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Regulatory, Technological and Human Resource Challenges for Enhancing Effectiveness of Indian Banks

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Shri Ashwani Kumar, Managing Director, Dena Bank, Dr K L Dhingra, Director, NIBM, distinguished bankers, distinguished faculty and staff of the institution and all the students present here today - A very good morning to all of you. At the outset I convey my Foundation Day greetings to all of you. National Institute of Bank Management or NIBM is a pioneering institute in the field of banking and risk management and its repute is not limited to the banking fraternity alone but transcends across. I feel privileged to address this gathering on this 48th Foundation Day. We look forward to pass on the baton of leadership and legacy**.** Foundation Day in the life of an institution is an important day and it is a day when we take stock of our adherence to the values enshrined by the founders of this academic institution.

I would like to describe my more than three decades of being a banker as a journey that has been a witness to some of the most interesting and challenging times in the banking industry. Indian Banking has metamorphosed from vanila banking to financial services provider and is soon moving to the era of financial solutions provider. The industry has seen certain watershed moments - nationalisation was followed by the deregulation and entry of new generation private sector banks, to Y2K, to automation with Core Banking Solutions and now the Financial Inclusion. Since nationalisation, there have been tremendous disruptive changes in both operations and business models of public sector banks. I would leap forward to the present times and I throw light to some of the mainstay issues that the public sector banks are currently facing. Of course, asset quality management is the most pertinent issue these days for all banks. We are passing through times which are not only complex but too full of multifarious challenges. In doing business, you play your cards within the perimeter. Further, banking business and technology go hand in hand. Technology is an enabler, and it has helped us achieve things that we could not have imagined three decades ago. Our manpower is our biggest asset and that's one of the main differentiating factors in today's highly competitive world. In the present context, customer management also demands for constant product innovation and effective delivery. Lastly, the existence and function of any organization stands tall on the pillars of honesty, integrity, values and ethics.

A. Regulatory Challenges

Banking systems around the world face diverse challenges by nature of their businesses. While developed economies like the United States, struggle with real estate markets, banks in some parts of Europe are left to deal with high funding costs arising due to sovereign risks and some of the Japanese banks have low capital, weak profitability, and a high exposure to Japanese government bond markets.

In India, the banking sector has largely influenced the growth of the financial markets. The global banking landscape is changing rapidly, and our domestic banking system needs to gear up in order to keep pace with its global counterparts. To sustain itself amidst fierce competition, the Indian banking industry needs to undergo transformation from a strategic viewpoint, focusing on aspects of scale, scope, prudence and knowledge. The Indian banking sector is at a critical juncture in its evolution and it is now clear that the slump in credit growth and increase in stressed assets has affected the profitability of all banks, and threatens the very survival of some of them. Shifts in consumer preferences, combined with changes in technology and regulations, have created a perfect storm.
The key regulatory challenges for Indian Banks are:

Basel III implementation (Capital Regulations): Indian banks are required to fully comply with the Basel III Capital Regulations (Basel Regulations) by 31st March 2019. Most of the public sector banks will need additional capital infusion to meet the higher capital requirements, which will consequently reduce the return on equity. As the GNPA ratio of Indian banks reached 9.7% in FY 2016-17 from 7.8% in FY 2015-16, a study by Fitch Ratings has revealed that Indian PSBs will need around $65 billion (nearly Rs 4.16 lakh crore) of additional capital by 2019 to address the problem of non-performing assets, to raise loan growth, tackle weak provisioning for rising bad loans and meet the Basel III guidelines. As a result, government support will be required, which may exert significant pressure on the government's fiscal position. As per Basel III guidelines, banks need to maintain CET 1 at 5.50%, CCB of 1.25%, Tier 1 at 8.25% and Total CRAR of 10.25% for period March 2017 to December 2017. CCB, an additional requirement of common equity requires banks to build up a buffer of capital in good times which may be used to maintain flow of credit to the real sector in difficult times i.e. to ensure the availability of tangible equity funds which can absorb losses during a stressed period (systemic or bank specific) without causing the bank to breach minimum capital requirements and continue normal business activities. As such in present time of upheaval to build and maintain the buffer at the required level is in itself a challenge. Banks in India are required to maintain 1% more capital beyond Basel prescription 1% of extra capital means a lot of money. Given the asset quality, profit generation capabilities, raising capital to meet the requirements is a huge challenge.

Tasks Ahead Towards Optimisation Of Business On Regulatory Capital Framework:

- Improvement in profitability by increasing revenue and a check on operating costs
- Business portfolio reorientation
- Recovery from NPA
- Improvement of Management functions to ensure conserving capital

Risk Management: Mere availability of capital would not help the banks in today's scenario. In fact we should also bring risk management in conscious awareness of the employee. All types of risks i.e. credit risk, market risk and operational risk need to be an integral part of our decision making process.

Risk management in banks has changed substantially over the past ten years. The regulations that emerged from the global financial crisis triggered a wave of change in risk functions. These included more detailed and demanding capital, leverage, liquidity, and funding requirements, as well as higher standards for risk reporting. The management of nonfinancial risks became more important as the standards for compliance and conduct tightened. Stress testing emerged as a major supervisory tool, in parallel with the rise of expectations for bank risk-appetite statements. The scope of regulation will continue to expand, propelled by two drivers. These regulatory trends are expected to have substantial implications for banks’ risk management, including:

Optimization within A Regulatory Framework : Capital, liquidity, funding, and leverage ratios, as well as recovery and resolution regimes, will likely force banks to construct balance sheets and businesses that comply with all constraints while aiming to fully utilize the capacity under the ratios. This limits banks’ strategic degrees of freedom and demands a new, highly analytical business-optimization and strategy-setting process.

Principles-based Compliance: Banks will need to comply with broad principles for protecting themselves against potential future rules and interpretations.

Automated Compliance : With the evolving complex structures, banks need to eliminate human interventions as much as possible in risk’s dealings with customers and to hardwire the right behaviors into their products, services, and processes.

Operational Risk Due To Changing Customer Expectations & Technology

Over the next decade, shifts in customer expectations and technology are expected to cause massive alterations in banking and give it an entirely different profile. By then, widespread technology use is likely to be the norm for customers. The current tech-savvy younger generation will be the major revenue contributor to banks. This generation is using number of **Apps** for various enquiries and making payments at ease. Companies are launching new payment techniques and new Apps are in abundance. How secure these Apps are. People are vulnerable to these Apps and it has brought us to a new era of **IT related risks**. This needs customer education to make them aware of the risks involved and the ways to mitigate them.

Technology has not only been changing customer behavior, but will also enable new risk-management techniques, often coupled with advanced analytics. Risk functions will most likely need new capabilities and processes to manage and track the emerging risks. There would be human resource challenges coupled with other factors to mitigate **Operational Risk**. The middle-management ranks of banks are being thinned by retirements which has not been offset with adequate fresh recruitment. In addition, banks need experts in specific areas like Project Evaluation, Treasury, HR and Risk Management. In order to grow, retain and provide with responsibilities at higher rank and specialist positions specific job roles need to be defined along with transparent Performance Measurement System while the employees are supported by necessary training and development.

Specialised Banking: In order to promote financial inclusion, new specialised banking licences (such as payments bank licences and small finance bank licences) are being granted by the RBI. This sector is currently evolving and from a regulatory perspective, it will be interesting to see how these specialised banks fit within the larger regulatory framework applicable to banks. Further, these banks have thrown a different type of competition. Born with advanced technology, sleek workforce and hassle free last mile delivery are their positives *vis-a-vis* legacy banks.

Asset Quality: The quantity of net non-performing assets (NPAs) of Indian banks has been increasing significantly. The RBI has taken various regulatory measures to revitalise stressed assets in the economy. These, among others, include issuing a ‘Framework to Revitalise the Distressed Assets in the Economy’ (which provides for early recognition of stressed assets, sale of such assets and steps for resolution or recovery of distressed assets) and a strategic debt restructuring mechanism, (which allow lenders to convert their debt to equity, gain control in the borrower and transfer the ownership to a new promoter).

To further strengthen the ability of Indian banks to deal with stressed assets, the RBI has recently revised the existing framework for revitalisation of stressed assets. This largely includes relaxations from the existing mechanism such as reduction in the divestment limits under the strategic debt restructuring mechanism, incentives for adherence to timelines under the joint lenders forum mechanism, etc. The RBI has also introduced a ‘Scheme for Sustainable Structuring of Stressed Assets’ (S4A), which provides for classification of loans as sustainable and unsustainable and allows banks to convert the unviable portion of debt into equity.

Additionally the Enforcement of Security Interests and Recovery of Debts Laws and Miscellaneous Provisions Amendment Act 2016 amends various legislations dealing with enforcement of security interests with an aim to harmonise the steps for enforcement and make the process more time-efficient. However, these reforms are fairly new and their effectiveness will need to be seen over time.

Enforcement of the New Insolvency Regime: Previously, the framework governing corporate insolvency and personal bankruptcy in India was set out under various legislations. This encouraged forum shopping and caused delays in completion of the insolvency process. In order to streamline the existing framework, the Insolvency and Bankruptcy Code (Code) has been partly notified.

The first few insolvency cases are under way and are being keenly watched to see how the process will work and which stakeholders stand to benefit. Further, once fully notified, the Code will cause an overhaul of the existing insolvency regime, posing a challenge for the regulator, banks and the adjudicating authorities to adapt and implement the changes appropriately. Despite these teething issues, the new regime focuses on dealing with financial distress in a cohesive and comprehensive manner and is aimed at creditor protection.

Financial Inclusion: Recently, there has been a further push for financial inclusion as the Government of India has acknowledged the need to make banking services available to the entire population. In our country, nearly one fourth of the population is illiterate and below the poverty line, ensuring true financial inclusion is a challenge. Due to illiteracy, the privacy of an individual's bank account may be breached. But with Aadhaar and Bio-metric, this gets obviated to an extent. Further due to poverty owing to lower income, lack of sustainable livelihood, lack of skills, under employment and unemployment, ensuring deposit operations in these accounts is a challenge. As discussed earlier, specialised banks such as payments banks and small finance banks are being set up to promote financial inclusion. We may see further policy changes to encourage the spread of the banking sector in currently under-banked areas.

Goods and Services Tax: GST the biggest tax reform in India founded on the notion of "one nation, one market, one tax" has been successfully implemented on 1st July 2017. The single biggest indirect tax regime has kicked into force, dismantling all the inter-state barriers with respect to trade. The GST rollout, with a single stroke, has converted India into a unified market of 1.3 billion citizens. The rollout has renewed the hope of India's fiscal reform program regaining momentum and widening the economy. The country would climb several ladders in the ease of doing business with the implementation of the most important tax reform ever in the history of the country.

The Insolvency and Bankruptcy Code, 2016 (IBC): IBC is an important reform for India and its successful implementation depends on meticulous transition planning. The IBC replaces a fragmented legal framework and a broken institutional set-up that has been delivering poor outcomes for years for creditors and distressed businesses seeking an exit.

Culture of Compliance: Keeping your enterprise compliant with industry regulations takes time, resources and continual vigilance. A 'right way of doing' is to be infused into every process and procedures. It also needs to be inculcated in all employees by encouragement, inspiration and motivation as well as by training and scrupulous vigilance. It will thus set the foundation for expected behaviour across the organisation and mitigates the risk due to non-compliance.

B. Technological Challenges For Enhancing Effectiveness of Indian Banks

Apart from the regulatory challenges, Indian banking industry has another equally formidable challenge. That is the technology front. It is changing faster than the processor speeds postulated in Moore's law. Facit Calculators, ALPMs, TBMs are a history. Perhaps, 50% of bank employees may not vouch, such terminology ever existed. Before our wonderment on CBS and data centres is exhausted, our banking business is migrating to the cloud or to the robotics.

Years after 2010

Times Are Changing And Tastes Too: Call centre babble will make a customer happy; a wobbling robot will guide a customer in the banking hall; a chat-bot will answer mundane banking on the website; kiosks help the Do-It-Yourself folks. Then, what is left for human hands? Even the human imagination or discretion is usurped by machines. Predictive analytics and artificial intelligence will show us the next borrower.

WhatsApp moment in Banking?

While deposits and loans are yet to witness a major break-out point, payment vertical of banks has lost a considerable revenue share, with the advent of NEFT/RTGS. Perhaps, the WhatsApp moment has arrived in the banking sector, as far as payments space is concerned. UPI bandwagon has brought countless payment options, to millions of finger tips. The day before yesterday, it was the launch of TEZ; Google's payment service. Appropriately, it is named as TEZ; signifying the speed and the magnitude of changes in the anvil. All this and more, will remove the dividing line between a bank and a non-bank, in the days to come.

Flood Gates "Financial Inclusion"

Though there were many banking milestones in the journey so far, the financial inclusion plan caused a major tectonic shift. It had thrown open, many technological challenges. Bandwidth, security, hardware, compute-power -- all were needed in enormous doses, as banks had to reach out to over hundred thousand hamlets, had to set up Ultra Small branches, had to connect to millions of Bank Mitras, roll out Adhaar enrolment, make bio-metric based payments -- each one of these activities, was a major chapter in itself, during the technology journey of the banking sector. What mattered was the pace of changes, the quantity of deliveries and the rough terrains that were to be reached, for implementing PM's ambitious trio - JAM (Jandhan, Adhaar, Mobile).

While the privacy debate continues unabated, Aadhaar based customer identification is another major challenge that the banking industry has in hand now. Banks have to extinguish, all accounts which are not owned by an Aadhaar holder. Banks are working 24x7 to identify billion plus accounts. Task has to be accomplished by this year end, which needs a lot of compute power and a lot more.

Enhancing Effectiveness of Banks

Banks have been resilient to all challenges and have been effective in delivering the much desired outcomes. But the obsolescence of technology is happening so fast that banks need huge investments to become relevant and continuously effective. Digital Banking and mobility are the in things today to bring delight to customers.

Cyber Threats, Risks and Security:

Digital world has a dark underbelly – a formidable hacker-force is always on the prowl for a loophole to enter our firewalls aiming to mutilate our data or to encrypt our files. This could be for fun on this could be an organised crime for a ransom. Wannacry was one such ransom-ware, the world had woken up to recently. Of course, Microsoft was prompt in dispatching patches to prevent the menace. The ransom ware brought huge losses to businesses. Malicious mail attachments opened by gullible employees or pen-drives inserted into office systems prove to be fatal to organisations.

We should deploy a stringent rule-based mail delivery system and may be a suitable insurance cover. We need to shield our core systems with a SOC (Security Operations Centre) so that we should not stare at reputational and/or financial losses. Beyond all these mitigates, we should also invest in employee training so that tools deployed will yield results.

Internal Determinants For Effectiveness

Sustained effectiveness can only be had, by investing in innovation, improving internal controls. While we grew rapidly, our control functions diluted in some areas. Effective risk management has to enhance, hand-in-hand, along with the technology growth. It has been amply established that technology will not deliver intended results from a top-down approach. Adaptation of technology has to happen at grass root level also. Extensive training to employees can help us in utilising technology optimally. A knowledgeable employee would avoid baits thrown by hackers and save the bank from virus onslaughts.

External Factors

Unto the Last: Remembering Mahatma Gandhi is very appropriate now. Antyodaya was his watch word. Extend technology to reach out to the last person on the ground. We need a robust network, continuous power supply and other infrastructure elements so that banks can be more effective in deliveries to the last man who is not even in the queue. Technology investments are huge, as every element of it is imported. Be it the Database engine (Oracle), be it the Core Computers (IBM/Sun), be it the Operating System (Microsoft) or the Network Infrastructure (CISCO). We are a nation with technology honchos who contributed in the growth of western technology giants. Now, it is the turn of our country which should have its own version of database, its own version of operating system and its own search engine. Banks should finance startups which can seed such giant trees. Our unemployed human asset base, which is too huge, can innovate and find alternatives to the MNCs.

Technology with A Human Face

While we improve upon technology for being effective, banking sector should also endeavour to avoid large scale displacement of humans by robots or by artificial intelligence. We are a land of masses and we should realise that gainful employment of all, is the key for sustenance of banking industry. The higher the employment, the higher the growth will be in our core business.

C. **Human Resources Challenges**

Public sector banks have been facing a human capital challenge for a while now, following a recruitment freeze in the 1990s, termed as the “retirement decade” by former RBI Deputy Governor Dr K C Chakrabarty. These banks are staring at the imminent retirement of about a quarter of the 1.5 lakh mid-level managers. They are due to retire over the next three to five years, creating a vast leadership vacuum.

The challenges that the public sector banks (PSBs) face today are not merely quantitative but qualitative which can be met only by skill development, competition and leadership. Presently, PSBs are increasingly witnessing many young officers at the top. While this can bring fresh perspectives on various issues, it is also a fact that given the strategic importance of leadership at the top, it is important to understand the training requirements of top management and fulfil the same.

The entry of new private banks has further increased the competition and thereby attracting talent from PSBs. In such a scenario, it is of paramount importance that we retain talent by offering challenging roles and also, to better equip them with management skills and quality decision making by imparting training. Some of the issues that are posing a challenge to the public sector banks:

Leadership: The stagnation of business across banks in the past few years is an indication of lack of proper leadership skills at various layers of the Banks. We call it a vacuum of Leaders. In our bank , We just need 3248 business leaders to man the equal number of branches. The challenge is in getting business leaders. We need to search these leaders, nurture them, motivate them and rise high. Talent loss has been happening by day and each month at least 3000 years of experience and expertise is lost.

Defining Job Roles And Hiring The Right Person For The Right Job: Defining job role of each desk would enable to assess the skill sets required to man that desk. In assessing whether the right person has been selected for the right job Banks seek to match the job holder's knowledge, skills and abilities to the requirements of the job. Thus, defining job roles would help the HR in mapping each desk function to the available manpower by imparting training to the existing staff or by recruiting appropriate people with the desirable skill sets. It is not only a important to acquire the right talents, but a tougher task is to manage / nurture and retain the such people. It becomes imperative to work to convert the PSBs into preferred work places. The current times with rapid changes pose a challenge of new variety, the ability to learn, unlearn and relearn inn our workforce. Narrowing the Cultural gaps / generation gaps in the workforce need a serious serious focus on the part of the managements.

Performance Measurement System: Incentivizing talent with fairness and transparency is a key objective of HR managers and the goal of the promotion policy of every organization. To make the Performance Management System work, we have to make it as objective an assessment as possible. We need to identify upfront the performance benchmarks for each individual and their performance and rating should follow from there.

Training and Development: Training and development remains one of the most maligned aspects of HR management in banks. There is an urgent need to earnestly attempt to assess the utility of training for the employee and conduct exercise to map the training needs of the individuals on the basis of their core competencies or their placement.

Employees Compensation: Finding skilled, experienced, responsible employees is a challenge for human resource departments in any industry, more so in a service-oriented industry like banking. The main task of the HR policy of banks is to create a favourable atmosphere where people get the opportunity to showcase their potential and receive adequate compensation. Inadequacy of compensation is made out as an issue in the PSBs, which encourages attrition.

Role of the Top Management: In a service-oriented industry like banking, the quality of human resources has to be the central plank. Unless the organizations do not leverage the strength of their human resource to the maximum, they would fail miserably in attaining a competitive edge. The HR policy needs to be strategically aligned and connected with business. Taking banking industry to the heights of excellence will require a new combination of technology, better business processes and human resources.

D. Enhancing Corporate Governance

A sound corporate governance mechanism, involving transparency and accountability of operations, is central to survival in a competitive market. Therefore, banks have to necessarily reorient their systems, procedures and operations in consonance with this. Moreover, it should be noted that the hallmark of good corporate governance at all times cannot be beyond honesty, integrity, values and ethics. The importance of Board is best explained by “The Fish rots from the head”.

Research shows that many risk management failures are due to breakdown in corporate governance which arises due to poor management of conflicts of interest, inadequate understanding of key banking risks and poor Board oversight of the mechanisms for risk management and internal audit. Therefore, it can be said that corporate governance is the foundation of effective risk managements in banks and thus the foundation for a sound financial system. Since, the Board has a major role to play in this, it should comprise of more experts and cult professionals which would bring enough wisdom and expertise to pave the way for growth by sharp guidance and diverse innovation.

Road Ahead

The current decade is already proving to be a challenging one for the HR professionals in banks, particularly for those in the public sector banks because of the significant number of skilled and seasoned employees retiring during this decade. Apart from posing unique challenges, it also presents opportunities for HR managers across the banking industry. In short, the ‘retirement decade’ provides an opportunity, especially for the PSBs, to transform their work force by hiring the right talent, right-sizing and right-skilling them and thereby bringing about a cultural transformation in the functioning of these banks.

Further, to stay ahead in the race, banks will have to leverage technology for innovative product development including developing sophisticated financial products. And as customers are now insisting on products which suit their individual requirements, banks are forced to opt for product innovation in order to hang on to their precious customers. Thus, the Indian banks will need to assess the needs of their clientele and offer customised products to meet their satisfaction.

To conclude, I would like to say that the Indian banking industry today is a result of the measured road maps periodically adopted by the Reserve Bank of India. The central bank has over the years played multiple roles – a developer, a facilitator and a catalyst. As we set sail through these changing times, I can only think of a quote by the famous American singer Jimmy Dean:

*“**I can’t change the direction of the wind, but I can adjust my sails to always reach my destination**.”*

Thank you!