Banks merger

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Manifest pedagogy A severe slowdown has resulted in government engaging in Pro active structural reforms. Also, the vision of a $5 trillion economy requires such changes for growth targets to be attainable. Financial sector and banking reforms are carried out in light of such events and bank mergers has been in the making after Narimhama committee suggested them.

In news: Recently Finance minister announced merger of banks.

Placing it in syllabus: Indian Economy – Banking reforms

Static dimensions:

- Scheduled banks in india
- Narasimham committee report,
- P J Nayak committee
- EASE framework
- Indradhanush

Current dimensions:

- Merger of banks (proposed)
- Total number and structure
- Benefits and criticisms

Content: Scheduled banks in India:

- Scheduled Banks in India refer to those banks which have been included in the Second Schedule of the Reserve Bank of India Act, 1934.
- RBI in turn includes only those banks in this Schedule which satisfy the criteria laid down vide section 42(6)(a) of the said Act.
- Banks not under this Schedule are called Non-Scheduled

Banks.

- To qualify as a scheduled bank, the bank should conform to the following conditions:
- The total minimum value of paid up capital and reserve must be of Rs. 5 lacs.
- The bank requires to satisfy the central bank that its affairs are not carried out in a way that causes harm to the interest of the depositors.
- The bank needs to be a corporation rather than a sole-proprietorship or partnership firm.

Scheduled banks enjoy certain rights such as:

- Right to receive refinance facility from the apex bank.
- Entitled for currency chest facility.
- Right to become members of clearing house.

However, they are required to fulfil certain obligations like maintenance of an average daily balance of CRR (Cash Reserve Ratio) with the central bank at the rates specified by it. These banks need to submit returns at regular intervals, to the central bank subject to the rules of Reserve Bank of India Act, 1934 and Banking Regulation Act, 1949.

Narasimham committee on banking reforms:

Narasimham Committee Report I – 1991

The Narasimham Committee was set up in order to study the problems of the Indian financial system and to suggest some recommendations for improvement in the efficiency and productivity of the financial institution.

The committee has given the following major recommendations:-

- The committee recommended the reduction of the higher proportion of the Statutory Liquidity Ratio ‘SLR’ and the Cash Reserve Ratio ‘CRR’.

- In India, since nationalization, directed credit programmes were adopted by the government. The committee recommended phasing out of this programme. This programme compelled banks to earmark then financial resources for the needy and poor sectors at confessional rates of interest.
- The committee recommended eliminating government controls on interest rate and phasing out the concessional interest rates for the priority sector.
- The committee recommended that the actual numbers of public sector banks need to be reduced. Three to four big banks including SBI should be developed as international banks.
- Regarding the RRBs (Regional Rural Banks), it recommended that they should focus on agriculture and rural financing. They recommended that the government should assure that henceforth there won’t be any nationalization and private and foreign banks should be allowed liberal entry in India.
- The committee recommended the establishment of an Asset Reconstruction Fund (ARF). This fund will take over the proportion of the bad and doubtful debts from the banks and financial institutes. It would help banks to get rid of bad debts.
- Those days banks were under the dual control of the Reserve Bank of India (RBI) and the Banking Division of the Ministry of Finance (Government of India). It considered and recommended that the RBI should be the only main agency to regulate banking in India.
- The committee recommended that in order to pursue competitiveness and efficiency, banks must enjoy autonomy so that they can reform the work culture and banking technology upgradation will thus be easy.

Narasimham Committee Report II – 1998

In 1998 the government appointed yet another committee under the chairmanship of Mr. Narsimham. It is better known as the Banking Sector Committee. It submitted its report to the Government in April 1998 with the following recommendations.

- The committee considered the stronger banking system in the context of the Current Account Convertibility 'CAC'. It recommended the merger of strong banks which will have 'multiplier effect' on the industry.
- Narrow Banking : Those days many public sector banks were facing a problem of the Non-performing assets (NPAs). Thus for successful rehabilitation of these banks it recommended 'Narrow Banking Concept' where weak banks will be allowed to place their funds only in the short term and risk free assets.
- In order to improve the inherent strength of the Indian banking system the committee recommended that the Government should raise the prescribed capital adequacy norms. This will further improve their absorption capacity also.
- It recommended a review of functions of boards and enabled them to adopt professional corporate strategy.
- The committee considered that there was an urgent need for reviewing and amending main laws governing Indian Banking Industry like RBI Act, Banking Regulation Act, State Bank of India Act, Bank Nationalisation Act, etc. This upgradation will bring them in line with the present needs of the banking sector in India.
- Apart from these major recommendations, the committee has also recommended faster computerization, technology upgradation, training of staff, depoliticizing of banks, professionalism in banking, reviewing bank recruitment, etc.

P J Nayak Committee report:

The P J Nayak Committee or officially the Committee to Review Governance of Boards of Banks in India, was set up by the

Reserve Bank of India (RBI) to review the governance of the board of banks in India. The Committee was set up in January 2014.

Recommendations:

- Repeal the Bank Nationalisation Act (1970, 1980), the SBI Act and the SBI Subsidiaries Act. This is because these acts require the government to have above 50% share in the banks.
- After the above acts are repealed, the government should set up a Bank Investment Company (BIC) as a holding company or a core investment company.
- The government to transfer its share in the banks to this BIC. Thus, the BIC would become the parent holding company of all these national banks, which would become subsidiaries. As a result of this, all the PSBs (public sector banks) would become ‘limited’ banks.
- BIC will be autonomous and have the power to appoint the Board of Directors and make other policy decisions.
- Until the BIC is formed, a temporary body called the Bank Boards Bureau (BBB) will be formed to do the functions of the BIC. Once BIC is formed, the BBB will be dissolved.
- The BBB will advice on appointments to the board, banks’ chairman and other executive directors.

EASE (Enhanced Access and Service Excellence) reform index:

EASE index is prepared by the **Indian Banking Association (IBA) and the Boston Consulting Group**. It is commissioned by the Finance Ministry. It is a framework that was adopted in 2018 to strengthen public sector banks, and rank them on metrics such as responsible banking, financial inclusion, credit offtake and digitisation.

Findings of the report (2019):

- Punjab National Bank has topped the list. It is followed

by Bank of Baroda, State Bank of India (SBI), and Oriental Bank of Commerce.
- The EASE Index report also noted PSU banks' strengthening of the bad-loan recovery process, pointing to the success of the Insolvency and Bankruptcy Code (IBC) in fast-tracking the resolution process.

According to the Finance Ministry, second round of reforms through EASE 2.0 would be initiated soon. The new performance parameters that may be introduced this year through the EASE programme include more stringent early warning signals (EWS) to tackle stressed assets, effective coordination in large value loans and bringing in new financial technology players to deepen financial inclusion and digitalisation.

Mission Indradhanush:

- Mission Indradhanush is a 7 pronged plan launched by Government of India to resolve issues faced by Public Sector banks.
- It aims to revamp their functioning to enable them to compete with Private Sector banks.

- Many of the measures taken were suggested by P J Nayak committee on Banking sector reforms as indicated.
- The 7 parts include appointments, Banks board bureau(BBB), capitalisation, de-stressing, empowerment, framework of accountability and governance reforms (**ABCDEFG**).

Proposed Merger of banks:

- Finance Minister Nirmala Sitharaman recently announced a slew of banking reform measures, including merger of 10 public sector banks into four entities.
- This would **take the number of banks in the country from 27 in 2017 to 12.**

- These bank mergers, and the ones already carried out, will lead to the creation of big banks with an enhanced capacity to give credit.
- These big banks would also be able to compete globally and increase their operational efficiency by reducing their cost of lending.

- The largest of the mergers announced is that of **Punjab National Bank with Oriental Bank of Commerce and United Bank.**
- The amalgamated entity – to be called Punjab National Bank will become the second-largest public sector bank in India, after the State Bank of India.
- It will also become the second-largest bank in India in terms of its branch network, with a combined total of 11,437 branches.

- The second merger announced was that of **Canara Bank and Syndicate Bank,** which would render the merged entity the fourth-largest public sector bank.
- The merger also has the potential to lead to large cost reductions due to network overlaps.
- The third merger of **Union Bank of India with Andhra Bank and Corporation Bank**, would make the merged entity the fifth largest public sector bank.
- The fourth merger announced is of **Indian Bank and Allahabad Bank.**
- There will be no retrenchment due to these mergers.

In order to make the management accountable to the boards of the banks, a board committee would be made in charge of appraising the performance of officers of the rank of general managers and above, including the managing director. The banks have also been allowed to recruit chief risk officers from the market, at market-linked compensation to attract the best available talent.

<u>Benefits and criticisms of Bank merger:</u>

The advantages are:

- It reduces the cost of operation.
- The merger helps in financial inclusion and broadening the geographical reach of the banking operation.
- Handling NPA and risk management are benefited.
- Merger leads to availability of a bigger scale of expertise and that helps in minimising the scope of inefficiency which is more in small banks.
- The disparity in wages for bank staff members will get reduced.
- Service conditions get uniform.
- Merger sees a bigger capital base and higher liquidity and that reduces the government’s burden of recapitalising public sector banks time and again.
- Redundant posts and designations can be abolished which will lead to financial savings.

The disadvantages are:

- Many banks have a regional audience to cater to and merger destroys the idea of decentralisation.
- Larger banks might be more vulnerable to global economic crises while the smaller ones can survive.
- Merger sees the stronger banks coming under pressure because of the weaker banks.
- Merger could only give a temporary relief but not real remedies to problems like bad loans and bad governance in public sector banks.
- Coping with staffers’ disappointment could be another challenge for the governing board of the new bank. This could lead to employment issues.