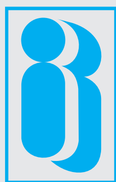

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SPECIAL ISSUE

New Paradigms in Banking

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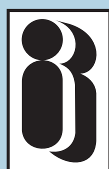

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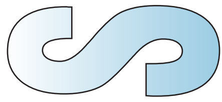

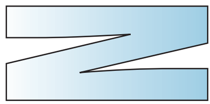
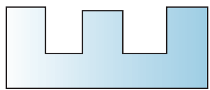

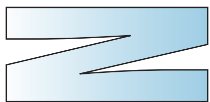
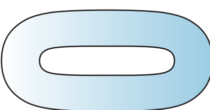
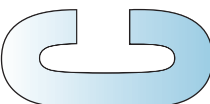

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ध्येय

संस्थान का ध्येय मूलत: शिक्षण, प्रशिक्षण, परीक्षा, परामर्शिता और निरंतर विशेषज्ञता को बढाने वाले कार्यक्रमों के द्वारा सुयोग्य और सक्षम बैंकरों तथा वित्त विशेषज्ञों को विकसित करना है ।

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The theme for the Asia-Pacific Association of Banking Institutes' (APABI) Conference-2015, identified by the APABI Steering Committee of the Institute, is "New Paradigms in Banking". Once the theme of the Conference was finalised, the Institute felt that it would be appropriate to bring out a Special Issue of Bank Quest on the theme of the Conference as reading material/conference volume during the APABI conference as was done in the previous year. For this, the Institute adopted a two pronged approach. Firstly, articles were invited from eminent bankers/academicians within India and from APABI members and overseas banking institutes on various topics such as Business Strategies of Banks, Risk Management & Regulation, Management of Banks, International Banking, IT Security Systems for Banks, Co-operative Banking, Mergers & Acquisitions and Leadership in Indian Banks. We have carried nine such articles for publication in this special issue and these are included in PART-I of this issue as Invited Articles. Secondly, the Institute also conducted an APABI conference paper competition and received sixty three papers. After evaluation of these articles by experts, the Institute has awarded prizes to three articles. These three articles are included in Part-II of this issue as Prize Winning Articles. In Part-III, a feature on "Legal Decisions Affecting Bankers" has been included.

The first article in this issue is by Ms. Arundhati Bhattacharya, Chairman, State Bank of India. In the article, she gives her thoughts on "New Paradigms in Business Strategies of Banks". The author provides a bird's eye view of how India's economic and social strata will change due to the new policies adopted by the Government. She outlines the support that banks need from Government and Regulator so that they can flawlessly prepare new strategies for business. She also explains the key business strategies that will evolve over time.

Mrs. V. R. Iyer, Member (F&I), IRDAI and Former Chairperson and Managing Director, Bank of India, explains her thoughts on "Risk Management & Regulation in Indian Banking Sector - New Paradigm" This is the second article in this issue. In her article, she explains global initiatives

for strengthening risk management practices in banks, present regulatory scenario in India with focus on BASEL-III, developments in cross boarder supervision, revitalising distressed assets, Depositor Education and Awareness Fund Scheme and Risk Based Supervision.

Mr. Arun Tiwari, Chairman and Managing Director, Union Bank of India has authored an article on "New Paradigms in Management of Banks." The author begins his article with the meaning of a bank and explains the changing landscape of banking since the global financial crisis. He explains how the business vocabulary of top management is changing from 'business' to 'business ratios'. He emphasises the importance of risk management and human resource management. Further, he explains the digital transformations and need to expedite the channel migration of customers from branch to digital channels. The article discusses capital efficiency growth, managing customer service standards, corporate governance in banks, consolidation & restructuring in banking sector and corporate social responsibility. The author also explains the H.D.R. Framework of his bank.

Mr. Stuart P. Milne, Group General Manager and CEO, HSBC India in his article on "New Paradigms in International Banking" presents his views on several drivers of change in banking like technology, regulation and customer behaviour & expectations. The author explains the impact of technology on banking operations. He opines that technology empowers the customer and it has significant implications for banking distribution channels and on the pattern of employment in the industry globally. He explains the use of digital banking and big data in financial inclusion particularly in India. He feels that regulators are likely to continue to favour less complexity in business models and more transparency. He also narrates how customer behaviour and expectation are driving distribution model in banking and customers are globally moving from brick and mortar branches to online mode.

The next article is by Dr A. S. Ramasastri, Director, IDRBT on "New Paradigms in IT Security Systems for Banks: Banking runs on Trust and Trust depends on Security". The author explains the importance of IT security for banks, role of regulators and different types of IT security. He also explains IT security from the point of banking through social media, mobile and cloud computing. The author explains concepts like Internet of Things, Security Operations Center, Big Data &

Analytics and forensics etc. He underlines the importance of information sharing and skills upgradation in implementation of IT security in banks.

Mrs. Suprita Thakker, General Manager, Saraswat Co-operative Bank Ltd in her article "New Paradigms in Banking" discusses the Indian growth story from the point of banking and a paradigm change in it. She also provides a detailed account of banking sector reforms in India and innovations in products and services of banks.

The seventh article by Mr. Kaushal Shah, from Kotak Mahindra Capital Company – a subsidiary of Kotak Bank is on "New Paradigms in Bank with focus on Mergers & Acquisitions" The article lists out some of the M&A which took place in the banking sector. The author explains the changing paradigm in Indian banking business and its impact on M&A. He also explains key drivers for M&A in Indian banking such as technological advancements and regulatory consideration.

Dr. Badrinarayan S. Pawar, IIBF Chair Professor, NIBM in his article titled "Leadership Competencies: Some Inputs from Literature for Enhancing Leadership in Indian Banks" explains the changes faced by the Indian banking sector and emphasises on the need for leadership in Indian banks. The paper provides a comprehensive and literature-based list of leadership competencies and points out the relevance of these literature-based competencies in Indian banks. The article draws three perspectives in leadership literature to outline a literature-based and comprehensive list of leadership competencies.

Lastly, we carry an article titled "Talent development in banks: New paradigms" by Mr. Tay Kay Luan, Chief Executive Officer, Asian Institute of Chartered Bankers, Malaysia. In his article, he has explained five prevailing trends that are shaping the banking landscape and new paradigms of talent development. The author explains new paradigms in talent development in banks in terms of Professionalism and ethics, Returns on learning, Competency based leadership development, Culture of learning and online or Class room learning.

The prize winning articles are included in Part-II of this issue. The first prize winning paper is by Mr. Manas Ranjan Das, Former AGM (Economist), State Bank of India. His paper is on "New Paradigms in Banking: The Case of Indian Banking Sector." The paper provides an historical

account of different paradigms in the Indian banking sector, the lessons learnt from banking paradigms in select countries, analyses the current paradigm in which Public Sector Banks in India are operating and assesses whether there is a need for a paradigm shift today and if yes, what the new paradigm and its various facets should be.

The second prize winning article included in this issue is "Capital Optimization – A need of the hour" by Ms. Priyanka Naik, Bank of Maharashtra. The author explains the concept of Capital Optimization and ways and means for Capital Optimization in terms of protection, generation and conservation.

The article titled "Strategic Debt Restructuring Mechanism- Defaulters' Envy, Bankers' Pride" by Dr. Akhilesh Tripathi, State Bank of Bikaner & Jaipur is the third prize winning article included in this section. The author in this article explains the Corporate Debt Restructuring mechanism and the challenges & issues in its implementation.

Some time back, the Institute used to publish a regular feature on 'Legal Decisions Affecting Bankers" in its quarterly journal. As this section will be useful to bankers, the Institute has decided to include this section in the Bank Quest from this issue. An article by Mr. M. G. Kulkarni, Deputy Director, IIBF on "Failure to provide CCTV footage amounts to deficiency in service on the part of Bank" is presented in Part-III of this issue.

We hope that these articles will be useful to the readers to enrich their understanding of the theme of the conference "New Paradigms in Banking". As these issues are similar in other countries, the views expressed in these articles may be useful to Asia Pacific, Africa, Middle East countries as well. We welcome readers' suggestions and feedback for improvement.

Dr. J. N. Misra

PART - 1

Invited Articles

New Paradigms in Business Strategies of Banks

Arundhati Bhattacharya *

The optimism regarding Indian economic growth portends well for Indian banks. As growth picks up, domestic supply bottlenecks ease and the stalled projects come back on stream again, the outlook for both manufacturing and services sectors would brighten. With a stable Government at the Centre, pace of economic reforms is likely to be further boosted in the industrial and services sectors and the financial markets, which would help improve commercial activity levels and productivity, thereby enhancing the growth potential. As the economy recovers, investment demand and the need for credit will pick up and here the banks will play the most important role. Retaining profitability and sustaining growth will however continue to be a challenge in the next decade. The banking industry has to continue to live up to high expectations. This article comprises of 4 sections. Section 1 gives a bird's eye view of how the India's economic and social strata will change due to the new policies adopted by Government. Section 2 deals with the support that banks need from Government and Regulator side so that they can flawlessly prepare new strategies for business. Section 3 deals with the key business strategies that will evolve over time and finally section 4 provides concluding remarks and way forward.

Section-I : A New India around the Corner

India is progressing into a new phase in the growth cycle with manufacturing sector likely to play a leading role in this phase. On the one hand while the country continues to be a world leader in shared services destination, it is also fast emerging as an alternate manufacturing location for many multinational corporations. The immense potential of the domestic market driven by demographic dividends, burgeoning, affluent and tech-savvy middle class, large pool of talent and cost effectiveness continues to make India a high preferred choice for investment.

India has been attracting attention from around the world for the last few years. India being the largest democracy in the world with the second largest population, nearly half of which is young, provides tremendous opportunity for the country as well as its external trade partners. The economy has shown a tremendous growth in the last two decades and has enormous growth potential in the longer term., A large domestic market, abundant natural resources with relatively cheap labour are the major advantages of the Indian economy. Growing consumerism opens ample space for market development.

The driving forces that help in creating a new India are :

a) *Make in India for making India a Manufacturing Hub :* Make in India initiative that plans to convert India as the manufacturing hub by inviting global companies to India is a positive move. The initiative has been taken to boost economic growth by inviting global companies to invest in the Indian market. As the NDA government has eased the foreign direct investment cap in several areas like construction, defence and the railways, the programme gives international companies easy access to the Indian market. If the foreign companies invest in Indian market, it will automatically create job opportunities and improve the financial condition of India.

b) *Banking for All :* The initiative towards financial inclusion by launch of the Pradhan Mantri Jan Dhan Yojna aiming at including every citizen under financial network has got overwhelming response on the ground. The target set for opening bank

* Chairman, State Bank of India.

accounts for all households has been met well ahead of the target date of 26 January, 2015. By opening 12.01 crore new accounts in a very short span, Indian banks have achieved a coverage of 99.8% of all households in the country and have mobilized deposits of ₹10,000 crore. The next phase of PMJDY includes providing a wide range of services including credit, insurance and pension while maintaining high standards of customer service.

c) *Housing to all by 2022 :* Government of India had announced in the Union Budget of 2014-15 that everyone would get houses by 2022. A Mission of Low Cost Affordable Housing will be anchored by the National Housing Bank.

d) *Insurance and Pension for All :* With financial inclusion coming to the forefront of government agenda, the newly launched Pradhan Mantri Suraksha Bima Yojna (PMSBY) and Pradhan Mantri Jeevan Jyoti Bima Yojna (PMJJBY) and Atal Pension Yojana (APY) are targeted at providing social security benefits to a large percentage of the low income earning population in India. It is estimated that 80% of the country's population is still outside the insurance coverage and merely 11% of the working population are under pension net. The PMSBY and PMJJBY are aimed at providing insurance at an affordable premia. Under the APY scheme, the subscriber will get a guaranteed minimum pension from the age of 60.

e) *Smart Cities :* The Prime Minister's vision has given a thrust in setting up smart cities and the Government aims to spend ₹7,060 crore for 100 smart cities.

Apart from these, initiatives in the area of faster clearances of the projects, reform in labour laws, ease of doing business, streamlining government functioning and facilitating infrastructure financing are great efforts to create a new India. This new India needs new business strategies for the banks, so that they can contribute in the process.

Section-II : Support from Government and Regulator

India is one of the fastest growing economies of the world having a varied geography and demography. New banking strategies would be needed to meet such requirements. However, to create a new landscape in banking, a lot of reforms are needed in various areas of banking operations.

A) Better Laws for Bad Loans : There is a dire need for some regulatory changes in order to enable banks to effectively tackle the problem of bad asset quality and to create a new and efficient banking strategy :

i) Loans to 100% Central Govt. owned entities (even without Central Govt. guarantee) also to be treated as "Standard Asset" even though they may be NPA, as is being done in case of loans guaranteed by Central Government,

ii) Official Liquidators should be statutorily mandated to wind up, sell and distribute the proceeds of the liquidated company's assets within a specified time frame. In case of delay, they should have to necessarily take additional time from the High Court citing specific reasons for delay and the affected parties should have a right to be heard on such requests,

iii) Various tax authorities should not contest Bank's priority charge on securities. This will ensure certainty of recovery of Bank's dues by enforcement of securities,

iv) Property values to be brought under a licensing authority with well-defined responsibilities, to ensure greater accountability,

v) SICA Repeal Act, 2003 to be made effective / implemented immediately,

vi) Restructuring accounts should continue to be classified as a standard asset at least up to 31st March 2017,

vii) Revenue Recovery Act to be introduced in all States and banks' loan default should also be included under the provisions of the Act,

viii) Bank loans wherever secured by mortgages are largely through equitable mortgages, as they are simpler and also save on stamp duty. However, this method is not fool proof. It is suggested that, instead of ad valorem stamp duty, an ad specific

stamp duty at nominal rates be levied to enable Registered Mortgages in all cases,

ix) In case of consortium advances, initiating SARFAESI action may be permitted in case the lenders having a share of 51% or above consent to such action (presently 60%),

x) Restructuring for infrastructure projects should not require provisioning by banks so long as debt service is evenly spread out in a manner that all debt is repaid at least 3-years prior to completion of the concession period, and

xi) Government should take initiatives to prevent the wilful defaulters of banks from accessing all kinds of funds, from individuals and from wholesale markets. Real time online uploading of details of all defaulters / wilful defaulters in the RBI or CIC website.

B) Consolidation for World-class Banks : The idea of consolidation was first mooted by the Narasimham Committee in 1991 and experts have recommended consolidation leading to 6-7 major players in the market. Bigger banks are likely to be more efficient and profitable than smaller ones and also expected to generate economies of scale and scope. Further, the reorganization can bring together synergies making the banks more efficient and profitable. This will lead to greater managerial efficiency, lower costs and better and varied offering of products and services. The need of the hour is a roadmap for managing consolidation. Banks voluntarily need to find ways for mergers so that the shareholder value is maximized.

However, presently there is no cartelization and banks are engaged in healthy competition. To be able to compete with global banks and have the financial muscle to finance the growing business of Indian corporates, we need consolidation that will create 2 or 3 world-size banks to begin with. The growing Indian economy provides enough space for global banks, national banks as well as regional banks as each of these banks has a distinctive identity and role, without being a clone.

Each bank has its own strength and distinct regional flavour. So, there is a need to differentiate between banks in the country and I believe there is enough space for banks to maintain their niche strengths in the geographies and businesses in which they operate. In fact, the concept of the local area bank, which was started in 1996, stopped after some licences were given. However, we are glad that RBI has issued the guidelines to issue licences to small banks, which will serve the people in the unbanked regions.

C) Re-look at Priority Sector Lending Norms : There is an urgent need to relook at PSL norms under following heads,

i) It would be more appropriate to make PSL targets as percentage of net lendable resources (instead of ANBC) as the credit outlay is a function of the available resources,

ii) Indian economy has shifted towards non-agrarian activities. Credit absorption capacity of Agriculture sector has declined. Credit given to areas which are strategic in improving rural infrastructure and would enhance absorption capacity, should please be considered under PSL,

iii) Term loans to the identified sectors are not covered under PSL. As banks have become the sole provider of institutional term credit, we may not need a distinction between term loans or cash credit in so far as meeting PSL targets are concerned,

iv) Target for lending to agriculture may be based on the activity without ceiling on the credit limit or category of borrowers,

v) Ceiling on credit limit may be removed for (a) Fertilizer / pesticide dealers, Agri input dealers etc. (ceiling : ₹5 crore) and (b) Cooperative societies of farmers for disposing of produce of members (ceiling : ₹5 crore), and

vi) Lending to infrastructure like Solar Power, Rural road, Agro Tourism, Drinking Water Tanks, etc. should be part of PSL.

D)More Autonomy in Functioning : In the last two decades of reforms some autonomy has been granted by the Government / Regulator to Indian banks. However in the HR related matters there is need to provide level playing field to public sector banks. Flexibility in recruitment exercise (for example, campus recruitment ideally suited for specialist domain jobs) independent incentive structure mapped to performance and balance sheet of banks, greater leeway in promotion of staff welfare activities and operational flexibility in matters of posting are some of the areas where PSBs need more autonomy from the Government side.

Section-III : New Business Strategies depend on Demography and Technology

The 90s, besides the reform of Indian financial sector, also saw the advent of the internet boom. Technology, the great disruptor made its way across Indian banking sector. The rapid growth of the IT services in India also helped in bringing a new phase in banking. Indian banks too have become technology driven. New technologies are changing the face of banking, like all industries, by modifying the behavior and expectations of customers and radically altering the way business is carried out.

Due to increase in mobile phone users, mobile banking is the new buzzword in banking. In addition, thanks to the growing e-commerce business, a shift to cashless and online payments is fast becoming a reality in India. Banking through the internet, e-banking and online payments have picked up and is expected to increase substantially in the future. With 356 million in the age group of 10-24 years, India has the world's largest youth population, according to UN report 2014. The current median age is 26.6. The median age by 2030 will be 31. The technology savvy population will have its own specific sets of needs and aspirations when it comes to banking.

A) Digital Banking

Digital financial service remains an unexplored area in India. Half of the existing bank accounts lie dormant due to reliance on cash transactions.

Mobile Banking in India

Year	Volume (Million)	Volume (₹ Billion)	Volume per Transaction (₹)
2010-11	6.9	6.1	884
2011-12	25.6	18.2	712
2012-13	53.3	59.9	1124
2013-14	94.7	224.2	2367
2014-15	172.0	1035.6	6021

Source : RBI; SBI Research.

i) Mobile Banking : The use of mobile banking will take banking beyond information access, making transactions like bill pay, funds transfer, and service requests more easy and right at finger tips. The vast potential of cellular technology in future banking growth is evident from the fact that mobile banking transaction costs about 2% of cost of branch banking, 10% of the ATM based transaction cost and 50% of the cost incurred on internet banking. This cost advantage of mobile banking still remains untapped. The future business opportunities of banks business will vastly depend on how well banks connect with customers, be it technology savvy or otherwise.

With the rapid growth in the number of mobile phone subscribers in India (about 933 million as at the end of Mar'14), banks have been exploring this mode, which has a potential to become the future of banking in India. At present, under Mobile Banking services, customers are permitted to check balances, payment's status, instruct banks to issue cheques / drafts, pay bills, deliver statements of accounts, etc.

Increasingly, banks in several countries, allow customers to open a new bank account through their mobile phones, making branch visits redundant. Mobile Remote Deposit Capture, a new technological innovation is a facility that combines digital photography and image recognition to enable customers deposit cheques *via* mobile phones and has become very popular in the countries where it is on offer. The mobile wallet technology could soon replace cash and card in financial transactions.

ii) Cash-less Banking : The experiences of advanced countries suggests that as the economies grow, preferences for substituting cash with more electronic based payment methods becomes imperative. The experience in India over the last couple of years has been somewhat on similar lines - a greater acceptance and penetration of modern electronic payment methods in the country. Even with an associated fee, electronic mode can be less expensive compared to the available alternatives. The use of electronic payment instruments also allows the unbanked to start building a transaction history, which can be a step towards initiating them towards financial inclusion. Additionally, available data in public domain suggests that debit cards are a more preferred option of use in India than credit cards. The experience in China and Germany, both of whose economies are bank dominated, suggest the same. This preference, if accounted in policy, can lead to significantly better product designs and hence customer satisfaction for banks.

issuance of debit card instantaneously. State-of-the art technology with the active help of remote relationship managers will enable an interactive environment for cash deposits and withdrawals, cheque deposits, enquiries etc.

iv) Cost Reduction : In terms of economics, Digital Banking will help banks in bringing down intermediation cost. Banks in India operate with an average net interest margin of 3.1% (2014). Digital Banking will also help in redistribution of manpower requirements (for example, from active to remote relationship managers) to a significant extent and will also impact positively on profitability of banks. Digital Banking model could be very effective and cost savvy for 'Payment Banks' and 'Small Banks' as these banks will be allowed limited banking access and are likely to be opened under differentiated banking license, once RBI comes out with final guidelines. Note the purpose of these banks is to hasten the process of financial inclusion.

Preference for Credit and Debit cards in Select Countries

	Western Countries			Eastern Countries		
In Millions	**USA**	**UK**	**Germany**	**India**	**South Korea**	**China**
Population	312	63	82	1202	50	1344
Cards with credit function	1680	57	27	18	122	285
Cards with debit function	286	86	104	278	136	2664
No of credit card per debit card	5.9	0.7	0.3	0.1	0.9	0.1

Source : SBI Research, BIS

iii) Technology Driven Financial Inclusion : Choosing a cost effective model for such financial inclusion will require banks to significantly free up human resources, apart from using a banking correspondent model. It may be noted that in the next five years, nearly one-third of the existing manpower of banks is going to retire on attaining superannuation. Against this background, banks can continue to encourage people to (a) go for Branchless Banking (mobile and internet banking) and (b) Digital Banking. While branchless banking is already prevalent, the concept of Digital Banking is beginning to get relevant for Indian banks.

In effect, through Digital Banking, the customers will be able to open accounts on their own along with

With increase in financial inclusion and digitalization of banking, requirement of cash in the economy will reduce thereby helping in controlling unaccounted money in the economy. With large sections of population using cash for transaction, with rapid financial inclusion, we expect the cash component in broad money supply to decline in India in line with developed countries like UK (2%), Australia (3%), and Japan (6.0%) on a going forward basis. The positive spill over from this structural transformation in the long-run will be enormous.

B) Banking through Social Media

The role of social media in new age banking is gathering speed in India. Social media networks like FaceBook and Twitter are the gateways to the digital consumers. This is

where the Gen Y not only researches and forms opinions about financial products but also where they air their views to influence those of others.

A study of various social networking sites across the world in the last couple of years shows that Facebook occupies a dominant position (more than 1100 million users). More than 60% of the market share of visits to social media websites and forums has been garnered by Facebook.

Banks should focus on Facebook and expand their reach and connectivity. A beginning has been made, but they need not only use the networking capabilities of social media and but also use the analytics in the background to understand and serve the customer better. This will allow banks to integrate products and services in a better way.

C)Banking through new Technologies

Branch banking is also likely to undergo transformation with the emerging technological innovations. For e.g., customer behavior can be studied using solutions which employ technology to capture images of customers' activity as they are in a retail outlet, and analyze this information to improve services and sales.

Automated queue management solutions and technology, enabling customers and bank officials to search for information over a tabletop touch screen are the other innovations.

Technology will undoubtedly be the biggest enabler of the banks in the future. For new age banking to work, mobile banking, internet banking and new technologies will have to complement with branch banking in service delivery.

Virtual Banking : Virtual banking is nothing but a virtual version of all banking services and transactions that traditional bricks-and-mortar banks are currently doing. Under the virtual banking, the internet banking channel has gained importance in recent times. There is a paradigm shift from paper-based payments to electronic payments. At present, around 60% of the banking transactions are being done through electronic mode, which stood at only 22% in 2011-12.

Remote Expert : Now, banks have established help desk to help the customers 24x7 on their basic banking needs. It enables banks to increase profitability by connecting the bank customers with their experts across well attended and self-service channels, delivering a interactive experience in an Omni channel environment. These facilities increase revenues, improve productivity, and enhance customer loyalty. Remote Experts note retail banking customers' request and connect with banking experts anywhere in the enterprise, using whichever channel and endpoint the customer prefers. It allows banks to create a virtual pool of experts and specialists, whether co-located in specific contact centers or dispersed throughout the enterprise.

Section-IV : Concluding Remarks

A paradigm is the generally accepted perspective of a particular discipline at a given time. The times that we are in are a time of transformation. The paradigms that governed the businesses are undergoing an overhaul. With the evolution of the financial system, the banking system, the cornerstone of the financial system is also not untouched. Banks are critical to the overall smooth functioning of the economy as they are the pillars of the financial system. They are the major source of credit and liquidity in the system. The traditional function of the banks is mobilizing the savings into capital formation. Though that remains the primary function, banks are now providers of various other financial products. As customers become time constrained and seek ease of doing business and customized solutions, banks will have to make sure they follow the clichéd albeit poignant motto of "Customer is King". Customers expect an end-to-end consistent experience in their banking, whether done through a branch, desktop, mobile or a tablet. In this context, embracing a digital business model becomes imperative for future growth. Robust online solutions for day-today transactions, collections and transfers are required to meet customer demands. A key initiative is the use of 'Big Data' to build better efficiencies and service levels into the processes. Big Data will have to be leveraged by means of advanced analytics, to unlock a treasure trove of information to understand

customers' distinctly individual needs. The early adoption of new age technologies will remain the key to success. Banks therefore need to work increasingly towards customer education and awareness. Experiential marketing is an ideal technique to boost the usage of new technologies.

Banks play a critical role in a modern market economy but there are restrictions in terms of market discipline *vis-à-vis* non-financial corporations. Banking is therefore one of the most regulated sectors, from licensing to supervision to deposit insurance. As the pace of economic activity gathers greater momentum in the coming years, banks will have to improve and strengthen their capital planning processes to support future business growth. Basel III Capital Regulations will be the governing principle for fulfilling regulatory norms regarding capital. Though the processes for the customers will have to be simplified, on the regulatory front banks will have to be sound. Enhanced regulation and supervision will have to be done for meeting new regulatory targets well ahead of deadline.

Finally any institution is made better by the quality of human capital that it employs. Until artificial intelligence is fully developed, human capital is needed to accomplish any task in the world today. In fact, creation of other forms of capital also requires human capital. Machine has eliminated the need to have human labour make products, but it needed human labour to build the machine. Going further human capital will become increasingly indispensable as we move to a knowledge-based economy. As banks transition into the future, building the capabilities of its employees, in terms of providing better quality service, as well as technology adoption will play a key role in differentiating the good from the best.

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Risk Management & Regulation in Indian Banking Sector - New Paradigm

V. R. Iyer *

Risk has always been an inherent part of the business of banking but the debate on managing risk has gained prominence after the financial crisis of 2008. Although accepting deposits and lending are the main activities of banks; with higher degrees of sophistication in banking operations today, many banks are now into derivatives, underwriting of securities, corporate advisory business, asset securitization etc. Others have expanded their transaction processing, custodial services and asset management business in the quest for increased fee incomes.

As the business and operations of banks, like any other business, are guided by returns and profitability, recognition and management of the risks on an ongoing basis have assumed significance. The element of risk in a bank's business is higher as they are highly leveraged institutions operating largely with borrowed money.

Banks basically have liabilities which are liquid and assets which are illiquid making them more vulnerable to risks. The main risks which have a significant impact on a bank's performance are credit, market and operational risks. Besides the above, the other types of risks which banks are exposed to include interest rate risk, liquidity risk, exchange rate risk, reputational risk, regulatory risk, etc. Also, banks are closely linked to different segments of the financial sector and the economy - both domestic and global. This at times can trigger widespread destabilization. Financial crisis in the past resulted in major blow outs wiping out billions of dollars of wealth from the system and pushing people and economies into bankruptcy. Stock market crash of 1987, Asian crisis of 1997, dotcom bust of 2000 & the latest, and still fresh crisis of 2007 are some of the notable examples of risks going out of control.

In fact banks were at the center of the financial crisis in 2007-08 that precipitated into a global economic crisis which was of a magnitude not seen since the 1930s. The crisis happened despite the implementation of BASEL-II norms in advanced market economies. This begets the obvious question as to what BASEL-II did not set right. Some of the major deficiencies that were identified by BCBS are -

Level & quality of capital : The ambit of definition of capital in BASEL-II left enough scope for banks to minimize the core capital that belonged to the shareholders. In fact, many banks just held about 2% core capital at the peak of crisis periods. Moreover, because of lack of clarity about definition of capital, regulatory adjustments were not uniform across jurisdiction, thus opening a window for regulatory arbitrage.

Counterparty Credit Risk : The financial crisis brought home the realization that coverage of counterparty credit risk (CCR under BASEL II) was inadequate. It was observed during the crisis that many large banks were holding large volumes of complex and illiquid credit products in their trading book and the existing guidelines only accounted for default risk. The credit market turmoil proved that large losses could arise due to credit migration combined with widening of credit spreads and loss of liquidity.

Liquidity and Maturity Mismatch : One of the fundamental aspects of intermediation function of the banking sector is the Liquidity and maturity transformation, i.e., funding of long term assets with short-term debts. Throughout the crisis period, many banks encountered unprecedented liquidity shortfall, requiring central bank support. Insufficient liquidity buffer was a major reason for banking sector's

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inability to function in the aftermath of large credit and trading losses. According to BCBS, "inaccurate and ineffective management of liquidity risk" is a key characteristic of the financial crisis.[1]

Securitized and Re-securitized Products : The critical role the securitized and particularly re-securitized products like CDOs played in engendering the financial crisis underscored the need of strengthening risk capital computation of these products. Under BASEL II, securitization was treated on the same footing as corporate debt instruments. This has led to significant underestimation of risk inherent in such products under a stressed scenario.

Excessive Leverage : One of the causes of the financial crisis was the degree of leverage that banks had built up over time. Since a high degree of leverage has a multiplier effect, having a comfortable capital adequacy ratio did not assure that a bank will not fail.

Transparency : The level of disclosures prescribed under BASEL II was not adequate for making a comparative assessment in regard to the adequacy or otherwise of capital and its quality across different banks.

Excessive Credit Growth : The financial crisis showed that losses incurred in the banking sector following excessive credit growth could be large enough to clam up the entire credit market. The resulting negative shock to the real economy unleashes a vicious cycle of lower demand for credit leading to further instability in the banking sector. Thus, the regulatory capital framework needs to be calibrated to build up capital defenses in the periods of excessive credit growth.

Systematic Risk : The interconnected nature of the banking system was not factored in the design of the BASEL II regulatory framework. The failure of one financial institution was enough to endanger the entire financial sector. There is, therefore, a need for identification of systematically important financial institutions and to assess the impact of failure of such institutions, even though individually such institutions may be having sufficient risk-based capital.

Thus several factors, both macro-economic and regulatory and supervisory have led to the crisis of 2007 of such large dimension. **In the ultimate analysis, risk measurement and management tools and methodologies have proved to be grossly inadequate despite tremendous development and sophistication brought about in risk modelling**.

The effect of the crisis has not only been severe but also prolonged with many of the economies still trying to come to normalcy. Clearly, there was failure of corporate governance in not putting in place adequate systems to mitigate risks.

Global initiatives for strengthening risk management practices :

A large overhaul of the regulatory framework has been undertaken to plug the gaps in regulation observed during the crisis and also to make the financial systems more resilient. The new set of regulations, popularly called BASEL III, seeks to address both specific and broader systemic risk. The measures relate to enhancing the quality and quantity of capital, liquidity risk management, valuation practices, dealing with pro-cyclicality issues and with systemically important banks including enhanced resolution mechanism for systemically important banking groups. It also covers compensation policy, stress testing, disclosures to enhance transparency and reducing systemic risk in the financial market by encouraging OTC derivatives to move to central clearing and settlement mechanism, etc.

Regulatory scenario in India

The Reserve Bank of India has been proactive and has been demanding that banks have in place a robust risk management system and has adopted an approach of limiting systemic risk.

RBI has agreed to implement BASEL III to fall in line with the international standards and has drawn a road map for the same to suit the country specific conditions.

Important regulatory and supervisory measures

In India, implementation of BASEL III capital regulations have commenced from April 2013 and would be fully implemented by March 31, 2019 close to the internationally agreed BASEL III transitional arrangements.

1. http://www.bis.org/publ/bcbs165.htm

Minimum Capital Requirements : RBI has stipulated minimum total capital requirements for banks under BASEL III at 11.5% *vis-à-vis*, 9% under BASEL II. RBI requirement is 1% higher than Basel Accord as a prudential measure.

Capital Requirements for Bank Exposures to Central Counter Parties (CCPS) : In order to promote central clearing through well managed CCPS, in January 2014, banks were advised their clearing exposure to a Qualifying CCP (QCCP) would be kept outside of the exposure ceiling of 15% of its capital funds applicable to a single counterparty. Other exposures to QCCP such as loans, credit lines, investments in the capital of CCP, liquidity facilities, etc., will continue to be within the existing exposure ceiling of 15% of capital funds to a single counterparty. However, all exposures of a bank to a non-QCCP should be within their exposure ceiling of 15%.

Countercyclical Capital Buffers : Taking into consideration the evolution of the Indian economy and other relevant factors including BCBS document on this aspect, a countercyclical capital buffer has been introduced vide RBI circular dated 21st July 2014. The major recommendations of the Internal Working Group are as under :

a. The trigger for CCCB decision has been defined to include credit to GDP gap, gross NPA growth, industry outlook assessment and interest coverage ratio.

b. The CCCB will be maintained only as Common Equity Tier-1 capital.

c. The CCCB shall gradually increase from 0 to 2.5% of RWA depending on the triggers used for CCCB.

d. CCCB may be operated in conjunction with the sectoral approach and for all banks operating in India shall be maintained in both solo and consolidated basis.

Dealing with Systemically Important Banks - D-SIBs : Based on the internationally agreed reforms, the framework for dealing with D-SIBs in India was issued in July 2014. The assessment methodology incorporated major indicator categories; size, interconnectedness, substitutability and complexity. Based on their systemic importance scores in ascending order, banks are slotted into four different buckets and will be required to have additional CETI capital ranging from 0.20% to 0.80% of risk-weighted assets depending on the bucket that they are slotted to. The computation of systemic importance scores will be carried out at yearly intervals and the banks classified as D-ISBs will be disclosed in August every year starting from 2015.

Capital & Provisioning requirements for bank exposures to entities with unhedged foreign currency exposure : Corporates' unhedged foreign currency exposures have been an area of concern not only for individual corporates but also for the financial system as a whole. The final guidelines, issued in January 2014, provide a methodology to be adopted by banks to compute incremental provisioning and capital requirements. More specifically the incremental provisioning requirements are to be calculated as per the ratio of likely loss due to foreign exchange movement to a company's earnings and depreciation and incremental capital will need to be provided accordingly. It is expected that these measures will incentivize corporates to hedge their foreign currency exposure and also enable banks to develop capabilities to measure and manage currency-induced risks.

Liquidity Coverage Ratio (LCR) : Taking into account the final guidelines issued by BCBS, the Reserve Bank issued its final guidelines on LCR, Liquidity Risk Monitoring Tools and LCR Disclosure Standards' in June 2014, keeping in view country-specific considerations as well. Therefore, besides the usual phase-in arrangements and definitional aspects, the guidelines by the Reserve Bank also consider the range of high quality liquid assets (HQLAs) available in Indian financial markets and their liquidity features. As a result, investment in government securities to the extent of 2 per cent of NDTL was allowed to be included as level 1 HQLAs.

Subsequently, banks have now (with effect from January 1, 2015) been permitted to reckon government securities held by them up to another 5 per cent of their NDTL within the mandatory SLR requirement as level 1 HQLAs.

Further, eligible common equity shares with 50 per cent haircut have been allowed to be included as level 2B HQLAs. Liquidity risk monitoring tools have also been suitably prescribed in RBI's standards. Accordingly, four additional returns have been prescribed for banks : the LCR, LCR by significant currencies, available unencumbered assets, funding concentration and other information on liquidity by banks.

Securitization : The Reserve Bank revised its guidelines on securitisation in May 2012 and introduced norms on minimum holding period, minimum retention ratio, and standards for due diligence to align the interest of the originators and investors, and induce 'Skin in the Game' concept to discourage 'Originate to Distribute' models.

Intra-group Transactions and Exposures (ITEs) : In order to avoid concentration of credit risk and large losses, limits have been prescribed on February 4, 2014.

Stress Testing : Guidelines and principles have been updated in tune with the BASEL Committee Principles. Stress Testing will complement other risk management tools such as Valuation Risk (VAR) and Economic Capital etc. As risks have increased along with business opportunities, stress testing has assumed more importance.

During 1980s, almost 45 countries and during 1990s, around 63 countries faced systemic banking crisis. It is our good fortune that we have not witnessed any severe stress in the past. This makes it difficult to introduce possible and plausible stress scenarios relevant to Indian conditions.

Compensation Packages : Perverse incentives due to irrational policies were one of the causes attributed to the outbreak of the crisis. It led to short term benefits / profits without getting recognition of the risks getting built over a long term period. RBI has issued guidelines on compensation practices for private and foreign banks based on the international initiatives.

Dynamic Provisioning : Building a countercyclical provisioning is a prudential measure for strengthening the resilience of the banking system. BCBS is working on an expected loss based provisioning methodology. In India we have the concept of floating provisions which RBI has permitted to use only under certain exceptional circumstances. While RBI is working on proper framework, in the interim period, our Regulator has developed a methodology based on Special Provisioning System which has been put up for public comments.

Setting up of Holding Companies : At present most of the financial groups in India are led by banks and organized under the subsidiary model. This puts the onus on parent banks for Corporate Governance, performance and capital requirement of subsidiaries. The working group on “Introduction of Holding Company” structure in India for banks has recommended for migration of major financial conglomerates to an holding company structure to address these limitations to some extent.

The Reserve Bank of India has from time to time issued regulatory guidelines on other important areas such as Corporate Governance, Fit & Proper, Know Your Customers / Anti-Money Laundering, Credit Intimation Sharing, Customer Services in addition to Specific Guidance Note on Credit, Market & Operational Risk Management, etc. and on pillar to risks to strengthen the overall risk management culture in Indian Banks.

Developments in cross-border supervision :

Basel Core Principles : In compliance with the FSAP (2011) assessment of the Reserve Bank as 'Materially Non-compliant' in respect of three Basel Core Principles (BCP) which include BCP 25 (Revised Principle 13) on 'Home-Host relationships', the Reserve Bank has made significant progress regarding supervisory information sharing and cooperation with jurisdictions where Indian banks are operating. As part of this process, the Reserve Bank has already entered into 20 Memoranda of Understanding (MoU) and one Letter for Supervisory Co-operation with overseas regulators / supervisors.

Supervisory Colleges : With a view to improving cooperation and information exchange between

home and host supervisors, the Reserve Bank arranged a supervisory college with respect to two major Indian banks in 2013-14 (Bank of Baroda and Bank of India). Supervisory colleges were hosted earlier for State Bank of India and ICICI Bank Limited in 2012-13.

Inspection of overseas branches / subsidiaries of Indian banks : Global operations of Indian banks are spread across 54 countries. In order to assess the financial position, systems and control of overseas branches, an inspection of eight banks in five overseas jurisdictions covering almost 60 per cent of the total overseas assets of Indian banks was undertaken in 2012-13. In 2013-14, an additional six banks in six jurisdictions covering another 20 per cent of the asset ownership were inspected.

Revitalising distressed assets : A framework for revitalising distressed assets in the economy was operationalised by the Reserve Bank with effect from January 2014. In essence, the framework outlines a corrective action plan that will incentivise an early identification of problem accounts which are considered viable and their timely restructuring and taking prompt steps for recovery or sale of unviable accounts. The salient features of the framework include :

a) A Central Repository of Information on Large Credits (CRILC) has been set up to collect, store and disseminate credit data with respect to borrowers having aggregate fund-based and non-fund based exposure of 50 million and above,

b) All commercial banks are required to mandatorily report their credit information on their borrowers / customers,

c) NBFC-ND-SI, NBFCs-D and all NBFC-factors (notified NBFCs, for short) are also required to furnish such information,

d) Banks were advised to furnish details of all current accounts with outstanding balance (debit or credit) of ₹10 million and above, and

e) Banks are required to monitor stress in borrowal accounts through three categories of special mention accounts (SMAs).

Sale of NPAs to Asset Reconstruction Companies (ARCs) : In February 2014, as part of the Framework for Revitalising Distressed Assets in the Economy, banks have been allowed to :

a) Reverse excess provision on sale of NPAs to profit and loss account to the extent of cash received on account of sale of NPAs is more than the net book value of the NPAs,

b) Amortise the loss on sale of NPAs to ARCs where the sale consideration is less than net book value (with regard to NPAs sold up to March 31, 2015) over a period of two years,

c) Sell financial assets to Securitisation / Reconstruction Companies (SCs / RCs) which are reported as SMA-2 by the bank / FI to CRILC, and

d) Use countercyclical / floating provisions for meeting any shortfall on sale of NPAs (i.e., when the sale is at a price below the net book value).

These measures are aimed at incentivising banks to sell their NPAs to SCs / RCs, who in turn are expected to act as a supportive system for stressed asset management with greater emphasis on asset reconstruction.

Depositor Education and Awareness (DEA) Fund Scheme, 2014 : Pursuant to the enactment of the Banking Laws (Amendment) Act, 2012, a separate section has been inserted in the Banking Regulation Act, 1949 relating to the Depositor Education and Awareness (DEA) Fund.

As per the scheme, which is applicable to all commercial and co-operative banks in the country, the amounts to be credited to the DEA Fund shall be the credit balance in any deposit account maintained with a bank which has not been operated for ten years or more, or any amount remaining unclaimed for ten years or more. The bank shall calculate the cumulative balances in all such accounts, as on the day prior to the effective date and transfer the amount to the DEA Fund on the last working day of subsequent month along with the accrued interest. The DEA Fund will be utilised for promoting depositors' interest and for such other purposes which may be necessary for promoting depositors' interests as specified by the Reserve Bank from time to time.

Risk Based Supervision

A significant shift has occurred in the approach to supervision of commercial banks in the form of risk based supervision. At the core of this approach is the evaluation of the quality of the banks' procedures for evaluating, monitoring and managing of risk and also banks' internal models for determining the Economic Capital. Targeted and more focused inspections form the basis of RBS. The success of RBS depends on the quality of integrity of data, skill levels and competency across banks and orientation of management at several layers to the risk-oriented business activities.

The initial process and activities commenced by RBI is creating anxieties for management of the Banks in streamlining its procedures and in the enhancement of MIS and data quality.

Risk Management Practices in Indian Banks

Risk management practices in Indian banks have improved over time. Banks operating in India have migrated to the standardized approach of BASEL II by March 31, 2009. As per RBI sources, some banks have been given approval for migrating to better methods of assessing and providing for credit, market and operational risks.

There is a renewed focus on risk culture today. Of course, there is still lack of adequate systems and data. Embedding risk appetite into business decisions is also a challenge.

Concluding Thoughts

The performance of Banks is inextricably linked to the performance of the Economy, more so in India where the financial sector is heavily dominated by the Banks. Since the beginning of the financial crisis in 2008, the global economy has continued to oscillate and our banking system has not remained immune. Geopolitical risks surrounding oil prices continue and the uneven effects of currency and commodity price movements also pose considerable challenge to us. Besides this, continued prolonged slowdown has led to serious concerns on asset quality, profitability and Capital adequacy of our banks.

The levels of gross NPAs and net NPAs for the system have substantially elevated in the last 3 years. As per preliminary data of RBI for March 2015, GNPAs and NNPAs have climbed to 4.45% and 2.30%. If we add the portfolio of restructured assets to GNPA numbers, the level of Stressed Asset Ratio as a whole stood at 10.9% as at the end of March 2015. The level of stressed assets, of course, is not uniform across all banks.

The piling up of distressed assets and consequent drop in profitability is largely a fall out of poor economic environment – both domestic and global. Our corporates also during good times have overleveraged themselves by investing in non-niche areas. Many during the last two years have come to grief and are unable to pay even the quarterly interest. While quite a few have tried to sell their non-core assets, considerable difficulty is being experienced in finding right buyer and also valuation.

With each quarterly corporate results season, we see increased market nervousness surrounding Asset Quality of the banks. Several investment projects, especially in infrastructure space, have got stuck for want of required approvals / reversal of approvals. Banks also lacked expertise in comprehending fully the magnitude of risks in these projects. There was no contingency planning. Assumptions of the Corporates were taken at par. No exit route was thought of. There is a need to improve the Credit Appraisal of projects and infrastructure finance and also monitoring system based on early warning triggers.

Two very disturbing facts which have hit us are –

a) The quality of equity of the promoters. In certain cases, it is the debt raised elsewhere by the promoter, which may be either in the holding company or in an SPV, which is used to fund their part of the equity. On account of this, most of the corporates are having very low interest service leverage ratios and are unable to service the quantum of quarterly interest also.

b) Many of the corporates have also resorted to high leverage and the banking system has failed to take adequate cognizance of the build-up of leverage while sanctioning or renewing limits.

The banks also need to improve their market intelligence and economic analysis, so that they can better identify demand–supply gaps. Only then, can we arrest the future built up deterioration in asset quality.

Turning to a related issue is the KYC, which to my mind is one of the most important concepts in banking parlance. It is a critical component of risk management framework. Today there is a greater need to know your customer, the nature of his business and the inflows / outflows of the account, if we are to provide customized solution to him. In addition, it is imperative to know through market intelligence customer's Business Risks, which should get ingrained into the banks processes and business decisions.

Imperatives

We have learned from the financial crisis that the biggest mistakes get made when the going is good. There is a creation of asset bubble; banks look for more collaterals instead of intrinsic cash flows. Liquidity risk comes to the fore. Banks get struck with illiquid assets; then banks get scared and withdraw credit lines and you have a contagion effect taking place. So all of this emphasizes the following :

a) There is a greater need to properly understand and monitor underlying risks at all levels in the organisation.

b) There has to be a proper communication between senior management, business heads and risk function heads to create enterprise-wise risk management frameworks.

c) There should be a robust Management Information System.

d) The output of risk management systems and models should get embedded in the decision making process.

e) Over reliance on quantitative models may underestimate the tail risks. Stress testing and back testing should be more gainfully utilized.

f) The assessment of risk is at the heart of risk management. However, simply assessing risk will not lead to optimizing risk return reward. The hurdles, we generally face are around getting buy-in at the business unit level. Risk assessment should define the framework for risk monitoring and reporting. It should be embedded into existing processes so that it ceases to be a conscious activity. What you need is a framework that is operating but invisible.

g) Control optimization corresponding to risk actually drives efficiencies. As such, care should be taken to ensure risk mitigation plans do not get relegated as a secondary part of the process. This, in fact should become fundamental to capital allocation and compensation processes.

h) Quantification does add value to risk functions; but at the same time, intuition or judgment should continue to be given due importance.

The new international regulatory measures under the Basel-III norms can have an adverse impact on the economic growth and banks will need to brace up to this fact. Higher capital and minimum liquidity requirements are likely to adversely impact the return on equity. On the part of banks, it is very necessary that Banks strengthen their integrated risk management systems and performance measurement approach covering RAROC for improving capital efficiency and optimization. Risk management has to become accepted as a discipline that has something to contribute in developing business strategy and business planning. Every organization has to create its own momentum for this.

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New Paradigms in Management of Banks

Arun Tiwari *

***Bank :** An organization where people and businesses can invest or borrow money, change it to foreign money, etc., or a building where these services are offered.*

—Oxford English Dictionary

Most people would easily concur with this definition of 'Bank'. At a core level, this is what banks do and should be doing. This basic definition got re-emphasised with the Global Financial Crisis (GFC) of 2008, which, in many ways, upturned ruling wisdom of the day. Governments, which earlier championed Laissez-faire ideology, had to step in for salvaging the failing banks; thus, de facto, nationalising several private sector banks. Role of the state in financial development has since been called upon to provide 'strong regulation and supervision and ensure healthy competition in the sector, and to support financial infrastructure, such as the quality and availability of credit information'[1].

In developing countries like India, the Government was, and continues to be, dominant stakeholder in developing financial institutions and, in process, wielded direct control in their operations. Indian banks, however, much to the surprise of the Advanced Economies, could withstand the shock of GFC well and remained stable in the post-crisis period. Indian banking sector also discovered its soft underbelly with economic slowdown post 2011 manifesting through strains on asset quality, shrinking loan opportunities, weaker pricing power, and enhanced capital requirement under Basel-III norms. If the current challenges are seen in their larger macro context, in my view, our banks have responded fairly so far.

Changing Landscape of Banking

Banking is poised for new shifts of the decade with changes imminent in scale as of variety. There has also been powerful debate on complexity of financial systems. Ownership and organisational structure of banks have got scrutinised to bare details.[2] Interestingly, universal banking model, which was so popular during pre GFC years, is now making way for leaner, specialised, and largely retail focussed banks globally. India is also experimenting with a mix of players on banking arena, like payment banks, small banks, foreign banks preferably through subsidiarisation route and of course, new set of universal banks. It promises to be an exciting phase of growth ahead for banking industry in India. Conventional banks rooted in brick-and-mortar branch driven delivery channels need to have an eye on Payments Banks. When most aspects of banking can be done online, competitive reach is no longer a function of branch networks alone. New bank licenses will indeed usher in more competition. However, given the extent of banking penetration in India presently (credit to gross domestic product ratio at 55 per cent), there is enough space to grow for the existing as also the new players without making it a zero sum game for the incumbent.

Changing Business Vocabulary

Contrast to a decade or two ago, today there is greater sensitization among bankers on the role which technology can play, need to adopt a customer-centric approach, need of motivating the workforce, providing performance incentives, etc. The GFC 2008 has, meanwhile, reminded us of importance of prudence over ideological adventurism of free markets. In the

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1. *Refer 'Global Financial Development Report 2013; World Bank'.*
2. *Refer reports by Liikanen Commission in European Union, Vickers Commission in U.K., and the Dodd-Frank Act in U.S.A.*

emerging banking scenario, therefore, the foremost shift warranted in management of banks is a change in the business vocabulary of Top Management — from 'business' to 'business ratios'. There ought to be synergy between the growth in overall business and the bottom line, i.e. profit. For this, there is a need to grow in focus areas, where the margins are better and which also help one meet the regulatory requirements. The growth, importantly, is to be weighed *vis-à-vis* its implications on efficiency and profitability ratios.

Risk Management

It has to be all pervasive. Changing contours of banking demands greater degree of sophistication. Risk starts right from origination of any liability or asset business and gets deeper with every step. Indian banks have relatively good systems in place and going forward, technology could be leveraged to empower the process of risk philosophy bank wide.

In current business cycle, asset quality deterioration has hit the bottom-line for banks, wherein public sector banks (PSBs) are hit hardest. The fact that the PSBs went big on expanding credit post the GFC, 2008, partly explains their disproportionate share in bad assets when the cyclical downturn hit rather sooner in 2011. Stress in key sectors however has peaked, though the elevated levels could keep financials under strain in near term.

If one goes behind the bad loan numbers related to the infrastructure sector, which has been greater chunk of non-performing assets (NPAs) of banks in India, what is important to appreciate is that they are not white elephants as such. These assets generate a stream of output that has ready demand. More importantly, the whole economy needs these sectors to be up and going given their high inter-and / intra-sector linkages. They therefore, will gradually start bringing in cash flows for investors and for banking system if certain concerns such as fuel supply, distribution losses of state electricity boards, and off-take agreement design, etc., get addressed.

Government and the Reserve Bank of India (RBI), working together with banks, have mostly accomplished the hard task of fixing the systemic concerns in last one year. These included special mention accounts (SMA) reporting norms, strategic debt restructuring (SDR) norms, tightening provisioning norms, Joint Lenders Forum (JLF) guidelines, long tenor instruments for better price discovery and risk management, etc. Nevertheless, banks have to stay aware of asset quality challenges in a still recovering economy and, therefore be vigilant through better loan origination, underwriting and right kind of monitoring approach. My sense is that, in a couple of quarters, Indian economy, a jumbo of 1.25 billion people, will take-off and will be soaring high in skies it is destined to.

Human Resource Management

With banking processes getting more complex and the inter-dependence of information technology processes with all operational aspects, it is all the more important to have requisite manpower with right amount of knowledge and experience at appropriate places. Amid ongoing mass retirements, the PSBs have to grapple with a near vacuum in the senior management over the next few years. A careful HR strategy is required, else it could hurt expertise in critical areas like Information Technology (IT), risk management, credit appraisal and treasury operations, etc.

Banks need strengthening systems that would harness skills and insights of people; that would spark new ideas and enable simplification of processes and deliverables. There is a felt need to invest in training and re-skilling of employees in a manner which is relevant, efficient and result-oriented. More importantly, banks need strengthening their Performance Management Systems (PMS) to clearly distinguish good performances and create further opportunities for the individuals in career progression, incentive, placement, etc. It is easy to lose sight of building human expertise in a quest of expanding core business.

Banking on Digital Channels

Digital transformation is expected to change banking dynamics in the not too distant future. Digital banking, as I see it, could shadow branch banking rather sooner than what most of present day bankers would acknowledge. Today, e-savvy banks

take greater share of payments made by customer. Going forward, the number of transactions facilitated by a bank will determine its market share in deposits. Mobile Banking in India is picking up rapidly. As per the Monthly Bulletin of the RBI, there were 21.4 million mobile banking transactions with a balance of ₹199.1 billion in May, 2015 as against 10.9 million transactions with a balance of ₹38.8 billion in May, 2014. Banks have now tied up with Telecom companies for Unstructured Supplementary Service Data (USSD) based mobile banking, which shall enable the rural population as well to operate mobile banking seamlessly.

India is having a very high mobile density with over 900 million mobile users in the country; however there are only 40 million mobile banking customers. There is a huge potential for leveraging on this technology and roping in mobile banking as financial inclusion drive for creating a payment ecosystem in the country. Moreover, the determined efforts of Government of India under its 'Digital India' campaign will further stimulate the mobile banking demand by making customers better informed and tech savvy. It is, therefore, imperative on us to expedite channel migration of customers — moving transactions from costly Branches to Digital Channels; of which migration from ATMs to Internet Banking and priority be on lowest cost alternative Mobile Banking.

Capital Efficient Growth

Banks have sufficient capital cushion as per prevailing regulatory requirements. The Capital to Risk-weighted Assets Ratio (CRAR) of scheduled commercial banks at the system level improved marginally to 12.9 per cent from 12.8 per cent between September 2014 and March 2015.[3] However, the levels for most PSBs are far lower than banks in emerging market economies and even compared to domestic private sector banks. Government has estimated the capital requirement of ₹2.4 trillion for the Public Sector Banks (PSBs) to make them meet Basel III norms by 2019. It is evident that the Government support alone will not be adequate. It is not desirable either. As profit making institutions, in my view, banks should not thrive on taxpayers' money. It should come from their operations. However, there is a lot that has been constraining the PSBs to realize their potential. I believe, as the economy improves, several of the projects currently classified as NPAs in banks' book would come on stream and begin the cash flows. This, in turn, would assist profitability.

In the immediate term, banks should undertake capital conservation measures such as data cleaning, rebalancing of asset portfolio towards sectors which provide a natural hedge against the cyclical downswing by anchoring profit margins with better yields, diffusion of credit risk, checking growth in risk weighted assets (RWAs) due to relatively resilient quality assets, etc. Furthermore, increasing fee income base will add up to profitability without increasing the RWAs.

As the Basel III transition is coinciding with India's smart take-off years, in my view, the best way forward is pursuing efficiency led growth. If efficiency gains are not there, rate of capital burn may remain high. During pre GFC years (2000-08), the PSBs gained on efficiency ladder much like private sector banks. However, of late, PSBs have been sub-optimal in value generation for stakeholders. The PSBs still have opportunity to increase efficiency by enhancing capabilities in the key areas like, loan origination / appraisal / monitoring, analytics, customer relationship management (CRM) and technology efficiency. These are some low hanging fruits which if properly approached can lead to efficiency gains for the PSBs.

Enabling Growth in Economy

As for enabling growth in economy, banks should target loan making on capacity building heads, e.g., education, first-time home loans, consumer durables, etc. Infrastructure would be obvious choice given the strong linkages in economic value chain. Recently, the RBI has also come-out with several enablers such as exemption from regulatory pre-emption on funds raised for lending to infrastructure; certain relaxations to delayed projects, wherein date of commencement of commercial operations (DCCO) of projects are allowed to be extended beyond the original DCCO; financing long term projects with an option to refinance

3. *Financial Stability Report for June, 2015; Reserve Bank of India.*

them periodically (5/25 scheme), which is welcome positive for the bank credit to sector. However, I would expect banks trading caution here as infrastructure already account for a significant share of their loan book (around 15% of outstanding credit) with associate asset-liability mismatches (ALM) concerns. The long-term funds available with the insurance and pension sectors can play an important role in financing the infrastructure sector. It's high time we give thrust to deepening corporate bond market in India.

Managing Customer Service Standards

Two decades of sustained high growth has given rise to a neo-middle class, with high flying aspirations. This class is an agile lot, and is found having low customer loyalty. Meanwhile, there has been huge influx of first generation banking customers : The Prime Minister's Jan Dhan Yojana (PMJDY) has augured 177 million new banking accounts opened in last one year. The two together, *viz.* neo-middle class and first generation customers, imply the challenge of sustaining differentiated value proposition is real. I see promises in digital banking as the new generation customers, from both neo-middle class as also newly bankable class, have sort of taken a technology leap, being well conversant with mobile telephony. However, to target the sales, one needs to read the digital footprints of customers. Accordingly the CRM of incumbent banks need a vigorous push if they are to maintain their brand equity intact amid the unleashing of new age banks, which will be free of any legacy issues.

Corporate Governance in Banks

Corporate governance is, by definition, a set of systems, processes, and principles which ensure that a company is governed in the best interest of all stakeholders. Banking sector has made marked gains in improving governance structure over the years. However, there is a large gap still in what is desirable and what is being practiced. The P. J. Nayak Committee, which has reviewed governance of Boards of Banks in India, has done well to underscore seven responsibility areas critical to the Board : a) business strategy, b) financial reports and their integrity, c) risk, d) compliance, e) customer protection, f) financial inclusion, and g) human resource. Delivering the corporate performance in terms of business growth, return to investors, etc is also integral aspect of governance. For this to happen, however, the Board of Indian banks should take custodianship of the organizational purpose, mandate and identity.

Consolidation & Restructuring in Banking Sector

One often hears arguments in media or business conferences about the PSBs perhaps are too many to be managed efficiently. That, the economy needs some king sized banks that could finance big-ticket projects or takeovers. That by merging some banks, some duplicity of networks / business can be avoided and thus a lot of expense could be saved. And these are forceful arguments for consolidating the banking sector. However, I have a view different than this prevailing narrative. Even if there be virtue in consolidation, sequencing is very much required. If the purpose is creating efficient banking sector, then increasing the bank's size doesn't guarantee this. If it were so, the largest banks in the country would have been most efficient banks. However, the fact is, banks which are doing well can be found at varied scale. Thus, first steps are required towards enhancing efficiency. And if the prospective partners see merit in pursuing mergers and acquisitions such that, that there is rise in stakeholders' value post mergers, the owners may facilitate that. We have just witnessed markets welcoming a merger between two banks from private sector. More important task is breaking the homogeneity syndrome. Banks of different sizes, from different geographies need not have similar business pursuits. We should rather be allowing each PSB to develop their own areas of expertise (distinct business models) rather than being clones of each other.

Being Responsible Corporate Citizen

In a country where one-third of population is still struggling to meet even the basic needs, voluntary efforts by corporate have remained woefully inadequate. There was a need felt, to widen the scope of corporate outreach in the society, which culminated in amendment

to Section 135 of Company Act, 2013. Through the amendment, the corporate social responsibility (CSR) spend has been benchmarked and made mandatory for Companies coming under the purview of the eligibility criterion as defined therein. The Act encourages companies to spend at least 2% of their average net profit in the previous three years on CSR activities. As responsible corporate citizen, banks have to be believer in the concept of 'Giving Back to the Society'. There are a number of ways banks can live their social responsibilities. Union Bank of India, for example, has established a Trust 'Union Bank Social Foundation', for spearheading its CSR initiatives in a wide range of social activities including girl child education, health care, disability sector, environment protection, skill development etc.

Union Bank of India - The H.D.R. Framework

Union Bank of India has it focus on strengthening three pillars, other than that of Basel. We call it the H.D.R. Framework. It stands for - 1) Human Capital, 2) Digital Banking, which is the bedrock of service delivery today, and 3) Risk Management. Focusing on these three aspects, the Bank aims to build an ecosystem, where people are hungry for knowledge, and are empowered to do more at individual level, harnessing the power of information technology, for quick, convenient, & quality service to customers on one side; and on other side transform big data to information, and to knowledge, so as to better serve the customers while meeting their varied banking needs. The Bank is now engaged in further improving its process design, uplifting sales performance, building analytics & campaign management capabilities and deepening digital channels as part of its HDR Framework strategy.

From a business perspective, the Bank has its focus on improving efficiencies through re-balancing of balance-sheet, wherein RAM Sector - an acronym for Retail, Agriculture, and Micro, Small & Medium Enterprises (MSMEs) - share in loan book has risen by 10 percentage points in last two years; RAM sectors now constitute near half of gross loan book of the Bank. The Bank is also focussing on encouraging fee-based income, challenging Treasury operations to earn more profits from market participation, harnessing our pan-India branch presence for low cost savings deposits mobilization and containing stress on asset quality.

Going forward

We are indeed living in exciting times : there is an interesting play of forces of harmony and dissonance. In a dynamic economy like India, one needs to be receptive to changes. We are witnessing technological revolution re-writing rules of game. One is witness to exponential rise of mobile telephony in India. Indians are increasingly getting internet savvy. There is a rapid expansion of urbanized habitations, called as census towns, which increasingly follow consumption- pattern of metro cities, even as the job / income profile are very distinct in these towns. These are mere glimpses of the sea of changes around. Importantly, such changes could not have been anticipated merely a decade ago.

There will be opportunities abound for all. However, to give India a definitive edge in the evolving world set-up, we should also be willing to shoulder responsibilities. Banking sector, of which the public sector is major constituent, has to take greater responsibility to ensure India doesn't lose her way for the want of funds. I am confident that banks will shoulder their responsibility nobly.

New Paradigms in International Banking

Stuart P. Milne *

The span of my career in banking, starting with HSBC in 1981, has marked the period of the most rapid change in the history of our industry. Yet the pace of that change is only accelerating and it will not be long before the traditional bank disappears altogether and is replaced by a very different type of organization.

There are many industries in which this evolution has already happened – the whole audio industry has been replaced by iTunes and its ilk. The traditional taxi industry is under threat by the Uber model and its competitors. And Amazon has massively disrupted first book-selling and now retail as a whole. So why should we in banking be any different? The truth is that we are not any different and we as an industry need to adapt rapidly or face extinction.

There are several drivers of change which I will discuss below in some detail : technology, regulation and customer behavior and expectations.

The impact of technology

When I joined HSBC and for some years thereafter, there were no desktop computers, no internet and no email. The NCR 299 machine reigned supreme. We communicated internally by mail in quadruplicate and were subject to the vagaries of the international postal system. So much so, that we often wrote to head office for an approval and rather than await a reply which might take a week to ten days, we would assume a positive response, exercise our judgment and go ahead.

The one positive thing about this was that it gave birth to our mantra at HSBC that Head Office should always respond within 24 hours to any request. Telex was available and as a young officer I spent many hours in the telex room coding and decoding confidential messages with the aid of a complex system of test keys which changed frequently – worthy of a James Bond film!

HSBC has been at the forefront of the technological changes which have transformed our industry in the last 30 years. At HSBC, we launched in the 1980s a universal banking system now used throughout our international network which allowed us to communicate effectively, operate off a common platform and make our operating processes more consistent globally. For our clients, this meant a more consistent global experience in dealing with HSBC as one bank rather than a collection of different banks.

Here in India, we were the first bank to introduce ATMs and the first to have all our India branches computerized and networked across the country. This record of technology adoption has continued up to today with our roll out of tablet based computing for our retail sales force, covering both Wealth Management services and Mortgage origination. I believe this innovation will prove to be as transformative as ATMs were 30 years ago.

Communications too have been revolutionized with the advent of the internet and the consequent ability to network globally, to have information instantly available and to integrate with our clients' own systems.

So much for the recent past. What about the future?

The key thing is that technology ultimately empowers the consumer. It drives transparency and immediacy, it makes it easier for our customer to do business, whether we are talking about personal customers or major global corporations and it ensures a more consistent and predictable level of service.

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From a customer standpoint, technology and the automation of the mundane, repetitive tasks of managing financial needs is a universal boon. There is nothing not to like about it. From my tablet at home, I can compare deposit rates across banks, I can make transfers across the globe, I have the power to manage my financial affairs when and where I want. I am freed from the tyranny of being tied to a physical location, waiting in line with masses of other people.

From a bank point of view, however, this transfer of power to the consumer is a mixed blessing. Yes, it frees the bank from processing highly repetitive tasks manually – which is expensive and prone to inconsistency and error. It allows us to present a more consistent brand to our customer. It allows us to manage our internal accounting with far greater efficiency.

But it also represents a threat. Banks have for centuries made money from inefficiencies. Being able to put to work cash in the process of clearing has long been an important revenue source for our industry. And there are many other examples of inefficiencies leading to revenue for banks. Technology is fast eroding such revenue opportunities and that is partly why as bankers we want to see more of our revenue, percentage-wise, coming from fees rather than interest margin.

One thing is certain : technological advance will eventually greatly reduce income from net interest margin on liabilities as well as on assets.

Technological advance also has significant implications for banking distribution channels and on the pattern of employment in the industry globally.

Let me give one example. In the UK, the number of bank branches has reduced by 40% between 1989 and 2012 and the trend has continued since. This dramatic fall in numbers has coincided with the advent of internet and telephone banking, driven by technological advance. This pattern is being replicated everywhere. The same will eventually happen here in India – it's a question of “when” and not “if”. This means fewer jobs in branch banking.

Just look at what happened with the telecom industry in India. Given the challenges of geography and the expense and time involved in building land line networks, India effectively leapt direct to mobile, leap frogging an entire technological generation. Something very similar is likely to happen in banking. The change will be dramatic and swift.

At HSBC, we have seen that the propensity of Indian customers to adopt the latest technology is very high – following the launch of our retail banking app on iPhones and Android in 2013, we saw more downloads more quickly than in any other country where we have launched the app, including China.

Another example of likely impact of technology on employment is in back office automation. Technology has given birth to the whole BPO industry and India has been at the forefront of this. However, in the future, technology will replace many of the people in the BPO industry too, allowing banks to become even more efficient.

Technology has helped banks become larger, offer more complex products and become more international. This process will continue, with the pace of product and service innovation only accelerating.

Digital banking could open a new phase of financial inclusion. It is much, much cheaper to use clients' mobile phones than to build branches. It can be something as simple as using air time as a pseudo-currency as they do in Africa, but it could be something as complex as managing a distributed asset portfolio in multiple markets.

Big data, particularly in a market like India, could lead to more cost-effective insurance; allow remote and non-invasive credit scoring so that farmers and small businessmen could get cheaper and more reliable loans.

In the future, we should expect technology to continue to be a primary driver of change, empowering our customers, eroding margin but also presenting opportunities to become more efficient, find new sources of revenue and benefit from scale and scalability.

Much more can be said about the impact of future technological change. But, let me summarise by saying that ultimately it represents a fundamental shift of power to the consumer. As banks, we must embrace the change and continue to innovate new products and services in order to make the returns our stakeholders rightly expect.

The Regulatory Angle

Now what about the regulatory landscape – how is that driving changes in our industry?

There is a growing nexus between technology and regulation – deregulation globally has allowed banks to offer more complex services for example, helping companies to hedge risks which they do not wish to manage themselves, such as interest rate and foreign exchange risk. Technology has allowed banks to take advantage of deregulation and in some cases has itself driven deregulation with the result being more choice and more services for our customers.

This nexus between technology and regulation will become closer over time, giving our regulators better control and insights into systemic as well as idiosyncratic risks. This has to be beneficial to society overall and we should welcome this.

Technology will eventually make redundant physical cash. This will have multiple benefits – more convenience for customers and less operating expense and risk for banks. For regulators (including tax authorities), dematerialization of cash means an end to unaccounted for wealth.

Clearly, in our post-financial crisis world, there is significant change happening globally on the regulatory front. The implementation of Basel III is a key target. Fundamentally, the banking sector needs to hold more capital against the risks we take. As a result, either investors need to accept lower returns on capital or banks need to either increase revenue or reduce costs. In reality, a combination of all three is more likely.

Regulators are likely also to continue to favour less complexity in business models and more transparency in oversight. Technology will help with this but it is also clear that global regulators, concerned about the question of resolution, do favour a subsidiary model for global banks rather than a branch model, rather like the model HSBC has operated for many years.

More and more regulators are automating the collection of data from banks which enables more efficiency, more timeliness, more accuracy and more flexibility in regulatory oversight. Identification of systemic and idiosyncratic risk becomes much more efficient.

Cooperation between regulators globally is likely to develop further. Not just between central banks or direct banking regulators but also between for example, the tax authorities of different countries. The US Foreign Account Tax Compliance Act regime is one example. The OECD developed Common Reporting Standard is another. We will probably also see consolidation of regulatory bodies where this has not already happened – e.g. creation of a super regulator covering capital markets, banking, insurance, etc.

Regulators are also supporting the trend towards increased transparency and improved risk management associated with moving more market transactions onto regulated exchanges and away from Other the Counter dealing. We can expect this trend to continue.

Regulators globally are also focusing on customer protection, especially for SME and retail customers. Banks need to make sure that the way we sell our products and services is fully consistent with the principle of "treating customers fairly". This is the right thing to do and the industry should embrace this trend.

In a broader sense, the regulatory landscape includes the World Trade Organisation and the new trading blocks which are taking shape globally. In our region, Asia, we are seeing convergence in ASEAN as well as in the Trans Pacific Partnership. These too represent opportunities for international banks to leverage networks and serve customers better. We should also see more efficiencies emerge in the processing of international trade transactions, allowing companies to manage and integrate more effectively their merchandise and their financial supply chains.

So the regulatory infrastructure will continue to evolve. It will reinforce the empowerment of customers already being deepened by the technological revolution. As

practitioners, we must evolve too and make sure that we are able to find the right business models to continue to deliver adequate returns to stakeholders in this new environment. No easy task indeed.

Changes in Customer Behaviour and Expectations

The major changes we have seen in technology, supported by regulatory change, are impacting customer expectations and customer behavior. Banks need to adapt to this to be successful.

We are seeing greater digital reliance as more and more tech-savvy customers now expect banks to provide secure best-in-class access to banking products and services, both online and on mobile devices, 24/7, anywhere in the world.

Research on the typical lifestyle of a working executive shows that consumers switch across different devices throughout the course of a day. They start off on their mobile phones, retrieving and replying to messages; then move on to desktops when they arrive at their workplace; switching to their tablets when they return home until bedtime.

Customers globally are moving away from brick and mortar branches and going online instead. Customers want convenience and the mobile smart phone is the ultimate in convenience. M-Pesa in Kenya, is a success story today in a country where 2/3rd of the population is actually using its services to carry out wireless money transfer transactions. For India too, the digital banking revolution, as envisaged by the Prime Minister through the 'laptop in every hand' dream for schools and villages, will eventually lead to a reduction in the cost of services and fuel the ability of the masses to take control of their financial destinies.

Corporate treasurers look for globally consistent services which allow them to control their cash from a central location – HSBC, for the last 3 years running voted the world's (and India's) leading international cash management bank in Euromoney's annual survey, sees this more than most. Expectations are rising rapidly and international banks must invest heavily to stay competitive. Such investment requires global scale.

Those banks which are able to meet or exceed customer expectations from digital banking will prosper and those which cannot, will not. For that reason, we will see banks spend more on digital and, over time, less on physical branches. Customer expectations and behavior are driving our distribution model.

One aspect of all of this which is becoming increasingly important to banks as well as to our customers and our regulators is around data collection, security of data and the right to privacy. For example, is it right that banks should include in a customer's credit score whether or not his friends on facebook have defaulted on a loan? Technology allows banks to make all sorts of connections which were not possible previously but there are questions about how far we go with this. This debate is likely to intensify in the future.

Therefore, success in banking is increasingly not about products any more, but customers. Banks need to become customer-centric rather than product-centric in their approach. It is not about cross-sell for the sake of cross-sell but enabling customers realise their goals through products that we offer.

We bankers like to believe that there are certain services where clients will continue to prefer face to face contact with a relationship manager. A good example is in retail Wealth Management. At HSBC, we are now using tablet based technology to enable our sales force to be more mobile and meet customers at their home or office or wherever is convenient to them.

However, I would suggest that eventually customers will become more and more comfortable with making investment decisions either by talking to someone over something like Skype or Facetime or indeed by talking to a computer equipped with sophisticated algorithms and a slick interface. Your financial adviser of the future could be a few lines of code presented as a hologram of your favourite actor or actress projected into your living room!

As customers move away from personal relationships with individuals and towards interfacing with the bank via. technology, customer loyalty is likely to erode. Customers will demand bank account number portability and regulators will eventually enforce this.

This has already happened in telecom, and banking is no different. Again, technology is leading to empowerment of customers.

In Conclusion

I could happily continue to hypothesise about how international banking will change over time but to summarise my thoughts, I would highlight a few points :

1. Customers will become dramatically more empowered in the future. This is true for corporate treasurers as well as individual customers. Those banks which are unable to adapt to this reality will not succeed.
2. The physical public forms of banking will diminish. Bank branches will reduce in number, there will be fewer relationship managers and even cash will no longer exist in physical form.
3. Banks will become effectively a technological platform. To succeed as a bank, it will be all about the look and feel of our interface and how empowered we make our customers. Products will be difficult to differentiate, so service becomes critical.
4. Convergence between banking and mobile telephony will accelerate as hardware prices decline and the regulatory environment adapts to technological advance.

Banking has always been a people business based upon a relationship of trust between banker and customer built over a long period of time. It will remain a people business but the emphasis is shifting. At centrestage will be the customer, and the relationship banker will step back into the wings. Our business will still be at its heart in a service industry, wherein service to the customer and ease of doing business are the fundamental drivers.

We have a challenging and exciting future ahead of us!

New Paradigms in IT Security Systems for Banks

Banking runs on Trust and Trust depends on Security

Dr. A. S. Ramasastri *

Banking runs on trust between banks and customers. The customer confidence in banks depends on the security systems put in place by banks. Banks have, over several decades, developed strong internal accounting systems and physical security of branches to give the required confidence to the customer. However, there have been rapid changes during the past two decades with the advent of information systems in the banks.

The banks now rely on information technology for most of its operations. Banking is no more confined to premises of bank branches. In fact, a child today recognizes her mobile as the bank. ATMs, PoS machines, Internet Banking and Mobile Payments have changed the banking scenario. The slogan of late nineties that "Customers need Banking, Not Banks" seems to be getting realized.

All these have, no doubt, enhanced customer convenience. But they raise an important question about customer confidence. The customer is dealing with faceless banks and with gadgets, whose security is not clearly understood by her. It is the responsibility of the banks to ensure that the new paradigm banking is not only secure, but is perceived to be secured by a customer.

Banks are grappled with this challenge now. They need to ensure security of their internal systems, delivery channels, customer interfaces and information. They have to not only build appropriate security systems, but have to keep evaluating them against the new threats and strengthening them on a continuous basis. Threats can be from insiders, motivated fraudsters and state sponsored groups. They can be from any part of the globe. A closer look at some of the recent attacks give a glimpse of the difficult task banks have on hand to implement information security systems and solutions.

Recent Attacks on Banking Industry

Reports of Carbanak Advanced Persistent Threat (APT) attack states an amount of 1 Billion USD is stolen from banks with malware silently taking control of database over a period of time without catching the attention of customer or the banker. Some of the banks in Asian countries are also impacted by Carbanak attack. The malware that breached 110 Million customers credit / debit card data of a large retail corporation, entered environment through systems monitoring heating, ventilating and air-conditioning (HVAC) equipment. Stuxnet, Flame and Duqu are some of the APTs that probably has perpetrators at nation level.

With stronger security practices and improving perimeter security in the banks, attackers are using Distributed Denial of Service (DDOS) attacks to create reputation loss and extortion threats. In 2012-13, large banks in US had severe DDOS attacks by a group of cyber fighters of Izz ad-din Al Qassam group. Cyber attackers' interest in developing countries started to increase with economies getting stronger and catching world attention. In a recent DDOS attack, attackers threatened banks to pay in Bitcoins or shall increase the scale of attack. DDOS attacks are meant to pump large volume of unwanted network packets creating congestion on computational resources (network, memory and processing time). IP Spoofing and pumping loads of NTP packets, SYN flood, Ping of Death, exploiting application buffer overflow are the recent trends of the DDOS attacks. Attackers are targeting banks with load as high as 400 Gbps of data crippling bank's public website and also choking ISP, these situations could also lead to disruption of service for other banks leveraging same ISP.

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Stealing millions of dollars from ATMs in few minutes across locations has been other recent trend. Tracking user card details with skimming devices and taking control of ATM switches is a growing concern. In late 2012-13, RAK Bank or Bank of Muscat ATM cash-out heist was more than 80 million USD.

The Poodle and Heartbleed attack exploited vulnerabilities in SSL / TLS. Several organizations including banks were impacted by Man-in-the-Middle attacks.

Compromise of issuance of digital certificates by one of the leading Certification Authority has crimpled organization's certification business.

Phishing has been an ongoing concern for banks. Customers get lured on the names of Central Bank, lottery, recruitment and share confidential information. There have been cases of police and bank personnel falling prey to phishing traps and losing big amounts.

Nations are getting involved in the attacks apart from individuals or gang of hackers. Some of the attacks may not lead to financial loss, but to reputational loss like the website defacing of a central bank of a country. The attack on Sony Pictures Entertainment before the release of "The Interview" movie is one of the recent attacks that have possibility of attack by a nation.

Injecting Malware into the environment, threatening posts on Social Media and performing DDOS attacks with extortion threats has been a growing concern. It is in this background that new policies and systems are being considered by nations and organizations.

Considering the trends in attacks, some of the feasible solutions are as follows :

- Some of the countries started creating internet boundaries and blocking illegitimate sites. Some of the countries in European nation are demanding to obtain their consent before linking their public web sites.
- There has been a gradual trend to adopt Open source and Open standards.
- Vulnerability concerns of some of the networking equipment manufacturers providing feeds to governments has exposed the importance of countries have their own set-up of Hardware, Software and Network equipment for critical infrastructure.
- Banking regulators are taking up information security of banks as a serious concern and guiding the banks for improvement in this crucial area.

Active Role by Regulators

Central Banks and Governments Agencies are coming with policies and guidelines for banks to protect their environment. Some of the instances like Internet Banking Guidelines from FFIEC, US provided guidance to banks for deploying strong information security framework. ENISA for European Union is another example to improve security of EU institutions and member states. The National Cyber Security Policy, IT Act from India, Cyber Security Bill of US, etc. have strong legal implication on attackers. Some countries are contemplating to consider cyber attack as an act against nation.

For Indian Banks, the cues from RBI guidelines, Gopalakrishna Committee recommendations, IDRBT Security Framework, ISO Series on IT Security and PCI guidelines have helped in drafting ISMS policy. The importance now has to be given to adherence and ongoing improvisation of guidelines with changing landscape of security threats.

Governance

The four pillars of security are Governance, Policy, Systems and Awareness. In view of its criticality for the operation of a bank, IT Security needs an ongoing investment and review at board level. Security at banks needs to adopt top-down and bottom-up approach. Members of the bank's board and head of risk should be aware of National Cyber Security Policy and IT Act to act for any violations / attacks that happens from external / internal attackers. Defining and review of security metrics (number of incidents, machines that do not have latest anti-virus patch, percentage completion of security awareness program, etc.) at board level would bring in increased commitment level. Compromising on security for either cost reduction or usability can have damaging reputational and financial impact on the banks. While one size fits all approach cannot be taken, smaller banks may have

to leverage a trusted partner's data center and get the required security controls as a service.

While banks already have audits from central banks, ISO and PCI empanelled organizations, an internal mechanism for assessing the maturity of security similar to Capability Maturity Model (CMM) for software implementation would provide reasonable confidence on the security controls. While banks perform risk assessment for all critical applications on regular basis, implementing GRC tool to ensure continuous monitoring of alerts / warnings and the risk mitigation would improve the maturity level of risk management.

Security Architecture

Security convergence refers to the convergence of two historically distinct security functions – physical security and information security – within banks. Security convergence is motivated to protect both physical assets and digital assets. Generally, physical assets are protected by security personnel and information assets are protected by IS Professionals. Security convergence mandates the teams of experts from both security functions.

For example, as more organizations deploy Single Sign-On (SSO) allowing users to login from anywhere to all applications via a single authentication, it is driving demand for strong user authentication and more comprehensive security policies for network and remote access. Standards such as Physical Security Bridge to IT Security (PHYSBITS), The Open Group Architecture Framework (TOGAF), and Sherwood Applied Business Security Architecture (SABSA) enable easier physical / logical access security integration.

Security architecture has same importance as enterprise architecture for an organization. SABSA, similar to Zachmann Model for Enterprise Architecture could be adopted for IT security implementation. Security Models as Chinese Wall, Bell-LaPadula, etc. provide guidance in implementing access controls and separation of critical assets. Banks adopting security principles like Defense in Depth and Least Privilege should validate the possible attack graphs and fortify the environment.

Banks could take holistic approach leveraging SAML or similar standards for implementing bank wide authentication and authorization. Banks could have Security Settings Document (SSD) for every IT asset to ensure standardization and also implement security controls in a consistent manner.

Physical Security

Endpoint security has been one of the greatest concerns for banks as branches are at remotest locations and also bankers deal with highly sensitive data of customers. With digitization of processes, the need for enabling pendrive access has reduced. With improvement in last mile connectivity in emerging markets, virtualization of desktops is making management of desktop, anti-virus signature updates, patching and upgrades relatively easier. With CCTVs and biometric based access controls at data centers, ATMs and branch locations, the difference between Physical Security and Information Security is reducing. Log Analysis of access records, image and video analysis of human movements using machine learning algorithms and image analysis techniques is reducing the intervention of human supervision.

Network Security

Most Banks have Network Management Systems to monitor and ensure availability of critical systems. While Banks are recommended and required to migrate to IPV6 for all public facing sites, banks should assess the security threats related to IPV6 tunnels and handling ICMP and multicast traffic. It would be advisable for Banks to have their own public IPs instead of leveraging public IP provided by ISPs. Apart from dedicated public IP for interfacing sites, some banks have websites with “bank” as the domain name, hoping this to reduce phishing attacks.

The first impact of DDOS is felt on network traffic before the applications and the data. Banks should have measures working closely with telecom sector for mitigating risks associated with DDOS attacks and participate in DDOS attack drills conducted by CERTs to ensure the infrastructure and incident management process are resilient. Though bundling all the security

features (Firewalls, IDS and IPS) in one appliance has advantages, it could also defeat the purpose of Defense in Depth principle.

Software Defined Networking (SDN) along with Cloud Computing is the emerging trend in banking IT infrastructure as it scalable, efficient and cost effective. Banks could adopt SDN after filling the skill gap and still retain the existing physical network infrastructure along with SDN implementation. SDN helps in bringing consistency for network management, isolation and traffic control to reduce the impact of a compromised server choking the entire bandwidth.

Tor (The onion routing) meant for sharing confidential data and maintain anonymity is being used by criminal enterprises and hacktivism groups as well to plan and launch attacks. Interpreting the communication, identifying and blocking the source IP of the attacker becomes a challenge in this set-up. Interestingly, Tor also went through DDOS attack and the exploits of heartbleed bug.

Application Security

Application is the last gate to obstruct the attacker before data pilferage. Adhering to Secure Development Lifecycle for application development incorporates "Design Thinking" principles for protecting the infrastructure. Applications should inherit Enterprise Architecture principles for authentication and authorization. Following OWASP guidelines and Threat Modeling techniques ensure security and privacy issues are identified and fixed before UAT. Any application (internal/external) has to go through VAPT before implementing in production. Load and Stress testing should be another definite life cycle stage for all internet facing applications.

With the increasing adoption of open source and the availability of good support environment and control on the source code, banks shall benefit on adopting open source. However, banks should ensure the source code has cleared VAPT requirements before moving into production.

Application security at ATM switches and strict adherence to PCI guidelines without compensatory controls is required to ensure vulnerabilities are not exploited. In one of the ATM heists, the attackers exploited vulnerabilities in JBOSS application server to reset the amount details and went about withdrawing amount in millions.

Aadhaar based authentication could be included for customer enablement sites. With the growing need for interoperability, banks must ensure security is implemented for Web Services built using SOAP or REST protocol.

Data Security

Critical data while at rest is susceptible to various threats hence protection against unauthorized access, leakage is critical. Data availability is also an important aspect for business continuity. Business Critical data should be protected against various threats like data leakage / theft by applying appropriate security controls. While, it is necessary to archive data for performance improvements adequate controls to maintain data integrity and confidentiality should be implemented for safe guarding the data. Access controls are required to ensure that data is not altered manually or electronically by a person or program. Meeting Legal and Regulatory requirements is one of the major aspects of the bank's business.

Banks are doing commendable job in protecting and archiving customer data. However, having Corporate Record Management policy ensuring data classification, data protection, data back-up and data destruction with enterprise wide implementation of all electronic and physical records ensures better control. Implementation of Information Rights Management, Privilege Identity Management and Digital Asset Management tools could provide relief to data related attacks.

JP Morgan Chase Bank customer data leakage incident provides the need for stronger processes along with tools. An enterprise wide change management and patch management policy should be strictly adhered without any compromise.

Cryptography

Poodle, Heartbleed and Shellshock attacks bring out the vulnerabilities in SSL / TSL. Apart from transactions

over the internet, banks have started providing e-vaults to customers. Banks should ensure data at rest and data in motion / transit are encrypted with strong encryption algorithms as designated by FIPS and country's IT Act. Apart from brute force attack and certificate key compromise, cryptanalytics using affine approximations are being used for decrypting sensitive data. Elliptic Curve Cryptography (ECC) and Quantum Cryptography are worth exploring to improve randomness for data secrecy. Banks should take Digital Certificates from organizations that are approved within the country and have rigorous process for issuance of certificates, following banking norms.

Apart from Cryptography techniques using AES and DES methods, tokenization can protect data from direct attack, cryptanalysis or brute force techniques. Tokenization techniques are used in EMV chip cards for card transactions. Some of the regulators have already given strict implementation deadlines for implementation of EMV cards.

Public Key Infrastructure (PKI) is a robust system that meets all requirements for information security, but comes at a significant operational overhead of managing the backend systems. However, two major alternatives to PKI are Identify Based (ID) - Public Key Cryptography (PKC) and Certificate Less (CL) - PKC. Both these techniques do not necessarily meet full requirements of the fundamental principles of information security, but these short comings can be overcome through proper deployment of the solution.

Social Media

Social Media has started for cutting the boundaries of place for interactions. This also opened up opportunities for banks for personalized interactions and serving the needs of customers. Myspace, one of the popular social media sites had CSRF attack with the attacker having details of millions of accounts. Banks deploying transaction apps using Social Media should not store data on the social media sites. They should perform VAPT before the deployment. Performing DDOS simulation is not possible as it could bring down the entire social media site. Hence, it is required for banks to understand the DDOS mitigation techniques that the social media sites deployed. This being another channel of customer related data, banks have to increase security awareness among customers to mitigate the risks of spear phishing attacks.

Mobility

The growth of Mobile Banking in the last couple of years has been exponential with smartphones and data getting cheaper. Apart from the traditional mobile banking appsm Remote Capture of Check images, RFID and NFC based payments, Mobile Wallets, Applepay, Peer2Peer payments using SMS / Email are gaining momentum. However, there has been growing concerns of rogue apps mimicking real banking app, Zeus, SIM duplication and reverse engineering. Apart from VAPT, containerization of apps, storing non personal data in encrypted format on the mobile devices, banks should also engage service providers and law enforcement agencies to bring down rogue apps similar to bringing down phishing sites. While Mobile Banking increased efficiency, it also has increased a vector for attacks. The data in the SQLlite databases stored in mobile devices may not be secure; hence banks could containerize the mobile banking apps apart from implementing encryption algorithms on mobile banking apps.

To facilitate faster process of requests and be available to customers all the time, bankers are using mobile devices on the field with access to customer data. Deploying BYOD and allowing access to customer data on mobile devices, would require implementation of MDM and MAM solutions.

In the future, we may also see increase adoption of Siri / Cortona / GoogleNow, which would definitely improve authentication and efficiency of banks but could also create privacy and security related challenges.

Cloud Computing

Cloud Computing is commoditizing and bringing in greater amount of transparency in IT procurement. Cloud Computing has opened up opportunities for faster growth across regions despite the last mile

network connectivity issues. The cloud providers and their supporters are assuring benefits like agility, flexibility, cost-effectiveness, the benefits of switching over from capex to opex model, on demand self-service, almost infinitely scalable, pay per use and manymore goodies. However, many potential and prospective users in financial sector are deterred by fear, uncertainty and doubt over privacy and security in cloud computing. Cloud Computing throws up challenges in terms of Data Security. If the data present in the cloud across regions of the CSP is breached, the legal course of action is tricky and could damage banks reputation apart from financial loss. Hybrid Clouds with data in the bank's environment and the web layer with the Cloud Service Provider (CSP) is the emerging trend. Security has to be part of DNA for the CSPs as it could endanger their existence. However, recent malware and DDOS attacks launched from some CSPs raises eyebrows on the process for providing cloud services and the technology available with the CSPs to disallow the attacks. Though NIST, CSA, ISACA, IDRBT Cloud Security Framework for Indian Banks and the recent ISO 27017 provide guidance on Cloud Security, Cloud Software Stack providers may take a step back and rethink on their approach of software development and provide a foolproof system.

Internet of Things (IoT)

IoT is fast emerging with individuals having connected devices at home, office and on the body as well. Wearables such as smart watches and smart glass are catching up as new fashion trend. Banks are launching apps to check account information and get information of nearest ATM, SMS, etc. on these devices. Exploits could be launched to modify behavior and trustworthiness of the devices leading to issues of personal safety and exposure of financial and other critical information. Banks could mitigate risks by performing Vulnerability Assessment and Penetration Testing and DOS simulation attacks before launching the apps on IoTs.

In the future with emerging clarity on aviation laws, Banks may also explore using Drones for documents and cash movement, inspection of agricultural fields, etc. This shall increase the pace and transparency of banking but could also lead to privacy challenges, if the data goes into wrong hands.

Security Operations Center(SOC)

SOC in a bank is responsible for the bank-wide security Operations. The activities of a SOC include :

- Continuous surveillance of the IT infrastructure of the bank to guard against information security breaches and incidents.
- Monitoring and reviewing of security logs of applications, operating systems, databases, networks, etc.
- Responsible for collection, aggregation, correlation, analysis and synthesis of information related to security incidents to learn effective lessons and to incorporate changes in policies and procedures accordingly on a continuous basis.

Implementing SOC is an expensive effort that requires changing some of the configurations of existing environment and it requires strong technical professionals that may be outsourced to a trusted partner. Though SOC provides the insights, acting and implementing the remedial actions should be the responsibility of Bank.

Big Data and Analytics

With the large amount of computing resources available in the form of Cloud, Mobile Devices, IoTs and variety of the data in terms of interactions on social media channels, transactions, Big Data has opportunities for cross selling and understanding customer needs better. It also provides opportunities to perform security analytics, improve coding practices for secured application development and understanding the impact of a defect / bug in terms of application security.

Fraud detection techniques look for repeating pattern matches in the set of data and apply descriptive / predictive / prescriptive analytics to prevent fraud. Automated alerts can be generated and sent to customers. Advanced analytic techniques even help in forecasting possible frauds and recommending preventive measures.

Some organizations are also using application log data for analyzing insiders' behavior including the possible attritions. The pattern recognition techniques and machine learning algorithms could be fed with data from SIEM tools containing the log data from servers, firewalls, IPS, IDS, etc. to identify bots, DNS requests, spoofing, false alarms and other threats and protect the infrastructure. Real time analytics with visual representation helps banks to identify vulnerable assets and attack patterns.

Forensics

Digital forensics, nowadays, is looked at for monitoring, analysis, prediction and prevention of cybercrime. Digital forensic analysis is mainly divided into reactive and proactive approaches. The reactive approach focuses more on doing investigation after the incident has taken place and involves "post-mortem". The proactive approach is focused more on prediction of a security breach and could be achieved with help of SOC / NOC and SIEM. Raw Image Acquisition, Crash Dump Image Acquisition, and Memory Image Conversion are the methods used for acquiring live system memory.

The Information Security teams of banks need to be adequately equipped to prepare FIR (First Information Report) post information breach.

Insider Threats

The recent publicly available fraud statistics suggest growing insider threats. While banks do commendable job in ensuring background verification before employing personnel, banks should also perform an ongoing background verification and there could also be a central repository of staff terminated because of involvement in fraud / nefarious activities similar to national skill registry by NASSCOM, India. Awareness program on importance of Information Security and strict action against non-compliance of security measures would reduce the insider involvement

Maker, Checker and Authorizer is part of banker's DNA. Banks should ensure that access to all critical systems is bio-metric enabled. Although anti-virus is deployed on all systems of the bank, banks should validate anti-virus software capabilities against behavior based attacks instead of limiting to signature based attacks.

Importance of Information Sharing

As the saying goes, "Those who cannot remember the past are condemned to repeat it", it is important that banks learn security issues from their past experiences and also from peer banks to implement tighter controls. In India, interaction with CERT, NCIIPC and IB-CART would provide banks inter and intra sector security threats, vulnerabilities and events. Aviation and Defence sectors also have heavily invested in IT security; interactions with their Management, CISOs and Security professionals could provide insights on the required preparedness. The newly formed Cyber Security Task Force of India plans to bring academicians, practioners, law enforcement agencies and ISVs together to ensure India has the right skill and tools to protect against cyber attacks.

Information sharing is one of the trusted ways for protecting the IT infrastructure. This helps in learning from each other and protecting bank's environment from past and ongoing security events in the banking industry. With the guidance from RBI, CERT-In and National Security Council Secretariat IDRBT has built a platform for Indian banks called IB-CART (Indian Banks- Center for Analysis of Risks and Threats). This platform provides a secured and anonymous way of sharing security events of banks. This helps member banks to learn from each other experiences and be proactive. A similar trend is followed in some of the developed countries like US (ISACs for Financial and other sectors), CBEST by Bank of England, Information Sharing Exchange by ENISA. With the initiative of DHS, US and MITRE Corporation, a global standard STIX and TAXII is emerging for sharing security events with the collaborative of security experts across the world.

In India, CISOs of banking sector formed CISOs forum under the aegis of IDRBT and collaborate on several issues. They form working groups for handling sectoral related issues, best practices and do mock drills or table top exercises.

Skill Upgradation is the Key

Banks have identified the need for the role of Chief Information Security Officers (CISOs) and have been posting senior officials to fulfill the role of CISO. The responsibility of CISO includes design, develop, build, evaluate and maintain appropriate security systems in a bank. The skill set requirement of a CISO and her team to take care of overall information systems security of a bank is vast, varied and ever changing.

Training has to be planned and imparted to the security professionals. Apart from fundamental training needs of security (network, application, data, physical, etc.), CISOs need to be trained on leveraging correlation engines, best practices across sectors and even on war tactics to understand cyber war.

While digitization has reduced the involvement of human intervention for mundane tasks, having the right people to interpret data and improvise pattern recognition algorithms to handle smarter attackers has become growing need for CISOs of banks.

The privacy laws in most of the countries including India are not well identified. However, CISOs part of Risk Management team need to ensure data protection looking at some of the best practices across the world.

When banks do not have adequate staffing, deploying ethical hackers and "Bug Bounty" is being explored. Banks need to do a thorough risk assessment before leveraging these emerging trends for identifying vulnerabilities in the environment.

With increase in cyber attacks, the need for highly skilled staff is an apparent need. Training and retaining this highly specialized talent is a behemoth task for management. Banks continue to rely on vendor for information security needs as well, this can be dangerous as this is similar to giving "bank locker keys" to outside personnel.

Eco System

Though banks build good information security systems and train their internal staff, they need to provide their systems to customers. Unless the customers are aware of the security features of the banking systems and are trained to adhere to them there is a possibility of breach of the system. Therefore, an equal focus is to be given to customer education as well. Gamification and leveraging Social Media channels are the tools for improving customer awareness.

In addition to customer awareness, banks need to put in place mechanism for redressal of customer complaints. There is a need for portals for receiving customer grievances, helpdesks to guide them and internal systems to ensure quick disposals.

There are systems beyond banks that help banks in ensuring security of systems. They are investigation and legal agencies. There is a need for the nations as a whole to improve the knowledge levels of those agencies in the areas relating to information security and cyber defense. Unless, the cyber crime investigation mechanism is able to handle the emerging attacks and help the banks to book the culprits and recover losses, it would be difficult for banks to fight the cyber war on their own.

Even after deploying right people and right tools attacks and frauds are possible. Cyber insurance providers are designing products to provide coverage to the damaging attacks. Banks and the cyber insurance companies have to work together to ensure that the risks are properly transferred and that the overall losses are minimized.

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Abbreviations			
APT	Advanced Persistent Threat	AES	Advanced Encryption standard
HVAC	Heating, Ventilating and Air-conditioning	DES	Data Encryption standard
DDOS	Distributed Denial of Services	EMV	Europay, MasterCard, and Visa
ISP	Internet Service Provider	PKI	Public Key Infrastructure
TLS	Transport Layer Security	PKC	Public Key Cryptography
SSL	Secure Socket Layer	CSRF	Cross-Site Request Forgery
FFIEC	Federal Financial Institutions Examination Council	VAPT	Vulnerability Assessment and Penetration Testing
ENISA	European Network and Information Security Agency	RFID	Radio-frequency identification
ISMS	Information Security Management System	NFC	Near Field Communication
CMM	Capability Maturity Model	BYOD	Bring Your Own Device
SSO	Single Sign-On	MDM	Mobile Device Management
PHYSBITS	Physical Security Bridge to IT Security	CSP	Cloud Service Provider
SABSA	Sherwood Applied Business Security Architecture	NIST	National Institute of Standards and Technology
TOGAF	The Open Group Architecture Framework	CSA	Cloud Security Alliance
SSD	Security Settings Document	ISACA	Information Systems Audit and Control Association
ICMP	Internet Control Message Protocol	SOC	Security Operations Center
CERT	Computer Emergency Response Team	SIEM	Security information and event management
IDS	Intrusion Detection System	SOC	System On Chip
IPS	Intrusion Prevention System	NOC	Network Operations Center
SDN	Software Defense Networking	NASSCOM	National Association of Software and Services Companies
OWASP	Open Web Application Security Project		
UAT	User Acceptance Testing	NCIIPC	National Critical Information Infrastructure Protection Centre
VAPT	Vulnerability Assessment and Penetration Testing		
PCI	Percutaneous Coronary Intervention	CISO	Chief Information Security Officer
SOAP	Simple Object Access Protocol	ISV	independent software vendor
REST	REpresentational State Transfer	STIX	Structured Threat Information eXpression
ECC	Elliptic Curve Cryptography	TAXII	Trusted Automated eXchange of Indicator Information

New Paradigms in Banking

Suprita Thakker *

Banking is in the news.... There is much talk about the change in banking, be it product design - leveraging technology, changed focus on aspects of preventive vigilance, enhanced levels of compliance & disclosures, strengthening internal controls, risk management , etc.

On pondering, we will realize that this is not a recent phenomenon....... Banking is undergoing a sea change since 1969 with the Nationalization of Banks and much before......

The Indian Growth Story in banking can be categorized in 3 phases :

a) *Phase I*- Government of India introduced the Banking Companies Act, 1949 to streamline the functioning of the commercial banks. This was later designated as the Banking Regulation Act, 1949. The power to supervise the banks was vested with the Reserve Bank of India.

b) *Phase II*- Major steps were initiated by the Government after independence. In 1955, the Imperial Bank of India was nationalised for providing mass banking services especially in rural and semi urban areas. State Bank of India was formed to act as the principal agent of RBI and to handle banking transactions of the Union and State Governments all over the country. Seven banks which were the subsidiaries of the State Bank of India were nationalized on 19th July, 1959. In 1969, the major process of nationalization was carried out when 14 major commercial banks were nationalized. Six more banks were nationalized in 1980 bringing 80% of the banking segment in India under Government ownership.

c) *Phase III* – This phase witnessed introduction of new products and facilities. In 1991, the Narasimhan Committee was set up for suggesting banking reforms etc. This decade also saw the entry of Foreign Banks in the country. ATMs, Phone banking and net banking were introduced.

Paradigm Change in Banking :

There has been a landmark change in the banking landscape – from the brick & mortar banking to the click & mortar banking....

There is a paradigm change in the banking – structure, business, strategies with a focus on risk, preventive vigilance, etc. What is the meaning of the word "paradigm"? The Oxford Learner's Advanced Dictionary describes the word as – "a typical example or pattern of something"....This leads us to the meaning of "Paradigm shift" – which can be inferred as – "A great and important change in the way something is done or thought...."

This new age banking as we may call it, is not only on account of the development in technology but also on account of the change in the regulations, etc.

The question – Why new paradigms in banking arises in our minds.... The very nature of the banking business and the way it is done has changed...... The old definition of banking – "Acceptance of deposits for the purpose of lending ...." appears to be a traditional definition in today's scenario. Banking is no longer restricted to the traditional business model... there is a change with more and more complex products being offered to the public. At the same time, the need for a change arises not only from an economic perspective, but it also arises on account of the regulatory and the social perspective.

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a) *Economic perspective* : The profitability angle…. In these times of intense competition, it is extremely difficult to maintain or even improve upon the profitability, especially in the current hard times of the global economic downturn. To overcome this and also to improve margins, enhancing fee based income appears to be one of the focus areas.

b) *Regulatory perspective* : This era of enhanced disclosure levels, transparency, IFRS, Basel II, Basel III will go a long way to strengthen market discipline and also contribute to the soundness of the financial discipline. This coupled with the good governance lends credibility to the banking institutions. The proposed "Bankruptcy Code" will also have a major positive impact on banking.

c) *Social perspective* : Currently, 'Financial Inclusion' is the buzzword…… The "methodology" for inclusion differs. Nowadays, it is just not about opening branches but reaching out to the un-banked populace through mobile banking, etc… Financial Inclusion is also responsible for the way in which banking is conducted. Another example is the CSR or the Corporate Social Responsibility which is mandatory for most companies according to the Companies Act 2013.

Banking Sector Reforms :

In India, the Government is trying to usher in the financial and banking sector reforms. Some of these are :

a) Permitting public sector banks to work on more professional lines. Our Honourable Finance Minister in his budget speech has said that the Government will reduce its stake in Public sector banks and also consider giving greater autonomy to them. Public sector banks roughly account for 70 per cent of the assets of the banking system. They require equity capital of ₹2.4 trillion by 2018 to meet capital adequacy norms under Basel III.

b) The Government has also expressed its intention of infusing capital in the well managed strong performing banks. This has resulted in most of the public sector banks trying to put their house in order and to come out with strong performances.

c) Consolidation of state-owned banks.

d) A sector-neutral Financial Redressal Agency is proposed to be established that will address consumer grievances against all financial service providers.

Capital infusion, financial inclusion and infrastructure financing are the challenges which stakeholders face.

The latest economic survey for 2014-15 also gives a four pronged solution for the banking sector – the 4 D's – De-regulation, Differentiation, Diversification and Disinterring which are as follows :

a) De-regulation will address the Statutory Liquidity Ratio and Priority Sector Lending.

b) Differentiation within the public sector banks in relation to recapitalization, shrinking balance sheets and ownership.

c) Diversification of source of funding from within and outside the banking sector.

d) Disinterring by improving exit mechanisms.

There has also been a paradigm change in the players in the banking field. The focus is not only on consolidation in the banking sector. The Reserve Bank of India has also been actively promoting granting of new license for banks and also released guidelines and invited applications for setting up payments banks, small finance banks, etc.

The above is as regards the banking sector at the macro level. Now coming to the micro level- changes in products and services, etc.

Innovations in Products and Services :

Who can forget the maxim "Customer is King…!" This was initially from the angle of the consumer preference perspective. Now, in the present world, it's happening from a digital perspective and also from a data volume perspective.

There has also been a tremendous change in the products and services offered by the banks. Competition has also intensified. Due to globalisation, growth of e-commerce platforms, internet popularity, banks need to keep themselves abreast with the latest trends in technology. Banks and especially the private

and foreign banks provide a wide array of services other than the traditional banking model – deposits and lending. The PSBs are not far behind e.g. in the Investment Banking field- In 1972 itself, SBI had set up its investment banking division.

Banks now offer a veritable bouquet of products as follows :

a) Portfolio and Wealth Management Services.

b) Third Party products like the insurance - Life and Non-Life.

c) Loan syndication, Channel financing, etc.

d) Demat services – On line Trading with Demat accounts, etc.

e) Foreign Exchange Services - Foreign Currency, travelers cheques, travel cards, etc.

The mediums through which these services are offered have also undergone a sea change with innovations in technology… net banking, mobile banking, etc are used as mediums for transacting business.

Previously, direct interaction with customers was encouraged and banks prided themselves on the personal touch. However, most of the private and foreign banks now do not encourage footfalls i.e. face-to-face interaction with the customers for normal operations - the reason being to save on transaction costs.

At the same time, with a view to promote financial inclusion, services are also now provided by banks even in the local languages… who has not heard or seen the option for "choice of language" in the ATMs? The ATMs are also providers of many services e.g. cash transactions, cheque deposits, account related information, value added services like – Fixed Deposits , Credit card bill payments and even mobile number registrations, etc.

As stated earlier, enhancement of the bottom line is one of the main aims – banks have introduced more value added products like net banking, mobile banking, etc and the advantage is – one need not even have to go to the bank premises to transact business. Most bank's website provide information on not only the basket of the products and services offered but also have educative 'demos' on the usage of the internet, mobile banking, etc. In fact, mobile banking can be commenced by merely downloading the mobile App or by even using the SMS facility. The private sector banks are even coming out with the "virtual digital banks" …. e.g. "Pockets" by ICICI is a unique digital bank with a mobile interface. A customer of any bank can create a Pockets wallet instantly and commence using the same to send or receive money, book cinema tickets, charge mobiles, gift e-vouchers, pay bills, etc. and again its usage is extremely easy……just by downloading the App! The tie-ups with the online retailers even enable the bank customers to get discounts. Thus, resulting in a win-win situation for all the three parties – banks, their customers and the on line retailers.

Now there won't be any need to even carry plastic cards (which replaced money) with the introduction of the "Pockets" wallet, etc.

With all these innovations, there has to be a strengthening of the internal controls, systems and processes. Nowadays, we hear about bio-metric ATMs. These are the latest inventions to help avoid frauds. As the PIN for bio metric ATM's is usually the finger print of the card holder or his / her eye retina scan, they are quite safe and secure. China has even developed the first ATM with facial recognition technology…..! After all banks have to be at least a step ahead of the fraudsters….!

With all the talk about the tech products, some people or may I say the prospective customers may have a "Tech" fear psychosis. Rest assured…. the websites of most banks are very informative and user friendly. There are tabs to actually guide the users for usage of these products. There is greater transparency regarding pricing of the services and banks are empowering customers like never before. May I, add that there are the guardian angels of the banking sector - RBI and BCSBI, which are not only the regulators and the watchdogs of banking, but also ensure good banking practices.

Banks are also now active on the social media and are trying to leverage the same for business growth and enhancing their top lines….Most of the banks are active on Facebook, Twitter and also have an active blog… However, one should not forget that the success of a social media campaign depends primarily on two factors- relationship building with the customers and brand value.

Also who can forget - Corporate Social Responsibility…… to build relationships, nation building as also to comply with the regulatory requirements. The mandate for Corporate Social Responsibility (CSR) has been formally introduced to Indian companies under the Companies Act, 2013. Not to be left behind, banks in India have also jumped on the CSR bandwagon and have undertaken / participated in various CSR initiatives like providing drinking water, setting up bus shelters, encouraging education, constructing classrooms, setting up of the financial literacy shelters, initiatives in the field of medicine, etc.

One question which arises in our minds – Is the shift or the new paradigms in banking solely driven by profits? The reply which quickly springs to my mind is an emphatic - No! It is indeed the 'Need of the Hour" ….with the competition heating up! Competition from small finance banks, payment banks and even from shadow banks! The "big" brothers in the banking fraternity have rolled up their sleeves and got down to the business of marking and spreading their presence in finance…. Agility and innovation are the key words and the very survival of banks may depend on it.

This leads us to the next level of innovation - it is now feasible to check balances on-line – a few private banks are now offering their customers the facility to check balances on-line across different banks. To offer this facility, banks have to either collaborate or there has to be a trusted third party service provider (e.g. NPCI), to make this feasible. Who would have thought about actual co-operation and tie-ups in banks for only providing services to customers!

The focus of the banks is to provide better services to customers by, inter alia, greater adoption of technology. This will enable banks to retain customers and thus give them a competitive edge.

Road Ahead :

The road ahead appears to be much smoother for Indian banking. The pro-business sentiments coupled with policy initiatives being undertaken by the Government, lead us to conclude, that there will be a revival of the Indian Growth story. The Indian economy is now poised for take-off. Positive business sentiments, speedy implementation of projects, consumer confidence could boost economic growth and in turn the banking sector. However, all this is to be seen with caution - especially in view of the backdrop of the meteorological forecast of a delayed and probable deficient monsoon coupled with an upside risk to inflation, geo-political uncertainties and a weak investment climate which may pose a major challenge to banks.

Conclusion :

We have often heard – Change is the only constant …….! Most of us will subscribe to this fact. With this ground reality, the changes in the banking field – structure as well as the services will continue and be an ongoing reality….. We have come a long way from the 'brick and mortar' banking to the 'click & mortar banking'….. With the trends in the innovative banking…… banks as 'edifices' or mortar structures may well be a thing of the past……

Reference

- http://indiabudget.nic.in/survey.asp

New Paradigms in Bank with focus on Mergers & Acquisitions

Kaushal Shah *

Introduction

Banking is core to any economy as it drives and supports socio–economic development in the country. Hence it's obvious that it's heavily guarded by the regulators and governments. Accordingly, Mergers & Acquisitions (M&A) in banking has been driven not only by the commercial rationale but also due to its social impact and national interests. The strategic rationale for inorganic activity has evolved and currently we experience number of key drivers like technological advancements and regulatory consideration among others driving M&A in India.

Banking – Fundamental and Indispensable

Banking, simply put is mobilizing excess funds and lending to the needy. However as the requirements of the customers have evolved, the offerings of the banking system have expanded. Banks offer a sleuth of services in addition to basic financial support, thereby becoming integral to the financial needs across the life cycle of the customer, individual or corporate. Banking also connects the country to the global financial framework. Banking system plays a predominant role in the Indian financial system, and as has been observed, most of the risks in the system tend to eventually find its way to the banking system.

The total credit offered by scheduled commercial banks and the deposits mobilized from customer's amount to [₹75.29 tn. and ₹136.51 tn. respectively as on 31 Mar 2015]. Total credit offered in FY15 was ~ 50%of the GDP.

Reserve Bank of India (RBI), its apex regulator has managed and developed the financial services system including the banking sector in India very well. India has successfully emerged out of all the crises including the 1991 Indian Economic Crisis, 1997 Asian crisis, 2000 tech bubble, 2008 Global Financial crisis among others. The resilience of the banking sector can be primarily attributed to the control and management of the RBI. Accordingly, there are number of regulatory considerations in context of Mergers and Acquisitions in Financial services sector in India, banking sector in particular.

Mergers and Acquisitions in the banking sector in India is not a new concept. Mergers and Acquisitions is a very broad concept and include number of strategic options being mergers, acquisitions, re-structuring, Joint ventures and alliances among others. The industry has seen alternative structures of such M&A, being between banks, banks and NBFCs, banks and financial institutions as well as with non-financial entities. Further, the conventional drivers for the M&A has been varied but based on precedents, can be typically attributed to Commercial and Regulatory rationale. Key commercial considerations in the Indian context include :

1) *Geographic Expansion :* This has been the preferred motivation factor for number of acquisitions in India. Targets have been primarily regional player or present in states / locations where the acquirer does not have any meaningful presence. Similarly, as the rural economy grew, banks wanted to go deeper and target entities having rural concentration For E.g. : CBoP – Lord Krishna Bank.

2) *Branch Network :* Acquirers looked at branch network from the perspective of last mile connectivity to customers / location not present hitherto or regulatory requirements, where branch expansion into a more lucrative urban / metro markets was dependent on the branches in rural / semi-urban locations. For E.g. : ICIC Bank – Sangli Bank.

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3) *Customers Acquisition :* Target may have niche customer segment, customer segment present in a category different from that of the Acquirer or it could be simply an addition to the existing customers set of the acquirer. Intent is to avoid the acquisition cost and offer Acquirer's diversified suite of products as a cross-sell / upsell and hence have a much larger wallet share. For E.g. : In Feb 2013, Kotak Mahindra Bank bought Barclays India's business loan portfolio gaining access to 6,000 business loan customers with a total outstanding of about ₹7bn.

4) *Product Portfolio :* Banks have regularly sought to portfolio buyouts, which either fills the portfolio gap or helps gain leadership position in that segment. For E.g. : In Dec 2013, RBL Bank acquired three businesses (business banking, credit card and mortgage portfolio) from Royal Bank of Scotland, India.

While size and scale has been a big determinant of banking M&A internationally, however this has not been prevalent in India, given regulatory limitations and growth potential in India.

Separately, there were some M&As which were based on order of moratorium issued by RBI (passed by Central Government in public interest, in the interest of depositors and the banking system). This was due to weak capitalization, inefficiency, leakage and lack of professional approach etc., resulting in asset quality issues of alarming levels, negative net worth and hence threat to depositor base.

The below exhibit details some of the precedent M&A deals in India with the potential rationale :

Name of Acquirer	Target	Year	Remarks
Centurion Bank	20th Century Finance	1998	Under Order of Moratorium
Bank of Baroda	Bareilly Corporation Bank	1999	Under Order of Moratorium
Union Bank of India	Sikkim Bank	1999	Weak bank
HDFC Bank	Times Bank	2000	Acquire a new age private sector bank, after licenses were issued in 1993
ICICI Bank	Bank of Madura	2001	Allowed geographic expansion in South India, primarily in Tamil Nadu, where ICICI Bank had minimal presence
Bank of Baroda	Benares State Bank	2002	Weak Bank
Oriental Bank of Commerce	Global Trust Bank	2004	Under Order of Moratorium
Centurion Bank	Bank of Punjab	2005	Complementary businesses – CB present primarily in South and West vs. BoP in north, CB focused on retail vs. BoP in SME and agri sector – Combined entity would have nationwide presence with meaningful size
Federal Bank	Ganesh Bank of Kurundwad	2006	Tap agriculture and retail portfolio
IDBI	United Western Bank	2007	Under Order of Moratorium
Indian Overseas Bank	Bharat Overseas Bank	2007	Consolidation with the largest shareholder
ICICI Bank	Sangli Bank	2008	Branch network and customer base in rural and semi-urban locations; allow ICICI to roll-out rural and SME banking operations
Centurion Bank of Punjab	Lord Krishna Bank	2008	Geographic expansion in South, especially in Kerala
HDFC Bank	Centurion Bank of Punjab	2008	Complementary customer base, expand geographic reach in South and North, acquire strong SME platform and increase in size
Standard Chartered Bank	American Express Bank	2008	Outcome of global acquisition, to enhance presence in financial institutions and private banking business
State Bank of India	State Bank of Saurashtra	2009	Consolidation – merger with one of the associate banks
State Bank of India	State Bank of Indore	2009	Consolidation – merger with one of the associate banks
ICICI Bank	Bank of Rajasthan	2011	Weak bank
Kotak Mahindra Bank	ING Vysya Bank	2014	Complementary business enhancing south presence where its presence was minimal, acquire a strong SME product where it was not present, get MNC clientele and trader community customer base and expertise in digital banking

Changing Paradigm in Indian Banking Business and its impact on M&A

The current business and economic environment is experiencing number of changes due to domestic and international developments and this has the potential, some of which are already initiated, of triggering M&A in the banking sector. The developments range from a more drastic and fast changes in the technology world to a more sedate changes in the foreign bank regulations. Accordingly, the sector may experience new triggers for M&A. Additionally, it may be different from a traditional merger or acquisition and may be more tilted towards JVs, alliances and restructurings. Some of the key paradigm changes impacting the banking sector include :

1) Emergence of disruptive Financial technology (FinTech) play which is a cause and effect of changing customer behavior and preferences for services and operations.
2) New lending models evolving globally and in the Indian market.
3) Issuance of new banking licenses.
4) Financial inclusion and deeper reach.
5) Conversion of foreign banks into 100% WOS.
6) Financial Holding company structures for existing banking groups.
7) Competitive landscape and capital needs requiring weak banks to merge with stronger and larger banks.

Financial Technology :

Technology, especially FinTech is the flavor of the day. FinTech is creating and pushing new frontiers in customer acquisition, customer connect, business operations, credit risk management etc touching every aspect of the banking business. This is not only causing but it's also an outcome of how new age customers operate and behave in their daily lives. Accordingly, this segment is experiencing innovation, led by start-ups and investment boom. The new FinTech era is focusing on offering solutions in payment processing, mobile payments, remittances, score based risk management models, online origination channels, data analytics, crypto currencies, automation of processes, last mile connectivity with underserved customers and the list goes on. Number of companies like Paytm, Bill Desk, Citrus Payment Solutions, Fino Pay Tech, One MobiKwik, Bank Bazar etc. have become meaningful and sizeable in this arena. Banks will need to develop / acquire these FinTech start-ups and integrate into the banking platform to remain ahead in customer services; this may soon be a hygene factor in offerings.

In November 2012, Vodafone India through its 100% subsidiary, Mobile Commerce Solutions Ltd. (MCSL) and ICICI Bank announced a strategic alliance to launch mobile payment services. In April 2013, they announced the successful launch of 'M-Pesa' – a unique mobile money transfer and payment service. Today, most private sector banks have launched apps for m-business, remittances and more. For Eg: KayPay from Kotak, PayZapp by HDFC Bank.

While the above instances are of working arrangements, banks could be acquirers of such entities if it challenges the existence or material impacts its business. Internationally, there are number of such cases and possibly, India may catch up with that trend.

Acquirer	Target	Period	Deal Value (US$ mn)
Mozido, US	PayEase, China	Nov 2014	750
Lending Club, US	Springstone Financial, US	Apr 2014	139
PayPal, US	Braintree, US	Sep 2013	800

New Lending Models :

An outcome of the technological advancements, new models have emerged to facilitate financing. Such models include online lending models (balance sheet lending), platforms facilitating a trade between a borrower and lender (Online Match Making / P2P Platform) and original channels. The said models use automated scoring system using data analytics and predictive analysis evaluating the capability and

the intent of payment of the customer targeting primarily mid-prime to sub-prime customers, unsecured loans, small ticket size loans and shorter tenure loans. Similarly, P2P platforms intend to get the borrower and lender together ensuring availability of financing options as well as reducing cost of funds. This is an innovative way of financial inclusion addressing financing needs of hitherto unbanked / under-banked customer segments.

Such models have recently emerged in India as well. For E.g. : Capital Float, LendingKart, M-swipe, Faircent, i-lend.in etc. The impact of such models is that recently one of the leading banks announced a 10-minute loan to its customers.

While such models are evolving they could be targets as they grow in size bringing certainty to the business model. Separately, SEBI had prepared a concept paper on regulations for Crowd Funding in India.

New Bank Licensees :

RBI had issued guidelines for universal bank licenses for which it gave licenses to Bandhan and IDFC. Similarly, it issued guidelines for issue of Payment Banks and Small Finance Bank licensees. Intent of such licenses has been primarily financial inclusion.

In August 2015, RBI in principally approved Payment Bank licenses to 11 out of 41 applicants with an objective to provide small savings accounts, payments / remittance services to migrant labour workforce, low income households, small businesses, and other unorganised sector entities. This is a new business opportunity including tapping a new customer segment but also somewhat impacting the fund transfer business of banks. Banks wants to safeguard its turf as well as be part of this new business opportunity. They have found a new way of getting this “option value” – be a financial investor or create alliances with such entities. Accordingly, Kotak Mahindra Bank tied up with Airtel, SBI tied up with Reliance Industries and IDFC has tied up with Telenor and Dilip Sanghvi for the payment banking foray. The above tie-ups can also gradually lead to merger with the banks after a reasonable growth of Payment Banks.

Likewise, RBI will be soon issuing in-principle licenses of Small Finance Banks (SFB) with an objective of providing savings vehicles, supply of credit to small business units, small and marginal farmers, micro and small industries and other unorganised sector entities, through high technology-low cost operations. There are 72 applicants for Small Finance Bank licenses. Such entities intend to create a commercially viable business model from the unbanked / underbanked customer segment, which has not been possible by the traditional banks. Similarly, SFBs would be targeting business which is qualified as Priority Sector Lending, where banks have seen consistent shortfall in meeting the regulatory stipulations. In case SFBs are able to create a sustainable model, there could be potential M&A in this area. Precedents suggest that there was considerable M&A action post issue of licenses in 1993. Similarly, Kotak, which was awarded license in 2003, is in the acquirer's bucket and recently acquired ING Vysya Bank.

Financial Inclusion and Deeper Reach:

As banks try to find new avenues of growth, obvious choice is to target the untouched segment. These would include the rural and semi-urban areas, unbanked / underbanked segments, SMEs, non-salaried and entrepreneurial customers and would seek models ensuring viable platforms for financing such segments.

Micro Finance Institutions (MFIs) have been able to successfully create a low cost, high returns and risk averse platform. These are also source of Priority Sector Lending book. In such a case, there is a potential of MFI being targets as it also needs consistent growth capital and may relent beyond a size. There could also be potential structures whereby it complies with objectives of banks and MFI. For E.g. : Certain geography of MFIs may be blocked for banks and for such locations, MFIs can act as an origination channel.

WOS of Foreign Banks :

After the Global Crisis in 2008, RBI issued a scheme for foreign banks to convert itself into Wholly Owned Subsidiaries (WOS) in India. Intent of RBI is to ring fence the Indian business of foreign banks from the global uncertainty and pressures which may adversely impact such foreign banks globally. Accordingly, RBI suggested creating separate legal entity by having a wholly owned subsidiary of the foreign bank. Foreign Banks who have entered into India after August 2010 would have to mandatorily convert their branches into wholly-owned subsidiaries.

One of the benefits of WOS is the ability of such entities to acquire banks in India. Foreign banks even after number of years of operations in India, are comparatively smaller in size, compared to most of the private sector banks. As they convert into WOS and look for growth avenues, andgiventhat M&A is now regulatory allowed, it may look at banking platforms which can give them branch network,customers,efficientoperationsandsize etc.

As understood, recently RBI has received applications from four foreign banks to set up wholly owned subsidiaries in India, almost two years after guidelines were released on the same. Also, DBS Bank Ltd. and SBM Bank (Mauritius) Ltd. have applied to start subsidiaries in India excluding the above four applications. Such banks could be potential acquirers of Payment banks, SFBs, traditional banks or even NBFCs. They would also be flexible to get into arrangements to ensure a growth platform.

Competition and Capital Requirements :

There is a need for Government to infuse their share of growth / regulatory capital into Public Sector banks. Further, weak banks need capital to manage their asset quality issues and operating inefficiencies. As per the new Basel framework, there is an overall funding need of ₹1.8 tn. across the PSU banks and the Government of India has approved infusion of ₹700 bn. in different tranches by FY19. One can easily identify weak banks from the lot based on their financial parameters. Given the constant pressure to fund such PSU banks, the Government may push for the weak banks to merge with large and stronger banks.

Schedule of compliance with Basel III norms :

Additionally, given the competitive environment including from the new age and technological advanced Payment Banks and SFBs, PSU banks may lose their edge which can critically question their existence. Accordingly, as in the past RBI may through an order of Moratorium cause the weak banks to merge with large / strong banks.

Schedule (%)	2013	2014	2015	2016	2017	2018	2019
Minimum common equity capital (CET 1)	4.5	5.0	5.5	5.5	5.5	5.5	5.5
Capital Conservation Buffer (CCB)				0.6	1.3	1.9	2.5
Minimum CET 1 + CCB	4.5	5.0	5.5	6.1	6.8	7.4	8.0
Minimum Tier-1 Capital	6.0	6.5	7.0	7.0	7.0	7.0	7.0
Minimum Total Capital	9.0	9.0	9.0	9.0	9.0	9.0	9.0
Minimum Total Capital + CCB	9.0	9.0	9.0	9.6	10.3	10.9	11.5

Conclusion :

Indian Banking Eco System continues to be vibrant and dynamic. There are numerous opportunities for the bank to partner with many other players from different segments of economy to make their operations more meaningful and economically viable. Future looks bright and let us hope the scenario lives up to the expectations.

Leadership Competencies : Some Inputs from Literature for Enhancing Leadership in Indian Banks

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Introduction

Several changes are being faced by the banking system (e.g., Bhaskaran, 2014a). The present Indian banking system facing a new paradigm due to several changes is required to simultaneously address the three issues of enhancing efficiency, innovation and adaptation, and human resources. Managing each of these three issues requires several leadership behaviors (Yukl and Lepsinger, 2005) and hence managing all three issues simultaneously is likely to create an acute need for leadership in Indian banks. Thus, the acute need for leadership in Indian Banks is reflected in Khandelwal Committee's (2010, p, xxi) assessment that "Most banks consider 'Leadership'as key to long term success of their organizations." However, competencies relevant to leadership in Indian banking have not been identified in a comprehensive and literature-grounded form. This is likely to impair the leadership development efforts in Indian banks. Consistent with this, Khandelwal Committee (2010, p. 8) notes that "Leadership development strategies in most banks lack focus and strategic orientation. This is the most critical issue for attention as the future of banks depends on leadership roles."

To address this inadequacy, this paper draws upon leadership literature to outline a literature-based comprehensive list of leadership competencies and points out the relevance of these literature-based competencies to the leadership in Indian banks. In doing this in the subsequent sections, it first outlines a few phases in the evolution of Indian banking and indicates that the present phase constitutes a new paradigm. It then refers to some literature on Indian banks to suggest that it has not identified a comprehensive set of competencies for leadership in Indian banks. It then draws upon three perspectives in leadership literature to outline a literature-based and comprehensive list of leadership competencies. Subsequently, it points out the relevance of these identified literature-based competencies to the leadership in Indian banking. Finally, the paper ends by outlining its conclusions and likely key contributions.

The New Paradigms in the Indian Banking Sector

The evolution and changing paradigms in Indian Banks can be divided in to four phases. The first phase could be seen as ending at nationalization of banks in year 1969. Tanksale (2014, p. 75) describes some of the features of this phase preceding the nationalization in 1969 by noting that during the pre-independence period, there were a large number of small and geographically narrowly focused private banks which experienced failure and money-lenders and indigenous banks were significant parts of the system. Tanksale (2014, p. 75) also notes that while this pattern continued in the early years following Indian independence, with the formation of State Bank of India, which undertook great geographical extension, the coverage of banking got considerably extended.

The second phase could be viewed as commencing with bank nationalization in 1969, and ending in year 1991-92, when the Narasimham Committee reviewed the Indian banking and financial system and made recommendations for its improvement. The state of Indian banking sector by the end of year 199, can be inferred from the view of the Narasimham Committee (1991, p. ii) which noted, "The Indian banking and financial system has made commendable progress

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in extending its geographical spread and functional reach. The spread of the banking system has been a major factor in promoting financial intermediation in the economy and in the growth of financial savings. The credit reach also has been extensive and the banking system now caters to several million borrowers especially in agriculture and small industry." However, while noting these positive contributions of the Indian banking system, the Narasimham Committee (1991, p. iii) also pointed out the negative aspect of Indian banking system by noting that "Despite this commendable progress, 4 serious problems have emerged reflected in a decline in productivity and efficiency, and erosion of the profitability of the banking sector."

The third phase could be viewed as covering the post 1991 period till year 1998. This phase was characterized by the implementation of reforms recommended in the Narasimham (1991) Committee. Thus, the Narasimham Committee (1998, p. i) noted that "Reform in the Indian banking sector is now under way following the recommendations of the Committee on Financial System (CFS) which reported in 1991." This phase mainly addressed, according to Tanksale (2014, p. 75), the issues of "weak health of the banking sector, low profitability, low capital base, and lack of adequate competition" and the reforms aimed at "strengthening the commercial banking sector by applying prudential norms, providing operational flexibility and functional autonomy and strengthening the supervisory practices" and enhancing competition by opening the entry of private banks.

The fourth phase could be viewed as involving the reforms post 1998-99. The context for these second set of reforms is reflected in the Narasimham Committee (1998, p. i) observation that "Major changes have taken place in the domestic economic and institutional scene, coinciding with the movement towards global integration of financial services. These developments have reinforced the importance of building a strong and efficient financial system." This suggests that the focus of these reforms was on responding to the domestic and global changes by strengthening the financial system and enhancing its efficiency. Tanksale (2014, p. 76) notes some of the features of the phase spanning from 1998-99 till 2013-14, which include sharp reduction in non performing assets, credit portfolio expansion, improvement in capital position, competition intensification, greater use of technology, enhanced customer service, and improvement in efficiency parameters such as an increase of nearly 300% in the return on assets indicator from 0.30 in 1991-92 to 0.89 in year 2013-14. While the above observations focus on Indian banking in general, Khandelwal Committee (2014, p. x) also makes some observations about the positive responses of and outcomes in the Indian PSBs as it notes, "Post liberalization, PSBs have caught up with retail revolution and many other customer-centric innovations. In the matter of technology, almost all PSBs have networked their branches, rolled out core banking, set up a vast network of ATMs and enlarged the basket of offerings to customer. They have also adjusted to the new prudential norms, improved their financials, as also productivity and efficiency." In this fourth and current phase in the evolution of Indian banking system, Indian PSBs in particular seem to be facing a distinct change in their evolution pattern as reflected in the Khandelwal Committee's (2010, p. x) observation that "With the advantage of effective regulatory systems, Indian banks today have the opportunity to improve their capability to become global leaders on their own strengths. In order to acquire global size, scale and pursue global banking, the system is likely to witness internal consolidation."

The fourth and current phase in the evolution of Indian banking system is likely to be affected of several contemporary factors. For example, Bhaskaran (2014a, p. 6) notes that "Banking has changed irrevocably" and outlines five reasons for the change as technological advancement, risk magnification, complex regulation, security concern intensification, and enhanced customer expectations. This changed and changing banking system associated with the current phase in the evolution of the Indian banking system constitutes a new paradigm. This new paradigm is likely to make leadership and leadership competencies important. This is outlined in the following section.

Importance of Leadership and Need for Identifying Leadership Competencies in Indian Banks

In the current phase of evolution of the Indian banking sector, which seems to be a new paradigm as outlined above, leadership has a critical role in the Indian banking system in general and in Indian Public Sector Banks (PSBs) in particular as reflected in various aspects. Some of such aspects are outlined below.

For example, in year 2010, at the commencement of this current decade at the unfolding edge of the new paradigm phase, Khandelwal Committee (2010, p. xxi) noted "most banks consider 'leadership' as key to long term success of their organizations. They also consider this as a major area of concern in the current context." As another example, Tanksale (2014, p. 79-80) also indicated that one of the actions for talent management in banks could be "the possibility of creating leaders at all levels from Branch manager to regional manager and so on." This seems to suggest that there is a critical need to develop leadership at various levels in banks.

Some characteristics of the required leadership in Indian banks are reflected in the literature. For example, in outlining some of the likely developments in PSBs, Khandelwal Committee Report (2010, p. x) noted, "all this will call for leadership of a very high order for managing large system besides higher level of skills and risk taking initiatives." This view from the Khandelwal Committee Report (2010, p. x) indicates the leadership requirement as being of "a very high order", for "managing large system", possessing "higher level of skills and risk taking initiatives." While Khandelwal Committee Report (2010, p. x, xxi) pointed out the critical importance of the leadership for the long term success of PSBs and noted some of the required characteristics of PSB leadership, it does not provide a comprehensive list of characteristics of the leadership required in PSBs. Some required characteristics of the top leadership at the level of Chairman and Managing Director (CMD) are reflected in the view of the Narasimham Committee (1991, p. 98) as it noted, "The Committee is of the opinion that in the appointment of Chairman and Managing Director of the banks professional competence and integrity should be the prime considerations." This view also points out the broader leadership requirement of "professional competence" and "integrity" but does not provide a comprehensive list of the required leadership characteristics in PSBs. Further, it focuses only on the specific position of the CMD in Indian banks.

Another set of top leadership requirement is reflected in the view of Tanksale (2014, p. 80) that "Second and Third layer in any organization is the Middle and Senior Management. This layer can make or break any new initiative or management or change programme. The top management need to pay attention to four levers to recharge and re-engage these layers." This view indicates that one of the competencies or characteristics of top leadership in a bank is to engage and energize the middle management and senior management of the bank.

Some required leadership characteristics can also be noted from Bhaskaran (2014b, p. 168-9) who outlined the level of knowledge and skills for various job profiles in banks ranging from the position of a frontline officer to the position of Deputy General Manager (DGM) and above. This outline covers the four aspects of product, procedure, process, and policy and within each of these four aspects indicates the level of knowledge and skill requirement for various job profiles in banks.

The above indicated literature suggests that leadership and particularly top leadership is important in Indian banks. However, in the above indicated literature, the characteristics or competencies of top leadership are not comprehensively outlined as only a few leadership characteristics are indicated in them. This inadequacy could have been one of the reasons for the observation of the Khandelwal Committee (2010, p. 8) that "Leadership development strategies in most banks lack focus and strategic orientation." In light of this, there seems to a requirement to outline a more comprehensive list of leadership characteristics or competencies that is likely to be of relevance to Indian banks. To address this requirement, I draw upon some of the leadership literature to outline some of the leadership characteristics or competencies. Subsequently, I discuss how some of these leadership characteristics or competencies may be relevant to Indian banks.

Inputs from Some Perspectives in the Literature on Leadership Competencies

Various perspectives in the existing literature suggest competencies that may be useful in leadership. Drawing on three such descriptions in literature, the various leadership competencies are outlined below.

Some inputs on leadership competencies can be drawn from the work of Kirkpatrick and Locke (1991). Kirkpatrick and Locke (1991, p. 48) use the term “trait” to “refer to people's general characteristics, including capacities, motives, or patterns of behaviors.” In light of this usage of the term trait in Kirkpatrick and Locke (1991), traits could be regarded as characteristics of effective leaders or competencies of leaders. Kirkpatrick and Locke (1991, p. 48) note that “effective leaders are different from other people in certain key respects.” As Kirkpatrick and Locke (1991), outline the traits possessed by effective leaders, these traits constitute the characteristics of effective leaders or characteristics that are associated with the effective leadership performance. As the characteristics that facilitate effective performance on a job are regarded as competencies for that job (e.g., Sanghi, 2007), the traits as characteristics of effective leaders could be regarded as competencies of leaders.

This position that the traits of effective leaders outlined in Kirkpatrick and Locke (1991) can be regarded as leadership competencies seems to be a justified position in light of how the term competency is defined in the literature. For example, Sanghi (2007, p. 9) notes “competencies are the characteristics of a manager” which “must lead to effective performance”. This definition of the term competency and Kirkpatrick and Locke's (1991, p. 48), use the term “trait” to “refer to people's general characteristics, including capacities, motives, or patterns of behaviors” suggest that traits associated with effective leaders which are outlined in Kirkpatrick and Locke (1991) constitute competencies of leaders. Further, Sanghi (2007, p. 10), notes that the mention of “underlying” characteristics while referring to competency suggests that “the competence is a fairly deep and enduring part of a person's personality and can predict behaviour in a wide variety of situations and job tasks.” More specifically, Sanghi (2007, p. 10), notes traits, self-concept, motives, knowledge, and skill as five types of characteristics that are referred to by the term competency. This view suggests that the term competency refers to a broad range of characteristics.

Consistent with this broad scope of the term competency, Sanghi (2007, p. 11), notes, “competencies can be defined as skills, areas of knowledge, attitudes, and abilities that distinguish high performers.” The broad scope of the term competency is also reflected in another view from Sanghi (2007, p. 12), that “competencies are components of a job which are reflected in behaviour that are observable in a workplace. The common elements most frequently mentioned in the term competency are knowledge, skills, abilities, aptitudes, personal suitability behaviour and impact on performance at work.” These various descriptions of the term competency suggest that competencies are various characteristics such as abilities, attitudes, knowledge, skills, and behaviors that are associated with or required for effective performance on a particular task or job. In light of this broad inclusiveness of the term competency, the term trait used in Kirkpatrick and Locke (1991, p. 48), to refer to a wide range of characteristics of effective leaders, can be regarded as leadership competencies.

It may be noted that the above view of competencies as including aspects other than behaviors is broader than the views that include only behaviors in competencies. For example, Dessler and Varkkey (2011, p. 156), note that “competencies are demonstrable characteristics of the persons that make performance possible…Job competencies are always observable and measurable behaviors.” Dessler and Varkkey (2011, p. 157), further note that “in practice, competency-based analysis usually comes down to identifying the basic skills an employee needs to do the job.” The view of competencies reflected in this description is narrower than the view outlined above which includes both behaviors and other characteristics such as traits in the term competencies.

In light of the broader view of traits outlined above, the traits discussed in Kirkpatrick and Locke (1991), are discussed below as the characteristics of effective leaders or competencies of leaders. Kirkpatrick and

Locke (1991), note that drive is one of the traits associated with effective leaders and indicate that the drive trait reflects various characteristics such as desire for achievement, ambitiousness, high level of energy, persistence, and proactivity. Leadership motivation is another trait of effective leadership indicated in Kirkpatrick and Locke (1991), and refers to a particular form of leadership motivation characterized by an individual's urge to influence others and to be in the role of leading others rather than following others. The discussion in Kirkpatrick and Locke (1991), also suggests that it is the urge to use the power and influence to attain organizational goals, rather than the urge to use power and influence to manipulate or dominate others, which is likely to facilitate effective leadership. Honesty and integrity, knowledge of the business, cognitive ability, and self-confidence are also included in Kirkpatrick and Locke (1991), as other characteristics of effective leaders. Kirkpatrick and Locke (1991), also note that possession of charisma, creativity, and flexibility as characteristics associated with effective leadership though the support for them is weaker than for the characteristics listed earlier above. In general, one can infer that these traits outlined in Kirkpatrick and Locke (1991), reflect ability to achieve, urge to achieve, desire to influence or lead and moral or ethical maturity.

Kirkpatrick and Locke (1991), include three other additional factors namely; vision formulation, vision implementation, and specific capabilities for actions such as making decisions. While these factor do not seem to fall in the category of traits, they seem to be close to abilities or actions / behaviors resulting from the abilities. As abilities are a part of competencies, these three factors, which seem to be close to abilities or actions / behaviors resulting from the abilities, can be regarded as competencies.

Another perspective on leadership from which some leadership competencies can be derived comes from the work of Yukl and Lepsinger (2005). Yukl and Lepsinger (2005), identified three factors that determine an organization's performance. These are managing efficiency and process reliability, facilitating adaptation and innovation, and nurturing human resources and relations. Yukl and Lepsinger (2005), identify three categories of leader behaviors of which each category of leader behavior influences one of the three factors determining an organization's performance. The leadership behaviors for improving efficiency and process reliability include doing short term planning, clarifying roles and objectives, monitoring operations and outcomes, resolving the emergent operational problems, and rewarding contingently (Yukl and Lepsinger, 2005, p. 363). The leadership behaviors for enhancing innovation and adaptation include external scanning, exploring the need for change, implementing change, and encouraging innovative thinking and collective learning (Yukl and Lepsinger, 2005, p. 363). The leader behaviors for enhancing human resources and relations include supporting and encouraging others, coaching and mentoring, empowering, and facilitating cooperation and team work (Yukl and Lepsinger, 2005, p. 363). While different leadership behaviors from the above categories will be relevant at different points in time depending on the need for managing a particular set of factors determining the organizational performance, perspective outlined in Yukl and Lepsinger (2005), suggests that effective leadership is likely to require the a leader performs several of these behaviors.

Another perspective, termed as transformational leadership (e.g., Bass, 1985), includes behaviors that are somewhat similar to the leader visioning and vision implementation factors outlined in Kirkpatrick and Locke (2001), and leadership behaviors for innovation and adaptation facilitation and human relations and human resources enhancement outlined in Yukl and Lepsinger (2005). The specific leader behaviour categories in the transformational leadership perspective (e.g., Podsakoff, MacKenzie, Moorman, and Fetter, 1990), include, vision formulation and articulation, setting a suitable model for subordinates, conveying high performance expectations, seeking subordinates' acceptance of group goals, providing intellectual stimulation to subordinates, and extending individualized support to subordinates. Each of these six leader behaviour categories is briefly described below by drawing upon Podsakoff, MacKenzie, Moorman,

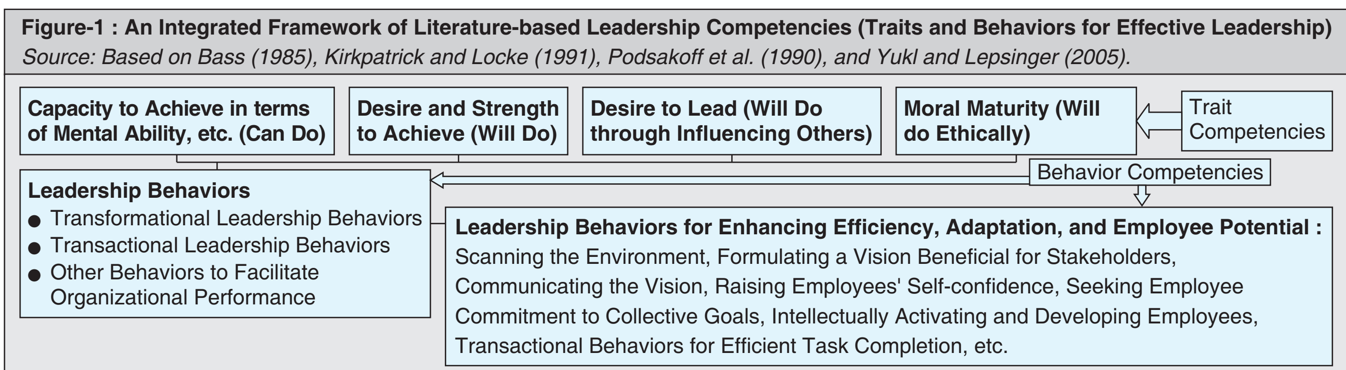
and Fetter (1990, p. 112). Vision formulation and articulation category of leadership behaviors includes a leader's creation of an attractive picture of an organization's future and its communication to followers. In the behaviour category of setting a suitable model for the subordinates, a leader behaves in a manner consistent with the values adopted by him in order to provide a role model for the subordinates to follow. In the behaviour category of conveying high performance expectations, a leader conveys that excellent performance is expected from the subordinates. In the behaviour category of seeking subordinates' acceptance of group goals, a leader enhances cooperation and common goal pursuit among the subordinates. In the behaviour category of intellectual stimulation, a leader encourages the subordinates to think in new ways about how their work can be performed. In the individualized support behavior category, a leader expresses respect for the subordinates and concern for the subordinates' needs and feelings. In contrast with the transformational leadership behaviors, transactional leadership behaviors seek to establish an exchange or transactions with the subordinates and providing rewards contingent upon the subordinates' effort provision is one of the main categories of transactional leadership behaviors (Podsakoff, MacKenzie, Moorman, and Fetter, 1990).

Based on the above descriptions of the transactional leadership behaviors and transformational leadership behaviors, their similarity with the leadership behaviour categories included in Yukl and Lepsinger (2005), perspective can be noted. Leadership behaviors for enhancing performance and process reliability in the perspective of Yukl and Lepsinger (2005), seem to be similar to the transactional leadership behaviors while leadership behaviors for facilitating innovation and adaptation and for enhancing human resources and relations in Yukl and Lepsinger (2005), seem to be similar to the transformational leadership behaviors.

Three perspectives on leadership characteristics are outlined above. First, Kirkpatrick and Locke's (2002), perspective indicates the traits and behaviors of effective leaders. Second, Lepsinger and Yukl (2005), perspective points out three categories of leadership behaviors namely, behaviors for enhancing efficiency and process reliability, behaviors for facilitating innovation and adaptation, and behaviors for enhancing human resources and relations. Third, the perspective of Bass (1985), and Podsakoff, MacKenzie, Moorman and Fetter (1990), outline multiple behaviour categories within transformational leadership and the contingent reward behaviour as one of the categories within transactional leadership. Collectively these three perspectives from the leadership literature suggest that the required characteristics of effective leaders or leadership competencies include possession of certain traits and performance of certain behaviors. As outlined in the earlier part of this paper, the term competencies includes both traits and behaviors (e.g., Sanghi, 2007, p. 9, 12). Thus, the effective leadership traits and behaviors included in the above outlined three leadership perspectives can be regarded as leadership competencies. The leadership competencies including traits and behaviors drawn from the above outlined three perspectives in the leadership literature and from the associated discussion are presented in an integrated form in Figure-1.

Figure-1 : An Integrated Framework of Literature-based Leadership Competencies (Traits and Behaviors for Effective Leadership)

Source: Based on Bass (1985), Kirkpatrick and Locke (1991), Podsakoff et al. (1990), and Yukl and Lepsinger (2005).



Relevance of the Literature-based Leadership Competencies to Leadership in Indian Banks

The above outlined leadership literature indicates that leadership is required to carry out a wide range of behaviors. The wide range of leadership behaviors are required in order to manage three performance determinants namely; enhancing efficiency and process reliability, facilitating innovation and adaptation, and managing human resources and relations (Yukl and Lepsinger, 2005). The aspects of efficiency, adaptation and innovation, and human resources and relations reflected in these three determinants seem to be the requirements of the Indian PSBs also. The presence of these aspects as being requirements in Indian banks is outlined below.

First, the requirement of efficiency in Indian banking is reflected in the Narasimham Committee's (1991, p. iii), observation that “Despite this commendable progress serious problems have emerged reflected in productivity and efficiency.” The Indian banking system has improved its efficiency since 1991, as outlined above by drawing on the assessment of Tanksale (2014, p. 76). However, the efficiency requirement in the PSBs in even the current period is reflected in a more recent observation of Khandelwal Committee (2010, p. x) that “Some of the major HR challenges before PSBs include building capabilities for future; improving productivity and performance culture...” Khandelwal Committee (2010, p. xi) also notes that “…PSBs are likely to lose their present status and be a drag on the efficiency of the financial system”. Further, Khandelwal Committee (2010, p. xxx) notes that “It is time that issues of productivity and performance acceleration are brought to the main stream discussion with Unions as for too long these issues have remained in the back stage.” These views and assessments suggest that the performance determinant of efficiency enhancement which, according to Yukl and Lepsinger (2005), outlined above, necessitates several leadership behaviors or competencies is a requirement in Indian PSBs. Thus, several of the leadership competencies indicated in Figure-1, are likely to be relevant to Indian banking and PSBs.

Second, the performance determinant of innovation and adaptation enhancement is also a requirement in Indian banks. For example, the Narasimham Committee (1991. p. xxii), noted that “The Committee believes that there has to be a recognition on the part of managements and trade unions that the system cannot hope to be competitive internally and be in step with wide-ranging innovations taking place abroad without a radical change in work technology and culture and greater flexibility in personnel policies.” This assessment of the Narasimham Committee (1991, p. xxii), suggests a need for being “in step with wide-ranging innovations taking place abroad”, the need for “a radical change in work technology and culture” and “greater flexibility in personnel policies” which reflect the performance determinant of facilitation of innovation and adaptation included in Yukl and Lepsinger (2005). As facilitation of innovation and adaptation requires several leadership behaviors (Yukl and Lepsinger, 2005), the need for innovation and adaptation in Indian banking system suggests the leadership competencies outlined in Figure-1, are likely to be relevant to leadership in Indian banks.

Third, the performance determinant of enhancing employee human resources and relations is also reflected as a requirement in Indian PSBs as outlined below. The importance of enhancing human resources and relations is reflected in the assessment of the Narasimham Committee (1991, p. xxii) that “It is equally incumbent on management of banks to adapt forward looking personnel policies which would help to create a satisfying work environment.” Similarly, the Khandelwal Committee (2010, p. 6) noted that “Reforms in HR have become overdue in the context of challenges and opportunities of new age banking.” More recently, Bhaskaran (2014c, p. 188), after outlining various suggestions received for updating bankers' competence levels, noted that “All such suggestions point to the need to create a responsive and empathetic work platform, which seems to be currently missing in a highly competitive, talent driven and target scarce work environment.” Thus, the performance determinant of enhancing human resources and relations, which as outlined earlier requires a range of leadership behaviors according to Yukl and Lepsinger (2005), is also

a requirement in Indian banks and PSBs. Therefore, the leadership competencies outlined in Figure 1, are likely to be relevant to leadership in Indian banks.

Conclusion and Key Contributions of this Paper

While this paper focused on Indian banks, at some places it has drawn upon assessment pertaining to only Indian Public Sector Banks (PSBs). PSBs constitute a large part of the Indian banking system which is reflected in various features. For example, the share of PSBs in the total assets of Indian banking system exceeds 70 per cent (Khandelwal Committee Report, 201o, p ix). Thus, the assessments and observations of PSBs are likely to be applicable to a large segment of Indian banks.

This paper has pointed out that while the Indian banks have evolved through multiple phases, the current phase constitutes a new paradigm and the leadership is a critical issue in banks. Drawing on some literature on Indian banks, it has also pointed out the need for comprehensively identifying the behaviors of effective leadership or leadership competencies in Indian banks. Using some leadership literature, it has indicated that a broad range of leadership behaviors are required to manage three performance determinants of enhancing efficiency, human resources and relations, and innovation and adaptation and that leadership competencies include a range of traits and behaviors as outlined in Figure-1. Finally, it also pointed out that the literature-based comprehensive leadership competencies outlined in Figure-1 are likely to be applicable to Indian banks because the three performance determinants for which leadership behaviors are required also need to be managed in Indian banks and PSBs.

The main contribution of this paper is that it has provided a comprehensive and literature-based list of leadership competencies and systematically interlinked them as outlined in Figure-1. Another contribution of this paper is that it has pointed out the relevance of these leadership competencies to Indian banks and PSBs. As some of the leadership competencies outlined in Figure-1, are traits and some are behaviors, the actions for enhancing leadership in Indian banks will require attention to leadership selection based on traits and leadership training and development to train leaders in effective leadership behaviors. Thus, the leadership competencies outlined in Figure-1 can serve as a guiding framework for a comprehensive leadership development program in Indian banks covering various actions such as leadership selection, leadership potential assessment, and leadership training and development. This contribution is likely to be significant because the Khandelwal Committee (2010, p. 8) notes that "Leadership development strategies in most banks lack focus and strategic orientation. This is the most critical issue for attention as the future of banks depends on leadership roles." Thus, this paper by providing a comprehensive and literature-based framework of leadership competencies and pointing out it relevance to Indian banks may make a significant contribution by guiding leadership development in Indian banks.

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Talent Development in Banks : New Paradigms

Tay Kay Luan *

Challenges, changing paradigms

The banking industry is undergoing through a tough process of restructuring and deleveraging since the global financial crisis. There is also a fundamental change occurring in today's highly competitive banking landscape where shifts are stemming from various economic, regulatory, consumer and technology perspectives.

These paradigm shifts are reshaping the banking industry and creating an even more challenging environment for banks operating locally or globally. Such environmental changes have forced banks to be more adaptable and re-look the way they do business in order to remain profitable and relevant.

Broadly speaking there are 5 prevailing trends that are shaping the banking landscape:

1. Impacts of changing banking regulations and compliances on banking operations and delivery systems in a complex environment;
2. Massive disruptions resulting from digital banking and automation posing real threats to conventional roles and skills;
3. Changing demography that shapes and influences the design and delivery of banking products and services;
4. Innovative products necessary to enable banks to diversify their revenue streams in a low margin era; and
5. Imminent threats from rapid emergence of alternative financial services offered by non- bank entities including financial technology companies (Fintech).

Digital threats and opportunities

According to a McKinsey report, half the world's banks are in danger of extinction from the impacts of digital transformation. For example, migration to online transactions has increased at such a pace that it has contributed to the closure of forty branches of The Royal Bank of Scotland. Since banks are also hard pressed to drive cost efficiency, going digital is an attractive alternative where technology has help improve customer experience with customers, suppliers and partners.

Reflecting this trend is UBS, the world's largest private bank which has stepped up its digital offering to meet the demands of IT-savvy clients by launching an innovation centre in Singapore. Further, Piyush Gupta CEO of DBS has asked banks to think the same way as technology savvy firms when it comes to innovation and delivery.

New paradigms of talent development

These forces of developments will demand a wider talent development agenda. New paradigms in talent development are necessary. The shift from knowledge to innovative era will require new workforce that are versatile and highly receptive to rapid changes especially when consumers are demanding higher standards of services.

It is in this context that we should view differently how we re-frame the talent development agenda, and how industry will need to realign talent investment in order to make that difference.

Talent development must acknowledge that banking now operates in a multi-disciplinary as well as in a more challenging environment. The industry no longer has a

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monopoly, its image in advanced markets has been tarnished following the financial global crisis and work impacts through technology and customer lifestyles can no longer be ignored.

Repositioning talent development is one way which can make a difference, so that the right talent with the right skills can add greater value to the organisation.

It must not only focus on assessing the right skills in which the organisation needs to implement its strategy but it also needs to ensure that talent from diverse backgrounds are considered.

We must also return to the basics to give the right talent the tools of the trade to implement business strategy. In this connection, technical content is the key and must be updated regularly and applied appropriately. However, there is a need to be aware of the paradox where increased automation inevitably reduces the need for technical know- how.

Understanding the availability of talent with the appropriate technical know-how is critical for planning purposes. Greater efforts are necessary to ensure right talent is selected, developed and retained. Often, the reasons why business strategies fail is that it mistakenly assumes that the organisation will always get the right talent to perform in the manner the strategy dictates. This is no longer the case as good talent is hard to find, let alone develop or retain.

All too often organizations suffer from mismatch even in identifying the right development courses and the application to be used to transfer the know-how. As a result, returns do not justify the time and resources spent.

The challenge is to ensure learners today understand performance and learning needs and how it impacts their business outcomes. It is therefore not surprising that new learning application of content and delivery of services have to be fully understood, appreciated and applied.

It is important to remind ourselves that having well-informed professional bankers is not only critical to the industry but one that is necessary to protect and sustain public interest in an increasingly regulated environment.

Strong and competent bankers will be expected to raise their level of professionalism in their expanded roles that requires critical thinking, problem solving and interpreting skills.

Professionalism and ethics

In recent years, global banks are being investigated and punished for their past mistakes. Bitter lessons learned from the experiences of global banks for non compliances have to date cost more than USD 230 billion in fines. Demise of Lehman Brothers, and lessons learned from RBS and Barclays have now called for professionalism and ethical practices.

The causes of non-compliances are due to the lack of professionalism and ethics, integrity, misconduct and poor governance which had severe consequences on public trust and confidence.

A McKinsey Study report suggests that since the economic crisis, consumers place greater importance on intangible factors such as trust, value and service. It is therefore imperative to ensure the public trust in the financial services industry is not only protected but enhanced. It is not unreasonable to expect regulators in order to protect public interest to treat responsibility and ethics as core disciplines towards the development of banking talent – present and future.

Malaysia has placed much effort in supporting the global agenda on professionalism and ethics for the financial services industry with the establishment of the Financial Services Professional Board (FSPB) in September 2014. The main objective of FSPB is to advocate for the development and application of universal standards of professionalism and ethics that are applicable across different sectors of the financial services industry.

Within this context the Asian Institute of Chartered Bankers has committed to raising the professional standards in education and training for the banking industry. One of these includes the inclusion of compulsory modules on professionalism and ethics

in its Chartered Banker syllabus. This is in line with the agenda of professionalising bankers. This is a new paradigm which the banks will need to embrace in order to be in line with best practices adopted by the accountancy profession towards ethics, integrity and public interest. Membership through Chartered Bank qualifications is part of this paradigm that is taking root.

Returns on learning

Many financial institutions are willing to spend huge amounts of money on training courses but it is important to ensure that the learning outcomes are in line with the development needs of the individuals.

This is not an easy task. It may be impossible to manage talent development in an organisation that does not see learning in the same way. It was common in the old paradigm to blame problems experience on the failure to deliver on training.

In future, learning professionals need to ensure proper matching of learning outcomes to developmental needs of learners.

Most conventional courses for example, leadership development programmes, are not worthy of its name.

There are an abundance of leadership development programmes available in the market, but majority of them do not meet the desired objectives. The feel good factor is not sustainable without addressing the fundamental environmental factors that govern human performance.

In today's environment talent development programmes must make a difference otherwise it is a waste of everyone's time and money.

Most talent development leaders do not quite understand that there are differences in the way people learn and unlearn. Some of us are more visual while others may be audio inclined or Kinaesthetic.

Learning styles must be integrated and better understood to avoid mismatch of training and person.

The distinction has to be drawn here, where fundamentally professional courses are more applied, industry based and the learning outcomes are more aligned to the organisational requirements. Increasingly, examinations are being accepted as the standard practice in talent development.

Specifically, learning specialists qualified with the expertise in talent and learning are able to see not only the larger picture but also understand the micro-requirements of people they serve. Social awareness and management competencies are, thereby, taken to a level where respective competencies can be known, enhanced and adapted for workplace. Equally the application of these emerging competencies must be fit for purpose in the world of unpredictable business.

One new paradigm therefore, is to ensure that the learning professionals with expertise across organisational development, leadership, learning, and talent management hold discussions with industry professionals about the merits and expected outcomes of different initiatives in learning and talent management.

Competency based leadership development

Experts on leadership development will say "It is unlikely that an organisation, having the right set of skills, will be unsuccessful in implementing it's business strategy"

For example, in the leadership programme, there is a need to view and treat leadership development as a competency based professional programme. New emerging competencies such as managing diversity, stakeholder engagements, and coping with uncertainty have to be demonstrated and taught. There is a difference between leadership and leader, where as in this context we are focusing on leadership as a process, and a competency.

Changing the nature of leadership has to do with the changing environment we live in. Having the ability to listen, empathize and adapt are top current and future leadership traits. Above all, leadership is about bringing out the best in people –according to Jack Welch.

This means that such competency matters will make a difference when using your emotional quotient (EQ) to discover yourself through self awareness, being able to empathize and manage the social environment.

In practice, we need to collectively commit to a combination of diagnostic and application tools where people need to learn to become better leaders. People learn better in leadership if they are given the opportunity to discover themselves rather than being asked to listen or told what to do.

When it comes to leadership development, there will be a need to make dramatic changes in the way programmes are designed. It will also be necessary to bring leaders together not only to learn but also to develop relationships with one another. This process will involve framing fresh objectives of leadership which will involve not only individual learning but also helping people to discover, reconcile and reconnect.

Recent studies have demonstrated that the following top leadership behaviours that will need to be recognised, and developed:

- Solving problems effectively
- Operating with strong results orientation
- Seeking different perspectives
- Supporting others

Culture of learning

There are not many of us who would pay attention to what we learn in courses and start making the changes immediately.

It is clear that people do not necessarily change their mindsets or behaviour because they need to; it is like telling them they need to eat in order to gain energy.

The rules have changed, and business as usual is no longer adequate. The new paradigm is to empower learners' choices and create and support a learning culture. A powerful development is the introduction of a more impactful blended learning culture and system, one that is more efficient through the integration of knowledge and application as well as bringing learners closer to the desired learning outcomes.

Online or Class room

There is now the option of online learning for busy people. However, local surveys among banks show that 60% of respondents prefer class room. Resistance to digital learning or online learning has to do more with perception of online as inability to allow exchange points of view, real debate and build relationship. There is some truths in this, which explains why the value propositions of digital learning have to be more than just cost efficiency.

Learning to do good for society

We can all agree that a strong and talented workforce is important towards the development of a vibrant banking sector. It is therefore very necessary that learners understand that their roles including among the contribution to societal development through building public trust and community development.

New paradigm

The alignment of talent development with the rapidly changing face of banking industry is a momentous task. It is however useful to consider shifting the paradigm on the way we view and approach talent management. Considerations should be focused on :

- The need to professionalise learning.
- The need to prioritise the agenda of professionalising bankers.
- Changing the approach to leadership development.
- Emphasising the culture of learning which is a key and integral part of overall development.

Reference

- www.aicb.org.my

PART - 2

Prize Winning Articles

New Paradigms in Banking : The Case of Indian Banking Sector

Manas Ranjan Das *

According to the Chambers Dictionary, 'Paradigm' means "a conceptual framework within which scientific theories are constructed". In a word, 'paradigm' means 'model'. However, more than 'paradigm' per se, 'paradigm shift' is important because 'paradigm shifts' lead to emergence of new paradigms – the topic of the present essay. The concept of 'paradigm shift' originated with Thomas Kuhn's book The Structure of Scientific Revolution in 1962. According to Kuhn, scientific advancement is "a series of peaceful interludes punctuated by intellectually violent revolutions". During these revolutions, "one conceptual world view is replaced by another".[1] In simple terms, a 'paradigm shift' denotes a 'fundamental change' in the way an individual or a community views occurrences.

Before we delve into the topic, it needs to be underscored that the financial system, financial development and economic growth are symbiotically correlated. The literature on Finance is replete with theoretical and empirical research on various facets of the symbiosis.[2] The balance of arguments and counter-arguments favour banks as better financial intermediaries than others in the market. The classical function of banks is financial intermediation between savers and investors by constructing an 'information highway' between them. This leads to better resource allocation, inter-temporal and inter-spatial risk sharing, corporate governance and functioning of payment systems, and all these ultimately promote and sustain growth.

Further, recent research reveals that despite post-2008 distortions, the financial sector can still support economic efficiency.[3] Thus, in an evolving industry like Banking, it is quite but natural for paradigm shifts to occur from time to time across various economies.

Against this backdrop, the paper is organized as follows : Section 1 provides an historical account of different paradigms in the Indian banking sector; Section 2 focuses on the lessons learnt from banking paradigms in select countries; Section 3 analyses the current paradigm in which PSBs are operating; Section 4 assesses whether there is a need for a paradigm shift today and if yes, what the new paradigm and its various facets should be; and Section 5 concludes.

The paper focuses on Public Sector Banks (PSBs), not on other segments of the scheduled commercial banking sector such as private sector banks, foreign banks, Regional Rural Banks (RRBs) and Local Area Banks. The reasons are two-fold : (i) PSBs are the major players in the banking turf and (b) the other segments operate under regulatory regimes and follow business models which are considerably different from those in respect of PSBs. Therefore, given the space constraint, it was not possible to deal with the paradigm shifts in all the categories.

Data available in the public domain are used in this paper. Statistical analyses are mostly restricted

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to March 2014 in order to facilitate full-year comparisons to yield consistent results.

1. PSBs - Trysts with Different Paradigms

Present and future are incontrovertibly linked to past. Therefore, this section summarizes the different models that PSBs have historically grown through (Table-1).

Table-1 : Paradigms of PSBs : The Evolutionary Process

Model	Drivers	Outcome
Nationalization of the Imperial Bank of India into the State Bank of India (SBI) in 1955 with the enactment of the State Bank of India Act, 1955.	- To change the focus of banking from 'credit worthiness' to 'purpose worthiness'. - To make banks 'agents' of socio-economic change in a young nation. - Institutional credit to replace indigenous credit.	- SBI opened 416 branches within 5 years in unbanked centres exceeding the target of 400. - Being 'government-owned' and thereby enjoying peoples' trust, SBI could compete against post offices and physical savings. - Had a salutary impact on branch and business expansion of other banks. - The then 8 banks which were SBI subsidiaries nationalised in 1960. Thus, the government got direct control over one-third of banking business.
Social Control over banking in December 1967 through the Banking Laws (Amendment) Act 1968, which came into force on February 1, 1969.	- To enhance spread of bank credit. - To ensure proper use of credit. - To 'direct' increased flow of credit to the neglected sectors to promote economic development in accordance with the plan priorities.	- The National Credit Council set up in February 1968 to assist RBI and the government in credit allocation in tune with the plan priorities. - Despite 'social control', a significant chunk of population continued to be deprived of institutional credit.
Nationalisation of 14 major banks with deposits of over INR 500million by promulgating the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969.	- To utilize bank deposits for holistic economic development. - To lend without any bias towards anybody, focusing especially on the weaker sections of the society.	- The 1969 Nationalization heralded an era of major structural transformation in the Indian banking industry. - Special thrust was put on making available banking facilities in the then unbanked areas through (a) enunciating a specific branch licencing policy and (b) initiating Lead Bank Scheme. - Banks expanded their branch network, especially in rural areas, regional disparity in distribution of branches diminished, and both deposits and loans grew steadily.
- A formal Priority Sector definition enunciated in 1972. In November 1974, PSBs advised to achieve a priority sector lending (PSL) target of at least one-third of outstanding credit by March 1979 which was subsequently raised to 40%.[4]	- To even out skewed distribution of bank credit among different sections of the society.	- Agriculture finance doubled between 1971-72 and 1974-75. - Rural credit-deposit (C-D) ratio increased significantly.
In April 1980, 6 banks with deposit liabilities of INR 2 billion and above nationalised.	- Governance issues with these banks. - Increased need to smoothen credit delivery in a greater way.	- Number of PSBs including the SBI and its Associates rose to 28 in April 1980, commanding over nine-tenth of bank deposits.

4. The PSL guidelines subsequently underwent several changes in 1979, 1985, 2007, 2012 and 2015.

Table-1 : Paradigms of PSBs : The Evolutionary Process		
Model	**Drivers**	**Outcome**
- Wide-ranging recommendations of the Government of India - appointed High-powered Committee on the Financial System (Chairman : M. Narasimham) (1991).	- Poor and deteriorating health of the banking sector. - Further erosion in safety and soundness to impact adversely depositor's confidence. - Financial sector reforms – a part of overall structural reforms initiated in 1991. - PSBs lacked adequate functional autonomy and operational flexibility. - Bureaucratic and political interference abounded.	- Ten new private banks set up by 1998, besides 22 foreign banks expanding their network. - However, the desired effect on competition remained unrealized. - Nevertheless, financial performance, capital adequacy and asset quality improved significantly.
Recommendations of the Committee on Banking Sector Reforms (Chairman : M. Narasimham) (April 1998) - second round of reforms in the banking sector.	- Safety and soundness, though improved after Narasimham Committee-I recommendations were implemented, fell short of international best practices. - The East Asian crisis in June 1997 brought to fore how a weak banking system can hold an economy to ransom. - Need to institute appropriate Asset-Liability Management practices, to be complemented with comprehensive risk management practices.	- Between 2003-04 and 2006-07 recovery of NPAs increased steadily. - Between 1999 and 2007 both Gross Non-performing Assets (GNPA) and Net Non-performing Assets (NNPA) ratios unwaveringly climbed down and Capital to Risk-weighted Assets Ratio (CRAR) improved.
RBI's Annual Policy Statement for the year 2005-06 asked banks to make Financial Inclusion an avowed policy objective.	- Emergence of Financial Exclusion as a serious issue, internationally. - Bank penetration in the informal credit market low, especially in rural areas, despite several efforts.	- Several milestones achieved, but exclusion still remained significant.
Introduction of Basel III norms.	- Aimed at strengthening regulation, supervision and risk management in the banking sector.	- In terms of Basel III capital regulations issued by RBI, the Capital Conservation Buffer will be implemented from March-end 2016. Consequently, the Regulations will be fully implemented as on March-end 2019. - PSBs require an estimated INR 2,400 billion capital by 2018 to meet Basel III norms.
Pradhan Mantri Jan-Dhan Yojana (PMJDY), August 2014	- To put Financial Inclusion on a 'mission' mode, combining banking and insurance facilities for the poor.	- Highly successful - India's Financial Inclusion effort featured in the Guinness Book of World Records.
Source : Majorly based on RBI publications.		

Thus, it may be emphasized that PSBs under various paradigms harbingered the financial sector in general and banking sector in particular to take roots and grow as well as served the nation remarkably well despite some rigidities creeping in which are quite but natural while operating in a gigantic and diversified system like India.

2. Banking Paradigms – A Cross-country View

It was attempted to study the banking models of 2 advanced countries, namely, the US and the UK, and 4 BRICS economies, namely, Brazil, Russia, China and South Africa. Due to space constraint, the models are not discussed here; however, the lessons are as under :

- Too much or too little regulation may precipitate crisis.
- Paradigm shifts follow crises.
- The government and government-backed banks play a crucial role in reviving the banking industry and economy from crises.
- A better model emerges, post-crisis.
- Too-important-to-fail (TITF) banks always pose problems and are normally bailed out.
- Paradigms are not static; these are dynamic.

3. Indian PSBs – The Current Paradigm

This section examines the current phase of the PSB model. For this purpose, the data for the period March-end 2010 to March-end 2014 are examined in respect of certain parameters divided into 4 aspects : (a) Business (b) Profit and Efficiency, (c) Safety and Soundness and (d) Employee Productivity. Particularly noteworthy is the trend during 2012-14.

PSBs on Pause Mode?

Table-2 presents the above-said analysis in order to explain how financial intermediation function of PSBs has lost some of its momentum, possibly temporarily.

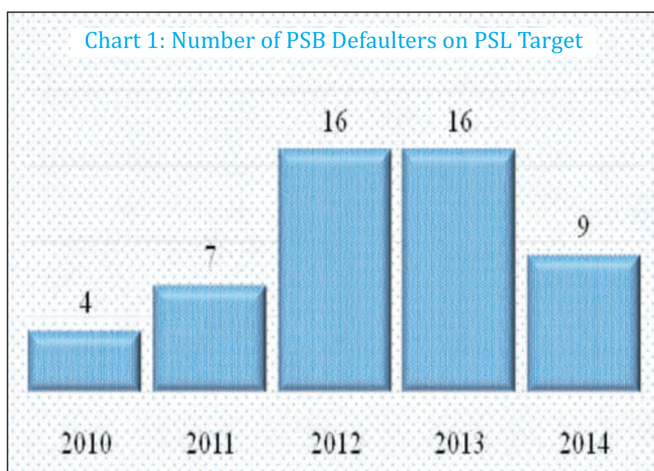
Table-2 : PSBs - An Account of the Current Paradigm

	Select Parameters	2010	2011	2012	2013	2014	Trend
	Business						
Y-o-Y Growth Rate	Balance Sheet Size	17.9%	19.2%	14.1%	15.3%	14.4%	
	Domestic Deposits	18.4%	18.0%	13.1%	14.0%	13.1%	
	Domestic Deposits (excluding Inter-bank)	17.6%	17.5%	12.1%	13.7%	12.2%	
	Domestic Credit	19.6%	21.7%	15.5%	13.9%	12.8%	
	Domestic Investments	20.3%	10.0%	12.9%	16.2%	11.9%	
	C-D Ratio (Year-end)	70.3%	72.5%	74.1%	74.0%	73.8%	
	Investment-Deposit (I-D) Ratio (Year-end)	33.8%	31.5%	31.5%	32.1%	31.7%	
	Incremental C-D Ratio (Y-o-Y)	73.9%	84.7%	86.0%	73.4%	72.1%	
	Incremental I-D Ratio (Y-o-Y)	36.6%	18.7%	31.1%	36.4%	29.0%	
	PSL Growth Rate	20.2%	18.9%	9.9%	13.6%	26.1%	
	PSL/ANBC* Ratio (Median Values)	40.92%	41.65%	38.76%	36.96%	41.11%	
	Profit & Efficiency						
Y-o-Y Growth Rate	Net Profit	14.2%	14.4%	10.3%	2.2%	26.8%	
	Interest Income from Advances	10.4%	21.0%	35.5%	13.7%	10.3%	
	Commission, Exchange & Brokerage	21.4%	17.2%	7.4%	1.1%	6.9%	
	NPA Provisions	87.1%	51.4%	33.2%	24.6%	28.5%	
Y-o-Y Growth Rate	Return on Assets	0.97%	0.96%	0.88%	0.80%	0.50%	
	Net Interest Margin	2.29%	2.77%	2.76%	2.57%	2.45%	
	Burden	0.42%	0.72%	0.70%	0.69%	0.71%	
	Safety & Soundness						
	GNPA Ratio	2.19%	2.40%	3.30%	4.10%	4.70%	
	NNPA Ratio	1.09%	1.20%	1.50%	2.00%	2.70%	
	Stressed Assets Ratio	5.73%	3.98%	6.59%	9.95%	10.86%	
	CRAR (Basel-II)	13.16	13.41	12.92	12.10	11.86	
	Tier I	8.21	8.69	8.99	8.49	8.25	
	Tier-II	5.00	4.33	3.87	3.23	3.19	
	Employee Productivity						
	No. of Employees (Y-o-Y Growth Rate)	1.1%	2.1%	2.5%	3.1%	4.0%	
	Profit/Employee (Rs million)	NA	0.79	0.84	0.81	0.48	
	Business/Employee (Rs million)	NA	140.80	149.90	165.10	137.15	

* Adjusted Net Bank Credit. NA - Not Available. Yellow indicates the highest value. PSBs' stresset assets and NNPA ratios rose to 13.5% and 3.2% respecively at March-end 2015 according to the RBI Financial Stability Report, June 2015. Further, the stress tests carried out by the Report do not paint a favourable picture for PSBs

Highlights

- The Business indicators revealed that the Y-o-Y growth in balance sheet size, deposits and loans declined, implying that the financial intermediation function of PSBs took a beating.
- Although the year-end C-D and I-D ratios maintained their levels at over 70% and 30% respectively, the incremental C-D and I-D ratios, which are more important parameters, stuttered in the last 1 to 2 years.
- PSL growth rates which dipped below 10% in 2012 gradually looked up. However, the PSL / ANBC ratio was largely on a decline. In 2012 and 2013 each, the ratio was below the stipulated 40%. Further, it needs to be underlined that several PSBs failed to reach the 40% level in all the 5 years (Chart-1) indicating disinterest among a cross-section of PSBs to reach the stipulated ratio.



- The Profit and Efficiency indicators showed that all the relative parameters were on a slippery path.
- A similar situation was obtained in respect of the Safety and Soundness indicators.
- In regard to the Employee Productivity indicators, although the Y-o-Y growth rates in number of employees was on ascent, profit / employee and business / employee each was on descent. However, a favourable observation was that the officers to non-officers ratio steadily declined from 1:1.66 to 1:1.35 during 2010-14.

Meanwhile, many PSBs used the 'breathing space' to consolidate their position on the IT and cards platform, especially by launching various futuristic mobile and e-enabled products and services, which is laudable.

4. Envisioning a New Paradigm for PSBs

At present, there are several macroeconomic imperatives, also professed by the government, which would ultimately precipitate a paradigm shift in PSBs to serve the economy better. PSBs may feel compelled or even enthused to partake the shift. Apart from helping macroeconomic parameters improve, the new paradigm will help rejuvenate PSBs too. Some of these imperatives are listed below :

- Accomplishing sustained growth rate of above 8% in the medium-term, which has to be inclusive, sufficiently employment-generating, especially for the youth, both skilled and unskilled, and accomplished at RBI-compatible inflation levels.
- Secondly, growth should be equitable and environment-friendly.
- For 'Make in India' to succeed, India must improve its ranks in terms of 'Global Competitiveness' and 'Doing Business in India.'
- Make for India' requires boosting domestic demand strongly in the light of prolonged subdued external demand.
- Urgent need to build adequate physical and financial infrastructure.
- Ensuring financial stability.

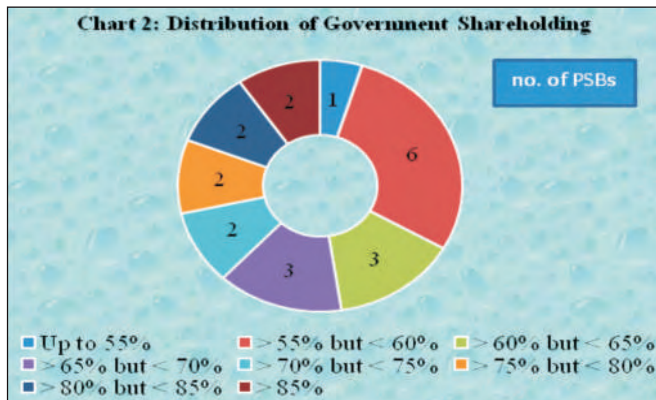
The paradigm envisioned below keeps in view the above-mentioned macro imperatives.

Recapitalization

The fountainhead of the envisioned paradigm will be the way PSBs are likely to be recapitalized in the near- to medium-term.

The government shareholding in 21 PSBs is in the range of 1.05% to 88.63% (Chart 2 presents the distribution). The total CRAR varies between 10.26% and 13.40%. Besides, the government's earlier easy recourse to recapitalization of PSBs through annual budgets is now

becoming increasingly difficult by the excruciating need for adhering to deficits benchmarks. This is reflected in the government's recent 'selective' recapitalization of PSBs with INR 79.4 billion whereby the more efficient ones (as per the stipulated efficiency parameters) got fresh capital.

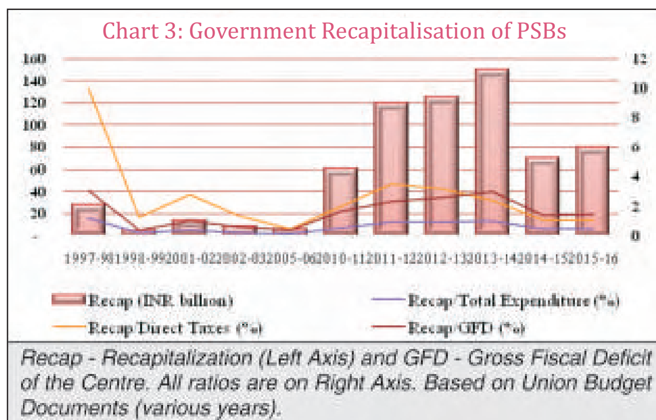


Second, for a prolonged period the whole process of recapitalization, not being adequately matched by expected improvement in recapitalized banks' performance, is proving to be uneconomical, ideologically unhealthy and taxpayer-unfriendly.

Third, the taxpayer is becoming increasingly 'sophisticated', albeit slowly, wanting to know how efficiently the government utilizes his money.

Fourth, continuous recapitalization generates perverse incentives among bankers to become overly aggressive, either deliberately or negligently, because they know that the bank would be bailed out if the unwarranted risks they take do not pay off.

Chart-3 illustrates the onerousness of the government recapitalization of PSBs.



Recap - Recapitalization (Left Axis) and GFD - Gross Fiscal Deficit of the Centre. All ratios are on Right Axis. Based on Union Budget Documents (various years).

Thus, if some of the PSBs cannot mobilize the required capital and are not to be kept as zombies, then either they have to be privatized or merged or perhaps in the worst case, be taken out of the ambit of the TITF doctrine. This will precipitate in a paradigm shift.

Even in the case of merger / acquisition, it is probable that the acquiring bank, depending on the level of earning assets of the merging bank, may refuse or find it strenuous to absorb all its liabilities. In that case, the different segments of business of the weak bank may have to be merged into different strong banks.[5] It is definitely not as easy as it is postulated above. However, breakthrough is certainly possible if steady, instead of ad hoc, action is taken in this direction by all the stakeholders concerned. It will be akin to 'Schumpeterian creative destruction'.

Structure

The Narasimham Committee-I had recommended a 4-tier structure as under :

- "3 or 4 large banks (including the State Bank of India) which could become international in character;
- 8 to 10 national banks with a network of branches throughout the country engaged in general or universal banking;
- Local banks whose operations would be generally confined to a specific region; and
- Rural banks (including RRBs) whose operation would be confined to the rural areas and whose business would be predominantly engaged in financing of agriculture and allied activities."

It is strongly felt that the above-said recommendation is still relevant and should be pursued to its logical conclusion.

Equally significant is the RBI's niche banking model (i.e., Small Business Finance Banks and Payment Banks) which should be pursued in tandem. However, PSBs have to arm themselves against the competition niche banking will unleash. Strengthening of the banking

5. *For example, Royal Bank of Scotland had sold its business banking, credit cards business and mortgage portfolio to Ratnakar Bank in 2013.*

structure constitutes one of the 5 pillars enumerated by the RBI Governor.[6]

NPAs

The erosion of capital basically emanated from sizeable incidence of NPAs. The recently-announced Strategic Debt Restructuring by RBI is a very good step. The objective is to maintain close relationship with borrowers which can lead to better recovery of loans in keeping with the Rajan and Zingales (1999) proposition.[7]

Further, 4 of several ideas that the RBI Governor elaborated in his speech at Institute of Rural Management,[8] if translated into action, will considerably change the stressed assets landscape in favour of PSBs.

- "The system protects the large borrower and his divine right to stay in control."
- "A more timely and fair application of current laws." However, changes in the existing laws, which generally favour the borrowers, as well as instituting different laws are required. Theoretical and empirical research shows that a well-functioning legal system facilitates the operation of both markets and intermediaries.[9]
- "New institutions such as bankruptcy courts and turn-around agents."
- "Finally, we need a change in mind-set, where the wilful or non-cooperative defaulter is not lionized as a captain of industry, but justly chastised as a freeloader on the hardworking people of this country."

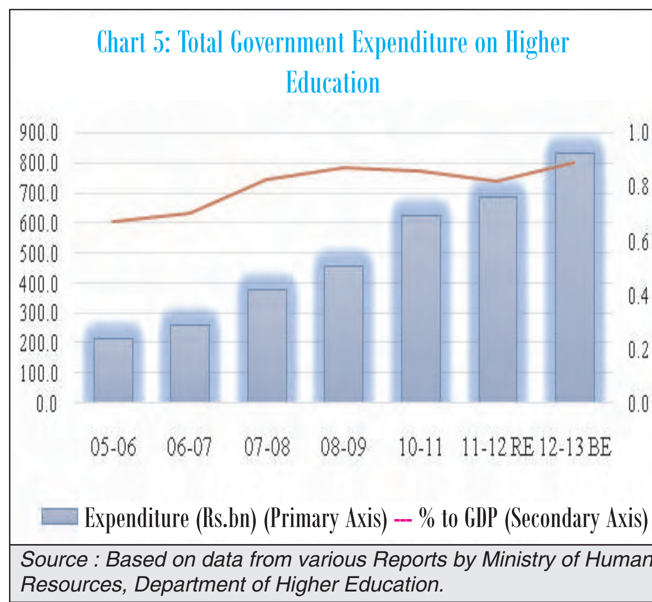
In order to make all these operational political and bureaucratic interference has to cease, literally.

Again, dealing with distress at corporate level and banks and effecting loan recovery is one of the 5 pillars referred to by the RBI Governor.[10]

Responsible Lending

PSBs' loan models should take care of some of the following issues :

- Environmental concerns : 'Sustainable' development necessitates environmentally and ecologically responsible investments, as deleterious impact of 'insensitive' bank financing erodes assets quality and return to banks in the long-term. PSBs do have Green Banking policies, but it needs to be assessed to what extent the rules are being followed at ground level. For instance, whether in their zeal to increase retail portfolios, are PSBs lending 'excessively' to the automobiles segment which is potentially detrimental to the environment in several ways? Studies including one by the RBI's Institute for Development and Research in Banking Technology (IDRBT)[11] opine that the Indian banks are still taking baby steps into Green Banking.
- PSBs to increase their loans to build and foster hi-end talent and skill to mitigate the low level of government expenditure on higher education which has also remained flat over time (Chart-5).



Source : Based on data from various Reports by Ministry of Human Resources, Department of Higher Education.

6. *Rajan, Raghuram. G. (2013). The Five Pillars of RBI's Financial Sector Policies. BANCON, November, 2013.*
7. *Rajan, R. G., Zingales, L. (1999). Which Capitalism? Lessons from the East Asian Crisis. Journal of Applied Corporate Finance 11, 40-48, as referred to by Ross Levine in Finance and Growth : Theory and Evidence" edited by Philippe Aghion and Steven N. Durlauf, 2005 Elsevier B. V.*
8. *Saving Credit, Talk by Dr. Raghuram G. Rajan at the Third Dr. Verghese Kurien Memorial Lecture at IRMA, November, 2014.*
9. *La Porta, R., et. al. Investor protection and corporate governance. Journal of Financial Economics 58, 3-27.*
10. *Rajan, Raghuram G (2013), ibid.*
11. *IDRBT. Green Banking. 2013.*

- Having burnt their fingers in several infrastructure projects[12] where various kinds of government clearances were required, banks have to be highly circumspect and should put forth collective resistance against the so-called practice of being 'nudged'.
- Gender Disparity Issue : India figures very low in the Washington-based Global Entrepreneurship and Development Institute's Female Entrepreneurship Index (2015) as well as the World Economic Forum's Global Gender Gap Report (2014). Therefore, in order to bridge the gender inequality PSBs should consider increasingly marketing both assets and liability products targeting women. Further, women are observed to be more progressive in their banking habits than men. In India, in 2006, the ratio of man:woman deposit accounts was 1:0.33 which moved up to 1:0.43 in 2014. The corresponding ratio of balances held improved from 1:0.27 to 1:0.42. In terms of average amount per account, the gender disparity (women lower than men) shrank from 19% to 4% over the same period.[13]

Human Resources

Banking has become knowledge and information intensive. However, today, PSBs' HR policies operate on some sort of "Jack of all trades and master of none" idiom. The generalists (i.e., Probationary Officers recruited at the entry level) are required to handle activities from A to Z at various stages of their career. Theoretically, it is unsound and practically, inefficiently done. Banks are "special" and therefore, should have special talent.

The first best policy should be to recruit special talent in various fields ab initio. However, the first best policies are not always feasible. The second best policy should be to recruit probationary officers, allow them to work as generalists dabbling in various areas say upto SMGS-IV or V, but thereafter allow them to specialize in some areas and further on, as they gain experience and maturity, let them contribute to policy making. (Illustrated in Annexure) Here, the HR Department's role and responsibility is required to be far more engaging, insightful and analytical than it is today.

However, in PSBs, the word 'specialist' has a very narrow connotation. It is understood and is actually defined to include a medley of Economists, IT specialists, Engineers, Law officers, Official Language officers, etc., and they constitute, according to a joint KPMG-National Skill Development Corporation report,[14] about 5-8% of total workforce. However, 'specialist' has to be understood in a much broader sense – anybody can be a specialist in any area whether he is recruited as a specialist or probationary officer. As the RBI Committee on Capacity Building in Banks and Non-Bank Institutions (Chairman: G. Goplalakrishna) (July 2014) observes, "The role of specialists is increasingly becoming crucial and hence there is need for suitable HR intervention in this regard." (pp.3).

PSBs should inculcate a progressive attitude towards training. In global banks, training system is regarded as the incubation centre for new ideas, experiments and capacity creation. The above-mentioned Goplalakrishna Committee has made wide-ranging recommendations encompassing training methodologies, training for different employee segments including even the Board members, capacity creation for training, skill development, etc., which are being debated. Hopefully, the recommendations, if and when implemented, would emerge as a trigger for a paradigm shift in the training system.

Board

The changes in capital structure of PSBs would necessitate changes in their Boards too. Both the Committee to Review Governance of Boards of Banks in India (Chairman : P. J. Nayak) (May 2014) and the Gopalkrishna committee have made several recommendations to spruce up the quality of PSB Boards and their functioning. These recommendations hold promise for qualitative and quantitative improvements in PSB Boards. As far as appointment of non-statutory members is concerned, one may

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12. The share of infrastructure sector in PSB advances as at December 2014 was 17.6% and in stressed advances 30.9% (RBI Financial Stability Report, June 2015).

13. Based on RBI Basic Statistical Returns (various issues).

14. Human Resource and Skill Requirements in the Banking and Financial Services Sector (year not mentioned but seems to be of 2012).

consider setting up an Exchange on the lines of Employment Exchange and inviting people with pre-specified qualifications, expertise and experience to register with it. A competent panel may interview the qualifying persons registered with the Exchange to select some of them as members of PSB Boards and recommend to RBI / government for appointment.

Digital Finance

'Digital Finance', which originated from the need to increase Financial Inclusion (a demand-side factor) and simultaneous availability of hi-end technology (a supply-side factor), is all set to bring about a paradigm shift in the payment systems, especially with the launch of 'Digital India' movement and introduction of Payment Banks. PSBs are also vigorously gearing up to accommodate the emerging demand for 'Digital Finance', principally on the mobile platform. Digital Finance has emerged as a safe, cheap, quick, diversifiable and scalable mode of monetary transactions for the unbanked, hitherto mostly in many African countries, Kenya being the exemplar. There are various business models through which PSBs can foray into Digital Finance; however, it is always better to go through an evolutionary process in the IT ecosystem than barging into something entirely novel, howsoever appealing it may be initially. PSBs should have independent evaluation machinery to assess benefit-cost of the models and be prepared for rapid technological obsolescence implying that they should not commit to any technology platform for a long time.

Despite Digital Finance and other IT-based alternate channels, brick-and-mortar branches will still be valuable for the customers. Even in the US, branches provide functions not commonly available through online and mobile banking, as observed in the FDIC National Survey of Unbanked and Underbanked Households (2013). Similarly, the BCG-FICCI-IBA Joint study (2010) had advocated continuation of branch expansion in the next decade in India.[15]

Social Media

The use of social media by PSBs today is at an embryonic stage. According to The Global Information Technology Report 2015 of the World Economic Forum, India is placed 89/143 countries in terms of 'Networked Readiness Index' with a value of 3.7 out of 7 - the lowest among the BRICS economies.

Thus, social media has a lot of unexploited potential. PSBs need to link social media with their business goals and look upon it as a medium- to long-term goal for increasing awareness and dispelling doubts of customers about their products and services, organizing customers' forums, gaining knowledge about their products / services brands and improving those, monitoring and following up with the borrowers as also the periodic depositors like Recurring Deposit accountholders, and ultimately building relationships. However, banks have to strictly maintain confidentiality of customers' personal databases.

Priority Sector Loans

Priority sector, despite being rejigged several times, seems to have become anachronistic. Therefore, though politically arduous, it needs to be phased out. In fact, the Narasimham Committee-I had recommended for reducing the scope of directed credit under priority sector from 40% to 10% (paragraph 3.32), which was not accepted. The system of target setting has lost its sacrosanctity. Many PSBs, as already mentioned, fail these targets and prefer depositing the shortfall in the Rural Infrastructure Development Fund (RIDF) because they get risk-free and effortless annual return of nearly 6%.

Studies demonstrate that the RIDF scheme has benefited directly or indirectly banks and the governments. However, farmers were deprived of funds amounting to INR 1,800 billion since the inception of the scheme. Estimates reveal that annually about 2 million farmers lose opportunity to enter into the banking network.[16]

Further, disbursement / sanction ratio under RIDF is declining steadily and fast (Chart-6).

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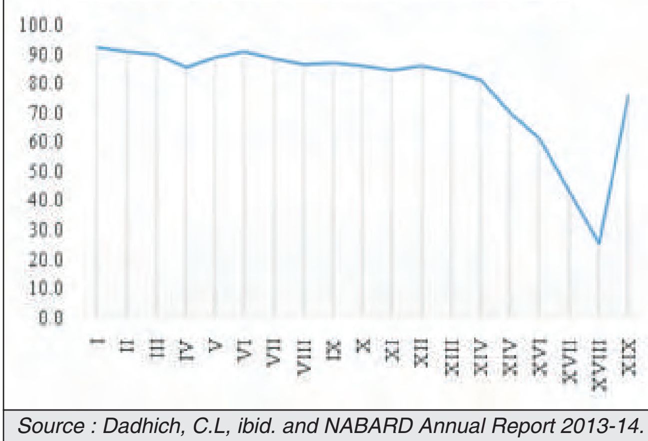
15. *Indian Banking 2020: Making the Decade's Promise Come True, September 2010.*
16. *For example, see Dadhich, C. L., Revisiting Rural Infrastructure Development Fund Scheme, Indian Journal of Agricultural. Economics, Vol.69, No.1, January-March 2014.*



Source : Dadhich, C.L, ibid. and NABARD Annual Report 2013-14.

Instead of 'directed' lending, one should let the rate of interest, coupled with availability of investible opportunities, and timely and adequate credit availability to be the prime mover in resource allocation. In fact, RBI moved somewhat in this direction by deregulating all loan rates above INR 2,00,000. Let there be "market matching" in PSL.

PMJDY

PMJDY has already established its role as a game changer in the Financial Inclusion landscape. However, the point to be emphasized here is that opening a bank account by the financially excluded is the first, but the most vital, step in the direction of achieving comprehensive Financial Inclusion. Therefore, first and foremost, the required confidence among the unbanked people has to be generated by the bankers by visiting them, as distinguished from calling them at branch. Once the seeds of confidence are sown in their minds, then banks can go for canvassing deposits.

Analysis reveals that the basic confidence is gradually being built as the incidence of zero balance accounts is gradually reducing (from 76.4% as on 18.9.2014 to 52.3% as on 17.6.2015). That means people are transacting in their accounts and/or by seeing their fellow beings open accounts, other people are also getting motivated to open accounts, with initial deposits too. Therefore, 'continuous transaction' is the key to watch.

5. Concluding Remarks

"The banking sector is on the cusp of revolutionary change" said the RBI Governor in his talk at the Annual Day Lecture of the Competition Commission of India, 2014.[17] The new paradigm would require the government to shoulder a good deal of leadership and responsibility. In order that PSBs wake up from their 'nap', the government has to kick start the economy by increasing public expenditure, especially through infrastructure expenditure which will have ripple effects on income augmentation and employment generation, and in turn help rejuvenate demand. For both allotting infrastructure projects to the private entrepreneurs and/or taking up projects by self the government has to take several timely decisions in transparent manner including those relating to allocation of natural resources starting from land to spectrum.

Secondly, the government has to somewhat loosen the strings of its purse. Leashing deficits is undoubtedly good, but there is little meaning in 'strictly' adhering to the deficits benchmarks when expenditure curtailment constrains capacity build-up in several critical sectors like social security, law and order, education, sanitation, health and transport. In other words, the objective of controlling deficits should be inclusive of improving the quality of human life.

Increased public expenditure must be accompanied by its proper transmission, targeting and utilization.

The government's role is critical in enacting new laws and/or amending / deleting the anachronistic laws which hinder PSBs' working and functions, especially those pertaining to loan recovery and default.

The reform measures for PSBs to operate in a new paradigm have to be properly sequenced and executed in time. Proper sequencing of banking sector paradigms is more than rocket science; if a rocket fails to launch nothing happens, but reforms failing to take off in time brings miseries to one and all (e.g. Greece of today). It will be worthwhile to revisit some of the recommendations of the

17. Rajan, Raghuram G (2013).Competition in the Banking Sector : Opportunities and Challenges.

Narasimham Committee (I & II) which were not implemented.

PSBs have to be conscious of respecting human rights in their business dealings. Many international banks have exclusive human rights policies. Global organizations like the UN-supported Principles for Responsible Investment Initiative and the Institute for Human Rights and Business are working towards effectively weaving human rights into investment decision-making and corporate social responsibility, and PSBs can contribute a lot in this direction. For example, each branch of PSBs may adopt one primary school in its area of operation or each bank can adopt a university. Even bankers can think of educating school children on banking like the Income Tax department has decided to teach taxation.

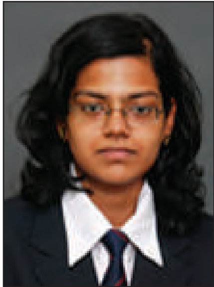
Finally, the government should consider giving appropriate awards, if not Padma awards, for PSBs as institutions or their Chairmen.

Annexure: Proposed Career Path of a PSB Officer

A to B - Scale I to V: B to C - Scale VI to VII and C to D - Scale VIII Onwards

X- Axis: ABEF - Learning Everything. BCGEFH - Specialization. CDIGHJ - Policy Making. Y - Axis - Experience, Maturity & Knowledge

J I
H G
F E
A B C D



Capital Optimization – A need of the hour

Ms. Priyanka Naik *

Structure :

- Capital Optimization
- Ways and means for Capital Optimization
- Looking ahead

When you walk in purpose, you collide with destiny.

~ *Ralph Buchanan*

Given the rupee volatility the woes of Indians travelling abroad for various purposes like education, training, meeting old relatives etc. have worsened. Adding to it are the thunderbolts of the Indian aviation sector - the cash flow crisis of Spice jet airlines who has obtained money from the steeply discounted ticket sales but has no money to fly the grounded aero planes.

Travel Companies all over India have rubbed the wrong side of the customers inadvertently but still for the true players in tourism sector the opportunities galore in the form of "Yatra" business. Majority of the Indians who are bound to travel for entertainment purposes or as a part of their religious obligations would definitely opt for reasonably priced and precisely planned domestic sight-seeing. With no passport or foreign currency hassles to handle visionary travel planners can strike gold even in these recessionary times. The foreign tourists attracted towards India owing to the monetary benefits too could be marketed the same "Yatra" tour packages. The situation is akin to a Coconut-water seller who has niche customer segment in the diseased and recovering patients, pregnant and lactating women, old people. But Coconut water is also recommended for people following diets for weight loss, besides it being a good alternative to cold-drink at any point of time for a person of any background and constitution.

Five star hotels offer catering services at the events hosted by the elite personas of the society in their own apartments or guesthouses charging ₹3,500 - ₹5,000/- per guest with a guest list of minimum 10 people. These business initiatives account for 10% of the total revenue of the five star hotels. These instances represent the ingenuity of the business owners, their never say die attitude which can create oasis in a desert or create a desert in a civilization. (Optimization)

Capital represents the owner stake in the business. It is used for procurement of fixed assets primarily laying the foundation of the enterprise. Current assets are the subsequent acquisitions created out of the carved portions of the total capital available with the Business owner. In Banking parlance capital is the solution for stabilizing the Bank against the unexpected losses whereas provisions carved out of profits serve as the buffers against the expected business losses.

The phenomenon of Capital optimization originates from the pressing need of the banks to insulate themselves from the refractory business decisions and electrified economy coupled with the Central Government's restrictions in terms of making additional funding available in lieu of other top priorities for public welfare.

i. narrowing the fiscal deficit gap,

ii. reversing the imports exceeding exports trend to exports exceeding imports trend by financially

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supporting the exporters as and when necessary with state subsidies,

iii. developing the infrastructure sector in our developing economy,

iv. retaining top class human capital in India.

Capital optimization

Capital optimization entails :

- *Capital Protection* – The losses caused owing to the erosion of profits of the bank by fraud occurrences need to be contained by preventive vigilance and timely forensic audits. This paves a path for Capital protection.
- *Capital Generation* – In addition to the capital available with the bank, new methods and techniques can be devised to generate capital from existing or new resources like increasing profits-interest income & non-interest income (fee based income, hiving off redundant liquid assets of the bank), approaching the capital markets – national & international, refurnishing the brand of the bank amidst the customers.
- *Capital Conservation* – The operational efficiency owing to adoption of new age technology and effective resource utilization of the human capital can arrest the increasing trend in operational costs leading to increased profits even with insignificant growth in the total income of the Bank.

Capital protection techniques are useful in case of disasters (natural or man-made) as well whereas capital generation techniques come handy given the operational costs more or less remain the same. Capital conservation techniques work best when the growth in the top line is sluggish.

Our Honourable Prime Minister, Shri. Narendra Modi, had called upon the international business entities for “Make in India” campaign which was further enhanced by our respected RBI Governor, Shri. Raghuram Rajan, with the call of “Make for India” campaign. The context of these campaigns should be correlated with the ground realities in terms of win-win scenario possibility creation both for the manufacturer and the customer as well.

A very Indian example of the above win-win situation is the emergence of retailing of the jumbo packs of soaps, detergents, biscuits, dry ready to eat snacks being the primary earning drivers with the likes of D-mart, Big Bazar, Easy Market etc. providing value pricing to urban nuclear families along with savings in the packaging and transportation costs for the producers.

Moving further in the international arena, multinational companies like Coca-cola, Pepsi have been called upon by the Prime Minister of the India to introduce a fruit-juice based soft-drink in India or rejuvenate a fruit-juice brand in India which would enable our poor but efficient farmers assured cash flows for their quality produce and enable them to repay their bank debts and overdues thereby paving a sustainable path for their prosperity. Another impact of such step is creation of a healthier and economically reasonable snacking option for parents and school-kids & teenagers alike.

In Indian Banking Industry, we need to enthuse the same reuse-recycle-redesign thinking to compete with the upcoming herculean labours like financial inclusion, emergence of payment banks, adoption of Basel-III norms etc.

In Ramayana, when the question of bridging the gaps between the big boulders (Ram setu or Adam's Bridge) cropped up a humble squirrel sorted out the issue with its minute fragile limbs by piling up its back with the sand of the sea and closing the gaps with the insertion. The squirrel not only earned the three golden stripes on its back by Shree Ram but also mesmerized the mankind with Napoleon Hill's words : “If you cannot do great things, do small things in a great way”.

Industry best practices always help to cut the operational costs, improve productivity, and boost the top line of the business with real sustainable growth in the profits earned by the business as well. They need not stem from the same industry always i.e. industry best practices can be picked up from other industries as well.

The multinational soft-drink manufacturers have different branded soft-drinks being produced and sold across the globe in various geographies. If they limit the bottle-design prototype to a standard 4-5 types with a bottle-cap design that fits all bottles across their beverages business, a substantial portion of their operational costs would be reduced leading to in-house profit generation. This practice could be well emulated across Indian Banking Industry by creation of variants of simple savings bank account like a savings bank account for working women (Kotak Mahindra Bank – Silk accounts, IDBI – Super Shakti accounts, Yes Bank - First women accounts, Corporation Bank – Corp Mahila power account) or a Yuva savings account meant for school-children or salary accounts cum saving bank accounts or special senior citizen saving bank accounts .At the end of the day for the bank as a whole the CASA (Current And Saving Account deposits) would increase and despite being variants the basic nature of such accounts would ensure sustainable low cost funds availability for the bank for prolonged period imprinting the positive interest rate gap in bank's asset liability management.

Ways and means for Capital Optimization

Methods for Capital Protection : All the preventive or investigative processes and procedures which timely identify the system inconsistencies (people, process, systems & external events)or irregularities that are to be rectified for mitigating unexpected financial losses stemming from disasters – man-made or natural converge the a ambit of capital protection.

- Electricity Audit (Minimizing Fire accidents)
- Corporate offices & Branch Premises Safety Audits (Minimizing Dacoity & Robbery – theft incidences)
- ATM premises safety audits
- Audit trails
- Information security audit
- Core Banking Software audit
- Management Audit
- Income Expenditure Audit (Detecting and recovering revenue leakages at various offices in the Bank)
- Surprise Inspection of the Branch
- Mystery Customer visits to the Branch
- Avoiding Regulatory penalties or legal litigations by adopting corporate governance practices in letter and spirit.
- Activating preventive vigilance by empowering whistle – blowers with security of anonymity and sufficient cash rewards.
- Making the ICAAP (Internal Capital Adequacy Assessment Process) document available to all bank staff members.

Methods for Capital generation : Increased profits earned by the bank would lead to increase in retained earnings which would lead to increase in capital. In capital generation we look into revenue growth measures which are as follows -

- Increasing profits – interest income component (The credit portfolio composition is tweaked to accommodate maximum AAA rated companies with minimum BBB or BB companies. This ensures a steady interest income for the remaining loan tenure. Similarly, the retail loan portfolio should be assessed for multiple financing cases or customer concentration risk. Also majority of the credit loan portfolio in AAA to A translates in lower loan provisions leading to meatier net profit figures for the bank).
- Increasing profits – non-interest income component (The bank should explore fee based business potential with its existing corporate clients and niche segments of customers like providing a payment collection solution to an educational institute).
- Demodulating the Bank's revenue model (The Bank's revenue model currently is advances driven but if it is remodeled to 40% advances interest income, 30% treasury income and 30% fee based income the bank stands to gain despite economic trends because of the strategic income diversification).
- Refurnishing the bank's brand amidst the existing and potential customers (Rebranding exercise for the bank would enable the bank to iron cast its identity among all its stakeholders like regulator,

majority shareholder, its customers. Just as sayings contain ancestral wisdom in just a line or a two, the refreshed bank logo and tag line would rejuvenate the top management and the grass root bank staff to bring back or create the golden days of the bank).

- By improving capital markets sentiments by the above rebranding exercise backed by delivery of rock solid financial results the chances of FPOs or bonds (RBI Basel II compliant debentures) being hit (in demand) among the investors grow exponentially – domestically and globally.
- Entering Merchant banking business (Primary dealership business, Underwriting shares and debentures – these business require credit skills of the banker as to whether the borrower and the company in question are really creditworthy as the banker doing the merchant banking on behalf of these clients is really staking his reputation as well).
- Equity shares trading & strategic equity investment (Investing is akin to granting credit facility i.e. just as which borrower is to be given which credit facility, a banker in the context of market risk has to take a call how much money is to be staked in which security and for what period).
- Treasury Income despite being a double-edged sword could be used to cut through the economic uncertainties on bank's earnings by adhering to resilient business lines like sale of prepaid multi-currency cards, acceptance of NRI deposit proceeds and remittances, investment in treasury bills (In equity trading income composition – conservative blue chip investments : 60%, strategic investments : 30% & growth stocks : 10%) etc.
- Third party referral service with no risk participation (the bank can direct its customers to other financial service providers for a small introduction premium per customer with no risk participation).
- Written off accounts should be focused upon by the Recovery Department at bank's H.O. through their Zonal counterparts, for the recovery of overdues in such accounts amounts to direct boost in profits.
- Sale of redundant assets with the Bank on one time basis would boost the profits through miscellaneous income.
- Methods to increase cash flows instantly – The bank can develop and strengthen existing online payment solutions in case of below -

  a) Railway ticket booking.

  b) Hotel reservations.

  c) Cinema tickets booking.

  d) Aggressive sale of Travelling prepaid rupee cards / multi-currency cards.

  e) Partnerships with online retailers like Flipkart, Snap deal, Amazon.

  f) NSE & BSE online fee collection.

  g) International certifications online fee collection.

  h) Tie-up with Malls, resorts, restaurants creating exclusive offers for bank customers.

Methods for Capital Conservation : The Bank can increase its profits by arresting its operational costs and by improving its people, processes and procedures –

A. In the Core Banking solution used by the Bank it should be ensured that -

- Financial to performance bank guarantee marking (The Credit Conversion Factor (CCF) for financial BGs is 100% which is 50% for performance BGs. If owing to mis-classification performance BGs are marked as financial BGs or vice versa the BG classification has to be checked stringently. Correction in risk weighted assets would provide a fair picture of the bank's capital needs).
- Blank security (ECGC / CGTMSE cover, Non-fund security value details, renewal of expired credit risk mitigant security details) field updation (The credit risk mitigants lower the risk weighted assets of the bank if appropriate security details are fed in the CBS leading to a boost in CRAR ratios).
- CRE-RH classification in CRE portfolio (As per RBI Basel II guidelines, commercial real estate carries risk weight of 100% whereas Commercial Real Estate – Residential Housing carries a risk weight of

75%. Lower the CCF lower the denominator, boosting the near constant numerator leading to improved capital ratios of the Bank).

- Expired letter of credit / bank guarantee cancellation from the CBS (Under Basel II / III framework unutilized portion of bank guarantees as well attracts the risk weights thereby hampering the bank's capital adequacy. Hence data cleaning in terms of cancelling LCs / BGs from the CBS is mandatory for improved capital ratios).
- External rating updation in portfolio (The bank's credit portfolio health can be gauged with external rating details. AAA, AA & A rated borrowers have lower risk weights than unrated borrowers which attract 100%.If the correct external rating details are not punched in the CBS then the system treats the borrower as unrated despite being rated and provides an incorrect picture of bank's capital adequacy).
- Standardized data feeding in computer enables hourly and daily tracking of the transactions in branches with near perfect analytics and forecasts thereby limiting the random component.

B. The Bank's top management should have a clear line of action in terms of "Balance-sheet size expansion vs. profitability "dilemma. It should put capital first profits second and not earn profits at the cost of the capital. The business model decisions should be aligned parallel to the cause of capital optimization not erode the financial results by way of myopic business decisions. If Bank curtails wholesale deposits and advances it is realigning its asset liability management internally but at the same time if it is aggressive on its retail customer portfolio for personal loans or credit cards it is attracting higher CCFs clients in its fold simultaneously negating the impact of its earlier decision.

C. The top management should adhere to the principal of "Effective resource utilization" i.e. first they should identify, analyze and reallocate the internal resources in the Bank for optimum results at minimum costs. They can begin by designating the right person for the right job by improved Human Resource systems and procedures. For newly recruited POs there should be a personalized "Career Map" so as to retain the fresh talented human capital in the Bank. This would arrest staff attrition owing to the young staff looking for greener pastures elsewhere. An internal HR campaign "Grow with the Bank" should be circulated and ingrained to boost employee morale thereby kick start the turnaround of the Bank.

D. The Bank should head for operational efficiency in terms of automation of small jobs and system driven report generation. A state of art Management Information System cell is the need of the hour than an adorned Corporate Office building.

E. Austerity measures as directed by the Ministry of Finance like having video-conferences with Zonal Managers instead of actual meetings etc. should be implemented for all the staff ir-respective of the cadres and proximity to corridors of power.

F. Green Banking should be embraced by Banks on a massive scale as it lowers operational costs (more e-transactions than visits to brick and mortar branches, more customer satisfaction, lesser labour union hassles and more productive time for branch staff to streamline its operations.) It also promotes the larger cause of saving trees and the environment thereby by reducing the mundane paper usage in vouchers and stacks of files / records. Thus, it directly helps the cause of "Swatcha Bharat" campaign as well.

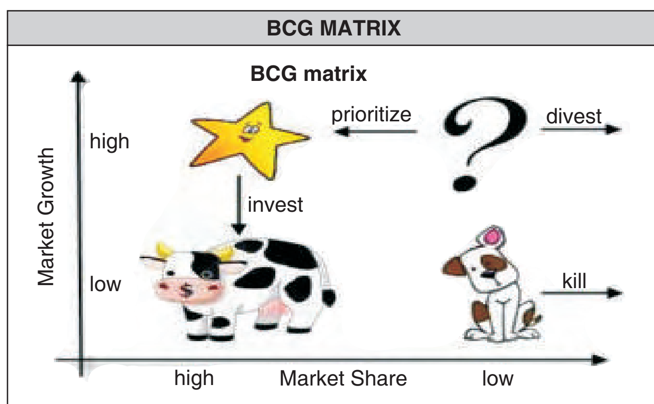
G. The Bank should have a corporate research cell specially dedicated to screening the electronic, print and social media for any new market developments which the bank as a whole could take advantage of. Best practices from other banks and other industries too could be extracted and how they could be made applicable to the Bank's operations should be deliberated by this cell with the top management.

H. The Credit Monitoring Department in H.O. should monitor the slippages and Special mention accounts (0-2) with regards to early warning signals and quick mortality cases so as to reign the non-performing loans to manageable levels with the assistance of their zonal counterparts.

I. Infrastructure shortages in terms of hardware, up to date software, skilled and enthused human capital should solved using out of box thinking. For example employee suggestions could be sought for "doing more with less" and the chosen ideas be implemented by the top management under the capable guidance of the particular employee. This would also serve as a preventive vigilance tool in terms of activating whistle-blower policy and its guidelines as a byproduct.

J. The Bank should think strategically in terms of its products and services earning prowess (Boston Consulting Group matrix) & Pareto's principle : 80% business is bestowed by 20% customers and 80% customers constitute 20% business.

BCG MATRIX



Looking Ahead

Faced with volatility in global capital inflows and outflows shaking and stirring the financial markets in terms of capital flight, Banks today cannot afford cocktail investing (mirror trading). Neither can they can be sidecar investors in terms of expansion of global and local advances portfolio.

The spillover effects of a scam in shadow banking arena too cannot be just repudiated (Saradha & Sahara Scam). The regulatory glares owing to "Ambulance chasing" activities coupled with "Helicopter drop" strategy adopted by other economies cannot be sustained on placebo promises. Being the custodians of public money, the public sector Banks of all places cannot afford to be "Barefoot – pilgrims".

Any corporate turnaround plan definitely envisages :

1. Cutting excess cost & staff.
2. Increasing sales of the organization by tweaking product portfolio (increasing number of products or increasing the price of the product or decreasing the content of the product at the given price or creation of low end and a premium version of the same product).
3. Enabling efficient, effective, value-additive and time saving manufacturing and servicing processes.
4. Being a game changer in the industry by adopting marketing and manufacturing innovations.

The internal rephasing rather resizing of the functioning of the Banks no doubt has ample room for scope for improvements but Rome was not built in a day. So, gradual and balanced- proactive approach for aligning the pace and phase of Banking is the writing on the wall.

Today Bisleri is synonymous with the term packaged water just as Xerox is for a photocopier though actually the machine might belong to Ricoh or Canon. These companies were pioneers in their own fields.

Indian vadapav can be marketed in foreign countries as Indian burger just as McDonald's burgers are foreign vadapavs for the local population in India. The product ingredients are more or less the same with both being takeaway foods substituting full-fledged meals for millions of Indians.

The mandate of the current government "Inclusive growth" is the lighthouse for the next generation Indians across all strata of society. Financial literacy is the heart of the inclusive growth movement with banks as the body. A body can survive with a malfunctioning heart owing to pacemaker but can a heart survive without a body?

In all above cases, a basic need of millions was fulfilled in the cheapest possible way. Banks as financial institutions make financial intermediation possible for millions of Indians today at the best possible rates. But for Banks today capital is a need not a luxury.

"One of the surest ways of success is to have breakfast when others are having Lunch"

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Strategic Debt Restructuring Mechanism - Defaulters' Envy, Bankers' Pride

Dr. Akhilesh Tripathi *

Corporate Debt Restructuring (CDR) a mechanism, introduced in 2001, by the regulator Reserve Bank of India (RBI), helps Indian Financial Institutions protect the underlying value of their loan assets. However, with the passage of time, the success of CDR mechanism has increasingly been questioned because of frequent failures of the packages extended to stressed companies.

What happens, many a time, despite enjoying substantial benefits from lenders under these restructuring packages, some stressed companies fail to come out of the blue on account of various visible / invisible operational / managerial inefficiencies.

These have raised concerns both for the lenders and the regulators. Hence, RBI has now come out with "Strategic Debt Restructuring'' (SDR) mechanism through which lenders have been empowered to recover their long outstanding dues from those restructured stressed companies which have failed to achieve the projected milestones those agreed upon in CDR package.

Observing repetition of CDR packages which are also growing at fast pace in the last few years, the RBI is of the view that instead of lenders, powerful shareholders, especially promoters of chronic defaulting companies, should be the first to bear the losses. Let they should feel the pinch a bit more and heavier. The regulator believes that promoters of these stressed companies should put more skin in the game and bear the initial loss, ahead of debt lending institutions.

Having blessings from both the prime regulators RBI and SEBI, the new restructuring mechanism authorises lending banks to convert their outstanding loans into a majority equity stake if they feel that a change in ownership can help them turn around the borrower's business.

Last year, RBI has tightened the noose around the chronic defaulters by allowing banks to categorise entire groups as wilful defaulters in cases if even one group firm has failed to pay its dues to banks in time. Now undertaking of SDR route to change the ownership by the lenders will strike a fear in promoters from defaulting as they might end up losing their companies. Experts believe that this fear might compel them to initiate suitable steps to keep their companies from slipping away.

Implementation of SDR Package –

Challenges & Operational Risk Issues

The SDR scheme is likely to have wide range of implications on the present recovery mechanism of stressed assets. Despite a few legal lacunae, displeasure and dissatisfaction from powerful promoters of large and mighty companies, scheme is expected to supplement recovery efforts of the banks which can now side line the crony capitalists and initiate suitable process to recover their long dues.

For successful implementation of the scheme, lenders need to identify, assess the challenges, risks, both existing and expected and then weigh the opportunities to make the pot boil and get the desired outcome. This is the reason for which this paper has been developed.

In the following paragraphs, we start with a discussion on the nature and origin of CDR followed by throwing light on a few reasons, responsible for failure of restructured cases. We then attempt to identify the risk especially operational risks factors which lenders might face while implementing the package. In the next section, we attempt to highlight the risks, challenges attached to the most important aspect of the SDR package – role of

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lenders as company's major shareholders and their involvement in the decision making of key operational functions of the company. In this section, we discuss important aspects related to business strategy, finance & accounts, cash flows generation, end use of funds and other similar areas from the lenders' point of view. We observe that exploring discussions on these aspects imbibes virtually opening of Pandora's Box. In this segment of discussions we also examine major risk contributing factors, causes and consequences of failures, on the basis of past performance of a company. We also analyse different features of operational risks and correlate these for meeting future strategies by the stressed companies. Finally, in the last section we present the concluding remarks on the SDR mechanism.

Lenders' point of view

Experts believe that SDR mechanism will help banks to clean up their books of accounts while still holding the assets therein. Conversion of their debt to stressed companies into equities will move their lending portfolio from loan segment to investment segment in their balance sheets. Besides, reviving and selling such sick companies would not only help them enhance their loan book but also add value in overall growth of the economy as the revived companies will add to the GDP. Bankers will also be benefited from capital market exposure and mark-to-market provisioning.

In the following table we discuss the major risk events, their expected challenges and envisaged opportunities through under noted five major risk events -

1. Risk attached with Implementation of Debt Restructuring Mechanism.
2. Risks attached with Defaulters.
3. Risks attached with conversion of debt into equity.
4. Risk attached with pricing of Equity holding.
5. Risk attached with Lenders running a company and finding buyers.

	Risk Events	Challenges	Analysis
1.	Risk attached with Implementation of Debt Restructuring Mechanism	It has no statutory and legal enforcing powers	Corporate Debt Restructuring (CDR) mechanism is a voluntary non-statutory system based on Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA). The principle of approvals by super-majority of 75% creditors (by value) makes it binding on the remaining 25% to fall in line with the majority decision makers. But in spite of ICA between various lenders, restructuring remains unenforceable as CDR mechanism is non-statutory in nature and has no statutory enforcing powers. As a result, borrowers do not pay serious heed to CDR structure and its implementation. They cleave stipulations which suit them, otherwise they simply walk out, making the whole exercise defunct.
		Involvement of all the lenders	For successful implementation of the package, involvement of all the lenders, even those outside the consortium, is necessary. At times, promoters create charge on few assets of the companies in favour of other lending institutions who, when requested, avoid participation in the process. This aspect needs to be looked into by the lenders while reviewing the terms of SDR package.
		Obtaining approvals from respective boards of lending institutions	Sometimes member banks are unable to obtain approval from their respective boards in time for various restructuring packages, which create unnecessary delay in the implementation thus hampering overall process.
		Reluctance by participating private and foreign banks	At times, the consortium members from private and foreign banks express their reluctance in joining the mechanism in wake of their banks' own interests, which create problems in extending the benefits to the stressed company in time.
2.	Risks attached with Defaulters	Genuine Defaulters - Challenges in protecting them unnecessary harm	Industry experts know well that most of the borrowers try genuinely to service their debt obligations in time. However when a particular sector gets into trouble the borrowers attached to this sector find themselves trapped into liquidity crunch. Under those circumstances, nothing can be done unless the overall economy picks up and that sector revives. Lenders have to identify these borrowers and protect them from any unnecessary harm.

	Risk Events	Challenges	Analysis
		Willful defaulters - Challenges in obtaining support from them	RBI Governor describes wilful defaulters as "freeloaders" who need to be chastised for not honouring their debt commitments. But wilful defaulters know the rules of the game and bypass the system effortlessly. Despite many positive prospects in new Strategic Debt Restructuring (SDR) scheme, lenders know that extracting change of ownership from unscrupulous promoters and wilful defaulters will not be an easy task. They will never allow snatching away their company easily. Having blessings from high and mighty from political and financial world, they may even get the lenders themselves involved in the legal tangle and get the entire process delayed.
3.	Risks attached with conversion of debt into equity	Challenges attached in obtaining approval from the board of restructured companies for converting bank loans to equity	In terms of SDR guidelines lenders have to incorporate a new clause in their CDR mandates for which the promoters of the restructured company will have to get approval from their shareholders. For the purpose, they might have to convene even an extraordinary general meeting and get the special resolutions passed, authorising them conversion of bank loans to equity shareholding. Lenders have to keep in mind that in absence of these approvals, they cannot extend the SDR package to the company.
4.	Risk attached with pricing of Equity holding	Challenges involved in recovering the debt outstandings properly and adequately	In terms of SDR guidelines, conversion of debt to equity of such companies will be done at a fair value. The guidelines also specify that share prices should not exceed the lowest of 'market value' or break-up' value. Market value of the share price will be decided on the average closing price of the company in the last 10 days, preceding the reference date for conversion. Whereas break-up value would be as the book value per share, to be calculated from the company's latest audited balance sheet, adjusted for cash flows and financials after the earlier restructuring. Where the latest balance sheet is not available, the break-up value shall be Re 1. Generally share price of stressed and defaulting companies are beaten down and their break-up value is low. That is the interested buyers may buy the company's shares in turn, its assets, at a very low cost. Now suppose the subject company is holding some hidden intangible IPR, brand value (e.g. Mosear Bear) and tangible assets viz land etc. Also consider a situation where some changes are expected from the Government or some other bodies in the near future by virtue of which the prices of land in that area are expected to shoot up tremendously. Under the circumstances, the smart promoters of other companies would like to buy the company's shares unhesitatingly visualising that they are buying the hidden treasure at rock bottom prices. Whereas lenders would barely be able to recover their money, even after conversion of debt into equity, because they cannot reap the benefit of such "envisaged changes in government policies". They will have to cede the transfer of the ownership of the company within the specific period of 18 months to new promoters. On the other hand, the new promoters would reap the benefits considerably whenever the prices of assets, land etc. rise.
		Conversion of Debt - approval from all participating lenders	In terms of guidelines on SDR, conversion of debt into equity will require approval from 75% of lenders in value and 60% in number. Suppose there are 5 lenders whose share in the loan outstandings is 45%, 15%, 15%, 15%, and 10%. As per SDR guidelines, conversion of debt into equity can take place with approvals from 75% of lenders in value i.e. approval from three top holding lenders (45%, 15%, 15%) only. Suppose, if the largest lender is interested to convert his share of debt into equity and then exit through a sale to a third party leaving the other lenders in doldrums. Under those circumstances, the outcome may be disastrous. Such situation can occur when most of the lenders are of the view that finding a buyer for selling complete share of their equity portion is uncertain or difficult. Sensing the apprehensions, many lenders may not convey their approval and conversion of debt into equity may not take place.

	Risk Events	Challenges	Analysis
		Reaping benefits from calculation of capital market exposure	Effective 1st April 2015 banks are required to provide 15 percent of outstanding in any CDR in their P&L accounts. However, the equity shares acquired and held by banks under the SDR scheme will be exempt from calculation of capital market exposure, investment in para-banking activities and intra-group exposure subject to its reporting to RBI. Such conversion will also not attract mark-to-market provisioning during the specified 18 months period. But to reap benefits from such stipulations, lenders have to ensure compliance with two important stipulations - incorporating the clause for conversion of debt into equity at the time of restructuring, and secondly the conversion of debt into equity is done at fair value.
5.	Risk attached with Lenders running a company and finding buyers	Challenges involved in running a company	A few experts believe that holding equity, taking ownership then running the stressed company to recover their money is a wishful thinking of the lenders. Running a bank / lending institution and running a company, both are all together a completely different ball-game. Both activities are on two opposite ends of risk spectrum.
		Finding buyers	SDR guidelines stipulate that banks will take control of stressed companies only to cede ownership to the new promoters. Lenders should divest their holdings in the equity of the company 'as soon as possible'. Guidelines also stipulate that the 'new promoter' should not be a person/entity from the existing promoters / promoter group. But selling the stake of a company with uninspired past record to a new promoter 'as soon as possible' is easier said than done. Inherent weaknesses and obsolete, unproductive assets of the subject stressed restructured company may shake the confidence of even venture capitalists. Lenders are going to have a hard time in finding solutions to this Herculean task.
		Ensuring no links with the Old Promoters	Lenders are also going to scratch their heads on finding solution to another stipulation of the SDR mechanism - to ensure that new promoters do not have any link to old promoters. In the societies of a country like India, micro-management from the backstage is a common feature. Men of mark, big guns push their decisions behind the curtain and the call the shots. Under the circumstances how the lenders will ensure adherence to this stipulation remains a big question.

Challenges & Operational Risk Issues - Monitoring Aspects - Opening Pandora's Box

RBI has also stipulated that Joint Lenders Forum (JLF) should closely monitor the restructured company's performance so as to ensure, inter-alia, compliance with the various terms of SDR package.

Lending institutions job is to lend (money) for the process and not to get lent (themselves) into the process. Implementation of the SDR scheme is not an easy task and carries complexities. The mechanism demands banks to involve themselves even in the operational activities of the company after taking over its reins through majority equity holding. To reap the desired outcome, lenders need to identify and assess the cracks, flaws, weaknesses in the working and functioning of the company which have put it out of the gear. It may be recalled that SDR package is to be extended only to potentially viable units which are facing hiccups in coming to the surface due to operational and managerial inefficiencies. The process requires lenders to apprise themselves with the causes behind these trippings and fallacies through opening of Pandora's box.

Against the backdrop, we study and analyse in the following paras the events, causes and consequences related to business strategy, finance, accounting, project viability vs. repeated restructuring, promoters' attributes &their inclination towards growth and sustainability of the company from the lenders' point of view. We try to identify and assess various risk contributing factors

responsible for its abrupt and out of the gear performance. With ultimate goal of divesting the equity holdings of the company to new promoters as soon as possible, we open Pandora's Box with a view to identify the factors responsible for various functioning, including day to day performance, of the company.

We delineate these Risk Contributing Factors related to various activities in the following manner :

1. Performance related.
2. End-use of funds.
3. Detecting deviations from terms of sanction.
4. Non- achievement of projections / targets
5. Competitive advantage and changing consumer habits.
6. Identifying early warning signals.
7. Meeting Rating Requirements.

	Risk Contributing Factors	Challenges	Analysis
1.	Performance related	Day to day operational issues	Normally higher prices, lower sales, unsold inventories, disproportionate debt obligations, high interest burden, repayment mismatch, derivative losses etc. are major contributing factors behind the poor performances of stressed companies.
		Non execution of contracts / orders	Industry experts share that one of the major factors towards the downfall of the stressed companies is delayed or non-execution of contracts / orders. Promoters and senior management of the company procure, at times, huge orders without sufficient planning of resources and funds at their stake thus fail to honour those in time. Sometimes they also find themselves in a fix because of the circumstances beyond their control e.g. delays in land acquisition by the Government, non-fulfilment of terms by joint venture partners etc. All these factors contribute to inordinate delay in execution of the contracts / orders in time.
		Delay in disposal of unproductive and slow moving assets	One of the solutions to revive company quickly is disposal of unproductive and slow moving asset. Bankers have to look into aspect deeply. This will also help them in generating cash flow.
2.	End-use of funds	liquidity problems-diversion of funds from short term to long term uses	Inadequate cash generation leads to liquidity problems. Sometimes companies fail to read the market properly and utilise working capital funds for unplanned capital expenditure and face liquidity problem. Lenders to analyse the status of such investments and explore possibilities of generating cash therefrom to improve liquidly position.
		Investments in associates and subsidiaries	Similarly few companies make huge investments in associates, subsidiaries or group concerns from where the return is shown negligible or almost nil. Such investments place the companies in a situation where they bear unnecessary losses in their books of accounts as the cost of funds by way of interest on borrowings is born by them without any return on the same.
		Cash flow issues	This is the major issue. Cash is king and poor generation of cash flows leads to liquidity problems and companies find themselves constrained in servicing their debts, payment of interest and instalments etc.Normally the problem has genesis in making unrealistic estimation of cash flows at the time of sanction of credit facilities or CDR package. Cash flow issues also arise from lower conversion of cash from unbilled revenue, work-in-process as well as company's huge and unnecessary investments in current assets. All these factors put the companies under strangle liquidity situation.
		Issues related with timely realization of receivables / debtors	Sometime companies undertake as a business strategy stretching of the receivables beyond a normal period to meet the competition and penetrate the market as well. But such stretching results in mismatch of cash flows and because of this, companies find themselves entrapped in a position where they are unable to meet even their immediate and urgent liabilities commitments.

	Risk Contributing Factors	Challenges	Analysis
3.	Detecting deviations from terms of sanction	Risk attached with companies entering into separate agreements with non-consortium banks / FIs	Despite strict terms and conditions of the lending institutions, stressed companies obtain sometime fund / non-fund based facilities from non-consortium banks / FIs. They also open unauthorised current accounts with them and diversify the funds therefrom.
		Infusion of equity funds by the promoters-exercising improper tactics	With a view to infuse their share of equity contribution to the company, promoters borrow funds from other banks / FIs and thus add more burden towards servicing of debt on their companies. Similarly, when funding for the deficit is arranged by the promoters partly by brining funds from their own sources and partly by diverting the short term funds, these result in depletion of net working capital.
4.	Non-achievement of projections / targets	Ambitious unplanned expansion	Ambitious unplanned expansion by the companies put them into financial crisis. Exponential growth not matched with corresponding amount of funds also play major role in poor performance. Lenders have to plug these challenges.
		Long gestation period of the project and achievement of targets	A few industries / sector such as hotel industry require more than normal gestation period. Considering the capital investment made *vis-à-vis* long gestation period involved in stabilising the operations, a company might find it challenging if this gestation period gets extended by a further few months or years more on account of unforeseen circumstances and thus delaying the overall process of cash flow generation.
		Capacity utilisation	Poor capacity utilization on account of non or late erection of plant, unsound marketing vision, suppressed market conditions and above all inadequate working capital to run the plants at optimal capacity play an important role in revival of a stressed company.
5.	Competitive advantage and changing consumer habits	Competition from established and new market players	Inviting reference to Michael Porter's competitive advantage strategic model, companies may also face constraints from adaptation to local socio-political environment. They may also experience delay in revival due to competition from already established and or from new players.
		One man show-Dependency on one person	If most of the key functions and affairs of the company are dealt single handedly & personally by one person, usually the main promoter, his withdrawal from the systems may create a vacuum in the company.
		Issues related with third party transactions	Instances may also get unearthed where companies have undertaken complex and non-transparent third party transactions. For example a company has made acquisitions through a complex structure in which there are many tiers between the company and flagship subsidiaries. Such lack of transparency in related party transactions may create problems for the lending institutions while reviewing, assessing and analysing the risks involved in these transactions.
		Creative accounting-concealment of facts	Some companies circumvent accounting norms to conceal their inherent weaknesses. For example, during the year a particular expenditure is not charged by them to the balance sheet, instead they show it as contingent liability as off balance sheet item. Next year the entire amount of this expenditure for previous as well as current year is charged to the balance sheet. Similarly, advances to various suppliers for CAPEX are shown as book debts. Stocks received for job work are included at times in the stock statements. Lenders need to analyse these and initiate steps accordingly.

	Risk Contributing Factors	Challenges	Analysis
6.	Identifying early warning signals	Demand and supply of products	Sluggish demand for the products, issues in execution of existing orders, poor inflow of fresh orders or even non-availability of fresh orders etc. all play important role in revival of a company.
		Extending repeated restructuring package	There may be instances when a company continues to suffer losses due to its inherent weaknesses of the project. In such cases, repeated restructuring process cannot help much in revival of the company.
7.	Meeting Rating Requirements	Submission of information to rating agencies for obtaining finance	In terms of RBI guidelines, enterprises are required to obtain credit rating from authorised rating agencies for obtaining finance from banking institutions. But when stressed companies fail to furnish the required information, data etc. to these rating agencies, they suspend undertaking rating of such companies. This creates problems for the companies, particularly lending institutions while considering sanction of restructuring package to these companies.

Conclusion

Strategic Debt Recovery (SDR), in times to come, may prove to be a valuable tool in the banker's kit to facilitate recovery of bad debts. Experts believe that this new arrow in the lenders' quiver will help them sell-off the businesses which have an unviable debt structure. Nonetheless, it cannot be seen as the end game because the problem of "ability of debtors to litigate" will persist till a formal strong and robust bankruptcy legislation is in place. Any borrower, who is expected to lose control of his company, will explore legal loopholes and try to get the issue land up in the court of law. To the extent, if the clauses enabling banks to become majority equity holders in the event of failed restructuring efforts are incorporated in the initial loan documents, the new mechanism may prove to be a significant deterrent, especially for those who tend to take the banks' recovery process 'lightly'.

However, strong restructuring mechanism and robust bankruptcy act both have a bearing on each other. In absence of a formal strong and robust bankruptcy legislation, banks are expected back to square one. Precisely, necessity of strong bankruptcy act and successful implementation of SDR are a catch 22 situation. For effective SDR a strong bankruptcy law is required and for obtaining benefits of Bankruptcy law, effective implementation of SDR mechanism is essential.

In addition, what is needed is a revamp of CDR in light of present macro and micro conditions. These could include realignment of the legal system with remedies available for the creditors as well as phasing out of curbs on asset classification and provisioning as it encourages the banks to only restructure viable accounts.

SDR Cheat Sheet

- Strategic Debt Restructuring (SDR) mechanism is a non-statutory and voluntary, based on Debtor-Creditor and Inter-Creditor Agreements
- Under the new SDR Scheme, RBI has allowed banks to take control of a defaulting company when a debt restructuring fails and convert their debts into equity of the defaulting company.
- Banks under Joint Lenders Forum can become majority owner in the defaulting company by holding 51 per cent or more stake. For the new norms to be applicable, banks need to insert a suitable clause at the time of restructuring, and convert the debt into equity at fair value.
- In terms of SDR guidelines, lenders under the JLF need to become the majority shareholder by conversion of their dues. They need to hold collectively 51% or more of the equity shares issued by the company.
- Lenders to divest their equity holdings of the company ASAP to new promoters. New promoter should not be a person/entity from the existing

promoter / promoter group and should acquire at least 51 per cent of the paid up equity capital of the stressed company. If the new promoter is a non-resident, and in sectors where the ceiling on foreign investment is less than 51 per cent, the new promoter should own at least 26 per cent of the paid up equity capital or up to applicable foreign investment limit, whichever is higher.

- Scheme covers multiple banking accounts / syndication / consortium accounts with outstanding exposure of ₹10 crores (both fund-based and non-fund based) and above by banks and FIs. It does not apply to accounts involving single lending institution only.
- Primarily the scheme is applicable to standard and sub-standard accounts but may also cover doubtful accounts, BIFR cases, suit filed accounts subject to specific stipulations.

For detailed reference - Circular issued by CDR Cell- CDR (PMJ) No.152/2015-16 dated 25.06.2015.

PART - 3

Regular Features

Legal Decisions Affecting Bankers

M. G. Kulkarni *

State Bank of India
Through its Chief Manager, Mandi
District Mandi, Himachal Pradesh .....Petitioner

Versus

1. Sansar Chand Kapoor
S/o Shri Bhikham Ram
R/o 80/1, Jawahar Nagar
Mandi, H.P.

2. Punjab National Bank

(Moti Bazar Branch), Mandi

Through its Branch Manager .....Respondents

(NATIONAL CONSUMER DISPUTES REDRESSAL COMMISSION NEW DELHI, Decided on 15/01/2015)

Issue : Failure to provide CCTV footage amounts to Deficiency in Service on the part of Bank?

Brief Facts :

Mr. Sansar Chand Kapoor (Mr. Kapoor) was having an account with State Bank of India (Bank). The Bank had issued ATM Card to Mr. Kapoor so that he can withdraw cash from ATMs as per the rules of the Bank.

An amount of ₹10,000/- was withdrawn on 10/11/2011 from the account of Mr. Kapoor using the ATM card provided to him. The said amount was withdrawn at the ATM belonging to Punjab National Bank (PNB). Mr. Kapoor claimed that neither he had withdrawn the said money nor given the ATM card to any person. He demanded video clipping of the footage recorded by camera installed in the ATM. The bank arranged the video footage for Mr. Kapoor. After watching the video, Mr. Kapoor alleged that the quality of the video footage was very poor and there was mismatch of timing of the said footage and the timing recorded by the ATM. Alleging deficiency on the part of bank and PNB he filed a complaint before District Consumer Disputes Redressal Forum (District Forum) seeking video footage and credit of ₹10,000/- withdrawn from his account along with cost of litigation and compensation.

Observations & Decision :

District Forum by its order dated 3/10/2013 directed the Bank to refund ₹10,000/- @ 9% interest p.a to Mr. Kapoor along with ₹3000/- towards compensation and ₹3000/- as a cost of litigation. Against this order of District Forum, Bank approached State Consumer Dispute Redressal Commission (State Commission). State Commission on 20-03-2014 dismissed the Appeal of the Bank.

Against the order of State Commission, Bank filed a Revision Petition before National Consumer Disputes Redressal Commission (National Commission), New Delhi. The Commission observed that without the use of ATM card issued by the Bank, no cash could be withdrawn from the account of Mr. Kapoor. If Mr. Kapoor himself has not withdrawn the cash on 10/11/2011, then his card must have been stolen or otherwise obtained by some unscrupulous person. Moreover the pin number of the card either must have been disclosed by Mr. Kapoor to the person who had withdrawn the cash or he would have not kept it in safe custody facilitating withdrawal of cash from the ATM by laying his hand on the pin. Hence there will not be deficiency in services on the part of Bank on account of alleged fraudulent withdrawal of ₹10,000/- from the account of Mr. Kapoor.

* Deputy Director (Legal), Indian Institute of Banking & Finance

It is admitted fact that the PNB provided CCTV recording to the Bank. But the Bank failed to provide copy of said video footage to Mr. Kapoor despite his request. Considering the fraudulent withdrawal claimed by Mr. Kapoor, showing of video footage to Mr. Kapoor and his relative is not sufficient, the Bank ought to have made available a copy of CCTV footage to him. The Bank was deficient in rendering services to Mr. Kapoor by not making available CCTV footage to him.

Hence National Commission set aside the order of District Forum and State Commission which have directed the bank to refund of ₹10,000/- to Mr. Kapoor. However held further that Kapoor is entitled to ₹6,000/- (₹3,000 + ₹3,000) towards compensation and cost of litigation.

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Devi Ispat Limited & Anr. ....Petitioners

versus

State Bank of India & Ors. ....Respondents

[2014] 125 SCL 324/45 taxmann. Com 87(SC)

Issue : Whether the writ petition could be filed before High Court when there is an alternative remedy provided under Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act)

Brief Facts :

Devi Ispat / Company was engaged in iron and steel business. It had availed credit facilities from State Bank of India. The credit facility though was enhanced from time to time to ₹68.5 Crores. However, its request for further enhancement for ₹93 Crores was not allowed by the Bank.

On 10/01/2013 Bank issued a letter to Devi Ispat to regularize its accounts by 14/01/2013 and that the outstanding as on date was about 11.7 crores. It was also brought to the notice of Devi Ispat by the bank that but for its failure to service the account; it would be likely to be classified as non-performing asset (NPA) in due course and will call up advance thereafter.

Being not satisfied with the reply of Devi Ispat, Bank issued another letter on 14/01/2013 calling upon to regularize accounts failing which bank will be compelled to take appropriate action. The bank not being satisfied with positive response from Devi Ispat sent a letter on 16/1/2013 informing that, its account has been classified as an NPA and hence to regularize the accounts within 7 days. Instead of regularizing the accounts Devi Ispat took objection alleging that the Bank is wrong in classifying its account as NPA and as such is against the guide lines of the Reserve Bank of India.

Observations & Decision :

The Bank issued notice u/s 13(2) of SARFAESI Act 2002 on 28/2/2013 demanding outstanding dues from the Devi Ispat. But Devi Ispat filed a Writ Petition before the High Court (single judge / bench) challenging the act of Bank classifying its accounts as NPA and also for setting aside previous letters issued by it (bank). The High Court, by its order dated 19/3/2013 dismissed the writ petition filed by Devi Ispat holding that it had an alternative remedy u/s 13(3A) of SARFAESI Act to make representation against letter issued by bank u/s 13(2). Devi Ispat made representation to the bank u/s 13(3A) and the same was came to be rejected by the bank.

Devi Ispat thereafter took up the matter to Division Bench of the High Court against dismissal of its writ petition by the single Judge. The Division Bench of the High Court after hearing the parties dismissed the Appeal filed by Devi Ispat by its order dated 26/4/2013 and up-held order passed by single judge / bench of High Court.

Aggrieved by the dismissal of its Appeal, Devi Ispat approached Supreme Court by way Special Leave Petition (SLP). Supreme Court dismissed the SLP of Devi Ispat and observed as under :

i) Company had an alternative remedy u/s 13(3A) of the SARFAESI Act and there was no reason to by-pass the statutory mechanism.

ii) The representation made by the company u/s 13(3A) of the SARFAESI Act was rejected by the Bank. Hence statutory remedy having been availed by Devi Ispat nothing survived in the dispute.

iii) Bank has taken possession of secured assets of Devi Ispat u/s 13(4) of SARFAESI Act and a possession notice has also been published in news papers.

iv) Since statutory remedy having been availed there is no reason to interfere with the impugned order passed by High Court. However it is left open for company to take appropriate steps as may be considered necessary for safeguarding its interests.

There is no merit in the SLP and it is accordingly dismissed.

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