March to the New Millenium by Indian banks *

It gives me great pleasure to be in the midst of this august gathering assembled here for felicitating the great personalities who have been conferred with the Bank of India Excellence Awards for 1999. I consider it a great privilege to present the Awards for Excellence to the doyens in their respective fields. I extend my heartiest congratulations to the awardees.

Bank of India is one of the oldest Indian Commercial Banks having commenced its business in the then Bombay Presidency on this day in the year 1906 and would be performing its centenary year celebrations in seven years hence. I am sure it would continue to strive to achieve excellent performance in all core areas of business befitting a century old bank. Being an early bird of the Indian banking industry, it has been a pioneer in many areas, including in the matter of opening overseas branches, with 19 branches spread over 10 countries and in almost all the important financial markets around the globe. It is but natural for a bank of this heritage and moorings to be in the forefront in bestowing recognition to those who excel in the various fields of the Indian society.

The awards function instituted as part of Golden Jubilee celebrations of Indian Independence, I learnt, is taking place for the second year in succession. I also note the consistency in the selection of most appropriate personalities selected by eminent panel, with one of the inaugural year awards conferred on His Excellency the Governor of Andhra Pradesh and former Governor of Reserve Bank of India, Dr.C.Rangarajan, for Excellence in the field of Finance. It is in the fitness of things that awards for excellence in finance is being conferred on Shri Y.H. Malegam, my distinguished colleague on the Central Board of Directors of Reserve Bank of India and a Member of the Board for Financial Supervision. I can proudly state in the light of my close association with Shri Malegam and the valuable contributions made by him through his association with various Committees in the financial sector that the award of exellence is in fact honoured by being conferred on him.

The Indian Institutes of Technology have been providing brilliant technocrats who have brought glory to India by excelling in various fields of business not only in India but also around the world and continue to be the mainstay of trained manpower in many of the industrialised nations. Both Shri Vijay Thadani and Shri Rajendra Pawar who are alumni of IIT, Delhi have gone around with unstinted zeal to promote and build NIIT, which is in the forefront in providing IT related training to a large number of Indian students, besides making sizeable inroads into the software development and exports. They thus richly deserve the awards for excellence in the field of Management.

Of late, a lot is talked about business and product related literature in the banking industry. I understand that Poet Shri Arun Kolatkar, who is conferred the Award for Literature excels in more than one language and represents a synthesis of varied cultures. I convey my hearty congratulations to him.

Shri Sham Lal is the well known media personality, particularly to those addicted to one of the country's leading dailies, Times of India. As an erudite writer, he has been famous for many of the forthright editorials during his tenure with that Newspaper. He is an excellent communicator and richly deserves the Award for excellence in the field of Media.

For a banker to unwind after a hard day amidst the financial cross currents of the Mumbai Market, Music and Arts are the soothing balm for diversion and relaxation. I am happy to note that Bank of India has not overlooked this important aspect and instituted an award for this field. I congratulate the Great Painter and Film Maker, Shri Akbar Padamsee on his being conferred the Award for excellence in the field of Music and Arts.

I am rather tempted to use this forum for saying a few things on some of the important issues on which I am concerned as a Central Banker. I also firmly believe that Indian banks have to address these aspects at the earliest if they desire to excel in performance and march towards the new Millenium as sound financial entities. With your forbearance and permission, I would like to briefly dwell on some of these concerns.

India is one of the few countries which could remain least affected by the contagion effect of East Asian financial crisis, but could learn a lot from the follies of others. In this connection I am inspired by the recent address of Governor, Reserve Bank of India, Dr.Bimal Jalan on the occasion of the 49th Anniversary Lecture at Central Bank of Sri Lanka at Colombo on the theme entitled International Financial Architecture: Developing Countries' Perspectives. To quote, the Governor declared

"The East-Asian crisis has also demonstrated the vital importance of financial institutions in sustaining the momentum of growth and development. It is no longer possible for developing countries to delay the introduction of strong prudential and supervisory norms, and introduce structural reforms in order to make the financial system more competitive, more transparent and more accountable."

After the Asian crisis, one of the important steps initiated by BIS was to set up the Willard Group which went into the ways of evolving a strong and transparent financial architecture. Its recommendations centred essentially around creation of well designed financial infrastructure backed by an efficient payments and settlement system. It has also been recognised that key elements of such a structure would need a proper legal and judicial framework, good corporate governance, comprehensive uniform accounting standards and an effective system of internal control and independent audits. The structure also pre-supposes a good market discipline which would in turn depend on good credit culture, in other words low level of NPAs, well developed equity and debt markets with variety of instruments of risk diversification. The Group also stressed that a strong regulatory and supervisory framework is an essential prerequisite to guard such a strong and transparent financial architecture.

Further BIS has recently circulated a consultative paper on new capital adequacy frame work suggesting risk weighting of assets which crosses in some cases even beyond 100 per cent of assets. The revised capital adequacy norms are expected to be in place over next 2 to 3 years which would cast the responsibility on regulators to prescribe new norms for compliance. Banks with overseas operations would be under pressure to adapt themselves to the new norms at a much faster pace than those with domestic operations. RBI has adopted the Core Principles for Effective Banking Supervision suggested by Basel Committee and most of the recommendations have been implemented. The few areas remaining to be fully implemented relate to cooperation between different regulatory agencies, introduction of risk management systems and consolidated supervision for banks and their related entities.

Narasimham Committee (II) on Banking Sector Reforms has supplemented the BIS core principles suggesting adoption of prudential norms on par with the international standards. RBI is working out further improvements to the prudential norms particularly relating to asset classification and provisioning standards. Some of the futuristic measures would entail prescription of higher provisioning for sub standard assets, over the present level of 10% in a phased manner, and bringing down the period for recognizing doubtful assets from the present norm of 18 months to 12 months.

Keeping in line with the emerging regulatory and supervisory standards at international level, RBI has initialised some of the macro level monitoring techniques to assess the true health of the supervised institutions. The formats of balance sheets have been prescribed by RBI with disclosure standards on vital performance and growth indicators, provisions, net NPAs, staff productivity, etc appended as Notes to accounts. To bring in further transparency in the banks' published accounts, RBI has also advised the banks to disclose data on movement of NPAs and provisions. These proposed additional disclosure norms would bring the disclosure standards almost on par with the international best practices.

Other countries have been gradually moving towards risk based supervision for which the important precondition is existence of adequate internal controls. Besides the various guidelines issued for strengthening concurrent audit of key business areas and internal audit set-up in banks, RBI is examining the feasibility of introduction of half yearly audit of accounts by external auditors towards improving the quality of auditing standards further.

RBI has instituted a mechanism for critical analysis of the balance sheet by the banks themselves and place such analysis before their boards to provide an inner feel of the health of the bank. The analysis which is made available to RBI forms a supplement to the already stabilized system of off site monitoring of banks.

While RBI had prescribed the ALM system in respect of overseas branches of Indian banks for over almost a decade, it has since introduced ALM reporting system commencing from this year in respect of domestic operations keeping in view the immediate need for such a system in a free interest rate regime prevalent in India. It may also be mentioned that the banks of late are moving from traditional credit related business to investment banking. Substantial expansion of non SLR investment portfolio of banks particularly in unquoted category in the last two years has brought in the need for adoption of better risk management and risk evaluation. In conformity with the BIS core principles and to keep pace with evolving international standards requiring banks to cover their risks, in addition to traditional credit risk, against all types of other market risks like, liquidity, interest rate, and forex as well as legal and reputational risks, RBI has finalised Risk Management guidelines which would be issued to banks shortly.

The banks in India which grew by leaps and bounds by increasing their branch network have to seriously think on consolidation and reorganisation of such net work by enforcing on stricter reporting system and head office controls over the branches. Control over such a large network of branches would require extensive use of Information Technology. It may be mentioned that to bring in better internal controls and monitoring standards for sensitive transactions, the Central Vigilance Commission has directed that at least 70% of a bank's business should be computerised by January 1, 2001. Such infrastructure upgradation along with early adoption of asset liability management system and risk management guidelines would facilitate Indian banking to migrate to better operational standards on par with global ones, and enhance their MIS capabilities for optimisation of earnings.

It has come to be widely accepted both in India and internationally that the banks have to reorient their policies, practices, procedures, products and clientele in tune with the changing global environment and at the same time conforming to their core competencies. Globally the bank mergers are taking place not by acquisition of weak ones by stronger institutions but among equally strong institutions. You may find contradictory objectives behind such consolidation, in some cases to expand the reach and coverage through retail banking and equally in some cases in pursuit of investment and wholesale banking, treasury services and such other activities which may not necessarily fit into the accepted tenets of banking business in the traditional sense in which it is understood. The objective of such mergers were more for synergizing strength of the respective institution in the new merged entity and at the same time leaving out those areas which are not considered as relevant for maximizing profits and expansion of assets.

In order to take advantage of these trends in the global arena, Indian banking system has to seriously think towards such consolidation in tune with the recommendations of Narasimham Committee. This will also pave the way for realisation of the concept of Universal Banking.

The banks even the strong ones should learn the art of shedding some of the non profit making subsidiaries which in many cases have proved to be a drag on the profits and operational efficiency of the parent banks, in some cases making even the stronger ones to flounder. I commend serious thinking on these lines by Indian banks.

In the same context, restructuring of some of the weak public sector banks is already being looked into by the Verma Committee, the expert group constituted by RBI for this purpose. The Committee would shortly come out with specific measures to put these banks on proper rails.

There are 24 old private sector banks. Though many of them report adequate CRAR in the context of comparatively low level of riskweighted assets, as many as 11 banks have capital funds less than the entry norm of Rs.100 crores prescribed for new banks. These banks have poor IT network and processing capabilities. They are also short of capital resources to go for upgradation of their operating levels. This had inhibited their growth in recent times particularly in the context of changing business environments and need for adoption of new products and strategies calling for massive deployment in infrastructure and IT skills. Some of the newly established private banks with their initial capital resources invested in such infrastructure have overtaken the old established private banks both in business volumes and quality of operations and in fact are as highly competitive as foreign banks.

Some of the old private banks are already showing signs of fatigue because of their traditional style of functioning and are not equipped to face competition. The fear of losing control over the management has made the promoters in some of these banks not to go in for public issues in adequate quantum, which is considered as very essential for their future survival. Such banks are advised to see the writing on the wall, take stock of their strengths and deficiencies and seriously work towards mergers in order to become future viable entities.

Globally many of the central banks are trying to evolve measures for restructuring the non-performing assets of their banking system, which are showing a rising trend. We at RBI are equally concerned at the increasing trend of incremental NPAs of the banking system and more particularly in respect of public sector banks. Though there has been a marginal decline in the percentage of gross and net NPAs as at the end of March 1999 over the previous year, the increase by way of incremental NPAs over the last few years calls for immediate corrective steps on the part of banks for improving the recovery performance.

RBI has come out with detailed indicative guidelines for compromise settlement of chronic NPAs in respect of small sector and the banks have been advised to have such proposals expeditiously processed and settled through Settlement Advisory Committees formed at regional as well as head office level. I would like to exhort my banker friends to adopt such transparent procedures in respect of other borrowers as well.

It is my earnest desire that the banks should make extensive use of the mechanism of Debt Recovery Tribunals particularly in pursuit of large wilful defaulters. I am aware of the legal impediments in effective enforcement of recovery procedures and RBI is separately pursuing for the legislative enhancements and improvements.

The banks have to resort to serious cost cutting measures and avoid all non productive expenditure so that they continue to remain as profit making entities. Besides controlling the interest expenditure, the non interest expenditure should be firmly controlled along with other overheads.

While concluding my observations, I would like to reiterate that for a successful march towards the New Millenium, which is going to be dominated by technology, the banks in India will have to improve their quality of assets by vigorous pursuit of better credit appraisal skills and treasury management, recovery procedures, adopt new technologies and diversify their product range. This calls for cost cutting measures, motivation and upgrading skills of staff, concentration on core business competencies, augmentation of own funds through approach to market as well as by retained earnings through improved profits, consolidation of existing business and branch network, and tightening of internal control and transparency in their operations.

I would like to thank the organisers of the Awards function for giving me an opportunity to share my thoughts with some of the most distinguished of the financial sector who have graced this occasion.

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* Address by Shri S.P.Talwar, Deputy Governor, Reserve Bank of India on the occasion of Awards function of Bank of India Awards for Excellence on September 7, 1999