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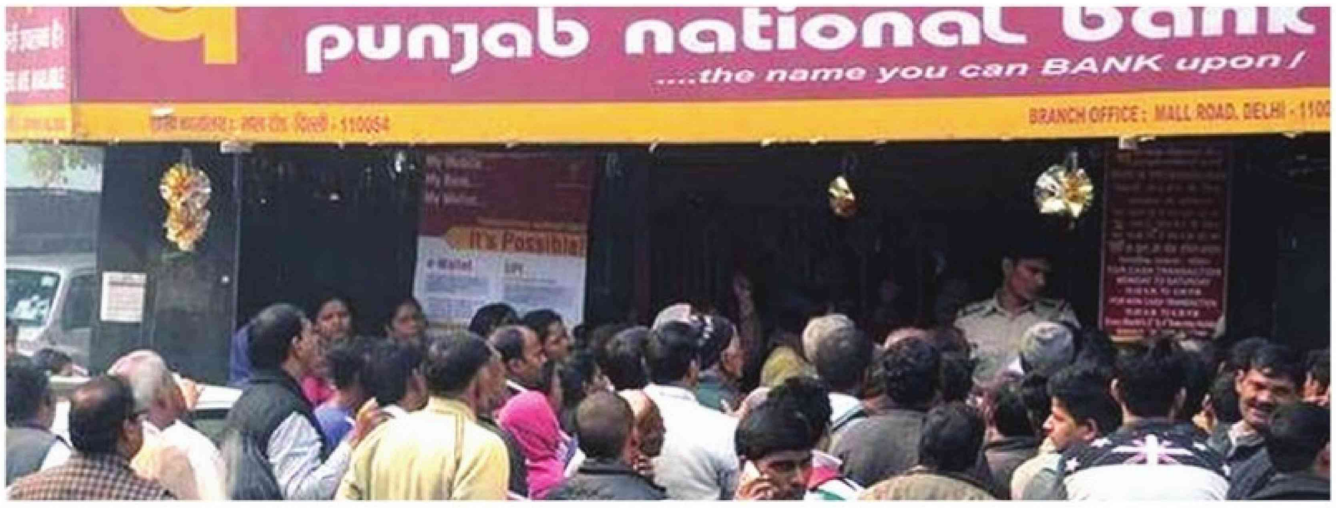
Downhill Ride for Banks

It is doubtful if Public Sector Banks marked for Prompt Corrective Action would ever become profitable. It defies imagination as to how the Government expects to turn around banks that continue to be staffed by the same set of people and continue to operate under the same guidelines that had brought those banks to the brink of bankruptcy



A multitude of fugitive bank defaulters thumbing their noses at the Government has brought in sharp focus all that is wrong with the Indian banking system. These persons ~ each owing banks thousands of crores of rupees ~ have brought many large banks to their knees. These defaulters are living not in any banana republic but in countries with liberal and democratic values with whom we have long standing extradition treaties. Though the nuances of the extradition proceedings have not been made public, it would seem that we have not been able to extradite them because non-repayment of a loan is not a criminal offence in the West and we have not been successful in proving that the fugitive defaulters cheated the banks or the Government in any way, which only highlights the weakness of our procedures and the venality of bank managements.

To add a touch of comedy, our enforcement agencies issue warrants and processes against the fugitive bank defaulters almost on a daily basis; knowing fully well that none of the warrants and processes would ever be served, much less enforced. One can only wish that all Government agencies had displayed the same degree of alacrity before the defaulters fled Indian shores.Recurring instances of deliberate, big-ticket defaults points to deep systemic flaws in our banking system which we are either unable or unwilling to address. Even to a layman, the credit extended to people like Mehul Choksi and Nirav Modi exceeded their net worth many times. Then, banks are supposed to keep a hawk's eye on utilisation of the loaned amount which they obviously failed to do. A case in the point is the overvaluation of Nirav Modi's assets pledged with the banks. Contrast it with the treatment you or me, an ordinary middle-class person, would receive if we went to the bank for a small loan. In addition to mortgaging all our assets, we would be treated like Mallyas in the making. Should we default even on one instalment, we would find the bank's strongmen at our doors.

In our childhood "safe as a bank" used to be a figure of speech. Pensioners used to put their life's savings in bank fixed deposits without batting an eyelid. Now, money is being spirited away from banks without breaking a single lock so much so that total non-performing assets (bad debts) of Public Sector Banks, as on 31 March 2018, stood at Rs.12.47 lakh crores. One shudders to think of the fate of depositors in these banks, had the Financial Resolution and Deposit Insurance (FRDI) Bill, 2017 become law, because FRDI would have shifted the responsibility of bank defaults on the depositors rather than the Government.

Several senior officials of Public Sector Banks have been arrested for loan fraud. Private banks are not any better off; consequent to investigation of various irregularities, the CEO of ICICI Bank has been sent on leave and the CEO of Axis Bank had her term curtailed. The women in question were iconic figures; many of their admirers were deeply disappointed when they found that their heroines had feet of clay. The shenanigans of well-respected bankers have made the public lose their faith in all kinds of banks, considerably weakening the case for a cashless economy.

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As of now, the RBI has placed 11 of 21 public sector banks (PSBs) under Prompt Corrective Action (PCA) which means that these banks would not be able to conduct a significant part of their banking business. On its part, the Government has injected Rs.1.4 lakh crores of capital into PSBs. A further capital infusion of Rs.65,000 crores, which may go up to Rs.1.1 lakh crores, has been budgeted for the current financial year. The advisability of throwing such humongous amounts of money at banks ~ that may have no chance of recovery ~ is doubtful at best. Incidentally, this sum does not include the amount spent by LIC to acquire the rogue bank, IDBI and would not include similar acquisitions of bad banks by PSUs in future.

The current banking crisis could have been averted or at least alleviated had the Government implemented the significant recommendations of the Narasimhan Committee-II (1998) Report. Mr Narasimhan, an erstwhile RBI Governor, had recommended the strengthening of Indian banks through merger of large banks. The Committee had further recommended a three-tier banking structure in India through establishment of three large banks with international presence, eight to ten national banks and a large number of regional and local banks. Weaker banks, unable to operate profitably were to be closed down.

Mr Narasimhan was of the view that greater autonomy should be granted to public sector banks to enable them to run professionally. Government equity in nationalized banks was proposed to be reduced to 33 per cent and the practice of nominating MPs, politicians and bureaucrats to bank boards was proposed to be done away with because such persons were found to be interfering in the day-to-day operations of banks, often forcing the banks to lend to undeserving persons.

Even after 20 years, none of these crucial reforms has been implemented. The Banks Board Bureau (BBB), which was formed for recommending names for selection of heads of Public Sector Banks and Financial Institutions found that all its recommendations had been turned down. Instead, contrary to common sense, the Government has unveiled a plan to appoint retired bureaucrats as heads of Public Sector Banks.

The current crisis has made the banking sector go into deep shock with banks adopting panic measures like restricting cash availability at branches to Rs.10 lakh and restricting cash withdrawals to Rs.2 lakh. At some banks, you are required to quote Aadhaar for cash deposits of paltry amounts – even if you are an existing bank customer. The instant justice meted out by enforcement agencies for perceived defaults is so quick that pusillanimity and inaction have become the flavour of the day. The alarm in banking circles is so palpable that Finance Minister Arun Jaitley is talking about re-drafting the Prevention of Corruption Act (PCA) lest all bankers end up in the CBI net.

In the final analysis it is doubtful if Public Sector Banks marked for Prompt Corrective Action would ever become profitable. It defies imagination as to how the Government expects to turn around banks that continue to be staffed by the same set of people and continue to operate under the same guidelines that had brought those banks to the brink of bankruptcy. Einstein probably had a similar situation in mind when he defined insanity as doing the same thing over and over again and expecting different results.

A much better alternative would be to simply liquidate the rogue banks. After selling off all assets, depositors may be repaid in full and good loans may be transferred to other banks. This step would reduce the number of banks, which anyway are over-represented in urban and semi-urban areas; each bank would then have sufficient business to sustain itself. Each bank branch would function as a profit centre with a mandatory annual audit, with commensurate rewards to staff for good performance. In this set-up, poor performance and fraud would be quickly identified and corrected without sending the entire bank into ICU.

With dis-investment of Government stakes as a long-term goal, the management of Public Sector Banks should be transferred to professional boards. Indian banks have no dearth of talent; people like RK Talwar and PCD Nambiar (former Chairmen of State Bank of India) are still reverentially discussed in banking circles though they retired long back, in the 1970s and 1980s. But as of today, North Block mandarins direct the day-to-day affairs of PSBs, senior appointments are made only after the express consent of the Finance Ministry which leads to banks implementing the vision (or lack of it) of faceless bureaucrats, who will never take responsibility should anything go wrong.

Much remains to be done. What should not be done, is to throw away taxpayers' money at perennially sick banks without addressing their basic inadequacies. Fresh capital infusion would be an anodyne; sick banks would return to their comatose state once the extra capital is exhausted. It is really surprising that while contemplating public sector disinvestment the Government is not even talking about disinvestment in PSBs, probably because it would reduce the favour-dispensing power of ministers and bureaucrats. Keeping Air India's experience in mind, after some time investors would not be interested in buying the rogue banks' assets leaving the Government with several albatrosses round its neck.