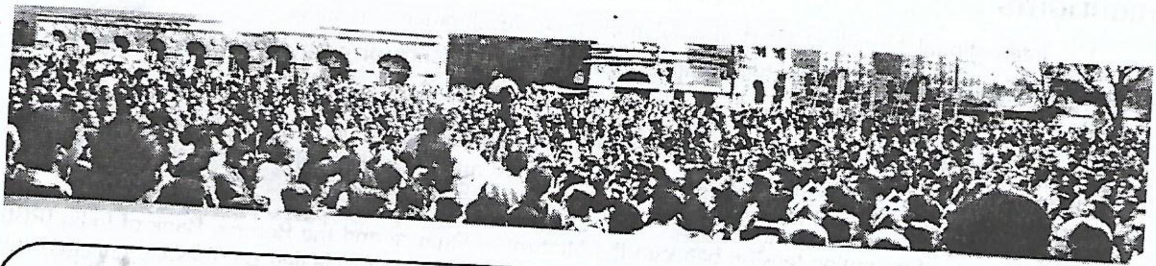
VOICE

SAVE RBI

SAVE THE NATION

BULLETIN OF RESERVE BANK EMPLOYEES ASSOCIATION, KOLKATA

OCTOBER 2018



RBI-Govt Rift :

Text of the Press Statement issued by Com. Samir Ghosh, GS, AIRBEA on 29.10.2018

RBI Deputy Governor, Dr. Viral Acharya's sharp observations on October 26, 2018 in a Memorial Lecture* in Mumbai about the Government's interventionist role vis-à-vis RBI has created a flutter across the nation. This is, however, not a sudden outburst, but was waiting to happen due to a long simmering discontent. He has compared the approaches of the two in a cricketing analogy with T-20 and Test Match. One is short term and the other a long term, the Government having a short tenure from election to election and so is prone to putting pressure on RBI to fall in line with its expediency, which RBI from a long term perspective might not and would not agree. Hence, there is an intrinsic schism and this is not regime specific. One remembers the well known duel between the then Finance Minister Sri P. Chidambaram and former RBI Governor, Dr. D. Subba Rao, when the latter commented in his parting speech that Sri Chidambaram had been so angry with RBI that he preferred to "walk alone without RBI", but he would definitely think, "Thank God the Reserve Bank exists".

However, the hiatus has widened now and Dr. Acharya has spoken more in disgust and despondency due to continuous nibbling by the Government and the Ministry of Finance. Even the RBI Board is being sought to be stuffed in a particular direction which would prompt the discerning people to look askance, and make it difficult for RBI to frame policies.

AIRBEA have many a times drawn the attention of the Parliamentarians, economists and the people to intervene and protect the autonomy and independence of RBI, which has got international recognition in saving our country's economy in perilous situations. Dr. Viral Acharya has drawn attention to several recent instances where the Government have sought to curtail RBI's role and cripple it, which the RBI could not accept.

We firmly hold that undermining the country's central bank is a recipe for disaster and the Government must desist. Let the two talk and sort out issues instead of the Government trying to ride roughshod over the RBI, what they are trying at the expense of the nation. We appeal to all right minded people and experts to speak out and persuade the Government to amend, and let RBI do its jobs in an unfettered way as per statutes, mandates, practices.

* Dr. Viral Acharya's speech, which is a must-read for all the RBI Staff, can be downloaded from RBI website www.rbi.org.in, also available at www.airbea.in

RBI Row : IMF Against Government Interference Of Any Kind In Central Banks

Expressing its displeasure, the IMF opposed any move that compromises with the independence of central banks anywhere in the world.

Press Trust of India, Updated : November 02, 2018

WASHINGTON :

HIGHLIGHTS

1. International Monetary Fund closely monitoring developments in India
2. IMF opposes any move that compromises the independence of central banks
3. IMF statement comes amid reports of a rift between the Centre and RBI

The International Monetary Fund or IMF said today that it was closely monitoring the reported rift between the RBI and the Centre in India, and expressed its opposition to any move that compromises the independence of central banks anywhere in the world.

There were reports of mounting tension between the Ministry of Finance and the Reserve Bank of India (RBI) over the autonomy of monetary policy makers after Finance Minister Arun Jaitley on Tuesday criticised the central bank for failing to check indiscriminate lending during 2008 and 2014 that has led to the present bad loan or Non-Performing Asset (NPA) crisis in the banking industry.

"We're monitoring the development on that issue and will continue to do so," International Monetary Fund (IMF) Director of Communications Gerry Rice told reporters on Thursday when asked about the row.

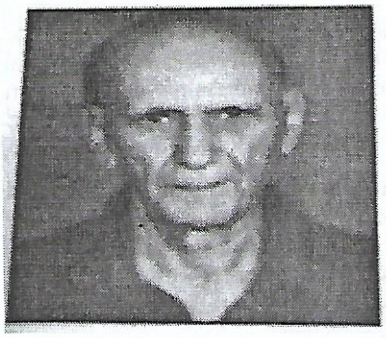
"Just stepping back, as a general principal, and we've said this before. I've said this before standing here that we support clear lines of responsibility and accountability... And, international best practice is that there should be no government or industry interference that compromises the independence of the central bank and financial supervisor," Mr Rice said.

This is true across the range of countries that the independence of the central bank and the financial supervisor is of utmost importance, he asserted.

"We regard it as such and we have to make that statement in the context of a number of countries. So, I think that's probably the best response I can give you," Mr Rice said, responding to a question on the increasing efforts globally to criticise central banks, including the one by the US President Donald Trump in recent weeks.

Com. G. K. Bhardwaj, Former Secretary, AIRBEA, passes away

Com. G. K. Bhardwaj, Secretary of AIRBEA from 1968 to early 1990s passed away on 1st Nov. 2018 at the age of 85 years. He was a legendary figure in RBI employees' movement in New Delhi in particular and had a stellar role during our anti-ordinance movement in 1979, when our New Delhi unit was in the forefront, courting arrests in hundreds. His was a charming personality, very popular, friendly. He was deeply associated with the bank employees' movement and trade union movement in and around Delhi. For years he was the Secretary and President of our New Delhi unit. He was also the founder General Secretary of BEFI, Delhi State. After retirement he engaged himself in Retirees' Association in New Delhi in various capacities. A man wedded to working class philosophy. Com. G. K. Bhardwaj was an inspiration to the activists and budding leaders of RBEA, New Delhi and AIRBEA.



AIRBEA pays respectful homage to Com. G. K. Bhardwaj and shares the bereavement of his family members, his innumerable friends and admirers.

We dip our banner in his memory and salute him.

Long Live Com. G. K. Bhardwaj.

Another assault on RBI .... Stop it.

It seems the Government have declared a veritable war against Reserve Bank, launching series of offensives. Clearly, the powers that be are hell-bent to render RBI, the central bank of the country, into a toothless, powerless, crippled entity devoid of autonomy, independence and jurisdictions mandated by statutes and practice.

A decade back, in 2007, the Government mulled the proposal to sever public debt management from the ambit of RBI on the excuse of "conflict of interest". The futility of this plea having been exposed by experts, central bankers, economists, as also a nation-wide vigorous and educative campaign launched by AIRBEA on practice, performance and global examples, this could not fructify fully so far, but the Government have not desisted still.

RBI was sought to comply with the Government's design of full capital account convertibility, which, subsequent developments have proved, would have been disastrous for national economy. RBI could successfully deflect it. AIRBEA, again, actively campaigned, so much so that an exponent of full convertibility expressed her ire by writing in jest in Indian Express, "Red Star over RBI".

Then started a government-sponsored "raid" on RBI balance sheet. The "wise men" in the Government commented that RBI had more money in its Reserve than is needed and hence it should part with the money to enable the Government to look after its fiscal needs. That this would financially cripple the central bank of the country with deleterious impact on RBI's capacity to effectively intervene in financial / banking emergencies was just ignored. Of course, RBI has put its foot down in opposition, but Government persists.

Simultaneously, Government demands that entire "surplus" of RBI has to be transmitted to Government treasury, without any transmission to RBI "contingency fund". Eventhough RBI have transferred its entire earnings for successive three years, from 2013-14 to 2015-16, amounting to about Rupees two lakh crores, Government arm-twists RBI to perpetuate the full payment, *ad infinitum.* To make this statutory they even propose to amend the relevant provision of RBI Act.

Besides, if FRDI Bill would have materialized, DICGC, a department of the RBI since the sixties, would have been abolished by now. The ill-conceived bill, however, had to be withdrawn mid-way, thanks to strident protest all around. AIRBEA also contributed its mite. By a well-drafted memorandum to the Parliamentary Committee set up to finalise the Bill, AIRBEA and the United Forum of RBI Officers & Employees sharply focussed on the loop-holes, inadequacy, anti-people character of the proposed Bill, its dichotomy and overlapping with statutes governing RBI, global best practices etc. which drew the Parliamentary Committee's approbation.

Centering around the recent fraud in Punjab National Bank by Nirav Modi and Mehul Choksi duo, a tirade was let loose by the Ministry officials including the Finance Minister himself on RBI and its "regulatory, supervisory failure". The attack was two-pronged: curtail RBI's powers and privatise banks. While the motivated criticism continued unabated, as if to score points, the RBI Governor's very cogent reasonings for adequate empowerment to monitor and supervise Public Sector Banks was flatly denied, which shackles RBI.

The latest in the chain of offensives so far is the proposal by an Inter-Ministerial Group to move the responsibility for governing the Payment and Settlement systems out of the RBI.

While the draft report of the Committee, under the Chairmanship of Secretary, Department of Economic Affairs, has been placed in the public domain before finalization, RBI, which was represented in the Committee by an Executive Director, have, **in an unprecedented move, also put in the public domain on October 19, 2018, a strong Dissent Note to the same, which is not only significant but has created a flutter nationwide.** Let us briefly go through the issue.

Trajectories of Payment & Settlement system in India :

The Payment & Settlement System is growing very fast in India bringing benefits to consumers as regards quick, accurate and safe payment. From the conventional payment mechanism through cash and bank cheques, there has now been a qualitative and quantum jump by use of sophisticated technology and proper monitoring. Today we can boast of a strong retail payments framework comparable to that of any advanced country and perhaps even better than some of them in terms of variety and efficiency. Various types of payment instruments now exist to meet the requirements of different users in different circumstances - bank accounts, cheques, debit and credit cards, pre-paid payment instruments etc. There are various systems to meet remittance requirement of users depending upon their time criticality and cost sensitivity viz., National Electronic Fund Transfer (NEFT), Immediate Payment Service (IMPS), Unified Payments Interface etc. The need for making bulk and repetitive payments is met by systems such as Electronic Clearing Service (ECS), National Automated Clearing House (NACH), National Payment Corporation of India (NPCI) et al.

Even the cheque clearing systems have evolved from manual clearing to MICR (Magnetic Ink Character Recognition) system in mid-1980s, whereafter cheque truncation system (CTS) came into effect. With this a very large share of cheque clearing in the country takes place on T + 1 basis as if they are being cleared as local cheques. The funds could be realized within the same day almost. For a country of our size this is no mean achievement which very few countries have achieved.

For, bulk and repetitive payments such as collection of utility payments, payment of dividends etc., the Electronic Clearing Service (ECS) was introduced in early 1990s, ECS Credit to facilitate one to many payments such as dividend, salary, interest payments etc. and ECS Debit to facilitate many to one payment such as utility payments. NEFT is a pan-India system today, as is Real Time Gross Settlement System (RTGS).

Now, the ubiquitous mobile phone system is being utilized for payment and remittance of funds, which has facilitated quick non-cash, non-paper payment. With growing use of internet over the mobile phone, this medium is becoming a channel of choice for both customers as well as service providers. Now, almost all banks are offering this facility to their customers.

This payment and settlement system is guided by the Payment and Settlement Systems Act 2007 which has authorized RBI to monitor, guide and innovate the system as per requirement. However, in his budget speech 2017, the Finance Minister announced, "it is proposed to create a Payment Regulatory Board (PRB) in the Reserve Bank of India by replacing the existing Board for Regulation and Supervision of Payment and Settlement Systems." ...."The Payments Regulatory Board will exercise the functions relating to the regulation, supervision of payment and settlement systems under the Act."

While Finance Minister's announcement suggested that the Payment Regulatory Board will function under the RBI, with RBI Governor as the Chairman, the aforesaid Inter-Ministerial Committee recommended that the Board will be an independent entity, whose Chairman will be nominated by the Government "in consultation with RBI Governor". This clearly delinks the said Board from RBI.

Reacting strongly to this, RBI's Dissent Note has brought forth, inter alia,

i) There is no case of having a regulator for payment systems outside the RBI.

ii) Payment systems are a sub-set of currency which is regulated by the RBI. Effect of Monetary Policy on payment and settlement systems and vice-versa necessitates that the regulation of payment systems to be with the monetary authority i.e., RBI.

iii) All payment and settlement system, cash or non-cash, originate and end in banks only. The banking system regulation is vested with RBI only. So regulation of the banking systems and payment system by the same regulator provides synergy and inspires public confidence in the payment structure.

iv) <u>Regulation of the Payment System by the Central Bank is the dominant international model for stability consideration</u>. Thus, having the regulation and supervision over payment and settlement systems with the central bank will ensure "holistic benefits".

v) There has been no evidence of any inefficiency in payment systems in India. The digital payments have made good and steady progress. India is gaining international recognition as a leader in payment systems. There need not be any change in a well-functioning system.

These and other relevant points cited by the Dissent Note were not considered by the Inter-Ministerial Committee.

Expectedly, there have been sharp reactions from the media and other expert commentators. Some of these comments are reproduced.

"Turf Battle : The RBI makes a valid case against the proposal for a separate payments regulator". [The Hindu, October 23, 2018]

"Note of Dissent: RBI's resistance to a separate payments regulator frames the question : Is Government trying to fix what is n't broken?"

[The Indian Express, October 22, 2018]

"A Bad Idea : A separate payments regulator could be counter-productive.

"......in the dissent note, the RBI has capably answered the doubts that were raised not just about its own ability to regulate but also about the requirements of the payments regime needed........." [Business Standard, 22 October 2018]

"Big Question: RBI regulates currency but not clear why it should not control payments." [Financial Express, October 25, 2018]

"RBI should be autonomous.

.... The Modi Government has been accused of rendering most autonomous institution toothless and usurping powers of various ministries into the Prime Minister's Office, including to get the Securities Appellate Tribunal (SAT) to resolve the payments cases, bypassing the RBI. This undermining of critical institutions and procedures must stop.".......

[Deccan Chronicle, October 23, 2018]

"The governance of payment and settlement systems have long been among the core responsibilities of central banks all over the world........ It is not clear what the provocation has been for proposing such a far-reaching change in the area, which is at variance with established global practice." [Dr. Rakesh Mohan, former DG, RBI, economic expert, Business Standard, October 04, 2018]

It appears that the Committee under the chairmanship of Secretary, DEA, Sri S. C. Garg was under instruction to make out a case for taking away this function from RBI, no matter even if a smooth functioning process is jeopardized and put at stake. Somehow or anyhow, RBI is to be pruned - that seems to be the objective.

In the face of angry public reaction and firm position taken by RBI, thanks to RBI Governor, Dr. Urjit Patel, it is reported that Government might relent. But how long the Government would continue to nibble at RBI?

Do not the mandarins of the Finance Ministry realize that by such antics they are simply making themselves ridiculous? They are not only harming the RBI, but the entire nation.

Let them desist and let RBI do its jobs.

This is my profound realisation that there is probably no heaven and afterlife either. I think belief in an afterlife is just wishful thinking. There is no reliable evidence for it, and it flies in the face of everything we know in science".

---Stephen Hawking

Govt. on Merger Spree - A Cover for NPA problem?

The whole country is outraged by huge frauds and wilful non-payment of loans taken from government owned banks by India's top corporate houses, whereas, failing to repay small loans taken from local sahukars, banks and cooperatives etc. **more than 3 lakh farmers have committed suicide in last three decades.** At such a conjuncture, when the banks and the Reserve Bank are grappling with the problem of huge NPAs and even common people are agitated over corporate delinquency and their moral turpitude, the Finance Ministry all of a sudden announced Merger of Dena Bank and Vijaya Bank with their larger counterpart Bank of Baroda on 17 September 2018 : two banks would be wound up and subsumed under the biggest one. There will be closure of many branches and many employees will be forced to leave the bank on some proposed premium payment, which in other words called "golden handshake".

This is clear that this sudden announcement of merger has been made to divert the attention of the people from the most burning problem of mounting bad loans crossing Rs. 10 lakh crores and corporates cheating the bankers thousand crores and fleeing the country under the nose of the government, enormous loan waiver to the crony capitalists to the tune of Rs. 2.5 lakh crore in last five years through write off or now through the new exit route of Insolvency and Bankruptcy Code. Yes, under this code, the bankrupt industries are being purchased by powerful capitalists for a song. "Mallya, Nirav Modi, Winsome Diamonds, Videocon are on the surface rocking the Banks. Many big names are hitting the headlines about their involvement. **Out of 21 PSBs, 19 Banks are in loss on account of bad loans and provisions for bad loans. 21 PSBs put together, as on 31-3-2018, the total Operating Profit was Rs. 155,565 crores but due to provisions for bad loans to around Rs. 270,000 crores, there is a net loss of Rs. 85,000 crores."**

Thus, when recovery of bad loans and taking criminal action on all those involved in the scams is the top priority, the Government, as a camouflage, is going for the merger of the 3 Banks to divert the attention from alarming bad loans.

Why Merger? Will this reduce the mammoth NPAs?

Story of the SBI merger

Not the least. The recent merger of subsidiaries of SBI with the parent body, SBI has revealed just the opposite. Total bad loan of SBI was Rs. 1,12,000 crores and that of 5 Associate Banks together was Rs. 65000 crores,that is total of Rs. 1,77,000 crore as on March 31, 2017. In 2018 total bad loans of SBI has reached 2, 25,000 crore. Merger, therefore, could not reduce bad debt rather increased it.

Not only this. In this very year (2018), for the first time in its century old history SBI has recordeda surprise loss. SBI has reported its largest ever quarterly loss of Rs 7,718 crore in the March-ended quarter. Its loss stands at Rs 4,875.8 crore in the quarter ended June. Ironically, it had earned a profit of Rs 2,006 crore just a year back.

The story of New Bank of India's merger with PNB

It was in 1993 the RBI under Section 45 of Banking Regulation Act, 1949 forced New Bank of India to merge with Punjab National Bank as the former faced serious liquidity crisis. PNB was a very strong bank, having good track record of netting profits every year. However, just the next year after merger it recorded a loss of Rs. 96 crore. An efficient PNB took a couple of years to come out of the after-effects of a forced merger.

Similarly, the merger of privately owned Global Trust Bank, then a new star of financial liberalization, with state owned Oriental Bank of Commerce in 2004, seriously affected the earnings of OBC.

Does Merger always leads to rise of revenue-A Survey by McKinsey & Company?

The stated reasons for M&A have been: Synergies of operation, enlargement of Geographic reach, sudden expansion of assets, economy of scale, cost effectiveness, ability to compete with its international counterparts, etc.

However, it is wrong to say that mergers always lead to synergies of revenues, that it provides economy of scale etc., etc. McKinsey & Company conducted a survey across a range of industries, geographies, and deal types and have accumulated data from 160 mergers so far. Let us see what has been their observation in this regard : "The area of greatest estimation error is on the revenue side-a particularly unfortunate state of affairs, since the strategic rationale of entire classes of deals, such as those pursued to gain access to the target's customers, channels, and geographies, is founded on these very synergies. ***Nearly 70 percent of the mergers in our database failed to achieve the revenue synergies estimated by the acquirer's management. "There is also loss of customers, and closures of branches and retrenchment of employees***".

M&A - Industry vis-a-vis Banking

Banking is quite different from other industries in that it is based on close relationship between bank and its customer. When banks give someone a loan, it should have an idea about the borrower. Even bank can advise its clients on what type of saving one should go for. As such, if banks become too oversized that relation is hardly sustainable. **It has been observed that the bigger banks move away from common people and feel more at home with big borrowers. The agriculture and small and medium scale industries suffer the most.**

Secondly, since the global crisis of 2008, it has become a common concern that a bank should not be so big that if for some reason it fails it can harm the whole economy of a country. Oversized banks therefor, become **"too big to fail"** (TBTF). A government cannot afford to let these TBTFs go bankrupt as because that would entail irreparable damage to the entire economy. Hence any bank would like to grow into a TBTF to enjoy protection from the government in case it fails. This certitude about government support creates a moral hazard. The big banks become more prone to risky exposures and thus create a crisis in the economy.

Public Sector Banks - vis-a-vis – Private Sector Banks

Indian banking system is characterized by predominant presence of State-owned Public Sector Banks. The public trust on the Indian PSBs is phenomenal. That is why it is quite unlike the banking system prevailing in Europe and USA, which are overwhelmingly dominated by private sector. Moreover, thousands of banks compete with each other in the US and the continent, unlike in India, where a very small number of banks covers the whole banking domain. Lot of studies by researcher from world-wide renowned institutions on the effect of M&A do not point to any agreement regarding positive achievements and desired results. **In sum, the international evidence does not provide strong evidence on merger benefits in the banking industry.**

We have a social banking system in India. It was originally at the time of its emergence in 1969 mandated with various social economic objectives. It was a strong partner of the government to implement the five year planning. It had innumerable social obligations like delivering credit at very low interest rate to the vulnerable section of the population, particularly to agriculture and SMEs. It had to give credit to 'Priority Sector'. As a result, the whole system was dedicated to development of Indian economy, particularly the neglected part of the economy and the people. Profit was not the motif.

Secondly, Indian Public Sector Banks continues with the conventional financial intermediation that is receiving deposits from people and lending out to vital sectors of economy. Of late, it has embarked on other activities like insurance and investment in mutual funds etc, nonetheless the RBI has conservatively and justifiably restricted banks to minimal use of derivatives and thus did not let it have too much exposure to risky financial transactions. The private banking system in advanced countries are more and more leaning on Off Balance Sheet activities, which led it to the worst financial crisis in 2007-08. Let us hear from Gary Dymski, a reputed US economist and expert on banking consolidation, "Why did the 2007 financial crisis occur? And why, compared to other post-War crises, has it been so profound and hard to control? One is the rethinking of banking practices and strategies at the onset of the neoliberal age, **which resulted in evermore**

securitization of intermediated credit and a shift of banks' net-revenue generation from interest income to fees."

We should not forget that Indian banking system could avert the terrible impact of the Meltdown of 2008 for its insulation from international speculative banking activities. It is therefore, obvious that the so-called synergistic effect of merger is not compatible with the role of PSBs in India.

Casualties of Merger - the employees and the consumers

The employees of the banks who actually run the banks providing numerous services to the customers day after day for long years, are never invited for discussion before the decision is taken by the authority. Customers are also taken for a ride. By closures of many branches they are rather deprived of their choices or preferences for receiving services from a particular bank or branch. There is often lack of cultural assimilation for both the employees and customers.

The glaring instance is the SBI amalgamating its subsidiaries. If the SBI merger could not reduce the NPAs or generate profit for the banks, one thing it could successfully do - that is to **close about 800 branches and reduce the total staff strength by four thousand and two hundred till date, via "Voluntary" Retirement Scheme.**

M&A - Human Resources - A Brief Review of Literature

Merger or acquisition process contains uncertainty, instability, disappointments and creates lack of commitment. When studying personnel particularly, the voluntary labour turnover is one of the severest human risks caused by these negative emotions. Voluntary turnover is at its highest in the early stages of the M&A process. This is due to the uncertain and ambiguous situation where employees are uncertain of what will happen and in which time scale.

I. Inian and M. Kannappan (2018) comments : "when organizations merge or make a plan for acquisition the most effective issue of their mind is increase or expansion or synergies, issue of the people is completely omitted. Either they are not involved anywhere or if involved then at very lower level. (Ms Mani Arora & Anil Kumar, 2012).KV Saraswath (2008), spotlights Human Resource Management as one of the sensitive issues on the road to bank consolidation. Some of the HR issues are discussed like salary structure, promotions, seniority, transfer, role of trade union. It is said that for the success of bank mergers, it is important to tackle the human resources related issues. Another study from M&A effect on bank employees of Pakistan finds:" Employees those who have worked in both pre and postmergers & acquisitions environment strongly feel that their motivation level is unsatisfactory. Employees... feel strong threat to their job security while working in such environment.(Muhammad Naveed, Muhammad Naeem Hanif, Shahid Ali, 2011)

Studies suggest that during M&A the customers are taken for granted and never invited to discuss the matter or suggest some proposals. SUFIAN, F. and HABIBULLAH, M. S., 2014 studies M&A effect in Malaysia reveals the gist of the effect on customers when he says: **"A merger in the banking sector facilitates access to credit for companies, but reduces it for households."** More emphasis is given by Gary Dymskie on the negative effect of M&A on consumers: "This brings us to the final question posed in the introduction - has the merger wave been good for consumers? The answer to this question really depends on consumers' income, wealthlevels, and location. For one thing, the second phase of the bank merger wave, upscale retail banking, is bifurcating the retail banking customer base. Those with high incomes and substantial wealth have more options than ever for conducting their banking business. They are the **pampered winners** in the global financial game. But those with lower incomes and lesser amounts of wealth are likely to be adversely affected by the elimination of banks that make "character" loans and focus on "customer relations". (Gary Dymisky, 2000)

All India Winter Sports Meet of RBI takes place in Bengaluru from 17th to 23rd November, 2018. We wish it a total success.

how RBI failed to notice and check this inherent conflict in IL&FS which was virtually acting as a lender as well as borrower. In fact, IL&FS is an embodiment of unparalleled, wide-ranging and deep-rooted conflicts of interest and could well be called an epitome of conflicts.

As the multiple layers of this circus unfold, the resulting burden would have to be borne by none other than the common man, and it is bound to be enormous. The Centre and RBI have already intervened, primarily to protect the financial markets. But they don't seem to possess any magic wand that can address these complex issues and yet prevent significant damage to multiple quarters. By comparison, Vijay Mallya and Nirav Modi may have caused much less damage!"

[Emphasis ours - Voice]

On IL&FS : Excerpts from Business Line Editorial of 8th November, 2018

...."The IL&FS saga has raised many vexatious questions about how a shaky NBFC managed to secure top-notch credit ratings, bag loans from big-name institutions, stray far outside its core business and build an empire right under the noses of regulators such as the RBI, SEBI and the Ministry of Corporate Affairs"....

WITHOUT COMMENTS

"RBI wants the nation to know about its differences with the government

A government looks to its central bank usually when it is in a financial problem.

A decision should best be taken at the start of a new government rather than by a government that is six months from completing its term.

The Reserve Bank of India (RBI) deputy governor Viral Acharya's speech has attracted much media attention, but probably the core issues the central bank is raising has not got the attention it deserves.

Firstly, there is much angst on why spill the beans in public and why not discuss them privately. It must be obvious to all RBI-watchers that the current regime, if anything, has so far preferred to keep a low profile and speak very little publicly.

If the RBI top brass is airing issues publicly, it has to be assumed that it tried hard to resolve issues privately but couldn't convince the government of its point of view. And because some of these issues are important for the country and for future generations, the RBI decided the people ought to have a chance to decide.

Two issues deserve the nation's attention :

First is the dividend to be paid by the central bank. It must be remembered the RBI is not any bank or company. It is the central bank. It can't be judged by the accounting standards of normal companies.

The RBI balance sheet should be such that it inspires the confidence of global investors. Also, the trust of global investors in the central bank's balance sheet is tested most when the government is in peril, when its fiscal and/or current account deficits are high and when there is a run on the currency.

A government looks to its central bank usually when it is in a financial problem. It is important, therefore, that it keeps its central bank's balance sheet worthy of triple A rating.

The RBI's equity capital is a mere Rs 5 crore. The bank's strength is its reserves of about Rs 10 lakh crore. Of this, Rs 7 lakh crore is due to the revaluation of the gold and foreign exchange that it holds. Then, the RBI has Contingency (& Asset Devt) Reserves of Rs 2.5 lakh crore which is the sum total of the profits it has made over the last many decades.

Adding the revaluation and contingency reserves, RBI has a total capital of about 10 lakh crore or 27 percent of its balance sheet, which former chief economic adviser (CEA) Arvind Subramanian said make it one of the most highly capitalised central banks in the world.

Some central bank watchers disagree. They say the capital of central banks of countries with current account surpluses can't be compared with countries which perennially run current account deficits and which bridge their deficit with foreigners bringing capital flows. Foreigners bring in dollars when they have confidence in the exchange rate and the ability of the central bank to steady the exchange rate during a crisis.

Coming to the reserves, most experts agree that the revaluation reserve should not be touched since it moves with the market value of the foreign exchange and gold reserves of the RBI. It is the contingency reserves (which is the sum total of retained profits over the years) that the likes of Subramanian believe, ought to be returned to the government or used for public purposes like capitalising banks.

At least three committees (including one led by YH Malegam) that went into the issue of reserves have held that RBI cannot do only with revaluation reserves, but must also have contingency reserves between 8 and 12 percent of its balance sheet. The current contingency reserve of Rs 2.5 lakh crore form 7 percent of its balance sheet.

Now should the NDA government be allowed to demand this amount?

Firstly, an extraordinary act of reducing the RBI's reserves accumulated over the 2-3 decades, ought not to be taken by the government of the day. It should be gone into by a well-regarded committee of central bankers, statesmen and economists and their conclusions nationally debated.

Secondly, such a decision should best be taken at the start of a new government rather than by a government that is six months from completing its term.

Finally, decades of retained profits can't be spent by one government that is about to go to polls. In all fairness, it should be spread over several years, probably by adjusting against the government bonds held by RBI. Ideally, this fund may even be used to smooth out dividend payments, which again should be decided by a committee comprising experts and leaders from the government and the opposition.

From the tone of the RBI DG's speech, it appears that RBI is under tremendous pressure to hand over its surpluses squirrelled away over years and hence its decision to take the issue to the people.

The other key issue raised in the speech is the demand from the government to dilute the Prompt and Corrective Action (PCA) rules. Under RBI's 2017 rules, banks whose capital falls below 10.25 percent, whose net NPA (non performing assets) is above 6 percent and which report negative return on assets for two 2 years or more are put under PCA.

Banks under PCA are restricted from lending to risky assets, that is to companies with a rating below A, until they bring down their net NPA to under 6 percent. The government has been arguing that world over banks are put into PCA only when their capital levels decline; other considerations like NPAs don't figure.

The RBI's argument is worth hearing out : Firstly, in most countries, banks are able to recover collateral from their defaulters in a few months. In India, the time taken to recover loans stretches from 4-14 years. On an average, only around 12 percent of the bad loans were recovered before the Insolvency and Bankruptcy Code (IBC).

Secondly, in most countries, banks have to provide 100 percent for a loan as soon as it is defaulted upon. In India, banks have to provide only 15 percent in the first year. Thus, by global standards, Indian banks are providing much less capital, especially when NPAs are high.

But that isn't the nub of the argument. The problem is throughout 2017, thanks to demonetisation, banks were flooded with deposits but had little capital. So they lent easy loans to non-banking financial companies (NBFC), which in turn lent some of it recklessly to builders. Now as cash has become expensive, the NBFCs aren't able to provide additional loans, leading to a fear that vulnerable builders and some SMEs may default.

Tug Of War

The tug of war lies here : RBI doesn't want the already weak banks to lend to these risky entities. The government wants precisely that. A cornered central bank has brought the issue to the nation. So here's what the nation has to decide : Should it allow one government with six months term left to take in all the accumulated profits of RBI (and possibly weaken it) and secondly should we allow the country's already weak banks to lend more risky loans.

Now can we say these issues aren't worth being brought to the people?"

Courtesy : Latha Venkatesh from CNBC

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