



CHANGING LANDSCAPE OF INDIAN BANKING SYSTEM

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Abstract: *Face of Global Banking is undergoing a transition. Banking is now a global issue. Reforms in the financial sector, covering banking, insurance, financial markets, trade, taxation etc. have been a major catalyst in strengthening the fundamentals of the Indian economy. The reform measures have brought about sweeping changes in this critical sector of the Indian's economy. Banking in India is generally fairly mature in terms of supply, product range, and reach-even though reach in rural India still remains a challenge for the private sector and foreign banks in the year 2007. The broad objective of the financial sector reform has thus been to create a viable and efficient banking system. Improvements in the growth rate can be effected through three, not necessarily mutually exclusive channels: improving productivity of capital, through investments in human capital and raising total factor productivity (TFP). Performance of the banking sector has impact across the length and breadth of the economy. The major banking sector reforms comprises of modifying the policy framework; improving the financial soundness and credibility of banks; creating a competitive environment, and strengthening of the institutional framework. The banking sector reform measures to enhance efficiency and productivity through competition were initiated and sequenced to create an enabling environment for banks to overcome the external constraints which were related to administered structure of interest rates, high levels of pre-emption in the form of reserve requirements, and credit allocation to certain sectors. An attempt has been made in this paper to provide a brief overview on performance of the Banking Sector in India. It also includes a critical review of the performance as well as impact of Banking Sector Reforms in India. It has also covered the role and measures initiated by the Reserve Bank in India [RBI] in order to implement the Banking Sector Reforms in India. The concluding remarks are provided at the end.*

Keywords: *Reforms, KYC, Sectors, Narasimham Committee Report, Banking, RBI.*

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INTRODUCTION

The face of banking is changing rapidly. The Indian banking system continues to be dominated by Government banks, with public sector banks accounting for three-quarters of total commercial banking assets.

The banking system is fragmented; with the exception of the State Bank of India, no one bank holds more than ten percent of total system assets. The combined assets of India's five largest banks are less than the assets of the largest Chinese bank (www.unpan1.un.org).

In most emerging markets, banks assets comprise well over 80 per cent of total financial sector assets, whereas these figures are significantly lower in developed economies. Another difference in the banking industry in developed and emerging economies is the degree of internationalization of banking operations.

A BRIEF REVIEW OF BANKING SECTOR IN INDIA:

The reform measures have brought about sweeping changes in this critical sector of the Indian's economy. For the past three decades that is 1970 to 2000, India's banking system has several outstanding achievements to its credit. It is no longer restricted to only metropolitans or cosmopolitans in India. (www.finance.Indiamart.com). In India, prior to nationalization, banking was restricted mainly to the urban areas and neglected in the rural and semi-urban areas. By 1991, India's financial system was loaded with an inefficient and financially unsound banking sector. Some of the reasons for this were viz. high reserve requirements, administered interest rates, directed credit, lack of competition, political interference and corruption. The Narasimham Committee Report (1991) recommended several reform measures such as reduction of reserve requirements, de-regulation of interest rates, introduction of prudential norms, strengthening of bank supervision and improving the competitiveness of the system. The second Narasimham Committee Report (1998) too focused on issues like strengthening of the banking system, upgrading of technology and human resource development (Ramasastry A.S. and Achamma Samuel, 2006). Banking in India is generally fairly mature in terms of supply, product range, and reach-even though reach in rural India still remains a challenge for the private sector and foreign banks in the year 2007. India has 88 scheduled commercial banks, 28 public sector banks that is with the Government of India holding a stake, 29 private banks do not having Government stake; they may be publicly listed and traded on stock exchanges, and 31



foreign banks. They have a combined network of over 53,000 branches and 17,000 ATMs. According to a report by ICRA Limited, a rating agency, the public sector banks hold over 75 per cent of total assets of the banking industry, with the private and foreign banks holding 18.2 per cent and 6.5 per cent respectively (www.wikipedia.org).

Pension fund industry in India grew at a CAGR [Cumulative Aggregate Growth Rate] of 122.44 per cent from 1999-2000 to 2006-2007. Rural and semi-urban India is expected to account for 58.33 per cent of the insurance sector by 2010. The ATM outlets in India increased at a CAGR of 53.99 per cent to reach 20,000 in 2006 from 2000. Rural and semi-urban centers account for 66 per cent of total bank branches. Indian Mutual Fund industry witnessed a growth of 49.88 per cent from May 2006 to May 2007, and higher growth is recorded in closed-ended schemes at 215.61 per cent. Increasing number of millionaires in India is increasing the scope of Wealth Management Services. Bankable household India is expected to grow at a CAGR of 28.10 per cent during 2007-2011. Banking sector investment in Information Technology is expected grow at 18 per cent in 2007 from 2006 (www.the-infoshop.com).

BANKING SECTOR REFORMS IN INDIA: A CURSORY LOOK:

The objective of reforms in general is to accelerate the growth momentum of the economy, defined in terms of per capita income. The broad objective of the financial sector reform has thus been to create a viable and efficient banking system. Improvements in the growth rate can be effected through three, not necessarily mutually exclusive channels: improving productivity of capital, through investments in human capital and raising total factor productivity (TFP). Performance of the banking sector has impact across the length and breadth of the economy (www.rbi.org.in).

The major banking sector reforms comprises of modifying the policy framework; improving the financial soundness and credibility of banks; creating a competitive environment, and strengthening of the institutional framework. The improvements in the policy framework are aimed at removing and reducing the external constraints bearing on the profitability and functioning of commercial banks. (www.rbi.org.in).

The banking sector reform measures to enhance efficiency and productivity through competition were initiated and sequenced to create an enabling environment for banks to overcome the external constraints which were related to administered structure of interest



rates, high levels of pre-emption in the form of reserve requirements, and credit allocation to certain sectors. The policy environment of public ownership must be recognized that the lion's share of financial intermediation was accounted for by the public sector during the pre-reform period. Consolidation is a crucial feature of the reform process.

Impressive institutional and legal reforms have been executed. To illustrate, A Board for Regulation and Supervision of Payment and Settlement Systems (BPSS) has been set up to prescribe policies relating to the regulation and supervision of all types of payment and settlement systems, setting up of standards for existing and future systems, authorization of the payment and settlement systems and determination of the criteria for membership to these systems. There have been a number of measures for enhancing the transparency and disclosures standards. All cases of penalty imposed by the RBI on the banks as also directions issued on specific matters, including those arising out of inspection, are to be placed in the public domain to increase transparency in the banking sector. The regulatory framework and supervisory practices have joined with the best practices. The minimum Capital to Risk Assets Ratio (CRAR) has been kept at nine per cent, and the banks are required to maintain a separate Investment Fluctuation Reserve (IFR) out of profits, towards interest rate risk, at five per cent of their investment portfolio under the categories held for trading and available for sale. It has prescribed prudential guidelines to encourage market discipline with a focus on ensuring good governance through fit and proper owners, directors and senior managers of the banks. The RBI has notified detailed guidelines on ownership and governance in private sector banks emphasizing diversified ownership. (www.bis.org).

Besides, research has also provided robust evidence supporting the view that financial development contributes to economic growth. To illustrate, at the cross-country level, various measures of financial development including measures of financial sector assets, domestic credit to private sectors, and stock market capitalization are found to be positively related to economic growth. At the firm level, firms in economies with deeper financial development are able to obtain more external funds to faster growth. Financial repression through statutory pre-emptions has been reduced, while stepping up prudential regulations and interest rates have been progressively deregulated on both the deposit and lending sides (www.rbi.org.in).



The financial sector in India has undergone significant liberalization in all the four segments banking, non-banking finance, securities and insurance and each of these sectors has grown significantly accompanied by a process of restructuring among the market intermediaries. Entry of some of the bigger banks into other financial segments like merchant banking, insurance, etc. which has made them financial 'conglomerates'; emergence of several new players with diversified presence across major segments and possibility of some of the non-banking institutions in the financial sector acquiring large enough proportions to have a total impact.

The RBI has allowed Indian banks to augment their capital funds by issuing of innovative perpetual debt instruments eligible for inclusion as Tier I capital; debt capital instruments eligible for inclusion as Upper Tier II capital; perpetual non-cumulative preference shares eligible for inclusion as Tier I capital and redeemable cumulative preference shares eligible for inclusion as Tier II capital. A number of banks have issued these instruments both in India and overseas to shore up capital.

The various options available for reducing the element of pro-cyclicality include, among others, adoption of objective methodologies for dynamic provisioning requirements, as is being done by a few economies, by estimating the requirements over a business cycle rather than a year on the basis of the riskiness of the assets, establishment of a linkage between the prudential capital requirements and through-the-cycle ratings instead of point-in-time ratings and establishment of a flexible Loan-To-Value (LTV) ratio requirements.

An efficient credit information system has been suggested to enhance the quality of credit decisions and in order to improve the asset quality of banks, apart from facilitating faster credit delivery. A scheme for disclosure of information regarding defaulting borrowers of banks and financial institutions too has been introduced (www.rbi.org.in).

PERFORMANCE OF BANKING SECTOR & BANKING REFORMS OF INDIA:

Bank profitability levels in India have also trended upwards and gross profits stood at 2.0 per cent during 2005-2006, 2.2 per cent during 2004-2005 and net profits trending at around 1 per cent of assets. Available information suggests that for developed countries, at end-2005, gross profit ratios were of the order of 2.1 per cent for the US and 0.6 per cent for France. The extent of penetration of Indian banking system in country as measured by the proportion of bank assets to GDP has increased from 50 per cent in the second half of



nineties to over 80 per cent a decade later. Operating expenses of banks in India are also much more aligned to those prevailing internationally, hovering around 2.1 per cent during 2004-2005 and 2005-2006. The proportion of net NPA to net worth, sometimes called the solvency ratio of public sector banks has dropped from 57.9 per cent in 1998-1999 to 11.7 per cent in 2006- 2007 (www.eac.gov.in).

Indian banks record high growth in the second quarter of 2007-2008 As per ASSOCHAM Eco Pulse (AEP) Study, of the Scheduled Commercial Banks (SCBs) have substantially increased their net profits with average rise of 30 per cent on the back of strong growth in deposits and fee based income in the second quarter of the financial year 2007-2008. The ASSOCHAM Study on 'Banking Sector Performance in Second Quarter' based on the quarterly results declared by the 17 major scheduled commercial banks has revealed that banks continued to maintain a strong momentum in both earnings growth as well as growth across all its core businesses, such as treasury income, fee based income and interest income. Major Scheduled Commercial Banks (SCBs) saw a rise of about 23.82 per cent in its treasury income in Second Quarter of the financial year 2007-2008. Fee based income of the banks registered a robust growth of 40.80 per cent in while the interest income posted a growth of 35.48 per cent in the quarter ending September 2007. Other banks, which saw significant profits, includes viz; Indian Bank (46.34 per cent), followed by Union Bank (42.04 per cent), HDFC Bank (40.14 per cent), State Bank of India (36.04 per cent), Centurion Bank of Punjab (33.76 per cent), ICICI Bank (32.79 per cent), Vijaya Bank (23.80 per cent), Allahabad Bank (14.17 per cent), IDBI Bank (12.23 per cent), ING Vysya Bank (11.09 per cent), Canara Bank (11 per cent), Syndicate Bank (10.98 per cent), Punjab National Bank (6.63 per cent) and Andhra Bank (3.26 per cent). The private sector banks continue to have higher pace of growth in their bottom lines with average 40 per cent growth as compared to 24 per cent growth recorded by public sector banks. While yes bank, HDFC Bank, Centurion Bank of Punjab was the best performers in the private sector, Axis bank, Indian Bank, Union Bank and State Bank of India remained at top among the PSBs. The AEP study also revealed that the bank deposits have grown by 26 per cent during the second quarter. Yes Bank (129 per cent), Centurion Bank of Punjab (69 per cent), IDBI Bank (61 per cent) and HDFC Bank (43 per cent) has registered maximum growth in their deposits.



(<http://www.banknetIndia.com/banking/71116.htm>). An attempt has been made to outline in brief considering selected criteria as follows.

(i) Performance Indicators:

The soundness parameters of the banking system have shown sustained improvement. The asset quality of the Indian banking system has improved. The NPAs of all SCBs, which stood at 15.7 per cent of gross advances and 7.0 per cent of total assets in 1995-1996, declined to 3.3 per cent of gross advances and 1.9 per cent of total assets in 2005-2006.

The financial performance of SCBs had also improved during the past as reflected in their profitability. The operating profit to assets ratio of SCBs, which was 1.69 in 1995-1996, increased to 2.03 in 2005-2006 (Table 2). Net profit to assets of SCBs remained in the range of 0.47 to 1.13 during the period 1995-96 to 2005-2006 (www.rbi.org.in).

(ii) Resolution of NPAs:

The Narasimham Committee- I had suggested the creation of an Asset Creation Fund to which the public sector banks would transfer the non-performing assets with certain safeguards. After considerations, it was decided not to adopt this approach. Instead banks were required to deal with all the non-performing assets themselves and it is clear from the performance indicators above that this strategy has been effective.

(iii) Ownership structure:

The Government holding in public sector banks range from 51 per cent (OBC, Dena) to 76 per cent (BOM). Of the privately held equity, significant portion (15 to 20 per cent) was held by foreign investors in quite a few public sector banks as on 30 September 2006. All new private banks are listed on stock exchange and there is considerable foreign investment in these banks. In five of the existing eight banks foreign shareholding had crossed 50 per cent.

(iv) Extension of Coverage of Reform Process:

The reform process initially focused on commercial banks. After significant progress was made to transform commercial banks into sound institutions, the reform process was extended to encompass other institutions such as regional rural banks (RRBs), Cooperative banks, All-India Financial Institutions (AIFIs) and non-banking financial companies (NBFCs). The regional rural banks, urban co-operative banks and rural co-operative credit institutions can play a major role in financial inclusion and deepening of the financial sector, in the rural areas (Source: Ibid).



ROLE OF RBI IN BANKING REFORMS IN INDIA:

The banking sector in India is poised for a quantum jump in productivity and scope for expansion in view of the competitive strengths acquired by the Indian industry. Public sector banks have shown substantial improvements, though in view of their large presence and some institutional constraints, further progress in reform is desirable.

An attempt has been made to outline measure initiated by the RBI as follows.

(i)Consolidation:

There are three aspects to consolidation viz., legal and regulatory regime governing consolidation, enabling policy framework where Government owns several banks and market conditions that facilitate such consolidation, recognizing that all mergers and acquisitions may not necessarily be in the interests of either the parties concerned or the system as a whole. While sanctioning the scheme of amalgamation, the RBI considers the financial health of the two banking companies to ensure, inter alia, that after the amalgamation, the new entity will emerge as much stronger bank. However, these provisions do not apply to viz., the nationalized banks, State Bank of India and its subsidiary banks.

(ii)Extension of Coverage of Reform Process:

The reform process has been extended to cover various other institutions such as Regional Rural Banks (RRBs), Cooperative Banks, All India Financial Institutions (AIFIs) and Non-Banking Financial Companies (NBFCs).

(iii)Payment System:

The current predominant mode of funds settlement is through the clearing process achieved by the functioning of about 1050 clearing houses in the India. In anticipation of the statutory changes, certain preliminary steps have been proposed by the RBI to build the requisite infrastructure for having effective supervision over payment and settlement systems.

A Board for Payment and Settlement Systems (BPSS) is proposed that would function like the Board for Financial Supervision. It would provide policy directions in areas relating to regulation and supervision of payment and settlement systems, approval of payment systems, criteria for membership, various aspects relating to admission, continuation, and denial of membership, handling of offences etc.



(iv) Rating of Supervision:

The supervision of banks is becoming very complex. The supervisors need to acquire technical skills, exhibit considerable judgments on systems and develop inter institutional interactions on a continuing basis. The RBI has made efforts to introduce a system of feedback from the supervised banks on the adequacy, appropriateness and quality of supervision. That would help in rating of our supervisory performance from time to time and also obtain suggestions for improvements from a large, small foreign and local bank.

(v) Users' Panel on Regulatory Instructions:

A Standing Technical Committee on Financial Regulation has been set up to advice on regulatory regimes administered by the RBI. The RBI has decided to prepare, self-regulatory organizations, a Users' Consultative Panel consisting of those in charge of compliance in the regulated institutions aimed at to obtain feedback on regulations at the formulation stage to avoid ambiguities and operational glitches (www.rbi.org.in).

The RBI has laid substantial importance on appropriate mix between the elements of continuity and change in the process of reform, but the dynamic elements in the mix are determined by the context. The Annual Policy Statement of May 2004 carried forward this focus and found out major areas requiring urgent attention especially in the areas of ownership, governance, conflicts of interest and customer-protection. It is necessary to articulate in a comprehensive and transparent manner the policy with regard to ownership and governance of both public and private sector banks keeping in view the special nature of banks. Inter-relationships between activities of financial intermediaries and areas of conflict of interests need to be considered.

In order to protect the integrity of the financial system by reducing the likelihood of banks' becoming conduits for money laundering, terrorist financing and other unlawful activities, and also to ensure audit track, greater accent needs to be laid on the adoption of an effective consolidated know your customer (KYC) system, on both assets and liabilities, in all financial intermediaries regulated by the RBI. It is essential that banks do not look for interfering details from their customers and do not resort to sharing of information regarding the customer except with the written consent of the customer.

The stability and efficiency imparted to the large commercial banking system is universally recognized, there are some segments which warrant restructuring. The annual policy



statement for the current year 2007 restates the concern for common person, while expressing a medium term framework, for development of money, forex and Government securities markets; for enhancing credit flow to agriculture and small industry; for action points in technology and payments systems; for institutional reform in co-operative banking, non-banking financial companies and regional rural banks; and, for ensuring availability of quality services to all sections of the population(www.rbi.org.in).

IMPACT OF REFORMS IN THE BANKING SECTOR IN INDIA:

One can state that the implementation of reforms has in the banking sector. India has lead to improve access to credit through newly established domestic banks, foreign banks and bank-like intermediaries. Government debt markets have developed, enabling greater operational independence in monetary policy making. The growth of Government debt markets has also provided a benchmark for private debt markets to develop.

One finds significant improvements also in the information infrastructure. The accounting and auditing of intermediaries and Information on small borrowers has improved and information sharing through operationalization of credit information bureaus has helped to reduce information asymmetry. The technological infrastructure has developed with modern-day requirements in information technology and communications networking (www.eac.gov.in).

The primary beneficiaries of the announced reforms are the state-owned banks, which control over three-quarters of total assets in the financial system. In the year 2005, the Central Government gave State-run banks significantly greater operational and managerial freedom, including the rights to: establish overseas branches or subsidiaries; exit non-profitable ventures; set human resource policies; and acquire domestic and foreign banks. Government of India removed limits on banks Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR) requirements, and gave the central bank greater flexibility to set the limits. In the first phase, between March 2005 and 2009, foreign banks will be allowed to establish a wholly owned subsidiary or to convert existing operations into a subsidiary. The RBI has raised the limit of Foreign Direct Investment in private banks to 74 percent from 49 percent. Before 2009, foreign banks will only be allowed to acquire up to 74 percent ownership of distressed private banks identified by the RBI for restructuring, After March



2009, foreign banks may be allowed to acquire any private bank, depending on a review of the outcome of the first phase (www.frbsf.org).

REVIEW OF BANKING SECTOR REFORMS:

In line with the recommendations of the second Narasimham Committee, the Mid-Term Review of the Monetary and Credit Policy of October 1999 announced a gamut of measures to strengthen the banking system. Important measures on strengthening the health of banks included: (i) assigning of risk weight of 2.5 per cent to cover market risk in respect of investments in securities outside the SLR by March 31, 2001 (over and above the existing 100 per cent risk weight) in addition to a similar prescription for Government and other approved securities by March 31, 2000, and (ii) lowering of the exposure ceiling in respect of an individual borrower from 25 per cent of the bank's capital fund to 20 per cent, effective April 1, 2000.

Banking Efficiency

It has been a key objective of financial sector reforms to improve the efficiency and profitability of the banking sector. In this regard, the interest rate structure has been fully deregulated. The statutory pre-conditions of bank resources through statutory liquidity ratio (SLR) and cash reserve ratio (CRR) have been substantially reduced. Banks' access to central bank liquidity through export credit refinance, marginal standing facility (MSF) and liquidity adjustment facility (LAF) has been enhanced. Furthermore, branch licensing norms have been relaxed and prudential norms have been strengthened. In addition, banks have increasingly adopted technology and accorded greater focus to human resource management. These changes have helped improve efficiency as borne out by various indicators.

The profitability of the Indian banking sector has been maintained at about 1.0 per cent in terms of Return on Assets (ROA), even in the post-crisis period. The banks have also shown significant improvement in other efficiency indicators such as cost to income ratio, business per employee and business per branch. However, net interest margin (NIM) has gone up indicating deterioration in allocate efficiency. Let me now turn to financial inclusion with a particular reference to the eastern-region.



Financial Inclusion

In order to sustain a higher economic growth, it is important to bring the excluded segment of the society into the fold of the formal financial sector. In recognition of this, the Reserve Bank has taken a number of steps to take formal banking to door steps of habitations with population over 2000 through the business correspondent (BC) model where the BCs provide basic banking functions acting as agents of banks. Simultaneously, a number of initiatives such as incentivisation of branch authorization scheme for banks to open branches in unbanked centers, simplification of Know Your Customer (KYC) norms, technological interventions and financial literacy-oriented programmes to increase awareness have been taken. While the initial impact of these initiatives has been positive, it has created a huge potential for expansion in banking business once the level of activity is scaled up and government social benefit transfers increasingly take place through the banking sector.

While we have our own data source to gauge financial inclusion, the Census of India provides useful information on access to banking. It shows that about 59 per cent of households had access to banking services in 2011 as compared with only 35 per cent in 2001. Increase in access for the eastern-region has also gone up significantly from about 29 per cent in 2001 to 47 per cent in 2011, though the region still lags behind the all-India average (Table 3). In 2001, the all-India average population per bank branch was 15,600, which has fallen steadily to 12,500 by 2012 again suggesting an increased penetration of the branch network. For the eastern-region population per branch has declined from 19,500 in 2001 to 17,300 in 2012. While the eastern region has witnessed an increase in banking outreach since 2001, its average has remained lower than the all-India average underlining considerable scope for expansion.

CONCLUDING REMARKS:

The Basel Committee intends to replace the current Capital Accord with a New Framework which is built on a three-pillar approach minimum capital requirement, supervisory review and market. There is also a need for improving further the accounting and disclosure standards to fall in line with the international best practices. Refinements in market risk management will have to be made by adopting sophisticated techniques like duration and



simulation and adoption of internal model-based approaches and credit risk modeling techniques by top banks.

The RBI has accepted the Basel Committee's Core Principles for effective banking supervision. There are gaps in the areas of consolidated supervision, country and transfer risk monitoring, inter-agency co-operation and cross border supervision. A framework of Prompt Corrective Action (PCA) is being evolved with various trigger points with the approval of the Government based on three parameters viz capital adequacy, asset quality and profitability to consider a set of mandatory and discretionary actions for dealing with banks that cross the trigger points. India has been sharing the increasing international concern on the use of the financial system for money laundering and financing of terrorism. The RBI is in the process of setting out the policy, procedures and controls required to be introduced by banks that include strict adherence to Know Your Customer (KYC) procedures for prevention of misuse of banking system for money laundering and financing of terrorist activity (www.rbi.org.in).

One could regard the past of the banking industry, wherein every branch of the same bank acted as an independent information storage tower, and multichannel banking such as ATMs, Net banking, tele-banking, etc was almost nonexistent. The deregulatory efforts prompted many financial institutions and non-financial institutions into retail banking and with multi-nationals focusing on the individual consumer in a big way, the banking system underwent a phenomenal change. Multi-channel banking has gained prominence in India.

Consumers got the choice of conducting transactions either the traditional way through the bank branch, or ATMs, the telephone or through the Net. Technology played a key role in providing this multi-service platform. (Anil Patrick R, www.networkmagazineIndia.com).

The growing competition, growing expectations has led to increased awareness amongst banks on the role and importance of technology in banking. The arrival of foreign and private banks with their superior state-of-the-art technology-based services have pushed Indian Banks also to follow suit by going in for the latest technologies so as to meet the threat of competition and retain their customer base (www.banknetIndia.com).

A few broad challenges facing the Indian banks are: threats of risks from globalization; implementation of Basel II; improvement of risk management systems; implementation of new accounting standards; enhancement of transparency and disclosures; enhancement of



customer service; and application of technology. The waves of globalization are sweeping across the world, and have thrown up several opportunities accompanied by associated risks.

The Committee on Full Capital Account Convertibility noticed that under a full capital account convertibility regime, the banking system would be exposed to greater market volatility, and this necessitated enhancing the risk management capabilities in the banking system in view of liquidity risk, interest rate risk, currency risk, counter-party risk and country risk that arise from international capital flows. The issues relating to cross-border supervision of financial intermediaries in the context of greater capital flows are just emerging and need to be addressed.

Basel II has brought into focus the need for a more comprehensive risk management framework to deal with various risks, including credit and market risk and their inter linkages. The diversity in the Indian banking system, stabilizing the RBI as an effective supervisory mechanism is another challenge.

Corporate Governance is the foundation for effective risk managements in banks and, the foundation for a sound financial system. There are four important forms of error that should be included in the organisational structure of any bank in order to ensure appropriate checks and balances: (i) oversight by the board of directors or supervisory board; (ii) oversight by individuals not involved in the day-to-day running of the various business areas; (iii) direct line supervision of different business areas; and (iv) independent risk management, compliance, and audit functions.

The RBI is considering the need for banks and financial entities adopting the broad underlying principles of IAS 39. That would give rise to some regulatory/prudential issues; all relevant aspects are being comprehensively examined. Adoption and implementation of these principles are likely to pose a great challenge to both the banks and the Reserve Bank. A further challenge which banks face in this regard is to ensure that they derive maximum advantage from their investments in technology and avoid wasteful expenditure which might arise on account of uncoordinated and piecemeal adoption of technology; adoption of inappropriate/ inconsistent technology and adoption of obsolete technology.



Feedback received reveals recent trends of levying unreasonably high serviceusercharges and enhancement of user charges without proper and prior intimation. (www.rediff.com/money).

In the current scenario, banks are constantly pushing the frontiers of risk management. Compulsions arising out of increasing competition, as well as agency problems between management, owners and other stakeholders are inducing banks to look at newer avenues to augment revenues, while trimming costs. Consolidation, competition and risk management are no doubt critical to the future of banking that governance and financial inclusion would also emerge as the key issues for a country like India, at this stage of socioeconomic development (www.rbi.org.in).

The banking sector reforms, which were implemented as a part of overall economic reforms, witnessed the most effective and impressive changes, resulting in significant improvements within a short span. The distinctive features of the reform process may be stated thus:

- 1) The process of reforms has all along been pre-designed with a long-term vision. The two Committees on financial sector reforms (Narasimham Committee-I and II) have outlined a clear long-term vision for the banking segment particularly in terms of ownership of PSBs, level of competition, etc.
- 2) Reform measures have been all pervasive in terms of coverage of almost all problem areas. In fact, it can be said that, it is difficult to find an area of concern in the banking sector on which there has not been a Committee or a group.
- 3) Most of the reform measures before finalization or implementation were passed through a process of extensive consultation and discussion with the concerned parties.
- 4) Most of the reform measures have targeted and achieved international best practices and standards in a systematic and phased manner.

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