

## *Statement by Dr. Raghuram G. Rajan on taking office on September 4, 2013\**

Good Evening. I took charge this afternoon as the 23rd Governor of the Reserve Bank of India. These are not easy times, and the economy faces challenges. At the same time, India is a fundamentally sound economy with a bright future. Our task today is to build a bridge to the future, over the stormy waves produced by global financial markets. I have every confidence we will succeed in doing that. Today I want to articulate some first steps, concrete actions we will take, as well as some intentions to take actions based on plans we will formulate.

Before I turn to specifics, let me repeat what I said on the day I was appointed. The Reserve Bank is a great institution with a tradition of integrity, independence, and professionalism. I congratulate Dr. Subbarao on his leadership in guiding the Bank through very difficult times, and I look forward to working with the many dedicated employees of the RBI to further some of the important initiatives he started. I have been touched by the warmth with which the RBI staff have welcomed me.

To the existing traditions of the RBI, which will be the bedrock of our work, we will emphasise two other traditions that become important in these times: transparency and predictability. At a time when financial market are volatile, and there is some domestic political uncertainty because of impending elections, the Reserve Bank of India should be a beacon of stability as to its objectives. That is not to say we will never surprise markets with actions. A central bank should never say "Never"! But the public should have a clear framework as to where we are

going and understand how our policy actions fit into that framework. Key to all this is communication, and I want to underscore communication with this statement on my first day in office.

### ***Monetary Policy***

We will be making the first monetary policy statement of my term on September 20. I have postponed the originally set date a bit so that between now and then, I have enough time to consider all major developments in the required detail. I will leave a detailed explanation of our policy stance till then, but let me emphasise that the RBI takes its mandate from the RBI Act of 1934, which says the Reserve Bank for India was constituted

"to regulate the issue of Bank notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage;"

The primary role of the central bank, as the Act suggests, is monetary stability, that is, to sustain confidence in the value of the country's money. Ultimately, this means low and stable expectations of inflation, whether that inflation stems from domestic sources or from changes in the value of the currency, from supply constraints or demand pressures. I have asked Deputy Governor Urjit Patel, together with a panel he will constitute of outside experts and RBI staff, to come up with suggestions in three months on what needs to be done to revise and strengthen our monetary policy framework. A number of past committees including the Financial Sector Legislative Reforms Commission (FSLRC), have opined on this, and their views will also be considered carefully.

### ***Inclusive Development***

I talked about the primary role of the RBI as preserving the purchasing power of the rupee, but we have two other important mandates; inclusive growth and development, as well as financial stability.

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\* Statement by Governor at RBI, Mumbai.

As the central bank of a developing country, we have additional tools to generate growth – we can accelerate financial development and inclusion. Rural areas, especially our villages, as well as small and medium industries across the country, have been important engines of growth even as large company growth has slowed. But access to finance is still hard for the poor, and for rural and small and medium industries. We need faster, broad based, inclusive growth leading to a rapid fall in poverty.

The Indian public would benefit from more competition between banks, and banks would benefit from more freedom in decision making. The RBI will shortly issue the necessary circular to completely free bank branching for domestic scheduled commercial banks in every part of the country. No longer will a well-run scheduled domestic commercial bank have to approach the RBI for permission to open a branch. We will, of course, require banks to fulfil certain inclusion criteria in underserved areas in proportion to their expansion in urban areas, and we will restrain improperly managed banks from expanding until they convince supervisors of their stability. But branching will be free for all scheduled domestic commercial banks except the poorly managed.

There has been a fair amount of public attention devoted to new bank licenses. The RBI will give out new bank licenses as soon as consistent with the highest standards of transparency and diligence. We are in the process of constituting an external committee. Dr. Bimal Jalan, an illustrious former governor, has agreed to chair it, and the committee will be composed of individuals with impeccable reputation. This committee will screen licence applicants after an initial compilation of applications by the RBI staff. The external committee will make recommendations to the RBI governor and deputy governors, and we will propose the final slate to the Committee of the RBI Central Board. I hope to announce the licences

within, or soon after, the term of Deputy Governor Anand Sinha, who has been shepherding the process. His term expires in January 2014.

We will not stop with these licences. The RBI has put an excellent document on its website exploring the possibility of differentiated licences for small banks and wholesale banks, the possibility of continuous or "on-tap" licensing, and the possibility of converting large urban co-operative banks into commercial banks. We will pursue these creative ideas of the RBI staff and come up with a detailed road map of the necessary reforms and regulations for freeing entry and making the licensing process more frequent after we get comments from stakeholders.

India has a number of foreign owned banks, many of whom have been with us a long time and helped fuel our growth. They have been in the forefront of innovation, both in terms of improving productivity, as well as in terms of creating new products. We would like them to participate more in our growth, but in exchange we would like more regulatory and supervisory control over local operations so that we are not blindsided by international developments. The RBI will encourage qualifying foreign banks to move to a wholly owned subsidiary structure, where they will enjoy near national treatment. We are in the process of sorting out a few remaining issues so this move can be made.

Finally, our banks have a number of obligations that pre-empt lending, and in fact, allow what Dr. Rakesh Mohan, an illustrious former deputy-governor, called "lazy banking". One of the mandates for the RBI in the Act is to ensure the flow of credit to the productive sectors of the economy. In this context, we need to reduce the requirement for banks to invest in government securities in a calibrated way, to what is strictly needed from a prudential perspective.

This cannot be done overnight, of course. As government finances improve, the scope for

such reduction will increase. Furthermore, as the penetration of other financial institutions such as pension funds and insurance companies increases, we can reduce the need for regular commercial banks to invest in government securities.

We also subject our banks to a variety of priority sector lending requirements. I believe there is a role for such a mandate in a developing country – it is useful to nudge banks into areas they would otherwise not venture into. But that mandate should adjust to the needs of the economy, and should be executed in the most efficient way possible. Let us remember that the goal is greater financial access in all parts of the country, rather than meeting bureaucratic norms. I am asking Dr. Nachiket Mor to head a committee that will assess every aspect of our approach to financial inclusion to suggest the way forward. In these ways, we will further the development mission of the RBI.

### ***Financial Markets***

Some see financial markets as competition to banks. They are that, but they are also complementary. Too many risks in the Indian economy gravitate towards commercial banks even when they should be absorbed by arm's length financial markets. But for our financial markets to play their necessary roles of providing risk absorbing long term finance, and of generating information about investment opportunities, they have to have depth. We cannot create depth by banning position taking, or mandating trading based only on well-defined "legitimate" needs. Money is fungible so such bans get subverted, but at some level, all investment is an act of faith and of risk taking. Better that investors take positions domestically and provide depth and profits to our economy than they take our markets to foreign shores.

Together with the government and regulators such as SEBI, we will steadily but surely liberalise our markets, as well as restrictions on investment and

position taking. Given the current market turmoil, our actions will have to be at a measured pace, but as a symbolic down payment, we will do the following:

1. Presently, exporters are permitted to re-book cancelled forward exchange contracts to the extent of 25 per cent of the value of cancelled contracts. This facility is not available for importers. To enable exporters/importers greater flexibility in their risk management, we will:
  - i. Enhance the limit available to exporters to 50 per cent; and
  - ii. Allow a similar facility to importers to the extent of 25 per cent.
2. Further to develop the money and G-sec markets, we will introduce cash settled 10 year interest rate future contracts;
3. We will also examine the introduction of interest rate futures on overnight interest rates.

### ***Rupee internationalisation and Capital Inflows***

This might be a strange time to talk about rupee internationalisation, but we have to think beyond the next few months. As our trade expands, we will push for more settlement in rupees. This will also mean that we will have to open up our financial markets more for those who receive rupees to invest it back in. We intend to continue the path of steady liberalisation.

The RBI wants to help our banks bring in safe money to fund our current account deficit. The Reserve Bank of India has been receiving requests from banks to consider a special concessional window for swapping FCNR deposits that will be mobilised following the recent relaxations permitted by the Reserve Bank of India. We will offer such a window to the banks to swap the fresh FCNR (B) dollar funds, mobilised for a minimum tenor of three years and over, at a fixed rate of 3.5 per cent per annum for the tenor of the deposit.

Further, based again on requests received from banks, we have decided that the current overseas borrowing limit of 50 per cent of the unimpaired Tier I capital will be raised to 100 per cent and that the borrowings mobilised under this provision can be swapped with Reserve Bank of India at the option of the bank at a concessional rate of 100 basis points below the ongoing swap rate prevailing in the market.

The above schemes will be open up to November 30, 2013, which coincides with when the relaxations on NRI deposits expire. The Reserve Bank reserves the right to close the scheme earlier with due notice.

### ***Financial Infrastructure***

Finance thrives when financial infrastructure is strong. The RBI has been working hard to improve the financial infrastructure of the country – it has made tremendous advances, for example, in strengthening the payment and settlement systems in the country. Similarly, it has been working on improving information sharing through agencies such as credit bureaus and rating agencies. I propose to carry on such work, which will be extremely important to enhance the safety and speed of flows as well as the quality and quantity of lending in the country.

On the retail side, I particularly want to emphasise the use of the unique ID, Aadhaar, in building individual credit histories. This will be the foundation of a revolution in retail credit.

For small and medium firms, we intend to facilitate Electronic Bill Factoring Exchanges, whereby MSME bills against large companies can be accepted electronically and auctioned so that MSMEs are paid promptly. This was a proposal in the report of my Committee on Financial Sector reforms in 2008, and I intend to see it carried out.

Finance is not just about lending, it is about recovering loans also. We have to improve the

efficiency of the recovery system, especially at a time of economic uncertainty like the present. Recovery should be focused on efficiency and fairness – preserving the value of underlying valuable assets and jobs where possible, even while redeploying unviable assets to new uses and compensating employees fairly. All this should be done while ensuring that contractual priorities are met. The system has to be tolerant of genuine difficulty while coming down hard on mismanagement or fraud.

Promoters do not have a divine right to stay in charge regardless of how badly they mismanage an enterprise, nor do they have the right to use the banking system to recapitalise their failed ventures.

Most immediately, we need to accelerate the working of Debt Recovery Tribunals and Asset Reconstruction Companies. Deputy Governor Anand Sinha and I will be examining the necessary steps.

I have asked Deputy Governor Dr. Chakrabarty to take a close look at rising NPAs and the restructuring/recovery process, and we too will be taking next steps shortly. The RBI proposes to collect credit data and examine large common exposures across banks. This will enable the creation of a central repository on large credits, which we will share with the banks. This will enable banks themselves to be aware of building leverage and common exposures.

While the resumption of stalled projects and stronger growth will alleviate some of the banking system difficulties, we will encourage banks to clean up their balance sheets, and commit to a capital raising programme where necessary. The bad loan problem is not alarming yet, but it will only fester and grow if left unaddressed.

We will also follow the FSLRC suggestion of setting up an enhanced resolution structure for financial firms. The working group on resolution

regimes for financial institutions is looking at this and we will examine its recommendations and take action soon after.

### **Households**

Everyone has a right to a safe investment vehicle, to the ability to transfer remittances to loved ones, to insurance, to obtain direct benefits from the government without costly intervening intermediaries, and to raise funding for viable investment opportunities. In addition, access to credit to smooth consumption needs or to tide over emergencies is desirable, especially for households in the lower income deciles, when it does not impose unserviceable debt loads. The Reserve Bank will continue to play its part in making all this possible.

In particular, I want to announce a number of specific actions:

First, households have expressed a desire to be protected against CPI inflation. Together with the government, we will issue Inflation Indexed Savings Certificates linked to the CPI New Index to retail investors by end- November 2013.

Second, we will implement a national giro-based Indian Bill Payment System such that households will be able to use bank accounts to pay school fees utilities, medical bills, and make person to person transfers electronically. We want to make payments anywhere anytime a reality.

Third, only banks are currently allowed to deploy Point-of-Sale terminals, and these are largely set up by a few banks in urban areas. As announced in the Annual Monetary Policy Statement, we will facilitate the setting up of "white" POS devices and mini ATMs by non-bank entities to cover the country so as to improve access to financial services in rural and remote areas.

Fourth, currently holders of pre-paid instruments issued by non-bank entities are not allowed to withdraw cash from the outstanding balances in their pre-paid cards or electronic wallets. Given the vast potential of such instruments in meeting payments and remittance needs in remote areas, we intend to conduct a pilot enabling cash payments using such instruments and Aadhaar based identification.

Finally, there is substantial potential for mobile based payments. We will set up a Technical Committee to examine the feasibility of using encrypted SMS-based funds transfer using an application that can run on any type of handset. We will also work to get banks and mobile companies to cooperate in rolling out mobile payments. Mobile payments can be a game changer both in the financial sector as well as to mobile companies.

This is part of my short term time table for the Reserve Bank. It involves considerable change, and change is risky. But as India develops, not changing is even riskier. We have to keep what is good about our system, of which there is a tremendous amount, even while acting differently where warranted. The RBI has always changed when needed, not following the latest fad, but doing what is necessary. I intend to work with my excellent colleagues at the Reserve Bank, the senior management of which is represented around this table, to achieve the change we need.

Finally, a personal note: Any entrant to the central bank governorship probably starts at the height of their popularity. Some of the actions I take will not be popular. The Governorship of the Central Bank is not meant to win one votes or Facebook "likes". But I hope to do the right thing, no matter what the criticism, even while looking to learn from the criticism – Rudyard Kipling put it better when he mused about the requirements of an ideal central banker in his poem "If":

*If you can trust yourself when all men doubt  
you, But make allowance for their doubting too:*

Kipling's reference to "men" only dates these  
lines, but his words are clear.

We will fill in details of what we have announced  
shortly, and lay out a broader roadmap of reforms  
soon after. Appropriate notifications will be issued  
shortly. As this is underway, we will turn to preparing  
the mid quarter policy statement.