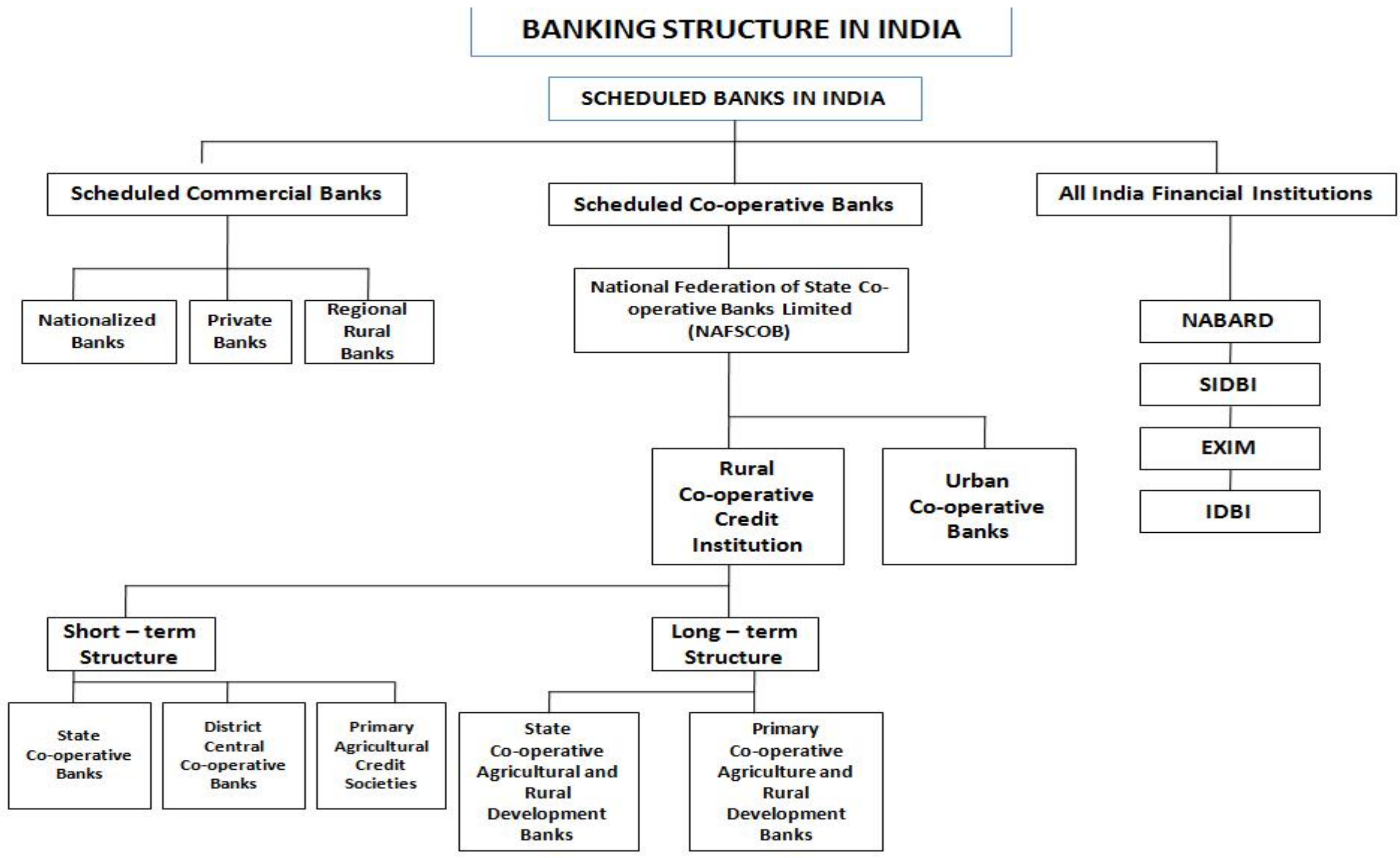
INDIAN BANKING SYSTEM

A globally competitive economy requires a robust and competitive banking system. The present banking system is a result of reforms and policy changes that have taken place in the past.



Ancient India

The Vedas (2000-1400 BCE) are earliest Indian texts to mention the concept of usury. The Sutras (700-100 BCE) and the Jatakas (600-400 BCE) also mention usury. Also, during this period, texts began to condemn usury. Vasishtha forbade Brahmin and Kshatriya varnas from participating in usury.

By 2nd century CE, usury seems to have become more acceptable. The Manusmriti considers usury an acceptable means of acquiring wealth or leading a livelihood. It also considers money lending above a certain rate, different ceiling rates for different caste, a grave sin.

The Jatakas also mention the existence of loan deeds. These were called *rnapatra* or *rnapanna*. The Dharmashastras also supported the use of loan deeds. Kautilya has also mentioned the usage of loan deeds. Loans deeds were also called *rnalekhaya*.

Medieval India

The use of loan deeds continued into the Mughal era and were called dastawez. The evolution of hundis, a type of credit instrument, also occurred during this period and they continue to be in use today.

Colonial Era

During the period of British rule merchants established the Union Bank of Calcutta in 1869, first as a private joint stock association, then partnership.

The Allahabad Bank, established in 1865 and still functioning today, is the oldest Joint Stock bank in India, it was not the first though.

Foreign banks too started to appear, particularly in Calcutta, in the 1860s. HSBC established itself in Bengal in 1869.

The first entirely Indian joint stock bank was the Oudh Commercial Bank, established in 1881 in Faizabad. It failed in 1958.

The next was the Punjab National Bank, established in Lahore in 1894, which has survived to the present and is now one of the largest banks in India.

Post-Independence India

The partition of India in 1947 adversely impacted the economies of Punjab and West Bengal, paralysing banking activities for months. India's independence marked the end of a regime of the Laissez-faire for the Indian banking. The Government of India initiated measures to play an active role in the economic life of the nation, and the Industrial Policy Resolution adopted by the government in 1948 envisaged a mixed economy.

The major steps to regulate banking included:

- The Reserve Bank of India, India's central banking authority, was established in April 1935, but was nationalised on 1 January 1949.
- In 1949, the Banking Regulation Act was enacted which empowered the Reserve Bank of India (RBI) "to regulate, control, and inspect the banks in India".
- The Banking Regulation Act also provided that no new bank or branch of an existing bank could be opened without a license from the RBI, and no two banks could have common directors.

Nationalisation of Indian Banks and up to 1991 prior to Indian banking sector Reforms

Government took major steps in the Indian Banking Sector Reform after independence.

In 1955, it nationalised Imperial Bank of India with extensive banking facilities on a large scale especially in rural and semi urban areas.

It formed State Bank of India to act as the principal agent of RBI and to handle banking transactions of the Union and State Governments all over the country.

Seven banks forming subsidiary of State Bank of India were nationalised on 19th July 1959. In 1969, major process of nationalisation was carried out. It was the effort of the then Prime Minister of India, Mrs. Indira Gandhi 14 major commercial banks in the country was nationalised.

Second phase of nationalisation in Indian Banking Sector Reform was carried out in 1980 with six more banks. This step brought 80% of the banking segment in India under Government ownership.

The following are the steps taken by the Government of India to Regulate Banking Institutions in the country.

i. 1949: Enactment of Banking Regulation Act.
ii. 1955: Nationalisation of State Bank of India.
iii. 1959: Nationalisation of SBI subsidiaries.
iv. 1961: Insurance cover extended to deposits.

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v. 1969: Nationalisation of 14 major banks.
vi. 1971: Creation of credit guarantee corporation.
vii. 1975: Creation of regional rural banks.
viii. 1980: Nationalisation of 6 banks with deposits over 200 crore.

After the nationalisation the branches of the public sector banks in India rose to approximately 800% and deposits and advances took a huge jump by 11,000%.
Banking in the sunshine of Government ownership gave the public implicit faith and immense confidence about the sustainability of these institutions.

New phase of Indian Banking System with the advent of Indian Financial and Banking Sector Reforms after 1991.

In 1991, the country was caught into a deep crisis. The government now decided to introduce comprehensive economic reforms. The banking sector reforms were part of this package.
The main objective of banking sector reforms was to promote a diversified, efficient and competitive financial system with the ultimate goal of improving the allocate efficiency of resources through operational flexibility, improved financial viability and institutional strengthening. Many of the regulatory and supervisory norms were initiated first for the commercial banks and were later extended to other types of financial intermediaries.
The reforms have focused on removing financial repression through reductions in statutory preemptions, while stepping up prudential regulations at the same time. Furthermore, interest rates on both deposits and lending of banks had been progressively deregulated.
In August 1991, the Government appointed a committee under the chair of M. Narasimhan, which worked for the liberalization of banking practices. The aim of this Committee was to bring about “operational flexibility” and “functional autonomy” to enhance efficiency, productivity and profitability of banks.
The Committee submitted its report in November 1991 and recommended:

- Establishment of a four-tier hierarchy for the banking structure consists of three to four large banks with SBI at the top.
- The private sector banks should be treated equally with the public sector banks and govt. should contemplate to nationalize any such banks.
- The ban on setting new banks in private sector should be lifted and the licensing policy in the branch expansion must be abolished.
- The govt. has to be more liberal in the expansion of foreign bank branches and foreign operations of Indian banks should be rationalized.
- The Statutory Liquidity Ratio and Cash Reserve Ratio should be progressively brought down from 1991-92.
- The directed credit program should be re-examined and the priority sector should be redefined to comprise small and marginal farmers, the tiny industrial sector, small business operators and weaker sections.
- Banking industry should follow BIS/Basel norms for capital adequacy within three years.
- Interest rates should be deregulated to suit the market conditions.
- The govt. share of public sector banks should be disinvested to a certain percentage like in case of any other PSU.
- Each public sector banks should setup at least one rural banking subsidiary and they should be treated at par with RRBs.

Measures to improve the fragile health and low profitability included adhering to internationally acceptable prudential norms, asset classification and provisioning and capital adequacy. Several measures were also initiated, the prominent being the enactment of The Recovery of Debts Due to Banks and Financial Institutions Act in 1993. Following this, 29 debt recovery tribunals (DRTs) and five debt recovery appellate tribunals (DRATs) were established at a number of places in the country.
Apart from this, Lok Adalats were increasingly used for settling disputes between banks and small borrowers. Also, credit data started to be shared between banks for guarding against defaulters. Also, NPAs were clearly defined - based on objective criteria in four heath codes from the earlier eight. The new health codes resulted in approximately one-fourth of the total advances made being declared as NPAs.

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Simultaneously, to create competition within the banking sphere, several measures were undertaken. These included the opening of private sector banks, greater freedom to open branches and installation of ATMs, and a full operational freedom to banks to assess working capital requirements.

In order to initiate the second generation of financial sector reforms, a committee on Banking Sector Reforms (BIS), again under the Chairmanship of M. Narasimhan submitted its report on 23rd April 1998 to the Finance Minister of Govt. of India. Narasimhan committee II report had had observed that Central Bank's role should be separated from being monetary authority to that of regulator of the banking sector.

The major recommendations of the second Narasimham II report were mentioned below:

- The committee favored the merger of strong public sector banks and closure of some weaker banks if their rehabilitation was not possible.
- It recommended corrective measures like recapitalization is undertaken for weak banks and if required such banks should be closed down.
- Suggesting a possible short term solution to weak banks, the report observed the narrow banks could be allowed as a mean of facilitating their rehabilitation.
- Expressing concern over rising non-performing assets, the committee provides the idea of setting up an asset reconstruction fund to tackle the problem of huge non-performing assets (NPAs) of banks under public sector.

Post 1998, a need was felt to restructure debt as the DRTs process was painfully slow due to legal and other hurdles. Therefore, a need to felt to build asset reconstruction companies. The enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 enabled the sale of financial assets to securitisation/ reconstruction companies.

Also, a Credit Information Bureau (India) Ltd (CIBIL) was established in 2000 that paved the way for the enactment of the Credit Information Act in May 2005, for credit information of borrowers.

Another feature of the second stage of reforms was the increasing competition between banks. Though 21 new banks (four in the private sector, one in the public sector and 16 foreign entities) entered, the overall scheduled commercial banks (SCB) reduced approximately four-fifths to 82 by 2007. Additionally, FDI in the banking sector was brought under the automatic route, and the limit in private sector banks was raised from 49 percent to 74 percent in 2004.

C Rangarajan Committee

The following is the Summary of the recommendations of the Committee on Financial Inclusion which were released to the media by its Chairman, Dr. C. Rangarajan:

Access to finance by the poor and vulnerable groups is a prerequisite for poverty reduction and social cohesion. This has to become an integral part of our efforts to promote inclusive growth. In fact, providing access to finance is a form of empowerment of the vulnerable groups.

Financial inclusion denotes delivery of financial services at an affordable cost to the vast sections of the disadvantaged and low-income groups. The various financial services include credit, savings, insurance and payments and remittance facilities.

The objective of financial inclusion is to extend the scope of activities of the organized financial system to include within its ambit people with low incomes. Through graduated credit, the attempt must be to lift the poor from one level to another so that they come out of poverty.

National Mission on Financial Inclusion

The Committee feels that the task of financial inclusion must be taken up in a mission mode as a financial inclusion plan at the national level. A National Mission on Financial Inclusion (NaMFI) comprising representatives from all stakeholders may be constituted to aim at achieving universal financial inclusion within a specific time frame. The Mission should be responsible for suggesting the overall policy changes required for achieving the desired level of financial inclusion, and for supporting a range of stakeholders – in the domain of public, private and NGO sectors - in undertaking promotional initiatives.

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A National Rural Financial Inclusion Plan (NRFIP) may be launched with a clear target to provide access to comprehensive financial services, including credit, to atleast 50% of financially excluded households.

Development and Technology Funds

The Committee has proposed the constitution of two funds with NABARD – the Financial Inclusion Promotion & Development Fund and the Financial Inclusion Technology Fund with an initial corpus of Rs. 500 crore each to be contributed in equal proportion by GoI / RBI / NABARD.

Business Correspondent Model

Extending outreach on a scale envisaged under NRFIP would be possible only by leveraging technology to open up channels beyond branch network. This, however, is in addition to extending traditional mode of banking by targeted branch expansion in identified districts. The Business Facilitator/Business Correspondent (BF/BC) models riding on appropriate technology can deliver this outreach and should form the core of the strategy for extending financial inclusion.

Joint Liability Groups

SHG-bank linkage has emerged as an effective credit delivery channel to the poor clients. However, there are segments within the poor such as share croppers/oral lessees/tenant farmers, whose loan requirements are much larger but who have no collaterals to fit into the traditional financing approaches of the banking system. To service such clients, Joint Liability Groups (JLGs), an upgradation of SHG model, could be an effective way.

Micro Finance Institutions - NBFCs

Micro Finance Institutions (MFIs) could play a significant role in facilitating inclusion, as they are uniquely positioned in reaching out to the rural poor. Many of them operate in a limited geographical area, have a greater understanding of the issues specific to the rural poor, enjoy greater acceptability amongst the rural poor and have flexibility in operations providing a level of comfort to their clientele. The Committee has, therefore, recommended that greater legitimacy, accountability and transparency will not only enable MFIs to source adequate debt and equity funds, but also eventually enable them to take and use savings as a low cost source for on-lending.

There is a need to recognize a separate category of Micro finance – Non Banking Finance Companies (MF–NBFCs), without any relaxation on start-up capital and subject to the regulatory prescriptions applicable for NBFCs. Such MF-NBFCs could provide thrift, credit, micro-insurance, remittances and other financial services up to a specified amount to the poor in rural, semi-urban and urban areas. Such MF-NBFCs may also be recognized as Business Correspondents of banks for providing only savings and remittance services and also act as micro insurance agents.

The Micro Financial Sector (Development and Regulation) Bill, 2007 has been introduced in Parliament in March 2007. The Committee feels that the Bill, when enacted, would help in promoting orderly growth of microfinance sector in India.

Micro Insurance

Micro-insurance is a key element in the financial services package for people at the bottom of the pyramid. The poor face more risks than the well off. The Committee concurs with the view that offering micro credit without micro-insurance is self-defeating. There is, therefore, a need to emphasise linking of micro credit with micro-insurance.

The country has moved on to a higher growth trajectory. To sustain and accelerate the growth momentum, we have to ensure increased participation of the economically weak segments of population in the process of economic growth. Financial inclusion of hitherto excluded segments of population is a critical part of this process of inclusion.

Urjit Patel Committee

An expert committee had been constituted by the RBI Governor on September 12, 2013 to recommend measures to revise and strengthen the current monetary policy framework, with a view of making it transparent and predictable. The Committee

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(Chairperson: Dr. Urjit Patel) submitted a draft report January 21, 2014.
The main recommendations are:

- **Choice of nominal anchor**: Currently, RBI uses a "multiple indicator approach" to draw monetary policy perspective. The Committee made the following recommendations:
  i. Inflation, as measured by Consumer Price Index (CPI) should be the nominal anchor for the monetary policy framework. This is because CPI, as an indicator of retail inflation, is the closest proxy of a true cost of living, and influences inflation expectations of households.
  ii. Nominal anchor will be targeted at 4% with a band of +/- 2%.
  iii. CPI inflation should be brought down to 8% over next 12 months, and 6% in the next 24 months before formally adopting the recommended target.
- **Organisational Structure**: Currently, monetary policy decisions are made by the Governor of the RBI, who is accountable to the Government of India.

The Committee recommended that monetary policy decision making be vested in a Monetary Policy Committee. This Committee should be composed of five members, with the Governor as its head. The Committee will be held accountable for failure to establish and achieve the nominal anchor.

- **Operating Framework**: Currently, the monetary policy framework operates via changes in repo rate, which sets interest rates for overnight borrowing by banks. The Committee recommended moving towards using term repo rate instead of overnight repo rate.

Nachiket Mor Committee

The Committee on Comprehensive Financial Services for Small Businesses and Low Income Households (Chairperson: Dr. Nachiket Mor) submitted its final report on December 31, 2013. The Reserve Bank of India (RBI), on September 23, 2013, had appointed the Committee to propose measures for achieving financial inclusion and increased access to financial services.
The Committee proposed the following to be achieved by January 1, 2016:

i. provide each Indian resident above the age of 18 with an individual, full-service electronic bank account,
ii. Set up widely distributed Electronic Payment Access Points offering deposit and withdrawal facilities at reasonable cost,
iii. Provide each low-income household convenient access to formally regulated providers that can provide suitable:
   a) Credit products,
   b) Investment and deposit products, and
   c) Insurance and risk management products at a reasonable price, and
iv. To provide every customer the legally protected right to be offered suitable financial services.

The major recommendations of the Committee are:

- **Wide-spread payment network and universal access to savings:** The Committee recommended that every resident receive a Universal Electronic Bank Account at the time of registering for an Aadhaar card. It recommended that RBI prohibit banks from refusing to open an account and that Aadhaar be made the universal basis for authentication.
  The Committee proposed the setting up of Payments Banks whose primary purpose will be to provide payments services and deposit products to small businesses and low income households. These banks will be restricted to holding a maximum balance of Rs. 50,000 per customer and will be required to have a minimum entry capital of Rs 50 crore.
  It further proposed the setting up of Wholesale Banks which will lend to corporates and purchase securitised retail and small-business loans. These banks will only accept deposits larger than Rs 5 crore and will require minimum entry capital of Rs 50 crore.
- **Sufficient access to affordable formal credit:** The Committee recommended a number of steps to be taken to help banks manage their credit exposures effectively, including allowing banks to purchase portfolio insurance.
  Universal reporting of information with credit bureaus should be mandatory for all loans,

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especially Kisan credit cards and general credit cards.

Further, it recommended that banks price farm loans based on risk and that any waivers be provided by the government through direct benefit transfer and not through interest subsidies or loan waivers.

The Committee proposed that a State Finance Regulatory Commission be set up into which all state level financial regulators will be merged.

It recommended that the Non-Performing Asset reporting provisions and other regulations for Non-Banking Finance Companies (NBFCs) be aligned with those of banks.

It also suggested measures to ease funding constraints of NBFCs including relaxation of External Commercial Borrowings and equity investment rules. Further, it proposed the removal of barriers to the transition of NBFCs into banks by including more sectors in the Priority Sector Lending (PSL) classification.

- **Priority Sector Lending:** The Committee suggested that investment by banks in bonds and equities and provision of guarantees to PSL beneficiaries be counted towards meeting the banks' PSL targets. It recommended the removal of the cap on interest rate on loans at the base rate plus 8% per annum. It also recommended that the PSL target be revised from 40% to 50% of credit provided.
- **Customer protection issues:** The Committee proposed that financial service providers be required to commit capital against customer protection risk. It proposed that firms be made liable to ensure suitability of products issued to customers and that RBI frame regulations regarding the same. It proposed the setting up of a unified Financial Redress Agency (FRA) that will handle customer grievances across all financial products in coordination with their respective regulators.

INDRADHANUSH – Plan for Revamp of Public Sector Banks

The Public Sector Banks (PSBs) play a vital role in India's economy. In the past few years, because of a variety of legacy issues including the delay caused in various approvals as well as land acquisition etc., and also because of low global and domestic demand, many large projects have stalled.

Public Sector Banks which have got predominant share of infrastructure financing have been sorely affected. It has resulted in lower profitability for PSBs, mainly due to provisioning for the restructured projects as well as for gross NPAs.

The present Government has put in place a comprehensive framework for improving PSBs. Most recently, we have made the announcement of capital allocation by Government for PSBs in the next four years. Announcement of capital plans for the PSBs is only one of the many steps taken by the Government. The other steps taken by Government are as follows:-

A. *Appointments:*

The Government decided to separate the post of Chairman and Managing Director by prescribing that in the subsequent vacancies to be filled up the CEO will get the designation of MD & CEO and there would be another person who would be appointed as non-Executive Chairman of PSBs. This approach is based on global best practices and as per the guidelines in the Companies Act to ensure appropriate checks and balances. The selection process for both these positions has been transparent and meritocratic.

B. *Bank Board Bureau:*

The announcement of the Bank Board Bureau (BBB) was made by Hon'ble Finance Minister in his Budget Speech for the year 2015-16.

The BBB will be a body of eminent professionals and officials, which will replace the Appointments Board for appointment of Whole-time Directors as well as non-Executive Chairman of PSBs.

They will also constantly engage with the Board of Directors of all the PSBs to formulate appropriate strategies for their growth and development.

The structure of the BBB is going to be as follows:

The BBB will comprise of a Chairman and six more members of which three will be officials and three experts (of which two would necessarily be from the banking sector). The Search Committee for members of the BBB would comprise of the Governor, RBI and Secretary (FS) and Secretary (DoPT) as members. The

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members will be selected in the next six months and the BBB will start functioning from the 01st April, 2016.

C. *Capitalization:*

As of now, the PSBs are adequately capitalized and meeting all the Basel III and RBI norms. However, the Government of India wants to adequately capitalize all the banks to keep a safe buffer over and above the minimum norms of Basel III. We have, therefore, estimated how much capital will be required this year and in the next three years till FY 2019. If we exclude the internal profit generation which is going to be available to PSBs (based on the estimate of average profit of the last three years), the capital requirement of **extra capital** for the next four years **up to FY 2019 is likely to be about Rs.1,80,000 crore**. Out of the total requirement, the Government of India proposes to make available Rs.70,000 crores.

PSB's market valuations will improve significantly due to

(i) far-reaching governance reforms;
(ii) tight NPA management and risk controls;
(iii) significant operating improvements; and
(iv) Capital allocation from the government.

Improved valuations coupled with value unlocking from non-core assets as well as improvements in capital productivity, will enable **PSBs to raise the remaining Rs. 1,10,000 crore from the market.**

D. *a) De-stressing PSBs*

The infrastructure sector and core sector have been the major recipient of PSBs' funding during the past decades. But due to several factors, projects are increasingly stalled/stressed thus leading to NPA burden on banks. In a recent review, problems causing stress in the power, steel and road sectors were examined. It was observed that the major reasons affecting these projects were delay in obtaining permits / approvals from various governmental and regulatory agencies, and land acquisition, delaying Commercial Operation Date (COD); lack of availability of fuel, both coal and gas; cancellation of coal blocks; closure of Iron Ore mines affecting project viability; lack of transmission capacity; funding gap faced by limited capacity of promoters to raise additional equity and reluctance on part of banks to increase their exposure given the high leverage ratio; inability of banks to restructure projects even when found viable due to regulatory constraints. In case of steel sector the prevailing market conditions, viz. global over-capacity coupled with reduction in demand led to substantial reduction in global prices, and softening in domestic prices added to the woes.

A meeting was held on 28th April, 2015 at Mumbai first with all the banks and concerned Ministries to understand the problems for each sector. Subsequently, meetings were held with project promoters of steel, power and road sectors at various levels to understand further the pain points of each and every sector.

Some of the actions proposed / undertaken after these meetings are as follows:-

i. Project Monitoring Group (Cab. Sectt.) / Respective Ministries will pursue with concerned agencies to facilitate **issue of pending approval/permits** expeditiously.
ii. Pending **policy decisions** to facilitate project implementation/operation would be taken up by respective Ministries/Departments.
iii. Ministry of Coal/PNG will evolve policies to address **long-term availability** of fuel for these projects.
iv. Respective **Discoms** will be provided **hand-holding** towards enabling early reforms.
v. **Promoters** will be asked to bring in **additional equity** in an attempt to address the worsening leverage ratio of these projects. Wherever the promoters are unable to meet this requirement, the Banks would consider viable options for **substitution or taking over management control.**
vi. The possibility of changing the **extant duty regime** without adversely impacting the downstream user industry would be considered by the Government. **The decision to increase import duty on steel has already been taken.**
vii. RBI has been requested to consider the proposal of the Banks for granting further

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flexibility in restructuring of existing loans wherever the Banks find viability.

b) Strengthening Risk Control measures and NPA Disclosures

Besides the recovery efforts under the DRT & SARFASI mechanism the following additional steps have been taken to address the issue of NPAs:

i. RBI has released guidelines dated 30 January, 2014 for "**Early Recognition of Financial Distress, Prompt Steps for Resolution and Fair Recovery for Lenders: Framework for Revitalizing Distressed Assets in the Economy**" suggesting various steps for quicker recognition and resolution of stressed assets:
    a. **Creation of a Central Repository of Information on Large Credits (CRILC**) by RBI to collect, store, and disseminate credit data to banks on credit exposures of Rs. 5 crore and above,
    b. **Formation of Joint Lenders Forum (JLF**), **Corrective Action Plan (CAP), and sale of assets. -** The Framework outlines formation of JLF and corrective action plan that will incentivise early identification of problem cases, timely restructuring of accounts which are considered to be viable, and taking prompt steps by banks for recovery or sale of unviable accounts

ii. **Flexible Structuring of Loan Term Project Loans to Infrastructure and Core Industries –** Long term financing for infrastructure has been a major constraint in encouraging larger private sector participation in this sector. On the asset side, banks will be encouraged to extend long term loans to infrastructure sector with flexible structuring to absorb potential adverse contingencies, **(also known as the 5/25 structure).**

iii. **Wilful Default/Non-Cooperative Borrowers:** RBI has now came out with new category of borrower called Non-Cooperative borrower. A non-cooperative borrower is a borrower who does not provide information on its finances to the banks. Banks will have to do higher provisioning if they give fresh loan to such a borrower. Fresh exposure to a borrower reported as non-cooperative will <u>necessitate higher provisioning</u>. Banks/FIs are required to make higher provisioning as applicable to substandard assets in respect of new loans sanctioned to such borrowers as also new loans sanctioned to any other company that has on its board of directors any of the whole time directors/promoters of a non-cooperative borrowing company or any firm in which such a non-cooperative borrower is in charge of management of the affairs.

iv. **Asset Reconstruction Companies:** Taking further steps in the area, RBI has tightened the norms for Asset Reconstruction Companies (ARCs), where the minimum investment in Security Receipts should be 15% which was earlier 5%. This step will increase the cash stake of ARCs in the assets purchased by them. Further, by having more cash up front, the banks will have better incentive to clean their balance sheet.

v. **Establishment of six New DRTs:** Government has decided to establish six new Debt Recovery Tribunals (DRT) (at Chandigarh, Bengaluru, Ernakulum, Dehradun, Siliguri, Hyderabad) to speed up the recovery of bad loans of the banking sector.

E. *Empowerment:*

The Government has issued a circular that there will be <u>no interference</u> from Government and Banks are encouraged to take their decision independently keeping the commercial interest of the organisation in mind. A cleaner distinction between interference and intervention has been made. With autonomy comes accountability, accordingly Banks have been asked to build <u>robust Grievances Redressal Mechanism for customers as well as staff</u> so that concerns of the affected are addressed effectively in time bound manner.

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The Government intends to provide greater flexibility in hiring manpower to Banks. The Government is committed to provide required professionals as Nominee Directors to the Board so that well-informed and well-discussed decisions are taken.

F. *Framework of Accountability:*

a. The present system for the measurement of bank's performance was a system called SoI – Statement of Intent. Based on certain criteria decided by Ministry of Finance, the banks used to come up with their annual target figures which was discussed between the Ministry and banks and finalized. The entire exercise took very long and sometimes the targets for banks used to be finalized only towards the end of the year which is not a desirable thing to do. There are two changes we are making in this:
   i. A new framework of **Key Performance Indicators (KPIs)** to be measured for performance of PSBs is being announced. It is divided into four sections totaling up to 100 marks. 25 marks each are allotted to indicators relating to **efficiency of capital use** and **diversification of business/processes** and 15 marks each are allotted for specific indicators under the category of **NPA management** and **financial inclusion**. The total marks to be allotted for quantifiable, measurable criteria is 80.
   ii. The remaining 20 marks are reserved for measurement of qualitative criteria which includes **strategic initiatives** taken to improve asset quality, **efforts made to conserve capital**, **HR initiatives** and **improvement in external credit rating**.

The new framework for KPIs is in the docket. Operating performance evaluated through the **KPI framework will be linked to the performance bonus** to be paid to the MD & CEOs of banks by the Government.

b. Dept. of Financial Services has issued a circular to PSBs laying down strict timelines for filing of complaints of fraud cases with CBI as well as for monitoring each and every case almost on a day-to-day basis.

c. Streamlining vigilance process for quick action for major frauds including connivance of staff. Under the new guidelines, a timeframe of six months, red flagging of accounts, constitution of a Risk Management Group (RMG) in banks to monitor pre-sanction and disbursement, nodal officer for filing complaints with CBI, provisioning in four quarters and creation of Central Fraud Registry have been laid down.

G. Governance Reforms:

The process of governance reforms started with **"Gyan Sangam"** - a conclave of PSBs and FIs organized at the beginning of 2015 in Pune which was attended by all stake-holders including Prime Minister, Finance Minister, MoS (Finance), Governor, RBI and CMDs of all PSBs and FIs. There was focus group discussion on six different topics which resulted in specific decisions on optimizing capital, digitizing processes, strengthening risk management, improving managerial performance and financial inclusion.

The decision to set up a **Bank Board Bureau** which was subsequently announced in the Budget Speech of Hon'ble Finance Minister, came out of the recommendations of Gyan Sangam.

Also, at this conclave, Hon'ble Prime Minister made a significant promise to the bankers that there would be no interference from any Government functionary in the matter of their commercial decisions.

The Gyan Sangam recommendations included **strengthening of risk management practices**. Each bank agreed to nominate a senior officer as Chief Risk Officer of the bank.

The Government has been constantly engaging with the Banks through review meeting and sessions for strategic reviews etc. The focus is on improving HR management practices and removing barriers so that the Banks can share and work together on

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common resources. Various steps have been taken to empower Bank's Boards.

P. J. Nayak Recommendations

A RBI committee headed by Mr. P.J. Nayak released the draft recommendations on governance changes for PSU banks and revamping their ownership structure. The report aims to address key issues such as improving the capital position of PSU banks, enhancing governance and resolving their external and internal constraints.

Key recommendations:

- *Make RBI the sole regulator with no interventions from GoI:* To ensure uniform implementation of regulations, the committee recommended that RBI be made the sole regulator of banks and GoI's intervention be stopped.
- *Minimum fixed tenure for top PSU bank executives*: The committee recommended a minimum five-year tenure for CMD and a minimum three-year tenure for Executive Directors in PSU banks. For private sector banks, the minimum and maximum age prescribed by the Companies Act at the time of appointment should be applicable to all directors.
- *To create Authorised Bank Investors (ABIs):* The RBI should designate a specific category of investors as Authorised Bank Investors (ABIs), consolidating all funds with diversified investors. A single ABI should be permitted a maximum 20% investment in a bank without approval, and 15% if it has a board representation in the bank. Other investors can hold no more than 10% without regulatory approval.
- *To set up a Bank Investment Company (BIC):* The GoI should set up a BIC as a core investment company under RBI's registration, to hold equity shares in banks which are presently held by GoI. The BIC should resemble a passive sovereign wealth fund.
- *Move towards fully empowered boards in PSU banks:* The committee recommended upgrading the quality of board deliberation in PSU banks to provide greater strategic focus. To empower and make these boards more effective, the committee recommends reconfiguring the entire appointment process for boards.
- *Privatise PSU banks or design a new governance structure:* To avoid repeated capital support from the government and ensure ability to compete successfully, the committee suggested either to privatise PSU banks or to design a radically new governance structure.
- *To move the bank licensing regime to a uniform license* across all broad-based banks, irrespective of ownership, subject to inter-jurisdictional reciprocity considerations in respect of foreign banks, and niche licenses for banks with more narrowly-defined businesses.
- *GoI to consider reducing its holding in banks to less than 50%,* to ensure restoration of a level-playing field for PSU banks in matters of vigilance enforcement, employee compensation and the applicability of the right to information.
- *To entrust selection of the top management of PSU banks during phase I to a newly-constituted Bank Boards Bureau (BBB)*. The committee also recommended that the BBB be set up by an executive order of the GOI and comprise three senior bankers chosen from among those who are either serving or retired Chairmen of banks, one of whom will be the Chairman of BBB.

Non-Performing Asset

A non-performing asset (NPA) is a loan or advance for which the principal or interest payment remained overdue for a period of 90 days.

Banks are required to classify NPAs further into Substandard, Doubtful and Loss assets.

1. *Substandard assets:* Assets which has remained NPA for a period less than or equal to 12 months.
2. *Doubtful assets:* An asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months.
3. *Loss assets:* As per RBI, "Loss asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted, although there may be some salvage or recovery value."

With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt the '90 days' overdue' norm

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for identification of NPA, from the year ending March 31, 2004. Accordingly, with effect from March 31, 2004, a non-performing asset (NPA) is a loan or an advance where;

- Interest and/or installment of principal remain overdue for a period of more than 91 days in respect of a term loan,
- The account remains 'out of order' for a period of more than 90 days, in respect of an Overdraft/Cash Credit (OD/CC),
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.
- Non submission of Stock Statements for 3 Continuous Quarters in case of Cash Credit Facility.
- No active transactions in the account (Cash Credit/Over Draft/EPC/PCFC) for more than 91days

However, in terms of Agriculture / Farm Loans; the NPA is defined as under:

- For short duration crop agriculture loans such as paddy, Jowar, Bajra etc. if the loan (installment / interest) is not paid for 2 crop seasons, it would be termed as a NPA.
- For Long Duration Crops, the above would be 1 Crop season from the due date.

Reasons for an asset turning NPA

There are various reasons either jointly or singly responsible for an asset becoming NPA can be classified as follows:-

A. Reasons from the economic side

1. Political: Mindset regarding paradigm, proactive, fiscal responsible, major portion of NPA arise out of lending to priority sector at the dictates of politicians and bureaucrats.
2. Economic: Growth, distribution, efficient allocation of resource.
3. Social: Acceptability, mobility, education.
4. Technological: Lack of adoption of IT makes data processing difficult.
5. Legal: loan contracts are not enforceable naturally be a tendency to default.
6. Environmental: Liberalization and globalization.

B. Reasons from the industry side

1. Global competition.
2. Cyclical downswing.
3. Sunset industry – industry growing slowly or declining.
4. Frequent changes in regulatory norms.

C. Reasons from the borrower side

1. Misconceived project.
2. Poor governance.
3. Product failure.
4. Bungling management.
5. Diversion of fund.
6. Dormant capital structure.
7. Regulator changes.

D. Reasons from the banking side

1. Parameter set for functioning was deficient.
2. Lack of freedom to choose product and pricing.
3. Unexposed to international marketing methods and products.
4. Wrong lending decision.
5. Lack of Resource and poor training.
6. Lack of system and procedure.
7. Lack of ability to handle assets and liability.
8. Lack of mechanism of credit information dissemination.
9. Lack of an effective judicial system for recovery from defaulters.
10. Collateral based lending to idle assets.
11. Fixing of price and quantum of loans.
12. Lack of effective IT system and MIS.

E. Reasons from the loan structuring side

1. High debt equity ratio.
2. Timing of raising equity.
3. Discrepancy between rate of interest charged and realistic rate of return.
4. Inconsistency between revenue generation and the loan repayment schedule.

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5. Lack of binding penal clause and performance guarantees.
6. Rising interest rate.

Effects of NPAs

1. Profitability – because of the money getting blocked the prodigality of financial institution decreases not only by the amount of NPA but it also leads to opportunity cost also as that much of profit could be invested in some return earning project/asset.
2. Difficulty in resource mobilisation.
3. Reduced liquidity of the financial institution.
4. Difficulty in sanctions and disbursement – due to insufficient fund financial institutions find it difficult to invest in new projects.
5. High operational cost of to the financial institutions.
6. Adverse impact on the goodwill – since main cause of NPA is lack of efficiency in management.

Solutions

1. Restructuring of finance - Bank has to increases the number of installment by minimizing the quantum of installment in order to recover the loan.
2. Asset Restructuring Companies (ARCs) - ARCs purchase bad or non-performing loans, either of a company or an entire portfolio, hoping to restructure the loan or sell the assets to make money.
3. Lok Adalats
4. Debt Recovery Tribunals - It was set up under the recovery of debts due to banks and Financial Intuitions Act, 1993 with exclusive jurisdiction to try and dispose of matters pertaining to recovery of debts due to bank and financial assets. It has the potential of playing a significant role in NPA realization.
5. Corporate Debt Restructuring (CDR) - Corporate debt restructuring mechanism was introduced as a platform for handling large NPA, with a potential to give long term package of financial and management restructuring. It rephrases the loan servicing obligation of the borrower and some concession in the interest rate
6. SARFAESI Act - There was no legal provision for facilitating securitization of financial assets of bank and FIs or power to take possession of securities and sell them. This resulted in slow recovery of defaulting loan and mounting levels of NPA of bank and FIs and a need was felt for keeping pace with changing commercial practice and financial sector reforms. Keeping with this an enabling legislative and regulatory frame work was put in place with the enactment of the securitization and Reconstruction of Financial assets and Enforcement of Security interest Act,2002.
7. Well-developed capital markets - A capital market brings liquidity and a mechanism for write off of loans. Without this a bank may seek to postpone the NPA problem for fear of capital adequacy problems and resort to tactics like ever greening. Monitoring by bondholders is better as they have no motive to sustain uneconomic activity. Further, the banks can manage credit risk better as it is easier to sell or securitize loans and negotiate credit derivatives. India debt market is relatively under developed and attention should be focused on building liquidity and volumes.
8. Contextual Decision making - Regulations must incorporate a contextual perspective (like temporary cash flow problems) and clients should be handled in a manner which reflects true value of their assets and future potential to pay.
9. Legal Issues - There have been instances of banks extending credit to doubtful debtors (who willfully default on debt) and getting kickbacks for the same. Ineffective Legal mechanisms and inadequate internal control mechanisms have made this problem grow – quick action has to be taken on both counts so that both the defaulters and the authorizing officer are punished heavily. Without this, all the mechanisms suggested above may prove to be ineffective.
10. Regular Training Programme - Executives have to undergo regular training program on credit

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and NPA management. It is very useful and helpful to the executives for dealing the NPAs properly.

11. Recovery Camps - The banks should conduct regular or periodical recovery camps in the bank premises or some other place, such type of recovery camps reduced the levels of NPA in the banks
12. Spot Visit - The bank officials should visit to the borrower's business place / borrowers field regularly or periodically.
13. Other methods –
    a) Persistent phone calls
    b) Media announcement.

Monetary Policy

Monetary policy is the macroeconomic policy laid down by the central bank. It involves management of money supply and interest rate and is the demand side economic policy used by the government of a country to achieve macroeconomic objectives like inflation, consumption, growth and liquidity.

Monetary policy is concerned with the measures taken to regulate the supply of money, the cost and availability of credit in the economy. Further, it also deals with the distribution of credit between uses and users and also with both the lending and borrowing rates of interest of the banks.

Objectives of Monetary Policy

a. Full Employment
b. Price Stability i.e. checking inflation and deflation
c. Economic Growth
d. Equilibrium in Balance of Payments
e. Equal Income distribution
f. Exchange rate stability

Instruments of Monetary Policy

Various instruments of monetary policy of RBI can be divided into quantitative and qualitative instruments.

Quantitative Instruments

The quantitative measures are Open Market Operations, Liquidity Adjustment Facility (Repo and Reverse Repo), Marginal Standing Facility, SLR, Bank Rate, Credit Ceiling etc.

1. Open Market Operations - In the case of excess liquidity, RBI resorts to sale of G-secs to suck out rupee from system. Similarly, when there is a liquidity crunch in the economy, RBI buys securities from the market, thereby releasing liquidity.
2. Liquidity Adjustment Facility - RBI uses the weapons of Repo Rate and Reverse Repo Rate for injection or absorption of liquidity that is consistent with the prevailing monetary policy stance. The repo rate (at which liquidity is injected) and reverse repo rate (at which liquidity is absorbed) under the Liquidity Adjustment Facility (LAF) have emerged as the main instruments for the Reserve Bank's interest rate signalling in the Indian economy.
3. Marginal Standing Facility - To curb the problem of volatility in inter-bank interest rates in the overnight rate, banks are allowed to borrow more funds against G-secs as collateral from the RBI at a rate 100 basis points above the Repo Rate. This is known as Marginal Standing Facility.
4. Statutory Liquidity Ratio - The banks and other financial institutions in India have to keep a fraction of their total net time and demand liabilities in the form of liquid assets such as G-secs, precious metals, approved securities etc. This fraction is called Statutory Liquidity Ratio (SLR).
5. Bank Rate - Bank Rate refers to the official interest rate at which RBI will provide loans to the banking system which includes commercial / cooperative banks, development banks etc.
6. Credit Ceiling - Under the credit ceiling, RBI informs the banks to what extent / limit they would be getting credit. When RBI imposes a credit limit, the banks will get tight in advancing loans to public. Further, RBI may also direct the banks to provide certain fractions of their loans to certain sectors such as farm sector or priority sector.

Qualitative Measures

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There are some qualitative measures also such as margin requirements, consumer credit regulation, guidelines, Moral suasion and direct action.

1. Margin requirements - This refers to difference between the securities offered and amount borrowed by the banks.
2. Consumer Credit Regulation - This refers to issuing rules regarding down payments and maximum maturities of instalment credit for purchase of goods.
3. RBI Guidelines RBI issues oral, written statements, appeals, guidelines, and warnings etc. to the banks.
4. Rationing of credit - The RBI controls the Credit granted / allocated by commercial banks.
5. Moral Suasion - Moral Suasion refers to a request by the RBI to the commercial banks to take certain measures as per the trend of the economy. For example, RBI may ask banks to not to give out certain loans. It includes psychological means and informal means of selective credit control.
6. Direct Action - This step is taken by the RBI against banks that don't fulfil conditions and requirements. RBI may refuse to rediscount their papers or may give excess credits or charge a penal rate of interest over and above the Bank rate, for credit demanded beyond a limit.

Cash Reserve Ratio (CRR)

Commercial Banks are required to hold a certain proportion of their deposits in the form of cash with RBI. CRR is the minimum amount of cash that commercial banks have to keep with the RBI at any given point in time. RBI uses CRR either to drain excess liquidity from the economy or to release additional funds needed for the growth of the economy.

CRR is that proportion of a bank's Net Demand and Time Liabilities (NDTL) that it has to keep as cash deposits with RBI. Cash deposits do not mean physical cash, but a credit balance in a current account that every bank maintains at RBI.CRR remains in current account and banks don't earn anything on that.

Statutory Liquidity Ratio (SLR)

SLR is the amount that commercial banks are required to maintain in the form of gold or government approved securities before providing credit to the customers.

SLR is stated in terms of a percentage of total deposits available with a commercial bank and is determined and maintained by the RBI in order to control the expansion of bank credit.

Repo Rate

The rate at which the RBI is willing to lend to commercial banks is called Repo Rate. Whenever commercial banks have any shortage of funds they can borrow from the RBI, against securities. If the RBI increases the Repo Rate, it makes borrowing expensive for commercial banks and vice versa. As a tool to control inflation, RBI increases the Repo Rate, making it more expensive for the banks to borrow from the RBI with a view to restrict the availability of money. The RBI will do the exact opposite in a deflationary environment when it wants to encourage growth.

Reverse Repo Rate

The rate at which the RBI is willing to borrow from the commercial banks is called reverse repo rate. If the RBI increases the reverse repo rate, it means that the RBI is willing to offer lucrative interest rate to commercial banks to park their money with the RBI. This results in a reduction in the amount of money available for the bank's customers as banks prefer to park their money with the RBI as it involves higher safety. This naturally leads to a higher rate of interest which the banks will demand from their customers for lending money to them.

Capital Adequacy Ratio (CAR)

CAR, also known as Capital to Risk (Weighted) Assets Ratio (CRAR), is the ratio of a bank's capital to its risk.

National regulators track a bank's CAR to ensure that it can absorb a reasonable amount of loss and complies with statutory Capital requirements.

It is expressed as a percentage of a bank's risk weighted credit exposures.

$$CAR = \frac{\text{Tier One Capital} + \text{Tier Two Capital}}{\text{Risk Weighted Assets}}$$

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This ratio is used to protect depositors and promote the stability and efficiency of financial systems around the world.

Two types of capital are measured: tier one capital, which can absorb losses without a bank being required to cease trading, and tier two capital, which can absorb losses in the event of a winding-up and so provides a lesser degree of protection to depositors.

Difference between Bank Rate and Repo Rate

a. *Loan vs. Securities* – Bank rate usually deals with loans, whereas, repo or repurchase rate deals with the securities. The bank rate is charged to commercial banks against the loan issued to them by central banks, whereas, the repo rate is charged for repurchasing the securities.
b. *Using a Collateral* – No collateral is involved in a bank rate. But a repurchase agreement uses securities as collateral, which are repurchased at a later date.
c. *Which rate is higher*? – Repo rate is comparatively lower than a bank rate.
d. *Effect on Lending Rate and Term Period* – Repo rate is usually used to cater the short term fund requirements of businesses. So, when central banks increase the repo rate, they try to reduce liquidity in the economy. However, it doesn't affect the market rate of interest, because commercial banks bear the additional burden to secure their customer base. But as soon as the bank rate increases, it directly affects the lending rate offered to customers, discouraging them from taking loans and damaging the overall economic growth. Repo rate might leave an impact on the investment amount, but its impact will not be as direct and drastic as a bank rate.

Sixth Bi-monthly Monetary Policy Statement, 2015-16

On the basis of an assessment of the current and evolving macroeconomic situation, it has been decided to:

- keep the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 6.75 per cent;
- keep the cash reserve ratio (CRR) of scheduled banks unchanged at 4.0 per cent of net demand and time liability (NDTL);
- continue to provide liquidity under overnight repos at 0.25 per cent of bank-wise NDTL at the LAF repo rate and liquidity under 14-day term repos as well as longer term repos of up to 0.75 per cent of NDTL of the banking system through auctions; and
- Continue with daily variable rate repos and reverse repos to smooth liquidity.

Consequently, the reverse repo rate under the LAF will remain unchanged at 5.75 per cent, and the marginal standing facility (MSF) rate and the Bank Rate at 7.75 per cent.

Modernising the monetary policy

The Finance Minister in his maiden Union Budget speech had observed that "it is also essential to have a modern monetary policy framework to meet the challenge of an increasingly complex economy. Government will, in close consultation with the RBI, put in place such a framework." Indeed, the government, according to press reports, is working on modernising the monetary policy.

Varying objectives

The objective of monetary policy varies in different countries. In the U.K., the objective of monetary policy is to deliver price stability — implying low inflation — and, subject to that, to support the government's economic objectives including those for growth and employment. Price stability in the U.K. is defined by the government's inflation target of two per cent.

In the U.S., monetary policy has two basic goals: to promote maximum sustainable output and employment, and to promote stable prices.

In India, according to the Reserve Bank of India (RBI) Act, 1934, the objectives of the Reserve Bank are "...to regulate the issue of Bank notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its

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advantage." The formulation, framework and institutional architecture of monetary policy in India have evolved over time around these objectives — maintaining price stability; ensuring adequate flow of credit to sustain growth; and securing financial stability.

Modernising monetary policy framework should not be confused with another approach popularly called inflation targeting (IT) just because over the years, from 1990 to 2008, about two dozen countries adopted it, prominent amongst them being Australia, Canada, New Zealand, and U.K. IT assumes that price stability is explicitly the mandate and a quantitative target for inflation is publicly announced.

Overall, monetary policy is based on a wide set of information that includes an inflation forecast; transparency in operations; and accountability mechanism. As can be easily noted, the IT approach mounts blinkers on the central bank and absolves it from other responsibilities: IT was in disrepute after the onset of the great recession in 2008. India resisted adopting IT all these years as it binds the central banker, and, after minting its own Multiple Indicator Approach in 1997, demonstrated its efficiency by following it meticulously to stave off the Southeast Asian Crisis as well as the great recession.

The monetary policy framework can be modernised by a number of initiatives which are successfully followed in other countries. In the U.K., every month, the Agent's Summary compiled by the Bank of England's (BoE's) 12 agents, following discussions with 700 businesses, is published to assist the monetary policy makers in conjunction with intelligence from other sources. Similarly, in the U.S., the Beige Book, published eight times every year, is based on anecdotal information on current economic conditions collected by each of the Federal Reserve Banks in their respective districts through reports and interviews with key business contacts, economists, market experts, and other sources. The Beige Book is an important source of real time market intelligence for the Federal Open Market Committee (FOMC).

Another key component of modern monetary policy is Monetary Policy Committee (MPC) which consists of members from within the central bank and experts in the country. In the U.K., the external members of the MPC are appointed for three years by the Chancellor and such appointments of independent members are designed to ensure that the MPC benefits from expertise in the area of economics and monetary policy. Each member of the MPC has a vote to set interest rates and the MPC's decision is not based on a consensus of opinion.

The standard practice in the advanced countries is to disseminate research and models that are being used for forecasting. Since monetary policy takes time to act on output and inflation, sometimes more than two years, a forward-looking assessment is essential. This forecast can be prepared with the help of large macro-econometric models. As the BoE has been actively engaged in IT, the modelling experience in the U.K. can serve as a good illustration.

The history of large macro-econometric models used in the BoE dates back to 1970s and though perfected over the years, the BoE still follows a multi-model approach to project inflation nine quarters in the future.

Initially, the BoE used to supply the projected path of inflation exclusively to the Treasury. Since adopting IT in October 1992, the BoE has been placing quarterly inflation report in the public detailing its assessment of inflation and growth along with methodology of computing fan charts, and assumptions and models used in forecasting. The inflation report helps the BoE share its thinking with the public, explaining the reasons for the decision.

Transparency, clear communication and forward guidance are other pillars of modern monetary policy framework. To enhance transparency in

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operations, the U.S. Federal Reserve Bank (FRB) prepares a quarterly report on balance sheet developments in addition to semi-annual reports to the Congress discussing the conduct of monetary policy and the future prospects along with a testimony from the Federal Reserve Board Chair. In the U.K., minutes of the MPC meetings, with the voting pattern are also released to public within a fortnight.

Forecasting inflation

To modernise the monetary policy in India, to begin with, regional report like the Beige Book can be initiated. As inflation impacts everyone in the country, appointments to the Monetary Policy Committee (MPC) should be made by the Government. As with Mission Mars, which took a year to complete, impact of changes in interest rates can be felt in an economy only a few months later. Hence, it would be useful to estimate the transmission mechanism and the time lag that a change in interest rate would take to impact inflation, investment and growth.

Therefore, models which are used for forecasting inflation should be placed in public domain to establish credibility and inspire confidence. In absence of such robust and trusted models, the markets would face uncertainty, misinterpret RBI's initiatives and yield contrary results. Once these relationships are quantified, and after wider and informed public discussion, India can consider adopting Inflation Targeting to yield effective results.

Five associate banks to merge with SBI

State Bank of India (SBI), the country's largest lender, has kick-started the process of merging its five associate banks with itself at one go. The merger is expected to be completed by the end of the current financial year.

The SBI board, which met on Tuesday, discussed the issue, and also explored the possibility to merge Bharatiya Mahila Bank.

"A proposal seeking an 'in principle' approval to start negotiations with associate banks will be submitted to the Central government, she said.

Asked for a time frame for the merger, she said, "We will try to do it as quickly as possible, within the current financial year definitely."

Market share will go up

She said the bank will try to merge all the entities together, "not on the same day but in close order." As all the associates are on the same technology platform, integration of the systems will not be an issue.

The merged entity will have one-fourth of the deposit and loan market, as SBI's market share will increase from 17 per cent to 22.5-23 per cent, while the total business of the merged entity will be over Rs. 35 lakh crore. SBI's staff strength will increase by 35-49 per cent while branch network will increase by 6,000. At present, SBI alone has more than 15,000 branches in the country.

The merger move comes after the government announced a road map for bank consolidation during the budget. This was required to build size, seen as necessary to fund the huge infrastructure financing needs of the country. No bank in India features in the top 50 banks of the world in terms of size.

The SBI will have to create and expand its present structure to ensure smooth operations of the merged entity.

"The SBI has to create a post-merger structure. Controlling the branches will be crucial," said Pratip Chaudhuri, who was the SBI chairman between 2011 and 2013 and merged one of its associates, State Bank of Saurashtra. "In Andhra Pradesh there are 1,200 branches of State Bank of Hyderabad while SBI has about 1000. The merged entity will have over 2000 branches. So, they may have to create one more circle," Mr. Chaudhuri said.

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