2. Public Sector Bank Reforms - Economy

Budget may unveil next round of PSB reforms . The upcoming Union Budget 2026–27 is poised to unveil a definitive policy direction regarding the next phase of Public Sector Bank (PSB) reforms. The government's strategy is expected to follow two parallel tracks- Consolidation 2.0 and the calibrated dilution of government ownership.

Proposed Reforms

The roadmap focuses on structural strengthening and ownership liberalisation to build resilient banking institutions.

Consolidation 2.0

Target Strategy- The government is considering the merger of the five smallest PSBs with mid-sized state-owned banks.

Objectives

Scale & Strength- To create banking entities with sufficient scale, robust balance sheets, and substantial market presence to compete globally.

Reducing Fragmentation- To minimize fragmentation within the PSB landscape, leading to fewer but stronger banks.

Ownership Reforms

FDI Limit Hike- A proposal to increase the Foreign Direct Investment (FDI) limit in public sector banks from the current 20% to 49% is under consideration to attract global capital.

Gradual Dilution- The government plans to reduce its stake in these banks closer to 51%, encouraging them to raise independent capital from the market rather than relying on the exchequer.

Privatization- The agenda includes renewing proposals to privatize two PSBs, a move aimed at reducing the government's footprint in the banking sector.

Operational Autonomy- Measures will be taken to grant greater decision-making freedom and operational autonomy to PSB boards, reducing bureaucratic interference.

Factors Propelling Performance of India's Banks

Several historic policy interventions have strengthened the banking sector, leading to its current stability.

Asset Quality Review (AQR) (2015)- This mandatory review compelled banks to recognize the true state of their loan books. It brought hidden Non-Performing Assets (NPAs) to light, ensuring transparency and strengthening the supervisory framework.

Prompt Corrective Action (PCA) Framework- This framework-imposed restrictions on weak banks to restore their financial health. It served as a precursor to the massive consolidation exercise that reduced the number of PSBs from 27 to 12 by 2020.

Insolvency and Bankruptcy Code (IBC) (2016)- Along with out-of-court resolution mechanisms, the IBC transformed India's credit culture. It provided a time-bound exit mechanism for stressed assets and significantly improved recovery processes.

Focused Debt Resolution- The pecuniary jurisdiction of Debt Recovery Tribunals (DRTs) was raised from ₹10 lakh to ₹20 lakh. This shift enabled tribunals to prioritize higher-value cases, thereby improving recovery efficiency.

RBI's Prudential Framework for Stressed Assets- This framework mandates early identification and reporting of stressed loans. It incentivizes lenders to implement a time-bound resolution plan before the asset value erodes further.

Challenges in India's Banking Industry

Despite improvements, structural and operational challenges persist.

Hidden Stress in Loan Books- While headline NPA numbers have lowered, recoveries have not fully matched fresh slippages. There is concern regarding stress lingering from pandemic-era restructuring schemes.

Basel III Transition- While large banks have successfully strengthened their capital buffers, smaller banks struggle to meet stringent capital adequacy, leverage, and liquidity norms required under Basel III.

Financial Inclusion Constraints- Expanding banking into rural and underserved areas faces hurdles due to gaps in digital literacy, poor internet connectivity, and a lack of general financial awareness among the populace.
Market Concentration Risks- Continued consolidation may lead to an oligopoly, potentially reducing competition. This could negatively impact customer choice, innovation, and long-term efficiency in the sector.

Way Ahead

The future roadmap requires a balanced approach between consolidation and inclusivity.
Balanced Consolidation- Future mergers must move beyond simple size expansion. Priority should be given to complementary geographies, technology compatibility, and operational synergies to ensure the merged entity is more efficient, not just larger.
Deepening Financial Inclusion- Access to banking must be converted into meaningful usage. This requires sustained investment in digital infrastructure, financial literacy campaigns, and last-mile connectivity.
Cybersecurity Management- As banking becomes increasingly digital, safeguarding financial stability is paramount. There is a need for enhanced supervisory oversight, rigorous stress testing, and robust cyber resilience frameworks to protect against digital threats.
Source- https-//www.financialexpress.com/business/banking-finance/budget-may-unveil-next-round-of-psb-reforms/4076672/