Indradhanush-
Banking Sector Reforms

Rajiv Kumar
Senior Fellow
Centre for Policy Research

Geetima Das Krishna
Senior Researcher
Centre for Policy Research

Sakshi Bhardwaj
Research Associate
Centre for Policy Research

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CENTRE FOR POLICY RESEARCH

WWW.CPRINDIA.ORG

Summary

The Indradhanush framework with its seven pronged plan was unveiled by Finance Minister Mr Arun Jaitley on 14th August 2015 for revamping Public Sector Banks (PSBs) of India. In this paper, we look at the deteriorating profitability, asset quality, capital position of PSBs along with previous bank recapitalisation expenditure of the government. The seven reform initiatives in Indradhanush are compared with Nayak Committee recommendations. We summarise that Indradhanush does not propose any ground-breaking reforms for the PSBs. Re-capitalisation or infusion of capital into PSBs is its central theme. This opens up a debate on whether the capital infusion is adequate for all banks. Given various constraints for the government, we feel Indradhanush is definitely the step in the right direction. It does incorporate some of the initiatives mentioned in Nayak Committee report but does not fully embrace the essence of the bold Nayak recommendations. PSBs accounting for 70 percent of the banking system and saddled with high NPAs will be an impediment to growth unless the government acts fast to revamp this sector.

Stressed Balance Sheet of Indian Banks

Balance sheets of the Indian banks have been weighing down with high levels of impaired loans, which is expected to impact their ability to extend credit to the productive sectors of the economy thereby hurting the pick-up in private capex. The PSBs which account for over 70 per cent of the banking system in India faces concerns regarding their profitability, asset quality, capital position and governance despite several measures taken to de-stress the sector.

The Financial Stability Report (FSR) of the RBI stated that deteriorating asset quality and weak corporate profit have increased risks to the banking sector in recent months. The report highlights the following points:

First, bank credit growth has fallen to single digits and unfortunately increase in profits has been due to decline in growth of operating expenses rather than a rise in growth of income. The profitability of PSBs has declined significantly. Both Return on Assets (RoA) and Return on Equity (RoE) of Scheduled Commercial Banks (SCBs) have continued to decline as seen in the table below. Profit after tax (PAT) of SCBs declined due to lower growth in earnings before provisions and taxes (EBPT) and higher provisions and write-offs. Among the bank groups, Profit after Tax (PAT) declined by 22.7 per cent for PSBs, whereas, it increased by 11.5 per cent for Private Banks (PVBs) and 4.6 per cent for Foreign Banks (FBs) during the same period.

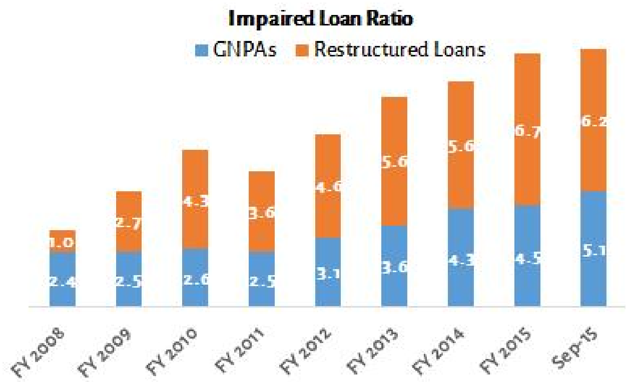
Table 1: Profitability of SCBs

%	RoA	RoE	PAT Growth	Earnings Before Provisions & Taxes Growth	Net Interest Income Growth	Other Operating Income Growth	Risk Provision Growth	Write-offs Growth
Mar-11	1.1	13.6	23.6	21.7	34.6	0.5	38.6	-50.6
Mar-12	1.1	13.4	14.6	15.3	15.8	7.4	35.6	-13.1
Mar-13	1.0	12.9	12.9	9.9	10.8	14.4	10.2	-8.5
Mar-14	0.8	9.5	-14.1	9.5	11.7	16.6	41.9	80.3
Mar-15	0.8	9.3	10.1	11.4	8.5	17.4	7.0	23.4
Sep-15	0.7	8.5	-4.4	8.8	8.6	11.0	22.2	49.2

Note: RoA and RoE are ratios, whereas growth is calculated on a y-o-y basis. Source: RBI Financial Stability Report

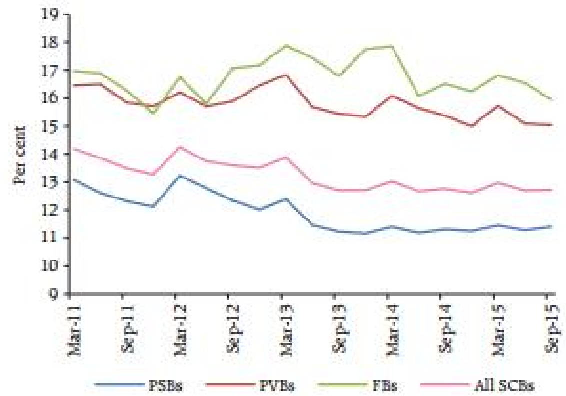
Second, the overall impaired loans (Non-Performing Assets and Restructured assets) in the banking sector increased to 11.3 per cent in quarter ending September 2015 compared to 9.9 per cent in FY 2014 and 3.4 per cent in FY 2008 - with PSBs having a much higher share. It is reported that stress advances ratio for PSBs rose to 14.1 per cent while the same for the private sector remained broadly flat at 4.6 per cent in the quarter Sep-15.[1] Five sub-sectors such as, mining, iron & steel, textiles, infrastructure and aviation together constituted 24.2 per cent of the total advances of SCB as of June 2015, and contributed 53.0 per cent of the total stressed advances. Moreover, the capital to risk-weighted assets ratio (CRAR) of SCBs declined to 12.7 per cent from 13.0 per cent between March and September 2015 (CRAR under Basel III: 10.5 per cent).

Chart 1: Impaired Loans of SCBs



Note- GNPAs – Gross Non Performing Assets
Source: RBI database, CPR research

Chart 2: Capital Adequacy



Source: RBI Financial Stability Report, CPR research

Third, banks have extended higher credit to the sectors that have high leverage and weak debt-servicing capacity putting further strain on asset quality of the banks. The macro stress test for credit risk suggests that under the baseline scenario, the GNPA ratio may rise to 5.4 per cent by September 2016 before improving. However, if the macroeconomic conditions deteriorate, the GNPA ratio may increase further to 6.9 per cent by March 2017. In that

[1]There is some scepticism about the accuracy of reported NPA numbers: banks may engage in creative accounting or "evergreening," and the current classification norms mapping loan repayment delay to NPA do not yet meet international norms.-Banerjee, Cole and Duflo in 'Banking reform in India', 2004

case, PSBs may record the lowest Capital to Risk weighted Assets Ratio (CRAR) of around 9.4 per cent by March 2017, as against 11.5 per cent as of September2015.

The norm for capital adequacy ratio for banks as per the Basel III is 8 per cent but the RBI prefers to keep it one per cent above that. However, banks cannot operate strictly at the minimum capital level stipulated by the regulator and usually prefer to keep it about 5 per cent above the minimum requirement so as to have the freedom to take risks in lending. This results in capital adequacy ratio of 14 per cent.

Considering deteriorating capital adequacy ratio of PSBs, it is necessary to inject capital into these banks. Some of this capital can be raised from the market but the government would have to chip in if it intends to retain its majority ownership. Banks might find it difficult to raise capital from market without improving its performance. The Indradhanush initiative aims to capitalisation PSBs with Rs 70,000 crore through budgetary allocations for four years up to financial year 2018-19. This has led to serious debate on whether this provision for recapitalisation is adequate to distress the banking sector.

Global Comparison

The performance parameters of Indian banks had steadily improved till 2009 approaching international standards and were among the better performers in the emerging market group. However, it started deteriorating after 2011 as seen in the tables below.

The banking sector's gross non-performing asset (GNPA) ratio, which is the value of non-performing loans divided by the total value of the loan portfolio, stood at 4.2 per cent as of the end of 2015. In contrast, the emerging markets of Brazil and Indonesia only recorded an NPA of 3.1 per cent and 2.3 per cent respectively during the same period. The disturbing fact is that the NPA in India has inflated to almost twice its size since 2010, while the same metric for its peers (Brazil, Indonesia and South Africa) remained steady or moved in the opposite direction.

Table 2: Cross-Country Comparison of NPA to Total Loans (%)

Country	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Brazil	3.5	3.5	3.0	3.1	4.2	3.1	3.5	3.4	2.9	2.9
China	8.6	7.1	6.2	2.4	1.6	1.1	1.0	1.0	1.0	1.2
Euro area	1.8	1.3	1.8	2.8	4.8	5.4	6.0	7.5	7.9	6.8
Indonesia	7.3	5.9	4.0	3.2	3.3	2.5	2.1	1.8	1.7	2.1
India	5.2	3.5	2.7	2.4	2.2	2.4	2.7	3.4	4.0	4.3
Japan	1.8	1.8	1.5	2.4	2.4	2.5	2.4	2.4	2.3	1.9
Russia	2.6	2.4	2.5	3.8	9.5	8.2	6.6	6.0	6.0	6.7
United States	0.7	0.8	1.4	3.0	5.0	4.4	3.8	3.3	2.5	1.9
South Africa	1.8	1.1	1.4	3.9	5.9	5.8	4.7	4.0	3.6	3.2

Source: World Bank

Bank capital to assets is the ratio of bank capital and reserves to total assets. Capital and reserves include funds contributed by owners, retained earnings, general and special reserves, provisions, and valuation adjustments. There is a need to improve the Capital to Asset ratio of Indian banks.

Table 3: Bank Capital to Assets Ratio (%)

Country	2006	2007	2008	2009	2010	2011	2012	2013	2014
Brazil	10.4	10.7	10.4	11.5	10.3	10.1	10.1	9.3	9.0
China	5.1	5.7	6.0	5.6	6.1	6.4	6.5	6.7	7.2
Euro area	6.6	6.7	6.2	6.4	6.1	5.4	5.8	6.9	7.5
Indonesia	9.3	9.2	9.1	10.1	10.7	11.0	12.2	12.5	12.8
India	6.6	6.4	7.3	7.0	7.1	6.7	7.0	6.9	7.1
Japan	4.8	5.3	4.5	4.3	5.3	5.1	5.1	5.5	5.5
Russia	12.1	13.3	10.8	13.1	12.9	11.8	11.8	11.5	8.5
United States	10.5	10.3	9.3	12.4	12.7	12.2	12.0	11.8	11.7
South Africa	7.9	8.0	5.7	6.7	7.0	7.2	7.8	7.9	7.6

Source: World Bank

Indradhanush, seven-pronged reform measures, announced by the government....

The Indradhanush framework with its seven pronged plan was unveiled by Finance Minister Mr Arun Jaitley on 14th August 2015 for revamping Public Sector Banks (PSBs) of India. Some of the recommendations were inspired by PJ Nayak Committee report that was submitted on 12th May 2014.

The table below looks at the seven issues highlighted in Indradhanush and compares these with recommendations made in PJ Nayak Committee report.

Reform	Indradhanush	P J Nayak Committee Report
Appointments	• Separate the post of Chairman and Managing Director. • CEO will get the designation of MD & CEO and there would be another person who would be appointed as non-Executive Chairman of PSBs.	• The positions of bank Chairman and CEO should be separated. • However, this was proposed during the Phase 3 of the transition process when all ownership functions would be transferred to the bank boards.
Bank Board Bureau (BBB)	• BBB will replace the Appointments Board for appointment of Whole-time Directors and non-Executive Chairman. • It will comprise of a Chairman and six members - three officials and three experts (minimum two from banking sector). • The Search Committee for members of the BBB would comprise of the Governor, RBI and Secretary (FS) and Secretary (DoPT) as members. The members will be selected in the next six months and the BBB will start functioning from the 01st April, 2016.	• BBB, entrusted with the appointments of bank board including Chairmen and Executive Directors, should entirely comprise of professional bankers - three senior bankers of high standing with a maximum tenure of three years. • Government should select in consultation with RBI. No government officials in BBB. • There will be no renewal of their contract thereby ensuring its autonomy and independence is not compromised. Boards will be empowered with the task after that.

Capitalisation	• Adequately capitalize all the banks to keep a safe buffer over and above the minimum norms of Basel III. • Extra capital for the next four years up to FY 2019 is likely to be about Rs.1,80,000 crore. Government to make available Rs.70,000 crores for four years. • About 40% of this allocated to the top six big banks. The remaining 20% to banks based on performance. Eight banks which did not get any money in first two tranche will get preference.	• Recapitalisation of these banks will impose significant fiscal costs. • There are two options: either to privatise and allow their future solvency to be subject to market competition, including through mergers; or to design a radically new governance structure which would better ensure their ability to compete successfully.
De- Stressing	A) Projects are increasingly stalled or stressed thus leading to NPA. Some of the actions proposed: • Project Monitoring Group to facilitate pending approval. • Address long-term availability of fuel for projects. • Early reforms in Discoms. • Promoters to bring in additional equity to address the worsening leverage ratio of projects. • Further flexibility in restructuring of existing loans. B) Strengthening Risk Control measures and NPA Disclosures.	• No recommendations to ease the bottleneck of stalled projects. • To strengthen risk management, committee underlined the need to upgrade the quality of board deliberation in PSU banks. • Business Strategy and Risk were identified as the most prominent themes for detailed board scrutiny.
Empowerment	• No interference from Government and Banks are encouraged to take their decision independently keeping the commercial interest of the organisation in mind. • Build robust Grievances Redressal Mechanism for customers as well as staff. • Greater flexibility in hiring manpower.	• All ownership functions related to banks transferred from the Government to BIC (Bank Investment Company). • Non-ownership functions, regulatory or development, transferred to RBI. • Reduce the proposed BIC's investment in bank to less than 50 per cent. • The Government should also cease to issue instructions to PSU banks.
Framework of accountability	• Key Performance Indicators (KPIs) to be measured for performance of PSBs is being announced. • Operating performance evaluated through the KPI framework will be linked to the performance bonus. • Circular to PSBs laying down strict timelines for filing of complaints of fraud cases. • Streamlining vigilance process for quick action for major frauds including connivance of staff.	• BIC should have the autonomy and set its objective in terms of financial returns from the banks it controls. • Incentives of BIC employees linked to financial returns of banks. • Penalties imposed if significant ever-greening is detected - unvested stock options granted to responsible officers should be cancelled, monetary bonuses paid to be clawed back and Chairman of the audit committee to step down.

Governance reforms	• The process of governance reforms started with "Gyan Sangam" - a conclave of PSBs. • Specific decisions on optimizing capital, digitizing processes, strengthening risk management, improving managerial performance and financial inclusion.	• Rapidly move towards establishing fully empowered boards in PSU banks, solely entrusted with the governance and oversight of the management of the banks. • RBI to conduct random detailed checks on the reported quality of banks' asset portfolio, particularly where compensation through stock options is liberally provided.

It is seen from the table above that recapitalisation of the public sector banks is the central theme in Indradhanush which was not suggested in Nayak Committee report. Other two issues that were new in Indradhanush include: i) the actions proposed to debottleneck the stalled projects and ii) the Key Performance Indicators (KPIs) to measure the performance of PSBs.

Many proposed reforms in Indradhanush follow the framework mentioned in Nayak Committee. There are:

- Splitting the position of Chairman of Board and MD & CEO of bank,
- Formation of BBBs to professionalise the appointments of bank boards,
- Empowering PSBs by not interfering in decisions and allowing flexible hiring.

A framework for tackling NPAs is absent in Indradhanush. Bad loans had piled up in PSBs, partly due to the manner in which these banks operate. The PSBs were forced to lend excessively to unviable infrastructure projects in previous years. Moreover, unlike private banks, PSBs have dual regulators - the RBI and the Finance Ministry. Between October 2012 and January 2014, the government had issued 82 circulars to PSBs, leaving them with little autonomy.

....falls short of the paradigm shift reforms proposed by Nayak Committee

The main essence of the Nayak Committee report was to provide level playing field for public sector banks in relation to their private sector counterparts by reducing government holding in banks to below 50 per cent.

The Nayak Committee had proposed that the Government's stake in banks should be transferred to a Bank Investment Company (BIC) incorporated under the Companies Act. This will require repelling of The Banking Companies Acts of 1970 and 1980, The State Bank of India Act, 1955 and The State Bank of India (Subsidiary Banks) Act, 1959. The transfer of powers from the Government to BIC and subsequently to the bank board would be done in three phases.

PSBs will be freed from dual regulatory framework. RBI will be the sole regulator of banks. The Government should cease to issue any instructions (regulatory or development) applicable only to PSBs. Any instructions should be issued after consultation with RBI and that will be applicable to all the banks – public and private.

Nayak committee had proposed reducing the BIC's investment in a bank to less than 50 per cent as that will free the bank from external vigilance emanating from the Central Vigilance Commission (CVC), Right to Information Act (RTI) and Government constraints on employee compensation. Vigilance enforcement and compensation policy will be the responsibility of bank boards. The competitive public sector banks are expected to improve financial returns for the Government with no effective dilution of control.

Even though the proposal for BBB in Indradhanush for appointments of top officials at PSBs is similar to that in Nayak Committee report, there are significant differences. Nayak Committee wanted BBB to comprise entirely of professional bankers without any government nominee but Indradhanush proposes to have government members. Moreover, BBB was supposed to be a temporary body with a maximum tenure of three years till the power of appointments are transferred to the bank boards. Indradhanush is not very clear on the composition and tenure of the BBB. In short, the PJ Nayak Committee Report had proposed bold reforms in terms of holding structure and governance of PSBs.

Re-Capitalisation of Indian Banks

The government has estimated in Indradhanush that the PSBs will require extra capital to the tune of Rs 1,80,000 crores in next four years up to FY 2019 assuming a credit growth rate of 12 per cent for the current year and 12 to 15 per cent for the next three years.

Table 4: Capitalisation of PSBs

Year	Rs Crore
FY 2015-16	25,000
FY 2016-17	25,000
FY 2017-18	10,000
FY 2018-19	10,000
Total	70,000

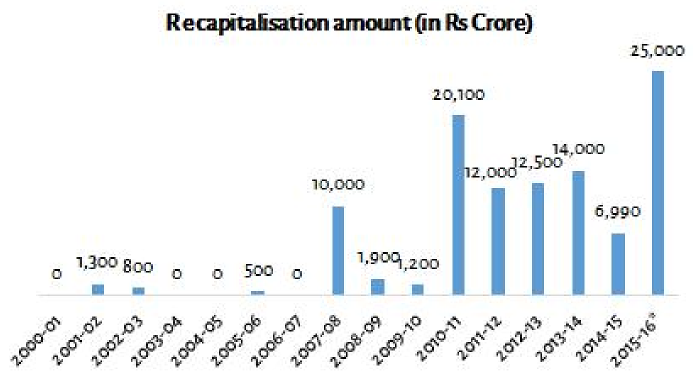
Source: Government press release, CPR research

Out of this, the Government will infuse Rs.70,000 crores out of budgetary allocations in next four years as shown in Table 4. PSBs will raise the remaining Rs 1,10,000 crore from the market to meet capital adequacy according to Basel III norm.

The government will also make extra budgetary provisions in last two years, if needed, to ensure that PSBs remain adequately capitalized to support economic growth.

The chart below shows the trend of recapitalisation expenditure of the government since 2000.

Table 2: Expenditure on Recapitalisation of Public Sector Banks



Source: RBI report, Union Budget documents, Report on Currency and Finance, 2006-08, CPR research, *Estimate in FY 2016

The government had infused Rs 6,990 crore in FY 2014-15 as against budgeted allocation of Rs 11,200 crore. In FY 2015-16, the budgeted amount for bank capitalisation was Rs 7,940 crore which is now expected to go up to Rs 25,000 crore.

The Indian government has infused Rs 80,000 crore into PSBs till last fiscal.

The question one needs to answer is whether recapitalisation of Banks is appropriate option and what could be alternative for this. Banerjee, Cole, Duflo in 'Banking reform in India' argues that bailouts of the public banks have proved more expensive for the government'. Non-performing assets (NPAs) are a major drag on PSBs. This is the third time, after 1993 and 2001 that the government is grappling with stressed assets. In 1997, the Narasimhan panel II had proposed an Asset Recovery Fund to take over the proportion of the bad and doubtful debts from the banks and financial institutes. The committee also suggested the formation of special tribunals to recover loans granted by the bank which did not materialize. During 1993-95, Rs. 10,987.12 crore was pumped into PSBs for recapitalisation. Narsimha Rao II committee was strictly against further recapitalisation operations.

On the other side of the spectrum, the 2011 UK's Vickers Commission report cited a study by the Basel Committee on Banking Supervision that placed a median loss of economic output following a banking crisis at 63 per cent. It also estimated that a financial crisis occurs every 20 or 25 years (or 4%–5% of all years) which the report interpreted as an annual loss of output of around 3 per cent of GDP due to bank crisis. The Vickers Commission stated that it is worth paying an annual premium of 3 per cent of GDP in order to prevent 5 per cent chance of a crisis occurring that would impose a loss of output of 60 per cent.

According to T T Ram Mohan, taking into account the expected Rs 70,000 crore planned over the next four years in addition to the amount injected earlier, it would amount to Rs 1,50,000 crore in total for bank recapitalisation, which is less than 0.5 per cent of the average GDP over the period 1994–2015. This makes India's recapitalisation cost amongst the lowest worldwide to help prevent a banking crisis.

In addition, bank recapitalisation cost cannot be considered as a waste as performance of the PSBs has continuously improved until recently since the start of the banking sector reforms in 1993-94 and the value of government holding in PSBs has appreciated significantly since 1990s.2

China had also recapitalised its large state owned banks through 1990s and 2000s. The "big four" state-owned commercial banks of China are considered the largest in the world. The 'Industrial and Commercial Bank of China' (ICBC), 'China Construction Bank', 'Agricultural Bank of China' (ABC) and 'Bank of China' have secured the top 4 spots in the FORBES Global 2000, a comprehensive list of the world's largest, public companies.

According to the paper 'The Chinese Banking System' by Grant Turner, Nicholas Tan and Dena Sadeghian, the NPAs in Chinese banks had increased significantly by late 1990s and the large state-owned banks' aggregate NPAs stood at more than 30 per cent. These banks were also severely undercapitalised. The people Bank of China (1999) said that 20 percent of total loans by state owned commercial Bank are NPA and 6 percent out of these are

[2] 'Unfortunately, we do not have a mechanism whereby the government can actively manage its portfolio of PSBs, selling off small portions of shares when prices are rising and realising gains that can then be ploughed back as capital infusion whenever required.' – T T Ram Mohan in the article 'Three Myths about Recapitalisation of Public Sector Banks' in the Wire on 3rd August 2015.

irrevocable. Similarly Davies (1997), Hanes and Lindorff (1998), Lu (1996) estimated bad loans to be around 25 to 40 percent of Chinese Commercial Banks.

The Chinese Government started an extended process of restructuring the four largest state-owned Chinese banks in 1998, injecting a total of $33 billion of capital into them, financed by the sale of bonds to the same banks (Table 3) to help boost their capital adequacy ratio to 8 percent (in line with the recommendation from the Bank of International Settlements). Four asset management companies (AMCs) established in 1999, one for each bank, were tasked with purchasing, resolving and selling the banks' NPLs. All these four banks underwent further recapitalisation and disposal of NPLs in the 2000s, and were subsequently listed on the Hong Kong and Shanghai stock exchanges. The IPOs of ICBC and ABC were the largest recorded in the world at the time.

Table 5: Capitalisation of state-owned Chinese banks in 1990s and 2000s

	BOC	CCB	ICBC	ABC	Total	*Memo: share of banks' assets*[(a)] Per cent
Initial capital injection in:	1998	1998	1998	1998		
US$ billion	5	6	10	11	33	3½
Initial NPL disposal in:[(b)]	1999–2000	1999–2000	1999–2000	1999–2000		
US$ billion	32	45	49	42	168	15½
Subsequent capital injection in:	2003	2003	2005	2008		
US$ billion	23	23	17	19	81	3½
Subsequent NPL disposal in:[(c)]	2004	2004	2005	2008		
US$ billion	33	15	86	117	252	8
Establish shareholding company in:	2004	2004	2005	2009		
IPO in:	2006	2005	2006	2010		
US$ billion	13	17	22	22	74	2

(a) Simple average of the four banks' shares at their respective times
(b) Value of NPLs removed from banks' balance sheets; purchased at face value
(c) Value of NPLs removed from banks' balance sheets; the purchase price was typically around 50 per cent of this
Sources: Liu (2004); Ma and Fung (2002); banks' annual reports

Indradhanush - Progress So Far

As part of process to reform PSBs, the government announced top level appointments in a number of banks at the same time as the Indradhanush was unveiled. In a significant change of policy, the government announced the appointment of private sector professionals, for the first time, as the heads of two major public sector banks (PSBs) — Bank of Baroda and Canara Bank – to bring more dynamism to PSBs struggling under rising nonperforming loans.[3] Mid-level officers in the PSBs are expected to be appointed from the private sector as 19,000 officers in PSBs would retire this year and another 18,000 next year.

[3] Ravi Venkatesan, an independent director on the board of Infosys and former chairman of Microsoft India, has been appointed non-executive chairman of Bank of Baroda and TN Manoharan, a director at Tech Mahindra and the Public Health Foundation of India, will be non-executive chairman of Canara Bank.

The government also separated the position of MD & CEO and Non-Executive chairman. The MD & CEOs of five banks - Bank of Baroda, Bank of India, Canara Bank, IDBI Bank and Punjab National Bank and Non-executive Chairman of 5 banks were also announced in August.

In the press release, it was stated that Non-Official Directors on the Boards of PSBs and non-executive Chairman in the remaining six PSBs would be completed in the next three months. However, there has not been any such appointment till date. The progress has been slow on proposed appointment of BBB members. The next 'Gyan Sangam', was expected to be held in January 2016.

Conclusion

Indradhanush does not propose any ground-breaking reforms for the PSBs. Re-capitalisation or infusion of capital into these public sector banks is its central theme. This opens up a debate on whether the capital infusion is adequate for all banks.

Both the previous committee reports – Narasimham II and Nayak - proposed lowering of government holding to below 50 per cent to free PSBs from dual regulators (RBI and Finance Ministry) and to ensure a level playing field with its private counterparts. However, given the politically sensitive issue of lowering the stake of government holding in PSBs, Indradhanush remains silent on that issue.

Indradhanush does not propose repelling of 'The Banking Companies Acts of 1970 and 1980', 'The State Bank of India Act, 1955' as legislative actions, under the present circumstances, might be difficult.

Moreover, it is understandable that government will like to have a say in the appointments to PSBs, as it is responsible as a majority stakeholder.

Given these constraints, Indradhanush is definitely the step in the right direction. It does incorporate some of the initiatives mentioned in Nayak Committee report but does not fully embrace the essence of the bold Nayak recommendations. Structural changes are required to improve the profitability of the PSBs.

According to RBI, in addition to the improvement of governance processes through initiatives like 'Indradhanush', the PSBs may need to review their business models, and examine strategic decisions like capital structure and dividend policy in order to overcome the challenges faced by them.

The NDA government's financial inclusion programs like Jan dhan yojna, social lending to priority sector, new bank branches in rural areas, financing start-up ventures that have Adivasi or Dalit youths will have to be properly monitored so that these initiatives do not result in further deterioration of the asset quality of the PSBs.

APPENDIX 1: Narasimham Committee Recommendations (1991 and 1997)

First and Second Generation Reforms in the Banking Sector in India

Indian banking system has undergone widespread structural reforms since 1991. The banks faced a decline in productivity, efficiency and erosion of the profitability by 1990 despite commendable growth. To restore the financial health of commercial banks and to increase their efficiency, the Government of India appointed an expert committee under the chairmanship of Sri M. Narasimham, ex-Governor of RBI, which submitted its report in November 1991. The Committee recommended a series of measures ensuring a degree of operational flexibility, internal autonomy for public sector banks in their decision-making process, and greater degree of professionalism in banking. These recommendations were a landmark in the evolution of banking system from a highly regulated to more market-oriented system. The reforms introduced since 1992-93 breathed a fresh air in the banking sector. It also opened the banking sector to private players as part of the liberalization process. Some of the major recommendations were:

- Reduction of Statutory Liquidity Ratio (SLR) from 38.5 per cent to 25 per cent over a period of five years along with progressive reduction in Cash Reserve Ratio (CRR).
- Stipulation of minimum capital adequacy ratio of 8 per cent to risk weighted assets by March 1996.
- Adoption of uniform accounting practices in regard to income recognition, asset classification and provisioning against bad and doubtful debts.
- Setting up of Asset Reconstruction Funds (ARFs) to take over from banks a portion of their bad and doubtful advances at a discount.
- Liberalizing the policy with regard to allowing foreign banks to open offices in India. Rationalisation of foreign operations of Indian banks.
- Giving freedom to individual banks to recruit officers.
- Ending duality of control over banking system by Banking Division and RBI
- Revised procedure for selection of Chief Executives and Directors of Boards of public sector banks

The Narasimham Committee II was set up in 1997 to review the progress of the implementation of the banking reforms since 1992 with the aim of further strengthening the financial institutions of India. Some of the recommendations were:

- Raise the capital adequacy ratio to 9 per cent by 2000 and 10 per cent by 2002 along with significant reduction in NPA that improved their Risk absorption capacity.
- Greater autonomy to PSB in order for them to function with equivalent professionalism as their international counterparts.
- The Government of India equity in nationalized banks should be reduced to 33 per cent for increased autonomy.
- No further re- capitalisation by government. Transfer of bad loans to Asset Reconstruction Company.
- Recruitment of skilled manpower directly from the market be given urgent consideration

Some recommendations like reduction in Governments equity to 33 per cent, the issue of greater professionalism, ending duality of control of PSBs and independence of the board of directors of PSBs are still awaiting Government follow-through.

APPENDIX 2: Recapitalisation of banks expected in this fiscal

Table: Capitalisation of PSBs in FY 2015-16

Sl No.	Bank	Capital Allocation (Rs Crore)
1	State Bank of India	5,531
2	Bank of India	2,455
3	I.D.B.I.	2,229
4	Bank of Baroda	1,786
5	Punjab National Bank	1,732
6	Canara Bank	947
7	Indian Overseas Bank	2,009
8	Union Bank of India	1,080
9	Corporation Bank	857
10	Andhra Bank	378
11	Bank of Maharashtra	394
12	Allahabad Bank	283
13	Dena Bank	407
	Total	20,088

Source: Government press release, CPR research

About 40 per cent of the 25,000 crores allocated this year would be given to those banks which require support, and another 40 per cent capital will be allocated to the top six big banks viz. SBI, BOB, BOI, PNB, Canara Bank, and IDBI Bank in order to strengthen them. As per the calculations done for Tranche 1 and Tranche 2, the specific capital allocation for each Bank is worked out as seen in the adjacent table.

The remaining portion of 20 per cent or around Rs 5,000 crore will be allocated to the banks based on their performance during the three quarters in the current year. Eight banks which did not get any money in first two tranche will get preference.

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