

# Raghuram Rajan's prescription to avoid NPAs: Distance PSU banks from govt

In a note to a parliamentary panel on NPAs, RBI governor Raghuram Rajan was critical of both the UPA and NDA governments for their role in the bad loans mess

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Former RBI governor Raghuram Rajan.

**New Delhi:** Distancing state-run banks from the government, timely appointment of top executives and improving governance at these institutions through initiatives including the establishment of stronger boards are some of the policy measures prescribed by former Reserve Bank of India (RBI) governor Raghuram Rajan to prevent a build-up of non-performing assets (NPAs) in future.

Rajan, who submitted a note on non-performing assets in the Indian banking system to the parliamentary estimates committee led by Murli Manohar Joshi, was critical of both the Congress-led United Progressive Alliance, or UPA, and the Bharatiya Janata Party-led National Democratic Alliance, or NDA, governments for their role in the NPA crisis.

The note was published on the website of the University of Chicago's Booth school of business, where Rajan is a professor.

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“Public sector bank boards are still not adequately professionalized and the government, rather than a more independent body, still decides board appointments, with the inevitable politicization. The government could follow the P.J. Naik Committee report more carefully. Eventually, strong boards should be entrusted with all decisions but also held responsible for them,” Rajan said.

“There is absolutely no excuse for banks to be left leaderless for long periods of time, as has been the case in recent years,” he said.

Rajan pointed out that the dates of retirement of chief executive officers (CEOs) of banks are well known and the government should be well prepared with succession plans. “Indeed, it would be good for the old CEO and the successor to overlap for a few months while they exchange notes,” he said.

Rajan also voted for outside talent to be brought into top management of state-run banks as well as a rethink of the compensation structures keeping in mind external hires.

The former RBI governor also sought an improvement in the process of project evaluation and monitoring to lower the risk of project NPAs while flagging the NPA risks from government schemes such as Mudra and Kisan Credit Cards.

“The government should focus on sources of the next crisis, not just the last one. In particular, the government should refrain from setting ambitious credit targets or waiving loans. Credit targets are sometimes achieved by abandoning appropriate due diligence, creating the environment for future NPAs. Both Mudra loans as well as the Kisan Credit Card, while popular, have to be examined more closely for potential credit risk,” Rajan said. The former RBI governor said the central bank probably could have raised more red flags about the quality of lending.

“What could the regulator have done better? It is hard to offer an objective self-assessment. However, the RBI should probably have raised more flags about the quality of lending in the early days of banking exuberance. With the benefit of hindsight, we should probably not have agreed to forbearance, though without the tools to clean up, it is not clear what the banks would have done,” Rajan said, adding that probably the Insolvency and Bankruptcy Code should have been more rapid.

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