

BANKING COMMISSION – THE NEED OF THE TIMES?

June 8, 2021

SUMMARY OF DISCUSSIONS

Background

In the last few years, there have been a number of initiatives of the RBI, both in regard to the content of banking and NBFC regulation, as also the categories of banks that could be set up to cater to specialised needs. While many of these have been welcome moves, there has always been the fear that too many standalone measures might not translate to a coherent and productive banking universe. It is perhaps time for a sufficiently high powered body, capturing in its membership, a wide variety of expertise and experience, to take a holistic view of the banking sector in India, and to suggest a roadmap which would meet the requirements of the foreseeable future. Piecemeal changes can never be a satisfactory solution to India's banking needs. It is necessary that a constructive dialogue on this subject is commenced without any loss of time.

DISCUSSIONS

- **Banking Commission** – India had set up a Banking Commission in 1969. Details of the work done by that Commission no longer feature in any discussions on banking.
- **Narasimham Committees** - There have been 2 Narasimham Committees, the first of which was on Financial Sector reforms (1991), and the second on Banking Sector reforms (1998). Both these committees made far-reaching suggestions, and the Government acted on many of them. However, some fundamental recommendations have not been acted upon so far, presumably because of the lack of widespread acceptability.
- **Other committees in banking sector** – Different aspects of banking have been addressed, from time to time, by committees specifically tasked to look into those aspects. There have been 43 such committees so far. However, none of them have addressed the totality of issues, or at least the far-reaching systemic issues, in a comprehensive and holistic manner.
- **Banking redefined** – In the earlier days, banking was no more than the acceptance of deposits for the purpose of lending or investment. With newer and more complex products that have come into being, to address the requirements of different segments of customers, banking has changed unrecognisably. Technology applications have also significantly contributed to the change. Newer categories of banking institutions, such as Regional Rural Banks (RRBs), Local Area Banks (LABs), Small Finance Banks (SFBs), Payments Banks (PBs) etc., have come into being. Development Financial Institutions (DFIs) had ceased to exist, with some of them being converted to banks. DFIs are now being felt to be relevant, and the first of them has come into existence. There are also new institutions that have been set up to address specific needs. These include the Insolvency and Bankruptcy Board of India (IBBI), Asset Reconstruction Companies (ARCs), and Credit Information Bureaus (CIBs). NBFCs, which are active in financial intermediation, also need to be seen as part of this ecosystem. Further, issues such as consolidation of public sector banks, privatisation of some public sector banks, and the emergence of Fintech are some relatively recent developments.

- **RBI's initiatives** – While there has been no holistic view taken of the manner in which the banking sector ought to be reengineered and repositioned, RBI has, from time to time, been taking a number of steps, and putting in place measures to address issues, both when they arise, and on occasion, in anticipation of their arising. This has been done through the setting up of committees tasked to address specific issues. While these have been, and continue to be, welcome steps to iron out difficulties and improve processes, it is no substitute for a body which can take an overarching, comprehensive view, on the various issues that need to be addressed expeditiously.
- **Suggestions of various committees** – While a number of recommendations made by committees have been accepted, and implemented, from time to time, a few far reaching recommendations remain the subject matter of continuing discussions. The role of the promoter, which is a concept unique to Indian law, has been seen differently at different points of time, and has led to different prescriptions on matters such as shareholding and voting rights. Whether the public sector should have ownership of some commercial banks, is also a matter that has seen seemingly interminable discussions, with strong views on either side. The related questions of whether there ought to be a Division in the Government dealing with banks, has also remained no more than a recommendation of the Narasimham Committee. The Committee's recommendation to reduce the ceiling of Government's shareholding in banks to 33% has not found acceptance. Meanwhile, action seems to be at an advanced stage to sell some of the existing public sector banks. With a number of positions on bank Boards remaining vacant, the fiction that banks are Board led organisations, is no longer taken seriously. Bank Boards are being seen increasingly as passive recipients of the directions of the majority shareholder, in regard to many important matters.
- **Lack of accountability** – It has also been seen that the leisurely pace of dealing with some recommendations has led to the recommendations being relatively less relevant by the time they are implemented. The root cause for this seems to be the lack of accountability. Once the recommendation is accepted, there can be no justification for dragging one's feet in implementation.
- **Foundational issues with banking sector**
 - **Talent shortage** – With several career options having opened up, especially in the last two decades, public sector banks no longer figure among the more attractive career options. The inability to access the best talent, coupled with restrictions on matters relating to recruitment, as well as the absence of incentivisation, has led to public sector banks suffering the most when it comes to attracting the best talent at the recruitment stage.
 - **Issues arising from ownership** – While contemporary thinking seems to be in favour of increased privatisation of the banking sector, adequate thought has not gone into the implications of not having a reasonable number of public sector banks.
 - **Challenge to regulation** – The nature of banking activity is such that risk is a necessary part thereof. Innovation brings increased risks, some of which are difficult to fully anticipate and provide for. At the same time, the sector cannot satisfactorily address diverse banking needs if innovation does not lead to more and better products. This is a challenge that Regulators have to address on a continuing basis. For this purpose, capacity building in regulatory organisations is an important requirement. If regulation does not keep pace with the far-reaching changes in the regulated universe, there could be systemic risks, which could shake the foundations of the sector, and even the economy.

- **Benefits of having a Banking Commission**

- **Holistic view** – A Banking Commission can have the much-needed holistic approach towards the banking sector, factoring in ownership patterns, and size and remit of different categories of banks etc. Also, with multiple regulation being a problem that has emerged, the Commission could ensure role clarity and prevent avoidable overlaps.
- **Regulations to keep pace** – The world of banking has changed. There is a need to relook at regulations to keep pace with these changes. The philosophy of a number of banking laws goes back to the colonial age. There is a lack of clarity on the need/ objective of regulations, and the outcome sought to be achieved through them. It is also necessary to have regular impact assessment exercises undertaken to ensure that regulations remain relevant and contemporary.
- **Level playing field** – The absence of a level playing field between the public sector and private sector has led to different levels of performance in respect of some aspects of banking. Regulatory efforts must be made to ensure that there are no comparative advantages or disadvantages arising from ownership. Also, with an increase in the market share of private sector banks, some of the responsibilities of the public sector towards priority sector, should be shared by the private sector.

- **If a Banking Commission is formed,**

- The membership will have to be carefully thought through, so that persons who understand the banking sector, in its current form, are members of the Commission.
- It should have complete political and statutory backing, so that its recommendations are not easily brushed aside.
- While a comprehensive exercise relating to the banking sector can take time, some of the emergent issues could be addressed without waiting for the final report to take shape.

- **However, a Banking Commission may not be the answer –**

- A number of suggestions, made by earlier committees, are yet to be implemented.
- One Commission may not be the answer to the complex and diversified activities, and problems, of the banking sector.
- **Institutional framework, in place of a Commission** - The whole financial framework needs a relook. The future cannot be seen through the lens of the past, or even that of the present. Instead of a Commission, there is a need for an institutional framework, which allows an inside view of the infirmities in regulatory architecture. It can suggest ways to keep the structure more contemporary. A Commission/ committee, making recommendations, will take a lot of time. Instead, if there is an institution, which can suggest a contemporary regulatory framework, changes can be made at a pace that serves the intended purpose.

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