

## Chapter I Introduction

### 1.1 Banking System in India

**1.1.1** Banks work within the financial system to provide loans, accept deposits and provide other services to customers. A strong and resilient banking system is the foundation for sustainable economic growth, banks being the centre of the credit intermediation process. Banks provide critical services to consumers, small and medium-sized enterprises, large corporate firms and governments who rely on them to conduct their daily business, both at a domestic and international level. On account of their criticality to the economy, banks are often extensively regulated, regulations being designed to protect public interest.

**1.1.2** The banking system in India comprises commercial and cooperative banks with commercial banks accounting for the bulk of banking assets. The commercial banks comprise 21 Public Sector Banks, 26 private sector banks, 43 foreign banks and 56 regional rural banks. There are 1,574 urban cooperative banks and 93,913 rural cooperative banks, in addition to cooperative credit institutions. The commercial banking structure primarily comprises scheduled commercial banks (SCBs), which are included in the second schedule of the Reserve Bank of India Act, 1934. SCBs primarily include the following:

- Public sector banks (PSBs) including State Bank of India and its associates<sup>1</sup> and other nationalised banks
- Private sector banks
- Foreign banks
- Regional Rural Banks

### 1.2 Significance of Public Sector Banks in Indian Banking System

Public Sector Banks (PSBs) are banks where the majority stake is held by the Government. PSBs constitute the single largest component of the Indian banking system, accounting for over 70 per cent of the deposits received in and advances made by SCBs. PSBs have consistently held the bulk of the assets in the Indian banking system as can be seen from table 1.1.

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<sup>1</sup> SBI had five associates, - State Bank of Mysore, State Bank of Travancore, State Bank of Bikaner and Jaipur, State Bank of Patiala, State Bank of Hyderabad which were merged with it, with effect from 1 April 2017

Table 1.1: Trends in share of Business of Public Sector Banks in India

(in per cent)

Year	2011-12	2012-13	2013-14	2014-15	2015-16
Share of PSBs in Total Advances of SCBs	76.4	76.1	75.7	74.1	70.8
Share of PSBs in Total Assets of SCBs	72.6	72.6	72.6	72.1	69.9
Share of PSBs in Total Deposits of SCBs	77.5	77.3	77.2	76.3	74.2

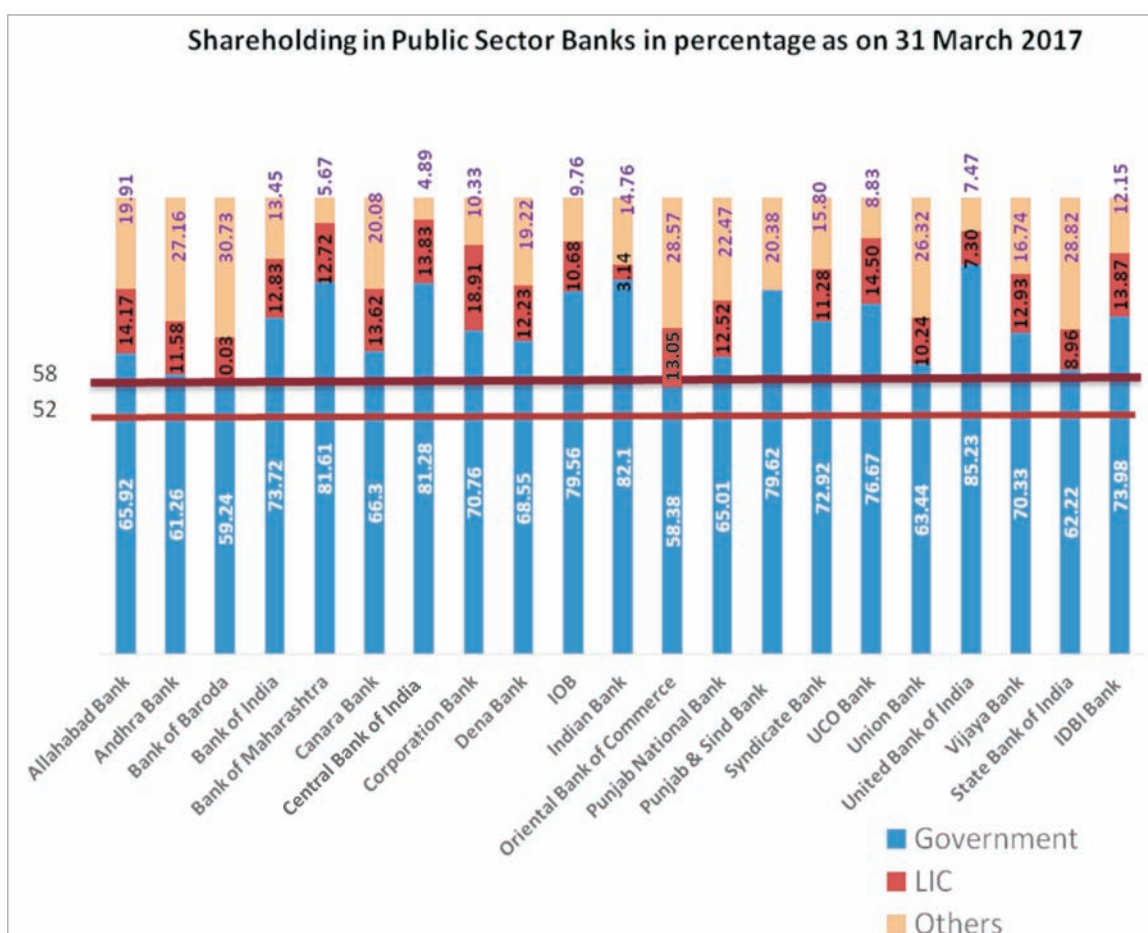
(Source: RBI Statistical Tables Relating to Banks in India)

Besides, PSBs, as part of their mandate, extend credit to diverse sectors of the economy including the priority sector comprising the agriculture sector, Medium, Small and Micro Enterprises sector (MSME sector), weaker sections, self-help groups, government sponsored programmes etc. PSBs, thus, are significant not only in the volume of credit extended by them but also in extending credit to all segments of the economy including those that are credit starved.

### 1.3 Shareholding Pattern in PSBs

**1.3.1** The statutory requirement in the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980 and State Bank of India Act, 1955, provides that the Central Government shall, at all times, hold not less than 51 per cent of the paid up capital consisting of voting equity shares of each PSB. To provide a headroom and enable PSBs to raise capital from the market at a future date without compromising their public character, the Cabinet Committee on Economic Affairs (CCEA) decided (December 2010) to raise the GOI holding in all PSBs to 58 per cent. Subsequently, the CCEA decided (December 2014) to allow PSBs to raise capital from public markets through Follow-on Public Offer (FPO) or Qualified Institutional Placement (QIP) by diluting GOI holding up to 52 per cent in a phased manner based on their capital requirement, stock performance, liquidity, market appetite and subject to such other conditions that may be prescribed for efficient use of capital and resources, on case to case basis, with specific approval of the Finance Minister for each PSB.

**1.3.2** The GOI shareholding in PSBs has, however, been consistently well above these limits (52 or 58 per cent). Besides, Life Insurance Corporation (LIC) has significant stakes in different PSBs. The shareholding pattern in the 21 PSBs over 2010-11 to 2016-17 is at **Annexure-I**. The shareholding pattern of the PSBs as on 31 March 2017 is shown in the chart below:



(Source : BSE and NSE websites)

## 1.4 Capital Structure of PSBs and Requirement of Additional Capital

**1.4.1** The capital structure of a PSB comprises different types of liabilities which are incurred to fund the lending and investment activity of the bank on the asset side of the balance sheet:

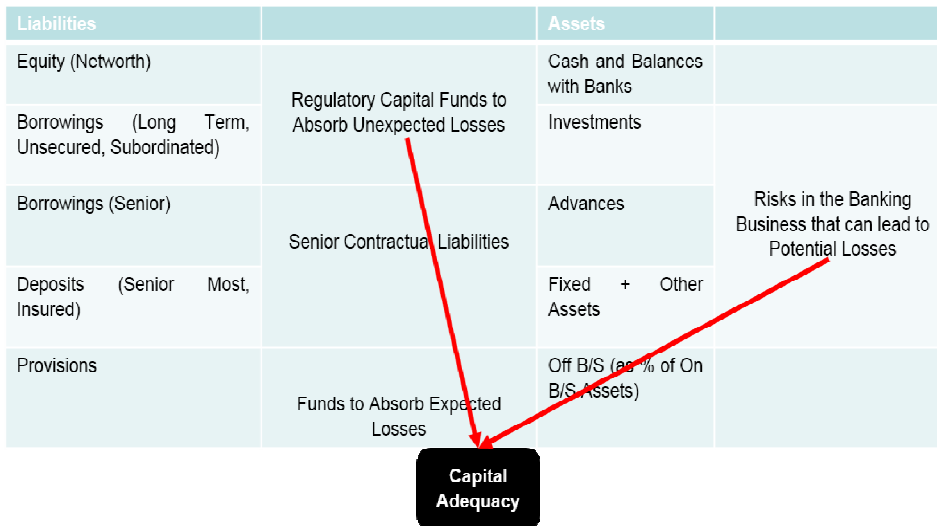
- **Shareholders' funds** include equity capital of the PSB (both common equity and preference shares), accumulated reserves and surplus, retained earnings from previous periods. These are the bank's "own" source of funds for financing investments depicted on the asset side. The amount of equity capital of the bank from an accounting perspective is the net worth, representing the margin by which assets outweigh outside liabilities, that is, the margin by which deposit funds and long term borrowings are covered if the bank were to liquidate its assets. The cost of equity funds is high, the return to the equity shareholder being through dividends and capital appreciation.

- **Borrowings** from the market are made through inter-bank lending, re-purchase agreements, money market borrowings and the issuance of bonds. These managed liabilities are subordinated to deposit funds, more volatile and rate-sensitive and their access is subject to market liquidity and the bank's own credit-worthiness. Borrowings could be secured or un-secured.
- **Deposits** from customers comprise the major funding source for the bank which are the senior most contractual liabilities of the bank, available at the lowest cost.

**1.4.2** The bank liabilities are used to finance its investments and advances which constitute its assets. The bank assets are exposed to multiple risks (credit risk on fund-based<sup>2</sup> and non-fund-based<sup>3</sup> credit, market risk on investments and off balance sheet derivatives, liquidity risk in the banking and trading books and

operational risks) which may lead to future losses. Poor quality of assets (advances which have poor probability of recovery)

Figure 1: Bank Capital Structure and Capital Adequacy



may require provisions to be created burdening the balance sheet of the bank. On the other hand, deposits and market borrowings of the bank are contractual liabilities, which if not paid when due, can cause the bank to "fail" (become insolvent). It is in this context, that the bank's own capital (the equity capital and subordinated debt) becomes crucial which can absorb the losses without leading to bank failure. The primary function of bank capital is to support the bank's operations, act as a cushion to absorb unanticipated losses and declines in asset values that could otherwise cause a bank to fail, and provide protection to uninsured depositors and debt holders in the event of liquidation<sup>4</sup>. Capital is thus critical to banks which employ high leverage, or gearing, compared to other businesses. From a regulatory perspective, PSBs should have adequate

<sup>2</sup> fund based credit - loans and advances  
<sup>3</sup> Non fund based credit – bank guarantees, letters of credit etc.  
<sup>4</sup> Functions of bank's capital as per the US Federal Reserve

capital funds to absorb large losses, so that depositor funds are not adversely impacted. The higher the quantum of bank capital, the higher the degree of protection to depositor's funds. Thus, banking regulations therefore require banks to meet stringent minimum capital requirements so as to maintain bank solvency, safety and soundness of the banking system.

## 1.5 Some Drivers for Additional Capitalisation of PSBs

PSBs, being the largest segment in the Indian banking system, need to be infused with capital to drive higher credit capacity while meeting the prudential regulatory requirements. The regulatory requirements of capital adequacy and credit growth needs of the economy are two of the significant drivers for additional capitalisation of PSBs, keeping in view the business plans of the PSBs and their risk tolerance.

### 1.5.1 Capital Adequacy Requirements

**1.5.1.1** Regulatory framework for banks is globally framed by the Basel Committee on Banking Supervision (BCBS) which is a committee of bank supervisors consisting of members from representative<sup>5</sup> countries. The Basel Committee is the primary global standard setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability. The RBI follows the Basel norms, though the RBI norms are often more stringent than the Basel norms.

**1.5.1.2** So far, three sets of Basel norms have been issued. The BCBS issued Basel I norms in 1988 to provide, for the first time, a global standard on the regulatory capital requirements for banks. This was imposed through a minimum Capital Adequacy Ratio (CAR), expressed as the ratio of regulatory capital funds to risk-weighted assets (RWA), which internationally active banks would be required to maintain. The CAR is also called Capital to Risk-Weighted Assets Ratio (CRAR).

$$CAR = \frac{\text{Regulatory Capital Funds}}{\text{Risk Weighted Assets (RWA)}}$$

Subsequently, Basel II norms were introduced in 2004 which further strengthened the guidelines for capital adequacy, risk management and disclosure requirements. The norms were further revised to Basel III norms in 2010.

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<sup>5</sup> **Representative – the number of countries represented in BCBS has changed over time. During the formulation of Basel I and II, RBI was not part of BCBS. However, RBI was represented in BCBS during the design of Basel III as part of the G-20 countries**

1.5.1.3 The regulatory capital funds of banks as defined under the Basel norms include Tier I and Tier II capital.

- **Tier I capital** consists mainly of share capital and disclosed reserves (minus goodwill, if any). It is deemed to be of the highest quality because it is fully available to cover losses. Hence, it is also termed as core capital.
- **Tier II capital**, also known as supplementary capital, consists of certain reserves and specific types of subordinated debt. Tier II items qualify as regulatory capital to the extent that they can be used to absorb losses arising from a bank's activities. Tier II's capital loss absorption capacity is lower than that of Tier I capital.

<p><b>Tier I Capital (going-concern capital)</b></p> <p><b>(a) Common Equity Tier I</b></p> <p>(i) Paid-up equity capital</p> <p>(ii) share premium resulting from the issue of equity capital;</p> <p>(iii) Statutory reserves;</p> <p>(iv) Capital reserves i.e. surplus arising out of sale proceeds of assets;</p> <p>(v) Other disclosed free reserves, if any;</p> <p>(vi) Balance in Profit &amp; Loss Account at the end of the previous financial year;</p> <p><b>(b) Additional Tier I</b></p> <p>(i) Perpetual Non-Cumulative Preference Shares and share premium on this</p> <p>(ii) Perpetual Debt Instruments that may be issued as bonds or debentures,</p> <p>(iii) Any other type of instrument generally notified by the RBI</p> <p><b>Tier II Capital (gone-concern capital)</b></p> <p>(i) General Provisions and Loss Reserves</p> <p>(ii) Debt Capital Instruments issued by the banks</p> <p>(iii) Preference Share Capital and share premium thereon, if any</p> <p>(iv) Revaluation reserves at a discount of 55 per cent</p> <p>(v) Any other type of instrument generally notified by the RBI</p>
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1.5.1.4 Bank assets carry a degree of risk with them. This includes credit risk<sup>6</sup>, market risk<sup>7</sup> as well as operational risk. Based on the riskiness of the asset, a specific risk weight is assigned to it and the asset value is adjusted as per the risk weight; more risky the asset, higher the risk weightage and lower its asset value. In India, RBI prescribes risk weights for different assets. Risk weight for different assets vary e.g. 0 per cent on a Government Dated Security and 20 per cent on a AAA rated foreign bank etc. The notional amount of the asset is multiplied by the risk weight assigned to the asset to arrive at the risk weighted asset.

1.5.1.5 Based on the regulatory capital and risk weighted assets, the CRAR of a bank is worked out. The guidelines for CRAR under the Basel regime have evolved over time in terms of quantum of capital, definition of regulatory capital funds, risk coverage and risk weight estimation methodologies. This evolution has been triggered by various lessons learnt by global supervisory authorities from the financial crises that have occurred in the course of time. The

<p><b>CET-I ratio is the ratio between common equity tier I capital and risk weighted assets.</b></p> <p><b>CRAR includes all tier I capital and hence CET-I is more restrictive than CRAR</b></p>
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<sup>6</sup> **Credit risk : the risk that a party to a contractual agreement or transaction will be unable to meet its obligations or will default on commitments**

<sup>7</sup> **Market risk : the risk of loss arising from movements in market prices or rates away from the rates or prices set out in a transaction or agreement**

evolution of Basel III norms was a fallout of the global financial crisis of 2007-08. Basel III is a comprehensive set of reform measures, developed by BCBS, to strengthen the regulation, supervision and risk management of the banking sector. These measures aim to (i) improve the banking sector's ability to absorb shocks arising from financial and economic stress (ii) improve risk management and governance (iii) strengthen banks' transparency and disclosures. The reforms target bank-level regulation, which will help raise the resilience of individual banking institutions to periods of stress and macro-prudential, system wide risks that can build up across the banking sector as well as the pro-cyclical amplification of these risks over time. In fact, Basel III has separately emphasized on the adequacy of Common Equity Tier I (CET1) ratio, over and above Tier I capital ratio and CRAR.

**1.5.1.6** The evolution of the Basel capital adequacy norms are summarized in the table below:

**Table 1.2: Evolution of the Basel Capital Accord**

	Basel I	Basel II	Basel III
<b>Application (BCBS)</b>	1988	2004	2010
<b>Regulatory Capital – Definition</b>	<p><b>Tier I:</b> Common Equity, Reserves and Surplus, Retained Earnings</p> <p><b>Tier II:</b> Subordinated Debt</p>	<p><b>Tier I:</b> Core Capital– Common Equity, Reserves and Surplus, Retained Earnings</p> <p><b>Lower Tier I:</b> Preference Shares (PNCPS), Innovative Perpetual Debt Instruments (IPDI)</p> <p><b>Tier II:</b> Upper Tier II Bonds, Preference Shares, Subordinated Debt</p>	<p><b>Going Concern Capital</b></p> <ul style="list-style-type: none"> <li>• <b>CET1:</b> Common Equity, Reserves and Surplus, Retained Earnings</li> <li>• <b>AT1:</b> Preference Shares (PNCPS) and Perpetual Debt Instruments (PDI) with loss absorption and PONV triggers<sup>8</sup></li> </ul> <p><b>Gone Concern Capital</b></p> <p>Long dated subordinated Bonds and Preference shares with PONV triggers</p>

<sup>8</sup> **PONV trigger – Point of Non Viability trigger. This is a condition imposed by Reserve Bank of India under Basel III under which if RBI identifies a Bank as non-viable, the non-equity bonds of the bank will have to be written down.**

<b>RWA Coverage</b>	Credit Risk Weighted Assets for on and off balance sheet positions	Credit, Market and Operational Risk Weighted Assets for on and off balance sheet positions	Credit, Market and Operational Risk Weighted Assets for on and off balance sheet positions, greater risk coverage
<b>RWA Methodology</b>	Standardized, <b>not risk sensitive</b>	Standardized and Advanced Model Based Methodologies, <b>more risk sensitive</b>	Standardized and Advanced Model Based Methodologies, <b>more risk sensitive</b>
<b>Minimum CRAR (BCBS)</b>	eight per cent	eight per cent	8 per cent plus 2.5 per cent Capital Conservation Buffer

[Source: Master Circular – Basel III Capital Regulations (July 2015), RBI and Master Circular – Prudential Guidelines on Capital Adequacy and Market Discipline – New Capital Adequacy Framework (NCAF), RBI (July 2015)]

The Basel II norms were based on three pillars, - minimum capital requirement, supervisory review and market discipline which were further strengthened in Basel III norms.

- **Pillar II- Supervisory review:** Basel II norms provided for stress tests for CRAR and additional internal capital buffers for risks not captured in the minimum capital requirements. These have been also emphasized in Basel III norms.
- **Pillar III- Market discipline:** Basel II norms provided for market discipline through more rigorous disclosures by banks. Basel III norms added reconciliation requirement of regulatory disclosures with accounting data of bank and disclosure of leverage ratio (the ratio of Tier-I capital to bank's average total consolidated assets; i.e. sum of the exposures of all assets and non-balance sheet items without risk weights and credit conversion).

**1.5.1.7** The application of Basel norms to the Indian banking sector is determined by the regulator, RBI. There has been a gap in adoption of the Basel norms; - Basel I norms (1988) were adopted in 1996, Basel II norms (2004) were adopted in 2008 and the transition to Basel III norms (2010) commenced in September 2013 and is expected to be complete by 31 March 2019. The RBI norms have, however, been more stringent than the Basel norms. As against the Basel norms of minimum CRAR of eight per cent, RBI prescribed a CRAR of nine per cent for Indian banks. At present, the minimum CRAR prescribed by RBI is 9 per cent plus 2.5 per cent Capital Conservation Buffer (CCB).



**1.5.1.8** To implement the Basel III norms in India, RBI has prescribed the following schedule of transitional arrangements to achieve minimum capital adequacy by FY 19 (Table 1.3):

**Table 1.3: Transition Schedule for Basel III Implementation in India**

	Percentage of Risk Weighted Assets (as on 31 March)					
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Minimum Common Equity Tier I (CET I)	5	5.50	5.50	5.50	5.50	5.50
Additional Tier I (AT I)	1.50	1.50	1.50	1.50	1.50	1.50
Minimum Tier I (CET I + AT I)	6.50	7	7	7	7	7
Capital Conservation buffer	0	0	0.63	1.25	1.88	2.50
Minimum Tier 1 + CCB	6.50	7	7.63	8.25	8.88	9.50
Minimum CET (including CCB)	5	5.50	6.13	6.75	7.38	8
Tier 2	2.50	2	2	2	2	2
Minimum Total Capital*	9	9	9	9	9	9
Minimum Total Capital + CCB	9	9	9.63	10.25	10.88	11.50
Phase in of all deduction from CET I #	40	60	80	100	100	100

\* The difference between the minimum total capital requirement of 9 per cent and the Tier I requirement can be met with Tier II and higher forms of capital.

# The same transitional approach will apply to deduction from Additional Tier I and Tier II capital.

(Source: Note for the CCEA dated 24 November 2014, approved on 10 December 2014)

**1.5.1.9** The implementation of Basel III norms has been coincident with subdued economic growth in Indian markets as shown in the table below:

**Table 1.4: Indian Economic Growth**

Financial Year	2012-13	2013-14	2014-15	2015-16	2016-17 (PE)
GDP Growth Rate (per cent) at constant prices (2011-12 series)	5.5	6.4	7.5	8.0	7.1

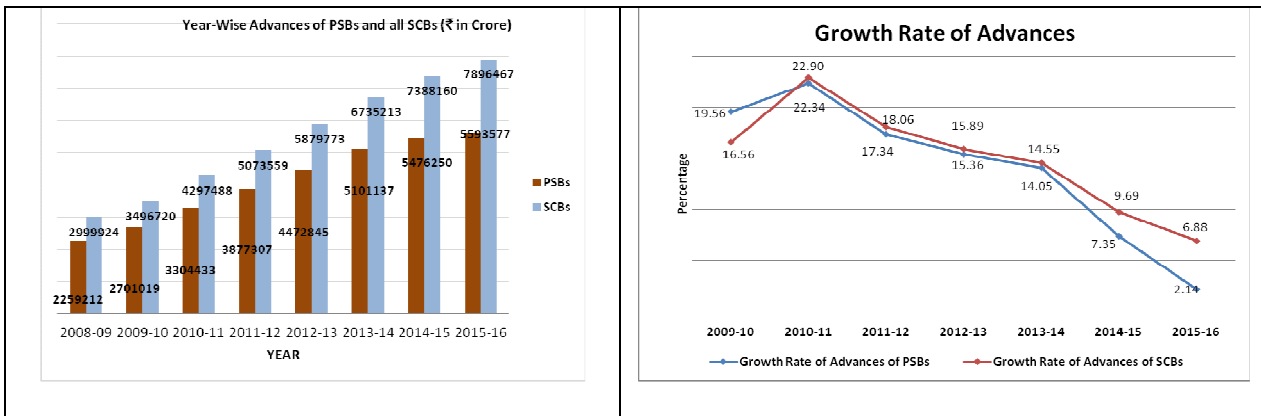
(Source: Ministry of Statistics and Programme Implementation, GOI)

The implementation of Basel III norms has also been coincident with increasing NPA related losses for Indian banks, leading to higher provisions and write-offs and lower recovery rates leading to faster erosion of banks' available capital.

### 1.5.2 Credit Growth

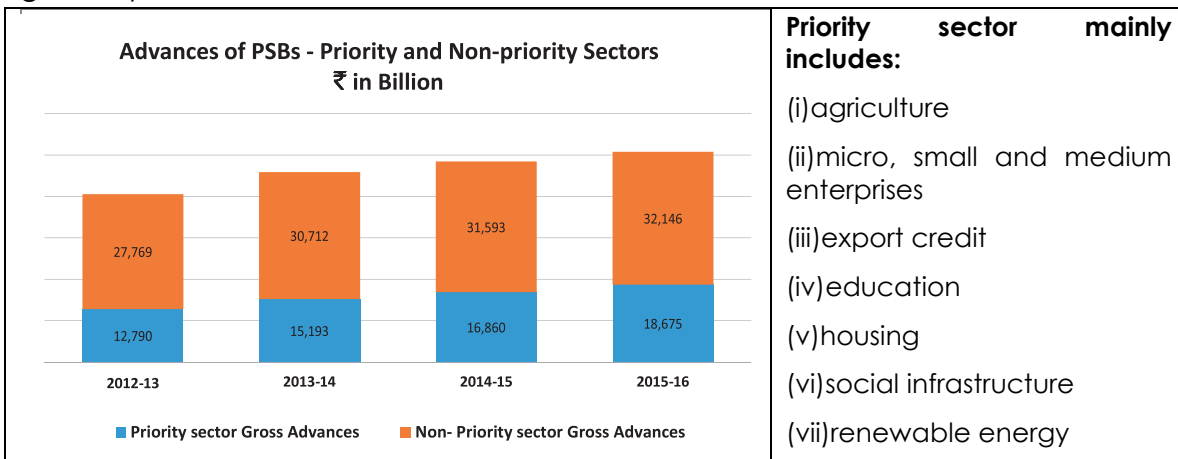
As economies grow, requirements of credit multiply. Depending on the pace of economic growth coupled with the business expansion plans of the banks, fresh capital infusion is necessary so that the bank maintains adequate capital to meet the prudential regulatory norms.

Over the period of study (2008-16), the advances of public sector banks have more than doubled, from ₹ 22,59,212 crore to ₹ 55,93,577 crore, though the rate of increase in advances has tapered in recent years (rate of increase in 2015-16 being 2.14 per cent as against 19.56 per cent in 2009-10). The year-wise quantum of advances by all PSBs vs all SCBs and the growth rate in advances is summarized in the charts below:



(Source: RBI Database : Statistical Tables relating to Banks in India)

As can be seen from the charts above, PSBs have been responsible for the bulk of credit in the economy. The bank-wise position of advances is at **Annexure – II**. The advances provided by PSBs is segregated into priority and non-priority sector advances. Over 2012-16, the priority sector advances have been in the range of 31.96 per cent to 35.72 per cent of total advances. The composition of advances given by PSBs over 2012-2016 is indicated in the chart below.



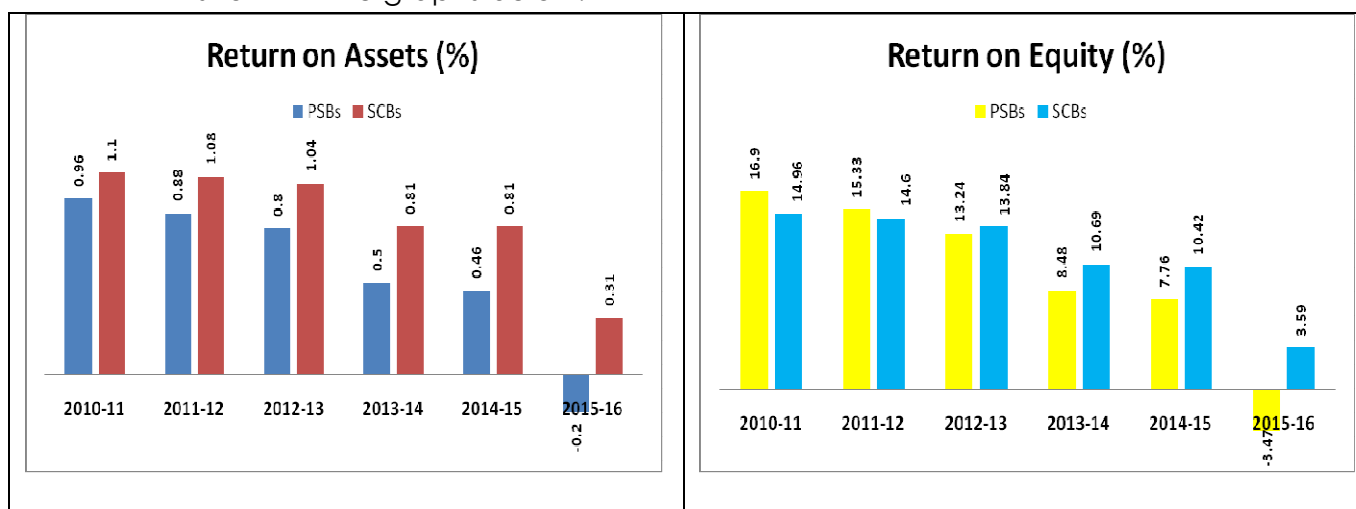
[Source : RBI Database : Statistical Tables relating to Banks in India: Domestic Operations]

### 1.5.3 Operational Performance of PSBs and Their Effect on Capital Requirements

**1.5.3.1** Bank performance is principally reflected in the return on assets (ROA) and return on equity (ROE).

- ROA indicates how profitable a bank is, relative to its total assets. ROA measures the efficiency of utilizing the bank assets to generate profit. It is worked out by dividing net income by average total assets. A higher ROA indicates a better managed bank. Besides the profit adding to capital, it also improves the bank's ability to access the markets for additional funds.
- ROE reflects the bank efficiency to utilize its shareholder's funds. A higher return on equity would also add to the capital of the bank through reserves and surpluses. A higher ratio indicates better management of shareholder capital. Low or negative ROE reduces the ability of the bank in tapping capital markets to raise additional funds to meet its regulatory capital needs.

**1.5.3.2** The ROA and ROE of PSBs along with all SCBs, over 2010-11 to 2015-16 are shown in the graphs below.



(Source : RBI Database : Statistical Tables relating to Banks in India)

As can be seen from the graphs, the ROA of PSBs has been consistently lower compared to all SCBs, while ROE of PSBs has been lower since 2012-13. In 2015-16, the ROA and ROE for PSBs has been negative, indicating a loss to the banks. In comparison, however, the overall results for all SCBs have been positive indicating the gap in performance of PSBs vis-à-vis private sector and foreign banks.

**1.5.3.3** The asset quality of the bank is also a significant indicator of the bank's performance. Worsening asset quality of the bank (greater

Non performing assets (NPA) of banks are assets (including leased asset) which have ceased to generate income for the bank.

defaults, lower ratings of borrowers etc.) will lead to faster erosion of available capital due to provisions and write-offs as well as higher risk weighted assets. A bank with poor asset quality will need to raise higher incremental capital to maintain the regulatory requirement of capital adequacy. The status of non-performing assets of SCBs in general and PSBs in particular is indicated at table 1.5 below.

**Table 1.5: Gross NPAs of Indian Banks by Banking Group**

(₹ in crore)

Gross NPA of SCBs	2011-12	2012-13	2013-14	2014-15	2015-16
<b>SBI and Associates</b>	48,214	62,779	79,817	73,509	121,969
<b>Other Nationalised Banks</b>	69,048	101,683	147,447	204,960	417,988
<b>Private Banks</b>	18,768	21,071	24,542	34,106	56,186
<b>Foreign Banks</b>	6,297	7,977	11,565	10,761	15,805
<b>Total Gross NPA</b>	<b>142,327</b>	<b>193,510</b>	<b>263,371</b>	<b>323,336</b>	<b>611,948</b>
<b>Share of PSBs (per cent) in Total Gross NPAs</b>	<b>82</b>	<b>85</b>	<b>86</b>	<b>86</b>	<b>88</b>

(Source: RBI Database : Statistical Tables Relating to Banks in India)

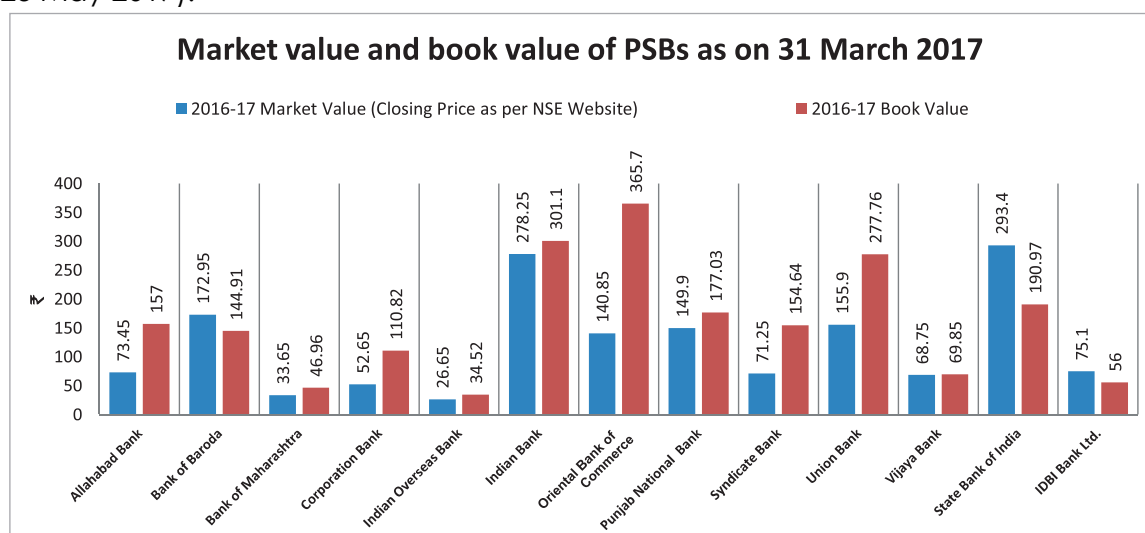
As can be seen from the table above, PSBs account for the largest share of NPAs in the banking sector which have consistently been on the rise over the past five years. The outcome of the rapidly deteriorating asset quality of PSBs on the banks' earnings is two-fold. First, with increasing NPA levels, the interest income of the bank is adversely affected since NPA accounts may not be servicing interest. Second, banks have to maintain higher provisions (from their reduced earnings), hence their net profits would be adversely affected, and could even turn negative, leading to faster erosion of banks' available capital.

## 1.6 Possible Modes to Recapitalise PSBs

**1.6.1** The more than two-fold increase in advances extended by PSBs during 2008-09 and 2015-16, coupled with the stringent capital adequacy requirements imposed by RBI in the wake of the Basel III norms and the poor performance of the PSBs have led to significant capital requirements. The recapitalisation needs of PSBs could be met either through capital infusion by the shareholders (primarily GOI) or the PSBs could obtain the required funds from the market.

**1.6.2** The primary responsibility of recapitalisation of PSBs often devolves on the Government, being the majority shareholder in these banks. Government may also infuse capital to address the broader objectives of distributional growth and equity in PSB operations. Besides, to ensure that the PSB character of the bank remains unaltered, dilution of Government stake below a fixed benchmark (58 per cent later lowered to 52 per cent in December 2014) may not be possible. However, as seen from chart in paragraph 1.3.2, the PSBs, at present have a high shareholding of GOI, well beyond the mandated benchmark of 52 per cent.

**1.6.3** A reason why PSBs may not be able to access funds from the market is their underperformance, particularly in cases where recapitalisation is necessary, to offset losses and erosion of capital arising from high NPAs. A comparison of market value and book value of PSB shares as on 31 March 2017 is indicated in the chart below (for 13 PSBs where information was available as on 25 May 2017).



(Source : Annual Reports of PSBs, PSB websites and NSE website)

There is a significant gap between book value and market value of PSB shares, with most PSBs having a lower market value compared to their book values. The poor market valuations of PSB shares would hinder the bank from approaching the market for additional capital funds. Besides, the lower share values would imply that the quantum of funds that could be raised from the market would be low and may not meet the requirements of recapitalisation of the PSBs while eroding the Government stake in them.

**1.6.4** Over the period 2008-09 to 2016-17, GOI has been infusing need based capital in the PSBs so that they maintain Tier - I capital adequacy while meeting the credit growth expectations. The capital infusion has generally been through preferential allotment of equity shares by the recipient bank to GOI. PSBs can also raise capital from domestic markets through Follow-on Public Offer (FPO), Rights Issue, Qualified Institution Placement (QIP), Exchange Traded Funds and preferential allotment to Investors (for example, to LIC, GIC and other private investors). A High Level Committee (HLC) on capital requirement of financial institutions was constituted<sup>9</sup> (September 2011) to assess possible options for raising resources to capitalise PSBs. The Committee had, inter-alia recommended creation of a holding company for PSBs which could then raise necessary extra budgetary resources (EBR).

<sup>9</sup> **Composition: Finance Secretary as Chairman, with Secretary Department of Expenditure, Secretary, Department of Economic Affairs, Secretary, Department of Financial Services and Chief Economic Advisor as members.**

### 1.7 Recapitalisation of PSBs during 2008-09 to 2016-17

Given their large share in the overall banking sector, the stability and solvency of Indian PSBs, is of paramount importance. In order to build up the capital adequacy of the PSBs, the Government of India, as the majority shareholder, infused ₹1,18,724 crore from 2008-09 to 2016-17 in PSBs.

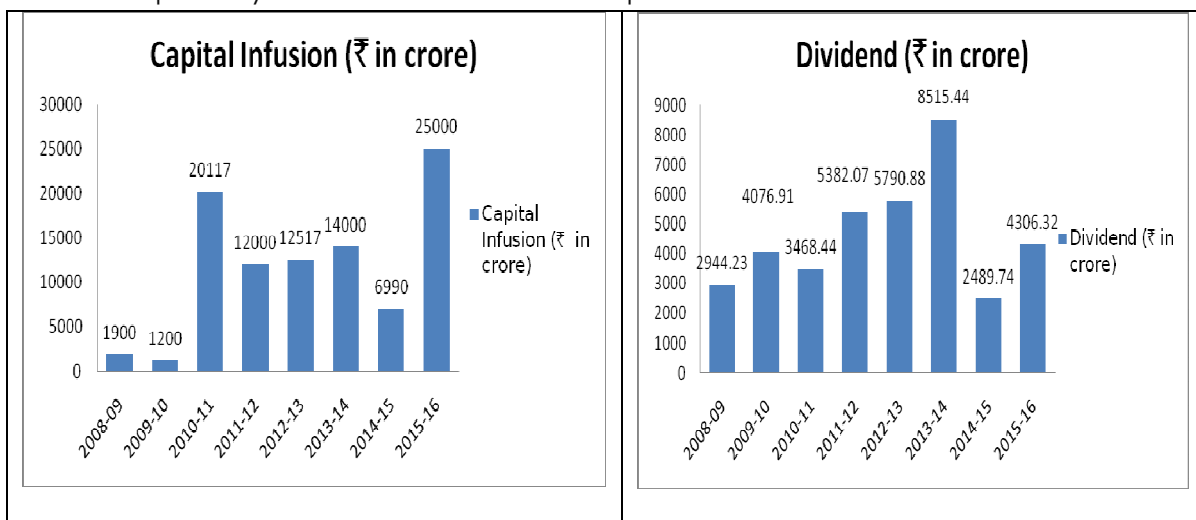
The table below indicates the Budget Estimates (BE), Revised Estimates (RE) and the Actual Outgo on account of re-capitalisation of Public Sector Banks.

**Table 1.6: Recapitalisation of PSBs- BE, RE and Actuals**

Financial Year	Budget Estimates	Revised Estimates	Actual Outgo
2008-09	N.A.	N.A.	1900
2009-10	N.A.	1200	1200
2010-11	16500	20157	20117
2011-12	6000	12000	12000
2012-13	14588	12517	12517
2013-14	14000	14000	14000
2014-15	11200	6990	6990
2015-16	7940	25000	25000
2016-17	25000	25000	25000
<b>Total</b>	-	-	<b>118724</b>

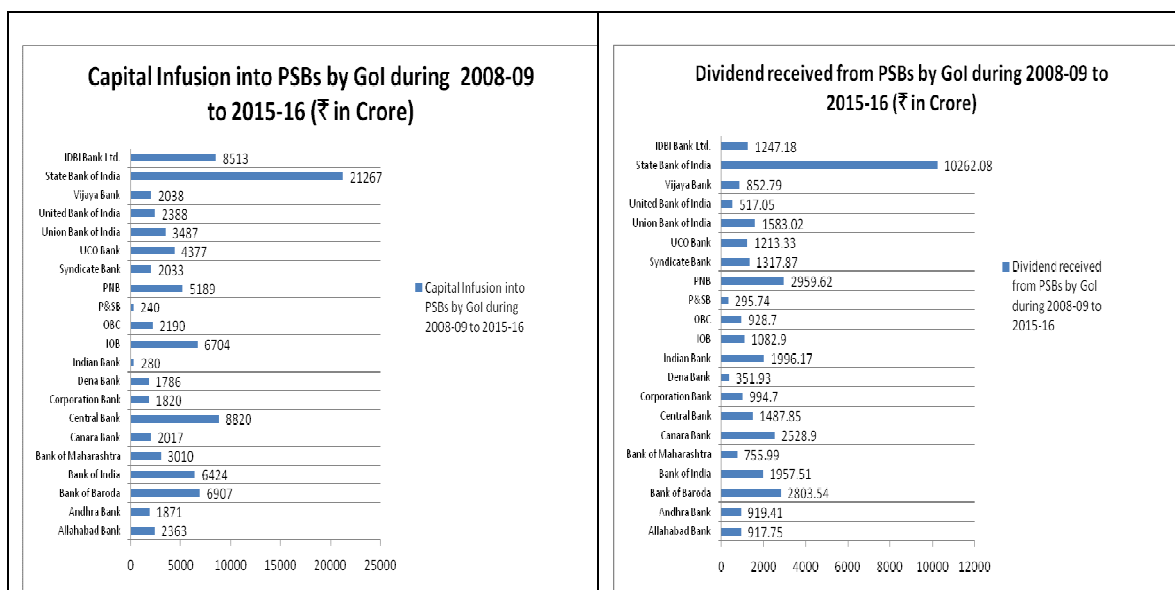
*(Source : Detailed Demands for Grants (2009-10 to 2016-17 and records of DFS))*

Over the period 2008-09 to 2016-17, GOI has infused capital of ₹1,18,724 crore in PSBs. The charts below show bank-wise capital infusion by GOI in PSBs vis-à-vis dividend paid by the PSBs to GOI over the period 2008-09 to 2015-16.



*(Source : Records of DFS and Data furnished by PAO, Banking, Ministry of Finance)*

The bank-wise position of dividends paid out to and capital infusions received from GOI is indicated in the charts on the next page:



(Source : Records of DFS and Data furnished by PAO, Banking, Ministry of Finance)

## 1.8 Recent Developments

**1.8.1** A High Level Committee (HLC) on capital requirement of financial institutions was constituted (September 2011) under chairmanship of the Finance Secretary. The mandate of HLC included assessment of :

- the need of various financial institutions including banks under DFS for next 10 years
- various possible options to raise resources to capitalise these financial institutions
- Global Experience of various Governments and in particular in developing countries to meet such capitalisation requirements and
- suggested preferred mode for capitalisation.

The HLC recommended creation of a Holding Company, to which all equity holding by GOI would be transferred and which would also be given some budgetary support each year, so that it could raise through domestic and international market and then capitalise the PSBs. Subsequently, it was decided by DFS not to act further on the proposal to create a financial holding company (September 2016).

**1.8.2** A Committee under the chairmanship of Sh P. J. Nayak was constituted by RBI in January 2014 to review governance of boards of banks in India. The committee gave its report in May 2014 and recommended, *inter alia*, that :

- the Government should set up a Bank Investment Company (BIC) to hold equity stakes in PSBs, with transfer of GOI holding to the BIC needing to be implemented in Phases – I, II and III
- the selection of the top management of public sector banks during Phase I be entrusted to a newly constituted Bank Boards Bureau (BBB)
- a minimum five-year tenure for bank Chairmen and a minimum three year tenure for Executive Directors.

Thereafter, a conclave of PSBs and Financial Institutions, 'Gyan Sangam' was organized in January 2015. The discussions culminated in a reform agenda which included adoption of Nayak Committee report, establishment of BBB comprising professionals and eminent bankers, empowerment of bank boards, establishment of Bank Investment Committee and strengthening legal framework for recovery from wilful defaulters. In March 2016, in line with the recommendations of the P J Nayak Committee and Gyan Sangam, the Banks Board Bureau was established by GOI for evolving a sound managerial policy for PSBs. One of the designated responsibilities of the Bank Board Bureau was to help PSBs in developing business strategies and capital raising plan.