Evolution of Banking

Challenges and Opportunities

Global Scenrio

Why do we need Banks

- **Lifelines of the economy**
- **Play a catalytic role**
  - **activating & sustaining economic growth**
- **Significant in developing countries like India**
- **Essential pre-requisite in the quest for growth**

Let us first understand the concept of GLOBALISATION

The concept of Globalisation infers that the globe is a single unit which functions as one when it comes to decision-making. In other words, Globalisation implies the free movement of goods, services and capital throughout the world.

- Globalisation involves the opening up of national economies to global markets.
- It involves increasing interaction and integration of national economic systems.
- This leads in turn to growth in international trade, investment and capital flows.

There is a rapid increase in cross-border social, cultural and technological exchanges because of the phenomenon of globalisation.

- With the advent of instantaneous communications, knowledge, trade and culture is being shared around the world simultaneously. This has resulted in an increase in international trade, investment and capital flows.

- Due to Globalization, all important institutions like the nation, state, family, work, services, trade, leisure, culture, knowledge etc. are changing. As a result of this, life styles of people throughout the world are also changing, making the world a single unit when it comes to decision making.
- The middle and late 90s witnessed great innovations in financial reforms, restructuring, convergence globalization etc. accompanied by a rapid revolution in communication technologies.

- Moreover, a major development was the evolution of the "convergence" of computer and communication technologies, such as the Internet, mobile / cell phones etc.

- Next , the arrival of foreign and private banks with their superior, sophisticated technology-based services forced Indian Banks also to follow the same by going in for the latest technologies so as to meet the threat of competition and retain their customer base. This also brought in revolutionary products and services which have been orchestrated by the Indian Software Industry.

- Today, the entire banking sector has undergone a restructuring during recent years as a result of recent developments. New technologies have added to the competition
- The financial market has turned into a buyer's market.
- Banks are also coping and adapting with time and are trying to become one-stop financial supermarkets.
- The market focus is shifting from mass banking products to class banking with the introduction of value added and customised products.

- Customised banking products, such as Investment Advisory Services; photo-credit cards; cash Management services; Investment products and Tax Advisory services have been introduced by a few foreign and private sector banks. A few banks have gone in to market mutual fund schemes
- The bank of the future has to be essentially a marketing organisation that also sells banking products
- **Advantages for Corporates**
- Corporates are deriving profits from the increased variety of products and competition among the banks. Certificates of deposit, Commercial papers, Non-convertible Debentures (NCDs) that can be traded in the secondary market are gaining popularity.
- Market has also seen major developments in treasury advisory services. With the introduction of Rupee floating rates for deposits as well as advances, products like interest rate swaps and forward rate agreements for foreign exchange, risk management products like forward contracts, option contracts and currency exchange are offered by almost every authorised dealer bank in the market. This list of services is still growing.

- Unfortunately, several concerns related to the banking sector still remain. The chief among these is the matter of ownership and control. India will be forced to apply the norms of developed countries to the Banking Industry. Else, Indian banks (including some of the biggest) will show very poor return ratios.
- Thus, it becomes imperative that the Banking Industry should streamline itself and become more compatible with global norms in the fields of operation and services
- Indian Banks have huge financial resources at their disposal. We started with aggregate deposits of about 5000 Crores in the Sixties which increased to 10 Lakh Crores this millennium. This denotes a 200-hundred-fold growth in three decades.

- A major tool which we have at our disposal is our knowledge capital-something which is being grossly under utilized currently. This is an extremely valuable type of capital.
- In banking we are short of intangible assets. Our knowledge capital is quite crucial to the success of banking in India. This we cannot garner from outside; neither can we go in for a public issue to mobilise intangible assets.
- Therefore banking employees have to embrace the need for higher learning and better knowledge.
- Banking in India has immense potential given the population figures in our country. With a little effort, careful planning and timely legislation this industry can be brought on par with the best banks in the world.

Macroeconomic Landscape

- **Financial crisis of 2008**
- **Global economy continues to face rough weather**
- **Indian economy and banking – not immune**
  - **Recovery uneven; at best, moderate**
- **Financial fragilities**
- **Macroeconomic imbalances**
- **Currency and commodity prices – volatile**
  - **Threat to economic stability**
- **Highly accommodative monetary policy in advanced economies**
  - **Challenge for emerging markets like India**

Indian Banks

- **Challenging times**
- **Threat from several quarters**
- **Risk of loss of opportunities**
- **Momentum of economic growth may falter**
- **Implications for banking and economy**

Challenges for Indian Banking

- **Asset Quality**
- **Capital Adequacy**
- **LCR Framework**
- **Unhedged forex exposures**
- **Human Resource issues**
- **PMJDY and beyond**

Challenges for Indian Banking (contd....)

- Globalization of Regulation
- Technology and its impact
- KYC AML compliance
- Risk Management
- Competition

Asset Quality

- **Overall banking system resilient**
- **Continued economic slowdown**
  - **Sustained pressure on asset quality**
- **Elevated levels of non-performing assets – gross and net**
  - **Inclusive of restructured assets**
  - **Alarming statistics**
- **Level of distress not uniform across bank groups**
  - **More pronounced in public sector banks**

Asset Quality (contd.....)

- High levels of corporate leverage
- >1/3rd of India's total debt is at risk – highest among emerging economies
- Pile of bad loans > GDP of 137 countries
- RBI measures
  - Early Recognition of distress
  - Formation of JLF
  - Corrective Action Plan
  - Refinancing of Project Loans
  - Sale of NPAs

Capital Adequacy

- Ability to raise additional capital
  - Concern – public sector banks
    - Higher provisioning requirements
- Basel capital norms – risk based supervision framework
- Need to sustain and meet impending growth in credit demand
- Poor valuations of bank stocks
  - Raising equity or debt becomes difficult

Liquidity Coverage Ratio

- Started from 2015
- Objective – to reach 100% by 2019
- LCR : ratio of HQLA to Total net cash outflows
- SLR likely to be reduced going forward

Unhedged forex exposures

- Wild fluctuations in forex market
- Potential to inflict significant stress on Indian companies with overseas debt
  - Impacts repayment of forex liabilities
  - Also hampers debt repayment capability to domestic lenders
- Need to curb tendency of dollarizing debt without adequate risk mitigation
- Banks need to have robust policies for risk mitigation of unhedged forex exposures of corporate borrowers

Human Resource Issues

- Decade of retirement for public sector banks
- Loss of experienced hands
- New recruitment at junior levels
- Virtual vacuum at middle and senior levels
- Adverse impact on decision making process
  - Affects critical role in translating top management strategy into workable action plans by middle management
- Overall attrition levels on the rise – resource gaps
- Need to continuously enhance skill levels to remain viable and competitive
- Training across cadres need of the hour for sustained efficiency
- Available talent pool to keep pace with changing banking needs

PMJDY and beyond

- **What next?**
- **Individual savings accounts to be kept active**
- **Leverage on new accounts for extending productive credit**
- **Credit absorption capacity to be enhanced**
  - **Consolidation of land holdings – land reforms**
  - **Financial literacy**
  - **Vocational training initiatives**
  - **Inculcation of savings culture**
  - **Investment habit**
  - **Pension products**

Globalization of Regulation

- **Globalization** of banking
- Standardization of regulatory practices
- Standard setting bodies
- Process for peer review of regulatory guidelines
- Compliance with global standards
- Failure to adhere – non-compliant standards – specially for overseas operations

Technology & its impact

- All banks on CBS platform
- Capabilities to offer anywhere banking
- Greater need for :
  - building data warehouses
  - Data mining and
  - data analytics
- Data needs to be used for effective decision making at various levels
- Product customization
- Develop business models
- Develop new delivery channels
- Need to upscale capabilities
- Train employees ; leverage on younger recruits who are tech savvy
- Requires a change in mind-set of senior management – to give freedom to experiment

KYC/AML Compliance

- Several enforcement actions on account of violations
- Fake e-mails soliciting unsuspecting customers
- Even well-educated individuals falling prey to incredulous offers
- Spreading financial literacy – challenge
- Banks cannot be absolved of responsibilities – money transfer through banking channels
- Obviously KYC compliance is deficient
- Deficiencies also in customer risk categorization – monitoring of transactions
- Sensitization to possibility of regulatory strictures for non-compliance

Risk Management

- **Risk is an inevitable and integral part of banking business**
- **Sound risk management framework – touchstone of an efficient bank**
- **Risk-Return tradeoff**
  - **maximizing return for a given risk**
  - **Minimizing risk for a given return**
- **Responsibility of setting risk appetite at whole-bank level – Board and top management**
- **Backdrop of changing market dynamics and regulatory prescriptions**

Risk management contd...

- Cyber threats
  - Growing penetration of computers and smartphones
  - Increasing access to internet
  - Innovative fraudsters
  - Greater investment required in preventive software
  - Technology upgrades need to be timely
  - Frequent re-assessment of risk – in-house and outsourced
- Bank fraud
  - Greater incidence of bank frauds
  - Reluctance to report timely

Competition

- Dominant themes of 2017 :
  - Universal banks born in 2015
  - 10 small finance banks
  - 11 payments banks
- Competition in the hinterland
  - New products
  - Higher deposit rates
  - Lower lending rates

Changing landscape

- Bank mergers and consolidation
- State Bank group – top 50 league
  - Greater risk taking ability
  - Expands bandwidth to lend
- Microfinance industry forging alliances
  - With digital wallet service providers
  - Disbursement and collection through banking channel
  - Operational cost may come down
  - Positive impact on lower pricing of loans

Changing landscape contd...

- NBFCs changing business model – need newer products to grow
- Slump in credit growth
- Increase in stressed assets affected profitability
- Threatens very survival for some banks

Core Challenges

- Public sector banks
- Undifferentiated, sub-scale
- Limited capabilities to be full universal banks
- Limited vertical-focused specialization
- Often, compete only on price
- Shoulder a disproportionate share of social and nation-building obligations
- Inhibited in ability to attract and manage talent

Economic challenges

- Vulnerable currency
  - Crude oil prices volatile
  - Trade deficit pushing up
- Export growth momentum needs to pick up
- Capital inflows – FPI and FDI support required
  - International investors jittery
- Divergent interest rate policies
  - Fed rates rising ; RBI rates falling
- Fiscal health and macroeconomic stability

Economic challenges contd…..

- Growing divergence between consumption and investment
  - Decline in industrial investment; corporate deleveraging
- Demonetization induced reduction in consumption demand
- Disturbed capex plans of SMEs (account for 45% of Indian manufacturing sector)

What do banks need

- Freedom with capital and talent
- Greater autonomy for boards
- Thinking beyond consolidation
- Innovation from existing and new players to be encouraged
- Deliver quality at speed
- Sustainable leadership through synergy

What else can we do

- Bring more financing to healthy firms
- Non-banking channels need to be opened up
  - Capital account to be liberalized
  - NBFCs to be strengthened and regulated
  - Opening up and deepening the bond market
  - Distressed asset funds – regulatory reform needed
- Tackle disruptive technologies
- Investment in innovation

EY has suggested five specific areas to help banks for 2017.

These are short term and medium term steps to have a "keep safe" and "make things better" strategic agenda.

Top three reshape priorities – all banks

43%

Simplifying/restructuring business operations or legal entities

39%

Developing partnerships with industry disruptors/ FinTech companies

24%

Developing partnerships or joint ventures with other financial organizations

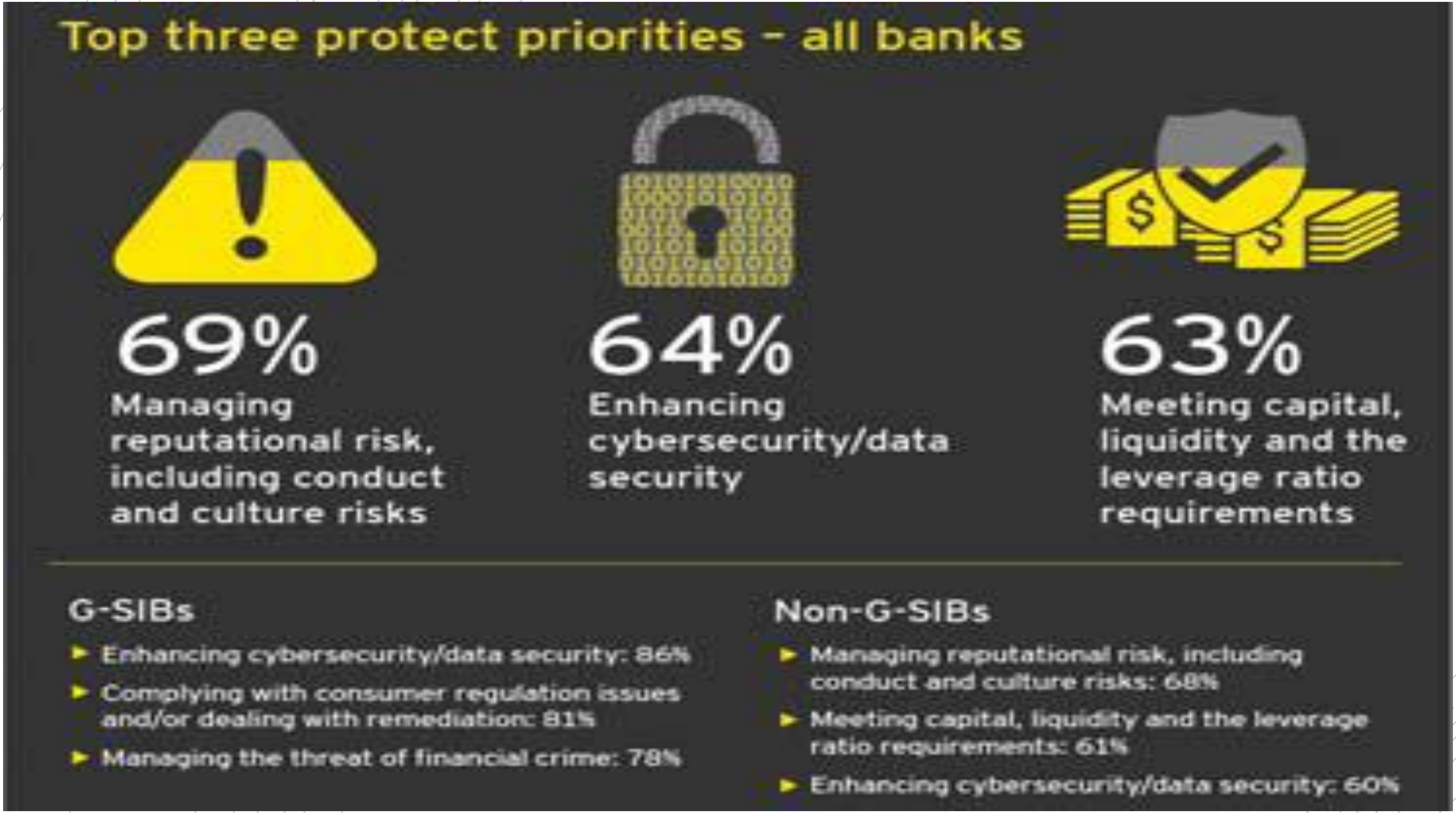
G-SIBs

- Developing partnerships with industry disruptors/FinTech companies: 68%
- Simplifying/restructuring business operations or legal entities: 64%
- Collaborating with peers to develop industry utilities: 41%

Non-G-SIBs

- Simplifying/restructuring business operations or legal entities: 40%
- Developing partnerships with industry disruptors/FinTech companies: 33%
- Developing partnerships or joint ventures with other financial organizations: 24%

Top three control priorities – all banks
66%
Meeting regulatory compliance and reporting standards
57%
Meeting tax compliance information reporting requirements
54%
Improving risk management
G-SIBs
Meeting regulatory compliance and reporting standards: 74%
Meeting tax compliance information reporting requirements: 74%
Improving risk management: 62%
Non-G-SIBs
Meeting regulatory compliance and reporting standards: 65%
Meeting tax compliance information reporting requirements: 54%
Improving risk management: 52%


Top three protect priorities – all banks
69%
Managing reputational risk, including conduct and culture risks
64%
Enhancing cybersecurity/data security
63%
Meeting capital, liquidity and the leverage ratio requirements
G-SIBs
► Enhancing cybersecurity/data security: 86%
► Complying with consumer regulation issues and/or dealing with remediation: 81%
► Managing the threat of financial crime: 78%
Non-G-SIBs
► Managing reputational risk, including conduct and culture risks: 68%
► Meeting capital, liquidity and the leverage ratio requirements: 61%
► Enhancing cybersecurity/data security: 60%

Top three optimize priorities – all banks

63%
Optimizing customer channels (digitization and focus on self-serve)

62%
Strategic efficiency and cost reduction

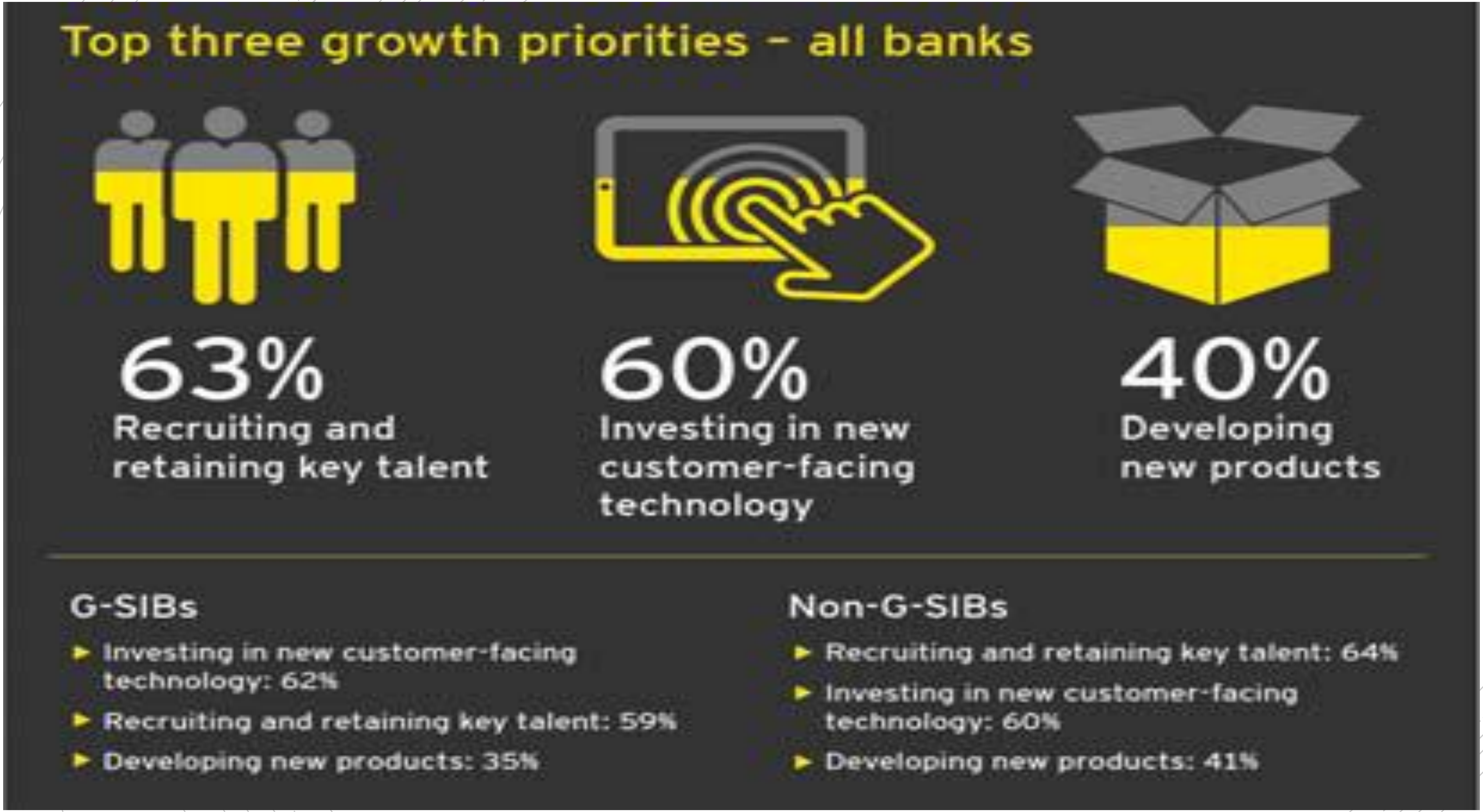
56%
Leveraging new technologies for efficiency (e.g., robotic automation)

G-SIBs

- Optimizing customer channels: 74%
- Rationalizing physical footprint: 63%
- Strategic efficiency and cost reduction: 62%

Non-G-SIBs

- Strategic efficiency and cost reduction: 62%
- Optimizing customer channels: 60%
- Leveraging new technologies for efficiency (e.g., robotic automation): 56%



Top three growth priorities – all banks
63%
Recruiting and retaining key talent
60%
Investing in new customer-facing technology
40%
Developing new products
G-SIBs
► Investing in new customer-facing technology: 62%
► Recruiting and retaining key talent: 59%
► Developing new products: 35%
Non-G-SIBs
► Recruiting and retaining key talent: 64%
► Investing in new customer-facing technology: 60%
► Developing new products: 41%

SOME CURRENT INTERESTING GLOBAL FACTS

International banks continue to grow their assets as the world economy expands. If no major economy falters, the expansion may continue.

Question - Which nation is home to the largest banks in the world?

International banking has created some of the largest businesses in existence. As the world economy moves forward, these banks will be significant players on the world stage.

International banks continue to grow their assets as the world economy expands. If no major economy falters, the expansion may continue.

Question - Which nation is home to the largest banks?

Answer – It is **CHINA**.

Important - The power in banking is unquestionably shifting eastward to China.

Out of the top 10 largest banks by assets, China holds the top four slots.

International banking has created some of the largest businesses in existence. As the world economy moves forward, these banks will be significant players on the world stage.

What Arab leaders could learn from Banks

Arab world is in upheavel. There are long running conflicts in Syria, Libya and Yemen. However Tunisa and Egypt are exceptions.

The failings of political leadership did not extend to the banks.
Reason being, during the good years they built up their capital positions, introduced new risk framework and strengthened their Balance Sheets.

Today they are reaping the benefits. In an environment of lower oil prices and elevated political risks, regional banks are a pillar of strength.

This is because of long term vision, hard work and recognition that difficult choices have to be made even when times are good.

EU's Single Resolution Mechanism (SRM)

Recent banking troubles in Europe have exposed significant inadequacies in the EU's SRM.

It essentially says that losses might be imposed on depositors and that only under special circumstances can deposits be left completely off the table.

There was a large scale bank run on Banco Popular in Spain. There was liquidity crisis, It was bought by Banco Santander for 1 Euro.

<u>Poland's popularity with investors</u>

Poland is attracting a lot of FDI through Special Economic Zone

Recently Rolls Royce came with new plans to invest in Poland – a joint venture with Safran Transmission Systems.

Why do businesses go to countries that are far more democratic and are dictatorial? It is because of the skilled labour force that they are interested in coming to Poland.

Point to be added here – Post Brexit, financial institutions like CITI, UBS, Credit Suisse have moved some functions to Poland from London. Along with skilled labour, low taxes and provision of good environment are other factors attracting investment and financial institutions.

What should the future be like

Digital Banking

Changing customer expectations in the digital age are forcing banks to rethink their strategies.

Customers are expecting a more intimate relationship with their bank and require a unique and compelling experience.

Expectations are shifting to instant, 24/7 contact through digital channels, which includes more personalized products and services as well as real-time insights.

One of the largest banks in Israeli has launched a digital bank, with no branches and 100% free - no checking account fees. With higher expectations from both corporate/ institutional and consumer clients, the need to provide a next-generation digital banking experience becomes a strategic necessity.

IoT

The Internet of Things (IoT) is a significant technological transformations on the horizon, with many already claiming that we are entering the second major digital revolution.

Analysts at an American research and advisory firm predict there will be 25 billion smartphones, smartwatches, wearables, connected cars and other connected devices by 2020.

Retail banks have actually been using an early prototype of an IoT device for decades: the automated teller machine (ATM). Since their widespread adoption, ATMs have been one of the top IoT devices that make banks far more efficient by removing the need for long wait times to see a teller at a brick-and-mortar bank.

A large public sector bank recently had introduced RFID-enabled banking cards whereby a branch/relationship manager can identify a valued client entering a branch with the card.

Similarly, one of the largest private sector banks in India has tied up with Indian start-up for an IoT based smart asset management solution.

Artificial Intelligence –from sci-fi to reality

Artificial intelligence (AI) and Cognitive technologies have the potential to transform both front office and back office Operations.

One of the largest Indian MNC bank has deployed software robots across 200 business process functions, reducing the response time to customers by up to 60%.

Robots have been deployed last year to support the branch staff at two large Indian banks. These robots can cost anywhere between Rs 7-8 lakhs and are equivalent to 3-4 FTE.

Last year an Indian MNC bank had launched its voice recognition service where customers are no longer are required to enter their card numbers, PIN and answer security questions to authenticate themselves

Their voice will now act as the password for banking transactions through the call-center

The voice recognition technology works on voice prints, which are unique to an individual

Thank You