Is the Reserve Bank of India toothless?

It is good that Reserve Bank of India (RBI) governor Urjit Patel has finally broken his long silence. Unlike his predecessors, Patel has been reticent in indicating the thinking of the central bank. While the interviews and speeches of governors and deputy governors work as powerful signalling and reassuring measures—both to the markets and to the general citizenry—the silence has also been an eerie signalling mechanism that was shaking our confidence. It is good now that there is some scope for debate and dialogue.

The governor's speech on 14 March at the Gujarat National Law University, Gandhinagar, highlights significant issues about the difference in regulation of public and private sector banks. The governor raised the issue of dual control over banks based on ownership issues. The problem is deeper than this. But while recognizing this, one is not sure that the current crisis could have been addressed in the framework suggested by Patel. He talked about powers to make board-level changes and forced mergers. Those powers are in the nature of deterrence and are too drastic to be curative in the current instance.

Let us break up the issue of dual control. This issue is not specific to public sector banks. Even in case of the cooperative banks, dual control was a festering issue, with the state governments, through the registrar of cooperative societies, having most of the powers that Patel alluded to. This is by virtue of the institutions being incorporated under The Co-operative Societies Act. This issue was addressed when Y.V. Reddy was the governor. The RBI was able to arrive at a regulatory framework for the cooperative banks. This was done through a memorandum of understanding with each state government which defined how the governance change and merger powers would be exercised in consultation with, and upon the recommendation of, the RBI. Therefore, pending deep reforms on the ownership and governance of public sector banks, there is a template for regulatory framework available. Deep reforms, as recommended by the P.J. Nayak committee, needs political will, which seems to be lacking every time.

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However, in the case of public sector banks, the problem of dual control is even deeper. In addition to ownership and governance-level control, there is also significant operational control that the Union finance ministry exercises. This control bypasses the boards. That is why one cannot hold the board residually responsible for the performance of the bank. A programme like the Pradhan Mantri Jan Dhan Yojana (PMJDY) is operationally guided by the ministry and bypasses the board-directed strategy. This is control on the banks through the tyranny of circulars, which doesn't affect private banks. Comparing the PMJDY numbers of private banks and their public sector peers is sufficient to make the point.

So, having identified that the framework for regulating public sector banks is different, can the governor cry victim, and does this let the RBI off the hook? Not really. How about exercising autonomy by suo motu recommending corrective action to the government if it has a problem with a specific bank? The government may not accept it, as it has not been accepting many of the recommendations of the central bank, but it would have at least done its duty.

Second, the governor is treading an even more dangerous path by pinning the blame on limited powers. Very much like the government exercising control through the board and through circulars, even the RBI has a board position in each public sector bank. Further, the RBI representative is on the management committee (that approves loans beyond a certain ticket size), the audit committee, the committee of directors (for reviewing vigilance cases) and the remuneration committee of each of these banks. So, not only does the RBI have regulatory oversight, it has board and sub-committee presence in each public sector bank, which should give the RBI much greater insights than it would get into a private bank.

Also, the RBI is party to the selection of the whole-time directors of the bank through the selection committee and through its membership on the Banks Board Bureau. The RBI has powers to remove the non-official directors appointed by the Union government as well as the shareholder directors if they do not fulfil the fit-and-proper criteria— section 3AB and 3B of the Banking Companies (Acquisition and Transfer of Undertakings) Act.

Moreover, the RBI has powers to appoint an additional director as per section 9A of the above Act. Theoretically, the RBI has a significant say in the constitution of the board of a public sector bank.

While there is a great deal of reform to be undertaken in the governance and management of public sector banks, the line that the governor has taken, of inadequate powers to act, may be untenable. The framework for the exercise of powers in private sector banks is different from the framework for public sector banks. This has to be recognized.

In the current instance, it would have been more honourable for the governor to own up the failure, and use this opportunity for deep reform, than play victim. That there is a crying need for reforming the governance structure of public sector banks is a valid point—but that is a matter for a separate debate.

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