CHAPTER- FOUR

FORMATION OF BANKING COMMISSION AND ITS RECOMMENDATIONS

Undoubtedly Indian commercial banks have made significant process after independence and started numerous banking activities. Yet, keeping in view the population, size and geographical area of the country, banking facilities are still inadequate. In India, for the process of banking sector many banking commissions are established. These banking commissions and its recommendations are as follows: --

Nadkarni Committee: -- A Committee under the chairmanship of Shri S.S. Nadkarni, former chairman of IDBI, was asset up to examine the various issues involved in cost overruns of project. All financial institutions have agreed to implement the recommendations of this committee.

Recommendations: -- Recommendations are as follows:

• Inflation Factor: -- While assessing the project cost, possible escalation in cost on account of inflation during the implementation period should be provided for. The rate of inflation to be taken into consideration is the rate of inflation mentioned in RBI Bulletin for the type of commodity as given below.
• **Civil Works:** -- Where the period of implementation is within one year the current cost can be taken into account. However, if the period of implementation exceeds one year, the cost of estimate should be inflated for the period of implementation by using inflation rate for Iron, Steel and Ferro Alloys.

• **Plant And Machinery:** -- Where quotations are received on firm price basis the same price should be accepted, and no further escalation in the cost is to be provided. In case the quotation is on "Cost Plus" basis or only indicative, the inflation rate as applicable for non-electrical machinery or electrical machinery as the case may be, should be taken into account for inflating the cost.

• **Miscellaneous Fixed Assets:** -- For all the machineries, the cost should be estimated as per the point 3 above. For furniture and fixtures where prices are not firmed up, the cost should be escalated for implementation period by using the inflation rate for manufactured products.

• **Pre- operative Expenses:** -- The pre-operative expenses increase in implementation period. Therefore, at the appraisal stage itself the schedule of implementation should be scrutinized and finalized on realistic basis.

• **Provision For Contingency:** -- It should be made a flat rate of 10% on all items excluding Margin Money for working capital.

• **Margin Money For Working Capital:** -- It should be worked out as per the 2nd method of lending suggested by Tondon committee.
Narang Committee: -- A study group under the chairmanship of Shri B.D. Narang, was set up in 1998 at the instance of the Board for financial supervision. The study group submitted its report in March 1999. The group studied frauds reported by commercial banks from 1995-1997 and confined itself to those areas which led to the weakening of the internal control system for prevention and detection of frauds.

Recommendations: -- The group has made following recommendations:

- There is always a time lag between the detection and reporting of a fraud.
- It is not the lacunae in the rules but the non-observance of the same, which leads to the fraud.

Verma Committee: -- The Committee was constituted on 8.2.1999 for suggesting of weak banks. The Committee submitted report on 3.10.1999. The Committee used the following 7 parameters for identification of banks strength/weakness in the area of solvency, earning capacity and profitability. The parameters are:

1. Capital Adequate Ratio 8% or more
2. Coverage Ratio 0.50% or more
3. Return on Assets Median level
4. Net Interest Margin Median level
5. Profit/ Average Working Fund Median level
Three weak banks identified were UCO Bank, Indian Bank and United Bank of India. The Committee identified key problems for dismal performance and suggested ways for improvement.

**Recommendations:** -- The major recommendations are as under:

- **Operational:** --
  - Cut staff strength by 25% through VRS
  - If VRS scheme fails cut wages across the board
  - Effective five years wage freeze
  - Close down subsidiaries of these banks, sell off foreign branches
  - Set up Government owned ARF manage by private sector AMC

- **Organizational:** --
  - Rationalize branch network
  - Reconstruct Bank Boards
  - CMD should have long tenure
  - Appoint 2 ED’s in big bank

- **Systemic:** --
  - RBI to set up a special wing to supervise weak banks
- Nodal body to monitor process of weak banks
- Debt Recovery tribunals to work on war footing

**Financial:**
- Spend Rs. 5500 crore over next 3 years on
- Rs. 300-400 crore on technologies upgradation
- Rs. 1100-1200 crore on VRS
- Rs. 1000 crore on NPA buy out
- Rs. 3000 crore for capital adequacy

**Ghosh Committee:** A Committee appointed by RBI in 1993 at the instance of Government of India, under the chairmanship of A. Ghosh, Former Dy. Governor of RBI, to enquire into various aspects of frauds and malpractices in banks.

**Recommendations:** Recommendations accepted by RBI w.e.f. 26.9.93 are:

- Photographs should be obtained while opening new deposit accounts.
- Bank to nominate a senior level officer as 'Compliance Officer' who should ensure and report that various items of work in different departments are carried out strictly in accordance with system and procedures laid down by bank. He should ensure that all RBI/Board instructions are meticulously observed.
Bank should provide desk cards for different type of works to help employees understand and observe their duties.

Cash and other valuables must be kept in joint custody. Currency Chest Transactions should be reported to RBI on the same day.

No official should exceed his delegated authority except in every emergent circumstance.

Cash should not be received other than in the cash department and cashier should not be allowed to make entries in passbook.

The paying cashier before making payment must ensure that the token number and signature of the person are obtained without fail.

**Padmanabhan Committee**: -- A Committee appointed by RBI in 1995, under the chairmanship of S. Padmanabhan, former chairman of Indian Overseas Bank, to suggest in the approach and style of inspection and follow up by the Central Bank.

**Recommendations**: -- RBI yet to accepts Recommendations:

(i) **On going supervision**

- Shift from the current system of periodical inspection to on going or continuous supervision

(ii) **CAMEL Rating Model**
• Each bank should be raised on a five score scale A to E indicating in descending order the soundness and strength of the bank

• For Indian Banks the rating will be based on six parameters (C.A.M.E.L.S.) (i) Capital Adequacy, (ii) Asset Quality, (iii) Management, (iv) Earnings, (v) Liquidity and (vi) Systems and control

• For foreign banks the rating will be based on four parameters (C.A.C.S.) (i) Capital Adequacy, (ii) Asset Quality, (iii) Compliance & (iv) Systems and control

• Periodicity of supervision should be discriminatory based on bank’s rating

Rashid Jilani Committee: -- A Committee was set up on 15th May 1992, under the chairmanship of Rashid Jilani, Former chairman of Punjab National Bank, to suggest alternative method of lending in place of the present cash credit system.

Recommendations: -- The major recommendations are as under:

• Permitting Authorised Dealers to initiate Cross Currency Position Overseas.

• Allowing Banks to lend and borrow short-term funds up to six months in overseas market.

• Permitting exporters to retain 100% of their export earning in foreign currency in India.
• Setting up off shore Banking unit in Bombay.
• Giving banks greater freedom to use derivative product for their asset liability management.

Shere Committee: -- A Committee was set up on August 1995, under the chairmanship of Smt. K.S. Shere, Principal Legal Advisor, RBI, to study all aspects of Electronic Fund Transfer.

Recommendations: -- The major recommendations are as under:

• To start with EFT can be introduced by framing regulations under RBI Act 1934. The Committee has suggested a model EFT agreement to be entered into between banks themselves and banks and their customers.
• A comprehensive EFT legislation may be enacted after gaining some experience.
• Amendment to RBI Act to pave the way for development of multiple EFT system in different segments like ATMs, EFT POS and other consumer payment systems.
• An amendment to Bankers Book of Evidence Act to accord status to admissible evidence to computer print outs and other electronic records.
Implementation: --

- RBI is farming regulations under sec. 58 of RBI Act 1934 to implement the EFTS pending introduction of the proposed Electronic Funds Transfer Act, Computer Misuses Act and amendments to RBI Act 1934 and Bankers Book Evidence Act 1891.

Saraf Committee: -- A Committee was set up on June, 1994 under the chairmanship of W.S. Saraf, ED RBI, to study technology issues in the banking industry.

Recommendations: -- The major recommendations are as under:

- To set up Electronic Fund Transfer.
- To start Electronic Clearing Service.
- Decentralization of cheque clearing
- Introduction of Delivery Vs Payment system in SGL transaction in Government Securities.
- Introduction of Cheque Transaction system.
- Promoting Card Culture.
- MICR clearing at all places with more than 100 bank branches.
- Establishment of an institute on Banking Technology.
Kalia Committee: -- A Committee was set up on November 1994, under the chairmanship of S.K. Kalia, to study on Working Group on Non Government Organization (NGOs) and self help group (SHGs).

Malegam Committee: -- A Committee was set up in 1994 by SEBI, under the chairmanship of Y.H. Malegam, Past President of Institute of Chartered Accounted of India, submitted report on 29.6.1995, to review the existing disclosure requirements for companies making public issues.

Recommendations: -- Recommendations accepted by SEBI are:

- Companies must quantify audit qualifications into actual figures.
- Appointed by IBA at the instance of RBI.
- Loan system for delivery of Bank credit, which means a major portion of the Cash Credit limit, should be given in form of loan. RBI already accepts this recommendation.

DR. A.C. Shah Committee: -- A Committee was set up under the chairmanship of Dr. A.C. Shah, to study on Working Group on Financial Companies.

Recommendations: -- Recommendations accepted by RBI are:
In order to be eligible to accept deposits from public NBFCs should adhere to the following:

(a) All non banking financial companies (NBFs) having a net worth of Rs. 40 lacs and above must get themselves registered with RBI.
(b) The total amount of deposits to be mobilised is to be restricted to certain times of net worth.
(c) They must maintain liquid ration @ 10% (i.e. 10% of their deposit liability to be kept in cash/ approved securities.
(d) They should get their debt instruments rated by rating agency compulsory.

J.V. Shetty Committee: -- A Committee was set up in January 1993, under the chairmanship of J.V. Shetty, CMD Canara Bank, to review the system of lending under Consortium Arrangement.

Recommendations: -- Recommendations accepted by RBI are:

- Where a borrower enjoys fund based working capital credit limit from the banking system for Rs. 50 crore and above. Consortium is obligatory.
- There is no ceiling on the number of banks in a consortium.
- Time frame for disposal of loan application etc.
Vaz Committee: -- A Committee was set up by RBI in 1993 and submitted report in September 1993, under chairmanship of Miss I.T. Vaz, ED, RBI, to review the role of RBI in laying down norms for bank lending for working capital purpose.

Recommendations: -- Recommendations accepted by RBI are:

- In case of units availing fund based working capital limit of less than Rs.1 crore, the working capital is to be computed minimum 20% of their projected turnover.
- Banks are given free hand to fix inventory norms etc.

Sodhani Committee: -- A Committee was set up in November 1994, under the chairmanship of O.P. Sodhani, the then ED, RBI, to study on Export Group on Foreign Exchange Markets in India.

Recommendations: -- Recommendations are as under:

- Permitting corporate to cancel and rebook option contract and hedge genuine exposure using options.
- Permitting banks to decide there open position limits.
- A company can come out with public issue only if it has been in commercial operation for two years or more and its post issue capital is minimum Rs.5 crore. However, there is no ban for any company to go for public issues through OTCEI.
• Process of public issue need be strengthening further by allowing book building process prior to offer to public.
• Companies with an issue size of Rs.100 crore or more would be allowed to use the book building process for that part of the issue, which can be allotted on a firm basis as per present guidelines.
• The lead manager to participate up to 5% of the issue size on firm allotment basis.

Kannan Committee: -- Kannan Committee is reported to have suggested that the prescribed uniform formula for Maximum Permissible Bank Finance (MPBF) should go and bank should have the sole discretion to determine borrowing limits of corporate.

Recommendations: -- Recommendations are as follows:

• Definition of an industrial group should be left to the perception of the financing bank.
• System of cash credit should be replaced by a system of loans for working capital.
• Banks should dispose off all the loan applications within 2 to 8 weeks.
• Banks should be allowed to decide policy norms for issue of commercial papers.
• The uniform formula for MPBF should be abolished and banks should have their own borrowings limits for corporate.
• Corporate borrowers may be allowed to issue short-term working capital debentures of 12-18 months maturity and banks may be subscribed to these debentures.

• Alternatively, the borrowers with credit requirements of Rs.20crore or more may be allowed working capital by way of demand loan to the extent of 100% and borrowers with requirements of over Rs.10crore and up to Rs.20crore may have a demand loan component of 75%.

• Interest rate incentives may be provided to borrowers opting for 100% working capital demand loan.

• Margins and holding levels of stocks and receivables as security for working capital facility may be left to the discretion of the financing bank.

• Bench-mark current ratio 1.33:1 and ideal debt equity ratio should be left to the discretion of the banks.

• QIS & CMA should cease to be a regulatory requirement.

• Borrowers will have to obtain prior approval for investment of funds outside the business like inter-corporate deposits, investment in associate concerns and in other investments.

• Bank should try out the syndicated form of lending.

• A credit information bureau is floated independently by bank.

• Rs.50crore mandatory limit fixed for consortium should be done away with.
S.L. Kapoor Committee: -- A Committee was set up under the chairmanship of S.L. Kapoor, to study on credit to small-scale industries sector.

Recommendations: -- Recommendations accepted by RBI are:

- Introduce tri-lingual loan application forms.
- Straightway use the application forms prescribed for facilities up to Rs.2lacs, for facilities up to Rs.10lacs, for facilities up to Rs.15lacs to be used for facilities up to Rs.50lacs and for facilities up to Rs. One crore to be used for facilities beyond Rs.50lacs.
- Adopt committee approach for sanction of limit and dispose off loan applications in time bound manner. The prescribed time limit is a fortnight for up to Rs.25000 and 8 to 9 weeks for facility beyond Rs.25000.
- For quick disposal of application the apprising official should maintain a checklist and advice the applicant to submit the additional information that may be required to appraise the application.
- Necessary help to the applicant may be provided to fill up the application forms properly. Sufficient number of brochures, schemes instructions of bank and RBI/ SIDBI/ NABARD/ State and Central Government should be made available at the branch.
• Branch Manager may be delegated power to grant adhoc facilities to the extent of 20% of the sanctioned limit subject to the usual lending discipline.

• Clear guidelines should be set up with the approval of the board of computing the working capital limits, particularly for borrowers requiring fund-based facility beyond Rs.4crore.

• Unless there is any contrary specific reason banks should accept the projections of the new units for the first year of operation as accepted by the term lending institutions.

• As now the flow of credit to the SSI Sector would be assessed by the date on disbursement instead of outstanding balances disbursement targets should be fixed along with outstanding balances. Out of the total fund allocated by banks to SSI Sector 40% should be earmarked to the units with investment in plant and machinery up to 5lacs only. 20% to the units having investments in plant and machinery between Rs.5lacs to Rs.25lacs.

• More attention is to be given to the backward states such as Bihar, J& K, Madhya Pradesh and North Eastern States while fixing the lending targets.

• The limits of composite loans may be enhanced from Rs.2lacs to Rs.5lacs so that entire requirement of the unit can be met by single documentation and security creation.

• This facility of composite loan to SSI unit requiring assistance up to Rs.5lacs may be given irrespective of their location.
• Single window concept may be implemented. Banks will entertain projects both the term and working capital loans of borrowers assistance up to Rs.3lacs. Similarly for projects requiring institutional credit of more than Rs.5lacs up to Rs.25lacs either the bank or the SFCs should sanction both the term and working capital facility.

• For requirement exceeding Rs.25lacs SIDBI should make arrangement with the public sector banks to have a memorandum of understanding to be signed by the SFCs with the selected banks active in different regions of the country for joint financing. Both the term loan and working capital facility should be shared along with sharing of securities on pari-passu basis. However, the borrowers may be given an option to avail the entire facility from a single agency.

• The overall interest rate payable by SSI units should be limited to the maximum PLR plus 4% as existing now. Additional spread over the PLR should be used a premium for guaranteeing the repayment of the loan. SSI units with good track record will thus have to pay lower premium and would derive some advantage out of lower spreads.

• The SSI units may be allowed to invest overseas up to US $20000 based on a simple procedure.

• More specialized branches may be opened to meet the requirement of SSI units and customer grievances machinery may be made more effective.
Vaghul Committee: -- The Vaghul Committee in its report (5th September, 1986) made the following suggestions for the improvement of Capital Market in India:

- Lowering of the discount rate applicable to bill from the ceiling of 16.75% to 15.5%.
- Government directives to issue to all public sector undertakings that payment for all credit purchases made by them should be made in the form of Bills.
- Penalty for not honoring the Bills on due date.
- Specific stipulations by RBI directing a phased increase in the proportion of bill acceptance total credit purchases to a level of 75% by April 1987.
- Establishment of a Finance House to ensure emergence of an active secondary market for bills, besides simplification in the procedure for Bills Rediscounting.

Recommendations: -- The Vaghul Committee recommended the following:

- To improve the Call Money Market.
- To improve the Bill Rediscounting.
- Short- term Commercial Paper.
- Government Paper.
- Setting up of a Finance House.
- Development of New Instruments.
• Inter-Bank participation Certificates.
• Certificates of Deposit.
• Factoring Services.

Khusro Committee: -- Khosro Committee (1993) was constituted to review the working of agricultural credit in India in the year 1986 but the report was tabled in parliament in the year 1993.

Recommendations: -- The Committee recommended that the PSL scheme should continue to support the national plan for agricultural development. It was also of the opinion that the human resource development should be emphasized for improving the quality of agricultural credit system. It laid stress over the pre-lending appraisal and strict monitoring of loans and recoveries. The Committee was of the view that the norms and procedures related to rural lending should be given to the branch managers with respect to sanctioning of loans. The Committee also suggested that information system should be improved in the banks. The crop insurance scheme should be started and a separate credit guarantee scheme should be formulated (covering co-operative credit institutions). It further recommended that the schemes, which are created for meeting the rural credit, such as IRDP etc, should be thoroughly reviewed.

Chakravartee Committee: -- Chakravartee Committee (1985) was set up to review the working of the monetary system in India. It was of
the view that there should be a controlled competition among the banks.

**Recommendations:** -- It recommended for rationalization of confessional interest rates and revision in the yields on dated securities and in the discount rates of treasury bills. The removal of ceiling of inter-bank call money rates and a stricter credit discipline were also suggested.

**Goiporia Committee:** -- Goiporia Committee (1991) made wide-ranging recommendations to improve the customer services in the commercial banks in India.

**Recommendations:** -- Recommendations are as follows:

- Opening & closing of bank counters in time & prompt commencement of customer service – working hours of the employees should start 15 minutes before the commencement of business hours, to facilitate the staff to settle on counters well in time.
- Cleanliness & upkeep of premises.
- Sitting plan of the office should be functional and designed to facilitate smooth flow of work.
- "May I help you," counters at all branches with staff strength of 25 or more.
- Display of norms for important services at the branch.
• Display of name plates/ badges by the staff members.
• Prompt & regular updating of pass books & issue of receipt (PNB 649) in case of Pass left overnight with the bank.
• Nomination facility – Nomination should be a rule (rather than an exception).
• Acceptance of small denomination notes for issuance of drafts from customers as well as non- customers.
• Term Deposits – Customer Awareness & Safe Custody:
  Popularize term deposit schemes through publicity & create awareness, offer of free safe custody of T.D. receipts to facilitate renewals.
• Return of dishonored instruments (Cheques, Bills etc) to the customer promptly.
• Delay in collection of cheques/ drafts:
  ➢ Pay interest for the delayed period beyond 10/14 days at the rate of min lending rating in case of credit to C/C, O/D or loan account. 2% above the saving rate in case of accounts other than above.
  ➢ Outstation cheques up to Rs.10,000/- in metro centres drawn on other metropolitan cities should be credited latest by seventh day even if advice is not received.
  ➢ Outstation cheques up to Rs.10000/- drawn on State Capital & other cebtres having 100 bank offices or more, credit should be afforded latest by 10th day.
• Delay in collection of bills – Pay interest @ 2% above savings rate for the delayed period computed on the basis of actual transit period.

• Value dating of TT's – Pay interest @ 2% above savings, bank rate from 3rd day in respect of TT's issued from & payable at state capitals & Area I centres (population 12lac & above). For other such interest may be paid from the date of receipt of TT/ Confirmation copy.

• Value dating of mail transfers – Interest at 2% above saving rate be paid for delay beyond 7 days (10 days in case of Sikkim & N.E. States) in case of remittance by Mail Transfer.

Tarapore Committee: -- The Committee on Capital Account Convertibility headed by Shri S.S. Tarapore, former Dy. Governor of RBI, set up by the RBI presented its report on 3.6.97. The other members of the Committee were S.S. Bhalla, M.G.Bhind, Kirti Parikh and A.V. Rajwade. The Committee was of the view that capital account convertibility (CAC) should be phased over a three- year period ending 2000 with the first phase starting in 1997-98, Second in 1998-99 and the third falling in 1999-2000. CAC means the freedom to convey local financial assets into foreign financial assets and view versa at market determined exchange rates. It implies freedom to citizen to buy and sell foreign exchange and utilize it for defined purposes.
Recommendations: -- The Committee recommends the phased liberalization of capital inflow and outflow to allow for the following:

- Allowing Indian companies to invest up to $50 million in venture aboard.
- Allowing exporters/exchange earners to keep their entire forex earning in the EEFC account and giving them full flexibility in the use of such funds.
- Permitting individual residential to invest in financial assets aboard up to $25,000 in phase I (1997-97) and rising up to $50,000 and $100,000 over the next two years.
- Allowing SEBI registered Indian funds to invest in securities aboard within an overall limit of 4500 million in phase I, and rising to $2 billion in 1999-2000.
- Giving banks greater freedom to borrow and deploy funds outside Indian in stages.
- Allowing FII portfolio funds to be invested and repatriated without prior RBI scrutiny.
- Allowing FIIs, NRIs and foreign banks full access to forward cover to the extent of their assets in India.
- Permitting banks and financial institutions to participate in gold markets aboard.

R.V.Gupta Committee: -- A Committee was set up under the chairmanship of Shri R.V. Gupta, to study on agriculture credit.
Recommendations: -- The recommendations are as follows:

- Interest rates on agricultural loans to be fixed by banks.
- 90% of loans applications to be cleared by local branches.
- A liquid savings facility in built into loan products.
- Special agriculture credit plans to accelerate flow of credit.
- Extension of composite cash credit limit to include farm credit.
- Abolition of stamp duty on mortgage of farmland.
- Indicate annual increase in credit flow to agriculture.
- Modify so as to provide borrowers a choice of banks.


Recommendations: -- The following are the main recommendations of the Committee:

- The Committee recommended that the government should reduce the Statutory Liquidity Ratio (SLR) from the present 38.5% of net demand and time liabilities of banks to 25% over the next five years. It also recommended that Cash Reserve Ratio (CRR) should be progressively reduced from the present
high level of 15% to 3 to 5%. The RBI should pay interest on impounded deposits of banks above the basic minimum.

- The directed credit programmes should be gradually phased out. The concept of priority sector should be redefined to include only the weakest section of the rural community such as marginal farmers, rural artisans, village and cottage industries, etc. The credit for redefined priority sector should be fixed at 10% of the aggregate bank deposit.

- The Committee recommended that market forces, without the intervention of the RBI, should determine the level and structure of interest rates. All controls and regulations on interest rates on lending and deposits of banks should be removed. However, all the interest rates should be closely linked with the bank rate. It also recommended a phased achievement of 8% capital adequacy ratio.

- To bring about greater efficiency in banking operations, the Committee recommended a substantial reduction in the number of public sector banks. The broad pattern of the banking system should be as follows:

  - 3 or 4 large banks (including the SBI) which could become international in character.
  - 8 to 10 national banks with a network of branches throughout the country engaged in general or universal banking.
➢ Local banks whose operations should be confined to a specific region.

➢ Rural banks including regional rural banks whose operations would be confined to the rural areas and whose business would be mainly to finance agriculture and allied activities.

• The Committee recommended abolition of branch licensing. Banks should be free to open or close branches purely on profitability considerations.

• The government should allow foreign banks to open offices in India either as branches or as subsidiaries. They should fulfill the same or similar obligations as the Indian banks. Foreign banks and Indian banks should be allowed to set up joint ventures regarding merchant and investment banking, leasing, etc. Thus, the committee recommended for liberalizing government policy towards foreign banks.

• The Committee recommended that the present dual control of the RBI and the Ministry of Finance over banking system should be removed. The RBI should be the primary agency for the regulation of the banking system.

• The Committee recommended the setting up of Assets Reconstruction Fund (ARF) to take over from the nationalized banks and financial institutions, a portion of their bad and doubtful debts at a discount. This arrangement would help the banks and financial institutions to take off bad and doubtful
debts from their balance sheets and reinvest the funds realized through this process into productive uses.

- The Committee recommended that the public sector banks should be free and autonomous. Every bank should bring about radical changes in its work technology and should adopt wide-ranging innovations taking place aboard.

- The appointment of chairman-cum-managing director should be made on the basis of professionalism and integrity and not on political considerations.

- The Committee gave the following recommendations regarding financial institutions:
  - The Reserve Bank should set up a new agency to supervise financial institutions like merchant banks, mutual funds, leasing companies, venture capital companies, etc.
  - The direct lending function of IDBI should be transferred to a separate institution. However, its apex and refinancing role should be retained.
  - An appropriate legal structure is developed to operate mutual funds.
  - Capital market should be liberalized.

**Implementations:** -- The Government of India accepted all the major recommendations of the Committee and started implementing them straightway. The following measures have been taken in this regard:
• The SLR on incremental net demand and time liabilities has been reduced from 38.5% to 25% SLR on outstanding net domestic demand and time liabilities was gradually reduced from 38.55 to 27% in March 1997 and 25.5 in October 1997.
• The RBI gradually reduced CRR from 15% to 10% by March 1997.
• The important changes in this respect are as follows:
  ➢ Interest rate slabs were gradually reduced from 20 to 2 by 1994-95.
  ➢ Interest rate on the high slab of bank advances has been deregulated to stimulate healthy competition among the banks and increase their operational efficiency.
  ➢ Scheduled commercial banks have been given freedom to set interest rates on their deposits subject to minimum floor rates and maximum ceiling rates.
• The revised format for balance sheet and profit and loss account reflecting actual financial position was introduced in 1992-03.
• The RBI has started prudential norms as part of the reformative process. Prudential norms required banks to make 100 percent provision for all non-performing assets. This step will help in effective supervision of banks.
• RBI fixed the capital adequacy norms at 8% in April 1992. By March 1996, all public sector banks had attained capital to risk weighted assets ratio of 8%. 
Scheduled commercial banks have been given freedom to open new branches and upgrade extension counters. They may close non-viable branches except rural branches.

The private sector banks have already started functioning. Besides, the Government of India has also approved some new proposals to set up new private sector banks.

The RBI has set up Board of Financial Supervision under the chairmanship of the Governor to strengthen the supervisory and surveillance system of banks and financial institutions. The RBI has also established in December 1993 a new department known as 'Department of Supervision.'

The Government of India passed 'Recovery of Debts due to Banks and Financial Institutions Act, 1993' to speed up the recovery of debts. Six special Recovery Tribunals have been set up in this regard.

**Narasimham Committee (1998):** The Government of India appointed Mr. M. Narasimham as chairman of one more committee known as 'Narasimham Committee on Banking Sector Reforms.' The Committee was asked to review the progress of banking sector reforms to date and give recommendations to strengthen India's financial system and make internationally competitive. The Committee gave its report to the government in April 1998.

**Recommendations:** Important findings and recommendations of this committee are as follows:
The following recommendations have been made regarding structural issues of banks:

- The Committee recommended the merger of strong banks, which will have a multiplier effect on industry. The Committee cautioned the merger of strong and weak banks, as it would have negative effect on the asset quality of the strong bank. Weak banks should be either nurtured into viable units or close down.

- Banking system should be reconstituted:
  - The country should have two or three banks with international orientation.
  - There should be 8 to 10 national banks, which should take care of the needs of large and medium corporate sectors.
  - There should be a large number of local banks, which should remain confined to smaller geographical regions.

- The Developmental Financial Institutions over a period of time convert themselves to bank.

- The minimum share holding by Government or RBI in the equity of nationalized banks and the SBI should be brought down to 33%.

- The RBI should not be the owner of any bank.

- The Deposit Insurance Scheme should be reformed.

- There should be rationalization of branches and staff.
The policy of licensing new private banks may be continued.

The following recommendations have been made to strengthen the banking system:

- 'Capital Adequacy Requirements' must take into consideration market risks in addition to credit risks.
- The minimum capital to risk assets ratio (CRAR) be increased from the existing 8% to 10%. Those banks should be penalized which do not maintain CRAR.
- Risk weight on advances given on government guarantee should be the same as on other advances.
- Those public sector banks be encouraged which are in a position to assess the capital at home or aboard.

The Committee made the following recommendations to improve asset quality of banks:

- The ratio of non-performing assets to the total assets of banks should be reduced.
- To evaluate the quality of assets portfolio, loans covered by government guarantees, which have turned sticky, should be treated as non-performing assets.
- The following two alternative approaches can be adopted for banks having high non-performing assets:
  - All loan assets falling under 'doubtful and loss categories' should be identified and their realizable value determined. Such assets may be transferred to an Asset Reconstruction Company, which would issue NPA Scrap Bonds.
The banks having high ratio of non-performing assets should issue government guaranteed bonds.

- The provision of interest subsidy in credit for private sector should be totally scrapped. Interest rates on advance below Rs.2 lakh should be deregulated.

- The Committee suggested the adaptation of the concept of narrow banking to rehabilitate such weak banks, which have accumulated a high percentage of non-paying assets (NPAs). Narrow banking implies that the weak banks place their funds in the short-term in risk-free assets.

- To improve the system and methods in banks, the Committee made the following recommendations:
  - An independent loan review mechanism should be evolved specially for loans of large amount and system to identify potential non-performing assets.
  - Banks and financial institutions should have proper system of recruiting skilled staff from the open market.
  - There should be rapid computerization of the banking facilities. With regard to banking operations, modernization and technology upgradation should be adopted.
  - Public sector banks should have flexible system to determine managerial remuneration taking into account market trends.
  - The scope of external vigilance and investigation agencies in respect of banking business should be redefined.
• There should be an integrated system to regulate and supervise the activities of banks, financial institutions and non-banking finance companies. The agency for this purpose be renamed as the 'Board for Financial Regulation and Supervision' (BFRS).

• The Committee expressed the urgent need to review and amend the provision of RBI Act, Banking Regulation Act, State Bank of India Act, etc. so as to bring them in conformity with the current needs of the banking system.

**Implementations:** -- Keeping in view the recommendations of Narasimham Committee 1998 on Banking Sector Reforms, the Reserve Bank of India announced a number of decisions as part of Mid-Term Reviews of monetary and fiscal policy. These related to phased introduction of risk weight for government-approved securities, risk weight for government guaranteed advances, general provision for standard assets and higher capital to risk assets ratio for banks. These decisions, however, have prospective effect.