NPA IN PUBLIC SECTOR BANKS IN INDIA-
IS IT NOT A MERE TECHNICAL ISSUE?

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Dear friends,

For the workforce in the Banks, joined in mid 80s, it is a million dollar question, "What sin I have committed other than totally listening to my Masters – the Government of India - over the period for which today I am branded as culprit, responsible for the Banks' failure?"

Yes, these lot of officers and employees, still remaining in the Bank

- Acted according to the direction of the master to concentrate in the poverty alleviation programs when the Banks were 100% owned by GOI.
- Fought against the Government move of privatizing the Public sector Banks during the dawn of 90s.
- Witnessed the Government's 'U' turn of introducing Private Banks and diluting the Government holding and extension of all the favors to such New private sector Banks.
- Undergone the agony of frequent shift in the Banking practices, from Manual to ALPM to LAN to CBS.
- Adjusted with the various new electronic gadgets, learnt everything at their middle age and still managed.
- Escaped the Government's lure of SVRS during 2001with a commitment to work for the Downtrodden.
- Absorbed, without murmurs, the loss generated by both the old and new private sector banks which were thrust on the PSBs.
- Shouldered the additional burden of increased business with the depleted staff after Government's decision of imposing embargo on recruitment in the post VRS scenario.
- Saved the PSBs, despite reduced staff strength, when the west was witnessing the extinct of mammoths in the financial industry due to the economic meltdown.

- Managed 70% of the market share in the domestic Banking arena in the midst of all the odds.
- Extended financial assistance to the Indian corporates to execute the huge infrastructure projects promoted by the Government of India which is the sole reason for economic stability and increased inflow of FII investment, the country is enjoying now.
- Listened to the Controller's direction and introduced the SDR, CDR and other restructure programs which only favoured the Indian corporates to rejuvenate those coffers which dried during the western financial crisis.
- Participated wholeheartedly in every Government sponsored program like JANDHAN YOJANA and DEMONETIZATION and earned the appreciation of the Hon'ble Prime Minister of the country.

It is always an enigmatic question in their mind,

When PSBs are having,
Adequate capital,
Optimally spread branch network
Activated manpower
Adoption of modern technology
Accelerated business model

Why we are failing and why the workforce of Public sector Banks is branded as villain before the public and is continuously being subjected to ill treatment and ultimately cornered to gasp even for survival?

As an officer belonging to such an unfortunate lot, it has been daunting me for quite long and during the desperate search of answer I got quite convinced that it is a best laid design being executed by the well oiled Government machinery.

The truth is that the Government wanted to hand over the Banks in the hands of private, in a platter and thus various measures are being adopted under the camouflage of Banking reforms of which one of the well crafted weapon is NPA.

This small write up is an attempt to establish the above mentioned truth duly backed by the documentary evidences authored by none other than the Controllers.

A PEEP IN TO THE PAST

1969- The Government of India nationalized 14 commercial banks on July 19, 1969

1980- The Government of India nationalized 6 more commercial banks on April 15, 1980

THE MAJOR OBJECTIVES OF BANK NATIONALIZATION ARE:

1. To mobilize savings of the people to the maximum possible extent and utilize them for productive purposes;
2. To ensure prompt operations of the banking system for a larger social purpose and subject it to close public regulation,
3. To meet the legitimate credit needs of private sector industry and trade (big or small);
4. To ensure that the needs of the productive sectors of the economy and, in particular, those of farmers, small scale industrialists and self-employed professional groups are met in an increasing manner.
5. To instruct the banks to provide banking facilities to the hitherto neglected and backward areas in different parts of the country; and
6. To check (stop) the use of the bank credit for speculative and other unproductive purposes

Though the big banks were nationalized, few Small private banks which are too small to be nationalized were allowed to continue till today.

Till 1990 there were amendments to this policy by GOI.

The major objectives of nationalization were pursued in letter and spirit till 1990.

1991 onwards – the government had taken a policy decision of diluting the Government share holding and permitting setting up of the Private Sector Banks.

Favoritism was shown for the survival of Private Sector Banks whereas stricter norms were scrupulously followed in the administration of Public Sector Banks thus creating an uneven playing field skewed towards Private Sector Banks.

Of the many Private Sector Banks that came into existence, today only a handful of Private Sector Banks which were promoted by the financial houses like ICICI, UTI, IDBI, HDFC are surviving and many of the Private Sector entities that commenced their banking operations after 1990 were either closed or merged.

In 2001, the transition process of Digitalization took place in a big way and to provide for its smooth implementation, Special Voluntary Retirement Scheme was introduced in Public Sector Banks in 2001 and there was a blanket ban on fresh recruitment in any cadre during the subsequent years.

Despite all these odds, the Public Sector Banks were improving their presence and were always holding a minimum 70% of the market share and continued their working for social objectives taking it as their pride.

The Banks were performing well as per the official statement released in the year 2008-09 by none other than the former RBI Governor, Mr.RAGHURAM RAJAN, when he was heading the Committee on Financial Sector Reforms, which submitted its recommendations in 2009 under the title "A Hundred Small Steps".

In 2009, the World Bank had also praised the Indian Public Sector Banking system, while extending a loan assistance to the tune of 2 billion dollars and also observed that the Indian Public Sector Banks are doing exceedingly well and the same was primarily due to the day to day monitoring of Public Sector Banks by DFS and RBI.

The infrastructure development projects like Road / Power sector were introduced in the year 2008 in a big way after the Public Sector Banks were certified as great both by the finance committee and the World Bank.

The budgetary allocation for executing such infrastructure development could be practically impossible for the Government which could have resulted in a deficit budget.

The government had adopted a new business model of public and private partnership to achieve its objective.

In the process, the Public Sector Banks had to extend the financial assistance to such corporates for carrying out the infrastructure projects aimed at the development of the nation.

The contracts were given to Indian corporates who were not having proper liquidity in view of economic meltdown witnessed in the Western Countries from where the Corporates earlier used to mobilize resources at cheaper rates.

To facilitate the easy and continued flow of finance to such corporates, the controller, the RBI has brought norms like ***Strategic Debt Restructuring and Corporate Debt Restructuring (SDR/ CDR)***.

These restructuring models made these private corporates to be eligible to avail the bank finance and the timely infusion of two billion dollars by the World Bank into the Banking Reforms had also helped.

The Public Sector Banks were branded as well administered and functioning with adequate capital under robust monitoring system of Government & RBI, as the day to day functioning was monitored by them.

BROWSING THE PRESENT

A. ***Almost all the PSBs have posted loss in their balance sheet as on March 2016 and many banks could not come out from the aftershocks, even now.***
B. ***All the associate banks were merged with SBI.***
C. ***Gyansangams divided the Banks into Anchor banks and target banks.***
D. ***Target banks were cautioned that they would not get capital infusion.***

E. ***Eleven banks are earmarked for implementing turnaround plans which includes the banks branded as Anchor banks.***
F. ***Even the trade unions are arm twisted to sign a MOU to implement the turnaround plan.***
G. ***Trade unions were threatened that the respective banks would not get capital infusion and the banks would be closed by invoking various regulatory provisions, if MoU is not signed.***
H. ***Controllers and the Government are continuously indicating the mergers, take overs and re-privatization, even while executing the turn around plan.***
I. ***Many PSBs have given fractured mandate to IBA to pursue wage revision.***
J. ***Private Banks and RRBs have not given mandate at all.***

ALL DUE TO MOUNTING NPAs

How the Public Sector Banks who are working under the direct supervision of RBI and the Government of India and branded performing well till 2009, went bad in March 2016?

The reasons are very simple; the defaulted Bank dues by the corporates were allowed to be snowballed by introduction of SDR / CDR while the prudential and provisioning norms were tightened slowly.

The NPAs, built over a period of time by the RBI and Government directive through SDR / CDR measures, were advised to be provided for immediately in the 3rd quarter of 2015 by the RBI officials invaded into the individual corporate offices of the Indian Public Sector Banks with the tools in their hand viz. Asset Quality Review (AQR) and instructed to brand all the re-structured assets as NPA in one go and advised the Banks to make provisions against those NPAs.

A little further extended look into the subsequent happenings will give ample understanding as to why these are all happening and how the controller is totally maneuvering the Balance Sheet of any performing bank by operating the two strings in their hand & command i.e., prudential and provisioning norms.

1. In 2015, the Government had announced illogical & illegal announcement that any Bank which is not generating Industry's average Return on Asset or Return on Equity would not be given capital infusion and also it was announced by Hon'ble Finance Minister expressing Government's objective of reducing its stake in the Public Sector Banks to 52%.

2. After making this announcement in Jan 2015 to close down the Banks with no profit or less profit, Government of India through RBI entered into Bank with AQR and converted all the restructured loans as NPAs to bring down the profit and profitability of the various performing Banks.

Thus to conclude that with the assistance of the two strings i.e., prudential and provisioning norms, the controller and the government is determining the NPA level of any Bank and branding the Indian Public Sector Banks as loss making Banks and also have gone to the extent of entering Bank's corporate offices with a weapon in their hand, Asset Quality Review (AQR).

It may be interpreted from the above that the very word NPA and its related norms merely technical than the real expression of business and economy.

Besides, the various policy directions and the accounting procedures, standards also had driven the Public Sector Banks into loss making.

Provision towards Standard Assets was made even during loss making years and also Income Tax has to be arrived at on the operating profit, before making provision for bad debts.

Unless and otherwise we understand the government intention of making the Public Sector Banks as loss making, we may not be able to give proper solution to control the menace of NPA as long as the above said two strings are in the hands of the controller and their intention is to paint the Public Sector Banks in red.

To a big question how the Indian Banks which were branded as performing banks in 2009 became loss making and made to be pushed even to the level of closure of such banks in 2016 can be understood if we browse the pages of "A Hundred Small Steps" written by

Sri.Raghuram Rajan, which was released during 2009 and also the IRBD Report submitted during August 2009 for extending the financial assistance of two billion dollars for the banking reforms.

When Public Sector Banks in India were doing well, closure of financial sector giants was observed in the western countries and the respective foreign governments were entering into such banks to bail them out by infusion of government funds, simultaneously, Mr.Raghuram Rajan submitted a report of the committee on financial sector reforms under the title "***A Hundred Small Steps"*** to Government of India in 2009, which consisted of, doyens in the industry as, members like,

Sri.O.P.Bhatt	-	Chairman, SBI
Sri.K.V.Kamath	-	MD&CEO, ICICI
Sri.Udhay Kotak	-	CEO, Kotak Mahindra Bank
Sri.R.Sridharan	-	Adviser, Financial Resources, Planning Commission

Few excerpts from "A Hundred Small Steps" are as below:

Proposal 3: Allow more entry to private well-governed deposit-taking small finance banks offsetting their higher risk from being geographically focused by requiring higher capital adequacy norms, a strict prohibition on related party transactions and lower allowable concentration norms (loans as a share of capital that can be made to one party). Make significant efforts to create the supervisory capacity to deliver the greater monitoring these banks will need initially, and put in place a tough prompt corrective action regime that ensures these banks do not become public charges.

It would also offer an entry point into the banking system, which some entities can use to eventually grow into large banks.

There is, however, no necessary link between size and honesty, as the recent experience with large banks suggests. Indeed, the larger number of potential applicants for small banks suggests the regulator can be far more selective in applying 'fit and proper' criteria. Moreover, technological solutions can bring down the costs of small banks substantially, even while increasing their transparency.

Finally, the failure of even a few small banks will not have systemic consequences, unlike the failure of a single large bank. ***In sum, the Committee believes there has been sufficient change in the environment to warrant experimentation with licensing small banks.***

The second organizational structure the Committee proposes makes it easier for large financial institutions to 'bridge the last mile'. Large institutions have the ability to offer commodity products like savings accounts at low cost, provided the cost of delivery and customer acquisition is reduced. ***They should be able to use existing networks like cell phone kiosks or kirana shops as business correspondents to deliver products.*** The RBI's proposals on business correspondents, with some relaxations, are an important step in this direction.

Proposal 6: Perhaps the greatest source of uneven privileges in the banking system stems from ownership. ***The public sector banks, accounting for 70 per cent of the system, enjoy benefits but also suffer constraints, with the latter increasingly dominating.***

There is little evidence that the ownership of banks makes any difference to whether they undertake social obligations, once these are mandated or paid for.

So on net, what matters is how an ownership structure will affect the efficiency with which financial services are delivered. ***And it is here that government ownership is likely to have serious adverse effects going forward.***

Much of the public sector is falling behind in its ability to attract skilled people, especially at senior levels, in its ability to takeadvantage of new technologies, in its ability to motivate employees at lower levels, and in its ability to innovate. Since all these capabilities are needed in the emerging areas of opportunity, public sector banks risk falling seriously behind, and because risk management is one of the needed new areas, also risk becoming destabilizing.

The majority of this Committee does not see a compelling reason for continuing government ownership. There are other activities where government attention and resources are more important.

However, the Committee does recognize that public opinion in the country is divided on the issue of privatization. A parallel approach is to undertake reforms that would remove constraints on the public sector banks, even while retaining government ownership.

Intermediate steps such as reducing the government's ownership below 50 per cent while retaining its control (as suggested by the Narasimham Committee) are also possible.

Unfortunately, ideology has overtaken reasoned debate in this issue. The pragmatic approach, which should appeal to practical people of all hues, is to experiment, as China does so successfully, and to use the resulting experience to guide policy.

One aspect of the pragmatic approach would be to sell a few small underperforming public sector banks, possibly through a strategic sale (with some protections in place for employees), so as to gain experience with the selling process, and to see whether the outcomes are good enough to pursue the process more widely.

Proposal 7: ***Sell small underperforming public sector banks, possibly to another bank or to a strategic investor, to gain experience with the process and gauge outcomes.***

For the largest Public Sector Banks, the options are more limited. The selling of large Public Sector Banks to large private sector banks would raise issues of concentration. The selling of banks to industrial houses has been problematic across the world from the perspective of financial stability because of the propensity of the houses to milk banks for 'self-loans'. Without a substantial improvement in the ability of the Indian system to curb related party transactions and to close down failing banks, this could be a recipe for financial disaster.

While large international banks could swallow our largest banks, it is unlikely that this would be politically acceptable, at least in the foreseeable future. That leaves a sale through a public offering. But such a sale would require confidence in the corporate governance of these enterprises so that a high price can be realized.

This Committee therefore believes that the second aspect of the pragmatic approach, especially for large and better performing public sector banks, should be to focus on reforming the governance structure, while perhaps also acquiring strategic partners, with the eventual disposition determined based on experience with privatization, the public mood and the political environment.

Proposal 8: Create stronger boards for large public sector banks, ***with more power to outside shareholders (including possibly a private sector strategic investor), devolving the power to appoint and compensate top executives to the board.***

Proposal 9: After starting the process of strengthening boards, delink the banks from additional government oversight, including by the Central Vigilance Commission and Parliament, with the justification that with government-controlled boards governing the banks, a second layer of oversight is not needed.

Further ways to justify reduced government oversight is to create bank holding companies where the government only has a direct stake in the holding company.

Another is to bring the direct government stake below 50 per cent, perhaps through divestment to other public sector entities or provident funds, so that the government (broadly defined) has control, but the government (narrowly defined) cannot be consideredthe owner.

Turning from the public sector to the banking sector as a whole, the Committee believes that fewer constraints should be imposed on banks and more growth, competition and entry should be encouraged. ***One method to foster bank growth is to allow bank mergers.***

To the extent that takeovers of Indian banks (or domestically incorporated subsidiaries of foreign banks) do not raise issues of excessive concentration or stability, they shouldbe permitted.

It may be sensible to start by being more liberal towards the takeover of small banks with a view to allowing bidders, targets, regulators and market participants gain experience in how to manage takeovers.

Domestically incorporated foreign banks should be treated on par with private and public sector Indian banks in this regard from April 2009, as announced by the RBI in its roadmap.

Proposal 10: ***Be more liberal in allowing takeovers and mergers, including by domestically incorporated subsidiaries of foreign banks.***

The commitment to allow foreign banks subsidiaries to participate in takeovers will substantially increase the pressure on domestic banks. This can be salutary, but domestic banks need to prepare themselves to meet the challenge.

A second way to foster growth and competition, but also to strengthen banks, is to de-license the process of branching immediately. ***The RBI can retain the right to impose restrictions on the growth of certain banks for prudential reasons but this should be the exception rather than the norm.***

Proposal 12: Allow holding company structures, with a parent holding company owning regulated subsidiaries. The holding company should be supervised by the Financial Sector Oversight Agency (covered later), with each regulated subsidiary supervised by the appropriate regulator. The holding company should be well diversified if it owns a bank.

Universal banking should thus be possible in India through holding company structures. Some legislative and tax change is required to make these structures viable and these are outlined in the report.

Proposal 19: ***Allow greater participation of foreign investors in domestic markets as in Proposal 2.*** Increase participation of domestic investors by reducing the extent to which regulators restrict an institutional investor's choice of investments.

Move gradually instead to a 'prudent man' principle where the institutional investor is allowed to exercise judgement based on what a prudent man might deem to be appropriate investments. Emphasize providing access to suitable equity linked products to the broader population as part of the inclusion agenda.

Proposal 34: ***Encourage the entry of more well-capitalized ARCs, including ones with foreign backing.***

Finally, while secured creditors have been empowered, unsecured creditors still have little protection. If India is to have a flourishing corporate debt market, corporate public debt, which is largely unsecured, needs to have value when a company becomes distressed. ***This means a well functioning bankruptcy code, that neither protects the debtor at the expense of everyone else including employees, as our current system does, nor one that allows secured creditors to drive a well-functioning firm into the ground by seizing assets***. A good bankruptcy code is especially needed for large complex infrastructure projects, which typically have many claim holders.

TAKING STOCK OF INDIAN BANKS:

The committee on Financial Sector Reforms commented on the position of Indian Banks as follows:

1. The role of the Indian banking sector isstill small relative to GDP. While the sizeof the banking sector relative to the economyhas more than doubled between 2000and 2007, ***with bank loans to GDP ratiorising from 22.7 per cent to 46 per cent, the banking sector in India is still relatively small compared to other emerging markets.***

2. India is an outlier in the extent of state ownership of the banking sector. Out of 138 countries surveyed by Barth, Caprio and Levine (2006), only nine had a predominantly state owned banking sector. India and China

are in this group, alongwith Bhutan, Libya, Algeria, Belarus, Turkmenistan, Egypt and Costa Rica. ***No high income country has a state dominated banking sector and we should note that China has recently made moves to introduce strategic foreign partners in its large state owned banks.***

3. In March 2007, there were 82 scheduled commercial banks in India Together, they accounted for about 80 per cent of the total assets of all formal institutions in the Indian credit market. Among the scheduled commercial banks the public sector banks accounted for about 70 per cent of the total assets in March 2007, Indian private banks 22 per cent and foreign banks 8 per cent.

   Interestingly, the share of the foreign banks has remained steady at about 8 per cent over the last decade or so even while the private sector banks have gained. Among the commercial banks, only eight are 'new' private sector commercial banks—banks that have been allowed to enter since the beginning of reforms in 1991.

   India does not have many small private banks. The United States has over 7,000 banks, over 85 times the number of banks in India, handling total deposits that are merely over eight times larger. It should be noted that many of these banks are small community banks, comparable to our cooperative banks, of which we have a vast number. But these have different governance and funding structure from the typical bank. While there are a number of notable exceptions, the experience with cooperatives has been mixed, in part due to problems with governance. These issues are addressed in Chapter 3, and the rest of this chapter will focus on scheduled commercial banks.

4. ***As a group, Indian banks have done exceedingly well in providing high returns to shareholders, registering the highest regional growth rate in assets, deposits, and ROE as well as one of the highest total returns globally according to a recent detailed survey of 14 leading public sector, new private sector and foreign banks conducted by McKinsey for the Indian Banks' Association (IBA)***.

5. Banks' contribution to GDP in India is comparable to the ratios in developed and developing world. Significant improvements were made in capital allocation between 2003 and 2007 reducing the share of

industries with returns lower than cost of debt from 56 percent to 22 per cent. ***NPA levels have been cut to about a third during the same period.***

Among the different bank ownership categories, foreign banks are clearly themost profitable. ***Apart from fee-based activities, these banks enjoy a significantly higher interest spread.*** Part of their success in maintaining this margin lies in their ability to attract low interest corporate checking account deposits. The profitability levels of Indian bank groups are largely comparable.

6. ***With an average spread exceeding 5 percent,*** intermediation costs in India remain high compared to other countries in the world as well as in the region. For example, spreads between borrowing and lending rates are 4 per cent in Thailand, 3.4 per cent in China and only 2.4 per cent in Singapore.

   The high spreads are more than offset by unprofitable priority sector obligations and statutory requirements, as we will argue later. But this means that the burden of these social and public obligations are borne by the Indian saver, whose low return pays for the grand bargain described in the introduction.

7. ***While Indian banks are fairly efficient in their spending on IT, the use of technology to reduce transactions costs of outreach is still at a nascent stage.*** For example, there are 19 ATMs per million people in India, compared to 51 in China or 193 in Brazil. Clearly, the cost of human-intermediated transactions is still low in India, but it is sufficiently high that significant portions of our population do not have access to financial services.

8. There are, however, fundamental differences between new private banks and foreign banks on one hand (the 'attackers' in the IBA-McKinsey study) and the public sector banks and old private sector banks (the 'incumbents') on the other. The largely comparable profitability levels across leading banks today conceal critical differences in the underlying economics that is likely to shape the future.

The first group enjoys significant relative advantages in terms of organizational capabilities, sales and distribution channels, credit and risk management practices and use of information technology and operation. Moreover, they target more affluent segments of the population in urban areas. Not surprisingly, therefore, since 2000 they have more than doubled their share of total assets, raisedtheir share of total profits by more than50 per cent, and account for almost halfof the total market capitalization of theindustry today enjoying over three timeshigher market valuation.

9. We have mentioned bank privileges andobligations a number of times. Before concluding this section, it is worth asking whether the banking system is benefited or hurt on net by obligations, pre-emption and interest rate caps. While a detailed exercise is beyond the scope of this report, aquick estimate by McKinsey,with all the caveats that accompany quickestimates suggests:

   a) The banking sector is, on net, hurt tothe tune of Rs. 10,000 to 15,000 croresby the 'grand bargain'.
   b) The greatest benefit from getting ridof both the obligations and benefitswould accrue to the ***public sector banks, whose profitability would riseby between 8,000 and 13,000 crores, a sizeable proportion of their current operating profits of about 42,000 crores.***
   c) The likely consequences are much smaller for foreign banks and private sector banks.

In sum, while currently in robust health, India's banking sector is relatively small and intermediates less than half the country's household savings. The sector enjoys very high spreads, in part through controlled interest rates on savings and checking accounts, but this last benefit is more than offset by the pre-emption of bank assets into government mandated channels. Banking could become increasingly unprofitable as competition from other institutions increases. Moreover, the system is relatively unsuccessful in reaching

(A Hundred Small Steps)

Dear Readers,

It may be interpreted from the above that the various norms which are employed now to show that the PSBs are in red is only to introduce Financial Sector Reforms Committee's recommendations of privatizing the PSBs which were suggested by the then Governor of RBI during the period 2008-2009 itself when the PSBs, in his own words, were performing well.

Now let us see the views and recommendations of IBRD while appraising the proposal for extending two billion dollars during 2009 as a Banking sector support loan to India.

Page no.8

1. ***The availability of funding slowed in 2008-09 and credit growth was largely due to the PSB***. India's large equity market fell sharply during the year, along with equity markets throughout the world. Private and foreign banks found their external funding drying up as the international crisis deepened in the second half of 2008. ***However, the PSB, who have a large and relatively stable deposit base upon which to leverage lending, managed to maintain their credit growth at 20.4 percent*** for 2008-2009 (compared to percent for foreign banks and 10.9 percent for domestic private banks)

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2. However, until the end of the 1980s, India's banking sector remained closed and controlled. The growth of deposits and amount of loans to the private sector were limited because of interest rate controls and regulations. Instead, banks channeled a large proportion of formal financial savings to agriculture and the public sector, at low cost. ***Nevertheless, the PSBs achieved their social objectives through targeted lending to designated priority sectors, such as agriculture, micro, small and medium-enterprises, self-help groups, and targeted groups in government-sponsored programs.***

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3. Planning Commission established the Committee on Financial Sector Reforms (2008), which issued a report called the Raghuram Rajan report after its Chairman, which provided recommendations in several areas, including improving the governance of the PSB.

   It observed that, if suitably compensated, all banks would be willing to assume the social obligations currently managed by the PSB, hence the rationale for continued government ownership of banks is weaker today.

   If privatization is not an option, and the report recognizes that under present conditions it is not (e.g. selling large PSB to large private banks raise issues of concentration), several measures could be taken to improve governance.

   It emphasized the need for stronger PSB boards, combined with reduced government oversight and the exercise of (a lower) government ownership share through the establishment of bank holding companies.

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4. ***India's banks are well capitalized, asset quality is good, and they have recorded impressive levels of profitability. The recently concluded Financial Sector Self Assessment declares that the banking system is robust and, over the last decade or so, there has been a significant improvement in the financial performance and condition of banks in India. Growth- even in the financial year ended March 31, 2009- while slower than last year, has been relatively strong, with credit expanding by over 17 percent and deposits by around 20 percent.***

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5. ***The Indian banking sector is well managed and efficient, and the cost income ratio has fallen by 15.8 percentage points between 2000 and 2009. This improvement in performance is a reflection of the quality of management prevalent in the banking sector.***

The Government has set clear objectives and targets for the PSB, as illustrated in the annual Statements of Intent, and holds their top management accountable for results.

These efficiency measures and good management practices have resulted in credible profitability performance. The sector has become increasingly profitable.

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6. ***India's corporate sector, which had relied heavily on foreign financing that suddenly was no longer available, was the first to feel the liquidity stresses in the financial markets.***

   This resulted in a shift to the domestic banking sector to fill funding needs. This substitution in their sources of funding put pressure on the domestic money and credit markets.

   At the same time, the foreign exchange market also came under pressure, just as corporate entities needed foreign currency to meet their external obligations. Financing and substitute financing needs of corporate borrowers will remain high over the near term.

   The entry into the domestic borrowing market of the larger corporate enterprises, who had been borrowing abroad, has put pressure on local small and medium businesses and made borrowing domestically more difficult for them.

   In addition, banks have become more risk averse at the same time as demands on their limited resources for lending have risen, in an environment characterized by a worldwide increase in demand for liquidity.

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7. ***Social banking is a core function of the PSB in India, therefore safeguarding priority sector credit growth, which is a key objective of the government's program for providing capital to the PSB, is vital.***

According to government guidelines, priority sector lending-for example loans to SME, artisans and village and cottage industries, self-help groups, and direct and indirect finance to agriculture-is targeted at 40 percent of the total lending of the commercial banks.

In addition, major banking programs exist for:

(a) facilitating payments by farmers (for example, the Kisan Credit Card scheme);

(b) supporting banking outreach (for example, the Self Help Group-Bank linkage program);

(c) promoting general employment and economic diversification activities among women, disabled and vulnerable groups (for example, the Prime Minister's Rozgar Yojana, the Swarna Jayanti Gram Swarozgar Yojana (a rural livelihoods scheme), and the Scheme for the Liberation and Rehabilitation of Scavengers programs), in addition to the agricultural debt waiver and other debt and interest payment measures that took place in 2008.

Among other factors, the expansion of such programs to address poverty concerns depends on the ability of the PSB to grow their portfolios. For example, about 60 percent of the Self Help Promoting Institutions in India receive their funding from banks and NABARD.

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8. There is a risk that the quality of lending will deteriorate faster than projected. This risk is associated closely with the depth and duration of the broader economic slowdown.

However, it also depends on the ability of the PSB not only to maintain lending to support economic activity, but also to do this without a sharp deterioration in the quality of their portfolios.

Often, the incentives to push lending are greater than those for managing credit quality.

Government owned banks in many economies, while capable of quickly supporting national plans for economic growth and macroeconomic stimulus, often find themselves suffering from financial distress a few years later due to poor underwriting and risk management standards applied to loan portfolios.

The Government of India has shown over the past years the ability to include social policy lending in its PSB, while at the same time pushing for high quality loans. The incentives are much the same today.

However, there is likely to be an increase in NPA as a result of corporate and consumer distress.

The Government has conducted stress tests, confirmed by the World Bank and others, based upon assumptions regarding different levels of NPA appearing during 2009-2011 in PSB balance sheets. These stress tests have been used to estimate the capital needs of the PSB.

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9. ***The sustained reform measures over a period of last fifteen years have resulted in the transformation of the Indian banking sector into a reasonably strong, diverse and resilient system.***

The major initiatives undertaken may be categorized under deregulation, prudential measures and approach to supervision, competition and enabling measures.

In consonance with the objective of enhancing efficiency and productivity of banks through greater competition, there has been a consistent decline in the share of public sector banks in total assets of commercial banks.

Nevertheless, public sector banks appear to have responded to the new challenges of competition, as reflected in their increased share in the overall profit of the banking sector.

This suggests that, with operational flexibility, public sector banks are competing relatively effectively with private sector and foreign banks. Shares of Indian private sector banks, especially new private sector banks established in the 1990s, in the total income and assets of the banking system have considerably increased.

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10. ***Despite tightening prudential norms in terms of classification of non-performing assets, the resulting measured asset quality of banks has improved considerably as the share of non- performing***

loans (NPLs) (as ratios of both total advances and assets) have declined substantially and consistently since the mid-1990s.

In fact, the ratio of net NPLs to net advances at 1 .O percent in India is now comparable to that of several advanced economies.

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11. ***Ownership***

The current statutory and other provisions require that the Government shall not hold, at any time, less than 51% of the equity capital of nationalized banks and IDBI Ltd, and 55% of the equity capital of SBI.

Further, the provisions contained in Section 3(2D) of the Banking Companies (Acquisition and Transfer of Undertaking) Act, 1970/80 provide that the shares of the Central Government in nationalized banks are not transferable.

There is presently no proposal to disinvest Government shareholding in public sector banks beyond the legally mandated permissible minimum thresholds, and this situation is not foreseen to change in the near future.

In the medium term, a calibrated approach has been adopted by Government and RBI to diversify ownership, primarily with a view to allow these banks to raise capital from the capital markets.

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12. ***Overall Assessment of Banking Sector in India***

The assessment of the Indian financial system during 2007-08 indicates that the banking sector in India continues to be healthy, sound and resilient.

The profitability of the banking sector, which has shown remarkable resilience in the last few years, improved further during the year.

Their capital position is also strong and they are less leveraged than they were a few years ago.

The performance indicators such as operational efficiency, asset quality and soundness indicators of the Indian banking system currently compare well with the global standards.

Although non- performing loans in absolute terms increased during the year, showing a reversal of the trend observed during the last few years, the gross NPA ratio (gross NPAs as percentage of gross advances) continued to decline.

Even though the credit risk environment is becoming somewhat uncertain, highlighting the significance of NPA management, banks with comfortable capital buffers appear to be in a better position to withstand any shock on their balance sheets arising out of evolving macro-economic environment. Financial Stability in India

Dear readers,

The second document discussed above must have cleared all the doubts and it is now apparent that all the SO CALLED REFORMS WERE DESIGNED TO IMPLEMENT IN THE YEAR 2008-2009 ITSELF WHEN THE SECTOR WAS PERFORMING EXCEEDINGLY WELL BY COMMITTEE ON FINANCIAL SECTOR REFORMS AND THE IBRD, AND CURRENTLY THE PERFORMANCE OF THE PSBs ARE UNDERMINED TO PAVE WAY FOR THEIR PRIVATIZATION.

IT IS NOT THAT THE PSBs ARE UNDER LOSS, BUT, TO FACILITATE THE REFORMS PROCESS WITH THE ULTIMATE AIM OF PRIVATIZATION, THE PSBs ARE BROUGHT UNDER LOSS.

TO PROCURE THE PROMISING FUTURE

THUS THE ENTIRE ISSUE OF NPA CAN BE CONCLUDED AS A MERE TECHNICAL ISSUE AND FOLLOWING SUGGESTIONS MAY BE CONSIDERED TO RELAUNCH THE INDIAN PSBs BACK INTO THE GROWTH ORBIT.

1. ***Re-visiting the factors employed to decide the NPA status of the accounts and altering the prudential and***

provisioning norms to suit the Indian politico, socio and economic conditions.

2. ***The NPA status can be attached to the individual loan accounts than the borrower and other group accounts as the economic viability and the technical feasibility is established more a project centric rather than promoter centric.***

3. ***Income Tax can be levied on Net Profit than on the operating profit before making statutory provisions.***

4. ***During such a problematic year (incurring loss), a tax holiday can be thought off.***

5. ***No need for provision towards the standard assets during the loss making year rather there should be a provision for write back of such entries during the loss making year.***

6. ***The real estate assets owned by Public Sector Banks may be revalued and recognized as Tier I Capital.***

7. ***Entire internal accruals can be converted into equity for the time being instead of paying dividend during these years of crisis, at least towards the Govt. and other Institutional investments.***

8. ***Any cost involved in executing the Government programs like Jandhan Yojana, demonetization etc., must be reimbursed by the GOI.***

9. ***Differential interest loss in executing any Government sponsored poverty alleviation programs shall also be reimbursed.***

10. ***Interest loss due to CRR shall be compensated by the RBI.***

I am sure that the newly recruited young lot in the Banking sector, equipped with the rich knowledge in Digitalization and with the active support of experienced elders would turnaround the Indian public sector Banks to become globally competitive, if above possible changes are implemented.

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