# BANKING SYSTEM FOR VIKSIT BHARAT: CHALLENGES AND OPPORTUNITIES

M. Nagaraju*

It is my privilege to deliver the fourteenth R. K. Talwar memorial lecture honouring the great legacy of late Shri Raj Kumar Talwar ji. He was truly an extraordinary leader of the banking industry, respected for his integrity, vision and service. His contribution to the banking industry and his accomplishments go far beyond his life of honesty, truthfulness and courage.

Fast forward to the current times, where developments across economies are happening at breakneck speed. As India has embarked on an ambitious journey of 'Viksit Bharat', it is pertinent to talk about the visions of Viksit Bharat and the onus of the same lying with our financial sector, led by banking, in augmenting India's fortune, in creating a strong economic entity promoting sustainable and inclusive growth amidst a disintegrated global landscape.

In this journey, I invite you all to time travel with me to experience the virtual reality of a robust and inclusive Viksit Bharat. While analysing the endeavours of our banking sector, I will also like to focus on the role of regulations, enabling a responsible yet frictionless pace of progress towards this ambitious mission.

## Global Macro perspectives

The global economy is on a roller coaster ride. According to the International Monetary Fund (IMF)'s World Economic Outlook, January 2025, global growth is projected to be 3.3% for both 2025 and 2026, which is below the historical average of 3.7% during the last twenty years. While the United States (US) economy continues to show strength, the Eurozone is grappling with stagnation. Though inflation is expected to moderate, uncertainties and risks, including those arising from geopolitical tensions, trade protectionism, inward looking strategies and policy ambiguities continue to loom large.

The challenging global economic landscape is further complicated by the strong dollar, which strains emerging market currencies and heightens financial market volatility.

## Strong Macro-economic dynamics: India's time

Prolonged geopolitical conflicts, geo-economic fragmentations, inward looking policies, renewed trade protectionism, competitive retaliation and emergence of trade war have created plenty of uncertainties in the global policy arena. India's growth, though not fully insulated from these vagaries, is driven by strong domestic fundamentals and much needed reforms.

Indian economy, ranked as 10th largest economy in the world in 2014, has risen to become the world's fifth-largest economy by nominal Gross Domestic Product (GDP) and the third largest in terms of purchasing power parity today. Indian economy maintains its stature as the world's fastest growing major economy in 2024 and is expected to upgrade its position in coming years. The well-coordinated fiscal and monetary policy in combination with structural reform have enabled building business friendly climate and has become home to the numerous global innovative firms.

Thanks to a confluence of factors, including the steps taken by the Government, the Indian economy has emerged as bright spot of stability and opportunity. We have not only kept our house in order against large

*Secretary, Department of Financial Services, Ministry of Finance.
14th Shri R. K. Talwar Memorial Lecture was delivered by Mr. M. Nagaraju, Secretary, Department of Financial Services, Ministry of Finance, on February 27, 2025, in Mumbai.

and overlapping global shocks but also improved our macroeconomic fundamentals and safety buffers. The balance sheets of banks and corporates are the healthiest in a long time and with the public investment push by the Government, have created favourable conditions in form of prime pumping for a sustained revival in investment.

Consumer confidence, which showed some signs of moderation in last couple of quarters, will certainly revive by the demand augmenting measures announced by the Honourable Finance Minister in the Budget 2025-26. As evident from surveys, revival in consumer demand, both in rural and urban areas is on a rising trajectory. Our external sector inspires confidence as we are reaping export opportunities in the services sector; our current account deficit remains eminently manageable; and we have bolstered our forex reserves with a 10+ months of import cover to deal with any potential adverse eventualities.

The large domestic consumption base of India constituting nearly 60-65% of GDP, helps India to insulate itself from the vagaries of global slowdown. With India's 1.43 billion populace with a median age of 28.2 years, 68% of the population belonging to the working age group. This helps the nation to enjoy demographic dividend and India is well poised to take advantage of this. Today, India has become the new global growth engine with its young demography, improving physical and digital infrastructure and above all, an enabling policy environment.

## Viksit Bharat mission

Viksit Bharat 2047 is the vision to transform India into a developed nation by 2047, the centenary of India's independence. This vision encompasses developments across various segments of Indian Economy so that they rise from the current state to drive the agenda set by the Honourable Prime Minister's vision.

Our aspirations of Viksit Bharat 2047 aim to strive for: India's GDP to be USD 30 trillion from current ~USD 3.89 trillion; per capita income USD 18,000-20,000 from current ~USD 2,700; bank credit to private non-financial sector as % to GDP to be 130% from current 56%; achieving 100% financial literacy and many more.

## Current challenges to Banking sector in its Viksit Bharat mission

Given the importance of banking system in supporting economic growth, the constraints the sector faces need to be addressed well in time so that the banking sector accelerates the wheels of Viksit Bharat mission. The first and foremost constraint of Indian banks is of having a strong capital base to support the Viksit Bharat mission and for which our banks would need to raise a significant amount of capital to support the country's economic growth. Hence, access to capital from international sources needs to be looked at and to be worked upon.

Ensuring universal financial inclusion is another major challenge. Banks need to create opportunities for every individual to grow and contribute to the nation's progress. This involves innovating and reimagining banking strategies to align with the evolving needs and preferences of customers. India needs to achieve 100% financial inclusion from current level of 64%. We need to work on developing more simplified micro-investment products. Financial awareness regarding financial products, digital transactions and other Government schemes in rural and remote areas needs to be accelerated. Also, the existing gender gap not just with respect to deposit account ownership but also with regards to access to credit needs to be overcome.

Expanding social security net is important through universal insurance and pension coverage. India's share in global premium is ~2%; Protection Gap in India is 87%. Given very low insurance penetration of 3.7% in FY23-24 in India against global average of 7%, banks need to support the masses to access the social security net, for the masses by financial literacy and product customization.

Large banks provide financing for large-scale projects, supporting massive infrastructure development requirement, driving economic growth and development. Large banks play a crucial role in the stability and growth of the global economy as they have resources and expertise to absorb shocks and manage risks better, ensuring stability in the financial system.

From innovation angle, large banks are always preferred as large banks invest in financial technologies, promoting innovation in the banking sector, which lead to more efficient and accessible financial services. Moreover, large banks ensures that both businesses and individuals have access to reliable and efficient financial services as intermediation costs for banks decline and makes them efficient.

Apart from the above, universal credit coverage for Micro, Small and Medium Enterprises (MSMEs) and Agriculture is must. Given, the MSME sector contributes 30% India's GDP, 45% to exports and 62% to employment, we need to have robust credit flow to the agriculture sector and enabling the access to credit for the MSME sector and supporting entrepreneurship and generation of employment.

Advancing digital capabilities and future competencies is essential. The banking sector needs to harness the full potential of its workforce using digitization and emerging technologies like Generative Artificial Intelligence (GenAI).

Moreover, building a strong banking system that enhances global confidence in India's economy is important. This will attract more foreign investment and support the country's economic ambitions.

Our aspirations of Viksit Bharat need a strong base to be laid down by the current incumbents and leaders and subsequently to be driven by coming generations. Having said that, we need to introspect our current strength that can be leveraged and the emerging challenges that need to be addressed. The aspirations require systematic changes, institutional reforms and regulatory overhauling.

**Banking in Viksit Bharat – Opportunities and Way forward**

Viksit Bharat mission reckons banks to deliver on certain structural themes. To begin with, mobilising deposits on permanent basis may be a top priority. This is because households are turning net borrowers from the banking industry, aggravating pressure on margins and liquidity. Enhancing productivity is also important as it is seen that over the past decade, costs have risen faster than income. Productivity gains have lagged cost increases. As technology and compliance costs are expected to be higher in coming days, banks need to deploy innovative solutions to boost income. Building future ready capacity by fully embracing future capabilities such as operation and tech resilience, Environmental, Social and Governance (ESG), AI & GenAI is vital.

We need multiple globally competitive large banks having presence across the globe, facilitating access to global funds, best talent and technical expertise. Currently, only two Indian banks i.e. State Bank of India (SBI) and HDFC Bank feature in the Top 100 global banks by total assets, which is not strong enough in comparison to banks from China and the US, which dominate the top 10 global banks list.

The current banking conglomerates need to expand horizon, extend operations into global financial hubs, identify and acquire mid-sized global banks, utilize green bonds, sustainability-linked loans and foreign debt markets to fund domestic credit expansion. The size and scale would enable these transformed global banks to fund ultra large projects spanning across Infrastructure and Manufacturing, entailing setting-up peripheral industries and projects, thereby, catalysing job creation and urbanization.

MSME is another segment, which despite the best efforts of all stakeholders, continue to rely on funds outside the formal banking channels. Multiple institutional reforms have been undertaken during the last few years including the Union Budget 2025-26, that increased investment and turnover limits of MSMEs, expanded credit guarantees facility, schemes for dedicated support for first-time entrepreneurs etc. This may minimize the formal credit gap to the sector. Lending institutions need to leverage Digital Public Infrastructure (DPI), Unified Lending Interface to expedite assessment and disbursement. However, the most important step is to handhold and support the MSMEs, which entails setting-up comprehensive support ecosystem that includes mentorship, financial literacy programs and advisory services to empower them in managing finances and making informed decisions. The new credit assessment method wherein the public sector banks have developed inhouse technology enables capabilities to assess MSMEs using their digital footprints instead of external assessments, aims to provide a more accurate evaluation and improve MSMEs' access to credit.

The National Infrastructure Pipeline (NIP) proposes an estimated expenditure of Rs.165 lakh crore over the next 5 years. With an envisaged Debt : Equity funding of 70:30, the NIP would require ~Rs.120 lakh crore of debt. The niche sectors like semiconductor require huge funding to set-up whole ecosystem. Financial sector needs to play the major role to make NIP a reality and provide funds towards capital intensive sectors.

While financing of capex and projects is vital, it is equally important that small ticket loans for employment generation grow even faster. Furthering of financial inclusion and unlocking productive potential of citizens is a national priority and a moral imperative. Schemes such as the Pradhan Mantri Jan Dhan Yojana (PMJDY), Pradhan Mantri Suraksha Bima Yojana (PMSBY), Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY), PM-SVANidhi, PM Vishwakarma, Micro Units Development & Refinance Agency (PM-MUDRA) Yojana etc. have contributed significantly in deepening financial inclusion in the country.

Digital payment system and FinTechs will play vital role in transforming the current state of economy. Digital transactions in India have grown over 90-fold during FY2013-24, constitute 99.5% of total payments in FY24. On the other hand, India is the third largest FinTech sector in the world with more than 13,000 fintech companies and a cumulative investment of more than USD 33 billion. These are testaments of the India's growing digital prowess and conducive policies and infrastructure in place. However, the future steps and initiatives would be more crucial than ever. We need to build a resilient policy and regulatory framework for fintech, putting in place- information repository, regulatory framework for FinTech, Digital Payments Intelligence platform to mitigate digital payment related frauds.

While strategic collaboration between banks and FinTechs have led to several innovations in the sector ranging from better customer service to last mile credit delivery, it calls for adequate safeguard to protect the digital infrastructure of institutions and customer endpoints.

Banks are expanding the skill development centres (Rural Self Employment Training Institutes or RSETIs) for handholding and providing technical training, setting up more Self-Help Groups (SHGs) across the country, imparting financial education and disseminating initial credit. Other stakeholders also need to pitch in to utilise their Corporate Social Responsibility (CSR) funds to provide all the basic support to these vulnerable segments, to uplift them from their current standing so that they become part of mainstream economy and actively contribute to the development.

The relentless reform and substantial investment in banks over the last few years has brought the banks to a position of strength, whereby, they have a strong capital base providing them enviable loss absorbing buffers. Credit growth is broad-based and is in double digit for last two years. To meet the growing credit demand, banks are raising capital from alternate avenues including capital market, long term bond, Certificate of Deposit (CD) issuances as well as through competitive deposit rates and drawing down their high-quality liquidity assets (excess Statutory Liquidity Ratio (SLR) deposits). Delinquency is at historic low level which is reflected through increased investor appetite for banking stocks, thereby, offering a good opportunity to reward shareholders and employees.

Today, the Indian banking system continues to be resilient, backed by improved asset quality, stable and broad-based credit growth and robust earnings growth. The reach and depth of financial intermediation is being aided by technology and growing digitalisation, which provide new opportunities for growth and financial inclusion. Tech innovations in the financial sector have improved credit delivery mechanisms, improving the scope for further innovation in banking and financial products, and for furthering differentiated banking needs. The recent measures undertaken by the Government on digitalisation of the economy and availability of data provide a more objective and comprehensive basis for credit assessment and thereby, enhanced lending to both individuals and businesses.

The evolving Indian financial landscape is increasingly becoming innovation and tech-driven, with India Stack, Artificial Intelligence (AI), embedded finance and robotics playing an instrumental role in its transformation. New technologies like generative AI, quantum computing, digital infrastructure of institutions comes with both risks and benefits which need to be harnessed in a calibrated manner. Setting up sponsored research chairs/incubation centres in the institutes of eminence to carry out cutting-edge research will need to fast pace so that the future technology architectures are aligned with the visions of Viksit Bharat.

Our financial system is one of the forerunners in addressing the issue of 'last-mile connectivity' by leveraging its world-class digital public infrastructure which includes the Jan Dhan, Aadhar and Mobile (JAM) trinity; the Unified Payments Interface (UPI); the Open Network for Digital Commerce (ONDC); and the Account Aggregators (AAs) framework, differentiated banking/insurance licences, Central Bank Digital Currency (CBDC), the Open Credit Enablement Network (OCEN), Digilocker etc. continue to drive the digital march.

Government in close co-ordination with various stakeholders has taken a number of critical steps to ensure robust cyber security systems by banks through its regular IT examinations, assessing bank's compliance with cyber security regulations and guidelines, and identifying and addressing any vulnerabilities in their systems. However, the financial institutions, particularly banks, need to move a notch up now and should include stress testing of 'cyber risk' as part of their Risk Assessment to gauge the impact, in case of any cyber-attack on their systems. Regulators in Europe and Singapore have already initiated steps in this direction and banks in India too need to take appropriate steps.

While addressing growth, it is important to ensure that the growth is sustainable which asks for special focus on climate related concerns. India has been vulnerable, in varying degrees, to a large number of natural, as well as human-made disasters on account of its unique geo-climatic and socio-economic conditions. It is highly vulnerable to floods, droughts, cyclones, earthquakes, landslides, avalanches and forest fires.

More so, India's economy is highly dependent on nature as one third of its GDP comes from sectors greatly reliant on nature. The impact of devastating nature catastrophes various part of the country lately, have severely impacted the natural course of life and economy. Future climate change may be more brutal and therefore, calls for necessary actions.

The financial sector has an important role to play in the fight against climate change by supporting reductions in climate change risk and mitigating the impact of adverse climate events. Risks can be mitigated and minimized through the use of Green Financing, with objective of actively addressing climate change, reducing environmental footprint and promoting sustainability, which encompasses various financial instruments and mechanisms designed to channel capital toward environmentally responsible and sustainable projects and initiatives.

Our banking regulator, the Reserve Bank of India has joined the Central Banks and Supervisors Network for Greening the Financial System (NGFS) in 2021 and is expected to implement global best practices and contribute to the development of environment and climate risk management in the financial sector, while mobilising mainstream finance to support the transition towards a sustainable economy.

To sum up, Indian banking is well paced to support and accelerate economic growth for a Viksit Bharat. As reform is an ongoing effort, the regulator and Government have aligned to promote growth supportive reforms with adequate safeguards. In this context, the role of regulations in spurring innovations and ensuring financial stability is critical, which is an age-old debate that I shall try to delve into in detail in this part of my speech.

## Right extent of Regulation in spurring innovations while ensuring financial stability

Regulation introduces both monetary and opportunity costs, requiring businesses to allocate funds to ensure compliance and often resulting in missed entrepreneurial opportunities. Hence, regulations need careful evaluation to ensure they achieve their social objectives at the lowest possible cost without stifling creativity, innovation or healthy market dynamics. Simultaneously, an overemphasis on innovation and competition without proper safeguards can lead to financial instability, resource misallocation and erosion of trust in the system.

The financial sector and its regulatory landscape are evolving rapidly, with emerging risks arising from new-age financial instruments and increased use of technology. The regulators in advanced economies provide assessment of compliance costs vis-à-vis intended benefits along with clear and definitive timelines, to ensure an informed decision-making in regulatory arena in transparent and efficient manner.

While ensuring stability of financial system remains the primary responsibility of regulatory framework, it is equally important to evaluate regulatory measures in terms of the associated cost and intended benefits. A robust compliance structure requires transparency in assessment and disclosure of compliance cost with definitive implementation timelines. As India's financial sector continues to expand, it is essential to ensure that the cost of compliance is commensurate with the intended benefits.

We need to be mindful of the five-pillar strategy of regulation – forward looking and proactive; nimble; data driven and impact assessment oriented; consultative approach; and collaboration with stakeholders.

Balancing regulatory quality is crucial for India's vast and diverse economy, its growing aspirations of Viksit Bharat and the significant investments required to sustain high growth and development. Globally, five key criteria are used to evaluate regulatory quality in an economy – democratic legitimacy; regulator accountability; fair and accessible procedures; expertise; and efficiency.

Since 2014, India has accelerated its regulatory reforms, simplifying taxation laws, rationalising labour regulations and decriminalising business laws to improve global competitiveness through grassroots-level structural changes. Regulation must consistently strive to find this equilibrium, implementing the reforms to maintain a balance that fosters growth while safeguarding the economy.

As banks are entrusted with the responsibility of serving society with sensitivity and inclusivity, they must always consider the needs of the people they serve, especially the vulnerable sections of society. Banks as well as bankers need to strengthen the inherent trust and integrity quotient of the general public. As trust bearers of society, our approach needs to be ethical, inclusive, responsible and prudent.

To keep pace within the guardrails of safety in the ever-evolving dynamic banking landscape, adopting and adapting right amount of regulation is crucial. It is well understood that banking regulation relies on pre-specified, time-tested and globally adopted toolkits like Basel Accords which indeed play a crucial role in shaping global banking regulations, much like a guiding text. These accords, established by the Basel Committee on Banking Supervision, provide comprehensive guidelines for banks to manage risks and ensure financial stability. Their standards, such as Basel I, Basel II and Basel III, have been instrumental in promoting sound risk management practices and maintaining confidence in the financial system worldwide.

In a rapidly evolving financial system, over reliance on existing regulation poses many potential challenges to the financial sector which are unforeseeable. Over the years, the sectoral dynamism has tested all regulations and every financial crisis has offered valuable insights, leading to modifications in these toolkits based on lessons learned.

Risk that seemed insignificant yesterday is quickly getting intensified today, posing threats to the stability of the financial system. Take the case of online scamming through digital arrest. The speed at which it spreads and damages the system was never anticipated till it struck. Therefore, we must remain vigilant and responsive to all financial changes occurring around us.

Present and future regulations should adopt a differentiated regulatory mechanism based on the size, complexity and contribution to the systemic risk. As the interconnectedness, scope of activities and harmonization of financial intermediation increase, an entity-based regulatory architecture may lead to arbitrage between different entities undertaking similar activities. Therefore, moving forward, regulatory thought should focus on activities as a common framework for future regulations.

One-size-fit regulation approach carries a great uncertainty in the current regime. A closer look at regulatory landscape highlights the core principles upon which it is framed. In the Indian financial sector, the debate between Principle-based vis-à-vis Prescriptive (or rule based) regulations centres on the best approach to ensure financial stability while fostering innovation and flexibility.

While Principle-based regulations offer a flexible framework that guides behaviour through broad principles and objectives, it allows banks to apply these principles in ways that best fit their unique operations and circumstances. This approach encourages innovation in risk management and operational practices, as banks have the freedom to determine how to achieve regulatory objectives. The emphasis is on achieving desired outcomes, such as financial stability and ethical conduct, rather than strictly adhering to detailed rules. However, this flexibility can lead to variability in compliance and enforcement, as banks and regulators may interpret principles differently.

In contrast, Prescriptive regulation involves setting specific, detailed rules that banks must follow. This approach offers clarity and consistency, making it easier for banks to understand and comply with regulatory expectations. The predictability of Prescriptive regulations allows banks to plan their operations with certainty, reducing ambiguity. However, this rigid approach can stifle innovation, as it may not account for unique situations or evolving financial practices. Banks may find it challenging to adapt within the confines of strict rules, potentially leading to inefficiencies and missed opportunities for growth.

In summary, Prescriptive regulation in Indian banking offers clarity, consistency and predictability but can be rigid and limit innovation. Principle-based regulation provides flexibility and encourages innovation but may lead to variability in compliance and enforcement. The challenge for regulators is to strike the right balance between these approaches to ensure a stable, efficient and innovative banking sector that can adapt to changing market conditions and foster sustainable growth. Each approach has its benefits and is often chosen based on the regulatory environment and the nature of the financial system. The key is finding the right balance between flexibility and consistency to ensure a stable and innovative banking sector.

In the financial sector, regulations should strike an optimal balance between stability and fostering innovation, efficiency and competition. By rationalising regulations and aligning them with international standards, India can accelerate economic growth and employment, especially in the face of unprecedented global challenges. Regulators in India must consistently strive to find this equilibrium, implementing the reforms to maintain a balance that fosters growth while safeguarding the economy.

Thank you once again Indian Institute of Banking & Finance (IIBF) for organising this lecture and giving me an opportunity to share my thoughts. Also, thanks to all the distinguished guests for your patient listening.

Thank you all!