IN CONVERSATION

"There should be sharing of information between banks – agreeably a difficult practice, but in the current situation would be advisable. Besides, banks also need to monitor their clients and have models that provide early warning signals."

Rajesh Mokashi - Deputy Managing Director
CREDIT ANALYSIS & RESEARCH Ltd (CARE), Mumbai

The banking sector in the country is currently going through a lean phase, however, likelihood of a revival cannot be ruled out given the planned capital infusion program of the government and recovery in the general business environment. However, the banking sector needs to identify and explore some effective solutions which could help them tackle some of the present and perennial issues like bad loans or NPAs. The Global ANALYST spoke to Rajesh Mokashi, Deputy Managing Director, CREDIT ANALYSIS & RESEARCH Ltd, about his perspectives on the issues impacting the sector, his suggestions for tackling these challenges and his vision for the sector in 2020.

Edited excerpts:

- **Indian banking is undergoing perhaps one of the most challenging times in the recent memory. What is your opinion?**

Indian banking is going through a phase of introspection as we have been saddled with a variety of challenges at a time when the structure of banking is undergoing a metamorphosis. The RBI has been giving permission for the creation of new banks which includes new commercial banks as well as payments banks and small banks. The Government has been pressurizing banks to race ahead with inclusive banking through the Jan Dhan Scheme. On the other hand, given the economic slowdown, there has been the build-up of NPAs which have still to show signs of coming down.

Further, the reconsideration of the concept of restructured assets, which are now to be treated as NPAs for the purpose of provisioning, is daunting for banks which have made them circumspect while lending. Simultaneously, there is pressure on banks to lower interest rates as the RBI has been lamenting that the transmission process is tardy. Amidst these challenges, the PSBs have to grapple with providing for capital for future growth. Therefore, as one can see there has been a plethora of developments on various ends which has changed the environment in which banks operate.

- **What factors do you feel are responsible for the current difficult situation?**

To my mind, there are two sets of factors that have pressurized banks: remaining profitable and prudential regulation. The first puts pressure on them to perform in an environment when the economy is not doing well and the interest margins are under pressure. On the prudential regulation front, we are yet to see a turnaround in the quality of assets, which I feel is linked with the slow growth process. While stalled projects have been cleared, we have seen limited momentum here which in turn pressurizes the NPA portfolio.

At times, promoters may be reluctant or unable to bring in additional capital which puts the burden on banks. The Basel III norms indirectly do pressurize banks to raise capital and while the government has promised to provide support over the next three years, there will always be pressure to match capital to future growth plans.

- **Bad loans and concerns of a credit downgrade remain two key challenges before the banks. What is your take?**

Bad loans will continue to be a problem until there is a turnaround in the economy. We have seen that there is a direct correlation of bad debts with the state of economy, especially industry. With low industrial growth in the last three years and limited movement in infra sector, coupled with mounting losses in this segment, banks are finding it hard to get by. Further, as rightly stated, the credit quality has shown feeble signs of improvement. While our own guide, the modified credit ratio (number of upgrades plus retentions to downgrades plus retentions) has improved in FY15, we have observed that in the last 3 quarters it has been moving down though it is higher than 1. While it is a broad measure of credit environment, the picture is one of feeble recovery only.

Do you foresee the NPA issue subsiding after several quarters of tough measures initiated by the sector, particularly PSBs?

Unless where there is wilful default, which will be a small proportion of bad loans, to my mind, the growth in NPAs is related to a combination of macroeconomic, industry specific and company related factors. While the last can be addressed through better governance and practices which the banks can insist on, for the former two factors, there is little that can be done by the banks.

While the government has been working hard on the policy front, issues like land, which has been responsible for holding up projects continues to be a challenge. Further, while coal auctions have taken place, thus removing the bottleneck, the price has gone up which has affected users especially of power or steel companies. While we would be sanguine of a recovery in these NPAs as we believe that the worst may be over, we still need to be watchful to see them decline before concluding that they will be moving southwards. As of now it more of a wait and watch approach that has to be pursued.

- **What effective solutions do you suggest to tackle the NPA menace forever?**

While factors such as the external environment cannot be predicted such as policy changes or global shocks, banks need to ensure that their systems are in order. First the credit risk evaluation process needs to be streamlined and done professionally. Second, best risk practices need to be followed to ensure that we are able to

buffer ourselves in case of perverse developments. Third, governance practices should be pursued with lending decisions based on commercial judgment. Fourth, banks need to relook their portfolios and selectively de-risk through diversification. Sectors like steel, textiles, infra, mining, etc., which are more vulnerable need to be dealt with caution. Fifth, there should be sharing of information between banks – agreeably a difficult practice, but in the current situation would be advisable. Sixth, banks need to monitor their clients and have models that provide early warning signals. These to my mind would help to alleviate the problem that banks are confronting today.

- **What is your overall assessment of the situation? And do you think that the credit off take is about to take-off or has already been taking off?**

Banks are in a cautious phase right now and are going slow on credit. This can be seen by their reluctance to lower rates in accordance with the RBI's actions. This is so mainly because the banks perceive higher credit risk for such activity. Hence, while there has been some migration to the corporate bond market and the CP segment, it has been partly at the expense of business of banks. They are cognizant of both the quality of assets and the capital issues which in a way is good as it is better to cautious given that the quantum of stressed assets is above 10%. We have seen no let down even as of June 2015.

On the other side, we have not seen much demand for credit notwithstanding the substitution that is taking palace though admittedly this is the slack season which coincides with the monsoon when there is typically less activity even in the construction space, which could be the driver going ahead as the government starts spending.

We have seen retail lending being relatively more cheerful, and banks are preferring this route as the delinquency levels are lower here. We are hopeful that there will be some pick-up from October onwards which should make the picture look better for the banks.

- **What could be your vision for 2020?**

The way things are moving, I would think that we will have a fairly stronger banking system by 2020. The PSBs should have gotten back on their feet with the capital infusion and given that our economy too would have gotten back on the rails, would be in position to support growth.

We can think of a three tiered system at that point of time. The lower base would be the small and payments banks which would be focusing on financial inclusion. The second layer would be the mid-sized banks across both the sectors that are catering to the mid segment and at the topmost part of the pyramid, there would be the large banks that will be driving large investment projects. But simultaneously, as RBI has indicated I do see greater reliance on the corporate bond market which is essential to also de-risk banks which do migrate a part of their large exposures to this segment, which will then a be a win-win situation for all concerned parties. TGA

Mission Financial Inclusion – It's Jai Jan Dhan

- PM Narendra Modi's ambitious drive PMJDY has hit the bull's eye with the country reaching near 100 per cent level as far financial inclusion is concerned.
- States of Kerala and Goa, union territories of Chandigarh, Puducherry and Lakshadweep and three districts of Gujarat — Porbandar, Mehasana, Gandhinagar were the first few off the block to be declared as 100 per cent saturated in terms of coverage of all households with at least one bank account by end of November 2014, official data shows.
- According to official data, 18.18 crore accounts have been opened so far, as on September 9, 2015. PSBs along with RRBs have led from the front, accounting for 17.5 crore accounts under the PMJDY, the biggest financial inclusion initiative in the world, whose first anniversary was celebrated on August 28, 2015.
- Further, as the government statistics show, nearly 1.65 lakh Jan Dhan account holders, of the total 18 crore accounts opened under the scheme, have availed overdraft facility.
- More than Rs 22,000 crore have been mobilized under the Pradhan Mantri Jan Dhan Yojana (PMJDY) and 15.74 crore Rupay debit cards have been issued, according to the government data.
- Aadhaar has been seeded in 41.82% of account opened under PMJDY.
- 847 Claims of Life cover of Rs.30000 and 389 Claims of accident insurance cover of Rs. 1 lakh have been successfully paid.
- As on 22nd August, 2015, 8.17 crore beneficiaries have been enrolled under the Pradhan Mantri Suraksha Bima Yojana and 2.76 crore have been enrolled under Pradhan Mantri Jeevan Jyoti Bima Yojana. 6.83 lakh account holders have been enrolled under Atal Pension Yojana.
- The scheme is a game changer for the Indian economy, the government declares. It has created a platform
- for inculcating the habit of saving money, providing formal credit facilities, plugging leakages in public subsidies and welfare programs. This is indeed a credible achievement of the Government for changing the economic condition of the people.