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Changing Landscape of Banking- A futuristic Perspective

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Faculty members and Dear Students of NIBM, Friends from electronic &print media

Ladies and Gentlemen

Good Morning all,

At the outset let me extend my heartiest congratulations to the management, staff and students of NIBM on this 48th Foundation Day. I am indeed delighted and overwhelmed to be a part of this wonderful occasion and humbled to deliver the key note address. The foundation day provides a platform to remember and celebrate the immense contributions made by all the stakeholders past and present which has made NIBM Pune today stand tall in the field of Banking training and Education. I congratulate each one of you who have helped in bringing glory to the Institute to where it is today for future generations to build upon. I don't think anybody at Top Management level in banking today who has not been chiseled from here. In fact, me and my colleague Ms Usha Ananthasubramanian both had undergone "Program on Leadership Development for Corporate Excellence" here in 2005 in collaboration with Kellogg School of Management, Chicago under Prof Asish Saha, Ex-Director, NIBM. I am happy to see Prof Asish Saha here on this day. I thank Dr.Dhingra and management of NIBM for inviting me on this great occasion.

I would be giving my address on the most contemporary topic **"Changing Landscape of Banking on a futuristic Perspective".** Here I would like to dwell upon the Banking Landscape in the Indian context where developments in the recent past have brought in a great deal of reforms in the Industry and the overall outlook of the banking Industry has completely changed. The different aspects of the banking landscape in our country may be broadly classified into 5 major sections of

Management of Stressed Assets, Recapitalization of Banks, Regulatory and Reform Actions,Technological Challenges, and **Customer Expectations.**I would also touch upon Small Finance Banks, Payment Banks and Capacity building.

As we all know, the growth of the Economy in a country and the credit growth of its Banks are always positively correlated. On an average, the Credit growth has always been**2.5 to 3.0 times** the real GDP growth in the past and this multiple has now shrunk. The primary cause for the recent slowdown in our growth may be attributed to the stress on the banking sector's balance-sheet, especially of public sector banks and lower demand for fresh capital investment. The stress in bank assets has been mounting since 2011 and has now materially crystallized in the form of non-performing assets (NPAs). When bank balance sheets are weak, it is difficult for them to support healthy credit growth.

To address this primary concern on stressed assets, the Reserve Bank and the Government of India have embarked upon various agendas for the balance sheet resolution. RBI had earlier created Central Repository of Information on Large Credits -CRILC in early 2014 to address the cross bank information asymmetry and inconsistencies in asset classification.The Reserve Bank also announced the **Asset Quality Review (AQR)**during the year 2015 which was a major exercise towards cleansing the Bank's Balance Sheet. From the Banks perspective, the AQR has largely helped in declaring NPA's whereby focus can be made on resolving the assets recognized as NPA's rather than trying to forbear them continuously[i].

The gross NPA (GNPA) ratio of the banking system at 9.6 % and the stressed advances ratio at 12 % as of March 31, 2017, on the back of persistently high ratios in the past few years is, indeed, a matter of concern. These increasing NPAs have adverse effect on the capital of Banks; as a result banks have very little appetite for taking fresh exposures in new projects[ii].

Various schemes were designed and also modified like the Corporate Debt Restructuring Scheme, SDR, Change in management outside SDR, 5/25, S4A etc. to address specific issues of stakeholders and for the resolution of stressed assets. Further, enactment of the Insolvency and Bankruptcy code (IBC) in December 2016 can be considered to have significantly changed the rule of the game. IBC guidelines provides for timely and transparent resolution of stressed assets. For faster recovery, the Government of India has recently brought changes in the SARFAESI & DRT Act.

The IBC allows for filing for insolvency proceedings with time-bound resolution and failing that initiation for liquidation is to be done. As the IBC process is to be completed within 180 days which can be further extended maximum by 90 days, it is expected that stressed assets resolution would be faster in coming days. Recently the RBI had directed banks to file insolvency applications against 12 large accounts comprising about 25% of the total NPAs of banking sector. The RBI has also advised banks to make higher provisions for accounts which are referred under the IBC, so as to improve bank provision coverage ratios and to ensure that banks are fully protected against likely losses in the resolution process.

While a whole ecosystem is evolving around the IBC and is expected to bring the much sought after relief to banks on stressed asset resolution, another important area which needs primary attention is capitalization of PSU banks. When bank balance-sheets are weak, it becomes difficult to support healthy credit growth and as such under-capitalized banks will have capital only to survive and not for growth.

Recent study documents that Bank capitalization has a strong effect on bank loan supply and a one percentage point increase in a bank's equity-to-total assets ratio is associated with a 0.6 percentage point increase in its yearly loan growth. In fact, if a banking system remains systematically undercapitalized and new lending is not kept under a tight supervisory watch, then the banking sector as well as economy can suffer[i].

Banksbeing a financial intermediary, capitalization is thus a pre-requisite for efficient supply and allocation of credit. Its central role in supporting economic growth is consistent with what other economies and regulators have experienced in the past episodes of banking sector stress.

For example in Japan, a massive real estate bubble collapse in 1990 led to a series of direct public capital injections into impaired banks, mostly in the form of preferred equity or subordinated debt.Another example, the sovereign debt crisis in Europe which affected the financial sector and lending to the private sector contracted substantially in Greece, Ireland, Italy, Portugal, and Spain.To improve poor bank health and sovereign indebtness, an indirect recapitalization measure was implemented by European Central Bank (ECB)[i].

The Government of India has been infusing capital on a regular basis into the public sector banks, to enable them to meet regulatory capital requirements and maintain the government stake in the PSBs. In 2015, the Government announced the ***"Indra-dhanush"*** plan to revamp the public sector banks. As part of that plan, a program of capitalization to ensure the public-sector banks remain BASEL–III compliant was also announced. However, given the correctly recognized scale of NPAs in the books of public sector banks, the lower internal capital augmentation,and declining credit growth, substantial additional capital infusion is almost surely required[i]. This is necessary even after tapping into other avenues, including the sale of non-core assets, raising of public equity etc. Another area of future challenge would be, introduction of IFRS from March-19 which will entail enhanced capital requirements.

While the asset quality and capitalization requires due reform actions, another major challenge which the Banking Industry is now facing is the pace at which **Technological advancements**are evolving new business models in the Banking Industry. During the last 2-3 years, use of technology has become integral to Banking Operations. Technology is now widely being used for **Data Analysis**, Understanding **Credit needs**, **Customer Interactions,** etc. and are helping banks to offer more focused products to customers. This emerging technological landscape in the financial world will be a formidable challenge including its cost factor and at the same time, a huge opportunity. Some new technological advancement which are gradually making a foray into financial sector include B**ig Data, Artificial Intelligence, Block chain Technology, Cloud based Computing** and **Internet of Things.** In addition Bitcoin, the cryptocurrency launched 9 years back is gradually making inroads with Japan recognizing it with effect from 01-04-2017 and this would be a big challenge globally for all the Banks.

Technology can be truly disruptive as tech-enabled products like Digital cash or Mobile wallet are providing services by completely bypassing the banking system.There had also been substantial innovation in the field of Payments infrastructure with new digital channels such as, UPI, USSD*99#, BHIM, BHIM Aadhar and Bharat QR emerging as cost-effective payments models for customers and merchants.

According to RBI's Annual report, the share of electronic transactions moved up to 89% in 2016-17 in total volume of non-cash payments from 84.4% in the previous year. During 2016-17, 3.5 billion transactions, valued at around Rs.6.6 trillion were carried out through cards. Mobile Banking Services has witnessed a strong growth of over 150% and the number of registered customers rose to 163 million in March'17 from 105 million in March'16.

Another phenomenon which is still at a nascent stage in India but has the potential to emerge as a competition as well as a disruption to traditional banking is **Crowd Funding**which uses the digital platform for raising capital**.** This concept has taken off in developed economies like **USA and Europe** and during the last couple of years it has gained considerable traction in Asia as well. The same is expected to make in-road in Indian Banking industry in future.

While banks are making good use of Technology,saving time, cash and money, there has also been a sharp rise in the cyber security incidents of significant concern.With a view to assessing banks' cyber security preparedness, the Reserve Bank has also mandated a baseline cyber security and resilience framework and conducted IT/cyber security examinations/ vulnerability assessments to evaluate their responses to cyber security incidents. Banks in India have initiated steps & streamlining their systems to protect themselves from such incidents[iii].With digitization, new risks are emerging which will entail more regulatory and compliance costs in coming years.

Going forward, it is the consumer who will be the ultimate beneficiary of the technological revolution and with adoption,customer expectations are also rising. It must be kept in mind that 70% of the customers may be below the age of 35, but 70% of the money resides with customers who are above the age of 40 and a large chunk of them want things to be delivered personally rather than digitally. Banks in order to cater to both these segments should continuously innovate and evolve new business models.

The technological disruption and changing customer need is paving way for competition in the industry. Off late there has been emergence of various Fintech companies offering banking solutions harnessing technology and customer demand for convenient financial solutions. The RBI has also given license to Payment Banks and Small Finance Banks to bring in a segmented service approach in the banking Industry. The Payment banks and Small Finance Banks with their minimal capital requirements and usage of technology platforms are expected to reach and scale customers at a much faster pace. The Banks will have to tie-up with Fintech for providing better customer service and products. Similarly, with the opening of more Small Finance Banks and Payment Banks, the commercial banks have to develop strategies for cooperation than competition.

Congruence of Information, Technology, Mobility, Analytics and Computing means are bringing new business models. Today, Banks are much prepared to offer every conceivable financial service to the customer in any form he wants be it manually, on the phone, in a computer or a complete set of services which include what wallets would do, what payment banks would do. If he comes to the bank say on mobile phone, he can buy mutual funds, buy insurance, he can download an app like a wallet, he can get his assets report etc. Banking industry is now pretty much ahead of the curve and is not complacent.

The RBI and the Government are conjointly putting efforts to resolve the NPA issues of the Banking Industry and working towards strengthening the balance sheet of the Banks. The regulatory and structural reforms are expected to bring in Indian Banks to the international standards in near future. Government's plan of Capital infusion is very much critical for credit growth in PSU Banks which invariably will lead to growth of the Economy.

Further being a technology-driven service industry, the future of banking industry more depends on adoption of technology with the ingenuity of the human mind. The traditional Banks definitely have an edge over the new entrants as they are sitting on a gold mine of data. The value proposition to the customers can be driven by that data. This is where the existing banks can use data-driven technology to disrupt the disruptors.Future of banking players depends upon their appetite and inclination to adapt with the environmental changes.

Consolidation of Banks is being considered actively by the Government of India which will again throw a major challenge to Public Sector Banks in terms of Manpower, IT Integration etc.

To conclude I will say that, the Banking Industry today has become highly dynamic with new research and concepts emerging very often, moreover the sector has become highly interconnected and most of its happening are highly visible. The paradigm changes in the sector has very wide ramifications and in addition to the reform actions, there is also a strong need for Banks to make conscious and structured effects in Capacity Building which is most critical. In addition to Capacity Building in the areas of HR management practices, Training methodologies and innovations, there is a need to look beyond an individual institution's perspective and consider various measures on a system-wide basis to support and drive capacity building. With rapid advancement in technology and changes in the Banking Industry, skill sets of yesteryears are becoming obsolete at a faster rate and there is a need for developing new skill sets.

It is in this endeavor of capacity building for the banking Industry, Institutions like NIBM Pune are doing a commendable job acting as a strong catalyst and supporting the Banks.On this foundation day, I once again congratulate you all for the continuous support in building a strong value system in the banking Industry. I am sure that NIBM will also scale up its capabilities and capacity keeping in view Future Prospective.

Thank you.

References :

[i] Speech on The Unfinished Agenda : Restoring Public Sector Banks' Health in India (Dr. Viral V. Acharya, Deputy Governor, RBI – September 7, 2017

[ii] Speech on Resolution of Stressed Assets : Towards the end game (Dr. Urjit R. Patel, Governor, RBI - August 19, 2017)

[iii] RBI Annual Report 2016-17