, but they are practicing it which is against the law.

xii. The interviewees reported that the MD/CEO of the banks have been appointed for three years with a short run vision, while the board should have a long-run vision. The MD/CEO tries to increase short-term profit during his/her tenure. It reduces operating governance in banks.

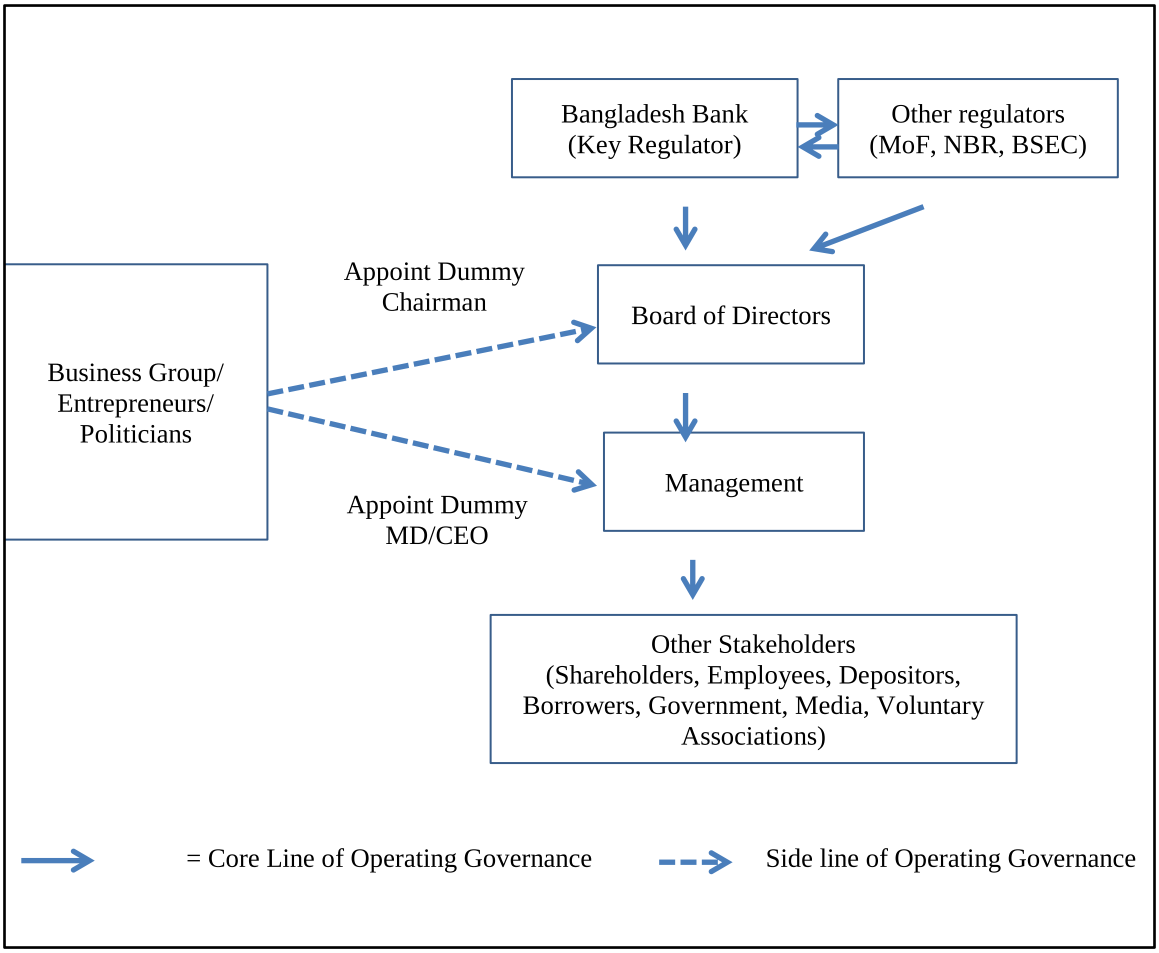
xiii. Accountability cultures of MD/CEO and Board have to be ensured. Bangladesh Bank found some cases that they (Board, MD/CEO) have money laundering incidents.

xiv. Rarely, a Chairman or Director resigns from the Board of the banks. In most cases, it is forced resignation. Even the MD of a private commercial bank changed his name to retain his MD position of the banks. The Chairman of the bank instructed him to change his name as his name matched with the murderer of Bangabandhu. There is an absence of conflict of interest between the MD and Chairman. Now the moot question is how this MD can ensure operational governance in banks.

xv. The presence of outsiders, including employees, in the bank's board meeting, is a great concern now. Some banks now permit outsiders to take part in their board of director's meeting. This practice is viewed as a breach of rules and serves a lack of CG in banks. As confidential issues of clients are discussed in the meeting, the information leak because of the presence of outsiders, could put an adverse impact on the interest of depositors – overall operating governance in banks.

Based on the above discussion, the study explicates the following operating governance model practiced in the banking sector of Bangladesh (Figure-7.1).

Figure 7.1: Operating Governance of the Banks in Bangladesh



8. Role of Board of Directors: Regression Result

8.1 Descriptive Statistics

The average NPL is 8.33, while the minimum was 0.10, the maximum was 57.86 and the standard deviation was 10.79. Again, the mean observer (Dummy Variable) was 0.18, followed by minimum and maximum of 0 and 1 respectively. Further, among the board composition variables, the minimum board size was 5 and the maximum was 20 which is within the prudential regulations of BB. Again, there were some banks which have no independent, female, foreign and institutional directors on their board. The maximum percentage of independent directors, female directors, foreign director and institutional directors are 80 per cent, 50 per cent, 20% and 82% respectively (Table-8.1). The minimum requirement for independence is one-fifth of the total board of directors of a particular bank (BSEC, 2018).

Table 8.1: Descriptive Statistics

Variables	Observation	Mean	Std. Dev.	Min.	Max.
NPL	228	8.33	10.79	0.10	57.86
Observer	238	0.18	0.39	0	1
BSize	198	13.07	4.15	5	20
IndD	198	0.21	0.12	0	0.8
FemD	198	0.12	0.12	0	0.5
ForD	198	0.01	0.04	0	0.2
InstD	165	0.20	1.23	0	0.82
ROA	225	0.80	1.23	-7.4	4.18
CAR	221	12.17	10.85	-43.79	42.88
LnSize	229	12.06	1.02	8.51	14.00
Age	238	22.48	12.60	2	47

Figure-8.1, 8.2 and 8.3 show the changes in NPL ratio, Return on Assets (ROA) and Capital Adequacy Ratio (CAR). NPL, ROA and CAR are the aggregated average of the banks in different categories. The state-owned commercial banks had higher NPL with a maximum of 33.30 in 2015, followed by 21.29 in Foreign Banks (FBs) and 6.29 in Private Commercial Banks (PCBs) (Figure-8.1). Further, Foreign Banks (FBs) had the highest ROA of 1.39, followed by 0.6 in PCBs and (0.8) in SOBs (Figure-8.2). Also, the foreign banks had the highest CAR by 23.66 followed by Private Commercial Banks (PCBs) by 14.29 and State-Owned Banks (SOBs) by 2.48 (Figure-8.3).

Figure 8.1: Changes in NPL Ratio

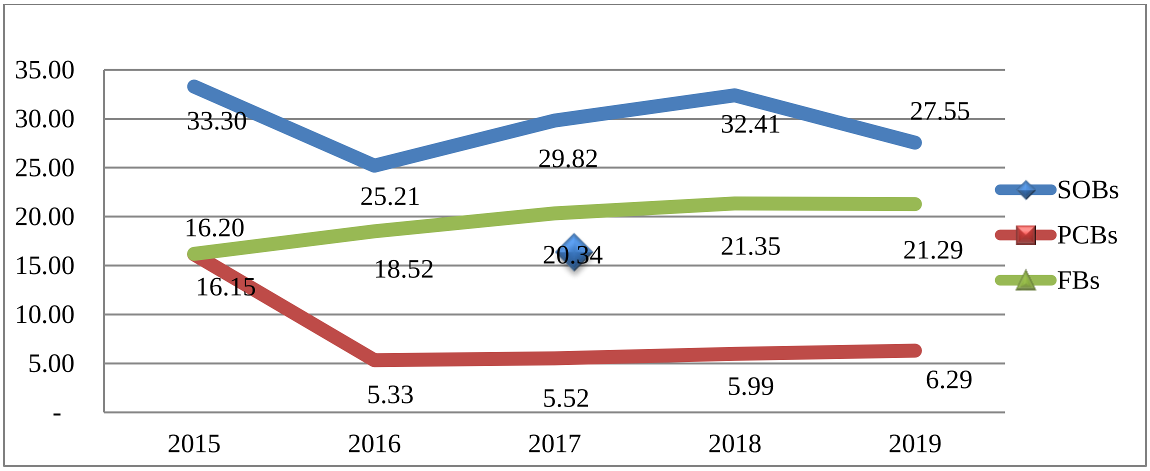


Figure 8.2: Changes in ROA

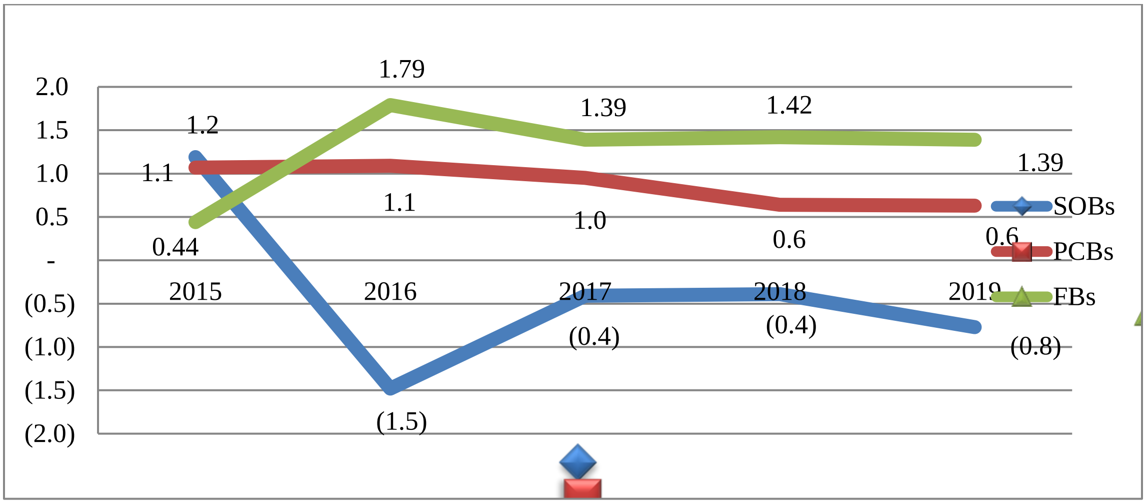
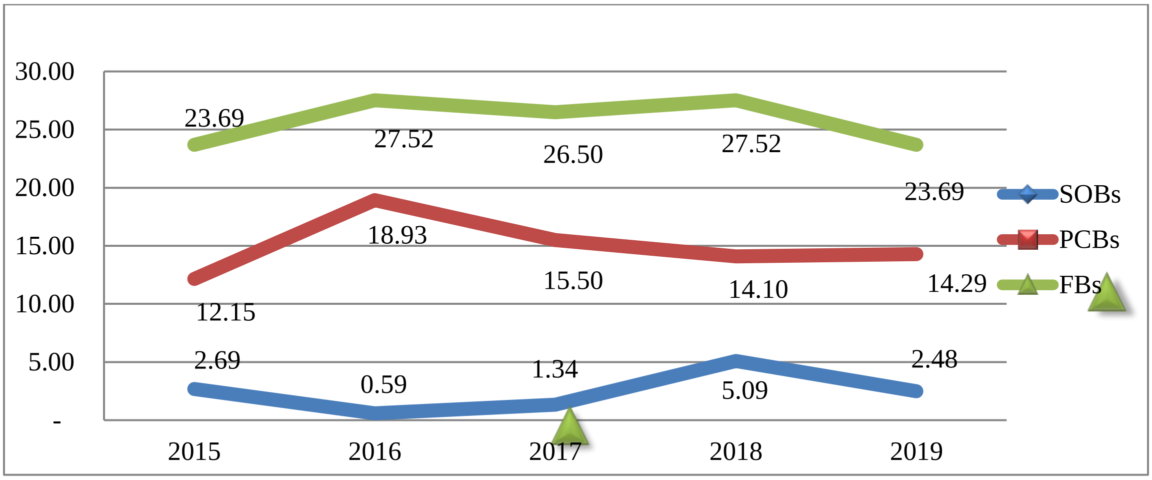


Figure 8.3: Changes in CAR



8.2 Correlations and VIF

Belkaoui and Karpik (1989) explained the need for multicollinearity testing because it ensures the fitness of the model. *Table-8.2* depicts the correlation matrix among the variables. We test Variance Inflation Factors (VIF) (Wooldridge, 2013) for assessing the presence of multicollinearity. The mean VIF was 1.92 (for LnNPL; Model-1) and the maximum was 2.82 for IndD. Again, for ROA, the mean VIF was 1.95 and the maximum was 2.82. For both cases, the maximum VIF was less than 10 and free from multicollinearity (Wooldridge, 2013).

Table 8.2: Correlation Matrix

	LnNPL	Observer	LnBsize	IndD	FemD	ForD	InstD	ROA	CAR	LnSize	Age
LnNPL	1.00										
Observer	0.23	1.00									
LnBsize	-0.32	-0.02	1.00								
IndD	0.13	-0.09	-0.70	1.00							
FemD	-0.23	0.02	-0.14	0.19	1.00						
ForD	-0.01	-0.06	-0.18	0.41	-0.21	1.00					
InstD	0.23	0.09	-0.58	0.49	0.29	-0.06	1.00				
ROA	-0.37	0.11	0.08	0.00	0.14	-0.00	0.01	1.00			
CAR	-0.15	0.10	0.12	0.02	0.15	0.00	-0.02	0.60	1.00		
LnSize	0.35	0.04	-0.23	0.29	-0.00	0.27	0.20	-0.01	0.01	1.00	
Age	0.52	0.14	-0.28	0.17	-0.20	0.13	0.14	-0.16	-0.11	0.70	1.00

Second, serial correlation is essential, as it biases the result by the Standard Error (SE) (Drukker, 2003). We ran VCE ROBUST (for Model-1 and Model-2) to adjust the standard errors in the regression result for better prediction. The full model with and without VCE robust are shown in *Table-8.3.*

Model-1 explains the regression result with and without VCE robust for LnNPL, while Model-2 explains the regression result with and without VCE robust for ROA. Regression result for LnNPL in Model-1 and Model-2 explain adjusted R^2 are 0.36 and 0.40 respectively. The study found that the governance variable 'Observer' to be statistically significant (β_1 = 0.79) at a 5% level, indicating that the appointment of observer or administration to the commercials banks is positively associated with the NPL of the banks. Further, board size (LnBsize) is negatively significant at 5% level (β_2 = -0.51).

The study considers Independent Directors (IndD), Female Directors (FemD), Foreign Director (ForD) and Institutional Director (InstD) as board composition. It finds that the presence of FemD and ForD are statistically significant while IndD and InstD are not statistically significant. Further, it clarifies that FemD is negatively correlated with the NPL of banks i.e., if the number of female directors on the board decrease NPL will increase vice versa. A similar result also shown in the case of ForD i.e. the presence of foreign directors on the board reduces NPL of the banks vis-à-vis. Model-2 for LnNPL has shown similar findings to Model-1 except for adjustments of the standard error and adjusted R^2 (Table-8.3).

Table 8.3: Regression Results with without and with vce Robust

	Model-1	Model-2	Model-1	Model-2
	(Without vce robust)		(With vce robust)	
Variables	**LnNPL**	**ROA**	**LnNPL**	**ROA**
Observer	0.79 ** (0.31)	0.36 (0.31)	0.79 ** (0.38)	0.36 (0.34)
LnBsize	-0.51** (0.24)	-0.01 (0.24)	-0.51* (0.31)	-0.01 (0.18)
IndD	-0.13 (0.70)	-0.10 (0.70)	-0.13 (0.70)	-0.10 (0.47)
FemD	-1.68*** (0.51)	0.09 (0.51)	-1.68*** (0.44)	0.09 (0.40)
ForD	-2.80* (1.49)	0.17 (1.50)	-2.80* (1.13)	0.17 (0.87)
InstD	0.48 (0.43)	0.15 (0.43)	0.48 (0.56)	0.15 (0.50)
CAR	-0.00 (0.00)	0.08*** (0.00)	-0.00 (0.03)	0.08*** (0.03)
LnSize	0.09 (0.09)	0.96 (0.09)	0.09 (0.12)	0.96 (0.16)
Age	0.02*** (0.00)	-0.01 (0.00)	0.02*** (0.00)	-0.01 (0.00)
Constant	1.39 (1.19)	-1.00 (1.19)	1.39 (1.81)	-1.0 (2.17)
Number of Observation	162	165	162	165
R^2 (Overall)	0.36	0.36	0.40	0.40
F	11.27	11.50	7.49	3.76
Prob >F	0.00	0.00	0.00	0.00

Notes: Values indicates the coefficient and standard error within the parenthesis.
*** Significant at 1% level; ** Significant at 5% level; * Significant at 10% level

Moreover, few case incidents on operating governance failures have been presented in Appendix-I.

9. Recommendations

Based on the findings, the study recommends the following measures to strengthen the operating governance in Banks in Bangladesh.

9.1 The Bank Companies Act- 1991 should not be changed frequently. In this regard, all stakeholders including BB, BSEC, RJSCF, MoF, Ministry of Legal Affairs, the banking community and academician should work together for the long-term and sustainable section of the Bank Companies Act.

9.2 The power of BB should be extended by changing the SEC.46 of the Bank Companies Act-1991. Bangladesh Bank should have the power to supervise all the banks in the country including changing the Chairman, Director, CEO irrespective of bank ownership.

9.3 The political will of the government is critical to ensuring good governance in banks. The coordinated efforts of Bangladesh Bank, banks, Ministry of Finance, BSEC and other stakeholders are necessary to improve government environment in banks.

9.4 The inference of the board members in daily activities including sanctioning loans, recruitment, selection, promotion, transfer of employee should not be allowed.

9.5 Independent directors should be selected based on competency and the selection process should be open and transparent to ensure good governance in banks.

9.6 All the related party transactions should be audited meticulously and disclosed properly in the annual report and website to ensure transparency in transactions.

9.7 The presence of outsiders who are not supposed be in the board meeting must not be allowed.

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The Bank Companies Act-1991 (Section-110) explains that under section-21 of the Penal Code, 1860 (Act XLV) in which every chairman, director, auditor, liquidator, manager and any other employee of a bank company shall be deemed to be public servants.

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Appendices

Appendix A: Perception Survey Questionnaire

Operating Governance in Banks: The Role of Board of Directors

Google Link:
https://docs.google.com/forms/d/e/1FAIpQLSc4XOuGFxniFUbQ0sfw29GzNd6VyAHiuFM1pRw7WAZYAFr0Hg/viewform?usp=pp_url
(We assure you that your name, designation and organization will not be disclosed in the research paper)

1. Name (Optional)
2. Name of the Bank:
3. Designation:
4. How many organizations have you worked including your current organization?
5. Reasons for switching the organization: (You can choose more than one option)
    - Grievance about the career
    - Unclear career path
    - Politics in the organization
    - Unwanted promotion of juniors
    - Unexpected influences by the top management and board
    - Grouping /Conflict among the colleagues
    - Salary increases
    - Better job offer/Higher post
    - Others
6. The Risk Appetite System (RAS) of the bank is driven by
    i) Top-down approach
    ii) Bottom-up approach
    iii) Both
7. Your bank follow:
    Centralized management system
    Decentralized management system
8. Do you think that there are dummy directors in your bank?
    a. Yes
    b. No
    c. Not sure
9. Do you think that there are undisclosed related party transactions in your bank?
    a. Yes
    b. No
    c. Not sure

Please indicate to what extent you agree or disagree with the following statements:
Strongly Disagree
Disagree
Moderately Agree
Agree
Strongly Agree

1. Board of the bank takes responsibility for approving and overseeing the activities of management ethically following specific rules and regulations.
2. Board takes responsibility for the bank's business strategy and financial soundness.
3. Board delegates some authority to the lower management of the bank.

4. Board clarifies and fixes the core responsibilities of the board, top management, risk management and ICC unit.
5. Board establishes long-term business target, and risk exposure of the banks effectively.
6. Board oversees the bank's approach to compensation, including monitoring and reviewing executive compensation
7. Board does not support excessive credit risk.
8. Board encourages employees' Whistleblowing-to identify loan scam, corruption, bribery etc.
9. Risk management unit of your bank can work independently.
10. The bank has an independent and effective internal audit function.
11. The board actively engages in succession plans for the CEO and other key positions
12. Board members are competent and qualified enough to understand and oversee corporate governance
13. The Board has a clear and rigorous process for identifying, assessing and selecting board candidates.
14. The board of the bank maintains and periodically updates organizational rules, by-laws, or other similar documents setting out its organization, rights, responsibilities and key activities.
15. The chairman of the board is ethical and trustworthy among the board members and other key personnel of different committees.
16. When a conflict of interest arises the board members forgo their own interest for the sake of the bank's interest.
17. Board specifically distributes the power to the CEO and lower tier to sanction of loan/investment.
18. Directors of the Board don't interfere directly or indirectly in the process of loan approval.
19. The Board reviews the reports submitted by its audit committee quarterly regarding the compliance of recommendations made in the internal and external audit report and BB inspections reports.
20. The Chairman of the bank does not involve or interfere in or influence over any HR affairs such as recruitment, promotion, transfer, training and disciplinary measures.
21. Board of Directors are not included in any selection committees for recruitment and promotion of employees (except MD and DMD).
22. The Chairman of the Board does not personally possess the jurisdiction to apply policy-making or executive authority.
23. The Chairman of the bank does not participate in or interfere in the administrative or operational and routine affairs of the bank.
24. The Chairman of the bank conducts an on-site inspection of branches.
25. The presence of Politicians as Board Member increases the performance of the bank.
26. Business Group/persons having political connection sits in the board increases the performance of the bank.
27. Employees' having strong ethics increases BoD efficiency in ensuring good governance in the bank.
28. Employees' having strong ethics reduces BoD interference in the banks' operational activities.
29. Family directors on the board increases the efficiency of the bank.
30. Having Dummy directors (Directors who have no roles) reduces board efficiency.
31. Related party transactions (transactions with business or directors or their family members) reduce operational efficiency of the bank.

Appendix B: List of Interviewees

Interviewee	Number of Interviewee
Chairman of the Board	1
Former Chairman of BKB and MD of Pubali Bank Limited; Former Deputy Governor of BB	1
Former Chairman of BKB and MB of 12 different Commercial Banks	1
Directors	2
MD/CEO (Islamic Banks)	1
MD/CEO (Commercial Banks)	2
GM (BB)	2
Total	**10**

Appendix C: List of Banks

Sl.	Name of the Bank	Sl.	Name of the Bank
1.	AB Bank Limited	25.	Modhumoti Bank Limited
2.	Agrani Bank Limited	26.	Mutual Trust Bank Limited
3.	Al-Arafah Islami Bank Limited	27.	National Bank Limited
4.	Bank AlFalah	28.	National Credit and Commerce Bank Limited
5.	Bank Asia Limited		
6.	Commercial Bank of Ceylon PLC	29.	NRB Bank Limited
7.	Basic Bank Limited	30.	NRB Global Bank Limited
8.	Bangladesh Commerce Bank Limited	31.	ONE Bank Limited
9.	Bangladesh Development Bank Limited	32.	Pubali Bank Limited
10.	Bangladesh Krishi Bank	33.	Premier Bank Limited
11.	BRAC Bank Limited	34.	Prime Bank Limited
12.	Dutch-Bangla Bank Limited	35.	Rupali Bank Limited
13.	Dhaka Bank Limited	36.	Standard Chartered Bank
14.	Eastern Bank Limited	37.	Shahjalal Islami Bank Limited
15.	EXIM Bank Limited	38.	Shimanto Bank Limited
16.	Farmers Bank Limited	39.	Social Islami Bank Limited
17.	First Security Islami Bank Limited	40.	Sonali Bank Limited
18.	HSBC	41.	South Bangla Agricultural and Commerce Bank Limited
19.	Islami Bank Bangladesh Limited		
20.	IFIC Bank Limited	42.	South East Bank Limited
21.	Jamuna Bank Limited	43.	Standard Bank Limited
22.	Janata Bank Limited	44.	The City Bank Limited
23.	Meghna Bank Limited	45.	Trust Bank Limited
24.	Mercantile Bank Limited	46.	United Commercial Bank Limited
		47.	Union Bank Limited
		48.	Uttara Bank Limited

Appendix D: OECD Principles of Corporate Governance

A. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

B. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

C. The board should apply high ethical standards. It should consider the interests of stakeholders.

D. The board should fulfil certain key functions, including:

1. Reviewing and guiding corporate strategy, major plans of action, risk management policies and procedures, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.
2. Monitoring the effectiveness of the company's governance practices and making changes as needed.
3. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.
4. Aligning key executive and board remuneration with the longer-term interests of the company and its shareholders.
5. Ensuring a formal and transparent board nomination and election process.
6. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.
7. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.
8. Overseeing the process of disclosure and communications.

E. The board should be able to exercise objective independent judgment on corporate affairs.

1. Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are ensuring the integrity of financial and non-financial reporting, the review of related party transactions, the nomination of board members and key executives, and board remuneration.
2. Boards should consider setting up specialized committees to support the full board in performing its functions, particularly in respect to audit, and, depending upon the company's size and risk profile, also in respect to risk management and remuneration. When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board.
3. Board members should be able to commit themselves effectively to their responsibilities.
4. Boards should regularly carry out evaluations to appraise their performance and assess whether they possess the right mix of background and competencies.

F. To fulfil their responsibilities, board members should have access to accurate, relevant and timely information.

G. When employee representation on the board is mandated, mechanisms should be developed to facilitate access to information and training for employee representatives, so that this representation is exercised effectively and best contributes to the enhancement of board skills, information and independence.

Source: G20/OECD Principles of Corporate Governance 2015.

Appendix E: BASEL Guidelines on Corporate Governance (Summary)

Principle 1: Board's overall responsibilities
The board has overall responsibility for the bank, including approving and overseeing management's implementation of the bank's strategic objectives, governance framework and corporate culture.

Principle 2: Board qualifications and composition
Board members should be and remain qualified, individually and collectively, for their positions. They should understand their oversight and corporate governance role and be able to exercise sound, objective judgment about the affairs of the bank.

Principle 3: Board's own structure and practices
The board should define appropriate governance structures and practices for its own work, and put in place the means for such practices to be followed and periodically reviewed for ongoing effectiveness.

Principle 4: Senior management
Under the direction and oversight of the board, senior management should carry out and manage the bank's activities in a manner consistent with the business strategy, risk appetite, remuneration and other policies approved by the board.

Principle 5: Governance of group structures
In a group structure, the board of the parent company has the overall responsibility for the group and for ensuring the establishment and operation of a clear governance framework appropriate to the structure, business and risks of the group and its entities.21 The board and senior management should know and understand the bank group's organizational structure and the risks that it poses.

Principle 6: Risk management function
Banks should have an effective independent risk management function, under the direction of a Chief Risk Officer (CRO), with sufficient stature, independence, resources and access to the board.

Principle 7: Risk identification, monitoring and controlling
Risks should be identified, monitored and controlled on an ongoing bank-wide and individual entity basis. The sophistication of the bank's risk management and internal control infrastructure should keep pace with changes to the bank's risk profile, to the external risk landscape and in industry practice.

Principle 8: Risk communication
An effective risk governance framework requires robust communication within the bank about risk, both across the organization and through reporting to the board and senior management.

Principle 9: Compliance
The bank's board of directors is responsible for overseeing the management of the bank's compliance risk. The board should establish a compliance function and approve the bank's policies and processes for identifying, assessing, monitoring and reporting and advising on compliance risk.

Principle 10: Internal audit
The internal audit function should provide independent assurance to the board and should support the board and senior management in promoting an effective governance process and the long-term soundness of the bank.

Principle 12: Disclosure and transparency
The governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participants.

Principle 13: The role of supervisors
Supervisors should provide guidance for and supervise corporate governance at banks, including through comprehensive evaluations and regular interaction with boards and senior management should require improvement and remedial action as necessary and should share information on corporate governance with other supervisors.

Source: Corporate Governance Principles for Banks, BASEL (January 9, 2015)

Appendix F: Major changes made in the Bank Companies Act 1991

The Bank Companies Act- 1991	Major Governance related issues: *Maximum number of directors (Section15; Subsection-6):* Maximum 13 except deposit director *Tenure of Director (Section 15AA; subsections – 1, 2)*: Maximum two terms for 3 years in each term; after one term can be reappointed for the same. *Minimum paid-up capital and reserve fund (Section 13; subsection -2):* Two hundred core Tk. or the amount equivalent to the risk-based capital that determined by BB whichever is higher. *Restriction on the buying of shares of a bank, etc. (14A subsection - 1):* The shares of a bank shall not be concentrated among the members of the same family and the members of a family shall not, individually, jointly or both, buy more than 10% of the shares of a bank. *Election of new directors (Section-15):* Subsection-4: prior approval needed to appoint and dismissal, released or removed of CEO/MD; Subsection-5: maximum two Deposit Directors can be appointed; Subsection-7: maximum *two members* from family if the shareholding is more than 5% while one for shareholding is less than 5%.
The Bank Companies Act- 1991 (Amendments in 1993)	Total amendments 25 Sections; Majors governance amendments: *Restriction on the buying of shares of a bank, etc. (14A subsection – 1):* maximum 5% Amendment of section 15 of Act No.14 of 1991.- The words and comma "and no managing director or chief executive officer appointed in this way shall be removed from his office, acquitted or dismissed without the previous approval of the Bangladesh Bank" in sub-section (4) of section 15 of the said Act shall be omitted.
The Bank Companies Act- 1991 (Amendments in 2013)	Total amendments 77 Sections; Majors governance amendments: *Election of new directors (Section-15; Subsection-9):* Maximum 20 directors including 3 independent directors; if numbers of directors are less than 20 then minimum Independent Directors must be two. Tenure of Directors (15AA subsection 1, 2): Maximum 6 years in two terms; three years in each term. Role of BoD (15 Kha; subsection-1,2-3) (New): Three committees have to be formed – Executive Committee, Risk Management Committee and Audit Committee.
Bank Company Amendment Bill, 2018	First provision Tenure of the board of directors of a private bank extended from six years to nine years. After one term (three years) can be re-elected for the same. Second provision Up to four members of a family may be appointed as board of directors for a bank. Under the act, family means spouse, parents, siblings, children and any person dependent on the sponsor director.

Appendix G: BSEC Corporate Governance Codes

1. Board of Directors
Size of the Board of Directors- The total number of members of a company's board of directors shall not be less than 5 (five) and more than 20 (twenty).
Independent Directors- At least one-fifth (1/5) of the total number of directors on the board shall be independent directors[2], so that the board, as a group, includes core competencies considered relevant in the context of each company.
CEO Duality - The positions of the chairperson of the board and the MD/CEO of the company shall be filled by different individuals.
Qualification of independent director; *the Directors' report to shareholders, m*eetings of the board of directors, code of conduct for the chairperson, other board members and chief executive officer.

2. Governance of board of directors of the subsidiary company.

3. Managing Director (MD) or Chief Executive Officer (CEO), Chief Financial Officer (CFO), Head of Internal Audit and Compliance (HIAC) and Company Secretary (CS) - appointment, duties and requirement to attend board of directors' meetings

4. Board of directors' committee - For ensuring good governance in the company, the board shall have at least the following sub-committees: (i) Audit Committee; and (ii) Nomination and Remuneration Committee.

5. Audit Committee.
- (1) Responsibility to the board of directors - shall assist the board in ensuring that the financial statements reflect a true and fair view of the state of affairs of the company and in ensuring a good monitoring system within the business. The Audit Committee shall be responsible to the Board.
- (2) Constitution of the Audit Committee - shall be composed of at least 3 (three) non-executive directors excepting Chairperson of the Board and shall include at least 1 (one) independent director;
- (3) Chairperson of the Audit Committee – shall be an independent director;
- (4) Meeting of the Audit Committee - at least its four meetings in a financial year;
- (5) Role of Audit Committee
- (6) Reporting of the Audit Committee - Reporting to the board of directors, BSEC, shareholders and general investors.

6. Nomination and Remuneration Committee (NRC)
- (1) Responsibility to the board of directors
- (2) Constitution of the NRC - The Committee shall comprise of at least three non-executive directors including an independent director.
- (3) The Chairperson of the NRC shall be an independent director.
- (4) Meeting of the NRC - The NRC shall conduct at least one meeting in a financial year.
- (5) Role of the NRC - NRC shall be independent and responsible or accountable to the board and the shareholders.

[2]who either does not hold any share in the company or holds less than 1% shares of the total paid-up shares of the company or who is not a sponsor of the company or is not connected with the company's any sponsor or any shareholders; who has not been convicted by a court of competent jurisdiction as a defaulter in payment of any loan or any advance to a bank or a Non-Bank Financial Institution (NBFI), among others.

Appendix H: Selected Regulations and Compliance Requirements BSEC and DSE

Areas of Regulations

Corporate Governance code

1. BSEC Act
2. BSEC Rules
3. BSEC Notification
4. DSE listing regulation
5. Right Issue Rules

Reporting Requirements

6. Submission of Annual Report, AGM minutes, audio & video CD of AGM etc.
7. Approval of Independent Director.
8. NOC from BSEC for Bond Issuance.
9. Approval of the issuance of Right Shares.
10. Submission of Statement of Monthly Shareholding Position
11. Notifying the BSEC in advance about the date and time of its board meeting for consideration/adaptation of its quarterly financial statements.
12. First, Second and Third Quarterly Financial Statements are submitted to Exchange and Commission within 45 days and one month respectively of the end on the First, Second and Third Quarter and published the same in two newspapers at least.
13. Annual Financial Statements are audited within 120 days of the ends of the financial year and submit the same to Exchange and Commission within 14 days.
14. While considering/adopting audited financial statements the Board of Director declares NAV, EPS and NOCFPS in the same board meeting and fixes the relevant date of AGM along with the decision with regard to recommending or not recommending dividend for shareholder based on financial statements.
15. Un-audited financial statements are authenticated on behalf of the Board of Directors signed by the Managing Director, at least two Directors including Chairman, Chief Financial Officer/Head of Finance & Accounts and the Company Secretary.
16. Any audited financial statements are authenticated as per the provisions and requirement of the Commission as well as the requirement of the primary regulator of the issuer if any.
17. Copy of annual report is furnished to the shareholders at least fourteen days before the general meeting and 30 (thirty) copies of such reports are also furnished to the Exchange and the Commission.
18. The required notice period shall be at least 14 (fourteen) market days but not exceeding 30 (thirty) market days from the date of the concerned Board Directors' meeting/Trustees' meeting under any circumstances: Provided that record date shall be a market day of the Exchange.
19. The annual general meeting (AGM) is held within 45 (forty-five) working days from the record date.
20. The dividend is declared and approved by shareholders in the AGM.
21. AGM of the Bank is held within the city, town or locality in which the registered office of the company situated.
22. All notices of the Annual General Meeting (AGM) are sent to the Exchange and simultaneously to the shareholders at least 14 (fourteen) days prior to AGM. Any resolutions taken therein is sent to the Exchange within half an hour if such resolutions contain any price-sensitive information
23. Continuous and uninterrupted audiovisual recording of the entire proceedings of AGM is furnished to the Exchange and the Commission within three working days from the date of holding of the said AGM.
24. Copies of attendance of shareholders/unitholders and minutes of its AGM are furnished to the Exchange and the Commission within 14 days of holding of such AGM.
25. A compliance report in respect of dividend payment is submitted to the Exchange and the Commission within 07 (seven) working days.
26. Price sensitive information is sent within thirty minutes of the decision on such information to the Exchange and the Commission by fax, through electronic communication and by special

	messenger or by courier service and such information/decision is published in two widely circulated daily newspapers, one in Bangla and the other in English.
27.	The board of directors' meeting involving price-sensitive decision is held either after the trading hour.
28.	The statement of shareholding position (shareholding of Sponsor/Director and shareholders who hold 10% or more) in the prescribed format of the previous month within the tenth day of each month of English Calendar is submitted to the Exchange and the Commission
29.	The statement of shareholding/unit holding position and free-float reporting showing the shareholding/unit holding position of, among others, each sponsor/director, foreigner, institution and shareholder who hold 5% or more in the prescribed format is submitted within the seventh day of each month of English Calendar to the Exchange.

Source: Islam *et al.*, 2018

Appendix I: Case Incidents

Case 1: Retired Managing Director of a Private Commercial Bank (PCB) Controls the Corporate Management Activities.

The retired Managing Director of a private commercial bank sits on the corporate floor and controls the management activities, although the bank has a regular Managing Director (MD). Before each board meeting, all memos are sent to him and afterwards, he gives tick (√) mark to the memos that are placed to the board for their approval. Only the files which are given tick (√) mark had been approved. It indicates that board decisions are made, based on the former Managing Director's wishes which is a violation of corporate governance and operating governance guideline. Hence, the role of the board, in this case, is like stamping on the decisions taken by that retired Managing Director. Bangladesh Bank (BB), in their investigation, found this irregularity and caught him red-handed. The Bangladesh Bank team found some files which were tick marked by him. He failed to give justification regarding the tick mark issue. The BB team seized the files and interviewed the regular Managing Director, board secretary, and senior-level management on this issue. Finally, BB restricted the retired MD for the next three years to become the director or consultant of any banking and non-banking financial institution.

Case 2: Opening New Branches

Bank usually spend a considerable amount of money while opening a new branch. The new branch requires interior decoration and related expenses. In an investigation conducted by the Bangladesh Bank (BB) team in a private commercial bank, it found that the bank spent more than the usual amount on interior decoration which involved one of the Director's relatives (nephew). After investigation, the BB team found that the interior decoration materials had been supplied by a relative (nephew) of a powerful director of the bank, which was also quoted as overpriced. In this process, the director of that bank gave undue benefit to his nephew at the cost of the bank. Due to the board member's undue influence, the bank's operating governance was at stake.

Case 3: Renting of the Bank Chairman's Building to the Bank

A Chairman of a bank rented his own building to the bank at a higher price than the market rate. A Bangladesh Bank inspection team physically inspected the bank branch and found that the current rental rate was 10 times higher than the existing market rate. BB team compared the rents of other bank branches in the same location and afterwards took necessary actions regarding this matter.

Case 4: Chairman of The Bank Maintain Office in The Bank every day

Bangladesh Bank (BB) got the information that the Chairman of a bank regularly maintained office every day. One day, in a sudden inspection at around 8 p.m. at the bank's head office, the BB team found that the Chairman of that bank was doing office and interfering in corporate management activities. The higher officials of BB found many routine files of the bank at his desk and seized them. It implies that the Chairman was involved in interfering in the routine work of that particular bank. The next day, the Chairman, along with some senior officials of the bank, met the Governor of Bangladesh Bank and promised that the Chairman will never interfere in the regular activities of the bank.

Case 5: Chairman Issued Office Order to Distribute Portfolio Among the Officials of The Bank

The Chairman of a bank-issued office order to distribute portfolios among MD, DMD and SEVP. He had issued an office order that "DMD and SEVP" have no direct hierarchy/Chain of Command to MD and hence create a parallel line of management by ignoring the tier of MD. He (the Chairman) has given some power to the DMD and SEVP that did not match with their position. There were no directions regarding the supervision of these DMD and SEVP.

Case 6: Involvement of Money Laundering by a Director of a Bank

Mr. X was a Director of a bank. He had personal business and he transacted a huge amount of cash and cheque by using a big branch of that bank. He used the bank's fund for settling his business transactions. Bangladesh Bank (BB) took this case into cognizance and carried out an investigation. The BB found that this Director had withdrawn cash against cheque from the branch and the amount of the cheque was huge and sometimes exceeded the regular volt limit. After checking Inter Branch Credit Advice (IBCA) and Inter Branch Debit Advice (IBDA), the BB found that that bank Director laundered money from the bank. BB took punitive measures against the MD and Branch Manager of the bank.

Case 7: Interference of Board for Employee Promotion, Training etc.

Bangladesh Bank (BB) team found that banks send their board minutes to BB where the employee promotion, training, transfer, foreign posting decision had been taken by the board. Although BB clearly instructed all banks that these are operational activities of the banks and corporate management will take these decisions, many commercial banks did not follow it which is against the corporate governance guidelines of the particular bank.

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USD 8.00