H R Khan: Banks in India – challenges and opportunities

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1. Smt. Arundhati Bhattacharya, Chairman, State Bank of India, Shri. Deepak Parekh, Chairman HDFC, Shri. V. G. Kannan, Chairman, SBI Cap Securities Ltd., Shri. Mani Palivesan, Managing Director, SBI Cap Securities Ltd, distinguished panelists and participants. It is a pleasure to address the BFSI Conference 2014 which features panel discussions on topical issues in banking. The first panel discussion, interestingly, is on Disruptive Themes for Next Decade. The word disruptive is usually used with a negative connotation and therefore to be chosen as the theme for the panel discussion is a bold decision. On a careful rethinking, it seems disruptions can be used as synonym for challenges posed by paradigm shifts in the environment, thereby questioning the way things are done today. These challenges are opening the opportunities which banks should harness if they want to remain relevant in the financial service space in India. Therefore, in my address I intend to focus on some of these challenges & opportunities.

2. As at end-March 2013, there were 155 commercial banks including 151 scheduled commercial banks (SCBs) of which Regional Rural Banks were 64. The total number of bank offices at end-March 2014 is estimated to have reached 1,15,014 and the population per office, 1,10,052. In terms of the regional spread of the bank offices, while North Eastern region accounted for about 2 per cent (2,785 bank offices), Southern region accounted for about 28 per cent (30,925 bank offices). Despite such vast expansion of banking network, banking penetration still remains relatively low. According to the CRISIL's financial inclusion index, *Inclusix*, which covers three parameters of branch penetration, deposit penetration and credit penetration, at all India level, the index is placed (on a scale of 100) at 40.1 in 2011, reflecting under penetration of formal banking facilities in most part of the country. While the Southern region witnessed highest financial inclusion with index at 62.2, North-Eastern region registered lowest with 28.5. Under-penetration is evident in terms of number of ATMs and POS per million population also. In India, it stood at about 94 and 695 respectively as compared to, say, 1200 and 4853 respectively in Russia. The credit to GDP ratio is at around 53 per cent, which is low compared to the credit-GDP ratio of many advanced & developing economies. Hence, there is a need for much greater banking and credit penetration going forward. This is so because despite efforts to develop the corporate bond market, the Indian financial system remains bank-dominated with commercial banks accounting for over 60 per cent of the financial sector assets. It is, therefore, essential for the Indian economy, striving for an accelerating, sustainable and inclusive growth in the medium to long-term, to have a healthy and growing banking system.

3. Indian banking in future is, thus, expected to grow exponentially supported by technology intensive processes and customer friendly models with focus on convenience and cost effectiveness. A report titled *Indian Banking 2020: Making Decade's Promise come True* brought out by the Boston Consulting Group in 2010 had identified ten broad trends for the Indian banking. These and a few other areas which should receive the attention of banks seeking opportunities for sustainable growth are summarized below:-

i. Retail banking will be immensely benefited from the Indian demographic dividend. It is important to note that the middle class population is expected to touch 200 million

by 2020 and 475 million by 2027[1]. This would imply mortgages would grow fast and likely to cross `40 trillion by 2020;

ii. Another segment that will provide huge opportunities will be the financing of affordable housing for growing "low" & "middle" class;

iii. Rapid accumulation of wealth in rich households will drive wealth management to 10X size;

iv. *"The Next Billion"* consumer segment will emerge as the largest in terms of numbers and will accentuate the demand for low cost banking solutions and innovative operating models, throwing up a big market of small customers;

v. Branches and ATMs will need to grow 2X and 5X respectively to serve the huge addition to bankable population. Low cost branch network with smaller sized branches will be adopted;

vi. Mobile banking will come of age with widespread access to internet on mobile reaping the benefit of the high mobile density in the country;

vii. Banks will adopt CRM and data warehousing in a major way to reduce customer acquisition costs and improve risk management. Banks will have to understand and adopt new technologies like, cloud computing and invest significantly in analytics based on big data;

viii. Margins will see downward pressure both in retail and corporate banking, spurring banks to generate more fees and improve operating efficiency;

ix. Banks will discover the importance of the SME segment for profitability and growth and new models to serve SME segment profitably will be found as more than three fourth of the segment is still waiting to be served;

x. Investment banking will grow 10X, driven by demand from corporates for transaction support and capital market access; and

xi. Infrastructure debt will surpass ₹ 45 trillion — half of which will be on bank's books. It will touch the ALM limits of banks and will require a significant upgrade of banks' risk management systems.

xii. The focus of agricultural financing will be on areas like end-to-end supply chain management, various aggregation models of financing, organic and other niche areas of agriculture. Rural banking predominantly will have to harness branchless

xiii. Although banks will continue to focus on domestic business, given the rising trend of globalization, cross-border banking business will need more attention. As per a recent World Bank report, India retained its topmost position with US$ 70 billion in remittances in 2013 followed by China (US$ 60 billion), the Philippines (US$ 25 billion), Mexico (US$ 22 billion), Nigeria (US$ 21 billion), Egypt (US$ 17 billion), Pakistan (US$ 15 billion) and Bangladesh (US$ 14 billion). Apart from remittances and deposit & investment related transactions originating from the growing Indian diaspora, India has been witnessing a significant increase in trade finance and outward direct investments. In other words, banks will need to gear up to reap the benefits of increasing business arising out of globalization of India and resident and non-resident Indians;

xiv. It has now been realized that manufacturing will have to be one of the key drivers of growth though in the recent past, with moderation in the growth rate, the sector also

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[1] Report of Ernst & Young: China and India: tomorrow's middle classes.

witnessed a slowdown. A recent report of the McKinsey Global Institute[2] observes that for making a substantial improvement in the standards of living of the Indian people and alleviating poverty, about 115 million new non-farm jobs will have to be created between 2012 and 2022 and of these, about 27 million new jobs need to be created in manufacturing. The required growth rate in manufacturing sector output needs to be at least 10 per cent a year, probably higher. The National Manufacturing Policy envisages share of manufacturing in GDP to 25 per cent by 2022. Achieving this rate of growth would require significant amount of financing by the banks.

4. Against this evolving milieu of opportunistic trends, I feel it is appropriate to take stock of the challenges facing banks going forward in terms of strategies and business models that they will need to adopt more specifically from the regulatory and payment system perspectives. I intend to highlight some of the major challenges.

Challenges from the regulatory perspective

Re-orientation of the Indian banking structure

5. As the economy expands, a greater quantum of resources will be needed for supporting the growth process. The Indian banking sector also needs to catch up the likely acceleration in the credit to GDP ratio as the economy expands. To support the economic growth as envisaged in the 12th Five Year Plan, the banking business needs to expand significantly to an estimated ₹ 288 trillion by 2020 from about ₹ 115 trillion in 2012[3]. Given this, there is a need for reorienting the banking structure to make it more dynamic and flexible, while ensuring safety and systemic stability. There is enormous scope for increasing the size and capacity of the banking structure. Accordingly, the Reserve Bank came out with a set of guidelines for licensing of new banks in the private sector in February 2013. The process of licensing culminated with the granting of "in-principle" approval to two applicants who would set up new banks in the private sector within a period of 18 months.

6. While announcing the decision to grant "in-principle" approval to the two applicants, the Reserve Bank indicated that going forward, it would use the learning experience from this licensing exercise to revise the guidelines appropriately and move to grant licences more regularly on "tap" basis. Further, Reserve Bank would work on a policy of having various categories of "differentiated" bank licences which will allow a wider pool of entrants into banking leading to greater banking penetration and more competitive environment. Reserve Bank has, accordingly, been working on the relevant guidelines for licensing payment banks and small banks.

7. Eventually, over the years, as visualized in the Discussion Paper, the reoriented the banking structure may comprise four tiers. The first tier may consist of three or four large universal Indian banks with domestic and international presence along with branches of foreign banks in India. The second tier is likely to comprise several mid-sized banking institutions including niche banks like Payment Banks with economy-wide presence. The third tier may encompass old private sector banks, Regional Rural Banks, and multi state Urban Cooperative Banks. The fourth tier may embrace many small privately owned local banks and cooperative banks.

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[2] From poverty to empowerment: India's imperative for jobs, growth, and effective basic services, February 2014.

[3] *Banking Structure in India-The Way Forward*, Discussion Paper, Reserve Bank of India, August 2013.

Competition

8. W. Chan Kim & A. Renee Mauborgne in their *"Blue Ocean Strategy"* have shown that companies can succeed not by battling competitors, but rather by creating *Blue Oceans* of uncontested market space. These strategic moves create value for the company, its buyers and its employees, while unlocking new demand and making the competition irrelevant. Unlike the *Red Ocean Strategy*, the conventional approach to business of beating competition, the *"Blue Ocean Strategy"* tries to align innovation with utility, price and cost propositions. Similarly, financial sector reforms have brought about significant structural changes and created several *blue oceans*. A manifestation of this development is reflected in the increase in bank competitiveness. The share of public sector banks (PSBs) in total banking assets, which was 90 per cent on the eve of reforms in 1991 has since declined to around 72 per cent, a decline of roughly 1 percentage a year. In a move that is further expected to increase competition in the domestic banking industry, the Reserve Bank released the framework for setting up of Wholly Owned Subsidiaries (WOS) by foreign banks to India in November 2013, besides the framework for new universal banks and differentiated banks, such as, small banks and payment banks, which is in the offing. As I mentioned above, new banks are set to enter baking sector. Further, banks are facing increasing competition from non-banks including NBFCs, MFIs and tech companies. Going ahead, there may be increase in the non-bank related financing activities through innovations like Peer-to-Peer (P2P) lending[4], direct consumer lendings and social investing. With increasing competition, banks, will need to tap into untapped business opportunities. This would also call for harnessing resources at the bottom of the pyramid. Small customers are as important to their business growth as big business opportunities. The challenge before banks would be to make the best use of technology and innovation to bring down intermediation costs while protecting their bottom lines

Basel III implementation

9. The implementation of Basel III framework will throw various challenges for banks. In particular, the adoption of Basel III capital requirements by Indian banks would push down their return on equity (RoE) to an extent. Investors have a wider choice and the stocks of the manufacturing sector may be preferred to banking sector stocks and, as such, it may perhaps be difficult to convince the investor community to invest in Indian banks in the short-term. It is, however, expected that by looking at the benefits of implementation of Basel III capital requirements by way of increasing resilience of the banking system, investors will get adjusted to the new reality. This issue also needs to be seen in a historical perspective to understand the fact that Indian banks have successfully transited in the past from the regime of no regulatory requirement for capital to progressively tighter capital requirements and it would be logical to expect that Indian banks would be able to navigate the current phase as well. Nevertheless, it needs to be recognized that while moderation of growth in RoE is inevitable, the key to cushion this impact is to optimise capital and augment efficiency.

10. On June 9, 2014, the Reserve Bank issued guidelines for the implementation of the Liquidity Converge Ratio (LCR), which is a part of the Basel III framework on Liquidity Standards. In India, the LCR will be introduced in a phased manner starting with a minimum requirement of 60 per cent from January 1, 2015 and reaching minimum 100 per cent on January 1, 2019. Further, Government securities in excess of minimum SLR requirements

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[4] P2P lending also referred to as "social investing", "marketplace lending" or "direct consumer lending" is the practice of borrowing and lending of money among unrelated individuals and business entities, on the online platforms, without any role of a traditional financial intermediary like a bank or a non-banking financial institution. Crowd funding is a common term where small amounts of money from large number of individuals/organizations is raised to fund an art work, social cause or start-up venture through web-based platform. The P2P lending is carried out through the websites of the P2P lending companies, using different lending "platforms", which charge a relatively small commission for their services.

and the Government securities within the mandated SLR requirement to the extent allowed by the Reserve Bank under Marginal Standing Facility (MSF) are permitted to be treated as Level 1 assets for the computation of LCR. Adoption of liquidity standards under Basel III may induce changes in funding preferences of the Indian banks reflecting the fact that availability of and access to quality liquid assets may be a challenge going forward when the LCR requirement increases incrementally.

Capital mobilisation

11. In the process of phased adoption of Basel III capital norms, Indian banks in general have a relatively comfortable capital adequacy position to begin with. Rising required amount of capital going forward would be, however, a challenge, to which I turn now. The Reserve Bank issued final guidelines on implementation of Basel III capital regulations on May 2, 2012. The guidelines became effective from April 1, 2013 in phases and will be fully implemented as on March 31, 2019. Though there are various estimates about the additional capital mobilization by the PSBs arising out of the phased implementation of Basel III capital requirements, one thing is clear that the required magnitude of capital in the run up to the full implementation will be substantial. During the last four years, the Government has infused ₹ 586 billion in the PSBs. The Government has made a provision of ₹ 112 billion in the interim budget for 2014–15. PSBs hold more than 70 per cent of the banking assets. Therefore, capital infusion from the Government of this order may not be sufficient. It is also important to note that there has been over reliance on the Government to infuse equity despite headroom available for the management of the banks to raise equity from markets. There have not been concerted efforts made by PSBs to shore up their equity capital base from the markets, keeping in view the Basel III capital adequacy requirements. Their internal generation of capital has suffered mainly due to sharp deterioration in the asset quality possibly due to /adverse selection of assets. The growing pressure on asset quality of PSBs and the threat of rating downgrades will further add pressure on the equity of banks. Further, there would be further requirement of capital based on supervisory review and evaluation process under Basel Pillar II framework.

12. With higher additional capital requirements, as discussed above, recapitalisation of PSBs could exert significant stress on the government's fiscal position. There are, however, several potential options available to meet the challenges of mobilization of additional capital. These would include:

i. Divestment of Government's shares in PSBs. Given the present level of government shareholding in these banks which ranges from 58 per cent to 89 per cent, there is substantial ground for raising equity from the market without diluting the public sector character;

ii. The roles and responsibilities of the Boards of PSBs could be reviewed. The effectiveness of the Board and senior management has a moderating effect on the risk profiles, and consequently, overall capital requirements in a bank. The Government, being the owner of the PSBs, could address the governance aspects concerning PSBs;

iii. In addition to the public and rights issues, banks have other routes available to raise equity in the form of qualified institutions' placement (QIP) and ESOP. Boards of PSBs need to explore all the feasible options to raise equity capital.

iv. Providing tax incentive to investors' on investments in banks' Tier 1 bonds like tax exemption of interest income(in part or in full) with a view to promoting and deepening the market for these bonds may be useful at this stage;

v. PSBs may issue non-voting equity shares to the public thereby while the Government can hold less than 51 per cent of the total equity shares, it can still maintain at least 51 per cent voting rights of the total voting equity;

vi. Similarly, the option of issuance of differential voting equity could also be considered. These issuances will allow the Government to maintain their voting rights at the desired level even though there may be a dilution in the economic interest, i.e., in terms dividend income to the Government;

vii. The Government's stake in PSBs can be diluted below 51 per cent in conjunction with certain protective rights given to the Government by amending the respective statutes governing PSBs;

viii. In this connection, the proposals of the Committee to Review Governance of Boards of Banks in India (Nayak Committee) to transfer the Government's shares in PSBs to an investment company viz., Bank Investment Company (BIC), reduce Government stakes in PSBs to less than 50 percent and provide more autonomy and professionalism to PSBs which are expected to improve the returns on equity and attract more capital from the market apart from reducing provision requirements, etc. are worth serious consideration; and

ix. As regards distressed banks in private sector, Nayak Committee has also recommended that private equity funds, including sovereign wealth funds be permitted to take a controlling stake of 40 percent.

Asset quality

13. During the quarter ended December 2013, banks collectively held loan provisions of about Rupees one lakh crores, an increase of 13 percent over the year, indicating that loan asset quality of banks in India deteriorated considerably The trend of y-o-y growth in gross non-performing advances (GNPA) outstripping the y-o-y growth of advances, that started from the quarter ended September 2011, continues although the gap in the growth rates is narrowed[5]. The PSBs continued to register the highest level of stressed advances at 11.3 per cent of the total advances as at end March 2014, followed by the old private bank at 5.8 per cent. Though agriculture sector showed the highest GNPA ratio the industry sector showed distinctly high level of restructured standard advances, resulting in the stressed advances of the industry sector reaching 15.6 per cent followed by the services at 7.9 per cent as at December 2013. There are five sub-sectors, namely, infrastructure {which includes power generation, telecommunications, roads, ports, airports, railways (other than Indian Railways) and others infrastructure}, iron and steel, textiles, mining (including coal) and aviation services had significantly higher level of stress and thus these sub-sectors/segments were identified as "stressed" sectors in the banks' lending portfolios. The share of these five stressed sub-sectors to the total advances of the SCBs is around 24 per cent. Infrastructure has the highest share at 14.7 per cent in the total advances. Among the bank-groups, these five sub-sectors have the highest share at 27.3 per cent in the case of PSBs.

14. It is widely accepted that the economic slowdown has affected the asset quality of banks adversely though the impact is not similar across bank groups. Sector-wise and their size-wise analysis of asset quality shows that the GNPA ratio of PSBs across the sectors and their size are significantly higher than the other bank-groups. How do we face up to the challenge of deteriorating asset quality of banks? Though analysts have often pointed out that the poor asset quality of the banks, to a great extent, could be attributed to the not so

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[5] The system level gross non-performing advances (GNPA) of SCBs as percentage of total advances, declined to 3.9 per cent in March 2014 from 4.2 per cent in September 2013.The net non-performing advances (NNPA) as percentage of total advances, also declined to 2.0 per cent in March 2014 from 2.3 per cent in September 2013. This improvement in asset quality was due to the lower slippage of standard advances to non-performing and a seasonal pattern of higher recovery and write-offs that generally take place during the last quarter of financial year. The stressed advances of SCBs also declined to 9.6 per cent of total advances as at end March 2014 from 10.2 per cent of September 2013. This improvement in the asset quality was observed across all the bank-groups.

encouraging macro-economic situation, it is expected that the implementation of the new initiatives by the Central Government would address these issues effectively. Skeptics, though may still point out at factors, such as, the threat of *"El Nino"* which could result in poor monsoon, global developments, such as, quantitative easing, etc. and geopolitical risks, could threaten the performance of banks in India. It is also true that even when general economic outlook is healthy, the asset quality of banks could still suffer due to inadequacies in credit management. There are no short cuts for proper credit appraisals and monitoring. Recognising early warning signals and taking timely measures to take care of the weaknesses observed are very important.

15. The Reserve Bank, on January 30, 2014, has issued a "Framework to Revitalise the Distressed Assets in the Economy", wherein banks would recognise at an early stage the stress in their assets and take prompt steps towards resolution/ recovery of distressed assets and detailed guidelines in this regard were issued on February 26, 2014. The Framework has identified certain structural impediments in the way of smooth resolution/recovery of stressed assets of banks and suggested steps, such as, revamping the SARFAESI Act, revitalizing DRTs, etc. and rejuvenating Asset Reconstruction Companies, are also being mooted.

16. The Reserve Bank of India has set up the Central Repository of Information on Large Credits (CRILC) to collect, store and disseminate data on all borrowers' credit exposures including Special Mention Accounts (SMA 0, 1 & 2) with aggregate fund-based and non-fund based exposure of `50 million and above. The CRILC has started disseminating information on large credit which will reduce credit information asymmetry and improve informed credit decision making by banks. Banks will be able to know large common exposures and build-up of leverage in the system. Banks will have access to asset classification of individual large exposures by different banks. Banks are required to activate the Joint Lenders Forum for initiating corrective actions when a lender reports a borrower as SMA2 to CRILC. We have engaged with banks to avoid delay in submission of data and ensure quality and integrity of data. It is expected that once it stabilizes, the CRILC framework would exert moral pressure/discipline on large borrowers to repay dues in time lest their names appear in SMA2 report and bank managements would be better equipped to assess the health of their high value credit portfolio for initiating timely action.

Governance

17. As mentioned earlier, Nayak Committee has made some major observations regarding governance aspects of banks in India, especially that of PSBs. According to the Committee, there is a need to upgrade the quality of board deliberation in PSBs to provide greater strategic focus. Further, there are seven themes which appear critical to their medium-term strengths comprising Business Strategy, Financial Reports and their Integrity, Risk, Compliance, Customer Protection, Financial Inclusion and Human Resources. All other items for discussion should be brought to the Boards by exception and should typically be discussed in committees of boards. It is added that, among these seven themes identified for detailed board scrutiny, predominant emphasis needs to be provided to Business Strategy and Risk dimensions. Further, the Committee is of the view that as the quality of board deliberations is sensitive to the skills and independence of board members, it is imperative to upgrade these skills in boards of PSBs by reconfiguring the entire appointments process. Otherwise it is unlikely that these boards will be empowered and effective. For this, the Government has to move towards establishing fully empowered boards in PSBs, solely entrusted with the governance and oversight of the management of the banks. The proposed BIC, which is expected to hold the shares of the Government in PSBs, should commence the process of professionalising and empowering bank boards by reconstituting them and this in turn would help to improve the corporate governance in a big way. As per the recommendations of the Committee, eventually in phase III, all ownership functions would be transferred by BIC to the bank boards. The appointments of independent bank directors and whole-time directors (including the CEO) would become the responsibility of bank boards.

Equally important from PSBs point of view would be the quality of the top management particularly from the points of view of experience, expertise & continuity. While professionalization and effectiveness of boards of PSBs emerged as a major challenge, it is no less as issue with many private sector banks, say for example, when there is domination of prominent shareholders/CEOs. Private sector banks also need to focus on the skill-set and profile of their top management and the board of directors.

Risk management system in banks

18. The design of risk management functions should be based on size, complexity of business and the quality of MIS. The banks should have the necessary skill set available or develop it through proper in-house capacity building. Banks, therefore, will need to refine and re-orient their risk management skills for enterprise-wide risk management. In addition, banks need to have in place a fair and differentiated risk pricing of products and services since capital comes at a cost. This involves costing, a quantitative assessment of revenue streams from each product and service and an efficient transfer-pricing mechanism that would determine capital allocation. Generally it is observed that some banks put the risk management architecture in place to meet the regulatory requirements without using the risk inputs for taking business decisions. The risk is not properly priced for various products. The most challenging part is the integrity and reliability of data. It must be appreciated that Risk Based Supervision (RBS) under which all the banks will be covered by the Reserve Bank over a period of time (28 banks were under RBS last year) is highly data intensive. The risk profile of a bank, its rating, and most importantly, the computation of supervisory capital which are the outputs of RBS are determined on the basis of data and other qualitative information furnished by the banks. It may be remembered that supervisory findings also go towards formulation of regulatory guidelines and other macroeconomic policies. It is, therefore, the responsibility of the top managements/Boards of the banks to ensure that this area is given utmost attention.

HR management

19. This is an area where most of our banks, especially the PSBs, are found lacking. In their eagerness to expand their core business they tend to forget the relevance of human expertise which drives their business in a sustainable manner. The complexities of modern banking and the dependence on IT makes it all the more important why the banks should have requisite manpower with right amount of knowledge and experience at appropriate places. Many of the present day ills in Indian banks, e.g., weak appraisal standards, not being able to pick up the early warning signals in problem accounts which leads to fraudulent transactions or accounts becoming NPA, recurring customer grievances, etc. can be ascribed to skill gaps in the manpower of the banks. Near vacuum in the senior management over the next few years, lack of expertise in critical areas like IT, risk management, credit appraisal and treasury operations, absence of succession planning for middle and senior management positions, attracting, retaining and nurturing fresh talent, ad hoc responses to capacity building and poor performance management system are some of the major HR challenges staring the PSBs. The proposal of universal and differentiated bank licenses being available on tap will make it tougher for PSBs to retain whatever skilled manpower is available with them. In respect of private sector banks, the problem in many cases relates to the work culture focussing unduly on achieving unrealistic targets by all means. This implies certain aversion towards employment in such banks and could have serious reputation risk implications for them.

Challenges from the payment systems perspective

Financial inclusion through the payments route

20. Leveraging technology enabled payment system for electronic transactions provides challenges and opportunities to the banks by expanding outreach in terms of expanding customer base, offering multiple product choices, achieving cost efficiency, providing assurance in terms of standardization, safety and safety. Despite the impressive growth in the volume and value of electronic transactions the same is concentrated in metros and big cities, thus widening the digital divide. This imbalance is reflected along various parameters, be it the deployment of ATMs, or the POS infrastructure, mobile banking services, etc. Needless to state, the vision of financial inclusion, aided through the payments path, cannot be achieved unless the rural and semi-urban areas find an equal footing in the policy horizon for banks.

21. While the ultimate goal is to migrate most of the payments to electronic mode, we cannot lose sight of the reality that large segment of population is still dependent on cash for day-to-day requirements. The lop-sided development of infrastructure mentioned above also contributes to this challenge. Hence, from a perspective of achieving inclusive payment system, it is also necessary to facilitate remittance and cash-handling requirements of a large segment of society, particularly the migrant population, The Reserve Bank has already put in place the policy framework under the Guidelines for Domestic Money Transfer (DMT) and now it is up to the banks to take this forward. Towards this end, experiments like "Cardless cash withdrawal" for the unbanked is gaining ground. We have recently given in-principle approval for two entities to take this service forward. Of course, for this to gain traction, active participation of and promotion by banks would be imperative as the delivery channels envisaged in these models are the ATMs and Business Correspondents (BCs).

Standardisation and capacity build-up

22. While any development in offering electronic services is welcome, stand-alone systems not only work in silos but also fragment the market to some extent. Hence, as the payments eco-system matures, inter-operability becomes essential, for which standardization in processes and procedures is a pre-requisite. This not only facilitates uniformity in transaction handling but also enables uniform customer experiences. A related point is that of ensuring that systems are not just adequate to meet present needs but also the growing volumes. Hence, even as the Reserve Bank is building capacity in the systems operated by it (for instance, the RTGS or NEFT), it is equally important for banks to review and upgrade their own infrastructure as well in tune with their policy and expected growth in business.

Partnerships with non-banks

23. Even as we have adopted a bank led model for achieving the goal of financial inclusion, opportunities have been given to the non-banks to involve themselves in payments area – whether it is through the BC, White Label ATMS (WLAs) or pre-paid card routes. In many of these areas, non-banks need to work in close coordination with banks. It is imperative that banks also see the potential for synergetic growth by partnering with these non-banks and leveraging on their strengths so as to reap efficiency gains for both the entities; a case in point is bank-MNO partnership for expanding mobile banking space. We have seen instances of such partnership, particularly with MNOs acting as BCs. Similar developments should occur in other areas too. A word of caution is, however, essential – banks cannot abdicate their responsibilities towards customers, in ensuring safe and secure services, particularly in scenarios where a large part of the activities involved in payments are outsourced. In some context, we have also observed concentration in a few service providers and banks should take cognizance of this.

Safety and security of payment transactions

24. Last but not the least is the consideration towards safety and security of payment transactions. This goes a long way in influencing customer behavior in the choice of payment methods. While the Reserve Bank has mandated many requirements to strengthen security and enhance risk mitigation standards for the electronic transactions, it is essential that these are implemented not only in letter but also in spirit. Further, with the increased volume of transactions, the need for Straight Through Processing (STP) becomes essential. Hence, while catering to large volumes, certain procedural changes would need to be made. For example, there is the requirement under NEFT and RTGS where the credit is afforded to the beneficiary customer's account solely on the basis of the account number given in the remittance request by the sender. While the intention behind this policy is to facilitate easier handling of growing volumes at banks through STP, the risk-based approach to handle customer grievance should not be lost sight of and banks should also seek to proactively address of the payee and redress customer issues emanating from such electronic transactions. Customer as well as frontline staff awareness and education is crucial in ensuring not only acceptability of the payment products but also their assurance in terms of safety and security.

Concluding thoughts

25. Finally, let me conclude by highlighting that the challenges facing banks as they gear up to the task of funding an economy, aspiring to become a middle-income country in the years to come, are known knowns. But the known unknown is how the banks will be able to adapt to the evolving situation and come on top of it. What compounds the matter further is the fact that Indian banks have to operate in an increasingly globalised environment, because of which there will be many factors – regulatory, technological, cross-border financial flows impacting them over which they may not have any control. In particular,

i. Will the banks be able to mobilise required amount of capital from the market for meeting their current and future business growth and prudential requirements?

ii. Will banks be able to understand the varied and dynamic requirements of its diverse set of clientele and devise customised products?

iii. Will banks be able to do so in a cost effective manner?

iv. Will banking be able to attract and retain skilled manpower and leverage them for both for business growth and risk mitigation without sullying their image as responsible and responsive employers?

v. Will banks be able to enlarge their outreach in terms of customer base and product choices by leveraging technology enabled payment systems in affordable, accessible, acceptable and assured manner?

I am sanguine that in trying to respond to these and the related questions Indian banks will be able to find ways to convert the challenges into potential opportunities to redeem their mandate of serving the real economy in an efficient manner. The Reserve Bank, for its part, will continue to endeavour to ensure an enabling regulatory framework that can act as catalyst in the process. I wish the conference all success.