

*Indian Banking – Journey into the Future**

Anand Sinha

Shri M. D. Mallya, Chairman, Indian Banks' Association and Shri M. Narendra, Chairman, Indian Overseas Bank, the joint organisers of this mega event of the Indian banking industry and other delegates. A very good evening. It is an honour for me to be here today to deliver the valedictory address of this Conference which has come to signify an annual confluence of banking minds for serious deliberations. These conferences give us all an opportunity to reflect on the latest developments in the banking space and chart the future course of action. In the current phase following the crisis, the environment has become so fluid and dynamic that bankers need to be in a constant state of awareness and preparedness to face the new challenges and also to adjust to the fast changing regulatory landscape.

2. The Conference, over the span of three days, as I see from the program schedule, has covered a wide range of important issues such as financial inclusion, wholesale banking, technology, consumer experience, etc. I am sure these discussions have triggered new thought processes and opened new vistas for us to go back and chalk out the implementation strategy for making Indian banking more efficient, resilient and socially more relevant.

3. As per the IBA-FICCI-BCG Report (August 2011), *'India's Gross Domestic Product (GDP) growth will make the Indian banking industry the third largest in asset size in the world by 2025'*. However, being largest is not enough – being efficient is what we have to strive for. The Indian economy has been growing fast and the GDP growth rate had averaged 8.8 per cent in the last 5 years preceding the crisis. Despite a subsequent slowdown, India's GDP is still growing at a reasonably fast pace. The Indian banking sector will, as such, need

* Expanded version of the valedictory remarks by Shri Anand Sinha, Deputy Governor, Reserve Bank of India at the Bancon-2011 at Chennai on November 6, 2011. Inputs provided by Ms. Anupam Sonal are gratefully acknowledged.

to match up to the requirements of a fast growing economy including the likely acceleration in the Credit to GDP ratio. Added to this is the demographic dividend with its myriad challenges and opportunities. There is thus a huge responsibility on, and opportunity for, the Indian banking sector going ahead.

4. Being responsible is no longer a choice for banks. Commercially profit is a laudable objective but we have to remember that balancing the interest of all stakeholders, included and yet to be included, is the only socially optimal choice which will ensure long term survival and growth. Casino banking has no future. In this context, let me quote from the review by Financial Times of Satyajit Das's book 'Traders, Guns and Money' – *'This makes fascinating reading old fashioned financiers will read it and weep ...'*

II. Achievements of the Indian Banking System

5. There has been appreciation for India for weathering the financial crisis relatively unscathed. Much of it hinged on the sound and resilient banking system in the country. The foundation for the banking sector resilience was laid with the introduction of the financial sector reforms in 1991 with focus on prudential regulation and increased competition. These reforms resulted in a comprehensive transformation of the banking sector. The reforms had a major impact on the overall efficiency and stability of the banking system. The outreach of banks increased in terms of branch/ATM presence. The balance sheets and overall banking business also grew in size. The financial performance and efficiency of Indian banks improved with increased competition, as reflected in their profitability, net interest margins, return on assets (ROA) and return on equities (ROE). The capital position improved significantly, and banks were able to bring down their non-performing assets sharply. This reform phase also witnessed increased use of technology which in turn, helped improve customer service.

6. While financial stability is not an explicitly stated objective under the Reserve Bank's statute (RBI Act, 1934), various measures were undertaken from time to time to strengthen financial stability in the system which covered a wide arena. The approach has evolved from past experiences and a constant interaction between the micro level supervisory processes and macroeconomic assessments. In the Indian context, the multiple indicator approach to monetary policy as well as prudent financial sector management together with a synergetic approach through close co-ordination between the Reserve Bank and other financial sector regulators has ensured financial stability. Some of the other policy measures include Capital Account management, management of systemic interconnectedness, strengthening prudential framework, initiatives for improving the financial market infrastructure, etc. Systemic issues arising out of interconnectedness among banks and between banks and Non Banking Financial Companies (NBFCs – our shadow banks) and from common exposures were addressed by, among other measures, putting prudential limits on aggregate interbank liabilities as a proportion of banks' Net Worth, restricting access to uncollateralised funding market to banks and Primary Dealers with caps on both borrowing and lending, increasingly subjecting NBFCs to more stringent prudential regulations as also restricting banks' exposure to NBFCs to contain regulatory arbitrage. The other noticeable aspect regarding policy measures has been the innovative use of countercyclical policies to address the pro-cyclicality issues. The countercyclical policies were introduced as early as 2004 by using time varying sectoral risk weights and provisioning, though RBI had used them sporadically even earlier. These unconventional measures taken in response to emerging risks are now widely acknowledged to have played a significant role in protecting the Indian financial system from key vulnerabilities.

7. We have, thus, much to be satisfied about, as we have come a long way since the 1991 reforms. Even as we rejoice in our achievements and success, we must have the humility to acknowledge that much more needs to be achieved in our pursuit of excellence. So let us look at the road ahead.

III. Indian Banking – The Road Ahead

8. Future is always uncertain but coming times look more uncertain than ever. I am reminded of a quip '*The trouble with our times is that the future is not what it used to be*'. There are plenty of '*Known Unknowns and Unknown Unknowns*'. The future holds a lot of opportunities as well as challenges for all of us. The Conference would have already focused on the opportunities and how to make most of them. Let me list out a few challenges that await us in the future.

9. For elaborating on the challenges that lie ahead of us, I would categorise them into three broad categories viz.

- A. Challenges in coping up with the emerging regulatory and supervisory framework
- B. Challenges in meeting the specific needs of the economy and
- C. Challenges in fixing the fault lines in the system.

A. Challenges in coping up with the Emerging Regulatory and Supervisory Framework

(i) Implementation of Advanced Approaches under Basel II

10. The implementation of the advanced approaches under Basel II poses several challenges for banks and the Reserve Bank alike. The standardised approaches have already been implemented in India and all the commercial banks have migrated to the standardised approach under Basel II framework as of March 2009. Migration to the Advanced Approaches is important for larger banks because it involves adoption of more sophisticated risk management systems. Moreover, there are reputational issues too if large banks continue with standardised approaches. However, the implementation of the advanced approaches raises several issues relating to development of human resource skills, technology upgradation, branch interconnectivity, availability and management of historical data, robustness of risk management systems, etc. Though the Reserve Bank has set an indicative time schedule for implementation of the Advanced Approaches, banks' response has not been encouraging so far. It is high time for larger banks to seriously

upgrade their systems and skill sets and migrate to the Advanced Approaches.

(ii) Migration to Basel III

(a) Capital

11. Basel II was designed because its predecessor, *i.e.*, Basel I was considered risk insensitive and too preliminary to cope up with the rapid developments in the financial sector resulting in substantial regulatory arbitrage. The basic purpose of Basel II was to leverage on the risk management systems of internationally active banks and use that for enhanced risk management architecture and, in the process, have better measurement of capital requirements. It is ironical that when the crisis took place, Basel II was either not implemented or just implemented in the jurisdictions. And yet we have had to leapfrog and go in for enhancements under Basel II.5 and Basel III. Under Basel III, an assessment of Indian banks in terms of capital requirements has revealed that, notwithstanding some issues with a few individual banks, the system, as a whole, is very well capitalised and the transition to the revised capital norms of overall capital adequacy, Tier I component or equity component would be smooth. The stress point, however, would be that banks will be required to adjust the unamortised portion of Pension and Gratuity liabilities in the opening balance sheet on April 1, 2013 on transition to IFRS.

12. Going forward, the capital requirement on account of increased coverage of risks would not be so material for Indian banks as either those activities are not allowed (*i.e.*, re-securitisation) or their magnitude is quite small (*i.e.*, trading book).

13. However, capital requirements, including equity, would be substantial for supporting the high GDP growth and the fact that Credit to GDP ratio, which is currently quite modest at about 55 per cent, is bound to increase substantially on account of structural changes in the economy, *i.e.*, Financial Inclusion program, increase in loan requirements from more credit intensive sectors such as manufacturing, infrastructure, *etc.*

14. The large equity needs, though over an extended time frame, would put downward pressure on the

banks' RoE. While the higher capital requirements would bring down risks in the banking sector and eventually investors would recognise the lower risks and be willing to settle for a lower ROE, in the short term, the only answer is raising productivity.

15. The Reserve Bank and banks would be estimating the capital requirements under Basel III once our guidelines for implementation of Basel III are finalised. While implementing Basel III, our dilemma is (a) where our capital regulations are more stringent, should we continue with the more stringent norms? and (b) should we adhere to the extended timetable or step up the implementation schedule, given the fact that the banking system would be comfortable at the starting point, *i.e.*, at transition?

16. Other areas that need strengthening include securitisation related regulation, market risk management tools and improvement to the Supervisory Review and Evaluation Process of Pillar II of Basel II as per the Basel III enhancements.

(b) Liquidity Management

17. The Financial Stability Report (FSR) of the Reserve Bank of India for the half year ended June 2011 has expressed concerns over growing reliance of banks on wholesale funding/market borrowing to fund assets. One reason for such reliance could be the low growth of deposits not commensurate with the credit growth. Such reliance, however, could prove disastrous as evidenced during the crisis as the wholesale funding sources can dry up quickly. Banks, therefore, have to factor this in their liquidity management. There, however, remains an issue under Basel III about the extent to which statutory liquidity ratio (SLR) holdings can be taken into consideration for the purpose of calculating the liquidity ratios. As the SLR holdings are required to be maintained on an ongoing basis, these would technically not be reckoned for liquidity purposes. However, it may be reasonable to reckon, under stress conditions, at least a part of the SLR holdings in calculating the liquidity ratio, as the SLR holdings are primarily government bonds against which the Reserve Bank provides liquidity. Further, the major challenge for Indian banks in implementing the liquidity standards is to develop the capability to collect

the relevant data accurately and granularly and also to formulate and predict the liquidity stress scenarios with reasonable accuracy and consistency. Given that Indian markets have not experienced the levels of stress that global markets were subjected to, predicting stress scenarios is going to require a qualitative judgemental call.

(iii) Shadow Banking System – Greater Consistency in Regulation

18. Another important regulatory challenge is ensuring 'greater consistency in regulation of similar instruments and institutions performing similar activity' to prevent or contain regulatory arbitrage. In the case of systemically important non-deposit taking NBFCs (NBFCs-ND-SI), a gradually calibrated regulatory framework in the form of capital requirements, exposure norms, liquidity management, asset liability management and reporting requirements has been extended, which has limited the space for regulatory arbitrage as also their capacity to leverage. Given the increasing significance of the sector, the supervisory regime for the systemically important NBFCs will need to be strengthened further for a more robust assessment of the underlying risks. A Working Group under the former Deputy Governor, Smt. Usha Thorat on NBFCs has, *inter alia*, examined the issues related to the regulatory gaps and arbitrage opportunities that exist in the system, and has given recommendations for addressing these issues as well as for enhanced disclosure requirements and improved supervisory practices, *etc.*

(iv) Other Issues

19. The Indian banking system has a modest leverage which provides comfort. The Reserve Bank has also been enhancing and fine-tuning its supervisory processes on an ongoing basis and based on the evolving financial scenario. A revised framework for monitoring of financial conglomerates has been rolled out since 2009. The Financial Stability and Development Council (FSDC) has also been activated under the aegis of the Government of India for system level monitoring of build-up of risks and instability, specifically, risks emanating from the Systemically Important Financial Institutions (SIFIs) including the financial conglomerates.

This is also expected to enhance co-ordination among the financial regulators. However, enterprise wise risk management processes need to be implemented/strengthened in the financial conglomerates and SIFIs.

(v) Structural Changes

(a) Financial Innovation

20. The crisis has also raised the issue of financial stability *vis-à-vis* financial innovation – in other words, the question of the 'social optimality' of financial innovations. One of the main reasons why India escaped the adverse impact of the crisis was a calibrated approach to financial innovation. However, we as regulators and supervisors need to guard against stifling financial innovation while at the same time remain cautious about the objective and purpose behind the new and complex financial products that are proposed or introduced by the industry. This is particularly relevant for a country like India as its resilience in the face of heavy financial turbulence can be quite limited and as no social safety nets are available. These concerns shape RBI's approach to financial innovation. Banks have to be cautious about the 'social usefulness' of new products and should have appropriate controls in place to ensure against mis-selling through robust 'suitability and appropriateness' checks. Several far-reaching measures have been taken recently in terms of allowing new products such as Interest Rate Futures, Currency Futures, and Repo in corporate bonds, *etc.* Such products are new for the Indian market and an assessment of their impact on other markets, institutional behaviour and system as a whole is critical. Going forward, a key focus area must be designing of robust market infrastructure and strengthening the systemic monitoring framework for these new markets.

(b) Financial Holding Companies

21. During the last decade, India has witnessed growth and evolution of financial institutions into large financial conglomerates expanding their presence in multiple non-banking financial activities. In this backdrop, the issue of the nature of corporate form adopted by financial groups in India has acquired relevance from two distinct, though inter-related, perspectives – one, efficient corporate management within the groups addressing the issues of growth, risk

management and capital requirements of the Group; and two, the degree of regulatory comfort with different models, particularly in regard to the concerns relating to contagion risks.

22. A Working Group set up by the Reserve Bank in this connection has recommended pursuing Financial Holding Company (FHC) model as the preferred model, as it enables, *inter alia*, de-risking the banks to a certain extent from the perspective of 'holding out' risks of the Group and freeing the bank management from the responsibility of managing the subsidiaries and other affiliates. This structure also facilitates better regulatory oversight and neater resolution. There are, however, numerous challenges in implementing the FHC model in India. The implementation of this model would require a new legislative framework, providing the right incentives to the existing financial conglomerates through appropriate tax treatment and resolution of strategic and public policy issues in the case of public sector banks.

(c) Changing Banking Landscape: Subsidiarisation of Banks

23. One of the key takeaways of the global crisis is the appreciation and acknowledgement of the benefits of subsidiarisation *vis-à-vis* branch presence of foreign banks. Reserve Bank has already taken steps in the direction of encouraging foreign bank presence in subsidiary form. The draft paper put out in this regard has suggested making the subsidiary route more attractive by providing near national treatment to the wholly owned subsidiaries of foreign banks. Presence of foreign banks in subsidiary form will generate greater competition for the Indian banks as this route will open up nearly equal opportunity to foreign banks in business expansion within India.

(d) Adoption of IFRS

24. There are certain issues that need to be addressed in implementing the convergence with the IFRSs. First, the very crucial IFRS 9 relating to Financial Instruments is still evolving and the final standard is unlikely to be available soon. Thereafter, the Institute for Chartered Accountants (ICAI) will need to promulgate the converged standard for India. This presents a moving target given the short time available for convergence

with IFRS. Converging to the standards would require considerable skill upgradation and modification in the IT systems of banks. The Reserve Bank has constituted a Working Group to address the implementation issues and facilitate formulation of operational guidelines for the convergence.

(e) Revamping Financial Legislation

25. Evolution of legislative framework is an interesting area. Laws are made keeping in mind the prevailing circumstances. However, if the circumstances change, the legal framework can become inadequate. This is more so in the financial world because the pace of change is very fast. Currently in the financial sector, we have about 60 Acts and multiple rules and regulations. The incremental changes made to these Acts over a period have made the laws ambiguous and complex. Government has taken an initiative by setting up a Financial Sector Legislative Reforms Commission (FSLRC) which seeks to rewrite and streamline the financial sector laws, rules and regulations to bring them in harmony with India's fast growing financial sector.

B. Challenges in Meeting the Specific Needs of the Economy

26. Indian economy is one of the fastest growing economies of the world. The economy with its varied geography and demography has specific requirements in order to traverse to the next orbit and attain its full potential. Banks have to gear up to meet such requirements by redesigning their business strategies. A few of the most important requirements of the economy are (i) Financial Inclusion (FI), (ii) Infrastructure Financing and (iii) Financing of housing and real estate.

(i) Financial Inclusion (FI)

27. It is estimated that despite the widespread expansion of the banking sector, about 40 per cent Indians still lack access to even the simplest kind of formal financial services. Such an extent of financial exclusion can severely retard the Indian growth story, both by blocking a major portion of the Indian population from participating in the economic mainstream and by, possibly, generating social tensions. As such, moving towards Universal Financial Inclusion

is both a national commitment and a policy priority. The Reserve Bank and the Government of India have taken several initiatives in this direction such as mandating opening of 'no frills' accounts coupled with provision of small overdraft facility, introduction of a General Credit Card (GCC), relaxation of KYC norms for small value accounts, allowing general permission for opening branches in Tier 2 to Tier 6 centres with population of less than 1,00,000, allowing use of Business Facilitator (BF) and Business Correspondent (BC) models, *etc.* in providing financial and banking services. Despite some improvement as a result of these initiatives in recent years, real financial inclusion still eludes us and major challenges remain. First of all, in the absence of a proper assessment of the extent of financial exclusion, initiation of appropriate policy responses is difficult. There is, therefore, a need to conduct specific survey or expand the scope of the decadal census for gathering information relating to financial inclusion/exclusion. Then, there is the issue of high operating cost of small transactions and difficulties in reaching out to far flung areas. Most importantly, banks need to perceive Financial Inclusion as a profitable, commercially viable business and not as an obligation. This can be attained through product innovation, use of technology for lowering cost of transaction and cross selling of products and services after thoroughly understanding the rural markets. Mobile banking has tremendous potential in this respect. Effective leverage of Information and Communications Technology (ICT) solutions, duly simplified, and use of products such as smart cards, biometric handheld devices, mobile and basic level ATMs, *etc.* can aid cost reduction. Cultural and attitudinal changes at grassroots, especially at the level of branches are needed to impart organisational resilience and flexibility. Financial literacy and credit counselling will create the right conditions for financial inclusion.

28. There is also a need to improve the absorptive capacity of financial services by providing basic infrastructure such as health, water, sanitation and education which can lead to faster income growth and increase in non-farm based activities in rural areas and lead to increase in demand for credit. Systems of reward

and recognition for the personnel initiating, ideating, innovating and successfully executing new products and services in the rural areas would also give financial inclusion the much desired fillip. Ours is a bank led model for financial inclusion because in our view only banks can provide a comprehensive inclusion programme – deposit and loan products and remittance facilities. Hence banks bear very large responsibility in making the financial inclusion programme a success.

(ii) Infrastructure Financing

29. India's infrastructural financing needs are not only huge but also vital. The targeted annual spend on infrastructure during 2007-12 is about US\$ 500 bn which is estimated to double in the next five year plan (US\$ 1 trillion during 2012-17). Shortfall in infrastructure financing, according to an estimate, would cost about 4 per cent of GDP every year¹ which is too costly for a growing country like India. Banks, traditionally, have been the major source of infrastructure financing and their exposure to infrastructure is already high at 17 per cent. Infrastructure projects involving long term funding plans have, however, severe implications for the asset liability management at banks. There are some alternatives to bank financing such as development of corporate bond markets, Infrastructure Debt Funds, *etc.* The challenge before banks in the fast evolving landscape is to realign their position in meeting the infrastructure finance needs, at the same time, however, not significantly increasing their risks. Take-out financing could be one option in achieving this balancing act. Government and RBI have recently come out with a structure for Infrastructure Debt Funds (IDFs) which would facilitate take-out financing, development of the corporate bond market, *etc.*

(iii) Financing of Housing and Real Estate

30. Financing of housing and real estate is another challenging area for banks. With a high rate of population growth, coupled with increased urbanisation and growing incomes, there is a tremendous business opportunity for banks to participate in this segment. The emergence of demand for housing finance is expected to be the key driver of bank credit in future.

¹ Indian Infrastructure- going beyond sound bites – City of London (2010).

However, real estate, owing to its imperfection in terms of information asymmetry and opacity, poses great challenges and banks need to tread with utmost caution and should avoid falling prey to irrational exuberance. Real estate is highly sensitive and prone to easy build up of bubbles, which could be mistaken for growth momentum. The global crisis bears a striking testimony to the disastrous impact the excesses in real estate sector could pose to the financial system and banks have to resist the lure of quick but risky returns.

C. Challenges in Correcting the Fault Lines

(i) Asset Quality

31. Non-performing Assets (NPA) have caused some concerns. While the rise in NPAs could partially be attributed to the adverse impact of the global financial crisis, the aggressive lending stance of banks during the preceding boom period as also inadequate due diligence and laxity in monitoring of the loan accounts are also responsible for deterioration in the asset quality. This has been so, especially in case of retail loans. While the gross NPA ratio declined from 3.30 per cent at end March 2006 to 2.25 per cent at end March 2011, mainly due to a commensurate increase in gross advances; the absolute amount of gross NPAs increased by ₹466.69 billion (an increase of 91 per cent) during 2005-06 to 2010-11. As such, the NPA stock has risen consistently. Slippage ratio of the banking system, defined as fresh accretion to gross NPAs to opening balance of gross standard advances, which had shown a declining trend from 2005-06 (1.9 per cent) to 2007-08 (1.8 per cent), abruptly increased to 2.18 per cent in 2008-09 and 2.21 per cent in 2009-10. At system level, new accretion to NPAs has been much faster than the reduction in existing NPAs due to lower levels of upgradation and recoveries. Also, despite write-offs, gross NPAs have continued to rise significantly.

32. The table below tracks the movement of stock of gross and net NPAs of the banking system during the period March 2006 through March 2011.

33. It may be comforting to take refuge under net NPA figures but the comfort is misplaced. Banks need to, not only utilise effectively, the various measures such as CDR mechanism, One Time Settlement schemes, Debt Recovery Tribunals, provisions of the SARFAESI

NPAs of SCBs

(Amounts in ₹ billion)

At end	Total Gross Advances		Total Gross NPAs		Total Net NPAs	
	Amount	per cent Change over Previous March	Amount	As per cent of Gross Advances	Amount	As per cent of Net Advances
Mar-06	15,506.30	30.46	511.99	3.30	185.32	1.22
Mar-07	20,126.65	29.80	505.13	2.51	199.56	1.01
Mar-08	25,078.85	24.61	565.25	2.25	246.75	1.00
Mar-09	30,376.06	21.12	692.92	2.28	316.80	1.06
Mar-10	35,450.00	16.70	846.48	2.39	377.19	1.08
Mar-11	43,586.28	22.95	978.68	2.25	418.13	0.97

Source: Reserve Bank of India

ACT etc. put in place by the Reserve Bank and the Government of India for resolution and recovery of bad loans but also have to strengthen their due diligence, credit appraisal and post sanction loan monitoring systems to minimise and mitigate the problem of increasing NPAs. Overall economic growth in the last decade or so, coupled with higher disposable incomes have led to an exponential growth in retail spending. As the efforts directed towards financial inclusion take off, the bankable population will see further rise. This would require that delinquency risks and quality of portfolio are carefully managed by banks. Adherence to the provisioning requirement, building countercyclical provisions and holding countercyclical capital buffers in good times can, to some extent, insulate banks from excessive default stress during crisis situations.

(ii) Consolidation

34. Mergers and acquisitions (M&A) as a means of inorganic growth are increasingly being used the world over to undertake restructuring of leading business enterprises. It is followed as a part of the strategy to achieve a larger size and faster growth in market share and reach, and to become more competitive through economies of scale and scope. India does not have larger banks to finance its huge infrastructural needs and large industrial projects. The structure of the banking system as recommended by the Narasimham Committee II consisting, along with medium sized and smaller banks, of a few large international banks, would not only meet

the financing needs of infrastructure and large projects and provide the economies of scale and scope but also leverage the country's image as a financial destination and enable Indian banks to compete globally in terms of fund mobilisation, credit disbursal, investment and rendering of financial services. This could be attained through consolidation. However, while encouraging/promoting the consolidation route, the need for competition within the domestic banking sector should not be overlooked nor the risks and challenges that emanate from the presence and operations of large systemically important financial institutions be ignored. While nobody knows what the optimum size in terms of largeness is, one thing which is very clear is that banks should refrain from, and regulatory dispensation should not permit, building complex structures.

(iii) Corporate Governance Deficit

35. Several studies have highlighted the direct relationship between good governance standards and the performance and efficiency of an entity. This is all the more true in respect of banks, which, in their fiduciary capacity deal with public money on one hand and on the other, enjoy government/central bank support due to their centrality in the overall financial system. The recent crisis has also amply demonstrated how weak governance framework contributed to the build up to the crisis through excessive risk taking. Transactions in risky and complex products which were barely understood, neither by the financial entities nor the customers, was another contributing factor. While over the last one decade, the governance requirements have been considerably enhanced in India, good governance has to be a continuous and ongoing process. In India we had the 'derivatives' episode recently which was a case of inadequate application of 'suitability and appropriateness' requirements and, consequently, was a case of governance deficit. As such the Board of Directors and the senior management have a great oversight responsibility in ensuring that the respective banks lay down robust compliance culture and corporate governance framework which is reviewed periodically for its efficacy and efficiency.

(iv) Information Asymmetry

36. Information asymmetry in a multiple banking scenario is a serious issue. A framework for pooling and sharing of credit information amongst banks had been put in place so as to enable banks to streamline their credit appraisal framework and also to instil discipline among the defaulting borrowers. The utility of such data, however, hinges inexorably, on its integrity and timeliness. Lapses in sharing of information defeats the very purpose of such arrangements. Unfortunately this arrangement has not worked. Banks should strive to make this work. Hopefully with licenses granted for additional Credit Information Companies, we expect the system to evolve a robust information sharing arrangement and further the development of the banking system.

(v) Product Pricing

37. Costing of banking products is an issue which has largely been escaping serious debate. Proper and fair pricing of risks and of banking products is essential from risk management and customer service perspectives. It can also enhance competition resulting in passing of the benefits of such increased competition in terms of lower costs to the ultimate customer. The challenge before banks is to make the best use of technology and innovation to bring down the intermediation costs while protecting their bottom lines. The issue of fairness to all classes of customers is also a very important issue. Today, there are a lot of complaints from customers about lack of fairness in floating rate products. Banks need to be sensitive to that. To deal with this issue, the Reserve Bank would be setting up a Working Group as announced in the recent Monetary Policy to look into the appropriate methodology for pricing of credit.

(vi) Customer Service

38. Banking is predominantly a customer oriented business and good customer service is the key to banks' growth and stability. With enhanced competition amongst banks, customer service becomes the sole differentiating factor to be leveraged to stay relevant

and to forge ahead in the business. However, in pursuit of returns and profits, customer service is often ignored if not totally forgotten. As the customer awareness grows, banks would be required to gear up for providing more efficient and at the same time, cost effective services leveraging the technological capabilities. Customer retention is going to be the key factor for banks, going ahead.

39. Recognising the need for revisiting the issue of customer service in banks, a Committee (Chairman: Shri M. Damodaran) was constituted by the Reserve Bank in May 2010. The Committee looked into the banking services rendered to retail and small customers and pensioners, structure and efficacy of the existing grievance redressal mechanism, the functioning of Banking Ombudsman Scheme, and possibility of leveraging technology for better customer service and has recommended steps for improvement. The recommendations and the public comments received thereon are being examined by the Reserve Bank for implementation. Meanwhile, in the recently concluded Ombudsman Conference, 10 action points were identified, which are essential to protect the rights of the customers.

(vii) Know Your Customer (KYC)

40. Money laundering is a growing menace and it not only poses serious threat to the stability and integrity of the financial system but also to the sovereignty and safety of nations worldwide. In the coming days, challenges before banks would primarily lie in saving themselves from the growing threat of money laundering. In India, prevention of money laundering act (PMLA) was passed in 2002 and it has been aligned with the financial action task force (FATF recommendations in 2009. Further, India has become a member of FATF in 2010. Banks are being extensively sensitised about money laundering and KYC norms. KYC discipline assumes critical importance especially in the light of our concerted efforts to widen the reach of banking as part of financial inclusion initiatives. Banks have to ensure a very high degree of KYC compliance and a very robust AML regime. Once these standards are achieved, a unified KYC for banking system could be thought of.

(viii) Risk Management, Technology and HR Development

41. In view of the current dynamic business scenario of increasing financial sophistication and innovative financial tools, banks are faced with complex risks. Thus, robust enterprise wide risk managements systems are the fundamental requirement for banks to be able to survive in the long run. Banks with proper risk management systems would not only gain competitive advantage but would also add value to the shareholders and other stakeholders. Banks, therefore, have to endeavor for integrated risk management systems, both within the bank and also across the group. Such an integrated risk management architecture would be currently difficult due to the disconnect between businesses, risk managers and IT systems across the organisations in their existing set-up. Indian banks have achieved most of the computerisation under the Core Banking Solution (CBS). This may not, however, prepare them adequately for the necessary MIS and analytical tools for risk management. In order to upgrade the risk management systems, banks need to upgrade their technology proportionately so that the MIS and the analytical tools for risk management are available. This will entail large investments in technology particularly for those banks who have to migrate to the advanced approaches under Basel II.

42. Further, with the explosive growth of the internet, mobile and wireless tools, the way both the economy and business are conducted today has been revolutionised and as such, the technological needs of banks are not confined to only risk management requirements. The need for technological innovation in the context of financial inclusion is of high priority. Technology has evolved as the integrator and holds the key to the future success of any corporate entity and more so for the banks. Speed, accuracy and quality in operations and delivery mechanism as also cost efficiency are some of the known benefits that would accrue to both: banks and their customers. However, enhanced usage of technology also poses severe challenges for banks both, in terms of keeping pace with the fast growing/changing technological demands so as to maintain an edge on the profitability, delivery

and quality fronts as also with regard to the recognition, understanding, management and mitigation of risks inherent in the use of technology.

43. The Reserve Bank of India, on its part, has taken several initiatives in this direction which include formulation of the IT Vision document 2011-17 which sets the priorities for commercial banks for moving forward from the core banking solutions to enhanced use of IT in areas like MIS, regulatory reporting, overall risk management, financial inclusion, customer relationship management and enhancing automated data flow within banks and to RBI without any manual intervention, etc. Measures are afoot to setup Next Generation RTGS (NG-RTGS) system taking into account the latest developments in the areas of technology, messaging and networking, etc.

44. On the part of banks, there is an imperative need for a three-pronged action agenda, viz., first, technology upgradation coupled with its integration with the overall business strategy to achieve an edge in respect of services provided to their constituents, better housekeeping, optimising the use of funds and building

up of MIS for decision making, better management of assets & liabilities and the risks assumed which in turn have a direct impact on the balance sheets. Second, a more dynamic and challenging work culture to meet the demands of customer relationships, product differentiation, brand values, reputation, corporate governance and regulatory prescriptions. Third, focus on internal controls, risk mitigation systems and business continuity plans to effectively mitigate possible operational risks arising out of adoption of technology which could have a potential bearing on the overall financial stability.

Conclusion:

45. Let me conclude by quoting *'Tomorrow belongs to people who prepare for it today'*. I am sure that we all draw lessons from our past and prepare ourselves for the challenges that the future holds for us.

I once again thank the Bancon for this wonderful opportunity for sharing my thoughts with you.

I wish you all the very best for the interesting times in future.

The Indian banking sector is at a critical juncture in its evolution. It is now clear that the slump in credit growth and increase in stressed assets has affected the profitability of all banks, and threatens the very survival of some of them. State-owned banks account for more than three-fourths of the stressed asset load, which is now far higher than their net worth. Provision levels are inadequate, as the banks hold only 28% of gross non-performing assets and restructured assets, as provisions. There is a \$110 billion gap between the stressed assets in the system and the provisions made. Sh YES BANK, India's fourth largest private sector bank is a high quality, customer centric, service driven, private Indian Bank catering to the Future Businesses of India. Since inception in 2004, YES BANK has grown into a "Full Service Commercial Bank" providing complete range of products, services and digital offerings, catering to corporate, MSME & retail customers. YES BANK operates its Investment banking, Merchant banking & brokerage businesses through YES SECURITIES, a wholly owned subsidiary of the Bank. Live Now #MGChangemakers Episode 3 : Chetna Sinha has single handedly turned sleepy, rural Mhaswad into a seat of entrepreneurial aspirations for women. Watch the video to learn about her inspirational journey & how she is "Driving India Into The Future". #MGChangemakers powered by MG Motor India and supported by UN Women India. Show your support by donating now: <http://bit.ly/Milap-MGChangemakers>.