BANKING SECTOR REFORMS (1999-2010)

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Abstract

In line with the recommendations of the second Narasimham Committee, the Mid-Term Review of the Monetary and Credit Policy of October 1999 announced a gamut of measures to strengthen the banking system. Important measures on strengthening the health of banks included: (i) assigning of risk weight of 2.5 per cent to cover market risk in respect of investments in securities outside the SLR by March 31, 2001 (over and above the existing 100 per cent risk weight) in addition to a similar prescription for Government and other approved securities by March 31, 2000, and (ii) lowering of the exposure ceiling in respect of an individual borrower from 25 per cent of the bank's capital fund to 20 per cent, effective April 1, 2000. This article analysis that how the banking sector reforms utilized in India for development of Indian economy.

Introduction

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Capital Adequacy and Recapitalization of Banks

Out of the 27 public sector banks (PSBs), 26 PSBs achieved the minimum capital to risk assets ratio (CRAR) of 9 per cent by March 2000. Of this, 22 PSBs had CRAR exceeding 10 per cent. To enable the PSBs to operate in a more competitive manner, the Government adopted a policy of providing autonomous status to these banks, subject to certain benchmarks. As at end-March 1999, 17 PSBs became eligible for autonomous status.

Prudential Accounting Norms for Banks

The Reserve Bank persevered with the on-going process of strengthening prudential accounting norms with the objective of improving the financial soundness of banks and to bring them at par with international standards. The Reserve Bank advised PSBs to set up Settlement Advisory Committees (SACs) for timely and speedier settlement of NPAs in the small scale sector, viz., small scale industries, small business including trading and personal segment and the agricultural sector. The guidelines on SACs were aimed at reducing the stock of NPAs by encouraging the banks to go in for compromise settlements in a transparent manner. Since the progress in the recovery of NPAs has not been encouraging, a review of the scheme was undertaken and revised guidelines were issued to PSBs in July 2000 to provide a simplified, non-discriminatory and non-discretionary mechanism for the recovery of the stock of NPAs in all sectors. The guidelines will remain operative till March 2001. Recognising that the high level of NPAs in the PSBs can endanger financial system stability, the Union Budget 2000-01 announced the setting up of seven more Debt Recovery Tribunals (DRTs) for speedy recovery of bad loans. An amendment in the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, was effected to expedite the recovery process.

Asset Liability Management (ALM) System

The Reserve Bank advised banks in February 1999 to put in place an ALM system, effective April 1, 1999 and set up internal asset liability management committees (ALCOs) at the top management level to oversee its implementation. Banks were expected to cover at least 60 per cent of their liabilities and assets in the interim and 100 per cent of their business by April 1, 2000. The Reserve Bank also released ALM system guidelines in January 2000 for all-India term-lending and refinancing institutions, effective April 1, 2000. As per the guidelines, banks and such institutions were required to prepare statements on liquidity gaps and interest rate sensitivity at specified periodic intervals.

Risk Management Guidelines

The Reserve Bank issued detailed guidelines for risk management systems in banks in October 1999, encompassing credit, market and operational risks. Banks would put in place loan policies, approved by their boards of directors, covering the methodologies for measurement, monitoring and control of credit risk. The guidelines also require banks to evaluate their portfolios on an on-going basis, rather than at a time close to the balance sheet date. As regards off-balance sheet exposures, the current and potential credit exposures may be measured on a daily basis. Banks were also asked to fix a definite time-frame for moving over to the Value-at-Risk (VaR) and duration approaches for the measurement of interest rate risk. The banks were also advised to evolve detailed policy and operative framework for operational risk management. These guidelines together with ALM guidelines would serve as a benchmark for banks which are yet to establish an integrated risk management system.

Disclosure Norms

As a move towards greater transparency, banks were directed to disclose the following additional information in the 'Notes to Accounts' in the balance sheets from the accounting year ended March 31, 2000:

- maturity pattern of loans and advances, investment securities, deposits and borrowings,
- foreign currency assets and liabilities,
- movements in NPAs and
- lending to sensitive sectors as defined by the Reserve Bank.

Technological Developments in Banking

In India, banks as well as other financial entities have entered the domain of information technology and computer networking. A satellite-based Wide Area Network (WAN) would provide a reliable communication framework for the financial sector. The Indian Financial Network (INFINET) was inaugurated in June 1999. It is based on satellite communication using VSAT technology and would enable faster connectivity within the financial sector. The INFINET would serve as the communication backbone of the proposed Integrated Payment and Settlement System (IPSS). The Reserve Bank constituted a National Payments Council (Chairman: Shri S. P. Talwar) in 1999-2000 to focus on the policy parameters for developing an IPSS with a real time gross settlement (RTGS) systemasthecore.

Revival of Weak Banks

The Reserve Bank had set up a Working Group (Chairman: Shri M. S. Verma) to suggest measures for the revival of weak PSBs in February 1999. The Working Group, in its report submitted in October 1999, suggested that an analysis of the performance based on a combination of seven parameters covering three major areas of i) solvency (capital adequacy ratio and coverage ratio), ii) earnings capacity (return on assets and net interest margin) and iii) profitability (operating profit to average working funds, cost to income and staff cost to net interest income plus all other income) could serve as the framework for identifying the weakness of banks. PSBs were, accordingly, classified into three categories depending on whether none, all or some of the seven parameters were met. The Group primarily focussed on restructuring of three banks, viz., Indian Bank, UCO Bank and United Bank of India, identified as weak as they did not satisfy any (or most) of the seven parameters. The Group also suggested a two-stage restructuring process, whereby focus would be on restoring competitive efficiency in stage one, with the options of privatisation and/or merger assuming relevance only in stage two. Deposit InsuranceReforms

Reforming the deposit insurance system, as observed by the Narasimham Committee (1998), is a crucial component of the present phase of financial sector reforms in India. The Reserve Bank constituted a Working Group (Chairman: Shri Jagdish Capoor) to examine the issue of deposit insurance which submitted its report in October 1999. Some of the major recommendations of the Group are : (i) fixing the capital of the Deposit Insurance and Credit Guarantee Corporation (DICGC) at Rs.500 crore, contributed fully by the Reserve Bank, (ii) withdrawing the function of credit guarantee on loans from DICGC and (iii) risk-based pricing of the deposit insurance premium in lieu of the present flat rate system. A new law, in super cession of the existing enactment, is required to be passed in order to implement the recommendations. The task of preparing the new draft law has been taken up. The relevant proposals in this respect would be forwarded to the Government for consideration.

Conclusion

Indian Banks have to convert the challenges into opportunities by means of venturing into innovative activities by changing their operational modalities. Banks should develop quest for excellence and achievement, and work with inspiration to complete in the future, with a sense of perfection to ensure survival and growth with profits.