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Banking Structure for India

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Over the last few years, various committees, working groups and discussion papers have emphasized the need to reform the structure of the banking sector as it exists today. On taking over as the Governor of RBI, Dr. Raghuram Rajan had emphasized on the strengthening of the banking structure as one of the five pillars of RBI's financial sector policies and developmental measures. In 2009, the Report of the Committee on Financial Sector Reforms stressed the need for well-governed deposit-taking small finance banks. A discussion paper by RBI on Banking Structures in India laid out the importance of the banking structure being flexible and competitive in order to serve the growing real economy, and to facilitate penetration and depth. It also emphasised the fact that the world over, banking structures are being revisited to incorporate the learnings from the global crisis.

The recent Nachiket Mor Committee Report on Comprehensive Financial Services for Small Businesses and Low Income Households too proposes a framework for a banking system designed to improve financial inclusion.

In the above context, CAFRAL organised a conference to bring together various stakeholders to deliberate on the need and the implications of the various emerging and potential bank structures. The deliberations during the conference have been summarised below:

Need To Think About Banking Structure

We are at a turning point for the financial sector and more specifically banking sector. If we put the extremes of choices we have about various options, one is a system which is underperforming with fragilities and relatively poor governance and therefore unable to fund the tremendous needs of this economy. There is another future where we have a strong, vibrant, outward looking, efficient banking system which reaches every corner of the country, and is also powerful enough to fund the needs of this economy and builds a strong global system.

The key sources of growth over next many years would be infrastructure, small and medium enterprises, retail customers and finally by bringing in the lower income persons into the fold of formal system. Finance is the enabler to funnel this growth and the critical lubricant that keeps the system growing. While credit is a critical need of all sectors, payments and savings are also central to an efficient system. One of the big concerns over the last few years has been the fall in financial savings. There is a need to increase that, and bring more people to save in the formal banking and financial system both for protection of savers as also for allowing credit flow to the productive sectors. There is therefore a need to create a robust financial system that fosters enough competition and also variety in terms of kinds of institutions and their focus areas. Vibrant institutions of various kinds e.g. big banks, niche banks, NBFCs, etc., can contribute to stability because not everybody does the same thing.

From financial stability perspective, it is also important to examine the different structures in the context of the recent experience of the demise of investment banking in US and also the problems in universal banks. Even within universal bank there are predominantly three types of models being followed in terms of physical structure:

1. Complete universal bank which is pre-dominantly being followed in Europe where all types of activities (other than insurance) take place inside the bank.
2. Bank itself is a holding company and then there are a number of entities under it to carry our various activities.
3. Financial holding company under which there is the bank and other financial services entities.

The last model is the one that has been proposed in the latest bank licence guidelines and has some distinct advantages – it is a simple structure, facilitates resolution of one part should it go bad, there is a segregation of financial and non-financial entities, and lastly it frees the bank from managing the other financial services entities. This structure also facilitates development of investment banking.

Public Sector Banks (PSBs) are a dominant part of the banking system in India and have been a great source of stability and employment. However, there are growing concerns on the governance structure and quality of assets. In order to address these issues as well as to reduce the fiscal burden on account of recapitalisation of PSBs, issue of non-voting equity shares or differential voting equity shares may be considered. Government could also consider diluting its stake below 51 per cent in conjunction with certain protective rights to the Government by amending the statutes governing the PSBs. PSBs are an integral part of the system and they need to be strengthened from where they are right now.

I. Differentiated Licenses for New Varieties of Banks

The basic premise for a move towards differentiated bank licences is that not everybody should or is capable of getting a universal bank license. As the economy grows and its needs become more complex, a variety of participants should be permitted to facilitate the growth. However, it is important to create a relatively arbitrage-free structure.

Grand Bargain

A universal bank licence in India gives a bank the right to access low cost retail deposits, deposit insurance for small depositors, connect to the payment systems and access to liquidity from the central bank. In return for these privileges, there are certain obligations imposed on the bank in the form of maintaining CRR and SLR and fulfilling priority sector lending. This is the grand bargain and differentiated licence is in a sense de-coupling this package that universal banks get. It's important to understand what aspects of the package are tied together and how can they be transformed to the other parts of the differentiated bank license, so that the playing field is levelled and there is no additional privilege to any segment of the banking sector. If a bank comes in as a payment bank and it takes deposits only for the purpose of payment and is not permitted to lend, then it is subject to CRR and SLR. This is an entity which has low arbitrage and is basically on the same playing field as the universal banks. On the priority sector lending the question to be debated would be should it be tied to raising low-cost deposits or should it be imposed on every bank that lends irrespective of its source of funding. Similarly, on the access to LAF the question would be whether all kinds of banks should have similar access or should it be graded. Equally so, level of SLR for banks needs to be looked at and regulator also needs to examine whether SLR has to be maintained at all times or could be permitted to be drawn upon at times of extreme liquidity stress.

Case for Differentiated Licensing

First reason is that it encourages specialisation among banks and helps them focus on their core competencies. Second, there is a strong need to reduce the cost of intermediation of the Indian financial sector so that the real economy is not at a disadvantage in competing on a global scale. Third, the disconnect between the banking system and technology for payments and finance, to where technology world is headed is so humungous, that at some point of time it may move out of the regulators' control as well. If the focus continues to be on controlling pockets of arbitrage and not on increasing efficiency of intermediation, there is the risk of technology disrupting the banking model forever. Fourth, it helps to lower complexity and reduces the likelihood of contagion from one type of business to another.

And lastly, it helps to focus regulatory resources on those activities that banks are specialising in.

Risks Involved in Differentiated Licensing

Regulatory arbitrage is most often cited as the reason against differential licensing. It will require the regulator to balance the grand bargain in a manner that such arbitrage is minimised, recognising it can never be completely eliminated. This apart the other risks are:

Concentration Risk: There will be higher concentration risk whenever there is specialization and it has to be tackled and there would be a regulatory cost. Small banks are potentially vulnerable to sector and geographical concentration risk. Part of the regulatory cost is already embedded in universal banks, because under Pillar II banks have to provide more capital if they have larger concentration. Since there are no reliable models today to calculate what should be the additional capital requirement, it is left to the judgement of the supervisor within the Pillar II framework. Empirical evidence suggests that financial consolidation led to higher concentration in countries such as US and Japan, though they continue to have much more competitive banking systems as compared with other countries. However, in several other countries, the process of consolidation led to decline in banking concentration, reflecting increase in competition.

Liquidity Risk: Globally it is experienced that regulators are moving from concentration on whole sale funding to diversified sources of funding. So, the question is whether the liquidity requirement on specialised banks which only raise wholesale liabilities, should be different as they are not accessing very liquid funds. In particular, there would be need to categorise short term wholesale funding within the category of deposits so that they will be treated as universal bank in terms of their funding structure and have similar norms.

Mortality Risk: The crisis has brought into sharp focus the need for effective deposit insurance and resolution regimes to deal with the failing/failed banks with least cost. In India, failures of commercial banks have been rare, and the beneficiaries of the deposit insurance system have mainly been the urban co-operative banks. So there has to be some amount of cross subsidization and some amount of rationalization. The FSB key attributes could be the guiding principles for setting up a resolution framework in India. The existence of an effective resolution regime is essential for any type of banking structure India may pursue.

Uniform Regulation, Focussed Supervision

In the context of differentiated bank licences, it is important to note that there is a distinction drawn between regulation and supervision. Regulation will be broadly similar across the board and all bank categories would come under the Banking Regulation act. There would only be certain tweaking built into the design of regulation depending on certain parameters like nature of activities undertaken by the bank, etc. However, supervision is where the main difference would be between different categories of banks based on the focus of supervision. Supervision is where the focus on opportunities for regulatory arbitrage would be checked.

Impact on Existing Banks

Competition from new players creates some tension and it may lead to some fragmentation, on the other hand it may also lead to new business practices which are far superior to other practices. Existing banks already have a head start and must make all efforts to consolidate their position in existing and emerging new markets, before the new category of banks take shape and form to be serious competition to them. If there is continuous entry of new participants in the banking system (through on-tap authorisation of licence), it causes less drain on the existing banks. Such entry would increase the level of competition; bring new ideas and variety in the system. However, it is important that the entry norms should be stringent. Authorities should seek to facilitate and encourage entry by only well-qualified entities in order to improve the quality of the banking system and promote competition.

Financial Inclusion and Differentiated Licence

In the context of financial inclusion, there has been a long standing debate on whether we need small number of large banks or large number of small banks. The Indian experience so far shows that while small banks with geographical limitations play an important role in the supply of credit to small enterprises and agriculture, however, risk management, capital requirements, exposure norms, regulatory prescriptions and governance have been the key challenges with these banks. On financial inclusion aspect, clearly there have been notable changes and there is need to foster that change. Business correspondents can be used more extensively and the impediments on such usage need to be examined. The feasibility and outcome of allowing NBFCs as BCs also need to be explored. Commercial banks have certainly made good progress in financial inclusion. However, there is a sense that it is far from enough and there is also a sense that this is driven by way of regulation rather than a self-sustaining effort as a business proposition. Universal banking facilitates ability to access deposits, payment systems, on the other hands brings with itself the obligations of CRR/SLR, priority sector lending and so on. If a separate wing of "payment bank" is created which will facilitate low cost deposit but will not be allowed to lend, the question is whether that segment of population which requires loans will be somehow excluded from the financial system. This issue can only be addressed through the experience in due course and it is hoped that whenever there is unmet demand or need, market forces automatically converge over time to fulfill it. Given the extent of task of inclusion ahead, there is a need to think through and experiment with newer models while continuing to foster the growth of existing banks in this area.

Cost Benefit Analysis

While RBI has so far not worked out what should be the regulatory framework for differentiated licensing, it would on one hand need to increase some regulatory cost both from the perspective of concentration risk and liquidity risk, on other hand it could ease some cost as the bank does not have some of the obligations. It is a mixed package and that is where the regulatory requirement would need to strike a fine balance such that it minimises regulatory arbitrage and one form is not decidedly superior to another form. It is more a matter of choice of which model banks wish to adopt.

NBFCs as Specialised Banks

Presently, in some sense, differentiated licenses already exist – there are banks, there are NBFCs. NBFCs are more or less doing the same activities what banks are doing and thus, it is much better to be a specialised bank rather than to be a specialised NBFC in terms of regulatory comfort. The added advantage is that they will be subjected to Basle rules and subject to closer supervision and will also have access to central bank liquidity to avoid a situation where there could be systemic risk due to sudden liquidity shortage.

II. Role and Regulatory Framework for NBFCs

Role of NBFCs in the Financial Sector

NBFCs are an integral part of the Indian financial system and have thrived and co-existed along with banks for a long time, in a hugely synergistic manner. NBFCs have catered to certain customer segments, and also very often certain geographies where banks have not had their presence or not served the customers as effectively as NBFCs. NBFCs have been game changers in segments such as the second hand vehicle financing, in MSME and in affordable housing. In some ways they have created a market where banks have dared to tread in to, like car financing, truck financing or home financing. In mid 80s, car finance was a domain completely dominated by finance companies only. Over a period of time, banks started finding this segment attractive and over time due to competition from banks, a number of NBFCs have pretty much vacated this space. The relationship between banks and NBFCs has been that of wholesaler-retailer. As banks have started offering products hitherto being offered only by NBFCs, the latter have moved to newer areas and segments.

12th plan document states that Rs.6,18,000 crore is to come from NBFCs and hence this sector is an important and integral part to the economy. In United States, 30-40% on an average is the quantum of leased assets of the total assets created, where as in India it is only 3-4% and that puts the perspective of the role NBFCs can play, particularly in leasing which is essentially in infrastructure financing.

Regulatory framework to enable the NBFCs to play their role

The role of the regulatory framework should be supportive but at the same time it should be ensured that regulatory arbitrage to a great extent is ironed out and the USP of NBFCs is preserved. Therefore while there is a case for convergence on recognition norms for NPLs between banks and NBFCs, the same legal and other enablers to maintain asset quality have to be made available to NBFCs also so that the entire lending system has same support to same legal and recovery frame work which can protect assets for NBFCs and the banks. The regulatory obligations imposed should be commensurate with the privileges given.

One possible way of looking at the regulatory regime for different types of non-bank and bank entities is to think of an entire continuum of non-bank and banks, by size. So at one end of the extreme would be really small finance companies that are not regulated and not registered (as recommended by Usha Thorat Committee), then there are NBFCs that are regulated where the supervisory infrastructure is less onerous and regulatory requirement are lighter touch until they reach a certain size as RBI may define, which makes them systemically important NBFCs. In case of such systemically important NBFCs, the systemic risk of liquidity is important in view of the interconnectedness of such entities and the regulatory regime could become more onerous and more intrusive. Drawing lessons from the crisis, it may be important to state that once an entity becomes systemically important and not just systemically important within the space of its own category but across the board in the financial system, then like in US there are far stricter regulations and all such entities (including insurance companies) are regulated by Federal Reserve Bank. Also taking forward the continuum idea, it may be more prudent to have size and activity combined to determine the nature of regulation.

Within NBFCs there already exist differentiated licences such as CIC, MFI-NBFC, Assets Finance Company, etc. So while these categories may have been created to serve a particular policy purpose, there is a need to rationalise the privileges provided within each category. For example, certain categories are permitted to have external commercial borrowings, whereas certain others are not, irrespective of their size.

While NBFCs are playing a stellar role in reaching credit to the underserved population, it's equally important to see at what terms are they delivering credit and therefore the role of RBI as customer advocate becomes important.

Funding of NBFCs

Liabilities side is where the NBFCs face the maximum constraints and this is also their main motivation to transition to become a bank. However, in this context it is important to take lessons from the effects of Asian crisis in 1998-2000 where it experienced the pitfalls of external financing used for the purpose of creating large illiquid domestic assets. One thought is that beyond a certain size the NBFCs should actually be encouraged to start developing as a deposit franchise because liquidity risk of running a very large balance sheet completely whole sale funded are much too high. So they might be given some kind of specialized banking license that allows them access to deposits of a certain kind may be only from institutional investors. Permitting NBFCs to become BCs is another idea which must be pursued after taking care of conflict of interest and other safeguards required. NBFCs have the manpower, knowledge, skill and the requisite infrastructure to work as BC for banks. There could be significant synergies if such networks are leveraged upon.

Liquidity Risks for NBFCs

From the ALM statements of NBFC sector, it is experienced that the first two buckets are not a major problem as they have been receiving sufficient funds, the problem is in longer end. When RBI allowed the back stop facility during the financial crisis, even though only one NBFC actually availed it, the very action of putting in place such a facility provided comfort and panic was averted. Allowing a regulated entity access to Lender of Last Resort (LOLR) from the Central Bank window is a provision gaining international recognition. Even in the case of Central Counter Parties (CCPs), RBI has put it in public domain that back stop facility will be made available.

Transition Path for an NBFC Which Has Grown Up to a Significant Size

Because NBFCs access bank borrowing as large part of their funding piece, there is a potential systemic risk even to banking system if we have large number of NBFCs at risk. Therefore when certain NBFCs achieve a significantly large size, they have to be nudged to become a bank.

Conversion to "Wholesale Bank"

On the liabilities side, banks mobilize retail deposits, access payment system and also access the wholesale market for funds. Non-deposit-taking NBFCs, in contrast, obtain funds from the wholesale market or access the capital markets through commercial paper, nonconvertible debentures, inter-corporate deposits and bank borrowing. On the assets side, there is hardly a difference as both banks and NBFCs undertake loaning and investment activities. Non-deposit taking NBFCs have no cash reserve ratio (CRR) requirement, nor are they required to maintain a statutory liquidity ratio (SLR). If NBFCs are permitted to convert as whole sale bank, they will be subjected to all prudential requirements including capital and liquidity and the effective cost of large ticket deposits will be much higher and not lower than what NBFCs access funds in markets now. So if there are going to be restrictions on specialized banks either on liability or on asset side then the regulation has to be so designed that it is worthwhile to that entity with proportionate privileges and obligations. One thought is to have differential CRR/SLR requirement for "wholesale banks" since they will not have access to short term and retail deposits. Then the related question that arises is should CRR/SLR be different for universal banks for their longer term and wholesale liabilities.

FSLRC Recommendation to Keep NBFCs Outside the Regulatory Domain of RBI

As regards the FSLRC recommendations to keep NBFCs out of RBI regulatory domain, it has to be ensured that organic link between monetary policy and credit function should not be disturbed. Therefore, the extent to which NBFCs are involved in credit function, they need to be within the ambit of RBI's regulation. On the other hand, there are many large insurance companies doing large ticket advances to infrastructure sector, but they are not being regulated. Any entity which is involved in credit should come under the ambit of regulation of RBI.

III. Presence and Structure of Foreign Banks in India

In India, foreign banks have been at the forefront of innovation with their off balance sheet products, forex derivatives, trade finance products and indeed in many ways to support India's international trade. They bring strong capabilities in risk management and technology and have added to competition in the banking system. In India, where we already have a low credit to GDP ratio compared to other countries, the share of foreign banks is less than 6-7% i.e. even out of a small pie, their share is miniscule. India has been quite liberal in allowing full universal licence to foreign banks, unlike other countries who insist on a step-by-step approach based on track record. Though in reality, most foreign banks in India are actually a specialist wholesale bank or a specialized investment bank. The primary reason for this is that their business model is HO determined and it leaves them with very little appetite to experiment in local markets.

Structure of Foreign Banks

So far as foreign banks' presence in Indian banking system is concerned, RBI wants depositors' protection, safe and sound banking system and financial stability. If it is seen purely from financial stability point of view, it makes sense to have subsidiaries in India to address the concern of contagion and capital outflows during times of crisis. In some countries there have been dramatic withdrawal of capital as well as shrinkage of activities and this has hurt; in some other countries, the foreign banks have seen as source of stability in bad times. Even during the recent Euro zone crisis, there were inflows by some European banks into Singapore. But other than financial stability, if we see the macro economy and the needs of large corporate, the branch model may be better suited as it provides pass through into the global entity in a more transparent manner. Also in times of crisis in the host country, the desire to support a branch would be much higher than that of a subsidiary.

The subsidiarisation guidelines are not particularly attractive to the foreign banks due to the following reasons:

- The carrot for the foreign banks is freedom with branch licences at par with other banks. However, given that most foreign banks here are not focused on the retail segment and are going increasingly for an on-line presence, this may not be incentive enough for them.
- PSL requirement goes up to 40% and this is a huge deterrent.

Dual mode of presence is another option for RBI to consider as is being followed in Singapore. In Singapore, foreign banks which have significant retail presence are required to make their retail operations in Singapore as subsidiaries. However, this requirement is only with respect to their retail operations and they can still retain and operate their wholesale operations as a branch.

Increase of Foreign Banks' Share in India

Over the next decade a major part of growth in economic activity would happen in emerging markets and a lot of new MNCs will come from countries like India, China, Brazil and Indonesia. The role of global banks in funnelling this growth would be critical. Additionally, NRI deposits are a significant source of funding for our country and foreign banks can play an important role in this offshore retail activity. There are various steps which, if taken, can lead to increase the presence of foreign banks here:

1. Allow foreign banks to acquire Indian banks and this may be permitted to only those incorporated as local subsidiaries.
2. Export credit and other export focused lending could be included in priority sector and foreign banks can play a useful role in them.
3. Tax laws and ease of doing business are equally important considerations for foreign banks in determining their extent of presence in India.
4. By compulsorily imposing 18% agriculture credit obligation on foreign banks, who have no skills or appetite for such lending, there is probably an addition to systemic risk. Instead it may be better to impose an explicit financial cost on them and not burden them with direct agriculture lending. Financial inclusion is a national goal and all players should be a part of it, but how it is to be achieved is a question that needs addressing.

Singapore Experience with Foreign Banks

It is useful to look at Singapore as an example since foreign banks account for two-third of the assets of the banking system in Singapore. There are three different types of licences and the primary difference between these different types of licenses is access to domestic retail markets. The restrictions on access to domestic retail markets was done to balance the considerations of encouraging foreign banks for competition and innovation while at the same time safeguarding a sufficiently large deposit base for the local banks who can act as a source of financial stability during times of crisis. A number of steps were taken in

Singapore to attract foreign banks – abolishing the limits on foreign ownership of local banks, greater retail market access through selected number of full banks, permitting foreign banks to share their ATMs and electronic payment networks to get better efficiencies. MAS also allowed them to access certain investment accounts viz. CPF, the central provident fund account, to enable them to reach out to more retail customers. On wholesale banking side, they freed up the entry to the market and removed the restrictions on number of whole sale and off shore banking licenses. For the foreign banks which have significant retail presence, it is mandatory to make their retail operations in Singapore as subsidiaries and not as branches. All this resulted in healthy development of the sector without compromising on financial stability. There were wider range of banking products and services, prices became more competitive and there was improvement in service standards to customers. In order to manage the risks associated with a dominant presence by foreign banks, Singapore follows the following:

1. Stringent admission requirements with proper due diligence.
2. Monitoring of foreign banks which are prone and exposed to contagion effect from their head office.
3. Close engagement with home country supervisor.
4. Regular desk-top exercises on crisis management both for business continuity as well as for liquidity risks.

IV. Future of Cooperative Banks & Regional Rural Banks

The co-operative sector brings unique capabilities in reaching poorer segments of the population and lending to small and medium industry. There are about 1 lakh branches of scheduled commercial banks which includes 16,000 to 17,000 branches of RRBs. There are about 10,000 branches of District cooperative banks and State cooperative banks and another 7,000 to 8,000 branches of the urban cooperative banks. RRBs, within the scheduled commercial banks have about 16 % or 17% share in the branch network and 16% of the total savings bank accounts of scheduled banks structure. These 16% deposit accounts, account for only 3% of the deposits of scheduled commercial banks. The same is true for the loan accounts. RRBs have about 16% or 17% share in the loan accounts of the banking system but only 3% of the total loan outstanding of the scheduled commercial banks. In terms of the average size of the deposit accounts, the private sector commercial banks have an average deposit more than Rs.1 lakh, the nationalized banks about Rs.70,000, SBI has about Rs. 70,000 to Rs. 80,000, foreign banks have more than Rs.6

lakh and RRBs are at Rs.15,600. Cooperative banks are meeting the deposit needs of more than 10 lakh depositors with an average deposit of less than Rs.10,000.

However, the cooperative banking system is subject to politicisation and there could be serious governance issues especially as the Board is in the hands of borrowers. As recommended by the Vaidyanathan task Force and Malegam committee, there is need to have depositor's say and representative on the Board. The biggest constraint in cooperative banks is their inability to raise capital like a joint stock company and hence they can grow only on basis of retained earnings. There should be an option for cooperative banks to convert to joint stock banks. The capabilities of this sector are being under-utilised and there is a need to figure out an alternative model to help strengthen the structure and get a vibrant co-operative sector.

Regional Rural Banks

Regional Rural Banks were established under the provisions of an Ordinance in September 1975 and the RRB Act, 1976 to provide sufficient banking and credit facility for agriculture and other rural sectors. RRBs are formed by the respective sponsor banks. However, over a period of time it has been experienced that the RRBs are facing various problems such as:

1. Lack of attention and co-ordination from sponsor bank.
2. Cost structure has over time started to resemble the sponsor bank and so is the case with product mix. Therefore their unique business model with which they were originally created is lost.
3. Various HR issues have overwhelmed the functioning, especially due to mergers which has resulted in loss of their "regional" character and the concept of having local resources with local knowledge and proximity to customers has been lost.
4. The RRBs have ceased to be outreached entity of the sponsor bank and they have become competitors of the sponsor bank resulting in an inherent conflict between the RRB and the sponsor bank which offer the same products.
5. There is also this issue of what is the role of small local banks in today's age of technology where the sponsor bank can directly access remote and small customers through multiple technology enabled channels and applications.

Some of the Ideas to Improve the Performance of RRBs are Discussed Below:

1. **Leveraging structural strength of RRBs and proper coordination between the sponsor banks and RRBs**

The five top most RRBs in the country have credit deposit ratio of 80% or more. This proves that by using right product, right processes, and by linking to or associating with the population, better results can be achieved. The USP of RRBs is that they know their people and that is where the commercial banks fail because every two years, the branch manager changes. In case of commercial banks, due to frequent transfer from one place to other, rural to urban etc. the continuity in learning and experience gathering in a particular area gets lost. Whereas, in case of cooperatives/RRBs even if they are transferred, they remain rural bankers in the same small geographies. So the learnings come faster and therefore they are able to relate. This strength needs to be leveraged into actual action.

2. **Priority sector lending eligibility for sponsor bank**

Lending by sponsor bank to RRBs for on-lending to agriculture and allied activities is considered as lending to indirect agriculture and qualifies for priority sector lending. However, the amount lent by RRBs out of funds borrowed from commercial banks/sponsor banks, is not permitted to be classified by RRBs as part of their priority sector advances. We need to examine the possibility of allowing on-lending by RRBs as part of their priority sector lending achievement for better encouragement and co-ordination between the two.

3. **Organisation culture and focus**

In case of Syndicate Bank, all the RRBs have CD ratio of more than 80%. Syndicate Bank initially was a small man's (essentially small trader's) bank and if that DNA really has some meaning, then perhaps that culture somewhere has gone to the sponsored RRBs as well irrespective of their location in the country. Proper nurturing, proper product mix, constant motivation from the top management, ensuring proper HR issues, adequate leverages on technology etc. have benefitted the progress of RRBs.

4. **Innovation in product design and business model**

There is need for the RRBs to innovate in product design to meet the needs of their target customer segments, rather than mimic what the sponsor bank offers. The total number of depositors in the country is 7 times the number of borrowers. So, a larger number of people want to make deposits and a much smaller number, one-seventh of them want to take loans. There is a significant need for small savings and these banks with the right focus and product design could be best suited to meet those needs.

5. **Mergers and acquisitions of RRBs**

Present owners may be permitted to divest their shares in the RRBs and new players could step in their place. The sponsor bank could be incentivised to do so through a reverse licensing process such that for every three branches of an sponsored RRB, sponsor bank can add one more rural branch and in the bargain can get one urban license. While new players would find it attractive to acquire RRBs from sponsor banks due to their reach and penetration, they would be deterred by issues like asset quality, HR issues, etc. The opaqueness on these issues would need to be minimised so that new investors can judge if they are a viable, dynamic and a good integrated investment proposition.

6. **Importance of size in order to widen and deepen outreach achievement**

When RRBs were created they were working in two or three districts. A District Central Cooperative Bank generally works in only one District. Urban cooperative banks mostly work as one city banks or two city banks. If we look at the two or three phases of consolidations that have happened in RRB sector, the overall profitability seems to have increased over these consolidation phases. Therefore, there might be reason to believe that size matters. In case of cooperatives, so far there has been no consolidation and there is a need for looking at this concept and to see whether outreach and viability can be enhanced through this route.

7. **Concentration risk and the issue of diversification in business model of RRB / LAB/ Cooperatives**

Ramachandran Committee report recommended stopping of licenses to LABs and no issue of further licenses. The main issue was too much of concentration risk in small banks like LABs/ RRBs. This is an issue with most co-operatives also. However, there are dozens of successful examples in co-operative where there has been diversification into allied activities such as trading, marketing, processing and agriculture support activities like leasing out equipment. Also, proper leveraging with the government schemes and ensuring linkages with adequate market set up will encourage customers to visit cooperatives instead of a commercial bank or RRB branch which cannot offer such services. This would improve cooperative-client relationship and enhance viability.

8. Merger and its adverse effects

While merger of various RRBs in a state has seemingly brought profitability to the RRBs in terms of consolidation and better balance sheet management, at the same time, there is a concern that the local expertise in terms of human resource is lost to some extent. This may create an adverse effect on the RRBs' role in future. A need has therefore arisen to look at the recruitment and transfer policy before merger and consolidation of such banks from different districts and regions.

9. Primary Agriculture Credit Societies as Business Correspondents (BCs) of banks

Primary agriculture credit societies are permitted to be BCs of commercial banks so that savings and loan services can be provided to the ultimate members of the PACS. However, so far there have not been any examples of that partly because of the worries that by linking the primary societies to commercial banks, the importance of the DCCB and the state cooperative bank could get threatened or their whole functioning could get affected. And the other critical reason is that banks want that if they become BC of the bank, then all their accounts need to be migrated to the bank's platform, so that the bank can have better control over the entire balance sheet and the PACS is not independently running a parallel book with cash transactions. As PACS' capacities to manage resources and risks are limited, there is general consensus among regulators, thinkers, and thought leaders, that a BC model can work well and a BC cum independent bank model will not work in the long run. There is a need to rethink and strategize the linkage of PACS as BCs of banks for better outreach and benefit of the poor people.

Annex 1

List of Conference Participants

Sr.No	Name	Designation	Organisation
1	A K Bera	PCGM, UBD	RBI
2	A. Udgata	PCGM, RPCD	RBI
3	Alpana Killawala	PCGM	RBI
4	**Anand Sinha**	Advisor	Reserve Bank of India
5	Anirudh Ghosh		ET Now
6	Ashwini Kumar	CMD	Dena Bank
7	Asokan Arumugam	Chief Compliance Officer	Reliance Capital
8	Atul Joshi	MD & CEO	India Ratings and Research
9	**B Mahapatra**	ED	Reserve Bank of India
10	Bazil Sheikh	CGM	RBI
11	Bipin Deokar	Deputy Director	EPW Research Foundation
12	Bobby Parikh	Chief Mentor & Head, Private Equity Practice	BMR & Associates
13	Chanda Kochhar	MD	ICICI Bank
14	D R Dogra	MD & CEO	Care Ratings
15	Deepali Pant Joshi	ED	RBI
16	Dimple Bhandia	DGM	RBI
17	Diwakar Gupta	Consultant	Aditya Birla Group
18	Dr. Mukund Abhyankar	Director, Chairman Emeritus	Cosmos Bank
19	**Dr. Prakash Bakshi**	Former Chairman	National Bank for Agriculture and Rural Development
20	**Dr. Rajiv Lall**	Executive Chairman	IDFC Limited
21	**Dr. Sudhir Kumar Goel**	Additional Chief Secretary, Agriculture and Marketing	Government.of Maharashtra
22	**Dr.Raghuram G Rajan**	Governor	RBI
23	Gayathri Nayak	Assistant Editor	Economic Times
24	Gopika Gopakumar	Special Correspondent (Banking and Finance)	CNBC TV18
25	Jay Kumar	DGM	RBI
26	K N Vaidyanathan	Chief Risk Officer	Mahindra & Mahindra
27	Kaku Nakhate	President & Country Head (India)	Bank of America
28	**Kalpana Morparia**	CEO	JPMorgan India
29	Karthik Srinivasan	SVP & Co-Head, Financial Sector Ratings	ICRA
30	**M S Sriram**	Visiting Professor, Centre for Public Policy	IIM, Bangalore
31	Manojit Saha	Reporter	Business Standard
32	N. S. Vageesh	Correspondent	Hindu Business Line

33	**Naina Lal Kidwai**	Country Head India; Director, Asia Pacific	HSBC
34	P Vijaya Bhaskar	ED	Reserve Bank of India
35	Pallavi Chavan	Asst.Advise, DBD, DEAP	RBI
36	Pankaj Sanklecha	CFO	Capital First
37	Pankaj Thadani	Chief Compliance Officer	Bajaj Finserve
38	**Paresh Sukthankar**	DMD	HDFC Bank
39	Prabhat Gupta	National Head – Regulatory Affairs	L&T Infra Finance
40	Prabodh Agrawal	Head, Institutional Research	IIFL
41	Pramit Jhaveri	CEO	Citibank, India
42	Pramod Karnad	MD	MSCB
43	R Balaji	Head of Strategy	Mahindra Finance
44	R N Kar	CGM, FED	RBI
45	Rajeev Rishi	CMD	Central Bank
46	Rana Kapoor	MD & CEO	Yes Bank
47	S Muhnot	CMD	Bank of Maharashtra
48	S S Bhandare	Chairman	All India Bank Depositors' Association
49	S S Mundra	CMD	Bank of Baroda
50	S.K. Banerji	MD	Saraswat Co-op Bank
51	Sanjiv Bhasin	GM & CEO	DBS Bank Ltd.
52	Shaji Vikraman	Senior Editor Head-ETIG	The Economic Times
53	Shinjini Kumar	Director; India Head - Banking & Capital Markets	PwC
54	**Shyam Srinivasan**	MD & CEO	Federal Bank
55	Smita Aggarwal	CGM (Programs)	CAFRAL
56	Surendra Jalan	Group President-Domestic Financial Institutions	Yes Bank
57	T T Rammohan	Professor	IIM (A)
58	**T T Srinivasraghavan**	MD	Sundaram Finance
59	Tabassum Inamdar	MD	Goldman Sachs
60	Tamal Bandopadhyay	Editor	Mint
61	**Uday Kotak**	MD & Vice-Chairman	Kotak Mahindra Bank
62	**Usha Thorat**	Director	CAFRAL
63	V. Lakshmi Narasimhan	Chief Financial Officer	Magma Fincorp
64	V. Srinivasan	Executive Director (Corporate Banking)	Axis Bank
65	V.C. Augustine	Asst. Adviser , DSIM	RBI
66	Vijay Chugh	CGM, DPSS	RBI
67	Viren Mehta	Partner & Joint Leader - Financial Services	Partner, E&Y
68	Vishwavir Ahuja	MD & CEO	Ratnakar Bank
69	**Wong Nai Seng**	Assistant Managing Director (Policy, Risk & Surveillance)	Monetary Authority of Singapore