Report of The Working Group on
Restructuring Weak Public Sector Banks

Summary

Introduction

1. The Reserve Bank of India, in consultation with the Government of India, set up the present Working Group under the chairmanship of Shri M.S. Verma, former Chairman, State Bank of India, and presently Honorary Adviser to the Reserve Bank of India, to suggest measures for revival of weak public sector banks. The terms of reference were (a) criteria for identification of weak public sector banks, (b) to study and examine the problems of weak banks, (c) to undertake a case by case examination of the weak banks and to identify those which are potentially revivable and (d) to suggest a strategic plan of financial, organisational and operational restructuring for weak public sector banks.

International experience

2. During the last twenty years, over 130 countries, developed and developing, have experienced banking crises in one form or the other. The Working Group has tried to understand the strategies adopted by some of these countries in the handling of the crises. Restructuring of a banking system needs to address macro systemic issues pertaining to factors responsible for ensuring banking soundness and also the micro level, individual bank problems. While there is no unique solution to banking crises that could be prescribed and applied across the board to all countries, there are some common threads that seem to run through all cases of successful restructuring. Initially, each bank needs to be restored to a minimum level of solvency through financial restructuring. Thereafter, only longer term operational and systemic restructuring can help them maintain their competitiveness and enable them to ensure sustained profitability. Only a comprehensive approach to restructuring can have a lasting effect on the cost, earnings and profits of the banks to be restructured.

Public sector banks: an overview

3. Till the adoption of prudential norms relating to income recognition, asset classification, provisioning and capital adequacy, twenty-six out of twenty-seven public sector banks were reporting profits (UCO Bank was incurring losses from 1989-90). In the first post-reform year, i.e., 1992-93, the profitability of the PSBs as a group turned negative with as many as twelve nationalised banks reporting net losses. By March 1996, the outer time limit prescribed for attaining capital adequacy of 8 per cent, eight public sector banks were still short of the prescribed level.

4. The emphasis on maintenance of capital adequacy and compliance with the requirement of asset classification and provisioning norms put severe pressure on the profitability of PSBs. Deregulation of interest rates on deposits and advances has intensified competition and PSBs now have to contend with competition not only from other public sector banks but also from old/new private sector banks, foreign banks and financial institutions. While some public sector banks have succeeded in adjusting to the changing business environment and managed competition some others have not been able to do so, and have displayed serious weaknesses.

5. The malady has been deep in the case of three banks, viz., Indian Bank, UCO Bank and United Bank of India. Continuous decline in profitability and efficiency of these banks and their dependence on capital support from government are causes for concern. They are trapped in a vicious circle of declining capability to attract good business and increasing need for capital support.

6. It is likely that the seeds of weakness are latent in some other public sector banks as well. The problem of weak banks, which could have spill over effect on the system itself, therefore, assumes serious proportions.

7. The Committee on Banking Sector Reforms (CBSR) had recommended that a weak bank would be one (a) where accumulated losses and net NPAs exceed the net worth of the bank or (b) one whose operating profits less the income on recapitalisation bonds has been negative for three consecutive years. To identify a bank's weakness or strength with a fair degree of certainty, the Group has recommended the use of the following seven parameters in conjunction with the two suggested by the CBSR: (i) capital adequacy ratio, (ii) coverage ratio, (iii) return on assets, (iv) net interest margin, (v) ratio of operating profit to average working funds, (vi) ratio of cost to income and (vii) ratio of staff cost to net interest income (NII) + all other income.

Identification of weak banks

8. All the public sector banks were evaluated on the above seven parameters keeping the median as the threshold in five of the parameters. For capital adequacy ratio, the threshold was 8 per cent and in respect of the coverage ratio it was kept at 0.50 per cent.

9. Indian Bank did not meet any of the parameters in both the years. UCO Bank and United Bank of India could comply with the capital adequacy prescription but failed in all the other six parameters. These banks, along with Indian Bank, were the only banks to have received capital infusion during the last two years and would not have attained minimum capital adequacy otherwise.

10. The above approach serves the immediate objective of setting the criteria for identifying weakness in banks in general and for locating potentially weak banks. The Working Group, therefore, recommends building a database in respect of banks on an ongoing basis for the purpose of benchmarking and on that basis identifying signals of weakness.

Causes of weakness

11. The causes of weakness need to be addressed properly so that the remedial measures adopted prove effective and actually succeed in improving the functioning of the weak banks. The weaknesses relate to three areas: operations, human resources and management.

12. Operational failures mainly relate to high level and fresh generation of NPAs, slow decision making with regard to fresh sanction of advances and compromise proposals and loss of fund-based advances and fee income. Declining market share in key areas of operations, limited product line and revenue stream, absence of cost control and effective MIS and costing exercise, weak internal control and housekeeping, poor risk management and insufficient customer acquisition due to mediocre service, low level of technology and non-competitive rates are the other causes.

13. The operations of subsidiaries and foreign branches, which are a drain on two of the banks, lead bank and RRB responsibilities and locational disadvantages are also related issues.

14. Overstaffing, low productivity and a high age profile are the main HR related issues. Restrictive practices in deployment of staff have further aggravated the cost of overstaffing. In the three identified banks, staff cost as a proportion of total operating income has been above the industry median. Another area of concern is the level of skill and low levels of motivation. Skills in foreign exchange, treasury management and other specialised areas are not significant enough to generate business in these areas on a sustained basis.

15. Training facilities are not adequate to meet the training requirements of the staff of the banks and motivation and morale of employees at all levels is low.

16. Under management related issues, lack of succession planning, short tenures and frequent changes in top management, inadequate support from the Board of Directors and the lackadaisical implementation of earlier SRPs and MOUs are causes of weakness. Even after infusion of Rs. 6,740 crore in the three banks over the last seven years, their basic weaknesses persist. Unconditional recapitalisation from the Government of India has proved to be a moral hazard as no worthwhile attempt has been made by the banks to gain adequate good business or to reduce costs.

Past efforts at restructuring

17. The restructuring efforts initiated so far have not had the desired impact. Hard options have been avoided and the steps taken so far have only had the objective of maintaining the capital adequacy ratio of the banks with the assistance of Government of India. The banks have failed to develop the required resilience or strength to become competitive in the true sense.

Present position of the weak banks

Indian Bank

18. Indian Bank continued to incur operating losses in 1998-99 also. The capital adequacy which had turned positive and reached 1.41 per cent in March 1998 with capital infusion of Rs. 1,750 crore from the Government of India turned negative again in March 1999. The decline in other income continued during 1998-99 as well. The bank did not make any provision for liabilities arising on account of the proposed wage revision. The deterioration on the NPA front is unabated. Gross NPA went up from Rs. 3,428 crore as on 31 March 1998 to Rs. 3,709 crore as on 31 March 1999, i.e., 37 per cent of gross advances. This was the highest among public sector banks.

UCO Bank

19. UCO Bank’s operating profit improved marginally in 1998-99. However, if the interest income on recapitalisation bonds is excluded, the bank would have incurred operating loss of Rs. 91 crore in 1997-98 and Rs. 157 crore in 1998-99. Recapitalisation by the government to the tune of Rs. 200 crore helped the bank achieve capital adequacy of 9.63 per cent in 1998-99. The bank has not made provision for liability on account of wage revision. Gross NPAs as on 31 March 1999 aggregated Rs. 1,716 crore (23 per cent). Net NPAs at Rs. 715.63 crore were higher as compared to Rs. 705 crore as on 31 March 1998. The inability of the bank to register any improvement in the net NPA position is a matter for concern.

United Bank of India

20. United Bank of India’s operating profit decreased substantially in 1998-99. Operating income increased mainly on account of extraordinary income by way of interest received on income tax refund. Further, if the interest income on recapitalisation bonds is excluded, the bank would have incurred operating loss of Rs. 89 crore in 1997-98 and Rs. 117 crore in 1998-99. Recapitalisation by the Government of India to the tune of Rs. 100 crore helped the bank achieve capital adequacy of 9.60 per cent in 1998-99. The bank has not made provision during 1998-99 for future pension liability and wage revision. The gross NPAs of the bank as on 31 March 1999 increased in absolute terms to Rs. 1,549 crore (32 per cent) from Rs. 1,451 crore as on 31 March 1998 (34 per cent). Net NPAs also went up to Rs. 573 crore (15 per cent) as on 31 March 1999 from Rs. 472 crore (14 per cent) as on 31 March 1998.

Assessment of revival plans prepared by the banks

21. The plans prepared by the banks at the Working Group’s instance were no better than the earlier ones that had failed in that they continue to be based on ambitious projections of growth in business and income for which the banks are not equipped in terms of skill or technology. The plans do not reflect the growing compulsions of having to achieve steady growth in income and sustained control of expenditure within as short a time as possible. Therefore, the restructuring plans drawn up by the banks do not meet the objectives. It is felt that, as long as government assurance as to continued capital infusion is there, the banks would only look at soft options regardless of the time and cost involved.

Future course of action

22. The restructuring exercise has to be comprehensive and must address operational and financial restructuring simultaneously. There is no room for half way measures or gradualism. It is tempting to confine restructuring to financial aspects since solvency is immediately restored and there is a visible impact on the balance sheet. But, if operational aspects are not attended to, long term sustainability cannot be ensured. This will only lead to additional problems necessitating further and costlier restructuring down the road.

23. Future restructuring strategies must incorporate the core principles of manageable cost, least burden on the exchequer, sharing of losses equitably and strong internal governance. There should be an independent agency that will constantly monitor the progress of restructuring.

24. Bank restructuring has been attempted mainly by using one or more of the following modalities: merger or closure, change in ownership, narrow banking and a comprehensive operational and financial restructuring. The Working Group has examined the applicability of each of the above options in the present Indian context.

Merger or closure

25. Merger would be advantageous only if it takes into account the synergies and complementing strengths of the merging units. The Working Group does not recommend merger as a possible solution in reviving the weak banks without first preparing them for it.

26. Closure has a number of negative externalities affecting depositors, borrowers, other clients, employees and, in general, the areas served by the banks being closed. This is an extreme option and would need to be exercised after all other options of successful restructuring are ruled out.

Change in ownership

27. Privatisation is an acceptable course as this process alone can reduce the government's responsibility of capitalising the three banks further and, in the long run, enable it to recoup, fully or partially, the investment made in their capital. This will remove the moral hazard implicit in the present situation that government support will always be available and make the three banks responsive to the rules of market economy. The three banks will then also have a sense of accountability to all the stakeholders and appreciate the need for good performance.

28. However, in their present state, it is just not possible to consider their privatisation because the cost of restructuring is prohibitively high and no private group can normally be expected to bring in the kind of resources that the three banks require at present. These banks are also not likely to succeed in accessing the capital market given their present position. Their present staffing pattern and level of skills and technology will be deterrents to any investor.

Narrow banking

29. All the three weak banks have pursued some form of narrow banking, without success, for reasons such as inability to lend to quality customers, as a matter of deliberate policy, high levels of NPAs and "fear psychosis". Preferring government securities to fresh lending creates dissatisfied borrowers who tend to change their bank. Banks' ability to generate non-interest income is linked to the size and quality of their advances portfolio. A restriction on this results in a fall in fee income. Such a two-pronged loss in income adds to the weakness of the bank making its recovery even more difficult. Further, resorting to narrow banking does not protect a bank against all risks as even investments in gilts are open to market risks. In any case, narrow banking can at best be only a temporary phase and cannot by itself be adopted as a restructuring strategy.

Comprehensive operational and financial restructuring

30. With the three other options not being found suitable to the present environment, the only other option left for consideration is that of a comprehensive operational and financial restructuring. The Group has tried to answer the question whether this option of restructuring is available in the case of the three identified weak banks.

31. The three banks are obviously beset with serious weaknesses and have not been able to turn around despite repeated recapitalisations almost all through the 1990s adding up to a massive sum of Rs. 6,740 crore. They continue to depend upon the government for further recapitalisation and Indian Bank alone will need another Rs. 1,000 crore urgently to gain the prescribed minimum capital adequacy of 9 per cent with no guarantee that at the end of the current year, they will once again not need further infusion of capital to maintain this ratio. The position of the other two banks is only marginally better as they do not need capital infusion immediately. However, their future operations too are unlikely to continue without further infusion of capital. It does not, therefore, make economic sense to let them continue in the present manner for, after all, the government cannot undertake to capitalise them endlessly.

32. It is, therefore, time to take a long term view and ensure that the present state of affairs does not get prolonged. The choice is, therefore, limited to either closing them or subjecting them to such extensive operational, organisational and financial restructuring as can effectively restore their competitive efficiencies.

33. In view of the very extensive network and large client base of each of these banks, as also the other attendant negative externalities, closure is to be considered only as the last option. The choice of comprehensive restructuring, therefore, requires careful consideration. Any such restructuring, however, will mean exercising hard options and involve firm, decisive and timely actions. There must be a firm political will backed by firm commitments from the bank management and the employee unions that the restructuring exercise will be completed without any let up or hindrance.

The management and employee unions of the banks will have to come to an agreement before the restructuring exercise begins as regards every important ingredient of the proposed exercise. The crux of the issue is that it is going to be an expensive one-time exercise and, unless its success is reasonably assured, it will not be worth undertaking.

34. Subject to what has been stated above, the Group has developed a four-dimensional comprehensive restructuring programme covering operational, organisational, financial and systemic restructuring. These are as under:

1. Operational restructuring involving

    i. basic changes in the mode of operations,

ii. induction of modern technology,

iii. resolution of the problem of high non-performing assets and

iv. drastic reduction in cost of operations.

2. Organisational restructuring aimed at improved governance of the banks and enhancement in management involvement and efficiency.

3. Financial restructuring with conditional recapitalisation.

4. Systemic restructuring providing for, *inter alia,* legal changes and institution building for supporting the restructuring process.

Operational Restructuring

35. In a well-researched document published by the IMF in 1997, one of its contributors, Gillian Garcia, has identified the following as key elements of operational restructuring:

a. Formulating a business plan that focuses on core products and competencies.

b. Reducing operating costs by cutting staff and eliminating branches where appropriate, ceasing unprofitable activities, and disposing of unproductive assets.

c. Implementing new technology and improving systems of accounting, asset valuation, and internal controls and audit.

d. Establishing and enforcing internal procedures for risk pricing, credit assessment and approval, monitoring the condition of borrowers, ensuring payment of interest and principal, and active loan recovery.

e. Creating internal incentive structures to align the interests of directors, managers, and staff with those of the owners.

The Working Group considers the above to be a very good and concise statement of operational restructuring requirements. The plan evolved by the Working Group for restructuring of the three banks is also on similar lines.

36. Operational restructuring for the weak banks is two pronged: one of increasing income and the other of reducing costs. Income has to be increased by revamping the banks' mode of doing business and by reducing the effect of current and future NPAs on their earnings. Cost reduction will have to be achieved by dropping the lines of business and products that are proving to be a drag on their profitability and effecting reduction in staff costs which account for most of the operating costs incurred by the weak banks.

Change in mode of operations

37. None of the weak banks is identified with any special business or customer niche. Each of them, therefore, needs to develop strengths in chosen areas and build its skills and business strategy around those strengths. By trying

12 to be all-India banks, they are neither any more dominant in the area of their concentration nor are they able to make a mark countrywide.

38. The growth of these banks' credit portfolios has been extremely limited and their fee-based earnings minimal. They need to take urgent steps to reintroduce credit culture and ensure a rapid growth in non-fund based earnings by laying stress on a few selected services, particularly, movement and management of funds.

39. These banks had left the traditional areas of business in which they had experience and moved into areas for which they neither had skills nor the experience and this has been their undoing. They need to go into areas in which they have the experience and can develop expertise in a short time. The appropriate markets for them will be the middle and lower segments of the credit market.

40. Unions have pleaded for allocation of a share of the PSU and other government departments related business. Such an approach is not practical nor is it desirable especially in the present deregulated environment where the banks need to stand on their own and where these bodies themselves are autonomous in their functioning.

Foreign branches and subsidiaries

41. Both UCO Bank and Indian Bank would find it extremely difficult to run their foreign branches in the short and medium term. The position even now is tenuous and would get exacerbated if any of these operations runs into the slightest of difficulty or if the local regulators stipulate conditions regarding capital adequacy which the banks may not be able to meet. This could pose a problem for not only the three banks but also for the Indian banking system. These branches need to be taken off their hands by selling them to

13 prospective buyers including other Indian public sector banks. The resources raised could fund some of the various demands of the restructuring operations.

42. The subsidiaries of Indian Bank are likely to be a continued drag on its viability and would add to the cost of restructuring. A decision to close them needs to be taken at the earliest. An effort could also be made to find buyers for the bank's holdings in the subsidiaries.

Adoption of modern technology

43. Public sector banks, particularly the weaker ones, are losing ground and share of business to the technologically well-equipped new private sector as well as foreign banks. The weak banks do not have either the skills or the resources to implement and maintain complex IT solutions of the kind that are required to meet the challenges. A desirable solution would be to have common networking and processing facilities. Such common facilities may be outsourced from an existing reputed company. The service provider could also be invited to follow a 'Build Own Operate Transfer' model for this purpose.

44. Implementation of an IT solution in the above manner will, among other things, enable introduction of extended working hours and shifts and improve overall customer service. In the first stage itself, which may be spread over twelve to eighteen months, the IT solutions should target coverage of over 70 per cent of the participating banks' present business. This would require that around 250 to 300 of the largest branches from each of the three banks be linked to the proposed outsourcing. The Working Group has estimated the total cost for this at Rs. 300 crore which may come by way of assistance from the government or from multilateral lending institutions.

<u>NPA management</u>

45. NPAs have been the most vexing problem faced by the weak banks with additions to NPAs often outstripping recoveries. A significant portion of the NPAs are chronic and/or tied up in BIFR cases. There are also loans given to state and central public sector units which have failed to repay. The operations of Debt Recovery Tribunals are such that they have not so far made a dent in the NPA position of banks. The route of compromises has also not been very successful despite setting up of Settlement Advisory Committees. It is necessary that measures are found to ensure an early resolution of chronic NPAs. Where guarantees have been given by the central or state governments and where these have been invoked by the banks, these demands need to be met.

46. Separate institutional arrangements for taking over problem loans have played a key part in bank restructuring in different countries with varying degrees of success. The Committee on Financial System (1991) and the CBSR (1998) had made similar recommendations. Such separation of NPAs is an important element in a comprehensive bank restructuring strategy.

47. It would be desirable to develop a structure which will combine the advantages of government ownership and private enterprise. The broad structure would be that of a government-owned Asset Reconstruction Fund (ARF) managed by an independent private sector Asset Management Company (AMC). Assets belonging to public sector banks can be transferred to the ARF. The ARF will be constituted with the objective of buying impaired loans from the weak banks and to recover or sell them after some reconstruction or in an 'as is where is' condition. The ARF may be set up by the proposed Financial Restructuring Authority under a special Act of the Parliament which while protecting it against obstructive litigation from the borrowers could also provide for quick and effective enforcement of its rights. The ARF may be required to acquire assets of the face value of about Rs. 3,000 crore. The capital needed by the ARF would be in the region of Rs. 1,000 crore.

48. The payment in respect of the assets purchased from the weak banks may be made by the ARF by issuing special bonds for the purpose bearing a suitable rate of interest. It may also be guaranteed by the government in order to improve its liquidity. The bonds may, however, be issued to the weak bank with an initial lock-in period of at least two years. These bonds as also those which will be issued for raising funds against the security of assets purchased by the ARF may have a maturity of five years.

49. The ARF should purchase from the banks loans, which are NPAs as on a certain date, say, 31 March 2000. The responsibility of recovering loans, which become NPAs after that date should remain totally with the banks concerned. It will, therefore, be adequate for the ARF to have a life of not more than seven years. The ARF may buy NPAs only from the banks which have been identified as weak, though the option of buying loans from other banks should not be closed. It should be possible to set up more such funds later if the need arises.

50. The transfer price has to be fair to both the buyer and the seller. It would be difficult to prescribe rigid arrangements or a floor price for the transfer of NPAs and each case may have to be decided on merits. So long as pricing is arrived at by mutual agreement and in a transparent manner, the Group does not consider it necessary either to prescribe a floor price or a formula therefor.

51. The management of the ARF would be entrusted to an independent Asset Management Company, a private sector entity, which will employ and avail of the services of top class professionals. The AMC can be compensated for the services it provides in the form of service commission on the value of assets managed coupled with incentives for recoveries if these are higher than an agreed benchmark.

52. In the ownership of the AMC, while the government would have a fair, may be even dominant, share of up to 49 per cent, majority shareholding will be non-government. The other shareholders could be institutions like SBI, LIC, GIC, UTI and IFCI whose participation does not add to government shareholding and also parties from the private sector. The initial capital requirement of the AMC is not likely to be more than Rs. 15 crore and it would, therefore, not be difficult to attract non-government participants therein. It would also be possible to attract participation of multilateral agencies like IFC or ADB. The possibility of an existing Fund Manager, in public or private sector, offering to manage the ARF may also be explored.

53. To the extent that NPAs are taken off the books of the three banks and are moved on to the Asset Reconstruction Fund, the Fund would be paying them for the assets taken over by way of bonds bearing interest. This interest earning will add to the concerned bank's income which to a considerable extent will help the bank in meeting their staff expenses. Assuming that NPAs will be transferred at a rate so as to bring them down to the average level of NPAs in PSBs which is around 15 per cent, the annual income for Indian Bank, UCO Bank and United Bank of India can be expected to be augmented by around Rs. 91 crore, Rs. 44 crore and Rs. 24 crore respectively.

Reduction in cost of operations

54. Cost income ratio of the Indian Bank, UCO Bank and the United Bank of India for the year 1998-99 worked out to 141.22, 93.94 and 89.90 per cent respectively showing clearly that the cost of their operations has reached unsustainable levels and that, unless the situation is corrected immediately, survival of these banks could be in jeopardy.

55. The cost of operations of the three banks is clearly unsustainable and is threatening long term viability and survival of these banks. When it comes to cost management and reduction, non-staff expenses are far less critical than staff expenses. These comprise of expenses incurred on items governed by market conditions over which banks have little or no control.

56. Management of costs necessarily boils down to management of staff expenses which in the year 1998-99 accounted for 76.37 per cent and 80.60 per cent of the total operating income (NII + all other income) in UCO Bank and United Bank of India respectively. In the case of Indian Bank, the position was much worse at 107.79 per cent. Other similarly placed public sector banks have this ratio generally below 45 per cent. Banks which have to allocate a comparatively lower portion of their overall income towards their staff costs obviously have a tremendous competitive advantage over the others.

57. Since chances of increasing income in the short term are remote, the weak banks have little choice but to take all possible measures to reduce their staff costs and bring it in line with at least the average performing public sector banks in terms of its percentage to total operating income (net interest income + non-interest income).

58. The three banks have not factored in the wage revision that is to become effective from November 1997. No provision in respect of the increase (12.25 per cent) has been made and should it become applicable to them not only will the yearly wage bill for the future years go up but substantial amounts will also go towards arrears for the period beginning from the date from which the revision becomes effective.

59. With the added income from transfer of NPAs in the form of interest on the relative bonds, the requirement of staff reduction would get suitably modified and has been estimated to be of the order of 30 to 35 per cent in the three banks. Considering all factors involved, the Group is of the view that initially a reduction in the staff strength of the order of 25 per cent may serve the purpose and should, therefore, be aimed at. This reduction in staff strength would help the banks reduce staff costs correspondingly which going by the expenses incurred in the year 1998-99, would work out approximately to Rs. 107 crore, Rs. 121 crore and Rs. 85 crore in the case of Indian Bank, UCO Bank and United Bank of India respectively.

60. This step is unavoidable since continuing with the present strength could jeopardise the survival of the three banks. In order to control their staff costs, the three banks will have to resort to a voluntary retirement scheme (VRS) covering at least 25 per cent of the staff strength. It is estimated that a reasonable VRS for the three banks aimed at 25 per cent reduction would cost between Rs. 1,100 and Rs. 1,200 crore.

61. The rightsizing of staff will have to be achieved by the individual banks structuring their schemes in such a way that they are able to maintain the required balance between the different categories of staff and do not lose the desirable experience and skills they possess. The scheme will have to be voluntary but the right to accept or reject individual applications should rest with the management. The scheme should aim at separation of employees in the age group of 45 and above especially those in the 50-55 age group. The scheme should be in operation for a period not exceeding six months. The banks will need to undertake considerable retraining and relocation of the post-VRS staff strength. Such reskilling and relocation should be made a precondition for future recapitalisation.

62. In order that the VRS and the needed reduction in staff costs have a real impact on the operating results of the banks concerned, it would also be necessary to place a cap on the staff expenses of the three banks. Towards this, the Working Group recommends that a freeze on all future wage increase including the one presently under contemplation, i.e., with effect from November 1997, be put in place. This may continue for a period of five years.

63. If VRS does not lead to the needed reduction in the banks' operating costs, there will be no alternative left but to resort to an across-the-board wage cut of an order which will result in a similar reduction in costs. It is with this urgency in mind that the Working Group has suggested keeping the VRS open for a limited period of six months.

64. The only other source of sustenance in these cases is recapitalisation support from the government but this too is not readily available because of the increasing pressures and other compelling demands on the government's resources. If, therefore, the banks are to survive, most efforts and sacrifices will have to be their own. Outside support can only be limited and short term and will be predicated upon what the banks can do themselves.

Organisational Restructuring

65. The complex administrative structure of the weak banks is a serious limitation impairing their decision making process. Each of these layers is delay laden and without any clarity of policies and purpose. Even though some delayering has been attempted in some banks, especially, UCO Bank, the administrative structure continues to be diffused. Delayering alone would not speed up decision making unless accompanied by clearly laid out policies and procedures, skills and adequate discretionary powers at the different levels of decision making.

66. The three banks have a larger network of branches than what their levels of business call for. There is also the question of concentration of branches in specific areas with which United Bank of India and UCO Bank are faced. There is an urgent need to consider rationalisation of branches in all the three weak banks.

67. The weak banks must take a hard and careful look at the branches the levels of business of which are below 50 per cent of the level of nationalised banks in similar area and after convincing themselves about their unviability decide to discontinue their operations By continuing such operations, hoping that these will improve in future or by showing them artificially as profitable using a transfer pricing mechanism which favours them unduly, the problem will be compounded and elude solution even in future. It, therefore, stands to reason that the banks merge two or more unviable operations into one viable operation.

68. Absence of dynamic leadership for long periods has been a major contributor to the consistent deterioration in the functioning of the three banks. There is a need for appointing CMDs who are especially suited to their jobs and are more in the nature of wartime generals possessing special skills and attitude required for restructuring. They should have a sufficiently long tenure of, say, four to five years and should be in the age group of 50-52 years. In order to ensure uninterrupted progress of the restructuring plan and to commit the top management thereto fully, this tenure may not be ordinarily curtailed. The right persons for these jobs should be provided with incentives, both monetary and non-monetary, for achieving the restructuring mission successfully even if giving such incentives means making a departure from existing norms. If in the four or five year career of a person as CMD of a weak bank the bank shows a definite improvement, he could be considered for heading one of the prime banks/financial institutions in the country.

69. A line of succession should be developed well in time and a system put in place whereby, save exceptions, an ED would succeed the outgoing CMD. Excepting in very small banks, there should be two EDs. One of the two EDs could be responsible for driving the restructuring process leaving the CMD free to pursue other strategic growth issues.

70. The boards need to be reconstituted to include eminent professionals, industrialists and financial experts with the necessary training, experience and background. There should be a clear distinction between the roles of ownership, which the government has, and that of management, which it does not. The government may, therefore, consider withdrawing from the banks' boards its own serving officers and replace them with independent nominees having relevant knowledge and experience.

71. Leadership is lacking in the middle levels of these banks because of inadequacies in skills both in the traditional areas of bank operations as well as in new and specialised areas such as credit, treasury operations, foreign exchange and IT. While a longer term training and reskilling programme will have to be undertaken, the banks would also need to resort to some recruitment in the senior and middle levels of management from the market.

72. The training facilities are inadequate to meet the needs that would arise following the restructuring efforts. These will have to be considerably strengthened. Training facilities created by more than one bank could be pooled for optimum utilisation of the limited training skills available. A sub-allocation out of the capital support earmarked for VRS may be made for re-skilling and training.

Financial restructuring

73. Financial restructuring has to be undertaken to ensure solvency. Capital infusion in the three identified weak banks has so far aggregated Rs. 6,740 crore. Further capital infusion in the case of Indian Bank is imperative to ensure its continued operations. Financial restructuring should aim at raising CAR to at least one per cent above the minimum required so that the banks can continue with their normal credit business.

74. To the extent immediate cash funds are not being made available, the present mode of recapitalisation by way of recapitalisation bonds may be continued. A portion of the additional capital requirement would need to be provided in cash in the form of either preference capital or long term subordinated debt. On this, the banks should have an obligation of giving a return.

Without this, they will fail once again to appreciate the necessity of developing minimum competitive efficiency and their obligation to service capital. Recapitalisation must be accompanied by strict conditions relating to operating as well as managerial aspects of the recipient bank's working. Conditions should also apply to the manner in which these funds can be deployed.

75. Additional capital is required to meet the cost of (a) moving some portion of the NPAs out of the books, (b) cost of modernisation of technology, (c) HRD related costs including that of VRS, relocation and training and (d) capital adequacy. Funds required under (b) and (c) will have to come by way of cash. Requirements for items under (a) and (d), however, can be met through recapitalisation bonds as hitherto. Funds should become available only when the banks undertake the specific activities for which these have been earmarked.

76. Recapitalisation should be under an agreement, between the government on the one side and the bank's Board of Directors, its management and staff and employee unions on the other, laying out the restructuring goals. The agreement, while stating clearly the extent of government's involvement and the responsibilities of the bank, should also contain details of the bank's obligations to perform and report, precise milestones for performance and measures that will follow non-performance, treatment of NPAs and near term improvements in operating results. It would also be desirable to assign selected financial indices for the bank to follow within a timeframe. The performance under this agreement will have to be monitored closely.

77. The overall cost of restructuring the three banks over the next three years is estimated by the Working Group to be of the order of Rs. 5,500 crore. A purpose-wise break-up of the required amount is given below.

a.	Technology upgradation	Rs. 300-400 crore
b.	VRS	Rs. 1,100-1,200 crore
c.	NPA buyout	Rs. 1,000 crore
d.	For capital adequacy	Rs. 3,000 crore

The estimate could turn out to be inadequate if some hidden surprises surface or some delays or other roadblocks are encountered in the course of implementing the programme.

Systemic Restructuring

78. In order to ensure success in restructuring of weak banks, Government of India should also consider setting up of an independent agency, say, Financial Restructuring Authority (FRA), to co-ordinate and monitor the progress of the programme. It will represent the owner, in this case the Government of India and, vested with due authority from the government, be able to give the banks undergoing restructuring, guidance and instructions for proper implementation of the programme including course corrections wherever necessary. It will approve bank specific restructuring programmes, enter into agreements with individual banks covering the terms and conditions of the programmes and follow up its progress with the bank and other concerned agencies. Among other things, it will also act as an owner of the Asset Reconstruction Fund on behalf of the government and ensure its proper governance. It would be desirable to set up such an authority under an Act of the Parliament so that with the force of law behind it the FRA enjoys a distinct individuality. The FRA is not being conceived as a permanent body as it is expected that, with the completion of the restructuring process of the weak banks, it would have outlived the utility of its existence and would be wound up with the winding up of the ARF it will own.

79. It will facilitate the process substantially and help effective implementation of the restructuring programme if within the Reserve Bank of India, a special wing is formed for regulating and supervising weak banks. On a number of issues like deposit insurance, regulation of subsidiaries, risk management, disclosures and regulatory compliance, the treatment of weak banks would need to be different from those of much stronger normal banks. This arrangement would also help early detection of and attention towards weaknesses emerging in other banks pre-empting a systemwide spread of their problems.

80. Prolonged litigation prompted by legal lacunae in different commercial enactments is one of the main reasons for the increase in the size of the banks' NPAs. Some of these enactments are several decades old and, in quite a few cases, out of line with the present day realities. These provisions need to be amended urgently and some new enactments are called for in order to cater to the requirements of the changed and far more complex current economic and business environment.

81. Countries like Thailand and Malaysia which have undertaken extensive bank restructuring recently have within a short period enacted amendments to their bankruptcy laws and improved provisions for foreclosures and court procedures to ensure speedier enforcement of lenders' claims. Malaysia is also setting up specialised bankruptcy courts and steps have been taken there to plug loopholes that previously allowed borrowers to contract additional debts or dispose of their assets while restructuring was being worked out. Our problems are similar and it would be of great help to banks' efforts in managing their NPAs if comparable laws are suitably enacted/amended urgently.

82. DRTs have helped the recovery process of the banks only in a limited manner. Their functioning is under review. Till necessary amendments to the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, are made, steps should be taken to remove the administrative and infrastructural problems relating to the DRTs to improve and facilitate their effective functioning. Insofar as the recovery process of weak banks and the ARF is concerned, an arrangement may be worked out for the DRTs to attend to their cases on a priority basis.

83. The investigations into accountability both at the bank and at the level of non-bank agencies if completed in a time bound manner would go a long way in ending uncertainties and help in the overall improvement of morale of the staff. A time bound approach is absolutely necessary for creating appropriate conditions in banks in general and in weak banks in particular.

Concluding remarks

84. The restructuring programme will have to encompass operational, organisational, financial and systemic restructuring and must be implemented in a time bound manner. Any delay will add to the cost of the restructuring. The different measures suggested by the Group for financial, operational and systemic restructuring are a unified package and for results to be really achieved have to be implemented as such. A stage has reached when gradualism will not succeed and if resorted to may cause more harm than good. By adopting a pick and choose approach, not only a total effect expected from the package will be lost, but even the individual measures picked up for implementation would lose much of their efficacy.