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CLASS NOTES
RESTRUCTURING OF BANKS

- **The CRR is calculated as a percentage of the net demand and time liabilities (NDTL).**
- **CRR is the money that banks are required to deposit with the RBI, for which they will not be paid interest. At present, the RBI has fixed this at 4%.**
- **SLR - banks have to deposit a portion of their money in relatively safe assets which are easily saleable - such as government bonds, securities or gold - to generate liquid cash in the event of a run on the bank. The current SLR is 18%**

MONETARY POLICY TRANSMISSION

- **For faster transmission of monetary policy rates. RBI made it mandatory for all banks to link floating rate loans , to retail customers and loans to MSME , to an external benchmark.(linked to repo rate)**
- **At present, interest rates on loans are linked to a bank's marginal cost of fund-based interest rate (MCLR) below which bank cannot lend**
- **The repo rate is the rate at which commercial banks would borrow from the RBI, and the reverse repo is the rate of interest they would earn when they deposit funds with the central bank.**
- **Banks can choose from one of the four external benchmarks — repo rate, three-month treasury bill yield, six-month treasury bill yield or any other benchmark interest rate published by Financial Benchmarks India Private Ltd.**
- **The repo rate is the most stable one as compared to the other options**
- **Deposit rates have remained high for two reasons. One, competing interest rates in the government's small savings schemes & the liquidity crunch triggered by the sudden inability of the non-banking finance companies to pay back loans**
- **Will lower rates spur economic growth?**

  - In an environment where the other factors of production (Capital, land & labour) are not favourable for an investor, low interest rates by themselves may not prove attractive enough.

MONETARY INSTRUMENTS: CAPITAL ADEQUACY RATIO

- **The capital adequacy ratio (CAR) is a measurement of a bank's available capital expressed as a percentage of a bank's risk-weighted credit exposures.**
- **A financial metric used to gauge the ability of a bank to withstand losses without affecting its lenders and depositors.**
- **There is a variety of capital adequacy ratios, it can be calculated simply by dividing the capital of a bank by its assets.**
- **In case of heavy losses, the bank's capital takes the first hit before the funds of lenders are affected**

CAR

- **Capital adequacy ratio, the most popular measure to rank bank strength.**

- **The government wants the capital adequacy ratio of banks to be at 8% as per Basel norms, but RBI has prescribed 9%.**
- **Any slackening of the prudential norms may result in a reset of their credibility/standing in the international markets.**
- **India is a bank-dominated financial system with about two-thirds of all financial assets in the economy belonging to the banking sector.**
- **With banking sector credit depth being low and concentrated to specific sectors, non-deposit taking NBFCs (NBFC-ND) have begun to fill part of the financing gap**
- **The depth of credit information index measures rules and practices affecting the coverage, scope and accessibility of credit information available through a credit bureau**
- **NBFCs are becoming dominant in segments such as microfinance, consumer durable loans, construction equipment finance and auto finance**
- **In the specific case of MSMEs, the share of NBFCs in total credit exposure has increased from 2 per cent in 2010 to 21 per cent in 2018.**
- **Non-performing assets (NPAs) at commercial banks amounted to ₹10.3 trillion, or 11.2% of advances**
- **Public sector banks (PSBs) accounted for ₹8.9 trillion, or 86%, of the total NPAs.**
- **The ratio of gross NPA to advances in PSBs was 14.6%.**
- **In 2007-08, NPAs totalled ₹566 billion (a little over half a trillion), or 2.26% of gross advances**
- **Credit boom of the years 2004-05 to 2008-09 - commercial credit doubled - the world economy & Indian economy were booming. Indian firms borrowed furiously.**
- **Most of the investment went into infrastructure and related areas — telecom, power, roads, aviation, steel -era of 9% growth**
- **According to Economic Survey of 2016-17, problems in acquiring land & getting environmental clearances, several projects got stalled. Their costs soared.**
- **The global financial crisis in 2007-08 & the slowdown in growth after 2011-12, revenues fell well short**
- **Financing costs rose as policy rates were tightened in response to the crisis**
- **The depreciation of the rupee meant higher outflows for companies that had borrowed in foreign currency.**
- **2014-15, RBI introduced tougher norms for NPA recognition under an Asset Quality Review.**
- **NPAs in 2015-16 almost doubled**
- **Higher NPAs mean higher provisions on the part of banks. Provisions rose to a level where banks, especially PSBs, started making losses. Their capital got eroded as a result.**
- **Capital from the govt was slow in coming and it was barely adequate to meet regulatory norms for minimum capital. Without adequate capital, bank credit cannot grow.**
- **Once NPAs happen, it is important to effect to resolve them quickly. Otherwise, the interest on dues causes NPAs to rise relentlessly.**
- **The problem is more concentrated in PSB**

- PSBs had a higher exposure to the five most affected sectors — mining, iron and steel, textiles, infrastructure and aviation. These sectors accounted for 29% of advances and 53% of stressed advances at PSBs in December 2014.
- In 2018, the State Bank of India's (SBI's) gross NPA/gross advances ratio was 10.9%. This was not much higher than that of the second largest private bank, ICICI Bank, 9.9%.
- The ratio at a foreign bank, Standard Chartered Bank, 11.7%, was higher than that of SBI.
- Private and foreign banks were part of consortia that are now exposed to some of the largest NPAs
- PSBs accounted for 86% of advances in these five sectors By coincidence, this number is exactly the same as the PSBs' share in total NPAs.
- Infrastructure projects impacted by the global financial crisis & environmental & land acquisition issues.
- In addition, mining & telecom were impacted by adverse court judgments. Steel was impacted by dumping from China.
- Wholesale privatisation of PSBs is not the answer to a complex problem. We need a broad set of actions, some immediate & others over the medium-term & aimed at preventing the recurrence of such crises.
- One immediate action that is required is resolving the NPAs. Banks have to accept losses on loans (or 'haircuts'). They should be able to do so without any fear of harassment by the investigative agencies
- The Indian Banks' Association has set up a six-member panel to oversee resolution plans of lead lenders
- An alternative is to set up a Loan Resolution Authority, if necessary through an Act of Parliament.
- The government must infuse at one go whatever additional capital is needed to recapitalise banks — providing such capital in multiple instalments is not helpful.
- The RBI needs to develop better mechanisms for monitoring macro-prudential indicators.
- Actions needs to be taken to strengthen the functioning of banks in general and, more particularly, PSBs.
- Overall risk management at PSBs needs to be taken to a higher level. This certainly requires strengthening of PSB boards. Induct more high-quality professionals on PSB boards.
- There is ample scope for improving performance within the framework of public ownership
- Except for some computer program-driven retail loans with factory-type outputs, a majority of the banks today do not venture into MSME or corporate loans - mandatory farmers' loans and education loans.
- Officers skip their assignment in credit-related work at the operational levels & find their way directly up to the top. Thus, knowledge of the business of credit becomes a casualty from top to bottom.
- Bank managers are supposed to lay their hands on KYC, insurance, Aadhar, mutual funds, demat, PMJDY, subsidies, financial inclusion, alternate channels, scholarships, pension payments
- Items like mutual funds and insurance are lucrative for the staffer as they offer handsome commissions
- No effort is made to garner quality advances as there is no incentive to do so.

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- Non-sanction of loan will cause complaints. So an unwilling sanction is accorded and the amount is disbursed.
- Loan travels its route to becoming an NPA due to lack of follow-up from the banker's side and the lack of understanding from the borrower's side.
- Medium advances (Rs. 1 crore and above) is a peculiar characteristic of PSBs that their internal communication system is from top to bottom. To bring in professionalism and objectivity, many banks have formed credit committees where these loans are discussed.
- Prudent and time-tested lending norms are violated in the guise of business considerations.
- Those seeking large advances invariably reach the bank with political clout.
- PSBs should shred the idea of becoming financial supermarkets, get away from incentive-centric insurance and mutual fund businesses, and get into the core areas of deposits and advances
- It should be recognised that handling advances requires specialised skill. Each area of advances, namely, identification, processing, sanction, documentation, disbursement, maintenance, and recovery, should reclaim its sanctity
- Loan Processing Cells functioning in some of the banks should be strengthened.
- After sanction and documentation, the documents should be vetted by the bank's panel lawyer, who should certify that all sanctioning conditions have been met and the documents are in order and the loan is ready for disbursement.
- Early identification of NPAs: It is a reality that banks delay identification of NPAs
- The risk premium that banks tack on to their prime lending rate, which itself depends on factors other than the policy rate.
- High growth over 2003-08, when the economy grew at its fastest ever, tells us that three factors had played a role in it. These were unusually high rates of agricultural growth, record levels of public investment and buoyant exports.

FINANCIAL STABILITY

- American model - reflects two things: the political power of financial interests in the U.S. economy and the global intellectual influence of the American economic model - minimum govt intervention
- This model revolves around the goal of maximum creation of wealth by private individuals unimpeded by societal objectives.
- Public regulation, which sets limits to private activity, is rejected as an unnecessary interference in beneficial
- Only one function, the control of inflation.
- Unanticipated inflation that is the problem for producers, as it has the potential to derail their profit calculations
- Even, anticipated inflation can harm holders of financial assets yielding fixed incomes by eroding their wealth.
- Borrowers on the other hand are better off with inflation as the real value of their outstanding loans are now less

- **The problem of inflation can in principle be tackled through inflation-indexation, the practice is not widespread. This leaves owners of financial wealth averse to inflation.**
- **As the volume of financial wealth in an economy increases so does the power of its owners over government & inflation control tends to take centre stage in economic policy formulation**
- **When inflation control is implemented via monetary policy it results in higher interest rates.**
- **Managers of financial wealth lobby for such a policy acts on behalf of their clients. This lobbying is the origin of the policy of inflation targeting.**
- **Inflation is retained as the target and the central bank is not accountable for unemployment**
- **Situations where growth, employment and inflation are jointly determined, inflation-targeting via the interest rate can lower inflation only by suppressing growth.**
- **Inflation targeting through minimum govt intervention - used in UK and USA**

  before the 'North Atlantic Financial Crisis' of 2008
- **Instability had progressed due to the complete violation of the norms of prudence by U.S. investment banks and housing societies in a climate of relatively lax regulation**
- **Slowing of the economy after 2016, which we are still experiencing, suggests that inflation-targeting may have had an impact on growth.**
- **We now see the emergence of instability in the private segment of the financial sector.**
- **Branch banking has fast emerged as a mere post office banks have been selling third-party products with much greater zeal than crucial banking products.**
- **IMF Chief Economist Gita Gopinath says the government should undertake structural reforms such as bank clean-up and labour reforms to address the slowdown in domestic demand.**
- **Gopinath said the policy priorities of the government should also include a credible fiscal consolidation path - needed to reduce the high level of debt and reduce crowding out which would free up financial resources for private investment - should be driven by subsidy-spending rationalisation and tax-base enhancing measures**
- **Banking is still metro-centric. Metro centres (53) had a share of less than 20% in branches but saw 51% of deposits and lent 64% of the total advances at the end of December 2018.**
- **Urban areas seemed to be the worst affected: with 18 % of the branches, they had a share of just 21.5 % deposits and a mere 15 % of the total advances**
- **While the credit-deposit (CD) ratio of metros is 96.5% , it is just 54.8 % in urban areas.**
- **The reach in rural & semi-urban areas together is 62%, their share in deposits is 10.5% and 16% respectively - the corresponding share of advances is 8.5 % and 12.4 %**
- **groups are: 'rural' centres, with a population of less than 10,000; 'semi-urban' centres, between 10,000 and 1,00,000; 'urban' centres, 1,00,000 and above but less than one million; and 'metropolitan' centres, one million and above.**

MERGER OF BANKS

- **10 banks owned by the Government of India will be merged into four larger banks**

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- Punjab National Bank will be merged with Oriental Bank of Commerce and United Bank of India; Canara Bank with Syndicate Bank; Union Bank of India with Andhra Bank and Corporation Bank; while Indian Bank will amalgamate with Allahabad Bank.
- The government also announced an infusion of ₹55,250 crore to help these newly merged banks extend more loans to their customers and meet crucial regulatory norms.
- last year, the government proposed the merger of three banks — Vijaya Bank and Dena Bank with Bank of Baroda — to create a larger bank
- Last year, the government proposed the merger of three banks — Vijaya Bank and Dena Bank with Bank of Baroda — to create a larger bank
- A merger is simply the combining of two business entities to form a larger one but with no explicit change in ownership
- This is in contrast to an acquisition where one business entity takes ownership control over another by paying for the ownership privilege in cash, stock, or other means.
- There will be no change in ownership but merely a restructuring of how these banks are organised
- Large banks will be able to lend more money and help revive the slowing economy.
- the merger will lead to increased operational efficiency that will help these banks lower their costs, thus enabling them to lower their lending rates
- Although the government has not projected the present merger as a measure to tackle bad loans, bank mergers in the past have been carried out simply to bail out struggling banks.
- Indian Bank, has a net NPA ratio of 3.8%; it is 5.2% for Allahabad Bank So the merger is expected to adversely affect the health of Indian Bank
- the shares of Indian Bank and other relatively strong banks witnessed a steep fall on the first day of trading after the announcement of the merger
- The merging of healthy banks with weak banks may not really improve the health of the banking system as a whole.
- The bad loan recovery process remains slow due to the inefficient judicial system in the country
- The present merger does not address the issue of political interference in the management of state-owned banks that is at the root of the bad loan crisis.
- The stated purpose of the nationalisation of banks in 1969 was to use bank credit to fund the various development goals of the government.
- Some argue that large banks may not really be essential when it comes to funding big-ticket business projects. In the past, several smaller banks have come together to extend large loans.
- As a construct, it provides much more than access to financial services.
- Enabled through the Jan Dhan Yojana under which the government has opened over 30 crore accounts with almost 60 per cent being in rural areas.
- Importantly, the zero balance accounts amongst these have declined from 77 per cent in 2014 to 20 per cent. Part of this has been driven through the linking of Aadhaar and doing Direct Benefit Transfer (DBT) to these Jan Dhan accounts.

- **The next step was to create an infrastructure which could handle all aspects of servicing such a large segment of the population**
- **Crisil disclosed the findings of its Inclusix financial inclusion index - index is not all-encompassing and looks primarily at credit, deposit, insurance & branch penetration, it gives a rough indicator of financial inclusion.**
- **Availability of credit remains a major roadblock for a vast majority of the population. The problem is exponentially greater for the unbanked segments of our society.**
- **The proliferation of unique credit models backed by increasing data availability for traditional agencies like CIBIL is establishing a new paradigm for lenders**
- **The need for increasingly enhancing financial literacy across society.**
- **Banks began to implement financial inclusion as part of their business policy only after the RBI directed them to adopt a three-year board-approved financial inclusion policy (FIP) that began in 2010**
- **80% of Indian adults have a bank account, but half of them are rarely used. According to the World Bank, 48%of the country's bank accounts have had no transactions in the last one-year.**
- **Globally, the percentage of inoperative accounts stands at 25.**
- **Despite priority sector lending norms, hardly 35 per cent of Indian farmers utilise institutional loans.**
- **IMF bemoans that only 13 per cent of Indian adults borrow through formal channels**
- **The agenda of financial inclusion includes development of entrepreneurship that can be nurtured only when bank customers can save, borrow, and remit/receive funds.**
- **RBI has taken several initiatives that include a recent launch of a pilot project of setting up Centres of Financial Literacy (CFL) based on the hub-and-spoke model.**
- **According to Standard & Poor's 'Global Financial Literacy Survey – 2014', 33 per cent of adults in the world are financially literate.**
- **The average financial literacy rate is 28 per cent of adults among BRICS (Brazil, Russia, India, China and South Africa) economies — with India's being 24 per cent, China 26 per cent, and South Africa 42 per cent.**
- **Due to rising operating costs of branches, banks are increasingly opting to deliver banking through digital mode.**
- **There has been a decline in the number of newly opened bank branches — from 8,749 in FY15 to 3,948 in FY18**
- **The number of ATMs has also started to drop — from 2,08,354 in March 2017 to 2,07,052 by March 2018.**
- **While digital channels are able to provide most of the banking services, they are unable to popularise loan products through digital platform due to lack of digital literacy.**
- **The regulator and banks will have to work in cohesion with local government agencies to educate masses on a large scale**
- **More branches of banks should be there in tier -5 areas.**

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- According to Raghuram Rajan, "Simplicity and reliability in financial inclusion in India, though not a cure all, can be a way of liberating the poor from dependence on indifferently delivered public services and from venal politicians.
- Raghuram Rajan :- , "in order to draw in the poor, the products should address their needs - a safe place to save, a reliable way to send and receive money, a quick way to borrow in times of need or to escape the clutches of the money lender, easy to understand life and health insurance and an avenue to engage in savings for the old age."
- The biggest challenge is one of altering the mind set — of banks, policy makers and bank customers, both potential and existing.
- Commercial viability of inclusion schemes will be the key to the programme's success.
- Many disabled people, especially in rural India, find it difficult to sign bank documents, and are denied ATM cards, cheque books and Internet banking
- Persons with disabilities are compelled to produce witnesses every time they visit banks to make online transactions through real-time gross settlement and national electronic funds transfer.
- The banking industry has classified its customers; it prioritises those it considers suitable for the banks' business
- Since 2001 when the Corporate Debt Restructuring mechanism started. You know how that contributed to all the problems of the pre-2014 NPA cycle. Credit to GDP ratio remains low
- Bank recovery rate is historically low at 25-30%
- Small tickets loan disbursement are low while recovery rates are high
- Indian banking witnessed boom & bust cycle
- The restructuring of assets started in this particular phase before COVID. My reference is, for example, to February 2020 when the real estate commercial sector was allowed restructuring.
- You effectively increase the repayment period; maybe by making it into a new loan, ever greening etc.
- The consequence is that the banks' balance sheets once again don't convey the true nature of their asset book.
- What a restructured standard asset label does is that it gives an NPA [Non-performing Asset] a veil of false legitimacy to hide the true nature of the asset.

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