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"Sound Banking activities need Better financial supervision & control of NPAs" - a conceptual study

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Introduction:

Financial supervision of banks is a form of Government regulations which subjects banks to certain requirements, restrictions and guidelines, designed to create market transparency between banking institutions, individuals and corporations with whom they conduct business among other things.

To safe guard interest of depositors and examining financial stability, the two of the major factors for putting in track is an effective system of supervision on banks and better renewable strategy to control NPAs of Banks.

Scope of the Study:

In recent days failure of large banks and financial institutions makes many economists and academicians pose them interest in studying the supervision activity of central bank.

Objectives:

1. To study the supervision activity of RBI and controls of NPAs
2. To study the cause of failure of financial supervision on PS Banks.

Review of literature:

Financial supervision is a continuous process to learning sound banking activities for the growth of raised the repo rate and stayed part as rates, through 2014 on concerns of raising inflations particularly in commodity market. In 2015 RBI started to cut down rates. But lower interest rates, as expected failed to revive credit growth and reduce loan delinquencies.

Over the last three years, banks earnings have decreased substantially and listed banks core net interest income grew by modest 7% in 2015-16. Compared to 10-12% in the previous two years. Earning fell by a step 70% in 2016 fiscal, driven mainly by PSU Banks by small performance.

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RBI unveiled a new tool scheme for sustainable structuring of stressed assets or NPAs that allows banks to convert up to half of the loans to streamed corporate into equity or equality like instruments. These measures helped little bit to ease the pressure of stressed loans on banks and RBI concentrated on Asset Quality Review (AQR) left banks saddled with more bad loans. The Banks will now look to the centre to revive the sector by thick starting fresh investments and freeing up capital locked up in older projects.

As a part of statistical support, the Central Government gave permission to banks to make auction sale of surplus land available with public sector units. The increased pace of clean-up, coupled with pulling the plug on bad investments much earlier, will help.

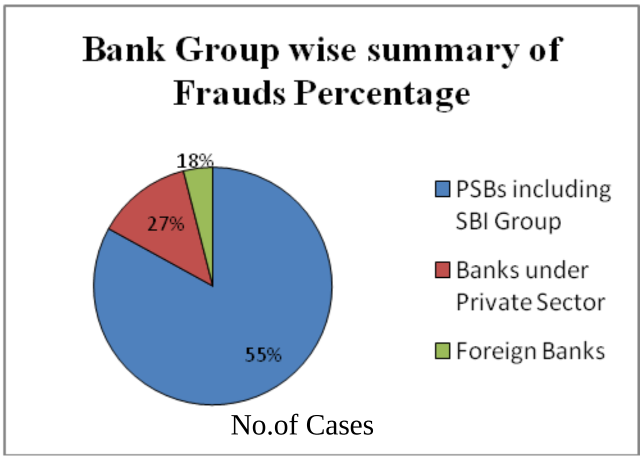
Data Collection

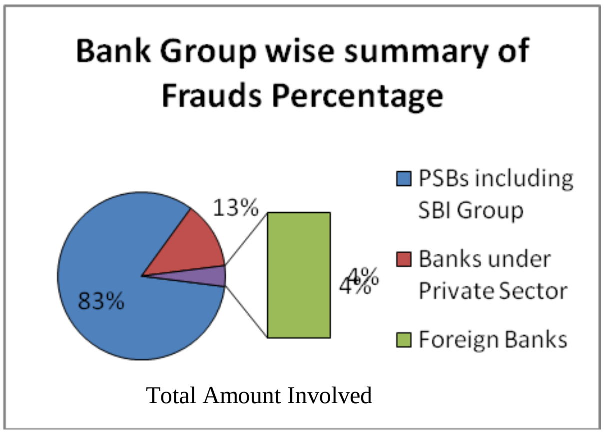
The main source of data is collected from secondary i.e. newsletters banking experts analysis, journals and from website i.e. Google search.

Platform for financial supervision coupled with NPAs

Prior to 1993 in India RBI had look after the regulations of commercial banks was handed by the Department of Banking operations and Development (DBOD). Globally, increasing financial dis necessitating enhanced regulatory attention towards these non-bank and near bank entities. The merger of financial institutions cell with the Department of supervision in June 1997 lead to the formation of an exclusive financial institutions division within the DOS.

Before Raghuram Rajan's entry banking section is living with bad loans and weak credit offtake. The Bank credit growth had already shifted to 13 odd percent in 2013. Bad loans had started to pain, with stressed loans (including restructured loans) exceeding 10% for PSU banks and many frauds are involved in number and amount in loans and advances. The below pie charts clearly elucidate the situation.





After taking charge Raghuram Rajan co-opting four non financial directors from the central board as members for a term of two years. The Deputy Governor of the Bank are ex-officio members. One of the deputy governors is nominated as vice-chairman. The Department of Banking supervision serves as the secretariat for the Banks Financial Services.

Banks has increased the activities across the world and promotions of financial markets globally the RBI has segregate its supervision activities into 1. Regulatory of financial activities and 2. Supervisory activities.

In recent budget session over Finance Minister proposed to establish a separate body i.e. Banks Board Bureau (BBB). "Bank Board Bureau" to be operational without intervention of policy of Government and RBI in personal matters of all Banks. A sound financial supervision is essential as suggested by Narasimhan Committee in 1993 and the result is establishment of Banks Board Bureau (BBB) on 14th August, 2015 with a joint stock company structure to supervise and guide the Public Sector Banks. It will recommend appointment of directors in PSBs and advice on ways of raising funds and dealing with issues of stressed assets. With the installation of BBB political interference in the functioning of PSBs must be ceased and commercial decisions must be taken on need base profit resulting to a better decision by PSBs top brass leads for better performance …. For a better economy.

Supervision, should be set up under the ages of RBI. A complete severance of supervision from Central Banking was not considered necessary or desirable in the Indian context. So, based on this recommendation the first board of financial supervision (BFS) was constituted on November 16, 1994 by the Governor as a committee of the Central Board of Directors of the Reserve Bank of India (RBI). It functions under the RBI (BFS) regulations, 1994 exclusively framed for the purpose in consultations with the Government of India and acts as a reconciliation machinery between Government and RBI for the welfare of all banks in India.

The board is chaired by the Governor and is committed by which was entrusted with both supervision and regulations over all development financial institutions in India, later the department of supervision was shift into Department of Banking Services (DBS) and Department of Non-Banking Supervision (DNBS) on July 29, 1997 with the letter being entrusted with the task of focused regulatory and supervisory attention towards the NBFC entrusted with the task focused regulatory and supervisory attention towards the NBFC segment.

The committee on financial system set up by the Government of India had suggested that the supervisory functions of RBI should be separated from the more is additional central banking functions and that a separate agency, which could may undivided attentions to Indian economy. The objective of financial supervision is to protect the depositor's interest and ensuring financial health of individual banks/FIS, an implicit over reaching objective of RBI's supervisory process should also be to ensure financial stability and customer protection.

Global Financial Supervision and effect on PSBs in India

1. According to European Investment Banks Eilakrelvi the best thing to keep yourself safely liquid and to keep other funding sources open.
2. In China "the CBRC took pre canto nary measures in advance and in 2011 required banks to set aside more in provisions with the economy was in an upturn cycle so that they were able to accommodate huge write when the economy was in a documentation cycle.
3. Deficiencies in evaluation can be somewhat compensated for by careful port lending monitoring, including careful documentation and perfection of collateral, as well as ensuring assets banking promoter guarantees are registered and tracked.
4. Banks are giving loans largely to big financial units and in some Banks are no lending to big units. This is due to short tenure of managers and lack of sound loan management.
5. Monitoring and Debt collection mechanisms are very poor in our country.
6. In private banks if project is giving loans then they will demand for additional collateral security or getting repaid surety. But PSBs continued supporting projects with fresh loans.

7. The Government has proposed legislative reforms to the judicial process, including speeding up the functioning of the debt recovery tribunals (which non a wait parliament)

The Human Face of Banks' NPAs – Future Projections

By March 2017, the Banks NPAs may hit 8.5% according to one survey. If the macro situation deteriorates further, the gross NPA ratio may even exceeds 93% - The Financial Stability Report released by RBI on June 28, 2016. The following table clearly explains the impact of Bad loans between March 2013 and March 2016 and projection to March 2017.

Table of Stressed Asset Rise

Period (6 monthly break)	NET NPA	Gross NPA	Stressed Assets
	Figures in Percentage		
March 2013	-	3.4	9.2
September 2013	2.3	4.2	10.2
March 2014	2.2	4.1	10.0
September 2014	2.5	4.5	10.7
March 2015	2.5	4.6	11.1
September 2015	2.8	5.1	11.3
March 2016	4.6	7.6	11.5
September 2016	-	8.5 (projected)	-
March 2017	-	9.3 (Projected)	-

Stressed assets mean Gross NPAs and forms Standard restructured assets.

According to P.K.Gupta, M.D., SBI, ARCs need to be rated based on recovery track records. This means, banks should be able to fix benchmarks and say that only those ARCs which are performing above these benchmarks can participate in buying assets from banks. This track record on how the assets are resolved by ARCs and SRs (Security Receipts) issued to banks are redeemed will be helpful for banks. Thus ARCs have a track record over one-two-three years for rating.

RBI Governor, Raghuram Rajan favour RBI funds to recap strong PSU Banks i.e., RBI surplus funds to capitalize along PS Banks. This resolves impact of "Stress Assets on Banking System". In his words, two actions will pay large dividends. First is to improve the governance of public sector banks so that we are not faced with this type of situation again. The second is to infuse banks capital, with some of the infusion related to strong performance so that better banks have more room to grow. According to him, 1.5 lakh crore had paid to central government as dividend. This could be used to recapitalize banks.

As a policy matter Centre injects Rs.22,915 crores into 13 public sector banks and the remaining amount, as promised by Government is to be released later, depending on the banks performance (The original promise 70,000 crores capital committed to invest in state run banks before 2019 out of the total outlay of 1,80,000 crores, where the balance 1,10,000 crores is to be raised by banks themselves by capital issues. The capital inadequacy as promised by to compensate by Government to PSBs is clear from this statement.

Capital infusion by Government of India to PSBs

Financial Year	Budgeted Promise	Cleared by Government
	(Rupees in Crores)	
2015-16	25,000	25,000
2016-17	25,000	22,915 (upto 19th July, 2016)
2017-18	10,000	-
2018-19	10,000	-

The aggregate loss of 11 PSBs as compared with 19,200 crore capital infused so far by the Government to SBI, PNB, BOB, IDBI, UBI, OBC, IOB, Central Bank and Syndicate Bank. In sharp contrast upto the date of loss, these banks posted Rs. 29,100 crore profit in 2014-15.

According to the Moody's estimate the capital infusion required to these banks by 2020 is morethan 45,000 crores even though infusion more fund goes against the spirit of fiscal discipline and challenge the Basel III frame work by 2019 deadline. As per the Basel III norms Fitch Ratings estimate $90 bn capital needed by the end of FY 2019 of which 51% as core equity Tier I capital, 31% as additional Tier I (AT-1) capital, and the rest as Tier-2 capital.

By cutting rates, the burden of corporate who owes huge amounts to banks may reduce substantially. The latest bankruptcy law may help banks to speedup debt recovery process.

The face of Private Sector Banks and top gross human chain better decision markers on NPAs; they feel better freedom both on sanctioning and recovering loan.

The net NPAs of the Private Bank in September, 2015 is 2.8 percent (PSUs 6.1 percent) sharply increased to 4.6% in March 2016. The relevant loan creation ratio due the period in 4% to PSUs whereas 24.6% i.e. private banks. On the same time deposits of PSUs grow by 5.2% where as for private banks it is 17.3% (RBI Report)

<u>Role of RBI Governor – Human facelift and inferences from behavioral attitude of Centre</u>

Mr. Raghuram Rajan announced his departure from RBI in the last month i.e. June 2016 and first repercussions of the impending activity is now be visible a move widely seen as being forced on him by Narendra Modi–led Government in New Delhi. The implementations for the RBIs institutional stability and strength and for the credibility of India as an investment destination weren't good; His stringent steps on state owned/controlled banks that comprise 70% of the sector are dealing with a fill blown bad loans crisis. Estimates of bad loans vary widely, but may total anywhere between 6 and 12% of GDP as per his estimate, they may hit 8.5% of GDP by next March.

In this contest, recapture among urgent; they need about $140 billion in capital by 2019, according to Fitch Ratings – but the Centre has kept little money for capital funding. The Government is trying to use RBI's funds instead of funding money from the General budget. In every activity, the attitude of present BJP led Government in RBI's independence is a forceful activity. Modi came into Office promising maximum governance and minimum Government. That's what both the RBI and the banking sector need not renewed state control.

Banks should perform (or) be privatized:

The era of social banking is over and inefficient Government banks should be sold off. Now, the question is how to go about privatization. In the views of the Governor of RBI; the number of loans which led to stressed assets in recent years were made in 2007-08 when Indian Economic growth was very strong and opportunities were very open and limitless. The only mistake done by PSBs at that time is no guaranteed/explained intellectuals in extending loans and advance without proper appraisal of projects even though they are viable i.e., lack of due diligence in evaluating proposals (major human error).

In his own words, Governor observed in a recent speech: "One promoter told me about how he was pursued then by banks having cheques, drafts, asking him to name the amount he wanted". He also acknowledges that there have been instances of malfeasance and investigating agencies are pursuing some such cases.

Privatizing PSBs: Mergers and acquisition is a debating solution to strengthen different same units in each industry and so in banking sector since 1991 and onwards. New bank of India and Punjab National Bank were merged in 1993, both were PSBs. Recently the Government announced the merger of State Bank of India and its associates and Bharathiya Mahila Bank.

Mergers can be successful in similar institutions with a similar culture, but cannot be extensively adopted because it leads to job cuts, branch closures and even in some cases a lowering of the quality of services and fall into losses.

Another alternative is setting rigorous standards for banking industry privatizing some of the inefficient loss making PSBs while rewarding; profit making PSBs. The concept of Privatization of Nationalized Banks is not confined to India and it is a world-phenomena: Ex: Russia (Soviet Union

Transitional Period) Finland-through asset sales: Issue of IPOs to Private individuals lead to privatization of management strong financial supervision is a strong hold for sound banking. Thus better financial performance is needed when a strong financial supervisio0n is involved in and as a significant shareholder in privatization.

The task of privatization of PSBs is not going to be easy, as it involve building consensus amongst various stake holders, including employees unions and parliamentarians. Hence a high power committee is to be appointed by Government to devise exact criteria, modus operandi, the privatization model to be adopted, and engage with the social ratifications before the practical work starts.

A word about the "Who moved my interest rate?" An uneasy relationship between currency Admin and Currency policy – disclosed by D.Subba Rao in his book. In his own words about the autonomy of RBI. I have been asked several times. If there was pressure from the Government on setting interest rates. There certainly was though the precise psychological mechanics would vary depending on the context, setting and the personalities. Even in administration of Central Bank Policy vary in appointment and the Government rejected the appointment of Deputy Governor proposed by D.S.R. he is clear.

Conclusion:

Any damage to the Banking Sector is due to the human err and financial supervision is a continuous process to bring sound banking activities for the growth of Indian Economy. The financial supervision is to protect the depositors interest and ensuring financial health of individual banks/FIS, an implicit over reaching the very objective of RBI's supervisory process and should also be to ensure financial stability and customer protection. Formation of 6 member monetary policy committee under the chairmanship of RBI Governor, the banks are putting special effort to effect recoveries with a focus on reviving squalled projects.

For any of the banking frauds, the personal involved are bank people only, as there is no proper supervision or body of control either by Reserve Bank of India or by Government. Hence the BBB is to be strengthened without the interference of political administration for effective personal decisions of PSU Banks.