

# Corporatae Governance Issues in Nepalese Banks and Financial Institutions and Legal Settlement at the Supreme Court of Nepal

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## ABSTRACT

*Corporate governance includes a set of relationships among Board of Directors, management team, employees, and other stakeholders of an organization. Corporate governance is a mechanism that determines the setting of goals, attainment of objectives, and monitoring of the performance of an entity. Banks and financial institutions (BFIs) in Nepal have been under great concern regarding good corporate governance from the regulatory body, Nepal Rastra Bank (NRB), a central bank of Nepal. After back-to-back off-site supervision and on-site supervision, issues of corporate governance have come to the surface. Issues of corporate governance at Nepalese BFIs go beyond the picture reflected in the books of accounts and financial indicators. Hence, issues of corporate governance have been raised in the courtrooms of Nepal. Thus, the paper conducted a case study on the issues of corporate governance within Nepalese BFIs. In such a scenario, the Supreme Court of Nepal, in most cases, gave verdicts in favor of the central bank, found the top managerial personnel to be the main culprit, and ordered it to settle the issues as corporate governance comes under the jurisdiction of NRB.*

**Keywords:** Corporate governance, Banks and financial institutions, Supreme Court, Legal cases, Nepal.

## 1. Introduction

The phrase 'corporate governance' has been used most frequently in the business sector by practitioners, practitioners, and the press (Dennis, 2001). According to the Cadbury Report (1992), corporate

governance is comparable to a structure that guides and governs enterprises. Corporate governance refers to the procedures through which the interests of a corporation's stakeholders are controlled by company insiders and management. Contrary to popular belief, this includes stakeholders as well, not just shareholders. This group includes debt holders as well as non-financial stakeholders like clients, staff, and suppliers (John & Senbet, 1998).

Corporate governance starts at the very bottom of the firm, with the directors and in the boardroom (Kocourek et al., 2003). It is a crucial component of why, how, and when the board of directors meets, collaborates, and engages with management. However, it is useless unless and until the directors change the way they behave to reflect the theory of measurement, performance standards, and process for qualitative reforms. Corporate governance is an umbrella term that refers to issues that arise during interactions between the board of directors, senior management, stakeholders, and shareholders (Tricker, 1994). It can also be thought of as a much more formal framework that holds senior management accountable to the owners. Corporate governance, on the other hand, broadly speaking, refers to the interdependence of official and informal contacts with the corporate sector as well as the outcomes it produces for society at large.

La Porta et al. (1999) analyzes the nations with common law systems offer greater protection to minority shareholders that have more dispersed ownership than nations with civil law systems that offer less protection to minority shareholders. Facio et al. (2001) investigated the connection between dividend payouts and the legal protection of minority owners, also support the findings. The amount of shareholder dividend pay-outs and the level of legal protection are found to be strongly correlated. However, the strong correlation between minority shareholder legal protection, relative ownership concentration, and dividend payments has come under scrutiny. Mueller (2006) demonstrated that Anglo-Saxon countries do indeed have larger average dividend payouts. The practice of corporate governance varies region-wise according to tradition and business culture. For instance, looking at Asian corporate culture, there is a lot of tightly held ownership, control-enhancing technologies are frequently used, and the controlling owners are frequently individuals or families. Due to these difficulties, corporate governance in Asia has garnered a lot of attention over the past few decades. The issues are not so different in context for the Nepalese banking sector as well.

Insider abuses, inadequate disclosure, lack of transparency, weak internal controls, ineffective boards, fusion of the Chairman and Managing Director positions, and non-separation of ownership from management are major concerns under corporate governance in Nepal's banks and financial institutions. Comparatively, banks and financial institutions (BFIs) in Nepal are considered highly supervised and inspected by the governing body, the Nepal Rasta Bank. However, time-and-time, the issues of poor governance surface. The management of issues regarding corporate governance within

BFI comes under the jurisdiction of Nepal Rastra Bank, the central bank of Nepal, as per Sec. 86 C (1), sub-sec. (e) of the Nepal Rastra Bank Act, 2002. Therefore, Nepal Rastra Bank, with its vested legal authority, handles issues of corporate governance that emerge within BFIs as a quasi-judicial body. Nevertheless, sometimes issues go beyond the control of central banks; thus, concerned parties knock on the door of the court.

Tandukar et al. (2019) revealed a closer connection between legal and regulatory provisions and effective corporate governance in the context of the Nepalese banking system. Similarly, Dangol (2021) found a negative connection between the board members and gender diversity, as well as no connection between gender diversity and the performance of BFIs.

Nevertheless, the study on corporate governance in BFIs in Nepal is based on variables related to the financial performance of the respective BFIs. Mainly, statistical analysis has been done to see the relationship between corporate governance and the financial performance of the firm (Poudel & Hovey, 2013; Pradhan, 2015; Subedi, 2018; Gnawali, 2018; Sapkota, 2020). On the contrary, the quality of corporate governance cannot be judged through quantitative data and figures. Corporate governance refers to the ethical and legal use of resources that are available to a company in a way that advances its overall corporate goal (Garba & Abubakar, 2014; Obamiro et al., 2019). The bank and financial institutions presenting a good financial position have dramatically been facing governance issues and even getting punished through governing bodies and the court. Hence, the paper illustrates the legal framework for corporate governance in the context of BFIs and how the Supreme Court of Nepal has forwarded verdicts related to the issues of corporate governance in the context of BFIs operating in Nepal.

## **2. Legal Framework for Corporate Governance in BFIs.**

The following legal provisions are laid down for good corporate governance in context to BFIs.

### **2.1. Nepal Rastra Bank Act, 2002**

As per Sec. 86 C (1), sub-sec. (e) of the Nepal Rastra Bank Act, 2002, the central bank can take action over the BFIs, which have been facing issues of corporate governance.

### **2.2. Bank and Financial Institution Act, 2017**

The Bank and Financial Institutions Act, 2017 (BAFIA) is the backbone for the smooth operation of the BFIs in Nepal. The Act was enacted by the Legislature-Parliament pursuant to Sub-Article (1) of Article 296 of the Constitution of Nepal. In the context of corporate governance, Sec. 22(2) has pointed out the need to maintain appropriate corporate governance in banks and financial institutions. Hence, to maintain good corporate governance, the act stressed the duty of the board of directors to operate

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the bank and financial institution in the interest of depositors, customers, and general shareholders.

Similarly, Sec. 69(4e) of the Act states the provision of the acquisition of banks and financial institutions in the course of weak governance due to frequent disputes in the Board of Directors of banks and financial institutions.

### **2.3. BFIs Regulation Department Unified Directive No. 6/079**

The directive was issued concerning the provisions to be complied with by licensed institutions concerning good corporate governance after exercising the powers conferred by Sec. 79 of the NRB Act, 2002.

The directive covers provisions related to the minimum acceptable standard of code of conduct to be observed by the board of directors of banks and financial institutions. In general, the directive is focused on the duties and responsibilities of the BoDs. Similarly, provisions regarding not being involved in activities against the interest of the licensed institution prohibit part-time working as chief executive officer, becoming a member of the BoDs of more than one institution, holding a trusteeship, and misuse of the position. The directive also directed us to maintain a complete and accurate record of accounts while maintaining confidentiality.

The directive has made provision for proper reporting to the BFIs Regulation Department and the concerned Supervision Department regarding compliance with the Code of Conduct.

The directive also prohibited the purchase, sale, pledge, acceptance, or conduct of transactions involving securities concerned with the BFIs carried out by a director, chief executive, auditor, board secretary, or other persons directly involved in the management and accounting activities of the BFIs, their family members, or an organization or entity owned or controlled by them during the tenure of holding such a position or up to one year from the date of retirement.

### **2.4. Banking Offence and Punishment Act, 2008**

The act was enacted to promote trust towards the banking and financial systems by mitigating the consequences of the risk the banking and financial systems might face due to an offense in the course of banking operations. Chapter 2 of the Act clearly elaborates on the actions by banks and financial institutions and their related parties that have committed banking offenses as per the Act. Though the act has not clearly mentioned corporate governance, it has mentioned not to misuse the resources of the bank by the Chief Executive Officer, employee, advisor, managing agent, associated person or organization, family member, or close relatives of such persons under Sec. 9. Nevertheless, the act is fully devoted to defining what 'not to do' while operating and regulating the day-to-day activities of BFIs.

## **2.5. Company Act, 2006**

In context with corporate governance, Chapters 7 and 8 of the Company Act make provisions for the transparency of books of accounts and the audit of the books of accounts. Similarly, Chapter 6, Secs. 92, 95, 99, 101, 102, and 105, have made provisions related to the authorities and responsibilities of the board of directors. At the same time, Chapter 12, Secs. 138 to 141 of the Act, make provisions related to equity and inclusiveness. In addition to these, Chapter 5, Sec. 67 to Sec. 76, introduces the concept of participation by addressing the various provisions of meetings. Hence, all these legal provisions also concern BFIs, as they are incorporated as joint stock companies in Nepal.

## **2.6. Securities Registration and Issue Regulation, 2016**

BFIs whose securities are listed on the secondary market have to publish a specified report as per Chapter 7, Rule 26(1), and Annex 14 of the Regulation. The detailed reporting regarding the corporate governance of the listed companies should be published as per No. 6 of Annex 14 of the regulation.

## **3. Materials and Methods**

The paper followed the multiple-case study research design to conduct an intensive analysis of the legal cases related to corporate governance issues addressed by the Supreme Court of Nepal. The following research design also helps to generate in-depth ideas and understand the multi-faceted issues of corporate governance in its real-life scenario. A purposive sample of the cases that are only related to corporate governance and the verdicts forwarded by the Supreme Court of Nepal, published in Nepal Kanoon Patrika, have been discussed in the paper. The cases analyzed in the paper are extracted from the official website of the Supreme Court of Nepal.

## **4. Decisions of Supreme Court of Nepal on Corporate Governance Issue in BFIs**

### **4.1. World Link Communication Pvt. Ltd. ex. rel. Public Relation Manager, Laxman Kumar Yadav vs Rastriya Banijya Bank**

World Link Communication Pvt. Ltd., a petitioner, claimed the due amount for the service provided for data connectivity for 33 branches of Rastriya Banijya Bank. In the case, the Lalitpur District Court pointed out an issue of corporate governance lapse in giving a verdict against the Rastriya Banijya Bank management committee for failing to make a payment to the petitioner. But the Supreme Court quashed the decision of the district court and argued that the decision was against the principles of promissory stopple and unjust enrichment, which were attracted to the act of Rastriya Banijya Bank.

### **4.2. Suresh Bahadur Malla, Board Member, Lumbini Bank Ltd. vs NRB**

The court decided that the central bank has full authority to take over the management of any BFIs as per the NRB Act, 2002, if the top management is not functioning as per the interests of the shareholders and depositors and to maintain

good governance.

### **4.3. Bhubaneswar Ghimire, President, Nepal Rastriya Karmachari Sangathan and Nepal Bank Ltd. vs Commission for the Investigation of Abuse Authority**

The Supreme Court stated that giving directions to distribute or not distribute bonuses to Nepal Bank Ltd. by the Commission for the Investigation of Abuse Authority is beyond its jurisdiction. NRB is the correct governing body for BFIs and also accountable for giving directives to them. In a legal and technical sense, the Commission for the Investigation of Abuse Authority could not intervene in bank and financial institution decision-making matters; the respective governing body and entity itself should use their consent and should not depend on irrelevant agencies to maintain good governance.

### **4.4. Uttam Bahadur Pun (grandson of Jung Bahadur Pun) Chairman, Nepal Development Bank Ltd. and son of Hem Bahadur Pun vs NRB**

NRB penalized the petitioner, the Chairman of the liquidated development bank, Nepal Development Bank Ltd., for a bill payment made by him. The governing body penalized NPR 500,000 as per the BFI Act, 2006, Sec. 74 (4c) and also decided to dismiss the chairman as per Sec. 74 (4e) of the same Act. The petitioner argued that the penalty was against the BFIs Act, 2006, and that he has the right to use the facilities for his job. However, the Supreme Court argued that the top management taking financial benefits from the problematic financial institution is against the practice of good corporate governance. The decision favoring the administrative monetary penalty from the central bank is correct for the strict implementation of good corporate governance.

### **4.5. NRB vs Laxman Gyawali, Managing Director, Paschimanchal Development Bank Ltd.**

NRB penalized NPR 500,000 Gyawali, respondent, for financial embezzlement as per BFIs Act, 2006, Sec. 74 (4c), and dismissed him from the post of Managing Director as per BFIs Act, 2006, Sec. 18 (1n). A respondent was accused of financial embezzlement in due process of branch expansion of the bank at Siddharthanagar, Rupandehi. NRB, a petitioner accused of financial embezzlement in a tender call for furniture and fixtures, decoration, drawing, and designing for the branch. The court saw a lapse in corporate governance on the part of the respondent, justified the action taken by the central bank, and put forward the penalized amount to be taken from the respondent.

### **4.6. Tej Bahadur Budhathoki vs Agriculture Development Bank, Ramshahpath, Kathmandu**

Budhathoki, a petitioner, argued that he was dismissed from the post of Chief Executive Officer without a hearing from the Corporate Governance Committee of the Agriculture Development Bank, which was essential as per Agriculture Development

Bank Rule No. 21(6). But NRB had dismissed the stated committee on June 26, 2004, when a petitioner himself was a member during the dismissal of the committee. Hence, the argument forwarded by the petitioner had no strength; therefore, the case was dismissed for further action.

## 5. Conclusions and Implications

The issue of corporate governance is a major concern for developing nations like Nepal. The Nepalese banking sector has been producing issues of corporate governance over a certain time interval, either in the form of poor internal audits, boardroom disputes, disputes between the board of directors and management, or embezzlement from top-level management that directly hamper the financial position and image of the entity. Hence, NRB could not sit tight, bounding its hand tight, and look at the public money, making it vulnerable to the BFIs.

NRB has the right and duty to monitor, control, and supervise the BFIs operating under its licensing to do banking operations. Hence, if issues of corporate governance arise in BFIs, NRB can take supervisory action against the respective BFIs. However, acting as a quasi-judicial body for BFIs, if the issues related to corporate governance are not settled, then the court comes between the governing body and BFIs.

Looking at the verdicts forwarded by the Supreme Court of Nepal on the case related to corporate governance in BFIs, it ultimately made decisions in favor of NRB. The court argued that issues of corporate governance with regard to BFIs fall under the jurisdiction of NRB, which has the ultimate authority to rectify issues related to corporate governance with the vested power provided by the BFI Act (BAFIA). Though the cases related to corporate governance have been pleaded at the court of law, the decisions go beyond the motive of good governance only, and actions taken by the central bank are also not limited to the subjects of governance only; hence, the depth and gravity of issues should be more familiar to the court's jurisdiction as well. Similarly, there is also a need for proper demarcation between good corporate governance issues and banking offenses to lodge a case against the culprit.

Ultimately, to minimize the issues of corporate governance in BFIs, the acts should be amended and directives should be forwarded as per the necessity of the changing banking practice scenario. Similarly, proper coordination with relevant governing bodies is also essential to tighten and strengthen the quality of corporate governance in the Nepalese banking sector. Finally, knocking on the door of the Supreme Court every time on issues of corporate governance will not be productive for the banking sector.

The paper has gone through the legal cases related to issues of corporate governance in the banking and financial sectors of Nepal, which are governed within the jurisdiction of the central bank, Nepal Rastra Bank. Though there might be legal cases related to corporate governance that have surfaced and came under the verdict of

the court and were interconnected with banks and financial institutions, they have not been discussed in the paper.

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