

# Regulatory Governance and Financial Stability: A Critical Analysis of Banking Law Reforms in India

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## Abstract:

This paper examines how India's banking-law reform trajectory sought to reconstitute regulatory governance, the institutional, procedural, and legal arrangements by which banking is licensed, supervised, disciplined, and resolved, in pursuit of financial stability. The central claim is that post-1991 reforms in India did not merely "liberalize" banking; they attempted to *recode* the legal foundations of prudential oversight from a directed-credit and fiscally subordinated banking model to one increasingly anchored in risk-sensitive capital norms, classification/provisioning discipline, and specialized enforcement and restructuring mechanisms. This shift is visible in the doctrinal architecture of committee recommendations, most notably the first Narasimham Committee (1991) and the second Narasimham Committee (1998), and in the subsequent layering of statutory and quasi-statutory instruments governing supervision, asset quality, and bank distress.

**Keywords:** Banking Law Reforms in India; Regulatory Governance; Financial Stability; Prudential Regulation; Narasimham Committee Reforms.

## INTRODUCTION

The first Narasimham Committee (1991) framed the key diagnosis: the banking system's profitability and balance-sheet integrity were impaired by (i) high statutory pre-emption of resources (SLR/CRR) and directed credit, (ii) weak capital and weak provisioning, (iii) opacity in accounting/disclosure, and (iv) slow legal recovery processes. Its prescriptions foreshadowed the prudential turn: phased reduction of SLR toward a prudential minimum (25%), progressive reduction of CRR, phased capitalization to match international "BIS norms," and explicit recognition that non-performing assets should not yield income recognition under accrual accounting. The Committee also proposed institutional measures to accelerate recoveries, including "special tribunals," anticipating later legislative developments in debt recovery.<sup>1</sup>

The second Narasimham Committee (1998) can be read as a refinement and deepening of prudential governance. It insisted on strict adherence to NPA definitions and condemned "ever-greening"; it recommended stronger capital buffers (raising minimum CRAR to 10%) given developing-economy volatility and legal impediments; and it advanced an institutional idea of supervision distinct from monetary policy, proposing evolution from the Board for Financial Supervision (BFS) model toward a more autonomous and professionally constituted supervisory board (BFRS concept). It also proposed measurable stability targets for NPA reduction (net NPAs below 5% by 2000 and 3% by 2002 for all banks).<sup>2</sup>

A critical governance inflection in the 1990s was the creation of the BFS through the *Reserve Bank of India (Board for Financial Supervision) Regulations, 1994*, which formalized supervisory/inspection functions inside the central bank's architecture. This institutional move embedded supervision into a rule-based committee structure chaired by the Governor, with defined membership and competence over banking companies, financial institutions, and non-bank institutions.<sup>3</sup>

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<sup>1</sup> M. Narasimham et al., *Report of the Committee on the Financial System* (Reserve Bank of India, Nov. 1991).

<sup>2</sup> M. Narasimham et al., *Report of the Committee on Banking Sector Reforms* (Apr. 1998).

<sup>3</sup> *Reserve Bank of India (Board for Financial Supervision) Regulations, 1994* (Gazette of India, Extraordinary).

From the early 2000s, India's stability strategy increasingly addressed the "stock problem" of stress through mechanisms for enforcement and restructuring. Statutorily, the *Recovery of Debts Due to Banks and Financial Institutions Act, 1993* (now styled as the Recovery of Debts and Bankruptcy Act) created dedicated tribunals to expedite bank debt recovery, reflecting Narasimham-era concerns about judicial delay. The *Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002* (SARFAESI) similarly created a legal infrastructure for securitisation/asset reconstruction, including regulation of asset reconstruction companies. Quasi-statutorily, the *Corporate Debt Restructuring (CDR)* framework (initiated via RBI guidelines) institutionalized a coordinated, out-of-court restructuring mechanism for multiple-bank exposures, and its governance design explicitly incorporated industry bodies such as the Indian Banks' Association (IBA) in core-group arrangements.<sup>4</sup>

India's reform arc also reflects a progressive convergence (not identity) with global prudential standards. Internationally, Basel I (1988) established a credit-risk centric minimum-capital framework for internationally active banks; Basel II (2004) expanded risk sensitivity via the three-pillar structure; Basel III responded to the global financial crisis with stronger capital definitions and liquidity standards, including the Liquidity Coverage Ratio (LCR) released in 2013. India's Basel III transition was legally operationalized through RBI prudential instruments (master circulars/guidelines) that took effect from April 1, 2013 in a phased manner.<sup>5</sup>

The paper's critique is that, although India's reforms significantly strengthened micro-prudential governance (capital, classification/provisioning, supervisory organization), the legal arrangements for resolution and systemic stability remained fragmented. While the Banking Regulation Act contained mechanisms such as moratorium and schemes for reconstitution/amalgamation (Section 45), these were not equivalent to the post-crisis "special resolution regimes" that emerged in the UK (Banking Act 2009) and the US (Dodd-Frank 2010). The UK's Banking Act 2009 explicitly conceptualized a special resolution regime with stabilisation options and dedicated bank insolvency/administration procedures; the US Dodd-Frank Act explicitly announced an end to "too big to fail" bailouts and reorganized accountability and resolution architectures for systemic risk.<sup>6</sup>

Finally, this paper argues that legal reform proposals should prioritize: (i) clearer statutory separation of supervisory and monetary functions while preserving coordinated information flows; (ii) a dedicated bank resolution regime with transparent triggers and tools; (iii) stronger governance reforms for public-sector banks to reduce political interference, an issue repeatedly diagnosed in Narasimham I.

## SCOPE AND METHOD

**Assumptions and scope.** This paper assumes an intended length of ~5,000–8,000 words because the request does not specify a shorter format. The jurisdictional focus is India. The temporal scope is limited to reforms, statutes, and official/academic materials published (inclusive), treated as the boundary year for Basel III implementation in India and for the Banking Laws (Amendment) Act, 2012 (enacted as Act No. 4 of 2013).<sup>7</sup>

**Research design.** The paper is primarily doctrinal and institutional: it reads statutes (Banking Regulation Act; SARFAESI; DRT/RDB Act; DICGC Act), official committee reports (Narasimham I & II; BFS Regulations), and prudential instruments and global benchmarks (Basel texts), and interprets them through the lens of regulatory governance and financial stability.

**Empirical posture.** Because this paper is constrained to publications and the RBI's "Trend and Progress" series is not uniformly accessible through the same archival route, empirical illustration is used selectively

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<sup>4</sup> Reserve Bank of India, *Corporate Debt Restructuring (CDR) Framework* (RBI circular, 23 Aug. 2001) and related revised guidelines.

<sup>5</sup> Reserve Bank of India, *Master Circular – Basel III Capital Regulations* (1 July 2013).

<sup>6</sup> *Banking Act 2009* (United Kingdom).

<sup>7</sup> *The Banking Laws (Amendment) Act, 2012* (India), No. 4 of 2013 (5 Jan. 2013).

and anchored in official reports that are accessible in this corpus, including the RBI's statutory publications and earlier Trend & Progress data.<sup>8</sup>

## HISTORICAL EVOLUTION OF BANKING LAW IN INDIA

India's banking law framework developed through layered statutory interventions that progressively redefined (i) what a "bank" could do, (ii) how it would be supervised, and (iii) how bank distress would be handled. The Banking Regulation Act, 1949 established the core legal skeleton for banking regulation, including RBI powers over licensing, control, and, in cases of distress, reconstruction or amalgamation. While this paper does not attempt a section-by-section exegesis, it is conceptually important that a stability-oriented power exists in Section 45, enabling RBI to apply for suspension of business and prepare schemes of reconstitution/amalgamation.

The **post-nationalisation era** (notably via the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970) created a banking structure where public ownership and public policy objectives were integrated into banking governance and credit allocation. This model, later scrutinized in the Narasimham reform discourse, produced tensions between distributive aims and prudential balance-sheet integrity.

By the early 1990s, the legal-economy context shifted: macroeconomic stabilization and structural adjustment policies were adopted in 1991–92, and international financial integration pressures intensified. IMF accounts of India's adjustment program in 1991 emphasize stabilization measures in a context of balance-of-payments stress; World Bank analyses similarly locate "bold steps" of reform in response to the 1991 crisis and subsequent reform agenda.<sup>9</sup> That macroeconomic setting directly influenced banking law reforms because India's banking system, dominant in financial intermediation, was both an instrument of policy and a point of systemic vulnerability.<sup>10</sup>

The Narasimham I report (1991) marks the doctrinal pivot: it treated banking reform not as a narrow technical shift but as a governmental project to secure operational flexibility, functional autonomy, and prudential discipline. It explicitly identified directed investments and directed credit as drivers of productivity decline and profitability erosion, and warned that deterioration in financial health could undermine depositor confidence.

## BANKING LAW REFORMS

The reform trajectory is best understood as *sequenced legal layering* rather than a single statute: committee recommendations articulated policy blueprints; RBI circulars and master directions operationalized prudential norms; and Parliament enacted targeted statutes to address recovery, securitization, and governance gaps.

## REFORM TIMELINE

The following table compresses a complex reform trajectory into a legally legible sequence.

| Period | Reform node                | Instrument and legal form                                 | Intended stability channel  |
|--------|----------------------------|---|---|
| 1991   | First-generation blueprint | Narasimham Committee I Report (official committee report) | Reduce fiscal pre-emption (SLR/CRR), improve capital/provisioning, enforce NPA recognition, accelerate recovery |

<sup>8</sup> Reserve Bank of India, *Report on Trend and Progress of Banking in India 2009–10* (RBI statutory report, year ended June 30, 2010).

<sup>9</sup> International Monetary Fund, "The Adjustment Program of 1991/92 and Its Initial Results in India" (IMF publication).

<sup>10</sup> International Bank for Reconstruction and Development / World Bank, *Structural Adjustment in India* (World Bank document).

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|---------|--|---|--|
| 1993    | Bank debt recovery tribunals                             | Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (statute)   | Faster adjudication/recovery to reduce NPA persistence and improve balance-sheet health                |
| 1994    | Supervisory institutionalization                         | RBI (Board for Financial Supervision) Regulations, 1994 (gazetted regulations under RBI Act)                            | Formalize supervision/inspection governance within RBI architecture                                    |
| 1998    | Second generation: capital + asset quality + supervision | Narasimham Committee II Report (committee report)   | Higher capital buffers, strict NPA definition, supervisory redesign, measurable NPA targets            |
| 2001–02 | Coordinated restructuring and enforcement                | RBI CDR guidelines (quasi-statutory), SARFAESI Act 2002 (statute)   | “Going concern” restructuring + secured creditor enforcement + asset reconstruction infrastructure     |
| 2009–10 | Post-GFC resilience framing                              | RBI Trend & Progress Report 2009–10 (statutory report)  | Evaluate stability performance; support prudential tightening and institutional coordination discourse |
| 2012–13 | Governance and Basel III transition                      | Banking Laws (Amendment) Act 2012 (No.4 of 2013); RBI Basel III implementation instruments effective from April 1, 2013 | Strengthen RBI powers; raise prudential standards consistent with post-crisis Basel agenda             |

### **NARASIMHAM I: FROM DIRECTED BANKING TO PRUDENTIAL GOVERNANCE**

Narasimham I proposed a legal-economic rebalancing: SLR should be reduced in a phased manner to 25% (explicitly reframing SLR as prudential rather than a device for financing the public sector), and CRR should be progressively reduced to enhance RBI’s flexibility and shift emphasis toward open market operations as interest rates deregulate. The Committee also recommended that banks should reach minimum capital adequacy milestones consistent with “BIS standards” (4% by March 1993, and 8% by March 1996), signalling early normative importation of international prudential expectations into domestic banking governance.

Crucially, Narasimham I treated accounting rules as stability rules: it recommended that income should not be recognized on non-performing assets under accrual accounting, and it proposed a classification system of assets into standard/sub-standard/doubtful/loss for provisioning with specified provisioning intensities. This is significant doctrinally: it recasts prudential regulation as a law-like discipline of truth-telling in balance sheets (income recognition, provisioning, disclosure), rather than a purely supervisory discretion.

Finally, it linked NPA governance to the legal system: due to delays in recoveries and enforcement of security, it recommended special tribunals and overdue legislation to speed recovery. This proposition anticipates later parliamentary statutes creating specialized recovery forums.

### **NARASIMHAM II: HIGHER CAPITAL, STRICT NPA DISCIPLINE, SUPERVISORY REDESIGN**

Narasimham II is explicit that prudential rules must fit developing economy conditions. It notes that capital adequacy ratios in developing countries may need to be set at higher levels than in developed economies due to volatility, legal impediments to recovery, and weaknesses in accounting practices. Based on these considerations it recommends raising the minimum CRAR to 10%.

On NPAs, Narasimham II normalizes legal realism: it notes that NPA figures can be understated if government-guaranteed advances that would otherwise be NPAs are excluded; it insists on strict adherence to NPA definitions “in spirit,” condemns evergreening, and proposes explicit NPA reduction targets (net NPAs below 5% by 2000 and 3% by 2002 for all banks).

Institutionally, Narasimham II critiques the partial separation of supervision and regulation within RBI and proposes an integrated regulation/supervision system with clearer separation from monetary policy functions; it suggests renaming/reshaping BFS into a Board for Financial Regulation and Supervision (BFRS) with statutory powers and professional autonomy, while maintaining coordinated functioning with the central bank.

### **DEBT RESTRUCTURING AND NPA MANAGEMENT: CDR, TRIBUNALS, SECURITISATION**

India's NPA governance relied on a mixed toolkit, combining tribunal-based recovery, secured-creditor enforcement, and coordinated restructuring.

The DRT/RDB model. The 1993 recovery statute establishes tribunals for expeditious adjudication and recovery of debts due to banks and financial institutions. While this law is not a complete insolvency system, it represents a targeted legal solution to the delay problem identified earlier: faster adjudication and recovery are treated as stability-enhancing because they limit the persistence of bad assets and improve recoveries.

The CDR model. The RBI's CDR framework is explicitly framed as an out-of-court restructuring mechanism for viable corporates with multiple banking arrangements, designed to operate outside the purview of BIFR/DRT and similar proceedings. Revised guidelines on CDR governance describe the Standing Forum/Core Group architecture and show the institutionalized participation of the Indian Banks' Association, reflecting a hybrid governance model where regulatory guidance and industry coordination are interlocked. This hybrid design matters for regulatory governance because it embeds private ordering (inter-creditor arrangements) within an RBI-recognized structure, raising questions of accountability and fairness.

The SARFAESI/ARC model. SARFAESI created a statutory infrastructure for securitisation, reconstruction, and enforcement of security interest, including registration and regulation of asset reconstruction companies.<sup>11</sup> RBI guidance on securitisation/reconstruction emphasizes fairness, transparency, and checks and balances when securitisation/reconstruction companies take measures such as change in management under SARFAESI powers. These norms represent a legal attempt to reconcile creditor enforcement with procedural legitimacy, an essential element of stability governance, because enforcement without legitimacy can produce systemic confidence shocks.

### **BANKING LAWS (AMENDMENT) ACT 2012: GOVERNANCE-STRENGTHENING**

The Banking Laws (Amendment) Act, 2012 (enacted as No. 4 of 2013) further amended core banking statutes including the Banking Regulation Act, the State Bank of India Act, and banking nationalization acts. Official summaries of the reform stress that the Bill/Act aimed to strengthen RBI's regulatory powers and to enable nationalized banks to raise capital through instruments such as preference shares, rights issues, and bonus shares, and to revise authorized capital mechanisms with governmental and RBI approvals.<sup>12</sup>

Conceptually, this legal move can be read as a *governance-capital interface*: it aims to make bank governance more resilient by enabling higher-quality capitalization pathways, directly relevant to stability in a Basel III transition context.

### **EXTERNAL INFLUENCES: IBRD/IMF AND THE REFORM EPISTEMIC COMMUNITY**

The relationship between domestic legal reform and international policy influence is visible in the macroeconomic reform context of 1991–92. IMF analyses of India's adjustment strategy in mid-1991 describe stabilization elements designed to restore macroeconomic balance. World Bank analyses similarly interpret the early 1990s as a structural adjustment period in which openness, fiscal revision, and reforms followed a liquidity crisis, shaping the policy environment in which banking reforms were advanced.

In the banking sector specifically, scholarly syntheses (e.g., UNESCAP work) identify concrete policy changes, such as reductions in reserve requirements and reforms to prudential and competitive conditions, as part of India's banking reforms since 1991. This is not to claim a simple conditionality story; rather, international institutions and transnational norms (Basel) helped constitute the epistemic vocabulary of

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<sup>11</sup> *The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002* (India).

<sup>12</sup> Ministry of Finance, *Salient Features of Banking Laws (Amendment) Bill 2012* (press note, Dec. 2012).

“capital adequacy,” “risk weights,” and “prudential norms,” which then became embedded in Indian legal/regulatory instruments.

## INSTITUTIONAL GOVERNANCE AND SUPERVISORY ARCHITECTURE

A key insight of the Narasimham reports is that financial stability outcomes depend not only on rules but on the governance machinery that makes rules credible: macro-policy framing, supervisory capacity, enforcement legitimacy, and the political economy of public ownership.

### CORE INSTITUTIONS AND THEIR STABILITY ROLES

The central institutional triangle in Indian banking governance comprises:

- **Reserve Bank of India:** prudential regulator and supervisor; issuer of master circulars and prudential guidance; statutory reporting entity; institutional locus of BFS supervision. The RBI’s statutory purpose includes securing monetary stability and operating the currency and credit system to national advantage, as reflected in its own statutory reporting discourse.
- **Government of India and Ministry of Finance:** legislative and policy authority in banking law (including bank nationalization and amendment legislation), and key actor in bank recapitalization and governance reforms (a major theme in Narasimham II’s discussion of recapitalization costs).<sup>13</sup>
- **Deposit Insurance and Credit Guarantee Corporation:** deposit insurance institution established under statute to insure deposits payable in India in bank failure conditions, providing a baseline stability backstop for depositor confidence.

This structure is complemented by other regulators and entities relevant to systemic oversight (e.g., **Securities and Exchange Board of India**), especially as financial conglomeration and market-based intermediation deepen, an issue explicitly acknowledged in Narasimham II’s emphasis on regulatory coordination and avoidance of “crossing of wires.”

### THE BFS MODEL: INSTITUTIONALIZING SUPERVISION INSIDE THE CENTRAL BANK

The RBI (Board for Financial Supervision) Regulations, 1994 created the BFS as a committee (Governor as Chair; Deputy Governors; four central board directors) and vested it with supervision and inspection functions under the RBI Act and the Banking Regulation Act across banking companies, financial institutions, and non-banking institutions. The regulations also contemplate a Department of Supervision reporting directly to the Board and allow external personnel to be engaged, signaling an institutional attempt to professionalize supervisory capacity.<sup>14</sup>

From a regulatory governance standpoint, BFS is significant because it formalizes decision structures and reporting obligations; however, Narasimham II’s critique suggests that this internalization did not fully resolve structural tensions between supervision/regulation and monetary policy functions, motivating recommendations toward greater autonomy and statutory empowerment of the supervisory board.

### INDUSTRY BODIES AND “COORDINATED PRIVATE ORDERING”

The CDR architecture provides a clear example of **governance by hybridization**, where RBI-guided frameworks rely on industry coordination to create effective collective action among creditors. The revised CDR guidelines explicitly embed the **Indian Banks’ Association** within the CDR Core Group structure, alongside major banks and financial institutions, to support policy decision-making for restructuring.

This form of governance can reduce coordination failures, but it also raises jurisprudential questions: Does such an arrangement sufficiently protect minority creditors, borrowers, and systemic transparency? The reform debate reflects awareness of these questions, but the legal architecture largely remains circular-based rather than statute-based, an issue relevant to accountability.

### FINANCIAL STABILITY TOOLS AND OUTCOMES

This section maps the principal legal mechanisms for stability in India and assesses their coherence and limits. It also embeds a comparative perspective with Basel/UK/US standards.

<sup>13</sup> *The Deposit Insurance and Credit Guarantee Corporation Act, 1961* (India).

<sup>14</sup> Reserve Bank of India, *Annual Report 2012–13* (2013).

## CAPITAL ADEQUACY AND MARKET DISCIPLINE

Domestic prudential turn. Narasimham I's capital recommendations explicitly referenced international "BIS standards," embedding minimum capital adequacy benchmarks into India's reform discourse. Narasimham II subsequently argued for *higher* capital adequacy requirements in developing economies and recommended increasing minimum CRAR to 10%.

**Basel convergence.** Basel I (1988) framed minimum capital as a convergence project to strengthen stability and reduce competitive inequality, and defined a two-tier capital structure (Tier 1 core equity/reserves; Tier 2 supplementary capital). Basel II (2004) formally reorganized capital regulation into a more risk-sensitive structure (famously associated with the three-pillar approach) and consolidated the revised framework in the June 2004 text. Basel III (2010) explicitly responded to the global financial crisis by strengthening capital and resilience; the Basel Committee subsequently released liquidity standards including the Liquidity Coverage Ratio to promote short-term liquidity resilience by requiring a stock of high-quality liquid assets. India's Basel III transition. RBI instruments (master circulars) indicate Basel III capital regulations were implemented in India with effect from April 1, 2013 in a phased manner. The legal form here matters: Basel standards are "soft law" internationally, but become "harder" domestically when translated into RBI master circulars and compliance obligations. This translation mediates sovereignty: India retains discretion for calibration, but accepts the vocabulary and architecture (e.g., CET1/Tier1/Total capital, buffers) as the baseline grammar of stability.

## LIQUIDITY GOVERNANCE: SLR/CRR AND THE SHIFT FROM FISCAL PRE-EMPTION

Narasimham I treated liquidity requirements as a dual-use instrument: SLR should be restored to a prudential role rather than a primary financing channel for the public sector, and CRR should be reduced to enhance RBI's monetary policy flexibility and to shift toward open market operations under interest rate deregulation. Scholarly accounts of India's banking reforms similarly emphasize reserve requirement reductions as a key reform vector across the 1990s.<sup>15</sup>

From a stability perspective, the doctrinal significance is that liquidity is treated as a *governance lever* to reduce crowding-out and to encourage market-based policy transmission, while also acknowledging that sudden deregulation without macro balance could encourage excessive lending to risky borrowers (a concern explicitly articulated in the Narasimham I summary discussion of interest rate deregulation risks).

## ASSET QUALITY DISCIPLINE: IRAC NORMS, NPA DEFINITION, AND PROVISIONING

India's stability regime depends critically on the legal discipline of classifying assets, recognizing loss, and provisioning appropriately. Narasimham I proposed a definitional rule for NPAs (interest past due beyond 180 days at the balance-sheet date) and proposed structured provisioning, including 10% general provision for sub-standard assets and full provisioning for loss assets, with phased transition. Narasimham II reinforced strict adherence to NPA definitions and condemned evergreening, arguing that definitional relaxation would understate NPAs and weaken provisioning discipline.

The governance logic is that *accounting discretions become systemic risk channels*: if banks can delay recognition, they can also delay recapitalization, thereby allowing systemic fragility to accumulate invisibly.

## RESOLUTION AND DEPOSITOR PROTECTION: STATUTORY POWERS AND THEIR LIMITS

**Bank reconstruction/amalgamation power.** Section 45 of the Banking Regulation Act authorizes RBI to apply for suspension of business and to prepare a scheme of reconstitution or amalgamation.<sup>16</sup> This mechanism is a core banking-law stability tool: it provides a legal pathway for administrative resolution-like actions even in the absence of a modern SRR statute.

**Deposit insurance.** The Deposit Insurance and Credit Guarantee Corporation Act, 1961 is a legal foundation for deposit insurance and credit guarantee functions. Deposit insurance supports stability by reducing

<sup>15</sup> United Nations Economic and Social Commission for Asia and the Pacific, S. Shirai, "Banking Sector Reforms in India and China" (UNESCAP, 2002).

<sup>16</sup> *The Banking Regulation Act, 1949* (India), Section 45 (reconstruction/amalgamation power framework).

depositor run incentives, but its effectiveness depends on coverage design, payout speed, and credibility, dimensions not fully analyzed here due to the sourcing constraint.

### ENFORCEMENT AND RESTRUCTURING: DRT, SARFAESI, CDR

The debt recovery statute (1993) and SARFAESI (2002) can be seen as complementary: DRTs provide adjudicatory pathways; SARFAESI provides enforcement mechanisms and supports asset reconstruction infrastructure. The RBI's guidance stressing fairness in SC/RC action under SARFAESI indicates a regulatory recognition that enforcement must be constrained by rule-of-law values to maintain legitimacy. CDR's out-of-court mechanism adds a third channel: collective restructuring to preserve viable firms while minimizing creditor losses.

### EMPIRICAL INDICATORS

This paper does not attempt a full econometric evaluation. Still, official reporting provides suggestive indicators of how the prudential turn translated into measurable stability metrics.

The RBI's Trend & Progress report for 2009–10 emphasizes that the Indian banking system withstood the global financial crisis pressures and analyzes financial soundness indicators such as CRAR and NPAs. It reports CRAR levels in the mid-teens for scheduled commercial banks in that period and discusses NPA ratio trends as part of financial soundness assessment.<sup>17</sup>

Earlier, Narasimham II reports that for public sector banks as a group, net NPAs declined from 14.5% in March 1994 to 9.2% in March 1997, while emphasizing wide variation across banks and the persistence of a backlog problem. These numbers, while dated relative, illustrate the reform trajectory's measurable intent: NPA governance was not merely rhetorical but treated as a quantifiable stability target.

### COMPARATIVE PERSPECTIVE: BASEL, UK, AND US

To situate India's legal trajectory, it is useful to compare how jurisdictions operationalized *resolution* and *supervisory architecture* following the same crisis experiences and international norms.

| Dimension                          | India   | UK  | US   |
|------------------------------------|---|---|--|
| Resolution legal core              | BR Act contains moratorium and schemes for reconstitution/amalgamation (Section 45); deposit insurance under DICGC Act    | Banking Act 2009 establishes a "special resolution regime" with stabilisation options and dedicated bank insolvency/administration procedures | Dodd-Frank Act explicitly aims to promote financial stability, end "too big to fail," and reorganize accountability and transparency |
| Supervisory architecture evolution | BFS formalized within RBI by 1994 regulations; Narasimham II proposes further separation/empowerment of supervisory board | Financial Services Act 2012 reconfigures UK regulatory architecture including PRA and FCA within a post-FSA "twin peaks" style design         | Post-crisis reform through Dodd-Frank with systemic-risk instruments and regulatory restructuring                                    |
| Basel integration                  | Basel rules translated through RBI master circulars; Basel III phased from Apr 2013                                       | Basel implemented through UK regulatory framework; post-crisis institutional reorganizations culminate by 2013                                | Basel interacts with multi-agency US regime; Dodd-Frank sets   |

<sup>17</sup> S. Banerjee, "Basel I and Basel II Compliance: Issues for Banks in India," Working Paper No. 68 (Madras School of Economics, 2012).

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|  |  |  | stability purpose<br>and broader<br>reforms |
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Two comparative observations follow:

1. India's resolution toolkit was legally present but not systematized into a single SRR statute. The UK expressly designed a special resolution regime in 2009.<sup>18</sup> India relied on a combination of Banking Regulation Act powers (including Section 45), deposit insurance, and ad hoc approaches, in addition to recovery and enforcement statutes.<sup>19</sup>
2. Institutional redesign after crisis was more explicit in the UK/US. The UK's Financial Services Act 2012 explicitly reorganized regulators (PRA/FCA) and amended foundational acts, with the reorganized framework operational. The US Dodd-Frank Act explicitly states systemic stability aims and attempts to end "too big to fail."<sup>20</sup> India's institutional debate appears in Narasimham II's recommendations (e.g., BFRS concept), but full statutory reorganization was still emergent boundary.

### CRITIQUE AND REFORM AGENDA

A critical analysis of regulatory governance and stability in India must distinguish between micro-prudential strengthening (where reforms were substantial) and systemic resolution design (where legal coherence remained comparatively underdeveloped).

### STRENGTHS

First, India's reforms show a clear doctrinal movement toward balance-sheet truthfulness: Narasimham I's transition logic, from accrual income recognition to non-recognition for NPAs and structured provisioning, represents a governance shift from administrative discretion to rule-based valuation discipline. Narasimham II's condemnation of evergreening underscores the importance of enforcement and supervisory vigilance as stability tools.

Second, institutionalizing supervision through the BFS regulations embedded supervision into a more formal governance mechanism within the central bank, reducing the vagueness of supervisory authority.

Third, the "stock problem" of NPAs was addressed via multiple legal channels: specialized recovery tribunals, securitisation/asset reconstruction statutes, and coordinated restructuring frameworks.<sup>21</sup>

### STRUCTURAL WEAKNESSES AND UNRESOLVED TENSIONS

Fragmented resolution architecture. Section 45 (BR Act) provides an RBI pathway for suspension and schemes, and deposit insurance provides a depositor backstop, but these do not compose a modern, transparent SRR framework with clearly articulated resolution tools and triggers comparable to the UK's Banking Act 2009. The absence of a single SRR statute risks ad hocism, which can elevate uncertainty during distress and thereby amplify systemic risk.

Supervision vs monetary policy functions. Narasimham II's critique suggests that simply creating BFS did not fully resolve the institutional tension between supervision/regulation and monetary policy within the central bank. The proposed BFRS design expresses a governance desire: supervision should be professional, autonomous, and not structurally entangled with monetary policy formulation.

Hybrid restructuring governance and accountability. CDR's hybrid structure addresses coordination failure but raises concerns about transparency, distributive fairness, and potential capture. Its governance design

<sup>18</sup> P.C. Bhattacharya, "Aspects of Banking Sector Reforms in India," *Economic and Political Weekly* (2001).

<sup>19</sup> *The Recovery of Debts Due to Banks and Financial Institutions Act, 1993* (India) (also styled as the Recovery of Debts and Bankruptcy Act).

<sup>20</sup> Federal Deposit Insurance Corporation (compilation), *Dodd-Frank Wall Street Reform and Consumer Protection Act* (United States, 2010).

<sup>21</sup> Basel Committee on Banking Supervision, *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools* (Jan. 2013).

explicitly integrates industry bodies such as IBA, which may be efficient but can blur lines between regulated entities and governance architects.

Capital and governance interface in public-sector banking. Narasimham reports repeatedly identify governance quality and political interference as drivers of poor banking performance. The Banking Laws (Amendment) Act 2012's focus on enabling capital raising pathways is helpful, but capital instruments cannot substitute for governance reforms that prevent repeated risk accumulation.

## RECOMMENDATIONS FOR LEGAL REFORM

Within the constraints of the 2013 time horizon, and drawing on the reform logic embedded in Narasimham II and comparative regimes, the following proposals emerge:

1. **Enact a dedicated special resolution regime for banks.** India's BR Act powers are significant but dispersed and not structured as a dedicated SRR statute. A single resolution statute should define triggers, allocate powers, and specify stabilization tools coherently, while coordinating with deposit insurance and tribunal/enforcement systems. The UK's Banking Act 2009 offers a statutory design template that can be adapted to Indian constitutional and institutional realities.
2. **Clarify supervisory governance and accountability mechanisms.** The BFS regulations formalize supervision, but Narasimham II's proposal points to the need for deeper institutional separation of monetary policy formulation from supervision/regulation, while maintaining coordination. This could be pursued either through a reconstituted supervisory board with statutory authority (echoing the BFRS concept) or through clearer statutory firewalls and reporting duties.
3. **Strengthen legal incentives against disguised stress (evergreening).** The most stability-damaging behavior is often legalistic compliance with the letter but defiance of the spirit. Narasimham II's critique suggests enforcement tools should penalize misclassification and incentivize truthful recognition.
4. **Formalize restructuring governance safeguards.** If coordinated private ordering (CDR) remains a central restructuring tool, legal design should ensure transparency, minority creditor protections, and borrower-side procedural safeguards, so that restructuring is a stabilizing mechanism rather than a channel for opacity or regulatory capture.
5. **Integrate Basel convergence with domestic legal realism.** Basel III's emphasis on higher-quality capital and liquidity resilience should be integrated without losing sight of Narasimham II's developing-economy realism: legal impediments to recovery, volatility, and governance weaknesses require higher prudential buffers and stronger enforcement.