RBI can’t be on bank boards – Here is why

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More than one RBI Governor has expressed his discomfort with having central bank nominees on the boards of state-owned banks. Some have even wanted to wash their hands off regulation altogether, asking that the central bank's responsibilities be restricted to framing monetary policy and managing the currency, forex reserves and so on. However, media reports suggest the government is in no mood to accede to Governor Urjit Patel's request to there being no RBI representatives on banks' boards.

That is unfortunate. As a regulator, the central banks must have the right to decide whether or not it wants RBI executives to be directors on the boards of PSU banks. While the government may feel comfortable with an RBI presence on the boards, at what is undoubtedly a very difficult time for the banking sector, it is preferable RBI not appoint its nominees. The government owns the majority stake in these lenders and it must accept full responsibility for their functioning; it needs to appoint capable executives who can run the banks.

However, RBI must continue to inspect and oversee banks to ensure they are not flouting the rules and regulations. RBI cannot give up this supervisory responsibility and must arm itself with the necessary resources to be able to inspect the banks efficiently. It should also have the powers to remove a bank executive for any malpractices or mismanagement. It is, in fact, surprising that in all these years, the central bank never felt it necessary to ask banks to classify their exposures in a true and fair manner until Raghuram Rajan initiated the Asset Quality Review (AQR) in late 2015. It must surely have known that lenders were ever-greening accounts of business groups and should have immediately asked them to rectify matters. It is also surprising that the central bank failed to caution lenders on the unjustifiably large exposures to certain companies. It is possible that bankers were acting on instructions from New Delhi. But RBI should have red-flagged the serious discrepancies in the loan books of PSU banks.

Rajan was the first Governor to speak out against big promoters, calling some of them freeloaders and talking of how the sanctity of the debt contract had been eroded. He said the reason banks were compelled to charge higher interest rates was because the risk premium was so high. No Governor before him even broached the subject. Indeed, the rules relating to exposure to business groups and companies were way too lax and a big reason why banks have ended up with such large

NPAs. The consortium arrangement, which is clearly an inefficient way to lend, too, was not stopped by RBI. Neither did it red-flag the dangers of multi-banking.