

Final Report of Advisory Group on Banking Supervision released

June 6, 2001

The Advisory Group on Banking Supervision has recommended that the Reserve Bank of India may urgently consider the desirability of introducing and participating in a scheme of formalised coordination between different regulators. It has also recommended designation of one of the regulators involved as a primary regulator and coordinator with clearly assigned roles and responsibilities.

The Advisory Group was set up by the Standing Committee on International Financial Standards and Codes. The Standing Committee under the Chairmanship of Dr. Y. V. Reddy, Deputy Governor, Reserve Bank of India with Secretary (Economic Affairs) Government of India as Alternate Chairman had set up ten such advisory groups in order to identify and monitor developments in global standards and codes in different subject areas, consider aspects of applicability of these standards to Indian financial system, periodically review the status.

The Advisory Group on Banking Supervision had Shri M. S. Verma, Chairman, Telecom Regulatory Authority of India as the chairman with S/Shri Janki Ballabh, Chairman, State Bank of India, K. R. Ramamoorthy, Chairman, Vysya Bank and H. N. Sinor, Managing Director, ICICI Bank as members.

The broad framework for the working of the Group included:

- (i) Study of the present status of applicability and relevance as well as compliance in India of the relevant standards and codes;
- (ii) Study of the feasibility of compliance and the timeframe within which this can be achieved, given the prevailing legal and institutional practices in India;
- (iii) Comparing the levels of adherence in India vis-à-vis industrialised countries and also emerging economies particularly to understand India's position and to prioritise action on some of the more important codes and standards; and
- (iv) Chalking out a course of action for achieving the best practices.

The first part of the Report was submitted in September 2000. The Report covered areas relating to corporate governance, bank transparency, supervision of cross-border banking and banks' internal rating systems. In its final report, submitted on May 29, 2001, the Group has assessed the level of compliance in India vis-à-vis the principles/ standards detailed in the 16 papers on the subject of banking regulation and supervision brought out by the Basel Committee on Banking Supervision of the Bank for International Settlements. The Group's assessment has been categorised under the following headings:

- (a) Core Principles for Effective Banking Supervision
- (b) Corporate Governance
- (c) Internal Control
- (d) Management of Credit Risk
- (e) Loan Accounting, transparency and disclosures
- (f) Financial Conglomerates
- (g) Cross-border Banking

While making its assessment in regard to the Indian position, the Group has concluded that given the level of complexity and development of Indian banking sector, the level of compliance with the standards and codes is of a high order. It has, however, pointed out a number of areas in which improvements are called for. In the areas of corporate

governance, internal control and management of risks, the Group has looked hard at the present practices and found certain urgent changes to be necessary. The most important recommendation in respect of corporate governance relates to the constitution of the boards and their accountability. In regard to the risk management, the Group has concluded that the current situation calls for greater orientation of the banks' management and their boards towards a better understanding of the risks and their management. In the opinion of the Group, the banks are handicapped in implementing a reliable credit rating and other risk management systems due to (a) lack of qualified personnel, (b) absence of reliable high frequency historical data, and (c) lack of proper appreciation of risks management concepts at the middle and senior management levels. Similarly, in regard to loan accounting and credit risk management, the Group has recommended that the formulae based system of classification and provisioning should give way to a more closer to reality assessment of the realisability of assets, relying on a risk-assessment based system.

For the purpose of providing an integrated view, the earlier report has been merged with the present Report. In accordance with the terms of reference of the Standing Committee, it has been decided to make these reports available to the public for wider discussion. The full text of the Report of the Advisory Group on Banking Supervision has been placed on the RBI website www.rbi.org.in

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