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BankFinology

BANKING SECTOR REFORMS

May 2025

Narasimham Committee (1991 & 1998)

- Advocated the **merger of strong banks** (public & private sector) to enhance efficiency and competitiveness.
- Recommended reduced government interference in bank operations.

CAMEL Parameters (Bank Performance Evaluation Framework)

- **C: Capital Adequacy** - Ensures banks maintain sufficient capital reserves to absorb risks.

Capital Adequacy Ratio (CAR)

$$= \frac{\text{Bank's Capital}}{\text{Risk weighted Assets}} \times 100$$

Bank's capital = Tier 1 + Tier 2 assets

Minimum CAR as per Basel III norms: 10.5%.

- **A: Asset Quality** - Examines the quality of loans and advances.
- **M: Management Efficiency** - Focuses on governance and operational soundness.
- **E: Earnings Quality** - Measures profitability and sustainability.
- **L: Liquidity** - Assesses ability to meet short-term obligations.

Scale-Based Regulation for NBFCs

- **Scale-Based Regulation (SBR)**, introduced by the **Reserve Bank of India (RBI)**, aims to regulate **NonBanking Financial Companies (NBFCs)** based on their size and systemic importance. The approach ensures that larger, more significant NBFCs face stricter regulatory requirements, while smaller ones are subject to lighter norms.

- **Differentiated Approach:** NBFCs are classified into **four tiers** based on their asset size and systemic impact:

Tier 1: Systemically Important NBFCs (SI-NBFCs), with significant impact on the financial system.

Tier 2: Medium-sized NBFCs.

Tier 3: Smaller NBFCs.

Tier 4: Niche-focused NBFCs.

- **Regulatory Requirements:** Larger NBFCs are required to maintain higher capital adequacy,

liquidity ratios, and disclosure norms. Smaller NBFCs face relatively lighter requirements.

- **Governance and Risk Management:** Larger NBFCs must adopt robust risk management and corporate governance practices. Tier 1 NBFCs are more stringently monitored for risks like credit, market, and liquidity.

- **Capital Adequacy and Liquidity:** The capital adequacy ratio (CAR) is higher for Tier 1 NBFCs, ensuring financial stability. For instance, SI-NBFCs are required to maintain a CAR of 15% or higher, based on RBI guidelines.

- **Data for SI-NBFCs:** As of recent RBI data, Systemically Important Non-Banking Financial Companies (SI-NBFCs) have a combined asset size exceeding Rs. 500 crore and are required to meet stringent capital adequacy and liquidity norms.

Mission Indradhanush

- A **7-pronged strategy** (ABCDEF&G) to resolve Public Sector Bank (PSB) challenges:

1. **Appointments:** Separation of CEO and MD roles.
2. **Bank Board Bureau (BBB)** setup to oversee appointments.
3. **Capitalization:** Infused ₹ 70,000 crores to meet Basel III norms.
4. **De-stressing:** PSBs by addressing NPAs.
5. **Employment:** Enhanced autonomy in hiring.
6. **Framework for Accountability:** Use Key Performance Indicators (KPIs).
7. **Governance Reforms:** Encouraged conclaves like Gyan Sangam.

Bank Board Bureau (BBB)

- Acts as a **middleman** to separate PSBs from Government control.

- **Functions:**

Recommends appointments for senior roles in PSBs. Develops strategies for capital-raising and performance improvement.

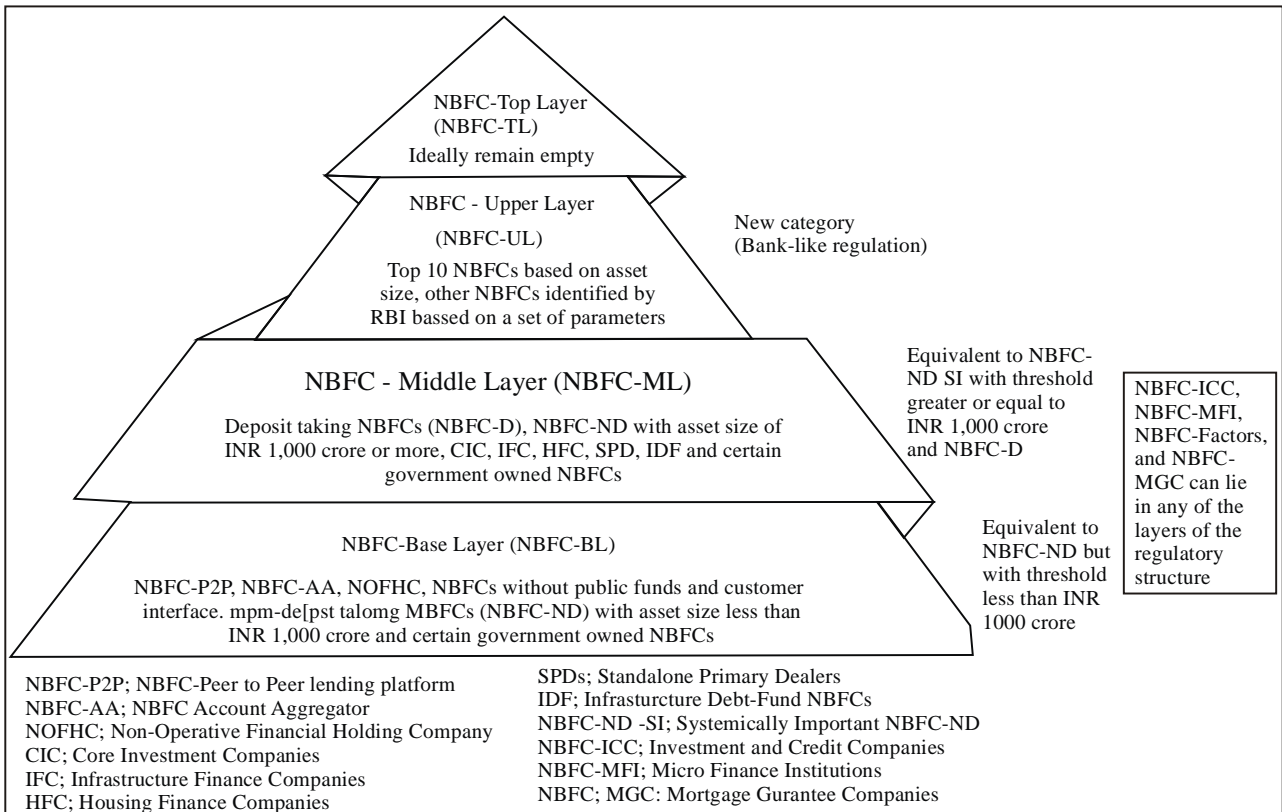
- **Superseded by:** Financial Services Institutions Bureau (FSIB) in 2022.

- It was suggested by **P.J Nayak committee** set up for Public Sector Bank reforms.

Core Banking Solution (CBS)

- A software platform enabling branch-less, centralized banking.
- **Examples:**
Finacle: Used by ICICI Bank.
E-Kuber: Used by RBI.
- **Features:** Real-time transactions, account management across branches, 24/7 service.
- **National Financial Reporting Authority (NFRA)**
- Independent regulator established under the Companies Act, 2013.
- **Composition:**
 Chairperson + 15 members.
- **Powers:**
 Investigates misconduct in auditing/accounting.
 Covers listed companies and unlisted companies with:
 Paid-up capital = Rs. 500 crore.
 Annual turnover = Rs. 1,000 crore.
- **Serious Fraud Investigation Office (SFIO)**
- Established on the recommendation of the Naresh Chandra Committee on Corporate Governance.

- **Purpose:** Investigates white-collar crimes.
- **Regulator:** Ministry of Corporate Affairs.
- **Insolvency and Bankruptcy Code (IBC)**
- Framework for resolving insolvency and bankruptcy issues in a time-bound manner.
- **Trigger Threshold:** Minimum default of 1 1 crore.
- **Resolution Timeline:**
 180 days (extendable to 270 days).
 Assets are liquidated if no resolution is achieved.
- **Excludes: Willful Defaulters.**
- **Key Pillars**
NCLT: Adjudicating authority.
Insolvency Professionals (IPs): Manage cases.
Information Utilities (IUs): Mitigate information asymmetry.
IBBI: Insolvency and Bankruptcy Board of India (IBBI) is the regulatory body.
- **Key Definitions**
Insolvency: Inability to pay debts when due.
Bankruptcy: Legal declaration of insolvency.
Bail-In: Bank’s deposits are used to stabilize itself.
Bail-Out: External rescue using public funds.



UNDERSTANDING CREDIT AND ITS TERMS

- **Formal Sector Loans:**
Loans provided by banks and cooperatives, regulated by the RBI.
- **Informal Sector Loans:**
Loans offered by moneylenders, traders, and employers without regulation.
- **Terms of Credit:**
Include:
- **Interest Rate:** Cost of borrowing.
- **Collateral:** Asset pledged as security (e.g., land, gold, deposits).
- **Documentation:** Papers required for loan approval.
- **Repayment Mode:** Structure and timing of repayment.
- **Collateral:**
Definition: A guarantee provided by the borrower to the lender until the loan is repaid. Examples include property, livestock, or bank deposits.
- **Teaser Loans:**
Loans offering lower initial interest rates as an incentive.
Risk: Linked to subprime lending.
- **Credit Rating Agencies:**
Indian Agencies (regulated by SEBI): CRISIL, ICRA, CARE, SMERA, Fitch India, Brickwork Ratings.
Global Agencies: Fitch Ratings, Moody's, S&P.

NON-PERFORMING ASSETS (NPAs)

- **Definition:** A loan where the principal/interest is overdue for >90 days.
- **For Agriculture Loans:**
Short-duration crops: Overdue >2 crop seasons.
Long-duration crops: Overdue >1 crop season.
- **Special Mention Accounts (SMAs)**
- Accounts showing **early stress symptoms** (before becoming NPAs).

SMA Category	Overdue Period
SMA-0	0-30 days
SMA-1	31-60 days
SMA-2	61-90 days

Loan Account Classifications

Category	Definition
Standard Account	Loan with timely payments.
Substandard Asset	NPA for <12 months.
Doubtful Asset	Substandard asset for \geq 12 months.
Loss Asset	Identified as irrecoverable, but not fully written off.
Restructured Loan	Loan terms modified to assist the borrower.
Stressed Asset	Sum of NPAs, written-off loans, and restructured loans.