RBI-BIS Seminar on Banking Supervision: RBI Governor stresses on capital for strong financial system

Dr C Rangarajan, Governor, Reserve Bank of India inaugurated the Seminar on Bank Supervision today at the Indira Gandhi Institute of Development Research, Mumbai. The five-day Seminar has been organised by the Reserve Bank of India in coordination with the Basle Committee on Banking Supervision and the Bank for International Settlements (BIS). Representatives of the central banks from several SAARC countries such as, Bhutan, Bangladesh, Nepal and Sri Lanka as well as from Thailand are participating in the Seminar along with representatives of the various operational departments of the RBI from all over the country and the NABARD. This is the second Seminar organised by the Reserve Bank of India in coordination with BIS. The first Seminar on Payment systems was organised in Pune in January 1997.

In his inaugural address, the Governor said that the Seminar assumes significance in the context of global concern for evolving the most appropriate form of supervision. Stating that the health of an economy depends on a sound and healthy financial infrastructure which can render efficient service, the Governor said that the world over banks and banking business are subjected to greater official regulation and supervision than other types of businesses because of strong public interest considerations and the potential danger of systemic risk that may arise on account of the failure of even one unit.

The Governor stated that there are three objectives of bank regulation and supervision. These are: promoting soundness of banks to protect depositor funds and maintaining public confidence in the banking system; fostering efficient and competitive banking system that is responsive to the community's needs for high quality financial services at a reasonable cost; and ensuring that banks comply with banking regulations. Having widened and deepened the financial system over the past three decades in India, the supervisory concerns now are focused on improving its viability and efficiency.

Summarising the reforms in the financial sector, the Governor and that they seek to improve the profitability and efficiency of the financial systems. The banking sector reforms have aimed at removing the external constraints by correcting and improving macro policy environment for banking operations, improving banks' financial health by introducing prudential norms and strengthening the institutional framework by allowing new institutions as well as improving the health of the old ones.

Dwelling at some length on prudential norms, the Governor explained that the capital adequacy standards have assumed importance in the developed countries in the context of increased risk borne by the banking system with the removal of barriers on movements of capital across the borders. The increased competition has also made banks operate on thinner margins and take higher risks. In the Indian context, the supervision of the banking system so far had been focusing only on the examination of credit quality. During the past four years, however, the Reserve Bank has expanded their scope to include prudential regulations, such as norms for income recognition, provisioning and capital adequacy.

Explaining the rationale for capital adequacy norms, the Governor explained that capital serves two purposes - it provides long term funds and acts as a buffer against losses.

As regards the question relating to the appropriateness of capital adequacy norms when the reserve requirements are high, the Governor stated that these served different purposes. While reserve requirements were related to liquidity, capital adequacy requirements were related to solvency. Further, since investments for reserve requirements carried zero risk, there was no need to maintain any capital against them.

Coming to the changes introduced in the focus and methods of supervision, the Governor said that under the aegis of the separately constituted Board for Financial Supervision, the Reserve Bank has stepped up initiatives in continuous and focused supervision. As recommended by the Padmanabhan Committee, the RBI's supervisory examination is now directed towards assessment of three broad areas, viz., appraisal of asset quality, solvency, earning performance and liquidity, quality of management and decision making process and regulatory compliance. Supervision now also covers stated that central bank supervision, external auditors and internal audit form the three legs of the tripod of financial health management and it was necessary that each supported the other in making the financial system more viable and stronger.

In his introductory remarks, Mr L Sahuquet of the Basle Committee of the BIS stated that BIS wishes to develop relationship with its new shareholders, especially with the RBI. He also said that the Seminar indicates the Basle Committee's desire for increasing cooperation with non-G 10 countries and work towards developing common standards of supervision around the world.

Earlier, Shri A. Ghosh, Chief General Manager, Reserve Bank of India's Department of Banking Operations and Development welcomed the guests and participants and said that the rules framed by the Bank for International Settlements on capital adequacy and risk management have been found very useful by supervisors the world over in putting in place a sound supervisory and risk management system.

(P.T. Achuthan)
Manager

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