AIBOC's response to RBI's Discussion Paper on "Structure of Banking in India – The Way Forward"

BACKGROUND:

The monetary policy statement announced by Reserve Bank of India Governor on 3rd May 2013 in Mumbai stated that the guidelines on licensing of new banks in the Private Sector issued in February 2013 indicated that the Reserve Bank would prepare a policy discussion paper on the banking structure in India within two months keeping in view the recommendations of Committee on Banking Sector Reforms 1998 (Chairman: Shri M Narasimham), the Committee on Financial Sector Reforms 2008 (Chairman: Shri Raghauram Rajan) and other view points. The discussion paper was expected to cover issues such as consolidation of large-sized banks with a view to having a few global banks, desirability and practicability of having small, localized banks as preferred vehicles of Financial Inclusion, the need for having investment banks with differentiated licensing regime for domestic and foreign banks instead of granting of universal banking license, policy regarding presence of foreign banks in India, conversion of Urban Cooperative Banks into Commercial Banks and periodicity of licensing new banks whether on block or on tap.

Reserve Bank of India released the much awaited discussion paper on banking structure in India on 27th August 2013. The discussion paper identified certain building blocks for the reorientation of the banking structure with a view to addressing various issues such as enhancing competition, financing higher growth, providing specialized services and furthering Financial Inclusion. The paper also emphasized the need to address the concerns arising out of such changes with a view to managing the trade off for ensuring financial stability. The envisaged policy will be required to be in the back drop of strong regulatory and supervisory regime with increased intensity for supervision for the systemically important banks. The overall thrust for reorientation is aimed at imparting dynamism and flexibility to the evolving banking structure while ensuring that the structure remains resilient and promotes financial stability. So far so good; we wish that the ultimate objective was as noble as it is made out to appear!

Before dwelling on the issues covered in the discussion paper, it is important to have cursory look at the efficacy of regulatory & monetary tools of the Central Bank to check the inflation and exchange rates in last few months. The untamed inflationary pressures have not only played havoc on the economy of the country but have also robbed the poor and not so rich of their purchasing power. The people living on fixed income are finding it difficult to arrange two square meals a day. The consequences of weakening rupee largely caused by the flight of foreign capital from the country on the rumors of tapering of stimulus package by the Federal Reserve/American government have been enormous. The outflow of foreign capital from India had double-edged effect on the country. It had created volatility in the currency market by surging demand for dollar and weakening local currency on one hand and widening the current account deficit on the other. It is the responsibility of the regulator and the government to ensure stability, growth & flexibility. We need to create a resilient and robust regulatory framework to ensure that the economy is protected against the intermittent shocks of globalization.

In the above background, it is recollected that our financial sector was able to withstand the shocks of US Financial Crisis 2008, Public Debt Crisis of UAE, Eurozone Crisis of 2011-12 for the simple reason that the Trade Unions in the banking sector have resisted the unbridled changes on the part of government to hugely integrate various sectors of our economy with the global market, more particularly full Capital Account Convertibility. This positive role of Trade Unions was acknowledged by none other than the governor of RBI in 2008-09. There is need to strengthen the existing banking system and enhance its efficiency of operations rather than attempting large scale structural changes on experimental basis. Any failed experiment in banking sector will be disastrous as India does not have the financial power of America which could afford to provide capital support and other stimulus packages to the failing banks and other financial institutions in the aftermath of sub-prime mortgage financial crisis. The managers of Indian economy need to focus more on upliftment of poor sections of society through effective Financial Inclusion not by merely opening ‘No Frills Accounts’ and using such accounts for Direct Benefit Transfers but by building capabilities amongst the people in socially and economically neglected sectors to help them earn their livelihood to sustain their families. The country offers huge potential for development of infrastructure, reduction in corruption not only in government but also in its entities and private enterprises, providing health care & sanitation, efficient water management – both for drinking purposes and prevention of floods/draughts etc. The banking institutions in the present form can play significant role in pursuing such agenda of the government and hence must be so utilized keeping in view the objectives of nationalization of banks by earlier Congress governments.

Any significant tinkering of the existing banking structure by way of experiments either through mergers by reducing the number of competitors in the banking space which runs a counter to the current moves of RBI and government to increase the number of competitors by considering the applications for issuance of new banking licenses and also permitting liberal entry of foreign banks either through the branch licenses or through the subsidiary routes, is a completely unwise, untimely and premature.

The Discussion Paper on **"Banking Structure in India – The Way Forward"** released by RBI on 27th August 2013 covers the following issues:

1) Small Banks Vs Large Banks
2) Universal Banking
3) Continuous Authorization
4) Conversion of UCBs into Commercial Banks
5) Consolidation
6) Presence of Foreign Banks in India
7) Indian Banks' presence overseas
8) Government ownership
9) Deposit Insurance and Resolution
10) Indicative reorientation of the banking structure

To have a better understanding of these issues and before examining and evaluating them critically, it is considered appropriate to examine the recommendations of the Narasimham Committee, Raghuram Rajan Committee and other viewpoints which incidentally also formed the basis of the RBI's Discussion Paper mentioned above.

The small banks Vs large banks theory recommended by Narasimham Committee more than two decades ago had not found favour with successive governments at Centre and the Central banking authority. The experiment with universal banking has resulted in Asset-Liability mismatches and increased NPAs of the commercial banks. Continuous authorization is as undesirable as the current attempts to increase the number of players in given banking space and thus reverting back to the banking era of pre-nationalization days. The move to convert Urban Cooperative Banks to Commercial Banks can be more purposeful if such banks are allowed to be taken over by the Public Sector Banks. The consolidation theory for Public Sector Banks is self deceptive since mere consolidation does not enhance the financial strength in true sense because the corresponding exposure also increases. The banking institutions in

Public Sector have the potential to perform better if their Boards are strengthened and allowed independence & freedom to manage the banks in professional manner completely devoid of bureaucratic and political interference in the matters relating to Human Resources and lending operations. This experiment will prove to be safe and sound unlike the move to consolidate through mergers of Public Sector Banks. The government ownership of the banks has been serving its avowed objectives and there is still a large unfinished agenda. The government should focus on converting the Indian economy to a developed economy which calls for the active financial and policy role to be played by the government. Any weakening of either financial or policy role on the part of government will result into further procrastination of the fulfillment of the dream of alleviation of poverty from the country. The government must therefore continue to stay invested in the banking institutions of the country and there is a strong case to expand the size of Public Sector banking which is the lifeline of Indian economy.

Narasimham Committee recommendations heralded the financial sector reforms since the beginning of globalisation of our economy. Many of its recommendations were implemented and many were not as there was lack of acceptability of those by the government and the Regulator coupled with a strong opposition by the Trade Unions in the banking sector. But we must realize that the capitalist model of business world-over has been so powerful that it has almost uprooted the socialist model of business from the world. The determination on the part of the champions of capitalism has been so strong that it has been continuously finding more and more friends. The multinational agencies like International Monetary Fund, World Bank, GATT, UN & its Subsidiaries etc., have been acting as a breeding ground for the new generations of the promoters of capitalism. The domination of capitalist powers in such multinational bodies has been so strong that it has created many takers of their capitalist philosophy in Indian Establishments too, to say the least. Hence the so called new generation reforms are strongly recommended and pursued by such new generation champions of privatization and capitalist model of economic development. If one has to discern the recommendations of Raghuram Rajan Committee on financial sector reforms, he would not discover anything different from what is aimed at by Narasimham Committee recommendations. The only difference between the recommendations of the two Committees being the road map to reach the destination as Narasimham Committee suggested the reforms in a crude manner and Raghuram Rajan Committee has suggested the sweet pills of milder potency with a longer period of experimentation. In his report – "A Hundred Small Steps" – Raghuram Rajan has made vide range of proposals with a suggested sequence to achieve the agenda of same reforms which were projected by Narasimham.

It would be interesting to learn that the Raghuram Rajan Committee on financial sector reforms was constituted by the Deputy Chairman of Planning Commission and not by the RBI or the government of India which exercise dual control over the banking sector and are accountable for its growth & development. The suggestion by the Raghuram Rajan Committee to privatize the Public Sector Banks or bring down the government equity below 50 per cent (33% to be précised) with still having control on shares and sell some of the smaller under-performing Public Sector Banks to Private or Foreign banks on an 'experimental basis' with the observation – '**if it succeeds it can be replicated and if it fails, sky is not going to fall'** is highly irresponsible as it undermines the seriousness of the issue that the hard earned savings of the people of the country are at stake. Raghuram Rajan cannot make light of such a serious issue as it is the faith of the people in Public Sector Banks that they have invested their money in and any irresponsible experiment of the suggested nature will result in avoidable & unwarranted financial disaster which will put a sudden extra burden on Deposit Insurance Corporation while increasing the accountability of RBI and the government in such an eventuality.

The very constitution of the Raghuram Rajan Committee on Financial Sector Reforms speaks volumes. A reading of the recommendations would reveal that they largely revolve around destroying the Public Sector character of our banking institutions. The committee of 12 members included K V Kamath from ICICI Bank and Uday Kotak of Kotak Mahindra Bank to represent the Private Sector Banks with about 22 per cent of business/market share whereas the Public Sector Banks having 70 per cent market shares were represented only by one representative viz., O P Bhatt of State Bank of India. At certain places it is stated in the report that there was no consensus in the committee but still it is desirable to carry out the proposals. The report is devoid of any disclosure about the weightage assigned to O P Bhatt who represented Public Sector Banks which were largely the targets for financial sector reforms. Another interesting aspect of the constitution of the committee is the non-inclusion of any representative from RBI, the Regulator. The seriousness of such omission gets further compounded by the fact that one of the terms of reference was "to identify changes in regulatory & supervisory infrastructure that can better allow the financial sector to play its role while ensuring that risks are contained". It is beyond comprehension that the Chairman of the committee who has been groomed in atmosphere of American economy was considered competent to suggest changes in the regulatory & supervisory infrastructure in Indian context without even being assisted by any representative from such Regulator.

Raghuram Rajan who was credited with forecasting the US Financial Crisis much before it erupted is also conscious of the fact that Sub-prime Crisis in America and high competitive price at home has deepened many people's suspicion that financial markets are merely glorified casinos manipulated by the speculators. Despite this, he courageously suggests serious business like finance against warehouse receipts to help banks achieve their targets for agricultural lending. It surprises us that instead of helping the poor farmers by ensuring provision of timely and cheaper credit, the prescription to finance against warehouse receipts is aimed at helping the rich traders indulge in hoarding of Agri-produce and build their capabilities to create artificial shortage of food grains in the country where the distribution chain suffers serious deficiencies. It would be interesting to see whether Raghuram Rajan now charged with the responsibility of containing the price rise and checking inflation will still promote such financing instruments which are detrimental to the core function of RBI, ie., to keep the inflation within manageable range. It would have served the interests of the country better if the committee has taken cognizance of rising incidents of frauds by the traders and business enterprises while borrowing from the banks. The complicity of warehouse keepers including those owned by the government in perpetrating frauds on banks in financing against warehouse receipts has been responsible for banks losing public money and being driven to avoidable litigations. The agencies suggested for certification of warehouse receipts cannot be taken on face value in view of the past experience of the banks not only in this area but also in the area of approved Lawyers and Valuers who have been giving false reports to the banks for petty considerations and thus exposing the public money to great risks. The major share of banks' NPAs is contributed by such loans & advances which are collateralized by such properties for which either the Lawyers have given wrong opinion or the Valuers have given inflated valuation.

The committee headed by Raghuram Rajan is under the illusion that the availability of cheaper credit is the remedy for all the ills of real sector of the economy. It could be so in American context but in Indian context, it is more important to ensure round-the-clock power supply at fair price to avoid lay-offs and lock-outs for want of power, reduce the excise and other government taxes, eliminate the power brokers and corruption in high places etc. Many industrial Units become sick in India for want of regular power supply. It has driven many industrial houses to have their own captive power plants which have been vying for their share of natural resources like coal and thus giving rise to avoidable scams like 'coalgate'. If only the government had continued to carry out its responsibility of power generation & distribution at fair price, it would have served the Indian industrial sector a great deal better. The implications of the proposals of the committee are far reaching in many areas and a detailed dissertation of the recommendations will throw more light on the dangerously tending aspects of the report.

Macro Economic Framework

Raghuram Rajan Committee had identified three reasons for financial sector reforms –

- **(i) To include more Indians in growth process**
- **(ii) To foster growth itself**
- **(iii) To improve financial stability, flexibility and resilience with a view to protecting the economy against the kind of turbulence that had affected emerging markets in the past and affecting the industrial countries today.**

The underlying theme behind all the proposals made by the committee is the need to enhance inclusion, growth and stability by strengthening the financial & regulatory infrastructure. Some of the measures suggested by the committee as 'small steps' are discussed hereunder:

(1) The need of a new paradigm in financial sector is to recognize that efficiency, innovation and value for money are as important for the poor as it is for Indian Multinational companies and it will come from deregulation, new entry and competition in banking space. The committee is of the view that the role of the government is not to take on the task that should be legitimately deregulated to the Private Sector but to create an enabling environment by building sound financial infrastructure. It is strange that the committee has attempted to equate deregulation of Telecom Sector with the deregulation of financial sector with a hope to reap similar beneficial results where rewards could be much more substantial. The committee is exhibiting oblivion to the fact that in Telecom Sector the experiment could be attempted as it did not involve the public savings. The Banking Sector enjoys the confidence of the people of the country who have placed their hard earned savings

with the banks. It therefore becomes imperative for the banks specially the Public Sector Banks that their funds are not deployed in vulnerable and speculative sectors which constitute the larger financial market in the perception of the committee. The committee's observation that in this dynamic environment we will need skilled Regulators who encourage growth and innovation even while working harder to contain risks has come to such a stage where we have the chairman of the committee as a Super Regulator in his new role as Governor of Reserve bank. The amount of attention hitherto paid to issues like capital account convertibility, privatization etc., has led to emergence of divergent views and lack of consensus in the country on these issues and hence the committee is of the view that the steps to achieve these ends must be slow & steady with more focus on small steps to create the infrastructure and carry out the process. The suggestion of the committee that the credit to SME sector could be boosted enormously if the trade receivable claims they have on large firms could be converted to electronic format, accepted by the large firms and sold as Commercial Paper as is practiced in Mexico and could be handled through National Securities Depository Limited is quite similar to securitization of Sub-prime loans in the US which triggered the financial crisis infecting the entire world.

(2) The committee believes that the market and institutions do succumb occasionally to excesses which is why the Regulators have to vigilant, constantly finding the right balance between attenuating risk taking and inhibiting growth wherein US clearly failed this time. It did not in the opinion of committee mean that the Regulator cannot find the right balance elsewhere and also the well functioning competitive market can reduce vulnerability. The members of the committee ought to have known that the Regulators like Monetary Authority of Singapore are quite vigilant and hence do not permit the banking institutions to take exposure in the firms whose native country has the potential of facing vulnerability. The committee also acknowledges that vulnerabilities may be building up in India and the under-developed market and strict regulation on participation are no guarantee that risks are contained; in fact they may create additional sources of risks, a fore warning of which may come from recent reports of substantial losses incurred by the firm on currency bets. It is beyond comprehension if strict regulation is not the guarantee for containing risks in the mist of vulnerabilities, then what else is the remedy?

The risks can be better contained by strict regulations of the market and hence the committee falls short in suggesting appropriate solutions.

(3) The foreign capital and open financial markets are as destabilizing and prone to crisis as poor governance, poor risk management, Asset-Liability mismatches, inadequate disclosures, excessive related party transactions and murky bankruptcy loss. The country needs reforms to check and avert the crisis triggered by such factors. The suggestions by the committee to open up India's debt/bond market to foreign investors and release the investment of banking institutions in debt/bond market constitutes a perfect recipe to not only link but expose the well founded debt/bond market to global vulnerabilities. The observation of the committee that our macro economic framework needs to adjust more to a world of rapid capital inflows exposes them to the situations of recent outflows of foreign investment/capital which had a substantially destabilizing effect on our currency and markets. The more helpless argument advanced by the committee can be seen from its observation that it will be impossible to control capital flows in either direction which will create substantial uncertainty & volatility in the market and also the real exchange rate which is the key factor in determining India's competitiveness is influenced by the factors such as productivity, growth and demand-supply imbalances that are not changed by Central bank's intervention against the Dollar. In this context the committee felt that given that the real appreciation has to take place, the country has the Hobson's choice of taking it as inflation or an exchange rate appreciation. The committee further suggests that the Central bank can keep the market guessing about which option it will choose and it can hop between two options – take inflation or exchange rate appreciation. But creating such confusion will have adverse effects on the market. The inflation leads to higher interest rates which hurts the growth and in the opinion of the committee, the RBI should therefore concentrate on checking inflation and intervening in currency markets only to limit excessive volatility. The committee has shown ignorance about the possibility of pursuing middle path wherein the inflation and exchange rate management both need to be given adequate attention instead of treating them as Hobson's choice. The committee while suggesting the Central bank to concentrate on checking inflation as the poorer sections are least hedged against inflation, is undermining the fact that India with a negative balance of payment largely on account of crude oil import cost will end up paying more foreign exchange which will lead to not only

increasing the cost of imports but also increasing the demand for foreign exchange with further resultant rise in exchange rate and such a vicious cycle will have significant impact on inflation. The focus of committee's discussion appears to be only on country's competitiveness in international market without any worry of domestic market competitiveness which offers huge potential for real and service sector owing to huge demographics. The committee argues that we should relieve pressures from inflows by becoming more liberal on outflows. As a counter measure, it has been suggested to encourage greater outward investments by Provident Funds and Insurance companies when inflows are high as such diversification will make these funds more stable. Hence the relevant constituencies need to be persuaded as by thus restricting their investment options to domestic government securities, they are generally limiting future returns and possibly increasing risks. It does not make any great sense to diversify across foreign government securities to offset foreign inflows into our government debt market with outflows into foreign government debt market without these forces driven into by RBI.

(4) The committee is of the view that strengthening, fiscal, financial and monetary institutions would reinforce each other for which the committee prescribes principal elements of framework as under:

(a) Government's fiscal discipline is as essential adjunct to the process of financial reforms. Higher public deficit financing soaks up capital and has serious consequences for macro economic development and also for the financial section.
(b) With more flexible exchange rate and more flexible capital account, fiscal policy has an important role to play as a short term demand management pool.
(c) Disciplined fiscal policy – lower levels of government deficit and declined ratio of public debt to GDP are necessary to free up the monetary policy to focus on its key objective of price stability.
(d) High budget deficit put a question mark on effectiveness, independence and credibility of monetary policy.

(5) Financial sector reforms also need to be accompanied by real sector reforms such as building out infrastructure, reforming the labour laws, improving the social safety net etc. The effects of the proposals made by this committee will be magnified if they can piggy-back on the real sector reforms.

Broadening Access to Finance

The committee has desired changes to the scheme of Financial Inclusion by suggesting the following measures:

(1) Instead of seeing the issue primarily as expanding credit – putting cart before the horse, committee urges a refocus to seeing it as expanding access to financial services such as payment services, saving products, insurance products, inflation-protected pension etc.

(2) Direct Benefit Transfer of government programmes to SB accounts of the poor to reduce leakage, help build savings histories with their banks which will then open the door to credit to poor. The committee therefore desired that 90% of household have access to deposit account and to the payment system for smooth implementation of various government schemes.

(3) Instead of forcing credit to the household and making them heavily indebted, the focus should be on making them creditworthy so that when opportunities & needs arise they have access to bank finance.

(4) To alter the emphasis somewhat from large-bank led, Public Sector dominated, mandate-ridden branch expansion to focused strategy for Financial Inclusion.

(5) The much needed efficiency, innovation and value for money can come from motivated financiers who have a low cost structure and thus see the poor as profitable, have capacity to make quick decisions and minimum paper work.

The committee suggests changed organizational structure to foster such deliveries of services to the poor. The committee seeks more liberal entry to private well governed deposit taking small finance banks offsetting their higher risks from being geographically focussed by requiring higher capital Adequacy norms, strict prohibition norms on related parties' transactions and lower concentration norms in the form of loan as a percentage of capital that can be lent to one party etc. This suggestion undermines the role of natural calamities like draught, floods, earthquakes, cyclone, tsunami, cloud bursts etc., in certain areas on a regular basis. The local area banks which could not sustain after implementation of Narasimham Committee cannot be expected to establish and sustain their business models despite stipulations of strict supervision and monitoring coupled with prompt corrective action. Though the committee recommends that these banks do not become the public charge, it is inevitable to so happen due to the factors mentioned above. In the era of advanced technology, the distance between the customer and the bank is immaterial for a speedy decision making. Hence the perception of the committee on this count is stale. The wishful thinking of seeing the local area banks eventually grow into large banks is completely untenable. The committee's observation that the failure of even few small banks will not have systemic consequences unlike the failure of large banks and hence we should experiment with licensing of small banks is not only completely absurd but is also demonstrative of the self inner contradiction as the same committee has elsewhere recommended consolidation of banks to create large-sized bank. It must be remembered that the small public savings of the customers constitute the funding of the banking institution and failure is certainly going to hit the customers who are not otherwise interested in systemic failure or protection. Their loss of money is what would hurt them and not the philosophy of the learned members of the committee.

The committee has recommended introduction of sale and purchase of Priority Sector Lending Certificates (PSLCs) towards fulfillment of priority sector obligations of those banks that undershoot their targets. The imposition of interest rate ceilings make priority sector lending unprofitable. Hence reluctance to lend to priority sector drives the poor to money lenders. The committee is of the opinion that liberalizing the interest rates while increasing the safeguards will help prevent exploitation. The implication of meeting the priority sector lending targets through the purchase of PSLCs as recommended by the committee will lead to lop-sided growth of priority sector lending only in the rich geographies thereby defeating the very purpose of the priority sector lending goals of equitable growth and development of hitherto neglected sectors of the society. Other suggestions by the committee as to what should be eligible for PSLCs and priority sector lending to the poor will be based on average interest on loans and the estimated cost of lending is impracticable apart from being prone to manipulations.

The committee has not visualized a situation where there are only buyers of PSLC in the market without there being any sellers; when the committee is of the view that the business of lending to priority sector is unprofitable, it is more likely that such situations may arise. The social objectives cannot be price-tagged as attempted by the committee.

Leveling the Playing Field

The committee is of the view that the banks are favoured in certain ways and disfavored in other ways; the competition should result in resources bei9ng allocated efficiently and the society get maximum benefit out of its productive resources. The interests of consuming masses may be emphasized instead of privileged producers being protected. It states that time has come to unwind the grand bargain underlying the treatment of banks in India whereby the banks get access to low cost deposits of the government in return for fulfilling certain social obligations such as lending to the priority sector, meeting prudential norms (SLR) that also have quasi-fiscal objective of funding the government requirements. In a competitive market the committee suggests that the government pay towards the social obligations more directly to the beneficiaries. The greatest source of uneven privileges stems from ownership but it is also a fact that while the PSBs enjoy the benefits, they also suffer constraints with later increasingly dominating. What ultimately matters is that how the ownership structure will affect the efficiency with which financial services are delivered. Much of the PSBs are falling behind in their ability to attract skilled people especially at the senior level and hence their inability to take advantage of the new technology, motivate the employees at lower level and also to innovate. Since all these abilities are needed in the emerging areas of opportunity, PSB's risk management capabilities being weaker could be destabilizing.

We are of the view that the ownership is important in developing economies as it helps in carrying out the development agenda of the government more smoothly. Sentiments of the people, public and political opinion and views of the trade unions are important and hence cannot be undermined. The issue of the ownership and consolidation of the banks has been debated even in the Parliament and it was dropped. It is also important to own the profitable business when the government suffers fiscal deficit. The alternatives suggested by the committee like reducing government share-holding to 33% or the concept of holding company structure to own the public sector banks or allowing large international banks to swallow Indian PSBs aim at serving the larger interests of global capitalist agenda without any reason or rhyme. Such attempts will also make the banking a costly proposition. It is desirable to enhance the level of the corporate governance and autonomy of the boards of the PSBs, improve technology to reduce time and transaction costs, take them out of CBI and

CVC purview as the nature of the business is commercial and decisions are taken in the prevailing circumstances. The nature of commercial decision being discretionary is subjective to a great extent and the decision takers are invariable booked on the basis of hindsight. There urgent need to enhance the training capabilities and opportunities in PSBs to avert frauds. It needs to be understood that bankers are not super human beings to detect the fraudulent intentions of every fraudster. Hundreds of frauds averted go unnoticed and one failure is used to ruin and shatter the life and career of the officers. Rationalization accountability policy is considered a single most important reform to enhance the speed and efficiency of PSBs. It is important to remember that all the banks in private sector do not have the best levels of efficiency and even the new generation banks do not have exactly same levels of competitive strength. The thought of privatization to bring about efficiency and competitiveness is thus misplaced.

The perception of the committee that PSBs are not able to attract the best of the talents is far from the fact as elsewhere the committee itself observes that PSBs have historical ability to attract talent and many former officers of PSBs are holding high positions in Foreign and New Generation Private Banks. The negative opinion expressed by the committee can also be contrasted against the reality that even the recruitment of Probationary Officers to fill up about 52000 vacancies in the current year attracted more than 22,00,000 applications and the selected candidates included a majority of Engineering Graduates & Post Graduates, MBAs and possessing other higher and professional qualifications. There is also greater need to internalize the post of Executive Directors and Chairman and Managing Directors to avoid unhealthy practices pre and post selection apart from preventing the cultural invasion causing de-motivation among the top supporting management. Futility of dual control of the banks by the Government and RBI was also emphasized by Narasimham Committee too. But there were no takers then and there will be no takers even now. The Government may probably be happy if RBI renounces its control on the banking system in favour of the Government. Will RBI Governor experiment in this field by sending some experts from RBI to strengthen the Government Control Mechanism?

After analyzing the relevant aspects of Narasimham and Raghuram Rajan Committees' recommendations, we now proceed to respond to the issues covered in RBI's Discussion Paper.

1. Small Banks Vs Large Banks (Mergers and Consolidation)

We have Regional Rural Banks and Urban Cooperative Banks at local level to cater to the banking needs of the people. Under the new liberalized branch licensing policy, the PSBs have opened large number of branches in rural, urban and unbanked centres. With the liberalization of branch licensing continuing and focus on financial inclusion further growing, we expect larger integration of rural economy in the mainstream economy of the country. That is what a developing economy needs. Raghuram Rajan Committee views the Indian Banks as relatively small vis-a-vis the international banks merely on the grounds that only one Indian Bank(SBI) finds a place in top 100 global banks and that too at 80th place. There is need to review such perception. The size of assets which is the basis of ranking the banking institutions is measured in terms of value in US Dollars. Here comes the role of exchange rates. If the currency of a country is weakening against US Dollar, the valuation of assets of the banks of the country will also deteriorate. That is what has been happening to the ranking of Indian banks internationally. Four Chinese Banks finding a place among top 30 banks is largely on account of appreciation of their currency against US Dollar and not because merger and consolidation in their banking sector. It is important to understand that the size of the business of banking is largely related to the size of economy of the country. In this context the Raghuram Rajan committee itself observes that the size of capital of 10 biggest Indian Banks to 10 biggest Indian Corporations is not disproportionate to the ratio elsewhere in the world. This ratio is 2.72 in India as against 2.45 in USA. As long as the banking institutions in the country are capable of meeting the credit needs of the economy, the size of the individual banks does not matter. There are huge sanctioned but unavailed credit facilities in the Indian banking system and it is a testimony to the capability of our Banks to meet the credit needs. The consortium, multiple banking and loan-syndication coupled with ECBs are adequately serving the purpose to meet even larger credit needs of the corporate.

The thought to initiate any move to merge or consolidate Public Sector Banks under such circumstances is unwise and aims to benefit foreign banks through intended takeover of Indian Banks at a later stage as envisaged by Raghuram Rajan Committee.

2. *Universal Banking*

Financial Sector in India till the advent of globalisation and financial sector reforms had Commercial Banks and also Development Financial Institutions to meet the credit needs of different segments of Industry. The Development Financial Institutions like IDBI, ICICI, UTI etc., saw reverse mergers with their off-springs and started universal banking which later on spread to Commercial Banks too. It has created problems like liquidity, asset-liability mismatch on one hand and scarcity of trained personnel to handle long term/infrastructure financing on the other. The job-rotation policy, transfer policy etc. mandated by Ghosh Committee, CVC and the Government even in the case of officers recruited in the specialized functions have only added to the woes of the bank managements in PSB. The awakening to have differentiated licensing particularly for infrastructure financing, wholesale banking and retail banking seems to be a belated thought when almost all the banks have exposure to infrastructure financing/long term project financing. Segregation will pose serious problems, which will need smart solutions. The differentiated licensing will help improve quality of credit as standard of appraisal will improve.

3. *Continuation Authorization*

Commercial Banking is a sensitive sector as it involves financial intermediation. Dealing with public money calls for extra care. The role of the Regulator is also important. The present level of competition in Indian banking space seems to be quite adequate where various categories of the banks enjoy a fair market share as under:

SBI group	:	*24%*
Nationalized Banks	:	*46%*
New Generation Private Banks	:	*15%*
Old Private Banks	:	*7%*
Foreign Banks	:	*8%*

In such an environment there is no pressing need to allow licensing of new players either in the private sector or in foreign sector. The entry of foreign banks either through the branch licensing route or through the subsidiary licensing route may be evaluated on the reciprocal basis. But there is hardly any scope to permit more banks in private sector. The licensing in any case must be 'block licensing' and not 'tap licensing' whenever there is a need to expand the sector on merits and in changed scenario. The mismanagement and consequent disappearance of Global Trust Bank, Times Bank, Centurian Bank, Bank of Rajasthan, Lord Krishna Bank etc., from the Indian Banking space must be taken as a lesson before granting new licenses.

4. *Conversion of UCBs into Commercial Banks*

The cooperative sector bank failures have been very common phenomenon in different parts of the country. In many cases the PSBs were directed to rescue the depositors by taking over the failed or failing cooperative banks. It would be worthwhile to explore the possibilities of take-over of UCBs by PSBs and free them from the local political interference and protect the public savings. The transfer of technology in such an eventuality will also improve the levels of efficiency of the branches and bring down the cost of operations.

5. *Presence of Foreign Banks in India & Indian Banks presence overseas*

The number of foreign banks having their presence in India is more than the number of public sector banks or private sector banks individually operating in the country. Hence there is no strong case for permitting liberal entry of more foreign banks into Indian banking space. It is however felt that as a global players India may adopt a balanced and reciprocal approach in deciding on this issue. Similarly the Indian Banks may be encouraged to expand overseas either by opening branches or by adoption of subsidiary route including joint ventures as done by three PSBs by incorporating India International Bank, Malaysia a couple of years ago.

6. *Government Ownership*

RBI in its Discussion Paper has desired an optimal ownership mix in the banking sector to promote a balance between efficiency, equity and financial stability while observing that there is a better pay off in enabling PSBs to improve their performance. Simultaneous growth of Private Sector banks will instill a fair amount of competition in the banking sector. The argument of reduction in fiscal burden on account of recapitalization of PSBs does not sound logical as the government collects much more amount in the form of aggregate dividend from PSBs. If the PSBs are relieved of political and bureaucratic interference and larger autonomy is allowed to their Boards, the profitability of PSBs will increase. It will eventually bring down the demand for recapitalization by PSBs. The strength of PSBs with Government ownership was widely acknowledged by the then RBI Governor and the Finance Minister on the floor of the Parliament for withstanding the economic crisis of 2008 and thus remaining unscathed. The options from the menu of choices such as non-voting equity shares or differential voting equity shares or adopting holding company structure or diluting government stake in PSBs are unwarranted tinkering with the well settled capital structure of PSBs.

7. *Indicative Reorientation of the Banking Structure*

The 4-Tier banking structure suggested by Narasimham Committee and also by Raghuram Rajan Committee is an oft-repeated prescription available in the market for last two decades. But there are no takers for the same which is an indication of its futility in a well established Indian Banking space. What is being suggested by the Discussion Paper released by RBI is largely description of the existing structure of banking in the country. Even today we have Banks like State Bank of India, Bank of Baroda, Bank of India and Indian Overseas Bank having presence in several global geographies apart from their Pan India presence. The remaining PSBs are having presence in India with little or no presence internationally. They thus constitute the second Tier. The third Tier may comprise NewGen Private Sector Banks leaving the Regional Rural Banks to constitute the fourth Tier. It leaves us with Urban Cooperative banks and Old Private Sector banks which are a good case for nationalization or take-over by PSBs. Such a move will save the Cooperative banks from interference by local politicians and Old Private Sector banks from exploitation and intermittent take-over bids by Interested Groups/ Private Business Houses. It would be worth emphasizing that our Old Private Sector banks have been serving the nation by functioning largely on the lines of Public Sector Banks and have played a sterling role in upliftment of socially neglected sectors of the society while achieving the priority sector goals/ Financial Inclusion. Their contribution in nation building needs to be recognized. They also have pan India presence. Their nationalization or take-over by Public Sector Banks will help maintain equilibrium in the banking space.

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