To Our Readers

The East Asian crisis has necessitated a fresh impetus to stability and reforms in the financial sector. Prudential regulations by the Central Banks has been a major measure to combat fragility of the financial sector. Reserve Bank of India (RBI) has been continuously fine-tuning its regulatory and supervisory mechanism in recent years to match international standards.

Migration to new capital adequacy framework (Basel II) based on a three-pillar approach— minimum capital requirements, supervisory review, and market discipline, involves implementation challenges for both RBI and banks. RBI has taken a number of initiatives to make migration to Basel II norms a smooth affair. Banks have been advised to undertake a self-assessment of the existing risk management systems and to simultaneously initiate suitable measures to upgrade them to match to international standards. As per a study, the Indian banks, notably state-owned entities, will need Rs. 11,900 crore more capital for meeting operational risks alone, and may raise Rs. 18,000-20,000 crore in the medium term when they implement Basel II capital norms from March 31, 2007.

During the year 2003-04, the banking sector witnessed strong growth in deposits and advances. Aggregate deposits of scheduled commercial banks (SCBs) grew by 17.5 per cent compared to 13.4 per cent in 2002-03. Credit and investments by SCBs increased by 15.3 per cent and 25.1 per cent respectively in 2003-04 compared to 16.1 per cent and 23.3 per cent respectively in 2002-03. There was a significant decline in the non-performing assets (NPAs) of SCBs in 2003-04. The gross NPAs of SCBs declined from 4.0 per cent of total assets in 2002-03 to 3.3 per cent in 2003-04. The corresponding decline in net NPAs was from 1.9 per cent to 1.2 per cent. Both gross NPAs and net NPAs declined in absolute terms. While the gross NPAs declined from Rs. 68,717 crore in 2002-03 to Rs. 64,786 crore in 2003-04, net NPAs declined from Rs. 32,670 crore to Rs. 24,617 crore in the same period.

The Hon'ble Finance Minister, Mr. P. Chidambaram in the Union Budget for 2005-06 has proposed structural reforms in the banking sector focussed on better risk management. The removal of restrictions of caps on the floor ceiling limit of 25 per cent and 40 per cent in statutory liquidity ratio and cash reserve shall not only boost lending resources of the banks significantly but is expected to make banking sector more competitive.

The multiplicity of regulatory control over Urban Cooperative Banks (UCBs) by the RBI, central registrar of cooperative societies in the case of multi-state cooperative societies and the state registrar of cooperative societies is perhaps the most vexatious problem of urban cooperative banking sector in the country. The major weakness of the UCBs is that they often have to pay high interest rates to attract deposits – and the inevitable corollary is riskier, higher interest bearing assets. They also suffer from an inability to attract professionals. No wonder so many urban cooperative banks have faced serious problems in recent years. Perhaps, it is time to review the *raison d'etre* of the urban cooperative banking system, which has a deposit base of Rs. 110,000 crore and NPAs in excess of 20 per cent. However, reforming the urban cooperative banking sector is a very serious proposition and perhaps requires comprehensive legislative changes to enable the RBI to be sole regulator in this sector.

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