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TRAVERSING THE BANKING LAW ON PUBLIC SECTOR BANKS IN INDIA

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ABSTRACT

In India, several reforms over the past few decades have been taken on by the country's public sector banks. Currently, there is a major crisis in the public sector banking industry. The purpose of this study is to suggest ways forward in the effort to create a reliable Public sector Banking system in India. An overview of the background is provided, and a statistical analysis of the current state is performed so that appropriate solutions can be proposed. The difficulties are listed under many topics, including nonperforming assets (NPAs), the need for recapitalization, governance problems, a dearth of qualified workers, and more. Based on these difficulties, suggestions have been made to improve the government and the economy. The authors made an effort to critically analyze the issue by drawing parallels to other countries while keeping their Indian heritage in mind. Finally, without placing too much emphasis on privatization, alternatives have been presented that will allow Public Sector Banks to retain their identity. Extreme measures for rebuilding have been emphasized. The primary challenges experienced by PSBs have been addressed to the best of our abilities.

Key Words: *Public Banks, Government, Banking Law, Non-Performing Assets, Nationalisation.*

RESEARCH OBJECTIVES

The researcher has formulated the following research questions after thoroughly reviewing the aforesaid literature:

(1) What is the status quo of Public Sector Banks in India?
(2) How has public sector banking developed in India?
(3) What are the developments and reforms made in the Banking Law of India since the nationalization of banks?
(4) What are the challenges faced by the Public Sector Banks in Modern India under the present Banking Law?
(5) What are the reforms and policies required to meet the challenges of the Public Sector Banks in India?

RESEARCH HYPOTHESIS

The primary goals of this study are to examine the following hypotheses:

(1) The Public Sector Banking underwent positive reforms after the Nationalisation of Banks.
(2) The Public Sector Banks are not devoid of challenges but are in dire need of reforms by rectifying the loopholes in the current Banking Laws in India.
(3) The Banking Law of India has numerous loopholes which require rectification and reform.

RESEARCH METHODOLOGY

The researcher has adopted Doctrinal Research Methodology. The Researcher has made excessive use of primary and secondary data available on the Internet in form of articles, thesis, research projects, blogs, and other sundry miscellaneous sources including books, commentaries, and legal research databases which are duly accredited with appropriate citations hereunder.

INTRODUCTION

"The Indian economy relies heavily on its public sector banks. If they are not healthy,

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the economy will suffer as a whole "At the Conference on "Reforms Journey for EASE in Public Sector Banks," Arun Jaitley, India's former Union Minister of Finance and Corporate Affairs made this declaration.[582]

The first thing that pops into mind after reading this is, "what is the huge role these banks perform?" When the government owns more than 50% of a bank, we call it a public sector bank. Customers feel more at ease knowing that the government is the owner. Their massive following of satisfied customers is a direct outcome of this.[583]

Banks in India have been instrumental in the country's progress and expansion. Public[584] sector banks in India have been instrumental in expanding access to banking services in the country's rural and remote areas. Since PSBs are responsible for such massive welfare programs, they must continue to be seen as credible and important institutions. To guarantee a steady banking system in the country, it is necessary to do extensive study to provide practical solutions to the issues faced by PSBs.

A BRIEF HISTORY

When India gained its independence, the country already had a robust commercial banking sector. In 1949, banking regulation was enacted and the Reserve Bank of India (RBI) became a state-owned organization. It laid forth the rules and regulations for how commercial banks in our country are regulated. The initial step toward nationalization, and still the locus classicus on the subject, is the report by the committee of all India rural credit. One unified commercial banking system, with a special emphasis on rural loans, was the key suggestion. The government of India nationalized the imperial bank, which it rebranded as the state bank of India. It subsequently absorbed many of the princely states' banks as subsidiaries. In the 1950s, this took place. In response to the growing demands of the commercial and industrial sectors, the banking sector underwent significant development in the 1950s and 1960s.

By 1967, the social regulation of the banking industry had taken hold. One of the goals was to alter how financial institutions dole out loans. The goal was to lessen the ties between corporations and financial institutions. An attempt at professionalization was made by appointing a full-time chairperson with specialized practical experience. It also allowed for bank takeovers in extreme cases.

As a result of political concerns, social control failed to function adequately. As a result, in 1969, the government nationalized fourteen large scheduled commercial banks. It incorporated national ideals and goals and was designed to support the expansion of the economy. After waiting for another decade, the government took over another six financial institutions. These financial institutions were too big for the minimum. There are several national and state-level development financial institutions that are state-owned in their entirety. In the business and agricultural sectors, refinancing organizations also emerged. When it comes to insurance, the government likewise stepped in to create a monopoly.[585]

The Bankruptcy and Insolvency Code was enacted in 2016. Lawyers and businesspeople were curious about this since it may drastically alter the current landscape. Modifying the insolvency procedure was the

[582] Arun Jaitley, *Public Sector Banks are lifeline of Indian economy, says the Union Finance Minister, Shri Arun Jaitley,* PRESS INFORMATION BUREAU (Feb. 28, 2019, 5:12PM), https://pib.gov.in/Pressreleaseshare.aspx?PRID=1566653.

[583] *What is Public Sector Bank? Definition, Working, Advantages and Disadvantages*, ASK ANY DIFFERENCE, (last visited November 20, 2022), https://askanydifference.com/what-is-public-sector-bank/.

[584] Charan Singh, *An Essay on Banking and Macroeconomics: Role of Public Sector Banks in India*, INDIAN INSTITUTE OF MANAGEMENT BANGALORE (last visited November 20, 2022), https://www.iimb.ac.in/node/1676.

[585] Y V Reddy, *Public Sector Banks and the Governance Challenge: Indian Experience*, (Apr. 18, 2002), https://rbidocs.rbi.org.in/rdocs/Speeches/PDFs/28065.pdf.

motivation for its introduction.[586] Several groups were formed to propose and implement changes to the financial system, including the PJ Nayak committee and the Narasimhan committee. Programs like Sashak were launched. There will be 12 PSBs (public sector banks) in India by 2021. The Government of India is the largest shareholder in each of these banks. The Public Sector State Bank of India is India's largest financial institution. SBI's sales in 2020 totaled 2.5 trillion rupees. India has been merging with its partner banks for the past decade.[587]

CRITICAL ANALYSIS OF THE CURRENT SCENARIO THROUGH THE LENS OF STATISTICS

There is a decisive moment happening in India's economy right now. It's dangerously close to the breaking point. The growing amount of nonperforming assets has been a major problem for these state-owned banks. Taking a look at the numbers could help paint a more complete picture. As of the year 2020, nonperforming loans at PSBs total at least 6.8 trillion rupees.[588] According to FICCI-IBA, NPA would increase in the first half of 2021. Nonetheless, the survey found that "However, in terms of outlook, nearly 68 percent of respondent bankers expect the NPA levels to be above 10 percent in the first half of 2021" According to the reserve bank's assessment of financial stability from January 2021, under a baseline stress scenario, gross NPAs might increase to 13.5% by September.[589]

The decline from last year is small, but it's nonetheless a warning sign of the deteriorating state of affairs. Except for SBI and IDBI, all national banks have been losing money. It has been estimated that taxpayers lost 400 billion rupees between 2016 and 2017. Given the relative simplicity of the criteria employed to assess the situation in comparison to Europe, these estimates may not reflect reality.[590]

If these numbers are any indication, the state of the banking sector in the United States is dire. Also, India's solutions are only effective in the near run. A long-term strategy to address this situation is urgently required. As we take in these numbers, we are confronted with a plethora of questions. In light of the current scenario in India, it is essential to have an open dialogue and do a thorough study. Such an approach would have to think about things like:

(a) What are the reasons which left Indian public sector banks in such an extreme condition?
(b) How much damage it has inflicted upon the economy so far?
(c) What approaches has India adopted so far, and what were the reasons for its failure?
(d) What should be incorporated to develop a long-term sustainable state, especially governance reforms?

The reforms that are required in the sector will not be possible without first answering these questions. There is no simple way to create a policy that will solve all of these problems. Taking things slowly and methodically is crucial.

CHALLENGES FACED

One problem with public sector banks, according to financial advisor Ashvin Parekh, is that the "challenge with public sector banks is that there are many internal organizational issues that are not being addressed or resolved," The first step in fixing

[586] *Short Note on Insolvency and Bankruptcy Code, 2016 (IBC, 2016)*, IBC LAWS (July. 30,2019), https://ibclaw.in/short-note-on-insolvency-and-bankruptcy-code-2016/.
[587] *Gross non-performing asset value of public sector banks in India from financial year 2018 to 2020*, STATISTA, (Mar. 19, 2021), https://www.statista.com/statistics/1064657/india-gross-npa-public-sector-banks-india/.
[588] *Id.*
[589] *NPAs expected to increase in first half of 2021: FICCI-IBA survey*, ET AUTO.COM (Mar. 18,2021), https://auto.economictimes.indiatimes.com/news/industry/npas-expected-to-increase-in-first-half-of-2021-ficciiba-survey/81566004.
[590] , *India's Public Sector Banking Crisis: Whither the Withering Banks*, OLIVER WYMAN (last visited November 20, 2022), https://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2017/aug/Indias_PublicSector_Banking_Crisis_Whither_The_Withering_Banks.pdf.

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the problem is identifying the causes of the sector's problems and challenges, which have caused the system as a whole to deteriorate over time.[591]

Taking a glance at the problems at publicly owned banks leads us to think that private-sector competition and technological advancements are to blame. Additional investigation, however, reveals that there is a plethora of problems, many of which have a lengthy background. The PSBs are confronted with several difficulties, including the following.

(A) Granting long-term loans leading to mounting NPAs: Since the 2008 global financial crisis, precipitated by the collapse of Lehman Brothers, the Indian banking industry has also been struggling. Indian banks responded to this situation by implementing strategies that involved widespread bank lending and reduced interest rates. During this period, major corporations took out massive loans. The expenditures aided in short-term recovery, but the increasing NPAs was a negative consequence. Consequently, the soundness and stability of India's public sector banks were severely compromised. In 2018, PSB loans accounted for 85.1 percent of all nonperforming loans. These rising nonperforming assets will cause banks to be cautious about making loans. We have less and less capacity to generate new credits.

(B) Recapitalization burden: Putting money back into the PSBs is what we mean when we talk about "recapitalizing" the banks. This is carried out to conform with the required levels of capitalization. There are several approaches used for this purpose.[592]

Since recapitalization is expensive and must be done regularly, it places a significant strain on financial resources. This is arguably the most compelling case against PSBs.[593] Despite its usefulness in restoring PSBs' solid position, recapitalization is expensive and not a long-term solution. There is no justification for reinvesting taxpayer money into a venture that yields paltry returns.[594] This financial load has ramifications, such as the government being forced to cut the amount of expenditure made in other sectors and increasing the amount of borrowing done. This demonstrates that the requirement for additional capital hurts the economy.

(C) Poor choice of top management: The government usually has a sizable investment in banks that operate in the public sector. Even the highest-level jobs in these banks are occupied by government officials. They frequently have a bank account in the political system, leading to subpar government regulation as a result. The banking industry's reputation would suffer, and nonperforming loans (NPAs) will increase as a result. Using its authority under the Banking Regulations Act of 1949, the RBI oversees all commercial banks. When it comes to public sector banks, however, the clause concerning the authority to remove management and directors does not apply. As a result, the government has more sway than RBI does.[595]

(D) Asset quality deterioration and additional capital requirement: The RBI is responsible for preparing reports on the status of the financial system. Public sector bank asset quality is discussed. Financial institutions' loan and investment portfolios are considered assets. The proportion of

591 MG Arun et.al., *Fixing the banking mess*, INDIA TODAY (Dec 18,2020, 11:40 PM) https://www.indiatoday.in/magazine/cover-story/story/20201228-fixing-the-banking-mess-1750945-2020-1218.

592 What is bank recapitalisation and how is it done?, THE ECONOMIC TIMES (Dec. 30, 2020, 03:53 PM), https://economictimes.indiatimes.com/budget-faqs/what-is-bank-recapitalisation-and-how-is-itdone/articleshow/73264682.cms.

593 Acharya, Shankar,*'A Vision for Banking'*, THE ECONOMIC TIMES, (Dec 6,2001)

594 K.B.L Mathur, *Public Sector Banks in India: Should they be privatised*, 37 ECON.POLITICAL WKLY2245, 2246-47, https://www.jstor.org/stable/4412218.

595 Ashwini Mehra, *Testing times for public sector banks' leadership*, MINT (Sep. 6,2017,01:05 AM), https://www.livemint.com/Opinion/MfVNtOKsNJi7TiZykQ1lbP/Testing-times-for-public-sector-banksleadership.html.

loans for which principal and interest have been repaid is a measure of asset quality.[596] According to the assessment of the economy's overall stability, the quality of the assets is getting worse. It gives the impression that the quality of loans is declining. It indicates that the assets are in the process of being stressed. The term "stressed assets" refers to nonperforming assets (NPAs), assets that have been written off, and loans that have been restructured.[597] To improve the overall performance of the PSBs, the government will need to inject more capital into the system. As was just stated, this imposes an additional cost on top of everything else.

(E) Capital adequacy requirement: The profitability and capital adequacy position shown by RoA and CRAR are two indicators that point to the potential strength of nationally owned banks.[598] The Reserve Bank of India (RBI) anticipates that the capital adequacy ratio could drop to 13.3% by March 2021 from its level one year ago under the baseline and 11.8% under the very severe stress scenarios. Both of these percentages are lower than the current level.[599] Having a higher value for CRAR indicates that you have a greater capacity to absorb risks. On the other hand, the requirement for PSBs is significantly lower than the average requirement. It demonstrates the precarious state of PSBs.

(F) Lack of quality of human resources: Human resources continue to be a competitive advantage for businesses in the modern era. To compete successfully, private sector banks have wisely absorbed human resources. PSBs still struggle with the issue of a centralized and regulated HR system, even though they no longer face an unfair advantage in terms of age, quality, skills, etc. Their training program is unclear and did not aid in the development of marketable abilities. There have been several inconsistencies and anomalies in promotion based on the standard regulations. Additionally, PSBs' lopsided incentive structure makes it impossible to prevent talented employees from leaving for other, more modern banks. Staff deployment is highly regimented due to banking and industry-wide agreements. When evaluating an officer's performance, PSBs have traditionally used a cookie-cutter approach. This does not cater to the specific requirements of the business.[600] To summarize, public sector bodies still have a long way to go in terms of developing their human resource practices.

(G)Increased competition and modern technology: The financial sector is not immune to the global trend toward digitization. New types of competitors, such as NBFCs, fintech firms, and younger banks, have emerged. The lack of this ability on the part of PSBs is exacerbated by the constraints imposed by regulations. Customers now have more options to compare prices and quality of service because of digitalization. Transactional loyalty is no longer a factor for customers. As a result, they will be less useful to PSBs.[601]

(H) Debates on privatization: Comparing public sector banks to their international counterparts is common practice. Performance is evaluated monetarily. In light of these parallels, the concept of PSB privatization has gained traction.[602] The proposal to privatize PSBs originates from the aforementioned financial burden and other

[596] Tojo Jose, *What is stressed assets?*, INDIAN ECONOMY (Feb. 14, 2016), https://www.indianeconomy.net/splclassroom/what-is-stressed-assets/.
[597] *Id.*
[598] Mathur, *supra* note 15, at 2252.
[599] Manojit Saha, *Why public sector banks are struggling to raise capital but private banks are having it easy*, THE PRINT (27 Aug. 2020, 2:12 PM), https://theprint.in/economy/why-public-sector-banks-are-struggling-to-raisecapital-but-private-banks-are-having-it-easy/490029/
[600] Anil K. Khandelwal, *Criticality of HR Reforms for Public Sector Banks in the New Era*, 40 ECON.POLITICAL WKLY 1128,1128-29(2005), https://www.jstor.org/stable/4416360.
[601] Mehra, *supra* note16.
[602] T. T. Ram Mohan & Subhash C. Ray, *Comparing Performance of Public and Private Sector Banks: A Revenue Maximisation Efficiency Approach* ,39 ECON.POLITICAL WKLY 1272,1272 (2004), https://www.jstor.org/stable/4414806.

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factors. To keep the public banking sector afloat, the government will need to inject new funds into the economy. The problem is complicated by the growing NPAs and the cost of recapitalization. In 2014, a committee led by PJ Nayak recommended reducing the government's stake in these banks. Consequently, only two options remained: either privatize the PSBs or completely overhaul the system.

WAY FORWARD-RECOMMENDATIONS FOR GOVERNANCE AND FINANCE REFORMS

Given all of these difficulties, why do we need public-sector banks? Considering the dire predicament of India's public sector banks, this is a reasonable topic to ask. Yet, we must not fail to recognize its significance to our culture. It's possible that private companies could contribute to the country's progress. However, public sector banks in India are crucial to ensuring the well-being of the common people, given the country's large population and complex social structure. When it comes to sending resources to the most out-of-the-way and rural parts of our country, PSBs play a crucial role.

Many foreign publications highlight privatization's advantages. However, in the case of India, the grounds for privatization are insufficient. A banking crisis in the private sector is not guaranteed to be impossible. If the legal framework is weak, private companies and institutions will suffer far more than public sector banks.[603] Therefore, it is preferable to maintain the status quo of the banks operating in the public sector by undergoing significant structural changes. We need to develop a strategy to establish a public banking system that is both financially secure and strategically focused on the common good. Reforms in the financial sector and reforms in government administration make up the bulk of these changes.

(A) Financial reforms: Increasing nonperforming assets (NPAs) have been identified as a contributing factor to declining PSBs. As a result, we are going to have to take action to remedy the issue. A lot of times, monetary changes like this are only stopgaps. The decisions made by the federal government are the most important ones in each of these situations.

First, it would be beneficial to eliminate loss-making departments. Banks require government recapitalization so they can adhere to capital adequacy regulations. Closing unprofitable divisions or locations can improve the efficiency of the recapitalization process. By doing so, we can limit the flow of money to less desirable places. It might be possible to form a committee to examine the unprofitable parts of the public banking system.

Also, securitizations are a viable option for increasing loan availability. When there are many problems in the financial sector, it can be helpful to revive the securities market. Publicly insured securitizations often require the recipients of those loans to reinvest a portion of the proceeds. It'll keep the economy's cash registers ringing just right. Because of the reduced risk, financial institutions will be able to increase their loaning activities.

As a third option, selling off groups of loans is quite effective. It will allow financial institutions to prioritize and attend to their most crucial responsibilities. Scandinavian and Anglo-Saxon countries both engage in the trade of NPL. [604] Similarly, most Spanish financial institutions have a department dedicated to overseeing troubled loans.

Finally, consolidation of financial institutions is a potential answer, the fourth. Many banks in India have merged in recent years. As an illustration, consider the case of the Bank of

[603] Mathur, *supra* note 15, at 2255

[604] Miriam Gidron & Reyes Pariente, *Getting a bank's balance in shape*, BBVA (last visited November 20, 2022), https://www.bbva.com/en/getting-banks-balance-shape/.

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Baroda's acquisition of the merged Dena Bank and Vijaya Bank. There are several advantages to merging banks. It's useful for combining forces and saving money. It's a boon to cutting costs overall as well. People on the whole will have to endure some short-term pain for the sake of progress, but the payoff will be substantial.

Fifthly, equities, bank investment firms, and other exchange-traded securities that mimic the characteristics of central public sector enterprises are recommended. The banks should be recapitalized with the help of exchange-traded funds. This sort of recapitalization would not add to the budget deficit or weaken government authority. As a result, the federal government's holdings in the banking sector as a whole can be diluted. All government assets might be handed to a newly formed bank investment firm. A firm like that would be able to generate enough money to satisfy its bankers and meet their capital needs.

Sixthly, we could learn from our international partners by emulating their strategies. The introduction of such concepts should be adjusted to meet the specific requirements of Indian culture. The UK government's asset protection program is one such example. The government guarantees a portfolio of troubled holdings in this scenario. While the bank will be responsible for the initial portion of any losses, the government will back them up against any unforeseen catastrophes. In doing so, the bank will be able to lower its exposure to losses and better prepare for its eventual recapitalization. No negative effects, such as those we usually see during recapitalization, would result from implementing steps of this kind during capitalization.[605]

Limiting the capital injection and adjusting the reserve requirement are two additional positive steps in the right direction. It is important to keep in mind that monetary measures are typically only valid in the short term and are reversible. It would be a huge win if we could shape policies that bring down government spending.

(B) Governance reforms: Reforms in banking governance are crucial in light of the need for a complete overhaul of the financial system. This is a perfect situation in which the advice of the PJ Nayak panel committee would make a huge difference.[606] The following are examples of possible changes to the system of government:

First, it will be a major change if the government's holdings in PSBs are reduced. Fortunately, this issue is addressed in the PJ Nayak committee's suggestions.[607] Maintaining the government's preeminent position is a good thing, thus this could work out well. Simultaneously, the banks will benefit from an increase in employee productivity thanks to the resulting increased levels of expertise.

Second, these banks' upper management teams need to be given the tools they need to do their jobs better. Candidates should be chosen based on their qualifications rather than their political connections.

The next step is to loosen up the system's stiffness. At present, the massive role of government discourages some investors. Investment capital is impacted.

Lastly, the banking industry is in dire need of the most important HR changes. Human resources play a pivotal role in every major company revamp, and this is universally acknowledged. Human resources are directly related to things like management credibility, strategy execution, innovation, etc. Public service organizations (PSBs) need to create a formal HR policy. Capability development is an obligation of the CEO. Safety in the

605 *Supra* note 10, at11-12

606 Report of the committee to review governance of boards of banks in India, https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/BCF090514FR.pdf

607 Khandelwal, *supra* note 21, at 1131-32.

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leadership-building infrastructure must be guaranteed. Employers in the PSB sector may institute a merit-based pay scale to encourage and recognize exceptional performance.

In conclusion, respectable business practices should always be utilized. Strong leadership, an accountable board, and well-thought-out guidelines are all essential.

CONCLUSION AND SUGGESTIONS

Bringing back the Indian banking system will be an ongoing task. The PSBs need to revise their policies in light of the emerging problems. Developing a conducive setting for the expansion of PSBs requires the firm determination of the government. Overall, the system needs to be made more malleable so that it can satisfy emerging demands.

It has been established that monetary changes alone won't be enough to keep PSBs working smoothly. Reforms of this nature require significant participation from the government. It is critical to ensure the security of PSBs due to their significance in society and the benefits they bring. India is still in its developmental stages. A robust public banking sector is necessary to support welfare measures. This study's suggestions can help inform PSB reform initiatives.

Therefore, it is reasonable to infer that public sector banks' continued existence is essential to progress. However, a strong legal framework, strong governance improvements, and financial reforms are required to tackle the current situation. In India, public sector banks (PSBs) may regain their former grandeur if measures were adopted on a war footing rather than concentrating on privatization.