

Global B@nking: Paradigm Shift 2007



(L to R) Joydeep Sengupta, Yogesh Agarwal, S A Bhat, O P Bhatt, Sanjay Nayar, Naina Lal Kidwai, Sir David Wright, Rana Kapoor, Gunit Chadha.

Federation of Indian Chambers of Commerce and Industry (FICCI) and Indian Banks' Association (IBA) organised a three-day (12th through 14th September 2007) conference on 'Global B@nking: Paradigm Shift 2007' at Hotel Hilton Towers, Mumbai. CRISIL was the knowledge partner to this international conference, which was well attended by bankers and regulators from Asia and outside.

Habib Khorakiwala, president, FICCI observed in his welcome address that 'the Indian banking was untouched by subprime crisis, which suggests that it has robust asset quality and risk management'. 'To become a significant player globally, Indian banks need to consolidate, reduce intermediation cost to international benchmark, and raise

additional capital even if it results in dilution of government's stake in the banks owned by it,' he suggested, and added that 'the high interest rate regime is not sustainable in the long run'.

M B N Rao, chairman, IBA and CMD, Canara Bank stressed on inclusive banking in his opening remarks. 'That no crisis happened on account deregulation points to the soundness and stability of Indian banking industry,' he stated, but cautioned that 'fast rate of growth of retail credit may result in delinquencies in future'. Referring to ICT (Information and Communication Technology) as 'movers and packers' of information, Rao predicted that major competition to financial services industry will come from telecom and software companies. He informed the audience that IBA is trying to set up a SAARC Bankers' Association, on the lines of the European Bankers' Federation, ASEAN Bankers' Association and the International Banking Federation (of which IBA will soon be a member).

Expounding the theme of the conference, O P Bhatt, chairman of FICCI's banking and financial institutions committee, and chairman of State Bank of India, asked, 'Is this growth sustainable?', agreeing with Rao and observing that 'most bad loans are made in good times'. He also commented upon the fractured nature of banking in India, and stated that there is a dire need for consolidation if Indian banks have to compete globally. He outlined various issues that were to be discussed in the next three days.

The opening session had Chanda Kochar, deputy managing director, ICICI Bank; Sanjay Nayar, CEO-India and area head for Bangladesh, Nepal and Sri Lanka, Citibank; making brief observations on the theme of the conference. Among other issues, both stressed on the need for additional capital for banks to meet the demand for credit in the fast growing economy.

Malcolm D Knight, general manager, Bank of International Settlements (BIS) in his special address, stated three important issues in global banking. 'First, market participants need to understand the changing nature of risk in the context of the increasing use of innovative and complex instruments that can be traded across markets and borders, in particular, those for credit risk transfer and liquidity risk management.' The enhanced disclosures under international financial reporting standards (IFRS) and Basel II will strengthen market discipline and contribute to the soundness of the international financial system, he observed. 'Third, good governance is important for supervisory agencies and central banks.' He informed that 2011 has been set as the deadline for banks to become IFRS compliant.



Dr C Rangarajan

The key attraction of the opening session was the inaugural address by Dr C Rangarajan, chairman, economic advisory council to the prime minister, government of India, and ex-governor of RBI. He also formally released the compendium of papers, prepared by CRISIL, for the conference. Dr Rangarajan observed that 'our banking sector reforms have been unique, as they could bring about fundamental changes in the banking system in a non-disruptive manner'. Commenting on the few select issues in Indian banking, he stated that 'the first issue is consolidation'. 'Banks in India will need to explore ways for inorganic expansion,' he stressed and added that, 'this, in turn, is likely to unleash the forces of consolidation in Indian banking'. However, he said that such consolidation will have to be driven by commercial motivation.

'Consolidation does not mean that small and medium sized banks will have no future,' he explained, 'these can co-exist with large global banks and remain profitable'.

The other critical issue, said Dr Rangarajan, is related to capital adequacy to match Basel II compliance and the rapid growth in the real sector. 'In case of public sector banks,' he said, 'the government needs to make up its mind either to bring in additional capital or dilute its stake below 51 percent'. A third alternative could be to include in the definition of government entities such as Life Insurance Corporation which are likely to remain fully owned in the future. He also stressed on risk management, and observed that 'no amount of sophisticated mathematical models of risk management can be a substitute for an understanding of the basic transactions'.

Other sessions on the first day were a special talk by Dr Muhammad Al-Jasser, vice governor, Saudi Arabian Monetary Agency; 'Trends in Global Economy and Banking System' by speakers from Standard & Poor's Ratings; panel discussions on 'Strategies for Financial Inclusion' moderated by Tilman Ehrbeck, partner, McKinsey & Company; on 'Bank Efficiency and HR Practices' chaired by Dr A K Khandelwal, CMD, Bank of Baroda; and on 'Payment and Settlement Systems' chaired by M V Nair, CMD, Union Bank of India.



V Leeladhar,

The proceedings of the second day started with the special address of V Leeladhar, deputy governor, RBI, who also chaired the session on 'Implementation on Basel II'.

In his address, Leeladhar covered in detail the issues and challenges in implementing Basel II in India, and outlined the approach followed by the RBI. 'It has been a conscious decision to begin with the simpler approaches,' he said while admitting that 'the standardised approach for credit risk leans heavily on external credit ratings'. 'Rating penetration in India is rather low, and confined to rating of

the capital issues,' stated Leeladhar, and observed further that 'credit rating provides only a lagged indicator of the credit standing of an entity, and is not a lead indicator'. He also dwelt at length on the issues involved in migration to advanced approaches.

Other pre-lunch sessions on this day focused on risk management, rating and pricing mechanisms, and structured credit products. The post-lunch sessions were held in parallel track mode, which continued into the third day too.

Later in then third day, Dr Rakesh Mohan, deputy governor, RBI delivered a talk on 'Economic Reforms and Corporate Performance in India'. Dr Mohan observed in the beginning of his talk that 'corporate profits before tax have registered extraordinary growth in recent years'. He presented a whirlwind tour of economic reforms since 1991 and used data to show that 'the reforms have resulted in the remarkable recovery of corporate profitability since 2002'. Dr Mohan observed that in China it took ten years after the reforms for benefits to become visible. Drawing a parallel, he said that we started reforms in 1991, and the results began to show only after 2003.

The conference concluded with the CEO's panel discussion on "Sustaining Growth Momentum and Living with



Dr Rakesh Mohan

Competition', chaired by O P Bhatt. 'Whether this growth is sustainable?' asked Bhatt, seeding the discussion. 'It cannot go on indefinitely without supporting infrastructure, both hard and soft,' he added, observing further that the present growth is largely driven by consumption, and that there is a huge shortage of talent. Joydeep Sengupta, global partner and head financial services, McKinsey presented the key issues that the panel was to deliberate upon. 'India's financial depth continues to be low as compared to other Asian countries,' he observed, 'hence, financial sector in India will have to grow faster than the real sector to be able to service it'. There will be 500 million bankable population

in China and India alone by the end of this decade, he predicted. Equity and debt market intermediation is still dominated by global banks, he informed, and drew attention of the panel to the fact that the established global players in this field have 'upped' their presence in India recently. Non-bank players like supermarket chains and telecoms are beginning to challenge banks in retail with disruptive business models.

Sir David Wright, vice chairman, Barclays Capital, spoke on the absence of consolidation in banking in India, and commented that restrictions on foreign bankers are not allowing the growth in investment banking in India. Naina Lal Kidwai, group general manager, and country head, HSBC India, called for an entrepreneurial mindset of employees and tolerance of business mistakes by them. Sanjay Nayar also expressed the opinion that there is a need for consolidation as Indian market is very fragmented. 'It is still one of the most under penetrated market,' he said and added that SME sector is 'over banked' but 'under served'. Gunit Chadha, CEO and MD India, Deutsche Bank, suggested disruptive models for dominance, while maintaining that the growth potential in the Indian market is such that there can be a lot of co-operation between banks.

Yogesh Agarwal, CMD, IDBI Bank, was of the opinion that the business model of top 10 banks in India is the same. 'There is hardly any differentiation,' said Agarwal, and suggested that this 'uniformity of business model with every bank trying to serve every segment needs to undergo a change'. Chadha pointed out during the discussion that 'talent' and not 'technology' is the next generation differentiator. S A Bhat, CMD, Indian Overseas Bank felt that public sector banks (PSBs) are facing threats from both foreign and private banks. 'These banks are using technology in an innovative way,' he said. On the issue of mergers and consolidation, Bhat was emphatic that 'we cannot do it now'. 'It will not happen till there is political will and the entire Indian banking industry realises that it is required. He also emphasised that PSBs need to use technology to make the delivery system cost-effective. He also stressed on the need for Indian banks to raise additional capital.

Rana Kapoor, MD and CEO of Yes Bank stressed on the issues of low-cost technology platforms, human capital adequacy, and the need to outsource non-core processes. He said financial inclusion presents a business opportunity. The discussion became quite lively after he raised the issues of level playing field not only in India, but in other markets as well. It was concluded that there is enough room for every bank to grow and live with the competition.