K J Udeshi: India’s potential in the banking and financial sector

Inaugural address by Ms K J Udeshi, Deputy Governor of the Reserve Bank of India, at the Conference on Banking and Trade Finance, organised by the International Chamber of Commerce, New Delhi, 9 December 2003.

Mr. Kanwar, Mr. Kiefer, and distinguished participants in the conference,

I am indeed privileged to be invited to inaugurate this conference and especially so, as this is the first time that the International Chamber of Commerce Banking Commission Meeting is taking place in India. The contribution made by ICC in standardization is well-known but perhaps what is not so well-known is that the ICC also contributes to making business policy by publishing policy statements and reports and laying down guidelines, goals and rules. This conference would, therefore, provide a forum for interaction between Indian bankers and corporates and their counterparts from other parts of the world. It is also an excellent opportunity to project India’s potential in the banking and financial sector. Kudos to Mr. Kanwar for having arranged this conference in India.

The Indian financial sector reforms launched a decade ago have transformed the operating environment of the financial sector from an administered regime to a competitive market based system. The reforms are an on-going process. There is increasing evidence of strong inter-linkages between markets. In the macro economic and financial spheres, inflation has been contained, external debt indicators have vastly improved, the exchange rate is flexible and the country is free of financial repression. The trade account is open and India has become much more integrated with the world economy. The economy has also become more resilient to shocks, both domestic and external.

The Indian economy has emerged as one of the fastest growing emerging market economies and the Indian banking sector is perceived, as being the best performer in Asia. The RBI has been at the forefront of upgrading the risk systems of the Indian banking system. It is, in fact, heartening to report that the risk capabilities of our banks have improved systematically over the past decade. The robustness of the banking sector is witnessed by a consistent rise in Return on Equity, strong earnings momentum, improved loan book quality, and unrealized gains on treasury portfolios. There are some structural factors that could drive credit growth, namely, the emergence of consumer loans, the shrinking of spreads on alternate assets and a higher risk appetite because of stronger foreclosure norms and statutory support for enforcement of creditor rights.

The Reserve Bank has initiated a host of measures for the creation of a competitive environment and improve efficiency in the process of financial intermediation.

It is important that banks continue to adequately finance activities that are of crucial importance to growth. The fostering of entrepreneurship in new industrial activities, in the emerging services sector and other non traditional activities, will all require proactive financing.

It may be of interest to the ICC Banking Commission that India has been closely associated with various standard setting bodies and has been taking active part in the work of several key international institutions devoted to the task of developing and promoting implementation of financial standards and codes. Although we are not a member of the Financial Stability Forum (FSF), we were one of the countries specially requested to help its Task Force on the Implementation of Standards and subsequently, the Follow Up Group on Incentives for Implementation of Standards.

The Reserve Bank’s Standing Committee on International Financial Standards and Codes (Chairman: Dr. Y.V. Reddy) has assessed Indian regulations against international best practices in order to facilitate positioning of international financial standards and codes in relevant areas of the financial system in India and to guide the overall process of implementation of appropriate changes in respect of various segments of the financial system. India is one of the countries that has sought participation in the joint IMF-World Bank Financial Sector Assessment Programme (FSAP). As part of the Reports on Observances of Standards and Codes (ROSCs), India’s compliance in respect of standards and codes has already been assessed in respect of six codes, viz., Monetary and Financial Policy Transparency, Fiscal Transparency, Banking Supervision, Securities Market Regulation, Payment and Settlement System and Corporate Governance. Currently, assessment is being undertaken with regard to Special Data Dissemination Standards.
The Narasimham Committee on Banking Sector Reforms (1998) had observed that a legal framework that clearly defines the rights and liabilities of parties to contracts and provides for speedy resolution of dispute is a sine qua non for efficient trade and commerce, especially for financial intermediation. Several legislative initiatives have been undertaken in the banking and financial sector.

The bills introduced in Parliament for amendment of the Banking Regulation Act will encourage foreign banks to set up subsidiaries and attract foreign investors. Historically, foreign banks have always been allowed to operate in India and have enjoyed national treatment and a level-playing field. With a view to developing trade and payment relationship, we have encouraged foreign banks from other countries which did not have historic links to establish branches in India. I may add that the WTO commitments on banking services has been fulfilled.

A critical issue of increasing international concern is the question of money laundering. The impact of money laundering is now beginning to extend from economic crimes to international terrorism. As financial transactions grow more complex, it becomes more difficult for banks to maintain a customer profile. The challenge, therefore, is to ensure that banks know their customers without hindering the smooth flow of financial transactions.

The Reserve Bank has issued several guidelines to banks and non-banking financial companies to implement the ‘Know Your Customer’ principle. The basic aim is to prevent banks being unwittingly used as the channel of funds derived from criminal activity or financing terrorism. The guidelines relate to identification of depositors and institution of systems and procedures to control financial frauds, identify money laundering and suspicious activities and scrutinize / monitor large-value cash transactions.

In India, recognizing the paramount role of exports in the overall growth process of the economy, the Government of India and the Reserve Bank of India have, over time, taken several measures to ensure adequate flow of credit towards export related activities. The important measures include rationalisation and liberalization of export credit interest rates, flexibility in repayment/pre-payment of pre-shipment credit, simplification of procedures relating to exports (like direct dispatch of shipping documents and enhancement in normal period for realization of export proceeds), flexibility to banks to source foreign currency funds for granting pre-shipment credit in foreign currency (PCFC) and export bill rediscounting (EBR), scheme and introduction of a transparent reporting system for export credit interest rates.

At present, exporters have the option to avail of pre-shipment and post-shipment credit in foreign currency from banks in India. In order to encourage competition among banks and also to increase flow of credit to the export sector, the Reserve Bank of India has liberalized interest rates on local currency export credit effective May 1, 2003 for pre-shipment credit above 180 days and post-shipment credit above 90 days. In the context of globalization, however, what one needs to keep in mind is that even though finance is a critical ingredient of production, what matters even more is the demand for the product and its competitiveness on quality considerations. Finance can only act as a facilitator when these two preconditions are satisfied. This is vindicated by the recent surge in growth of exports of automotive components and C.D. Roms.

The initiative with regard to the setting up of an Electronic Data Interchange (EDI) in the banking sector for the benefit of the exporters and importers bears mentioning. EDI provides several benefits to the corporates such as operational efficiencies and cost savings by elimination of paperwork, logistical benefits by better scheduling and reduced stockholding etc., and strategic benefits through competitive and advantage and access to new markets. Under the EDI project, one of the major benefits for the exporters is that the RBI has abolished GR forms for export transactions. The exporters can now fill up a common Statutory Declaration Form (SDF) for the customs from where the data relevant to the banks and the RBI can be extracted. Presently, EDI is working at 23 ports covering 80 per cent of exports. Under the EDI project, bank branches at 114 export intensive centers identified by the Ministry of Commerce are to be provided connectivity with the customs authorities.

The Reserve Bank has provided the enabling conditions for promotion of trade and investment, both domestic and international, by ensuring adequate liquidity, a competitive interest rate regime measures to encourage decentralized decision making and ease procedures in the credit delivery systems and most importantly financial stability in the midst of a world economy beset by uncertainty and recessionary trends. It is now necessary for market participants to have enough confidence to make investment decisions.
The Reserve Bank, on its part, would continue to ensure financial stability, strengthening of prudential norms with the strategy of convergence of international best practice, consistent with our specific needs, as also progressive strengthening of the supervisory framework. Accordingly, the focus of our policy initiatives would be on streamlining banking operations in order to reduce transaction costs, infusing flexibility into the system, upgrading risk management systems, enhancing the level of compliance by banks with accounting standards, operationalising consolidated accounting practices and last and most important of all, providing the public with a financial system they can trust.

While there is substantial progress in the financial sector reforms initiated in 1991, the accent at the present time is an implementation of the reforms at the grass roots level. In this context, the endeavour is to facilitate ease of transactions by the common persons, further broadening of the consultative process and continued emphasis on the institutional capacity to support growth consistent with stability. Furthermore, the credit delivery system is being strengthened to ensure that financing gaps do not constrain the acceleration of growth.

Governor, Dr. Y.V. Reddy, as part of the Mid-Term Review of Monetary and Credit Policy for the Year 2003-04 has announced a number of initiatives to bring about a significant and enduring improvement in the functioning of the financial system. The financial Sector now takes increasing challenges and complexities in the context of globalization and risk management. A Standing Technical Advisory Committee on Financial Regulation has been set up by the Governor which, through a consultative process, will endeavour to simplify and rationalize the regulatory regime to move towards a clear and unambiguous framework.

In another initiative, Standing Committee on Procedures and Performance Audit on Public Services provided by the RBI is being set up to bench mark the current level of service and to enhance the timeliness and quality of these services. The Committee will also coordinate with the Ad hoc Committee on Customer Services being set up by each bank. These initiatives would, it is expected, bring about a significant improvement in customer service in the financial sector.

The central objective of financial reforms is to attain a significant improvement in the efficiency of financial intermediation and the endeavour of the RBI would be to provide a regulatory framework in which economic agents can perform their activities in an optimal manner. In this endeavour, the RBI would approach issues in a collaborative manner, and in this, seek the hand of market participants.

I wish your deliberations all success.