

## **M Narasimham's Contribution - The father of banking reforms**

### **What is the issue?**

With the demise of M Narasimham, former RBI Governor, it is imperative to reflect on his contribution to reforms in the financial sector.

### **Who is M Narasimham?**

- Maidavolu Narasimham (1927-2021) was the thirteenth governor of the RBI [from May 1977 to November 1977].
- He was the only governor of the RBI to have risen to the position from the central bank's ranks.
- He is most recognized for the role he played in liberalizing India's banking and financial system.
- He is rightfully the architect of modern Indian banking.
- What is seen in the banking system today in terms of the struggle to bring about change, had its genesis documented in Narasimham's epochal reports.

### **How did the banking system take in these recommendations?**

- **BIS** - The first was bringing in prudential concepts as propounded by the Bank for International Settlements (BIS).
- These were regarding income recognition, capital adequacy, quality of assets, provisioning, etc.
- These concepts took time to digest, and the RBI played a stellar role in bringing them in a calibrated manner so that the system was not disrupted.
- Basel II and Basel III were extensions of the same course.
- To note, the RBI took time to bring the 90-day concept for recognising non-performing assets (NPAs) so that the system was able to absorb this rule.
- **Private banks** - He had propagated the concept of having more private banks.
- This was a timely recommendation as the system was typified by public sector banks (PSBs), given the shadow of nationalisation.
- Getting in new private banks has brought about a technology revolution in the banking sector.
- They have now permeated all banks, making the system globally comparable.
- Along with this suggestion was the extended frame provided to foreign banks

to operate in India.

- There was also a firm signal that there would be no further nationalisation.
- **Interest rates** - The interest rates on deposits and loans were to be freed.
- This was significant because until that point of time all decisions came from the 'above'.
- Here, RBI had gradually moved towards giving banks the freedom to fix their rates on the deposits side.
- However, the lending side is once again back to the fold of partial regulation, with the central bank asking them to follow a formula.
- **CRR & SLR** - The reports argued for sharp reductions in the CRR (Cash Reserve Ratio) and the SLR (Statutory Liquidity Ratio) of banks.
- While banks argue against having a CRR, the system had a rate of 15% in 1989 and again in 1994, after which it has been brought down to 4%.
- The SLR at its peak was at 38.5% in 1990.
- The move to lower these pre-emption reserves owes a lot to the recommendations.
- **Government securities** - The concept of marking-to-market the portfolio of government securities was again a takeaway from the report.
- This was a way of making them market-oriented and also ensuring that the real value of bonds was accounted for by banks.
- **Four-tiered structure of banks** - Narasimham had suggested creating a four-tiered structure of banks, which is seen for the past three decades.
  - i. large banks that can be globally competitive
  - ii. regional banks that serve specific purposes
  - iii. niche banks that cater to communities
  - iv. new small banks and payments banks
- This was subsequently strengthened by an RBI committee where differentiated banks were spoken of.
- **Weak banks** - The identification of weak banks and putting conditions was again a concept from the reports.
- It is from this that the RBI has drawn the PCA (Prompt Corrective Action) policy.
- The report suggested ways to tackle such banks and get them out of the mess with narrow banking being an intermediate route.
- **Transparency** - The reports recommended introduction of transparency in bank accounts.
- Today, all annual reports include all disclosures and follow fixed formats.
- It is thus now possible for one to analyse any aspect pertaining to all banks in a uniform manner.
- **Mergers** - The concept of mergers across the financial sector was envisioned

in terms of synergies being created.

- The report also spoke of mergers between PSBs, which is now a reality.

### **What are the key recommendations yet to be fulfilled?**

- **Privatisation of PSBs** - This is something that the government is looking at seriously, as per the Union Budget of 2021-22.
- Banks are being targeted for full disinvestment.
- Given that PSBs that have been merged are out of this loop, it looks like the candidates would be smaller ones.
- These may not have the best financials, though are bestowed with strong infrastructure and processes.
- **Remuneration** - The remuneration factor was something that Narasimham had spoken of for PSBs as recruitment was to be made independent.
- There has been no attempt here on the pay structure, which is still a bargaining process.
- The Indian Banks' Association (IBA) plays a vital role here.
- However, in a rather feeble manner, lateral hiring with market-related salaries for specialised posts has come in from the backdoor.
- Now, even some of the large PSBs have a lateral recruit as a CFO.
- **Priority sector** - The reports recommended reducing the amount of lending that had to go to the priority sector from 40% to 10%.
- There has been no change in this regard and it looks unlikely that this issue will ever be discussed.
- Given the political economy, it looks expedient for governments to retain this limit to show that they are pro-poor.
- There can be arguments on the legitimacy of such lending.
- However, the fact is that if 40% of lendable resources are to be directed at pre-decided sectors, there is less flexibility for banks when it comes to lending.
- **Deposit insurance** - The reports had also recommended differentiated deposit insurance premium for banks.
- This is notable because banks carrying a higher risk on their lending portfolio would be made to pay a higher premium for cover on their deposits.
  - [This is based on the CAMELS (capital adequacy, asset quality, management quality, earnings, liquidity, and sensitivity to market risk) score of RBI.]
- This will be quite appropriate to ensure that banks pay more attention to the quality of assets.
- In all, three decades down the road a lot had changed, albeit gradually.
- On the whole, the progress made is satisfying, given the socio-economic conditions in the economy, but structural changes take time.

**Source: Financial Express**

