Standing Committee Report Summary

Banking Sector in India - Issues, Challenges and the Way Forward

- The Standing Committee on Finance (Chair: Dr. M. Veerappa Moily) submitted its report on the Banking Sector in India – Issues, Challenges and the Way Forward on August 31, 2018. Credit and deposit growth in banks have recently been slow. High volumes of non-performing assets (NPAs) in banks have eroded their capital base, and restricted their ability to lend. Key observations and recommendations of the Committee include:
- **NPAs of public sector banks:** The Committee noted that the problem of high loan write-offs and NPAs, combined with low asset growth, is more severe for public sector banks (PSBs) than private banks. However, it stated that once most of the larger NPAs get resolved as per the Insolvency and Bankruptcy Code or other mechanisms, the situation will become better for PSBs. In this regard, the Committee observed that the present crisis is transient and should not warrant privatisation of public sector banks.
- The Committee expressed concern about limited improvements in the short-term earnings of PSBs as a result of NPAs. To help in pre-empting frauds by structured sharing of credit information and follow-up action among banks, it recommended the formulation of a law to set up a Public Credit Registry.
- **Lowering of Capital to Risk-weighted Assets Ratio (CRAR) requirement:** The Committee noted that RBI's requirement of a minimum CRAR of 9%, to prevent banks from becoming highly leveraged, is 1% higher than the Basel III norms for internationally active banks. This is applicable to all PSBs, even though nine of them do not operate internationally. The Committee observed that such a high CRAR requirement is impractical for these banks, and a relaxation would (i) release capital of approximately Rs 5.34 lakh crore, (ii) grow loans and generate an additional Rs 50,000 crore of income annually, and (iii) avoid the need for capital infusion in these banks.
- **Banks under Prompt Corrective Action (PCA):** The Committee observed that 11 PSBs have been placed under the PCA framework by the RBI based on factors such as capital inadequacy and high NPAs. These banks have restricted lending and deposit-taking capabilities as a result. Despite the imposition of PCA, recoveries in these banks have either been stagnant, or grown marginally. The Committee recommended that the RBI should provide a roadmap to these banks to enable them to come out of PCA and resume normal operations.
- Further, it observed that bringing more banks under PCA would affect both the banking sector and the economy at large, by aggravating the problem of credit availability. It recommended that banks under PCA be closely monitored, and restrictions be relaxed and reviewed, especially for banks where even retail banking is prohibited. It also recommended that RBI's knee-jerk reactions to fraud, like discontinuing Letters of Undertaking that provide cheap credit, should be avoided, as they hinder credit growth.
- **Performance of the National Company Law Tribunals (NCLT):** The Committee noted that resolution of larger NPAs under the Insolvency and Bankruptcy Code (IBC) have been taking much longer than the stipulated time period of 270 days. It recommended that NCLTs' resources be increased to enable them to dispose of such cases swiftly.
- Further, the Committee observed that several lenders have had to take unduly large 'haircuts' (difference between loan amount and the value of the collateral) for some of their loans. It recommended that a reasonable base price should be fixed for bidding so that large 'haircuts' can be avoided by creditors in the course of the IBC process in NCLT.
- **Powers of the RBI in case of PSBs:** The Committee noted that the RBI had stated that some powers available to the RBI under the Banking Regulation Act, 1949 are not available in the case of PSBs. These include: (i) removing and appointing Chairman and Managing Directors of banks, (ii) superseding the Board of Directors, and (iii) granting licences. The Committee also noted that the RBI can, however, (i) inspect the bank, (ii) consult with the government on appointing senior bank officials, and (iii) have a nominee on a PSB's management committee. In this regard, the Committee recommended that the government should constitute a high powered committee to evaluate the powers of the RBI with respect to PSBs as provided under various statutes.
- **Incentives for PSB employees:** The Committee recommended that higher remuneration be given to senior management of PSBs, as there exists a wide gap with their private sector counterparts. Further, an overlap should be provided between tenures of successive CEOs to facilitate smoother transition. The retirement age of CEOs of PSBs should be increased to 70 years (similar to private banks) to utilise the expertise of senior bankers. Further, criminality of bankers should not be presumed for decisions taken in the normal course of business, and bankers should be afforded a chance of explaining their decision before any actions are taken.

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