(1) INDIAN BANKING SECTOR

Indian banking sector has been evolving since the year 1770 when the Bank of Hindustan was established in Calcutta and subsequently in its various avatars—when the General Bank of India, which came into existence in 1886 again in Calcutta; and then Bank of Calcutta (later Bank of Bengal - 1806), Bank of Bombay and Bank of Madras merging in 1921 to become the Imperial Bank of India which became the State Bank of India (SBI) in 1955.

The Indian banking system saw another phase of metamorphosis in 1969 when all the leading commercial banks were nationalised by the then prime minister and finance minister, Indira Gandhi. The third phase which actually started changing the face of the Indian banking was the post-1991 economic liberalisation which opened up the banking sector to increased competition and transformation offering better fare to customers.

As per the Reserve Bank of India (RBI), India’s banking sector is sufficiently capitalised and well-regulated. The financial and economic conditions in the country are far superior to any other country in the world. Credit, market and liquidity risk studies suggest that Indian banks are generally resilient and have withstood the global downturn well.

Indian banking industry is expected to witness better growth prospects in 2015 as a sense of optimism stems from the Government’s measures towards revitalizing the industrial growth in the country. In addition, RBI’s new measures may go a long way in helping the restructuring of the domestic banking industry.
Growing Indian Banking Size

The Indian banking system consists of 26 public sector banks, 25 private sector banks, 43 foreign banks, 56 regional rural banks, 1,589 urban cooperative banks and 93,550 rural cooperative banks, in addition to cooperative credit institutions. Public-sector banks control nearly 80 percent of the market, thereby leaving comparatively much smaller shares for its private peers.

As of November 11, 2015, 192.1 million accounts had been opened under Pradhan Mantri Jan Dhan Yojna (PMJDY) and 165.1 million RuPay debit cards were issued. These new accounts have mustered deposits worth Rs 26,819 crore (US$ 4 billion).

Standard & Poor’s estimates that credit growth in India’s banking sector would improve to 12-13 per cent in FY16 from less than 10 per cent in the second half of CY14.

Technological Changes

Banks have changed in their operations and moved towards universal banking along with the increased usage of technology and technology-based services offering alternate channels such as smart cards, ATMs, usage of the internet, mobile and social banking. Banks have started deploying core banking, human resource management (HRM) and enterprise risk (ERP) management and process re-engineering etc. to improve on their performance and productivity. Majority of banks are insisting on cashless and paperless payment modes.

According to a one study as of FY2012, non-cash payments constituted 91 per cent in value terms as compared to 88 per cent in FY in 2010 and 48 per cent in terms of value from 35 per cent in FY 2010. A bank analyst says the payments made through cheques in total non-cash transaction too has come down to 52 per cent from 83 per cent in volume terms, and to nine per cent from 85 per cent in value terms during between FY 2006 and FY 2012.
Global efficient and on time transactions system

20 Indian banks are now global banks. In 2010, the UK-based Brand Finance's annual ranking put these banks in the top 500 banks by their brand value. In 2007, only six Indian banks had the top standing globally. To see further growth in the banking sector regulators and policy makers have been emphasising on financial inclusion to cover all sections of the society. Half of India's population does not bank. The regulators and policy makers have started taking a serious view of this. As a result, the top regulator the Reserve Bank of India (RBI) is now encouraging various entities including non-banking finance companies (NBFCs), co-operative banks, regional rural banks (RRBs), and self-help entities, business correspondents in rural areas and microfinance companies which have now given exposure to non-banked rural areas. This shows that at some point of time banking services would reach rural areas as much as they do in urban and semi-urban areas.

The government and the regulator have taken several measures including mandatory opening of at least 25 per cent of new bank branches in unbanked rural areas, giving impetus to opening of new branches in tier III-VI cities. The mandatory and simplified Know Your Customer (KYC) detailing for opening small accounts have made things easier for banks to extend their reach.

Banks have also become finance providers for community services development. Post-liberalisation India has also been attracting banks from various foreign lands. These now number 40 - from 28 in FY in 2008 and have a 7 per cent share of the total assets management. Over 20 Indian banks have now opened over 240 offices overseas.

The slowdown in growth

In the balance sheets of banks witnessed since 2011-12 continued during 2014-15. The moderation in assets growth of scheduled commercial banks (SCBs) was mainly attributed to tepid growth in loans and advances to below 10 per cent Growth in investments also slowed down marginally. The decline in credit growth reflected the slowdown in industrial growth, poor earnings growth reported by the corporates, risk aversion on the part of banks in the
background of rising bad loans and governance related issues. Further, with the availability of alternative sources, corporates also switched part of their financing needs to other sources such as external commercial borrowings (ECBs), corporate bonds and commercial papers. On the liabilities side, growth in deposits and borrowings also declined significantly. Bank-group wise, public sector banks (PSBs) witnessed deceleration in credit growth in 2014-15; private sector banks (PVBs) and foreign banks (FBs), however, indicated higher credit growth

**Slow rate of Advances in all sections:**

- Credit growth to priority sector also declined during 2014-15 and this decline was spread over all the subsectors with growth in credit to agriculture declining to 12.6 per cent from 30.2 per cent in the previous year. Credit to priority sectors by PSBs, PVBs and FBs was 38.2 per cent, 43.2 per cent and 32.2 per cent (of adjusted net bank credit (ANBC)/credit equivalent of off-balance sheet exposure, whichever is higher) respectively, during the year. Thus, PSBs indicated a shortfall from the overall target of 40 per cent. Within priority sector credit, both PSBs (16.5 per cent) and PVBs (14.8 per cent) had a shortfall in advances to agricultural sector against the target of 18 per cent.

- Retail loan portfolio of the banks continued to grow at around 20 per cent during 2014-15 even though there was deceleration in the total credit growth of banks. Housing loans (constituted around half of the total outstanding retail loans) and credit card receivables grew by more than 20 per cent. Auto loans also recorded a recovery.

- Capital market, real estate market and commodities market have been classified as sensitive sectors as fluctuations in prices of underlying assets in these sectors could adversely affect the asset quality of banks. In 2014-15, sensitive sectors accounted for 18.5 per cent of the total loans and advances of banks. Within these sensitive sectors, more than 90 per cent comprised lending to real estate market.
However, in line with overall trend, credit growth to sensitive sectors also witnessed a decline on account of lower growth in lending to real estate market. Nevertheless, lending to capital market recorded higher growth during 2014-15.

**Focus on improving operating efficiency and outsourcing**

Indian banking sector is at an inflexion point. To meet the demands of India’s huge potential, heavy infrastructure spending, and the government’s ambitious financial inclusion plan the banking sector will have to gear up for unprecedented challenges. To prepare for the upcoming challenges, the government formed a commission with a task of overhauling the regulatory landscape of financial sector. The commission – Financial Sector Legislative Reforms Commission – drafted a code called the Indian Financial Code (IFC). The IFC has called for a unified regulator for the financial services sector which will regulate insurance, capital market, pension funds and commodities derivatives market. It has recommended that the RBI should continue to exist outside the unified regulator although with modified functions of setting monetary policy, regulating banks and payment systems.

To what extent the RBI’s functions will be modified is not known yet. However, one of the most important challenges the sector is likely to face is the challenge of governance and compliance. Achieving optimal growth, balancing stakeholder expectations and complying with regulations is likely to be a tight rope walk for the sector. However, with support from the RBI and the government, it is likely to be a rewarding experience.

Group present of one of the leading private sector bank of Indian (who own the Best Banking award of Economic Times-2014-15) had said that Indian banks are now getting to be somewhat mature users of technology and are investing significantly in good data mining solutions to understand the behavioural trends of customers and offer intelligent cross sell solutions to customers, primarily to improve productivity. He further observed that there is also concurrently an increasing trend towards outsourcing to retain flexibility,
manage scale more efficiently and cut operating costs, essentially to leverage on partners’ strengths in specific areas.

With increasing competition, emerging customer demands, regulatory interventions, technology-led disruptions, higher shareholder expectations, Indian banks are being forced to constantly review and revisit their operating models. The resulting changes are making Indian banks nimbler, more cost efficient, better focused on customer services and witnessing good returns through fee based services and products.

Indian banks are constantly optimising the use of technology as the change agent, in order to improve operational efficiency and enhance customer experience. It is estimated that Indian banking and securities companies will spend INR 416 billion (USD 6.75 billion) on IT products and services in 2013, which will be 13 percent increase from INR 370 billion (USD 6.0 billion) spent in 2012.

Emergence of low cost channels like internet banking, mobile banking, and mobile ATMs have been successfully implemented by many players and have also found wider acceptance in the customer base. This has led to enhanced focus on digital banking and self-service channel usage to reduce the cost of operations. The number of mobile banking transactions doubled to 5.6 million in January 2013 from 2.8 million in January 2012. The value of these transactions increased three-fold to INR 625 Cr (USD 105.73 million) during the month from INR 191 Cr (USD 32.31 million). Banks have either centralised mid/back office processes through a shared services centre or have outsourced their technology requirements to a third party. In addition to focus, this also gives banks a huge cost advantage.

For example, Indian market has witnessed an increasing number of ATMs under outsourcing management. By outsourcing their ATM management to service providers like Fidelity National Information Services (FIS), the bank is able to focus on its core business expansion and customer service initiatives - allowing for more rapid growth while ensuring its customers have a high-
quality, reliable ATM service. FIS the market leader and world’s largest provider of banking and payments technology manages about 11000 ATMS across India.

Karnataka Bank is the latest to join more than half of India’s top 30 banks who rely on FIS’. By outsourcing the management of its ATM estate to FIS, Karnataka Bank would be in a position to release vital capital to redeploy on core activities, increase operational efficiencies, provide better service to its customers and insulate itself from technology obsolescence. The announcement made by Karnataka Bank in May 2013 underscores a growing trend in India for banks to contract non-differentiating services, such as ATM driving, to expert providers such as FIS. Banks benefit by redirecting investments tied up in ATM equipment and operations to more strategic areas, thus deriving operational efficiencies. In addition, banks can leverage the ATM driving expertise of FIS to deliver a high-quality and reliable ATM service to their customers. While transaction based banking operations are being successfully

Increase Fee based income portfolio

Fee income has gained significant focus as a source of revenue in the past decade. With the rising pressure on cost of funds, it is imperative for banks to look at other avenues to boost their income. The fee income in FY 13 for 67 banks in our sample set10 was INR 64,418 Cr; clocking a three year CAGR of 12 percent and five year CAGR of 15 percent. PSBs have constituted a large part (60 percent) of this basket since the beginning, owing to their reach and size.

However, in recent times with the overall pressure on the economy and changing regulations, the fee based incomes of banks have come under pressure. Banks earned lower corporate banking fees due to slowdown in project finance. Also, with The Reserve Bank of India’s (RBI) recent measures to tighten liquidity and curb volatility in foreign exchange rates have led to a rise in bond yields leading to a drop in treasury incomes for banks. On the retail side, fee income earned by banks on account of sale of gold coins has
dried up with the government banning sale of gold coins by banks. These factors have necessitated banks to revamp their fee based product portfolio.

**Recent Development**

In the past few months, there have been many investments and developments in the Indian banking sector

- Global rating agency Moody’s has upgraded its outlook for the Indian banking system to stable from negative based on its assessment of five drivers including improvement in operating environment and stable asset risk and capital scenario.
- Lok Capital, a private equity investor backed by US-based non-profit organisation Rockefeller Foundation, plans to invest up to US$ 15 million in two proposed small finance banks in India over the next one year.
- The Reserve Bank of India (RBI) has granted in-principle licenses to 10 applicants to open small finance banks, which will help expanding access to financial services in rural and semi-urban areas.
- IDFC Bank has become the latest new bank to start operations with 23 branches, including 15 branches in rural areas of Madhya Pradesh.
- The RBI has given in-principle approval to 11 applicants to establish payment banks. These banks can accept deposits and remittances, but are not allowed to extend any loans.
- The Bank of Tokyo-Mitsubishi (BTMU), a Japanese financial services group, aims to double its branch count in India to 10 over the next three years and also target a 10 per cent credit growth during FY16.
- State Bank of India has tied up with e-commerce portal Snapdeal and payment gateway Paypal to finance MSME businesses.
- The United Economic Forum (UEF), an organisation that works to improve socio-economic status of the minority community in India, has signed a memorandum of understanding (MoU) with Indian Overseas Bank (IOB) for financing entrepreneurs from backward communities to set up businesses in Tamil Nadu
- The RBI has allowed third-party white label automated teller machines (ATM) to accept international cards, including international prepaid
cards, and said white label ATMs can now tie up with any commercial bank for cash supply.

- The RBI has allowed Indian alternative investment funds (AIFs), to invest abroad, in order to increase the investment opportunities for these funds.
- In order to boost the infrastructure sector and the banks financing long gestation projects, the RBI has extended its flexible refinancing and repayment option for long-term infrastructure projects to existing ones where the total exposure of lenders is more than Rs 500 crore (US$ 75.1 million).
- RBI governor Mr. Raghuram Rajan and European Central Bank President Mr. Mario Draghi have signed a MoU on cooperation in central banking. “The memorandum of understanding provides a framework for regular exchange of information, policy dialogue and technical cooperation between the two institutions. Technical cooperation may take the form of joint seminars and workshops in areas of mutual interest in the field of central banking,” RBI said on its website.
- RBL Bank informed that it would be the anchor investor in Trifecta Capital's Venture Debt Fund, the first alternative investment fund (AIF) in India with a commitment of Rs 50 crore (US$ 7.51 million). This move provides RBL Bank the opportunity to support the emerging venture debt market in India.
- Bandhan Financial Services raised Rs 1,600 crore (US$ 240.2 million) from two international institutional investors to help convert its microfinance business into a full service bank. Bandhan, one of the two entities to get a banking license along with IDFC, launched its banking operations in August 2015.

Government Initiatives

The government and the regulator have undertaken several measures to strengthen the Indian banking sector.

- The Government of India is looking to set up a special fund, as a part of National Investment and Infrastructure Fund (NIIF), to deal with
stressed assets of banks. The special fund will potentially take over assets which are viable but don’t have additional fresh equity from promoters coming in to complete the project.

- The Reserve Bank of India (RBI) plans to soon come out with guidelines, such as common risk-based know-your-customer (KYC) norms, to reinforce protection for consumers, especially since a large number of Indians have now been financially included post the government’s massive drive to open a bank account for each household.

- To provide relief to the state electricity distribution companies, Government of India has proposed to their lenders that 75 per cent of their loans be converted to state government bonds in two phases by March 2017. This will help several banks, especially public sector banks, to offload credit to state electricity distribution companies from their loan book, thereby improving their asset quality.

- The Reserve Bank of India (RBI), the Department of Industrial Policy & Promotion (DIPP) and the Finance Ministry are planning to raise the Foreign Direct Investment (FDI) limit in private banks sector to 100 per cent from 74 per cent.

- Government of India aims to extend insurance, pension and credit facilities to those excluded from these benefits under the Pradhan Mantri Jan Dhan Yojana (PMJDY).

- The Government of India announced a capital infusion of Rs 6,990 crore (US$ 1.05 billion) in nine state run banks, including State Bank of India (SBI) and Punjab National Bank (PNB). However, the new efficiency parameters would include return on assets and return on equity. According to the finance ministry, “This year, the Government of India has adopted new criteria in which the banks which are more efficient would only be rewarded with extra capital for their equity so that they can further strengthen their position.”

- To facilitate an easy access to finance by Micro and Small Enterprises (MSEs), the Government/RBI has launched Credit Guarantee Fund Scheme to provide guarantee cover for collateral free credit facilities extended to MSEs up to Rs 1 Crore (US$ 0.15 million). Moreover,
Micro Units Development & Refinance Agency (MUDRA) Ltd. was also established to refinance all Micro-finance Institutions (MFIs), which are in the business of lending to micro / small business entities engaged in manufacturing, trading and services activities up to Rs 10 lakh (US$ 0.015 million).

- The central government has come out with draft proposals to encourage electronic transactions, including income tax benefits for payments made through debit or credit cards.
- The Union cabinet has approved the establishment of the US$ 100 billion New Development Bank (NDB) envisaged by the five-member BRICS group as well as the BRICS “contingent reserve arrangement” (CRA).
- The government has plans to set up a fund that will provide surety to banks against loans given to students for higher education.

**Emerging trends**

- Banks looking to increase fee-based income are shifting focus to selling life insurance and general insurance policies (through bancassurance tie ups or as insurance brokers). Indian bank recently partnered with United India Insurance and launched a web portal for its ‘Arogya Raksha’ group mediclaim insurance policies. Moving forward, the bank is in talks with a life insurance company for a similar tie-up in the life insurance space. The bank expects a 30 percent growth in income from insurance this fiscal. Some of the other recent bancassurance tie-ups include PNB with MetLife and Axis Bank with Max Life insurance. With the increasing trends in insurance penetration on both life and general insurance side, banks identify this as one of the key drivers of fee income growth.

- Retail fee income is another area where banks have increased focus to augment their growth. Retail fee income of banks typically comprises commissions they earn from sale of third-party products, like insurance and mutual funds, transaction charges on savings and current
accounts, processing fees on consumer loans and credit cards, and fees from foreign exchange transactions and remittances.

- Private sector banks are specifically focusing on income on foreign exchange transactions and remittances. Axis Bank, the third largest private sector lender in the country, reported close to 43 percent rise in retail fee income in FY13.

- The banking system has to implement Basel III guidelines as per the directive of the RBI to make it a stronger sector. Some of the key measures of this include creating firm measures to make it foolproof of systemic risks, stringent timelines, ongoing improvement of quality and quantity of capital, liquidity risk management, value-based practices, solid mechanism, disclosures for total transparency and reduction of systemic risk in derivative and other money-related markets.

- The RBI has stipulated a time frame of five years to implement Basel III norms. But there are economy related hurdles as the government which holds majority stake in the public sector banks (PSBs) copes with the high fiscal deficit. Once the government decides to dilute its shares in the PSBs and brings it down to around 51 per cent, the Indian banking sector would see a sea change. Also, a large number of foreign players and big Indian corporates are awaiting government clearances for setting up new generation banks. Once there is clarity on this issue things would change drastically.

- The Indian economy is on the brink of a major transformation, with several policy initiatives set to be implemented shortly. Positive business sentiments, improved consumer confidence and more controlled inflation are likely to prop-up the country’s the economic growth. Enhanced spending on infrastructure, speedy implementation of projects and continuation of reforms are expected to provide further impetus to growth. All these factors suggest that India’s banking sector is also poised for robust growth as the rapidly growing business would turn to banks for their credit needs.

- Also, the advancements in technology have brought the mobile and internet banking services to the fore. The banking sector is laying
greater emphasis on providing improved services to their clients and also upgrading their technology infrastructure, in order to enhance the customer’s overall experience as well as give banks a competitive edge.

- Many banks, including HDFC, ICICI and AXIS are exploring the option to launch contact-less credit and debit cards in the market shortly. The cards, which use near field communication (NFC) mechanism, will allow customers to transact without having to insert or swipe.

**CHALLENGES OF INDIAN BANKING SECTOR**

- **Asset Quality**
  The levels of gross non-performing advances (GNPAs) and net NPAs (NNPAs) for the system have been elevated. As per preliminary data received at RBI for March 15, while the GNPAs have increased to 4.45% for the system as a whole, the NNPAs have also climbed up to 2.36%. When seen in isolation, the NPA ratios do not appear very distressing; however, if we add the portfolio of restructured assets to the GNPA numbers, this rises alarmingly. Stressed Assets Ratio (Gross NPA+ Restructured Standard Advances to Gross Advances) for the system as a whole stood at 10.9% as at the end of March 2015. The level of distress is not uniform across the bank groups and is more pronounced in respect of public sector banks. The Gross NPAs for PSBs as on March 2015 stood at 5.17% while the stressed assets ratio stood at 13.2%, which is nearly 230 bps more than that for the system.
  As you all know, RBI has taken various steps to improve the system’s ability to deal with corporate and financial institution distress. This includes issuance of guidelines on "Early Recognition of Financial Distress, Prompt Steps for Resolution and Fair Recovery for Lenders: Framework for Revitalising Distressed Assets in the Economy, detailed guidelines on formation of Joint Lenders’ Forum (JLF), Corrective Action Plan (CAP), ‘Refinancing of Project Loans’, ‘Sale of NPAs by Banks’ and other regulatory measures, which emphasized the need for early recognition of financial distress and for taking
prompt steps for rectification, restructuring or recovery, thereby ensuring that interests of lenders and investors are protected.

RBI had given a road map for ending the regulatory forbearance on asset classification of restructured accounts long back and accordingly, the forbearance has come to an end on March 31, 2015. There has been a lot of clamor from all quarters for extending this forbearance.

- **Lack of Product Innovation**

  As the Indian banks moved gradually towards universal banking and as they positioned themselves as financial service providers, banking business had been points out that in view of intense competition in the business environment, the banking sector emphasised on product innovations over service innovations. Thus, product innovation is of utmost importance as competition in the sector has increased tremendously and product boundaries have blurred. Moreover, the distinction between various players in the financial segment is also getting blurred and banks are facing competition from foreign banks, financial institutions, mutual funds, NBFCs, provident funds and pension funds etc. More flexibility in terms of products of the banking services is needed. Looking to the requirement of the consumers of the bank different banks are allowed to do some alteration to their product with in the setup framework. For creating competitive advantage one should go for innovative product development including developing sophisticated financial products Interestingly the Indian banking market is seeing discontinuous growth driven by new products and services that include opportunities in credit cards, consumer finance and wealth management on the retail side, and in fee-based income and investment banking on the wholesale banking side. Bottle tight framework or too much restrictions of the regulators makes such situation. Tailor made or consumer segment based product development is necessary. Moreover, given the demographic shifts resulting from changes in age profile and household income, Indian consumers will increasingly demand enhanced institutional capabilities and service level from banks. Thus, the challenge for Indian banks is on how to
assess the needs of their clientele and offer customised products to meet their satisfaction. There are many advantages.

- **Human Resource Issues**
  Development of Knowledge and Skills of its Human Resources For any service organisation, Human Resource Development is the most important need and banks are no exceptions. To meet the challenges of a fast growing knowledge economy, the trust needs to be on Human Resource Development for which the existing training systems of banks need to be revamped. This is felt necessary in order to keep pace with the fast-changing banking environment at home and abroad. It is commonly observed that in public sector banks especially, there are certain rigidities. In matters of recruitment, it has been seen that initially the public sector banks were able to attract the educated manpower but not the specialists. Thus, the focus must shift from generalist orientation of the staff to specialist orientation i.e., recruiting those who have the ability to imbibe and absorb technology. In the light of this requirements there need to be thorough improvements in the existing practices of recruitment, training and redeployment. Therefore, large investments will have to be made both in Information Technology and Human Resource Development for imparting knowledge and skill

- **Continuous Evaluation and Training**
  The banks need to continuously enhance the skill levels of their employees so as to remain viable and competitive and to take advantage of new opportunities. The banking personnel, across the cadres need to be suitably trained to acquire necessary skill sets to perform their jobs more efficiently. The biggest challenge is to build capacity at a rate which matches the loss of existing talent and skills to retirement, poaching and resignations. The training initiatives must ensure that the available talent pool in the banks is able to always keep pace with the fast changing ways in which banking is conducted. Of course, in these challenges also lie an inherent opportunity for banks to redraw their organizational profile and to create HR systems and processes best suited to the needs of the future.
• **Revision to the Priority Sector Lending Guidelines**
  The revised priority sector lending guidelines have been released last week. Lending to a few new sub-sectors like renewable energy, social infrastructure and to the medium enterprises would now be treated as priority sector lending. Concept of a tradable Priority Sector Lending Certificate (PSLC) has also been introduced, which would enable the ‘deficit’ banks to buy these certificates from ‘surplus’ banks to meet their targets. There is also readjustment in some sub-targets, whereby the banks are now required to progressively achieve 8% of lending to Small and Marginal Farmers and 7.5% to the micro enterprises among the MSEs in a phased manner. This has been brought about with an underlying objective of making available finance to the neediest and the most alienated of the borrowers. This may probably pose a bit of a challenge initially but with proper planning, these targets could be achieved sooner rather than later.

• **PMJDY and beyond**
  Cost of 14.5 cores inoperative savings bank accounts opened in PMJDY is very high. It is difficult to recover cost of such facility in near future. The credit absorption capacity of the farmers can be enhanced through consolidation of fragmented landholdings by ushering in land reforms or through pooling of land holdings in a SHG format. Similarly, customers may also be trained to undertake non-farm activities. Efforts to enhance the credit absorption capacity must also be supplemented through financial literacy and vocational training initiatives. Improved financial literacy would aid the inculcation of a savings culture and investment habit amongst the customers, which can be leveraged by the banks by offering suitable small savings, investment and pension products.

• **High cost of Operation**
  A major challenge for the banks would be to manage their banking correspondent model effectively. The problems relating to their viability, governance, cash management, linkage and oversight from a base branch
need to be quickly addressed. The entire financial inclusion ecosystem must progressively develop, if the momentum gathered under the PMJDY exercise has to be sustained for all-round benefit of all stakeholders.

- **Technology and its impact**
  
  All PSBs are now on CBS platform and have developed capabilities to offer anywhere banking. Few have also started offering basic banking transactions on mobile for their customers. But this is just scratching the surface as the technology can be leveraged for a far greater effect. PSBs must be able to leverage technology for building data warehouses and then be able to do data mining and analytics. The goal should be to use data for effective decision making at various levels, including product customization, developing business models and delivery channels, etc.

  - PSBs must be able to pitch suitable products for their customers through internet and mobile banking channels. Traditional businesses are slowly moving on-line and e-commerce is the preferred choice of the gen-next customer. The challenge before the PSBs is to upscale their capabilities, train their employees on the new technologies to benefit from the possibilities that adoption of technology can open up.
  
  - A good thing going for the banks is the current recruitment of youngsters in the work force. This new-generation staff is tech-savvy and can quickly connect with technology. The enterprising among them must be accorded freedom to experiment and suggest ways in which the bank could reengineer its processes for its own benefit and that of its customers. This would require a change in mind-set of the senior / Top Management and this must happen if the PSBs have to compete efficiently and effectively with the private sector counterparts in future.

- **Treating Customers Fairly**
  
  Protection of bank customers has been one of the thrust areas for RBI in recent times. As you may be aware, RBI has issued a Charter of Customer
Rights based on the global best practices. The Charter comprises of following five rights:

- Right to Fair Treatment
- Right to Transparency, Fair and Honest Dealing
- Right to Suitability
- Right to Privacy
- Right to Grievances Redress and Compensation

A model customer rights policy jointly prepared by IBA and BCSBI incorporating these rights has been circulated to all banks by IBA. The banks have been advised to prepare a Board Approved Policy based on the model policy before July 31, 2015. RBI may review the policies framed by the banks and their implementation as part of our supervisory assessment over the next 12-18 months.

• **Risk Management**

Risk is inevitable in the banking business and hence, a sound risk management framework is the touchstone of an efficient bank. The risk management effectively aims at balancing the Risk-Return Trade-off which is “maximizing return for a given risk” and “minimizing risk for a given return”. The responsibility of setting a risk appetite for the bank as a whole is that of the Board and the Top Management. In practice, however, we seldom see the articulation of an objective risk appetite statement by the PSBs. If you haven't set out a risk limit for each type of risk that the bank runs and an aggregate risk appetite for the bank as a whole, how do you measure and monitor risk? We must understand that risk management is integral to the success of the bank and hence, the Top Management should strive to put in place an efficient risk management framework keeping in view the changing market dynamics and the regulatory prescriptions.
(2) INDIAN INSURANCE SECTOR:

Indian economy and the insurance industry landscape
Despite strong improvement in penetration and density in the last 10 years, India largely remains an under-penetrated market. The market today is primarily dependent on push, tax incentives and mandatory buying for sales. There is very little customer pull, which will come from growing financial awareness and increasing savings and disposable income.

In the long run the insurance industry is still poised for a strong growth as the domestic economy is expected to grow steadily. This will lead to rise in per capita and disposable income, while savings are expected to be stable.

Indian Insurance Market
- The insurance industry of India consists of 52 insurance companies of which 24 are in life insurance business and 28 are non-life insurers. Among the life insurers, Life Insurance Corporation (LIC) is the sole public sector company.
- Out of 28 non-life insurance companies, there are six public sector insurers, which include two specialised insurers namely Agriculture Insurance Company Ltd for Crop Insurance and Export Credit Guarantee Corporation of India for Credit Insurance. Moreover, there are 5 private sector insurers are registered to underwrite policies exclusively in Health, Personal Accident and Travel insurance segments. They are Star Health and Allied Insurance Company Ltd, Apollo Munich Health Insurance Company Ltd, Max Bupa Health Insurance Company Ltd, Religare Health Insurance Company Ltd and Cigna TTK Health Insurance Company Ltd.
- In addition to 52 insurance companies, there is sole national re-insurer, namely, General Insurance Corporation of India. Other stakeholders in Indian Insurance market include licensed Agents (Individual and Corporate), Brokers, Common Service Centres, Web-Aggregators,
Surveyors and Third Party Administrators servicing Health Insurance claims.

- Insurance Laws (Amendment) Act, 2015 provides for enhancement of the Foreign Investment Cap in an Indian Insurance Company from 26% to an Explicitly Composite Limit of 49% with the safeguard of Indian Ownership and Control.
- Insurance penetration of India i.e. Premium collected by Indian insurers is 3.90% of GDP in FY 2013-14. Per capita premium underwritten i.e. insurance density in India during FY 2013-14 is US$ 52.0.
- Here are some performance highlights of the Indian insurance industry.

**Life Insurance Business Performance:**

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<td>Premium Underwritten (Rs in Crores)</td>
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<td>Public Sector</td>
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<td>Private Sector</td>
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<td>Benefits Paid (Rs in Crores)</td>
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<td>134922</td>
</tr>
<tr>
<td></td>
<td>58994</td>
<td>56923</td>
</tr>
<tr>
<td>Individual Death Claims (Number of Policies)</td>
<td>760334</td>
<td>750576</td>
</tr>
<tr>
<td></td>
<td>125027</td>
<td>127906</td>
</tr>
<tr>
<td>Individual Death Claims Amount Paid (Rs in Crores)</td>
<td>8475.26</td>
<td>7222.90</td>
</tr>
<tr>
<td></td>
<td>2385.33</td>
<td>2147.32</td>
</tr>
<tr>
<td>Group Death Claims (Number of lives)</td>
<td>267296</td>
<td>245467</td>
</tr>
<tr>
<td></td>
<td>158682</td>
<td>119970</td>
</tr>
<tr>
<td>Group Death Claims Amount Paid (Rs in Crores)</td>
<td>1882.83</td>
<td>1697.37</td>
</tr>
<tr>
<td></td>
<td>1222.25</td>
<td>949.08</td>
</tr>
<tr>
<td>Individual Death Claims (Figures in percent of policies)</td>
<td>98.14</td>
<td>97.73</td>
</tr>
<tr>
<td></td>
<td>88.31</td>
<td>88.65</td>
</tr>
<tr>
<td>Group Death Claims (Figures in percent)</td>
<td>99.65</td>
<td>99.54</td>
</tr>
<tr>
<td></td>
<td>90.45</td>
<td>87.79</td>
</tr>
<tr>
<td></td>
<td>85284</td>
<td>289336</td>
</tr>
<tr>
<td>--------------------------------------</td>
<td>-------</td>
<td>--------</td>
</tr>
<tr>
<td>No. of Grievances reported during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Grievances resolved during the year</td>
<td>85828</td>
<td>288836</td>
</tr>
<tr>
<td>Grievance Resolved (in percent)</td>
<td>100.64</td>
<td>99.83</td>
</tr>
</tbody>
</table>

(Source: Annual Report IRDA: 2013-13)

Insurance growth drivers in India

The demand for insurance products is likely to increase due to the exponential growth of household savings, purchasing power, the middle class and the country’s working population. Listed below, are the various underlying growth drivers for India’s insurance industry:

- Growing of the financial industry as a whole
- Growth of life and non-life industry
- Promoting innovation and removing inefficiency
- Competition and orderly growth
- Growth of specific insurance segments such as motor insurance

The Indian insurance sector has 52 insurance companies, of which 28 are in non-life insurance business and 24 in life insurance. India’s life insurance sector is the biggest in the world with about 36 crore policies and is expected to increase at a compound annual growth rate (CAGR) of 12-15 per cent over the next five years. The insurance industry plans to hike penetration levels to five per cent by 2020, and could top the US$ 1 trillion mark in the next seven years.

This bright outlook for the sector is primarily due to the Government of India’s efforts to strengthen the industry. For instance, the Union Cabinet in July 2014 approved a proposal to relax foreign direct investment (FDI) limit in the domestic insurance sector to 49 per cent from the previous 26 per cent, signaling the Centre’s intent to bring capital and investment into the sector.
Growing Market Size of Indian Insurance Industry

The total market size of India’s insurance sector is projected to touch US$ 350-400 billion by 2020 from US$ 66.4 billion in FY13.

By 2020, a report by Boston Consulting Group (BCG) and Google India, projects insurance sales from online channels to increase 20 times from present day sales by 2020, and overall internet influenced sales to reach Rs 300,000-400,000 crore (US$ 48.51-66.68 billion).

Investment corpus in India’s pension sector is anticipated to cross US$ 1 trillion by 2025, following the passage of the Pension Fund Regulatory and Development Authority (PFRDA) Act 2013, according to a joint report by CII-EY on Pensions Business in India.

Indian insurance companies are expected to spend Rs 117 billion (US$ 1.89 billion) on IT products and services in 2014, an increase of five per cent from 2013, as per Gartner Inc. Also, insurance companies in the country could spend Rs 4.1 billion (US$ 66.29 million) on mobile devices in 2014, a rise of 35 per cent from 2013.

Key Developments in insurance Sector

The following are some of the major investments and developments in the Indian insurance sector.

- The Insurance Regulatory Development Authority (IRDA) believes that the country's insurance sector needs capital infusion of Rs 50,000 crore (US$ 8.08 billion) to expand reach, maintain a healthy capital base and enhance solvency standards. "Industry needs a huge amount of capital," as per Mr. TS Vijayan, Chairman, IRDA.

- The IRDA has come up with a long-term motor third-party insurance policy for two-wheelers, with a three-year term. As per the regulatory body, the total premium for the third-party coverage would be three times the yearly third-party premium for two-wheelers as decided by the regulator.
• Export Credit Guarantee Corporation of India Ltd (ECGC) has signed a Memorandum of Understanding (MoU) on cooperation with the Export Credit Insurance Agencies (ECA) of BRICS countries. The MoU which was signed in the presence of Heads of Governments from BRICS countries will aim to strengthen collaboration among the member countries’ ECAs.

• Kotak Mahindra Old Mutual Life Insurance Ltd has launched Kotak Assured Income Accelerator. The product gives the insured the convenience of three different payment and payout terms to cater to their different needs.

• Future Generali India Life Insurance Company Ltd has launched pure insurance term plan, Care Plus Plan. Future Generali Care Plus provides two options - Future Generali Care Plus Classic Option for cover up to Rs 2,500,000 (US$ 40,426.28) and Future Generali Care Plus Premier Option which covers up to Rs 2,500,000 (US$ 40,426.28) and beyond.

• General insurance companies are beginning to cover pre-hospitalization expenses apart from the standard hospitalization costs. Also, these companies are starting to provide several other features such as worldwide emergency cover, disease-specific covers, and health maintenance benefits, among others.

**Government Initiatives**

The Union Cabinet has cleared a bill to raise the foreign investment ceiling in private insurance companies from 26 per cent to 49 per cent, with the proviso that the management and control of these companies will be with Indians. This ceiling will be composite - both foreign portfolio investment and FDI. The benefit of accidental insurance cover of Rs 100,000 (US$ 1631.97) has been made available to all those who opened accounts under the Pradhan Mantri Jan Dhan Yojana (PMJDY) launched on August 28, 2014 by Prime Minister Mr. Narendra Modi; it would now cover also those who have opened zero balance accounts before August 28, to avoid duplication.
The Indian government plans to launch a new insurance scheme for farmers in order to protect their incomes against price and production risks, as per Mr. Radha Mohan Singh, Agriculture Minister. These risks can affect farmers’ capacity to invest in advanced crop varieties and impede capital formation in the sector. To facilitate banks to provide greater choice in insurance products via their branches, a proposal could be made which will allow banks to be corporate agents and tie up with multiple insurers.

The Indian insurance industry seems to be in a state of flux. After a decade of strong growth, the Indian insurance industry is currently facing severe headwinds owing to:

- Slowing growth
- Rising costs
- Deteriorating distribution structure
- Stalled reforms

**Emerging trends**

- Multi-distribution i.e. increasing penetration through new modes of distribution such as the internet, direct and telemarketing and NGOs
- Product innovation i.e. increased levels of customization through product innovation
- Claims management i.e. timely and efficient management of claims to prevent delays which can increase the claims cost
- Profitable growth i.e. expanding product range, developing innovative products and expanding distribution channels
- Regulatory trends i.e. mandated regulatory changes by the IRDA to promote a competitive environment in both the life and non-life insurance sectors

**Life insurance:**

**Key challenges**

In FY12, the life insurance industry witnessed a decline in the first year premium collected which dropped from INR1,258 billion in FY11 to INR1,142 billion.
billion, a drop of approximately 10%. This was owing to the following challenges that the industry faced in

- Products strategy and design
- Cost
- Taxation
- Distribution
- Prospects and challenges of various channels
- Compensation
- Customer service
- Governance and regulatory issues

CHALLENGES OF INDIAN INSURANCE SECTOR:

1. **No flexibility in the Product:**

   Insurance is considered as one of the tools of tax savings or investment option in the Gujarat. Penetration level of the insurance in the country is lower due to such mind set. Marketers or designer of product of insurance company are not allowed to make changes in the insurance product. This leads to development of non-lucrative or unattractive insurance plan. Insurance companies should develop such a product in which consumers can get more than one benefit for such. Requirement of the consumers at the different life stage of insured person is ignored.

2. **Misleading Communication:**

   Agents are playing very important role in achieving target of the insurance companies. Many a times insurance agents makes puffing or providing wrong information to the proposed insurance client. This leads to mis-statement from insurance company. Attracting consumer on wrong claim and deceive at the time of claim settlement is affecting adversely to the entire insurance industry. Different insurance plans are required to be presented in comparison with others. Assurance dimension of the insurance company had been damaged to great extent in this case. Impression crated by the agent for getting business at the cost of insured’s fund had long lasting negative
Impact in the mind of insured as well as it spread faster by word of mouth publicity.

3. Poor Concept Selling
Insurance penetration level is very low in India in terms of life insurance. Even after government's efforts of significant lower insurance premium penetration level does not enhances. Concept selling of insurance is necessary at this juncture. Getting policy from the same consumers does not create great base of insured person. Concept selling of insurance requires great efforts at grass root level as well as regular habit of savings. It is long term process. At present insurance companies are not ready for such long term plans. Thus overall customer base does not increase at all.

4. High cost of ESTABLISHMENT
Insurance business in India is suffering from one very important problem of high cost of establishment and very long gestation period. As cost of license and other establishment charges are high insurance companies can’t make profit in the initial year. Over and above tough competition leads to lack of consumers in the initial years. Thus profitability aspects of the insurance companies is negative in initial years.

Future of Insurance Sector
The Indian insurance market is poised for strong growth in the long run. It stands at the threshold of moving towards a stable position, delivering “stable profitable growth.”

- **Significant latent market** - The insurance market has a considerable amount of latent potential, given the fact that the Indian economy is expected to do well in the coming decades leading to increase in per capita incomes and awareness.

- **Channelizing industry focus** - In meeting the significant potential, the industry has an increased role and responsibility. Three areas of focus could be — a) product innovation matching the risk profile of the policy
holders b) reengineering the distribution and more significantly c) making sales and marketing more responsible and answerable.

- **Distribution** - Distribution channels evolved in response to market dynamics and changing consumer preferences. The alignment of economic incentives with distribution dynamics should be driven by market forces rather than regulatory intervention.

- **Regulation** - The industry should be given time to adjust to regulatory changes in a phased manner aligned with a regulatory impact assessment. Regulations need to drive transparency and simplification of products and services.

The stakeholders should eventually work toward maintaining a favorable environment for stable growth, increasing the penetration of insurance to rural and underpenetrated areas and increasing the contribution to the economy.

**Non-life insurance: factors impacting growth**
The non-life insurance industry has been growing in excess of 20% over the last two years however the penetration was as low as 0.7% of the GDP in FY10. The key factors for growth include:

- Product pricing, innovation and simplicity
- Distribution
- Compensation
- Micro-insurance in non-life widening reach
- Governance and regulatory changes
- Health insurance
- Innovative products to counter the competition
- Improved fraud control mechanisms
- Standardization to reduce claims loss
- Reducing inefficiencies by revisiting third party administrator (TPA) agreements

The future of India's insurance sector looks bright. The country has a favorable demographic, growing awareness, investment friendly government
which is constantly working towards framing policies that can attract investment, customer-centric products, and practices that give businesses the best possible environment to grow. India's insurable population is anticipated to touch 75 crore in 2020, with life expectancy reaching 74 years. Furthermore, life insurance is projected to comprise 35 per cent of total savings by the end of this decade, as against 26 per cent in 2009-10.

Banking and Insurance both are basic services from the view of retail customers of the country. Banking and Insurance both sectors were under control of the government for more than forty years. At present both sectors had been opened for the private sectors and foreign players with several restrictions. Economy of the country is highly depending upon banking system. Insurance and Bank sectors are now attempted to be regulated by the regulators to certain extent. After privatisation and liberalisation efficiency and profitability of sector has been increased. Competitive market of both industry understand the importance of consumers. Consumer perception for the Banking and Insurance services is key area for the creation of customer satisfaction for the services. Perception of the Banking and Insurance staff towards consumers is not changes much. In the present age consumers' expectations from service providers had been enhances. Importance of para services has been increased along with the main services in the banking sector and in case of insurance sector importance of flexible products had been enhances. Bankers and Insurance service providers are in the efforts of matching consumer's expectations by aligning every aspects of service delivery. Customer's experience with the insurance or banking organisation is playing very vital role in the creation of new customer base and maintaining current customer base. Cost of obtaining new customer is always higher as to cost of maintaining customers. However in case of Insurance sector in particular and for various allied services of banking in general service providers are required to do work in the direction of increasing customer base as well as retain present customers. Reliability of the customer on the claims made by the respective service providers' boots confidence in the brand or service providers. Demographic factors like age, income and life stage of the consumers are playing vital role in customer satisfaction for the services of
the banks and insurance companies. All the dimensions of service quality are playing unequal role in the creation of customer perception for specific services. In present research work and attempt has been made to know the relationship between customer perceptions with the customer satisfaction. Constant critical evaluation of service quality and service delivery is need of both industry. Service quality as per expectations of the consumers ensures brand loyalty in long run and which will turn into higher profitability. Hence we can conclude that better service quality is key of higher profitability in the service sector.