How confidential should bank inspection reports be?

An emotional affirmation to disclose sensitive, confidential exchanges generically must be avoided

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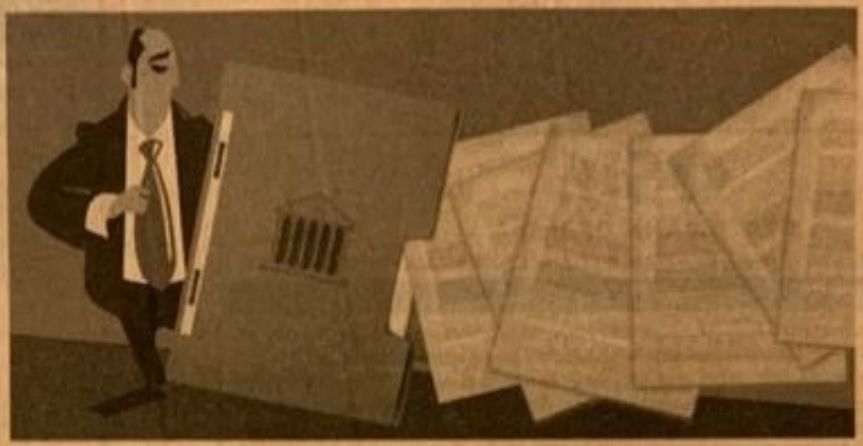
Transparency and maximum disclosure are the immutable cornerstones of an effective democracy. However, absolute and uncontrolled information flow may sometimes be antithetical to the objective this proposition seeks to achieve. It is for this reason that legislation, albeit with circumspection, creates exceptions to this principle. This requires judicial intervention to balance the conflict between the expectation of the information seeker and the right of the information owner and set in harmony the contrariety between transparency and confidentiality. Disclosure being the primary legislative intent in governance is manifested through various statutory and regulatory mandates where regular and time-bound disclosure is mandated for almost all entities. Beyond the realm of the mandatory disclosure requirement is the Right to Information Act (RTI).

Whilst over the last decade, the rule in favour of information sharing has been dealt with extensively. In December 2015, the Supreme Court in the case of *Reserve Bank of India v. Jayantilal N Mistry* was once again faced with the task of having to balance the conflict between information seekers and information owners. This time, the information sought was primarily the "inspection reports" of the Reserve Bank of India (RBI) with respect to the various banks over which RBI exercises supervisory jurisdiction.

RBI as a part of its supervisory responsibility has the power to continually conduct inspection on the constituent bank and may also instruct the bank to take remedial or corrective measures. Inspection reports are repositories of extremely confidential information. They include deliberations and dialogues between the RBI and the bank on myriad complex issues on which proactive or corrective measures may be taken by the bank. It is under this power that RBI constantly manoeuvres the banks to stay the course and avoid any perils. The right to inspect and direct is probably the most influential tool in the hands of the RBI, which allows the banking system as a whole to take protective and pre-emptive measures. Any apprehension of public disclosure of such deliberations and dialogues is bound to inhibit seamless exchange of information between the banks and the RBI. An atmosphere of constant cautiousness and hesitation in sharing information with the RBI would be disastrous for meaningful and effective supervision, which is the most fundamental ingredient for a robust banking framework.

In *RBI v. Jayantilal N Mistry*, the counsel for RBI strenuously argued that inspection reports reflect the supervisors' critical assessment of banks and their functions, disclosures of which may prematurely and unnecessarily create misunderstanding and misinterpretation in the minds of the public. The counsel also argued that, apart from such disclosures specifically being



restricted under the Banking Regulation Act, such disclosure would be counter productive and adversely impact public confidence in the banking system.

The Supreme Court comprehensively rejected the contention of the RBI and ruled in favour of complete disclosure of the inspection reports. Interestingly, while rejecting the contentions of the RBI, the Supreme Court did observe that *"it is equally true that there is some information which if published or released publicly, might actually cause more harm than good to our national interest ... disclosure of information about ...the regulation or supervision of banking, insurance and other financial institutions, ... could in some cases harm the national economy, particularly if released prematurely"*. However, despite the observation, the Supreme Court allowed unobstructed disclosure of the inspection reports. The issue is far from closed and the Supreme Court may need to relook at the same.

In USA, the principle behind the need to not disclose inspection/examination reports was most appositely articulated by the Court of Appeals for the District of Columbia Circuit where the court held that *the bank examination privilege is firmly rooted in practical necessity. Bank safety and soundness of supervision is an iterative process of comment by the regulators and response by the bank. The success of the supervision therefore depends vitally upon the quality of communication between the regulated banking firm and the bank regulatory agency. This relationship is both extensive and informal. It is extensive in that bank examiners concern themselves with all manner of a bank's affairs. Not only the classification of assets and the review of financial transactions, but also the adequacy of security systems and of internal reporting requirements, and even the quality of managerial personnel are of concern to the examiners. The supervisory relationship is informal in the sense that it calls for adjustment, not adjudication. In the process of comment and response, the bank may agree to change some aspect of its operation or accounting; alternatively, if the bank and the examiners reach impasse, then their dispute may be elevated for resolution at higher levels within the bank regulatory agency. It is the very rare dispute, however, that culminates in any formal action... Because bank supervision is relatively informal and more or less continuous, so too must be the flow of communication between the bank and the regulatory agency. Bank management must be open and forthcoming in response to the inquiries of bank examiners, and the examiners must in turn be frank in expressing their concerns about the bank. These conditions simply could not be met as well if communications between the bank and its regulators were not privileged.*

The CJEU aptly observed that *effective implementation of the prudential supervision regime requires that both the institutions and the authorities can have confidence that the confidential information provided will remain confidential. The absence of such confidence is liable to compromise the smooth transmission of the confidential information that is necessary for prudential monitoring.*

The courts and the authorities must be especially mindful that in the age of social media, sensitive information in the hand of irresponsible persons may have uncontrollable and catastrophic consequences. It is true that recent revelations with respect to certain financial institutions have taken the entire nation by surprise. An emotional affirmation of the need to disclose inspection reports generically as a reaction to specific governance failures is exactly what must be avoided. Apart from unfairly painting all banks and NBFCs with the same brush, it will irreparably damage the entire banking framework by permanently impeding effective supervision by the RBI.

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