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Emergency in the Public Sector Banks in India

Introduction

Today world politicians look at Prime Minister Narendra Modi as 'Giant Indian Political Icon'. On various international forums and global summits, he has represented India with full zealand marvellous speech. His international media management is excellent. He visited most of the developed countries of America and Europe, developing countries of Asia and Africa and developed eastern countries of Australia and Japan with spectacular popular support. His gorgeous image has been developed in the world through this.

We live in a country which varies in cultural inheritance, social beliefs, political views and economical background. India still has around 1/4th of her billion population sustain under extreme poverty and 2/3rd of her population who will become poor if opportunities wasted.

The political party with full majority in the largest democracy in the world got the chance to rule India, the diverse but great nation. As discussed by many media persons, as a dynamic economic agent to transform Indian economy by domestic economic ideas and thoughts, the government has done two wonderful financial disruption – one of stopping Rs.500 and Rs.1000 currency notes from circulation in 2016 (popularly known as Demonetization) and another of hasty implementation of Goods and Services Tax (popularly known as GST).

Present situation of PSBs in India &PNB Fraud

Today, Indian economy is at an important juncture from where it is not possible to ride back on old times of conservatism, but it is faithful to move ahead with tender steps to avoid large mishaps. With this background, the credit culture of Indian Public Sector Banks(PSBs) has been diluted with poor implementation of enforcement actions against specific violations and breaches of laws, rules and directions. Recently, government of India has recapitalized the PSBs with Rs.2 lack crores of monetary assistance for growth of productive sectors of the economy.

In this 21st century, we are living in a world of financial globalization with easy flow of money from one country to another. Cross-border banking flows have increased globally. International trade linkages have significantly risen through interconnections among developing and developed countries. India's cross border gross financial flows both inflows and outflows have increased from 12% of GDP in 1990-91 to 47% of GDP in 2016-17. Therefore, today we are more exposed to global financial vulnerabilities and that is why we need international policy coordination today to decrease estimated financial menace. Risk sharing is one of the most important aspect of them.

Now the time has come that all Government PSUs must follow strict policy framework to avoid risk especially operational risk from top to bottom level. Recent scams of Punjab National Bank (PNB) and earlier of Vijay Mallya (owner of one of the IPL cricket team)have given clear evidence that the performance of India's PSBs is sub-standard, full of financial mismanagement and supervisory lacuna.

India's second largest bank PNB in the month of February 2018 declared publicly that diamond merchant Nirav Modi and his uncle Mehul Choksi have duped it to the tune of Rs. 13,000/- crore through misuse of Letters of Undertaking (popularly called LoUs). These LoUs are an undeniable guarantee provided by a bank on behalf of its customer (here Nirav Modi and Mehul Choksi). If there is a default, the bank would make payments for losses. Such guarantees are sanctioned when the customer provides security for the amount equivalent to the LoUs. Between 2011 to 2017, PNB's Brady House branch in Mumbai issued LoUs without any collateral and rolled over the loan amount to Mr. Modi and Mr. Choksi. The scam was found when a PNB officer named Gokulnath Shetty who has been arrested, retired and a replacement found out the violations of rules. The bank argued that the fraud could not be detected because of its basic banking system and it was used for international transactions – swift – were not integrated. This situation shows really shocking to all of us.

Increased mal-allocation of funds and poor governance have given way to stressed assets (Non-Performing Assets- NPAs) and high credit risk. According to RBI's latest 'Financial Stability Report', Gross Non-Performing Assets (NPAs) rose from 9.2% in September 2016 to 9.6% in March 2017. As on 30th September, 2017, data from CIBIL shows that the amount outstanding on account of wilful defaulters at nationalised banks together with the State Bank group was Rs. 93,359/- crores. This was 83.6% of the entire outstanding on account of wilful default in the banking system, including foreign banks.

Generally speaking, NPA is any asset of a bank which is not producing any income. That is a loan or lease is not meeting its stated principal and interest payments. On a bank's balance sheet, loans are listed as assets. There is huge risk involved when customers who take out loans stop making their payments, causing the value of the loan assets to decline. According to RBI, term loans on which interest or instalment of principal remain overdue for a period of more than 90 days from the end of a particular quarter is called a Non-Performing Asset. This is nearly 10% of the total loans given in the country. This means about 10% of loans will never be paid back, resulting in substantial loss of money to the banks.

PSBs are very much disturbed by increasing competition in widening CASA (current account-saving account) deposit base. There is lack of transparency and governance today. Politicians are directly or indirectly connected in the approval and sanctioning of loans of big financing projects.

There are many reasons for increasing banking sector frauds in recent decade like failure of risk management in the bank, increase in share of total stressed assets, political interference, role of auditors, misuse of SWIFT transactions, the Government and RBI itself. Politicians have often viewed banking as gold mines to carry out government objectives into risky infrastructure projects. RBI in its Financial Stability Report of June 2017 pointed out the rising trend of frauds in commercial banks and financial institutions. According to P.J. Nayak committee, "If the governance of banks continues as at present, will impede fiscal consolidation, affect fiscal stability and eventually impinge on the government's solvency."

There is also a problem of tendency of employees of public sector banks in India. They are rarely promoted based on performance or punished for non-performance. There is negligible incentive to make good decisions. In the private sector banks, bad loans would lead to losing one's job, and taking sensible and calculated risks would lead to appreciation, bonuses and promotions. But in public sector banks these all are missing. In PSBs, core integrated banking system is of poor status and hence a risky business leading to large borrowers.

Prevention of Banking Frauds

Indian banking industry has to be very careful in dealing with various issues like fraud checking, payment processing, account infrastructure, KYC processing, computer authentication, service provider etc., while opening new accounts, accepting high volume deposits and disbursing larger amount as advances.

Nowadays many discussions happen to either privatize PSBs or greater regulatory norms requirements. But government should not privatize all 21 PSBs at this juncture because of social obligation, policy of exclusion and prevention of errors and omissions. Yes, it is true that PSBs need strong internal control system with compatible use of technology to reduce the chances of human connivance. Government should set up Special Fraud Investigation Agency with officials specially trained to detect financial deception. Government should be vigilant towards the role of chartered accountants, auditors and advocates who are involved in ill-advice and should also examine with tough eye.

RBI should be given greater autonomy in controlling and managing banking frauds. There must be clarity in the dual control and regulation of PSBs by RBI and the Government of India. India needs a safe and efficient banking practice to serve the needs of a growing economy. The government and RBI must exploit the current situation to strengthen the banking system to maintain the trust of depositors in this age of misinformation.

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