CAFRAL
CENTRE FOR ADVANCED FINANCIAL RESEARCH AND LEARNING
Promoted by Reserve Bank of India

CAFRAL Advanced Credit Management Program (Indian Leg)

Mumbai, India

Takeaways from CAFRAL Advanced Credit Management Program Indian Leg

The Centre for Advanced Financial Research and Learning had organised an international program in association with Stern School of Business, New York University (NYU Stern) in the month of September 2017. The Indian leg of the program was held over two days in Mumbai from September 15-16, 2017. This is the first program conducted by CAFRAL in association with NYU Stern.

Summary / Takeaways

1. **Global & Domestic outlook and International banking developments**

Global financial crisis of 2008 has resulted in a huge dip in global growth in 2009. Since then global growth has picked up quite fast and global growth is back to normal. World Economic Outlook, April 2017 indicated that global economic activity was picking up and the prospects of an economic upswing with a long-awaited cyclical recovery in investment, manufacturing and trade. Advanced economies continue to grow below trend, but incipient signs that economic expansion, supported by improved investment may be gaining some ground even as risks to sustainability remain. The lower growth rate is not cyclical but due to structural stagnation; therefore policies need to be different. However, the output gap for the advanced economy is reducing. There are some signs that global economic activity is increasing more in USA and in parts of Europe. Global trade has also picked up. Indian economy today has very reasonable macro-economic stability. Economy is a far cry from the crisis it faced in 2013. It has the strength of the reasonable macroeconomic stability that has sustained for over two years now. Overall fiscal position is still weak for the Indian economy as improvement in central finances has been nullified by deteriorating state finances. Combined deficits still remain large. Opportunity for the Indian economy lies in current state of the world (both Advanced Economies and Emerging Market & Developing Economies have slowed down) and India continues to outperform its peers in the BRICS block. However, Q1 data shows that overall growth has slowed down due to various factors like demonetization and rolling out of Goods and Services Tax (GST). Lead indicators for Q2 on the whole suggest growth may have improved. The biggest risk (threat) to the Indian economy relates to leveraged corporate balance sheets and asset quality problem faced by the banks. Multiple initiatives have been taken by the regulator to tackle the deteriorating asset quality position in banks' books - Regulatory forbearance stands withdrawn from April 2015; Asset Quality Review (AQR) has been undertaken in 2015-16 and RBI is making more effective use of Central Repository of Information on Large Credits (CRILC) database to bring out divergences in Non-performing Assets (NPA) reporting. A major shift has been seen in Indian economy. Market-based finance has picked up. India has large equity, bond, money, forex and commodity markets. Exchange traded electronic platforms have picked up.

2. **Governance & Business Strategy**

   Good governance and strong business strategy are necessary for banks to perform better. A good management would ensure that the bank performs reasonably well in bad times and exceptionally well in good times. Non identification of NPAs as per Income Recognition and Asset Classification (IRAC) norms, overexposure to certain sectors like power, roads, telecom, etc., rapid rise in loan book in a short time, higher recognition of profit on account of under provisioning, lumpy share in consortium lending, shortage of skilled staff for credit appraisals, high rate of attrition among skilled employees are some of the indicators of a poor governance system. Banks must concentrate on improving operational resilience, tackle cyber threats effectively, allocate adequate budget for Information Technology (IT) infrastructure, improve risk governance, reduce human resources and skill gaps and leverage technology to serve the customers effectively at a lower cost. In the years to come, rapid urbanisation and rising income will open up opportunities for banks.

3. Risk Management

A major challenge for any bank is to achieve a balance between a sales-driven top-line culture and a risk-focused culture. There is a need to make the front line businesses the custodians of risk culture and the supervisory responsibility should lie with the centralized risk function. The regulator has issued guidelines to improve the risk management system in banks; however, the organization can go beyond the regulatory prescription and decide their own risk management structure for more efficient risk management in the organization. The Chief Risk Officer must ensure that a strong risk culture prevails in the organization and must improve risk awareness in the bank through communication at various levels. Mere forming of policies won't help; policies need to be mapped to the processes. Risk management practices must be reviewed, monitored and upgraded periodically.

4. Restoring Public Sector Bank Health in India

Indian banking system is facing slowdown in growth and primary reason for that is the stress in banks' balance-sheets, especially public sector banks. The stress in banks' assets has been mounting since 2011 and has now materially crystallized in the form of non-performing assets (NPAs). Weak bank balance-sheets cannot support healthy credit growth. Under-capitalized banks need capital even to survive, let alone grow. Those banks which barely meet the capital requirements need to improve capital adequacy quickly. A decisive and adequate bank recapitalization is a critical necessity to address this balance-sheet malaise.

5. Risks in Information Technology environment and cyber risk

Usage of technology in banking is rapidly increasing. Banks face enormous challenges to upgrade the technology as also control and mitigate the cyber risks. Interconnectedness of the systems pose a major concern as there is a rise in highly sophisticated cyber-attacks affecting the entire system. As a regulator, RBI has established a Cyber Security and IT Examination (CSITE) Cell within the Department of Banking Supervision in 2015. Besides the regular financial inspections, the Reserve Bank of India has initiated separate IT Examinations of banks to assess their cyber resilience. Another major initiative by the regulator is the periodic conduct of cyber-drill exercises on banks, in collaboration with the Indian Computer Emergency Response Team (CERT-In), to assess preparedness and response capabilities of the banks to cyber-attacks. It has mandated online reporting of unusual cyber security incidents within 2-6 hours of detection and a summary reporting system has been introduced. Pursuant to the Monetary Policy announcement on February 8, 2017, an inter-disciplinary Standing Committee on Cyber Security has also been established with a mandate to review the inherent threats in the existing/emerging technology, study various security standards/protocols, inter-face with stakeholders and suggesting appropriate policy interventions. Going forward all stakeholders must remain alert and vigilant about threat landscape. Round the clock surveillance of banks' systems, robust data security standard and collective action by banks could help detect, respond, mitigate and recover from breaches.

6. Indian banks' operations in US and US regulatory requirements

Foreign banks operating in USA are exposed to multiple regulators. Compliance of their recently introduced regulations and guidelines are driving up their operational cost. The biggest challenge for Indian banks working globally is credit rating and having a profitable business model. Recent financial crisis has shaken the confidence of the customer in banking system as a whole. Banks need to continuously redefine their financial products, offer multiple product packages, attract customers through different channels and create an efficient operation model to win the customer satisfaction and trust. Another challenge staring at the foreign banks operating in USA is the HR issue. Hiring of locals for the foreign operations has not been always successful and Indians posted in USA by rotation need time to understand the culture of the country before they can successfully contribute in bank's operations in foreign land. Technology has replaced the traditional banking operation world over. Ever increasing cyber security threat is looming large due to increased dependence on automated systems and procedures.

7. Recent developments in financial markets

A risk manager in a bank must be aware about what is happening in the market. Higher knowledge will help in taking advantage of market disruptions and getting a better deal for your own bank. In India the depth of money market is increasing. The USD-INR spot market has lot of liquidity, but money market is very unpredictable. It is better to buy insurance to hedge the exchange risk than to expose one in the volatile market.

8. Resolution of stressed assets

Factors behind buildup of stressed assets are:

- Economic slowdown.
- Projects stalled at various stages due to delay in clearances and issues in fuel linkages.
- Persistent policy paralysis delaying structural reform.
- Significant build-up of excess capacity financed mainly through excessive leveraging.
- Deficiencies in the credit appraisal and due diligence processes, particularly at PSU banks.
- Lack of capital and resolution mechanisms.

Various regulatory responses viz. Corporate Debt Restructuring (CDR), Joint Lenders Forum (JLF), Strategic Debt Restructuring (SDR) and Scheme for Sustainable Structuring of Stressed Assets (S4A) did not help in reducing the NPA burden. Recently introduced Insolvency and Bankruptcy Code, 2016 is a law that seeks to protect value of businesses under stress and provides for a transparent and time bound resolution process. 222 cases and 900+ Insolvency Professionals have been registered during the last nine months since its inception. Major issue in the resolution process is to have a fine balance between bankers and financial creditors, promoters, Operational creditors including government and the consumers.

Compiled by CAFRAL Team