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Banking Sector Reforms and Emerging Issues

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BANKING SECTOR REFORMS AND EMERGING ISSUES

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Abstract

Narismhan Committee reports of 1991 and 1998 form the foundation of banking reforms in India and are still regarded as the blue print of future banking landscape. Reforms have provided necessary platform to the banking sector to operate on the basis of operational flexibility and functional autonomy, thereby enhancing efficiency, productivity and profitability. Further reforms have brought out structural changes in the banking sector, eased external constraints in the working of the banks, , introduced transparency in reporting procedures, restructuring and recapitalization of banks and have also increased the competitive element in the market. The special features of Indian approach have been gradualism; coordination with other economic policies; pragmatism rather than ideology; relevance to the context; consultative processes; dynamism and good sequencing, so as to be able to meet the emerging domestic and international trends. So far, India's approach to banking-sector reforms has served the country well, in terms of aiding growth, avoiding crises, enhancing efficiency and imparting resilience to the system.

INTRODUCTION

Economist, former finance secretary and governor of RBI, Sri M. Narismhan was the architect of financial sector reforms. His two reports of 1991 and 1998 form the foundation of banking reform in India and are still regarded as the blue print of future banking landscape. These reforms have provided necessary platform to the banking sector to operate on the basis of operational flexibility and functional autonomy, thereby enhancing efficiency, productivity and profitability. Further vulnerability of the banking sector as revealed by the global financial crisis such as inadequate loss-absorbing capital; insufficient liquidity buffers; excessive build-up of leverage; procyclicality of financial markets; focus on firm-specific supervision and neglect of macro-prudential supervision of system-wide risks; moral hazard from too-big-to-fail institutions; weak governance practices; poor understanding of complex products; and shortcomings in risk management etc. have to be addressed through reforms. India has been able to face all these challenges in the reform process through gradualism; coordination with other economic policies; pragmatism rather than ideology; relevance to the context; consultative processes; dynamism and good sequencing, so as to be able to meet the emerging domestic and international trends.

An attempt has been made in this paper to map reforms of the banking sector since adoption of Narismhan Committee recommendations, their implications and also lay down emerging agenda of reforms under consideration of the government

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of India /Reserve bank of India.

REFORMS

- **Enhanced competition and entry of private sector banks** – In tune with the Narsimhan Committee I recommendation, RBI has relaxed norms for issuing license to new banks with objective to induce greater competition, reduce cost, improve quality of service, promote financial inclusion that would ultimately support inclusive growth. Many new private sector banks have been set up out of which YES Bank is the latest offering. As competition mounted, Public Sector Banks, which operated on the comfort of sovereign guarantee, were forced to keep pace with private sector counter parts by upgrading their work process through technology and also becoming customer focused. Banks are replicating the story clearly seen in telecom and aviation sectors. While presenting Budget of 2010-11, finance minister announced that more banking licenses will be issued to private sector players and non banking finance companies to enhance competition and help financial inclusion. As per draft paper released by RBI (BL 12.08.10), prospective promoters of new banks in private sector could be industrial and business houses and non-banking finance companies and they could be allowed higher shareholding of 20% for a long period say ten years. RBI also proposes to put stringent conditions to raise capital between Rs. 500 crores to Rs. 1000 crores and cap foreign investment through FDI, NRI, FII etc. to below 50%.

- **Branch licensing**- RBI has permitted opening of branches in tier 3 to tier 6 cities (population up to 50000 as per 2001 census) without prior authorization under general permission. However banks will have to obtain prior authorization for opening branches in tier 1 and tier 2 centers. Banks will have to plan their branch expansion in tier 3 to tier 6 cities in such a manner that at least 1/3rd of newly opened branches are opened in under banked districts of under banked states as notified by the RBI.

- **Road map for entry of foreign banks**- RBI has notified 'roadmap for presence of foreign banks in India and guidelines on ownership and governance in private banks.' As per the roadmap, foreign banks wishing to establish a presence in India for the first time could either choose to operate through branch presence, or set up 100% wholly owned subsidiary (WOS) following the 'one mode presence criterion'. In phase-I, foreign banks already operating in India will be allowed to convert their existing branches to WOS. In phase-II, WOS of foreign banks will be accorded full national treatment, including opting for going public, subject to 26% of the capital being held by resident Indians at all times. RBI has also allowed some flexibility in individual stake and subject to RBI approval this stake can exceed 10%. However, if foreign banks' assets in India (both on and off balance sheets items) exceed 15% of the system, RBI may deny licenses to new foreign banks. RBI vide Monetary Policy April 2009 decided to keep on hold branch licensing of foreign banks in view of current global financial market turmoil and uncertainties surrounding the financial strength of banks around the world. It was indicated in the

Monetary Policy Statement of April 2010 that drawing lessons from the crisis, a discussion paper on the mode of presence of foreign banks through branch or wholly owned subsidiary (WOS) would be prepared by September 2010. RBI floated the discussion paper on presence of foreign banks in India in January 2011 soliciting views/comments from all stakeholders, including banks, non-banking financial institutions. RBI has stated in Monetary Policy statement May 2011 that the comprehensive guidelines on the mode of presence of foreign banks in India are being formulated, keeping in view the suggestions/comments on the discussion paper, received from all concerned.

- **Capital and functional autonomy-** Percy Mistry committee report recommended that government give up its ownership by 2014 and Raghuram Rajan Committee recommended that government to give up its ownership at least in few banks. The Standing Committee on finance has cleared the proposal to bring down the government stake in PSBs from 51% to 33% but GOI has decided to keep the government equity to 51% minimum. The recommendation of Dr. C. Rangrajan that holding of public sector undertaking like LIC, ONGC etc. be included in 51% government ownership has also not found favour from the government. In final stimulus package of 2008-09 and also in 2009-10 , GOI has approved capital infusion by way of preferential capital in ten public sector banks -mostly mid sized banks so as to help them in improving CRAR as most of these banks have hit the threshold limit of 51% and more dilution would mean going below the thresh hold level. RBI has also permitted banks to raise long term funds through bond for infrastructure finance to overcome problem of assets liability mismatch. Further GOI has introduced a bill for amendment in Banking Regulation Act 1949 so that bank can access the capital market through preference share, bonus share and private placement of shares. Further a proposal for comprehensive amendment of the Banking Regulation Act, 1949 and the Banking Companies (Acquisition & Transfer of Undertakings) Act, 1970 & 1980 was introduced in the Parliament in March 2011. The important amendments relating to the Banking Regulation Act include insertion of a new section to override the provisions of the Competition Act, 2002 and to exempt the applicability of such provisions to amalgamations/reconstitutions/mergers/acquisitions, etc. of different categories of banks; removal of the restrictions on voting rights; enabling banking companies to issue preference shares subject to regulatory guidelines by the Reserve Bank; formation of a depositor education and awareness fund; facilitating consolidated supervision; and a provision for supersession of boards of directors by the Reserve Bank; and increase in the quantum of penalties. The proposals relating to the amendment of the Banking Companies (Acquisition & Transfer of Undertakings) Act, 1970 & 1980 include raising the authorised capital of nationalized banks; enabling them to raise capital through "rights issue" or by issue of bonus shares; and raising the restrictions on voting rights.
- **Issue of preference shares/ other hybrid instruments-** RBI has permitted banks to raise capital through preference share route so that government holding in banks

is not diluted below 51%. Present legislation also caps the maximum tenure for which preference shares can be issued. RBI has recently allowed banks to issue hybrid instruments like perpetual bonds, as it will not require any legislative change. RBI has also permitted banks to issue these bonds with "call" and "step-up" option. Perpetual bonds are those in which investor does not have the right to ask for the money back but the issuer has the right to pay back investor. Typically insurance companies and pension funds subscribe to these bonds. Banks are now scouting with the finance ministry for tax benefits on these bonds, as these are long-term instruments.

- **Deregulation of lending interest rates**- All lending rates (except for export credit, loan to staff members and lending under interest subvention of Government of India) have been de-regulated. Banks have introduced floating and fixed interest rate products and are more aggressive in their offering.
- **Deregulation of deposit interest rate**- Interest rates on deposits are largely deregulated except for (a) savings deposit accounts and (b) non-resident Indian deposits and banks enjoy complete interest rate freedom. Banks are also free to offer differential interest rate on high-ticket deposit of Rs.15 lakh and above.
- **Base Rate**- Under RBI directive, Base rate system was introduced w.e.f. 1st July, 2010. Banks have been advised to declare their base rate each quarter and they can not lend below base rate. Further base rate will be applicable across the board and bank will not be in a position to discriminate between old and new borrowers. RBI has also made lending rate disclosure mandatory for banks to bring greater transparency and has also advised banks to announce Base Rate after taking into consideration (a) the cost of deposit , (b) adjustment for negative carry of cash reserve ratio and statutory reserve ratio, (c) unallocatable overhead cost for banks and (d) average return on net worth.
- **Phasing out of statutory preemption**- The SLR requirement has been brought down from 38.5% in 1991-92 to 24% in 2011 and CRR has been brought down from 15% in 1991-92 to 6 % 2011. After passing of Reserve Bank (amendment) bill 2006 legislative cap of 3% CRR and 25% SLR has been removed. However RBI has decided that no interest will be paid to banks on minimum CRR limit of 3%.
- **Capital Adequacy**- CRAR of 9 % prescribed with effect from end March 2000 against 8% laid down in Basel II. .
- **Credit Delivery**- Credit authorization scheme (CAS) has been withdrawn. Selective Credit Control (SCC) has been relaxed excepting sugar. Norms for assessment of Maximum Permissible Bank Finance (MPBF) as per 2nd method of lending has been relaxed. Mandatory formation of consortium has been dispensed with. Banks have been given freedom to decide norms of assessment of MPBF and they enjoy complete freedom to decide their credit policy as per approval of their board.
- **Exposure norms**- RBI has advised banks to fix exposure norms for individual as

well as group so as to keep the exposure within prudential limits. It has also advised the banks to fix exposure for industry specific risk for prudential credit risk management as per international best practices.

- **Income Recognition and Prudential Norms-** With a view to adopting the international best practices in regard to Income recognition, asset classification and provisioning, number of policy changes have been made viz. prescription of provisioning requirement of 0.25% to 1% in respect of standard (or performing) assets, reduction of the time period for classification of doubtful assets from 18 months to 12 months from March 31, 2005, introduction of 90 days norms for classification of non performing assets w.e.f. March 31, 2004, stipulating 70% minimum provision coverage ratio by 30th September 2010. The provisioning norms are more prudent, objective, transparent, uniform and standardized as per global norms to avoid subjectivity.
- **Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act-** Securitisation and Reconstruction of Financial Assets and enforcement of Security Interest Act 2002 allows setting up of Asset Reconstruction Companies (ARC) by banks with unprecedented powers to take over the management of a defaulting company or take over and sale distressed loans. The Act provides for 60 days notice to borrower to discharge the liability in full failing which a bank can take possession of mortgaged/hypothecated assets and sale them for liquidation of dues.
- **Assets Reconstruction Companies-** ARCs set up under Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act have been empowered to take over NPA from banks, engage in innovative corporate finance such as merger, sale of brands or plants, inject new capital, convert distressed companies into new companies and even take out an IPO. ARC will have to work within RBI guidelines and subject to registration/license from RBI. ARCs should have minimum owned funds of Rs. 100 crores and maintain minimum capital adequacy of 15% at all times. ARCs are hardly a successes story since they have been able to buy only a fraction of NPAs and banks are complaining that they are not offering right price to them. This problem is expected to be solved with setting up of few more ARCs because it will increase competition.
- **Central Registry of Securitization Asset Reconstruction and Security Interest of India-** A Central Electronic Registry, incorporated under section 25 of the Companies Act, 1956, as the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) to give effect to the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 has been set up. The objective of the central registry is to prevent frauds in loan cases involving multiple lending from different banks on the same immovable property. The registry became operational from March 2011 and its jurisdiction covers the whole of India.
- **Transparency in financial statements-** RBI has advised banks to disclose certain

key parameters such as Capital to Risk Assets Ratio, percentage of NPAs, movements of NPAs, movements of provisions towards NPAs, movement of provisions held towards depreciation of investments, the total amount of standard/sub-standard assets subjected to Corporate Debt Restructuring , maturity pattern of deposits, borrowings, investments and advances, foreign currency assets and liabilities, lending to sensitive sectors, Net value of investment, Return on Assets, Profit per employee and interest income as percentage to working funds etc. Further the Joint Parliamentary Committee 2001 wanted the annual reports of banks to carry the RBI's comments arising from its inspection reports to ensure greater transparency and to make sure that the shareholders get a fair idea of the operations of a bank. After failure of Global Trust Bank, the demand has been made again which if placed up front might help the ordinary depositor and shareholder of the danger ahead.

- **Accounting Standards-** RBI has unveiled new accounting norms for banks, which seek to move towards full compliance by banks with the accounting standards issued by Institute of Chartered Accountants. The new norms seek to bring intangible assets within the purview of the Banking Regulation Act. The accounting standard 24 and 28 has been made effective from 1st April 2004.
- **Penal Action-** The RBI has decided to publish penal actions against the bank. The banks will have to publish such penalties in the note on account of their balance sheets with effect from 1st November 2004.
- **Scheme of Banking Ombudsman-** Banking Ombudsman has been introduced since 1985 to look into and resolve customer grievances. RBI has further widened the scope of the banking ombudsman scheme to cover all individual cases/grievances relating to non-adherence to the fair practices code evolved by IBA and adopted by individual banks and also the credit cards/ATM cards. Complainants have been permitted to file eComplaint after down loading the complaint form from RBI site.
- **Hiving off of regulatory and supervisory control-** Board for Financial Supervision (BFS) was set up under the RBI in 1994 after bifurcation of regulatory and supervisory functions. An independent Department of Banking Supervision (DBS) has been set up in RBI to assist the board.
- **Risk Management Systems-** In view of the diverse financial and non-financial risks confronted by banks in the wake of the financial sector deregulation, RBI has put the risk management system in place. Banks have been asked to adopt sophisticated techniques like VaR, Duration and Simulation model-based approaches as also credit risk modeling techniques as part of risk management measures.
- **Risk Based Supervision (RBS)-** RBI has issued detailed guidelines for RBS and have advised banks to develop risk assessment processes in accordance with their risk profile and control environment which will subjected to review and

supervisory intervention by RBI as necessary. The emphasis will be on evaluating the quality of risk management and the adequacy of risk containment. The transaction based internal/external audit would be replaced by Risk Based Internal Audit (RBIA) system.

- **Prompt Corrective Action-** RBI has evolved a framework of Prompt Corrective Action (PCA) with various trigger points. The framework is based on three parameters viz. capital adequacy, asset quality and profitability. The framework contemplates a set of mandatory and discretionary actions by regulator (RBI) for dealing with banks that cross the trigger points.

- **Regulation Review Authority-** The purpose of this Authority is to provide an opportunity to the public at large to seek justification for and suggest deletion or modification of any regulation, circular or return issued, or required by the Reserve Bank. Anyone can apply to the Regulations Review Authority – a citizen, a non-resident Indian, an institution (including banks), an association, an academic or even an RBI employee. It is not necessary for the applicant to be an affected party. The applicant may simply put down the details on a plain white paper and give his suggestions stating justification, in as much detail as possible, with an illustration to enable the Authority to take an expeditious view on the application.

- **Appointments of business correspondents-** Banks are now allowed to outsource lending and deposit taking activities NGOs, micro-finance agencies, post offices, NBFCs, Agents of small savings schemes/insurance companies, individuals who owns petrol pumps, individual public call office (PCO) operators, individual kirana/medical/fair price shops, cooperative societies, retired bank employees, ex-servicemen and retired government employees, so as to reach rural and remote areas. RBI has clarified that institutions for profit can also be appointed business correspondents as earlier notion was that banks will appoint only non-profit organizations. Under the scheme banks will have to prescribe suitable limits for receipt and payment by business correspondent and transaction done through agent will have to account for either on the same day or next working day. Banks will be responsible to customer for any act of omission or commission for their agent. BC model is considered as extremely vital for achieving the goals of financial inclusion.

- **Inclusive growth drive-** GOI and Reserve Bank are working in tandem to push the agenda of inclusive growth and to bring villages of population of 2000 and above within banking fold. GOI has announced setting up a fund of Rs. 800 crores to compensate banks for cost incurred in reaching credit to unbanked areas. This will be in addition to existing Rs. 1000 crores financial inclusion fund and financial inclusion technology funds set up with NABARD. RBI and GOI has identified 72395 villages that will be covered in another two years. Public sector banks have been asked to prepare the financial inclusion plan to tap the fortune of 'bottom of pyramid'.

- **Bancassurance-** Insurance business by Indian banks- GOI issued notification that insurance is permissible business under Banking Regulation Act section 6 (1) (o) followed by RBI guidelines dated 8th August 2000 for entry into insurance business with risk sharing model and with fee based business. While few banks have started insurance business through subsidiary route, other banks have entered in the business through agency route or under referral model.

- **Money Laundering and Financing of terrorism-** India has been sharing the increasing international concern on the use of the financial system for money laundering and financing of terrorism. RBI has set out the policy, procedures and controls to be introduced by banks. These include strict adherence to "Know Your Customer" (KYC) procedures for prevention of misuse of banking system for money laundering and financing of terrorist activity, reporting of suspicious transaction and developing in built system in the banks to monitor cash transaction above thresh hold limit.

- **Guidelines on securitization of standard assets-** RBI has issued guidelines for securitization of standard assets with a view to have 'fit and proper criteria' on continuous basis. RBI has also decided to prescribe a minimum lock in period and minimum retention criteria for securitizing the loans originated and purchased by banks so as to avoid sub prime like situation in India.

- **Code of conduct for credit cards-** In view of growing complaints against various malpractices for issuing of credit cards, RBI has decided that code of conduct for issue and transparency in service charges evolved by IBA in consultation with leading banks will be adopted by all credit card issuers. There is also debate of introducing anti-tying regulations, which will prohibit banks to force customers from buying unwanted products/services.

- **Setting up of Banking Codes and Standards Board of India-** In annual policy of April, 2005, RBI has proposed to set up a Banking Codes and Standards Board of India on model of the mechanism in the UK in order to ensure that comprehensive code of conduct for fair treatment of customers are evolved and adhered to. The said board has been established in February 2006 under the chairmanship of former RBI deputy governor Mrs. K J Udeshi. It is now mandatory for every bank to adopt a compensation policy to make up for losses incurred by customers due to mistakes committed by bank employees once it signs the charter of the Banking Codes and Services Board (BCSB). The gamut of retail banking services, including savings accounts, term and demand deposits, credit cards, debit cards, foreign exchange remittances, and loan accounts will have to be covered by the compensation policy.

- **Tax Sops for Fixed deposits-** Union Budget 2006 has permitted fixed deposit of five years above as eligible investment for tax exemption under 80 C (prescribed ceiling is Rs. 100,000) bringing it at part with NSC/PPF etc. Government has further relaxed the rules and allowed payment of money to second joint depositor in event of death of first depositor before lock in period of five years. It is expected tax sops on deposits will help the banks to garner larger share of savings from households.

- **Core investment companies to register with RBI-** Investment companies with assets size of Rs. 100 crores are considered systemically important and have been asked to get them registered with RBI. As per notification such companies will have to obtain RBI registration within six months. It is stipulated that leverage ratio (ratio of outside liability to tangible net worth) should not exceed 2.5 and these companies must maintain minimum capital ratio where by the adjusted net worth shall not be less than 30% of risk weighted assets.

- **Corporate Governance-** An adequate institutional and legal framework is in place in India for effectively implementing a code of sound corporate governance in banks. The statutes have built in legal provisions that prohibit or strongly limit activities and relationships that diminish the quality of corporate governance in banks. As a major step towards strengthening corporate governance in banks, banks have been asked by RBI to place before their Board of Directors the Report of the Consultative Group of Directors of banks and FIs (Dr. Ganguly Group) set up to review the supervisory role of Boards of banks. The recommendations include the responsibility of the Board of Directors, role and responsibility of independent and non-executive directors, etc. With number of banks now listed on stock exchange and accountable to shareholders, it is necessary to focus on corporate governance in letter and spirit as quality of decision making will be crucial in enhancing share-holders' value.

- **Financial stability and development council-** As a follow up of budget proposal of 2010-11 to set up Financial Stability and Development Council (FSDC), GOI through Securities and Insurance Law amendment ordinance (2010) has set up a monitor macro prudential supervision authority including supervision of large financial conglomerates and to deal with inter regulatory coordination. Finance Minister has clarified that government will maintain autonomy of all regulators and ordinance will play its role only when there is conflict of interest among two regulators on hybrid products. FSDC has been made functional to deal with financial stability, financial sector development, inter-regulatory coordination, financial literacy, financial inclusion, macro prudential supervision including functioning of large financial conglomerates.

- **Banking out of purview of Competition Commission of India-** The GOI has finally decided that banking sector including the mergers and acquisitions of banks will be out of purview of the Competition Act 2002.

- **Prepayment penalty in home and other loans-** The practice of banks imposing pre payment charges in home, auto and other loans was under scrutiny by competition commission of India as it is alleged that it restricts the choice of borrowers to move to other bank and is against competitive opportunity for borrowers. Although CCI has ruled in favour of banks but still RBI has taken an adverse view to anti customer measures and have advised banks to be transparent and fair with the customers and explicitly explain such policies to borrowers while granting loans.

EMERGING ISSUES

- **Deregulation of savings deposit rate:** RBI is set to deregulate saving deposit rate of interest and has put discussion paper on public domain for the purpose. It is argued that deregulated rates improve the efficacy of monetary policy by improving the correlation between retail bank deposit rates and market interest rates.

- **Financial sector legislative reforms commission (FSLRC)-** Finance Minister in budget speech February 2010 has announced that government will rewrite financial sector laws through FSLRC. The aim is to simplify and streamline the legal framework to possibly suggest a completely new regulatory structure. GOI has now floated a consultation paper citing response from various regulators. The commission mandate will be to examine the kind of inconsistencies and overlap in financial sector laws and workout standard principle based financial regulation.

- **Financial Sector Assessment Program (FSAP) -** A comprehensive self assessment of the financial sector in 2009 under a committee on Financial Sector Assessment Chairman Dr Rakesh Mohan and Co-chairman Shri Ashok Chawla was done based on the IMF-WB methodology. RBI has now decided to set up a task force to take steps for implementation of the recommendation of G 20 working groups viz. Enhancing Sound Regulations and Strengthening Transparency and Reinforcing International Cooperation and Promoting Integrity in Financial Markets and will also suggest an implementation schedule.

- **Basel III- Banks will have to adhere to internationally agreed phase-** in period (beginning January 1, 2013) for implementation of the Basel III framework. The Reserve Bank is studying the Basel III reform measures for preparing appropriate guidelines for implementation. It is taking steps to disseminate information on Basel III and help banks prepare for smooth implementation of the framework.

- **FII cap in PSU banks-** Presently a cap of 20% exists for subscription in banks equity for foreign institutional investors. GOI is considering to raise this cap up to 24% as in most of the banks FII cap has hit the upper ceiling. As per legal provision, FII cap below 26% will be non-controversial as neither the FII will get a birth in board nor does it have authority to block any move by calling extra-ordinary general meeting. It may be recalled that Indian Bank Association has recommended to government to hike the FII cap and also to keep ADR/GDR out of purview of FII cap.

- **Regulatory oversight over credit rating agencies-** It is argued that all credit rating agencies whose ratings are used for regulatory purposes should be subject to a regulatory oversight regime that includes registration and that requires compliance with substance of the IOSCO code of conduct Fundamentals. It is argued further that RBI should look into cumulative default rate and transition matrix of the rating agencies to continue accreditation.

- **Regulation over Micro finance institutions-** Commercials banks who have lent more than Rs. 18000 crores to MFIs are facing great stress due to regulatory restrictions put forth by AP Act on interest rate restrictions, periodicity of repayment not earlier than month and restructuring obligations. Central government is contemplating legislation to ensure regulatory frame work and to overcome threat of NPA which is already high in agriculture sector.

- **Size Matters-** Urge to Merge - After merger of Global Trust bank with Oriental Bank of Commerce and IDBI Bank with parent IDBI, the experts opine that more mergers and amalgamations will take place in the next 4-5 years to create Mega-banks. The banking sector is now moving from a regime of "large number of small banks" to "small number of larger banks." Hardening yields and consequent fall in value of securities and lesser treasury income coupled with higher requirement of capital due to Basel III are the main triggers of merger and consolidation. Otherwise also there are sufficient reasons for consolidation in the banking sector like increased efficiency resulting from economies of scale, reduced intermediation cost, greater capacity to access the capital market and greater capacity to meet competition with international players. It may be recalled that Narsimhan Committee - I recommended mergers and acquisitions of banks so as to make 4-5 world-class banks that would compete in global market. Indian Banks Association report on M & A in banking has suggested corporatization that would make all bank coming under Companies Act 1956 and therefore under common legal framework. It has also recommend amendment of section 72A of Income Tax Act to extend the benefit of set off of accumulated losses and un-absorbed depreciation.

- **Depositors' protection fund-** This fund is to be set up by crediting deposits remaining unclaimed for more than ten years and fund to be used for promotion and protection of depositors' interest. The unclaimed deposit kitty of banking sector was Rs 913.40 crores as on December 2003.

- **Transforming Deposit Insurance system-** RBI is examining the transforming the Deposit Insurance and Credit guarantee Corporation (DICGC) from a 'pay box' system to a one attending to all aspects of the bank failure resolution process. Non-involvement of DICGC in the failure resolution process is considered a major area of concern. 'Pay box' system in banking parlance means that deposit insurer serves only as an agency to reimburse depositors. Central government budget proposal 2002-03 proposed to covert DICGC into BDIC (Bank deposit Insurance Corporation).

- **Separate Common Insolvency Code for banks-** Committee on financial sector assessment has suggested that a separate common and comprehensive insolvency code for banks. Separate code is considered vital in view of financial global uncertainty and legal complexities. So for PSBs are concerned there are no solvency issues as sovereign is more than 50% shareholder but for private sector banks this kind of legislation is considered necessary.

- **Bank's entry into Merchant trading** -The RBI has proposed an amendment in the Banking Regulation Act, 49 to allow banks to become members of stock exchanges and undertake merchant trading- to do trading on behalf of others. This will be followed by an amendment in Securities Contract Regulation Act that will permit banks to conduct this business. As per present rules, bank's can take exposure up to 5% in equity market. It may be recalled that RBI recently announced to consider relaxation in 5% norms on case-to-case basis.
- **Removal of cap on 10 year fixed deposit-** Banks are requesting RBI to remove cap on more than 10-year deposits so that they have no asset-liability management problem to finance long term loans like housing and infrastructure. Present guidelines permits to accept deposits more than 10 years only from minors and that too under certain conditions.
- **Changes in financial system-** High level panel on financial sector reforms chaired by Professor Raghuram G Rajan has recommended (ET 7.4.2008) that the government should liberalize the interest rate regime of priority sector lending, sell loss making small state run banks, encourage takeover of banks and reduce the oversight that the government maintains on state banks in addition to the controlling their boards. The committee has also made a strong case of removing the restrictions on opening of bank branches and ATMs and for rewriting financial sector regulations. It has also recommended that government should legislate to remove the oversight of bodies such as CVC over public sector banks for better and speedy decision making.
- **Exemption from Company Bill provisions-** The Reserve Bank of India has sought exemption from the provisions of the new company bill 2008 following the strong conflict with the Banking Regulation Act 1947. For example new Company Bill has not made any specific provisions for banks as was the case in erstwhile Companies Act 1956. Among major items which will get affected without a suitable amendment to the Companies Bill is the preparation of bank balance sheet. While public deposit by companies as treated as borrowing for banks they are only deposits. Similar problem is in case of off balance sheet items /contingent liabilities. While it is normal for companies to have preference share, banks usually maintain preference shares at exceptional cases and that too with RBI approval. Derivative items which are hedging products are some time shown off balance sheet or on balance sheet if they are marked to market for losses. Corporate debt restructuring which is unique to banks and not to companies is other stumbling block. Another problem is exclusion of government nominee director in company bill from the category of independent director.
- **International financial reporting system (IFRS):-** RBI has recently constituted a task force to address implementation issues of IFRS convergence with banking system by April, 1, 2013. It may be mentioned that banks will also have to adhere to various risk reporting dead lines including transition to internal-rating based (IRB) based approach for credit risk by March 31, 2014. Leading multinational bank

outside India are implementing Basel II initiatives that are IFRS compliant for loan loss provisioning.

SUMMING UP

Financial sector reform is a continuous process that needs to be in tune with the emerging macroeconomic realities and the state of maturity of institutions and markets. So far, *India's approach to financial-sector reforms has served the country well, in terms of aiding growth, avoiding crises, enhancing efficiency and imparting resilience to the system.* It is expected that ongoing reform process will help us to build globally competitive banking sector in India.

REFERENCES AND ACKNOWLEDGEMENTS

RBI monetary policy announcements
RBI notifications/ guidelines/discussion papers/master circulars
Reports of working group/committee set up by RBI/GOI
GOI notifications/ press reports
News/ press reports In Economics times, Business Lines, Business standards etc.