

## **K C Chakrabarty: Vigilance administration – encouraging probity in public life**

Keynote address by Dr K C Chakrabarty, Deputy Governor of the Reserve Bank of India, at a seminar organised by the Centre For Integrity, Governance and Training on “Vigilance Administration”, Mumbai, 11 November 2013.

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1. Shri A. K. Handa, Chairman, Centre For Integrity, Governance & Training on Vigilance Administration (CIGVA); Shri S .K. Goel, former CMD, UCO Bank; Shri R.V. Verma, Chairman, NHB; other officials of CIGVA; delegates to this seminar on Vigilance Administration, ladies and gentlemen! At the outset, let me congratulate CIGVA and Shri Handa for creating an institutional forum which seeks to strengthen the governance processes with an underlying objective of bringing about qualitative improvements in public service delivery for overall societal benefits. It is, indeed, commendable that CIGVA has been organising these training programmes for generating fresh capacities and for raising the competency levels of personnel involved in vigilance administration so that the standards of ethical conduct are effectively met in all public institutions. The exchange of ideas and anecdotes that happen in such seminars increase our knowledge exponentially and make us aware of issues afflicting the system as a whole.

### **Introduction**

2. The importance of vigilance in our daily life is aptly established in the quote of John Philpot Curran, an Irish orator, politician, lawyer and judge who stated that “The condition upon which God hath given liberty to man is eternal vigilance”. Pearl S. Buck, an American writer and novelist had further reinforced the importance of vigilance in our daily life by stating that “When good people in any country cease their vigilance and struggle, then evil men prevail”. These observations made years back hold true even today, where one has to be ever vigilant to ensure that no harm befalls him, his family or the society at large. Hence, the need for awareness about vigilance and the various dimensions to it has become all the more critical in the modern public space.

3. The dictionary defines Vigilance as being watchful and wary to detect danger; being ever awake and alert. While being vigilant is important in all walks of life, the observance of vigilance becomes more critical in the financial sector and particularly for institutions like banks, which deal with public money. While in my address today, I would draw specific references to the banking sector, the fundamental issues that I intend to raise are pretty much sector neutral as far as the Government and public sector undertakings are concerned. However, though, the vigilance issue is relevant in the private sector as well, the issue does not assume such a big proportion ostensibly on account of expeditious and summary nature of punishments meted out to the guilty.

4. Banks, which act as an intermediary between depositors and lenders, are duty bound to observe the highest standards of safeguards to ensure that money accepted from depositors are not mis-utilised and are put to gainful use or are available with them to be paid on demand. In order to ensure this, banks are not only required to do due diligence on the borrowers but are also expected to put in place appropriate safeguards to ensure that the transactions being undertaken by the staff are as per laid down guidelines. The watchfulness enforced by the vigilance function is required to ensure that public money, which banks hold in fiduciary capacity is not allowed to be misused by the delinquent elements in any manner. Precisely, the same logic holds good for the need for a vigilance function in other public sector enterprises or in the Government as these institutions too are custodians of public funds. In a sense, an effective vigilance is a *sine qua non* for good Governance.

## Vigilance function in banks

5. The need to have a dedicated body to look into vigilance and anti-corruption issues in public sector undertakings was felt way back in the early 1960s when Government of India set up the Committee on Prevention of Corruption [popularly known as Santhanam Committee] on whose recommendation the Central Vigilance Commission (CVC) was set up in February 1964 as an Apex Body with its vigilance units headed by Chief Vigilance Officers. The Commission was since accorded statutory status on August 25, 1998 through the Central Vigilance Commission Ordinance, 1998 which was substituted by Central Vigilance Commission Act, 2003.

6. Public Sector banks fall under the jurisdiction of Central Vigilance Commission on account of their incorporation and operation as public sector entities. Further, RBI also issued guidelines in May 2011 advising all the private sector banks to evolve suitable structure within their organization which would scrutinize all cases where any foul play is suspected from vigilance angle. This mechanism is intended to ensure that reckless decisions resulting in loss – of money and reputation – to the bank – are identified and suitable action is initiated against the delinquent employees promptly and effectively. The existence of a credible and responsive vigilance system acts as an effective deterrent to disorderly conduct.

7. The guidelines on vigilance administration are issued by the Central Vigilance Commission. The Chief Vigilance Officers in the respective organisations have been authorised to decide upon the existence of a vigilance angle in individual cases, at the time of registration of the complaint. Once a complaint has been registered as a vigilance case, it will have to be treated as such till its closure, irrespective of the outcome of the investigation. Although formulation of a precise definition is almost impossible, generally a vigilance angle could be perceptible in cases characterised by:

- commission of criminal offences like demand and acceptance of illegal gratification, possession of disproportionate assets, forgery, cheating, abuse of official position with a view to obtaining pecuniary benefits advantage for self or for any other person;
- irregularities reflecting adversely on the integrity of the public servant;
- lapses involving gross or wilful negligence, recklessness, failure to report to competent authorities, exercise of discretion without or in excess of powers/jurisdiction, cause of undue loss or a concomitant gain to an individual or a set of individuals/a party or parties and flagrant violation of systems and procedures.

I would like to add here that not only the financial propriety of transactions but at times, certain non-financial aspects also need to be examined from a vigilance angle. I will return to this issue in a little while.

8. As in all organisations, vigilance activity in financial institutions is an integral part of the managerial function. The vigilance function should not be seen as an impeding factor in the decision making process in any institution. It should be viewed as internal litmus test to identify the bonafide decisions taken in the institution, irrespective of the fact whether the decision taken has resulted in loss to the institution or not. It is not that all decisions which result in loss to the banks are to be viewed as decisions taken with ulterior motives but, at the same time, the banks need to go into the merits of each decision so that actions taken with ulterior motives and without clear adherence to the laid down procedures can be recognised, segregated and dealt with incisively. The role of the vigilance structure envisaged in the banks has to be to strike a fine balance between the role of risk taking which is the *raison d'être* of banks and the responsibility as trustees of public deposits.

9. The incidence of frauds and levels of NPAs in the banking system have been on an upswing for quite some time now. I would return to these specific issues a little later in my address, but, at this stage I would like to emphasize that the adverse developments like

rising incidents of frauds and ballooning of NPAs in the banking sector and similar adverse outcomes like mispricing of national resources in other public sector entities and the Government departments has led to a situation, where vigilance function has become extremely critical to ensure good governance standards and probity in the implementation of projects involving public money. The primary reason for such adverse outcomes is that a large majority of such projects are mainly supported by debt (whatever equity is brought in is mainly money raised as debt or quasi debt) and hence key stakeholders in the project i.e. borrowers, lenders and administrators have virtually no downside risk from the failure of projects, but substantial upside return. Only stakeholders who have some downside risk are the politicians primarily due to compulsions of electoral politics and media gaze, which is, understandably, of very short term nature. There is virtually no accountability for the top decision makers and on most occasions it is only the public interest that is sacrificed. In such an environment, vigilance administration in the public sector undertakings becomes very critical and needs to be carried out with extreme care and clarity.

### **Three aspects of vigilance administration**

10. There are three aspects to the vigilance function – Preventive, Punitive and Participative – (surveillance and detection). In normal course, banks should strengthen preventive vigilance functions by inculcating a sense of honesty and integrity among its employees and establishing internal systems and controls, which would act as a defence against malafide activity. Preventive vigilance function is, perhaps the most crucial and yet, the most challenging of the three aspects of vigilance that I mentioned earlier. It is crucial because it has the potential to prevent lapses from occurring by stemming the rot at the initial stages itself. However, it is challenging because it needs to be a continuous exercise across all levels of the organization and demands the focussed attention of the management. This involves keeping close watch on the activity profile and the life style of the employees. The employees, who maintain a flashy life style without accounted for means to support such life style, who rarely take leave, who do not share the finer points of work with fellow colleagues, who take extra interest in the work assigned to others, who are ever ready to help vendors dealing with the institution, who are under debt etc., need to be closely watched from a vigilance angle.

11. This should be followed by strengthening participative vigilance function which encompasses reviewing the existing systems and control, identifying lacunae and putting in place sufficient red flags so that the scope for misconduct is minimised and transgressions are detected swiftly. The systems of the institution which allow the employees to take independent decisions without subjecting them to “four eye principle”, allowing use of excessive powers without scrutiny, giving unrestrained financial powers to individual employees, allowing employees to change the terms and conditions of any contract without involving the original sanctioning authorities etc. need to be reviewed and proper checks and balances need to be put in place to avoid misuse of powers by individual employee for their personal benefit. When the precautions become part of the culture of the organisation, the same also act to improve the surveillance and detection vigilance function in any organisation.

12. To strengthen the preventive vigilance function in any institution, involvement of all stakeholders irrespective of their standing in the institution can play an important part. For example, if any branch manager accommodates any constituent after the office hours for some pecuniary benefit for himself or his close friends, the best source to collate information about the activities of such branch manager may be subordinate staff who may be present in the office during this period. Similarly any information about the nefarious activities of officials dealing with outside vendors can be collected through market intelligence.

13. Holding periodical workshops and training programmes for the dealing staff on vigilance aspects to sensitise them about the need to be cautious while dealing with outsiders and making them aware about the penal provisions which an employee will be subjected to

following detection of his involvement in such nefarious activities is one of the most effective tool of participative vigilance as it instils a sense of responsibility in the minds of employees and serves as a warning against engaging in self enriching activities at the cost of the interests of the organization.

14. The concept of whistleblower is another effective tool for preventive vigilance which acts as deterrent for the employees to keep themselves away from such activities. The whistleblower is generally an insider who has near full knowledge of the nefarious activities of fellow worker or higher official and can provide clinching evidence against the delinquent employee when required. The management should support the culture of whistleblowers in their organisations so that this channel of information gathering from the inside sources can be nourished and built into an effective arm of the vigilance function.

15. With regard to concept of whistleblower, perhaps it will be appropriate to quote Churchill who had said "*Courage is what it takes to stand up and speak, Courage is also what it takes to sit down and listen*". I would urge all of you who are present here and are entrusted with vigilance functions in the respective organisations to remember Churchill's words to encourage employees to speak up when they come across activities which are not in the interest of the organisation. The decision makers in the organisation should also show courage by listening to somebody who may be speaking necessary but unpalatable truths.

16. Punitive vigilance is the most important and most dreaded part of the vigilance function in any organisation. The management can use this function to instil a sense of responsibility and accountability amongst its work force. To make this tool really effective, the management should strive to complete the investigation process promptly without any bias and impose penalty which is commensurate with the gravity of the offence committed and the loss suffered by the organisation. For this purpose, there need to be close coordination between the organisation and investigating agencies like police/ CBI/ CVC. Care should be taken to place bonafide business decisions on different footing from decisions guided by ulterior motive of deriving undue personal benefit from the transactions. This is important to ensure that the decision making ability is not impacted adversely.

### **Progress in vigilance administration in banking sector: RBI's experience**

17. Our experience with implementation of these three aspects of vigilance function by the banking industry does not inspire enough confidence. Our observation is that preventive vigilance does not get the desired focus while surveillance and detective vigilance function is almost non-existent. The punitive vigilance aspect is also not implemented with required objectivity and alacrity.

18. In banks, credit related decision making has a very high potential for indulging in unfair and corrupt practices, but at the same time, it is extremely difficult to establish that officials have resorted to such practices. One of the manifestations of the vigilance failure is a sharp increase in the number of high value advance related frauds especially in the public sector banks (Annex 1). In this context, I must admit that there are definitional incongruities surrounding fraud and there is a need to draw a clear distinction between a crystallization of business risk taken in normal course and a fraud. My own view is that unless the borrower disputes his liabilities or the advance is not utilized for creating any asset or its deployment is in complete disregard to the purpose for which the sanction and disbursal is made or unless fund is siphoned off by the borrower, the advance should not be treated as a fraud. However, notwithstanding the definitional part, we observe a tendency on part of the sanctioning authorities to brandish their credit appraisal failure as a fraud perpetrated by the borrower. I am not sure how a borrower who has maintained good banking relationship with the banks for a few years suddenly becomes a fraudster. My assessment of the situation is that, in such cases more often than not, it is the failure of the credit appraisal and post disbursement supervision processes which results in accounts becoming non-performing or being

classified as fraud. This state of affairs in public sector banks is a reflection of a general lowering of guard by the vigilance administrators in banks.

19. Our analysis of large value frauds (greater than Rs. 50 crore in value) has thrown up some interesting conclusions like an inordinate delay in declaring the accounts as fraud (Annex 2), covering too many officials in the probe, holding junior officers responsible for frauds etc. We have also observed that in frauds in consortium/Multiple Banking arrangements, while some banks do not find any staff accountability, several others do the opposite(Annex 3). Our analysis also suggests that out of 719 officers who were found accountable in 230 large value fraud accounts in the banks over a period of time, 426 officers were up to the rank of Senior Manager, 196 officers were Chief Managers and AGMs, 94 officers were of the rank of DGM, GM and CGM and only 3 Officials were from the Top Management and the Board of Directors. This statistic highlights the skewed nature of our punitive vigilance process and its tendency to focus on the lower level functionaries. Another factor which greatly erodes the efficacy of the vigilance function is the disconnect between the punishment meted out and the offence. We observe that in public sector banks, most of the officials found liable were let off with minor penalties – caution, warning, censure, stoppage of increments for limited period etc. which sends out a wrong message – a message about passive tolerance rather than active intolerance towards misconduct! Incidentally, private and foreign banks operating in India adopt a no nonsense approach as reflected by the quantum of penalties imposed for similar misdemeanours including dismissal from service.

20. Based on our analysis of large value advance related fraud cases, I would like to highlight following issues for closer scrutiny by the vigilance administration in banks:

- (i) Dragging in too many people in the ambit of probe not only delays the process but also scuttles the identification of actual perpetrators
- (ii) Holding lower rung officials accountable for frauds even though the sanctioning of advances is usually at the level of senior executives/Board
- (iii) The officials at junior level should be brought under the ambit of probe for accountability only if there is deficiency at the monitoring/implementation level
- (iv) Establishing accountability in all member banks even in the case of consortium/Multiple Banking arrangements where there is common tendency on part of the member banks to absolve themselves of all responsibilities and squarely blame the lead bank for deficient credit appraisal/ post-disbursement monitoring

21. Therefore, what is of essence is the speed with which the fraud is acknowledged, investigations are concluded, staff accountability is fixed and deterrent action is taken. While on the subject of fraud in banks, let me also raise another wider issue. As vigilance officials your focus is on the internal staff but what about the fraudulent borrowers. Who ensures that they are appropriately punished? I feel there is an urgent need to ensure that the system joins hands in punishing the perpetrators of frauds including an outright refusal of banking facilities to them. Similarly, stringent and exemplary action including debarment from further hiring also needs to be taken against professionals like chartered accountants, lawyers, valuers who aid and abet the fraudulent practices.

### **Vigilance administration: the non-financial aspects**

22. Let me now come back to the issue of examining non-financial aspects as part of vigilance administration. We see many instances of close relatives of the officials working for the commercial entities which these officials also supervise. As some of you may be aware there is a raging furore and an investigation of JPMorgan by Securities and Exchange Commission in the USA for hiring Chinese “princelings” (the privileged children of ruling Communist Party leaders) in order to land business in the country. Do we make an analysis of how many of these recruitments are based on merit and how many of these are

accommodations? Sooner or later, such issues are also likely to come up for debate in our society. It is important, therefore, that we take cognizance of the problem before it snowballs into a major controversy. Further, there is also this issue of bureaucrats, regulators, supervisors taking up appointments with the entities they regulated/supervised, soon after their retirement. This is an inherently dangerous practice which needs to be curbed with appropriate polices.

23. Similarly, I have an issue with the concessional pricing extended to the few so called "special" borrowers on considerations like overall business relationship. Pricing is essentially meant to cover inherent risks and administrative cost. I do not know how business relationship brings down the risks inherent in lending transaction or the cost of administration. In order to eliminate the element of discretion in such transactions, it is essential that the respective Boards/ Ministries/ Departments lay down well documented policies/rules for pricing of products and services or national resources. I would urge the vigilance machinery in the institutions to closely focus on this aspect.

24. To my mind, one of the major sources of corruption is spending beyond sanctioned authority by the public institutions. There is virtually no accountability for unnecessary or unethical spending across institutions. The spending is very often hidden in the garb of legal/audit or regulatory expenses. The problem is more endemic at higher levels where such spending is never questioned. Do you as vigilance officers probe into these spending? In the developed economies, there is a system of disclosing the donations made to political parties, expenses incurred on bureaucracy/regulators/ policy makers etc. I wish to raise a debate here on why we should not have similar disclosure norms and transparent practices by our corporates. In the meantime, there is a need for a strong internal control framework for such expenses, which should necessarily be monitored by the organization's vigilance mechanism.

25. I would also urge the community of vigilance officers not to go overboard and remain circumspect while dealing with corruption cases. One has to be able to draw a distinction between a "tip" and a "graft". It would, perhaps, be in order for the organisations to prepare a code of ethics which should clearly outline the expectations from the employees while dealing with the various stakeholders.

### **Improving effectiveness of vigilance function**

26. This brings us to the basic question of how to make the vigilance function more effective without creating any fear in the mind of employees. In my view, institutions should lay more emphasis on the preventive vigilance aspect so that the problem may be addressed in the initial stages itself. Organizations can benefit by inculcating a sense of honesty and responsibility among its employees. Ownership of the vigilance function should not rest merely with the few officials manning the vigilance department, it should traverse across the length and breadth of the organization.

27. In this context, it will be appropriate to quote renowned poet Alexander Pope who said "An honest man is the noblest work of God. So my friends, there is no substitute to honesty. Honesty is not a concept or a word. It is a way of life. Honesty pays in life. Dishonest people may prosper at times but in the end, it is the honest man who wins. Honesty needs no excuses. Honesty leads to mental peace. It answers your conscience. An honest man needs no vigilance. It is meant for people who are black sheep in any organization. So, let us all pledge to be honest in life, not only in our public dealings as public servants but as human beings to fellow human beings on the earth. One must have a value system and must stick to that on all costs".

28. The second aspect in my opinion would be a clear and transparently professed intolerance for misconduct, by both insiders and outsiders. While well laid down vigilance policy can address the internal requirements, actions such as caution listing of persons involved in fraudulent activity, information sharing within the industry, creation of fraud

registries, availability and access to credit bureaus can to a large extent help identify and mitigate threats to vigilance on account of external influences.

29. Thirdly, there is a need to keep yourself updated about what is happening in the industry. Many times people who are posted in vigilance departments feel that there is nothing much to learn apart from the vigilance manual. Some also feel dejected that they are out of the mainstream of the organisation. In my opinion these are very myopic views. People entrusted with vigilance should be as updated as people in marketing. In fact, I may add that people involved in the vigilance function need to be abreast of developments across business lines and verticals as compared to their colleagues in other departments who only need to be updated on developments in their respective operational areas. Only if you know what is happening around you or what is the trend or what are the features of the new product that is being rolled out can you be vigilant and quickly put in safeguards.

30. Finally, management and investigative agencies must be sensitive enough to differentiate between the negative consequences arising out of bonafide decisions and those arising out of malafide intentions. There should be a robust vigilance system in place for prompt investigation and the guilty should be brought to books by imposing exemplary punishment to act as a deterrent for others. No doubt, this is a tough call, particularly when adherence to disclosure requirements and good corporate governance standards may result in adverse publicity and avoidable public enquiry. However, an impartial and adept vigilance function can also serve to enshrine the culture of integrity within the organization and enhance its reputation and standing in the eyes of the world.

## **Conclusion**

31. An improvement in efficiency of public delivery service and an efficient utilisation of public funds is incumbent upon efficient governance process which, in turn, depends upon a responsive accountability regime. The Governance process can only improve if the organisations have a culture, which encourages officials at all levels, right from the Board downwards, to be accountable for their actions. It is in this context that the vigilance officers have their task cut out. Rather than focussing solely on the punitive aspect, the vigilance machinery has to work on the preventive and participative aspects and have to help promote a culture which breeds probity and integrity.

32. As a concluding thought, my advice to people in vigilance administration is:

- Know the essence of the vigilance function – What is expected of you?
- Evaluate decisions against two tests – Was it for the good of the organisation? Was it done at the cost of the public /common good?
- Have an open and inquisitive mind – Be aware of things that may affect the interests and good governance in your respective organizations
- When the rest of the organisation is looking to push business interests, focus on ensuring that ethics and values are not lost sight of

33. If you bear the above thoughts in mind while attending to your call of duty, I am sure the objective of vigilance function would have been well served. I once again thank CIGVA and Mr. Handa for inviting me to this seminar and giving me an opportunity to interact with the participants representing a wide cross-section of the public sector. I observe that CIGVA has assembled an impressive set of speakers with vast practical experience and I, therefore, hope that you would have two very interesting days of deliberations. I hope some of the issues that I have raised this morning would be debated during the course of the seminar and some actionable ideas on improving the Governance process in public sector enterprises would emerge from these deliberations. I wish you the very best in all your future endeavours.

Thank you!

## Annex 1

Facility wise distribution of Large value fraud cases (> Rs 50 crore)						
Sr. No.	Type of facility	No. of Frauds	No. of borrowal accounts	Amount involved	% to Total Accounts	% to Total amount involved
1	Deposit	3	3	604.35	1.30	3.86
2	Advances	53	190	11681.73	82.61	74.51
3	Off Balance Sheet - LCs, Guarantees	5	23	2547.86	10.00	16.25
4	Forex Transactions	7	14	843.09	6.09	5.38
		68	230	15677.03	100	100

Bank Group wise distribution of Large Value Fraud Cases (> Rs. 50 crore)				
Sr. No.	Bank Group	No. of borrowal accounts	Amount involved	% of amount involved
1	Public Sector Banks	197	13766.24	87.81
2	Private Sector Banks	26	1244.54	7.94
3	Foreign Banks	7	666.24	4.25
	All Banks	230	15677.03	100

## Annex 2

Time taken for crystallisation of facility as fraud (Large value fraud cases involving an amount > Rs 50 crore)				
Sr. No.	Period of crystallization of account as fraud	Number of cases	Amount Involved	Percentage to Total
1	Within 1 year	14	1317.49	8.40
2	Above 1 year and up to 3 year	21	2488.68	15.87
3	Above 3 year and up to 5 year	14	1274.92	8.13
4	Above 5 year and up to 10 year	93	3611.85	23.04
5	Above 10 years	88	6984.07	44.55
	Total	230	15677.03	100.00

### Annex 3

Staff Accountability in Frauds in Major Multiple Banking / Consortium arrangements									
Sr. No.	Name of A/c	Total Banks	Amount Involved (In crore)	Amt. Involved in cases where (in crore)			% of Amount involved where staff accountability found to total amount involved	Total Officers involved	DGMS and above found accountable
				Staff Accountability is found	Staff Accountability is not found	where examination of Staff Accountability is under progress			
1.	A	25	2726.09	862.32 (8)	1362.54 (13)	501.24 (4)	31.63	49	15
2.	B	14	2456.20	508.51 (4)	1096.58 (7)	851.11 (3)	20.70	52	5
3.	C	11	386.09	317.45 (7)	6.38 (1)	55.36 (3)	82.22	57	4
4.	D	20	1003.28	612.63 (11)	206.40 (7)	184.25 (2)	61.06	55	8
5.	E	5	461.88	333.71 (3)	128.71 ( )	-	72.25	26	6
6.	F	12	107.58	8.10 (2)	99.48 (10)	-	7.53	4	0
7.	G	11	280.77	63.84 (4)	216.93 (7)	-	22.73	22	3
8.	H	6	192.66	165.54 (5)	27.12 (1)	-	85.92	20	3
9.	I	5	158.21	90.61 (2)	67.60 (3)	-	57.73	3	0
10	J	4	776.25	-	-	776.25	-	-	-
11	K	14	1262.29	-	-	1262.29	-	-	--

**Note:** All annexures are based on a detailed study conducted by Department of Banking Supervision of the frauds committed in the banking system over the last two decades, where the total amount involved per fraud across all the banks was more than Rs.50 crore each. The total number of such frauds across all commercial banks (as outstanding in the books of the banks as on September 30, 2013) was 68 and involved 230 accounts.