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CENTRE FOR ADVANCED FINANCIAL
RESEARCH AND LEARNING

Promoted by Reserve Bank of India

**Roundtable
on
Nachiket Mor Committee Report**

February 4, 2014

**Committee on
Comprehensive Financial Services for
Small Business
and
Low Income Households**

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Banking Systems Design

- Payments, Deposits and Credit are the functional building blocks of banking system (*pg.46*)
- Horizontally Differentiated Banking System (HDBS) : Full-service banks with all these blocks
- Vertically Differentiated Banking System (VDBS) : Focus on specialising in one or more of the building blocks

Banking Systems Design

It is important to have a regulatory flexibility to approach payments, savings and credit independently (the VDBS design) and to bring them together (the HDBS design) when the efficiency gains are high and other costs are low. *(pg.51)*

Banking Systems Design – Types of VDBS (pg.50)

- **Payments Network Operator (PNO)** : Does not accept deposits or issue e-money but merely routes payments
- **Payments Bank** : Designed to provide payment and deposits but not credit
- **Full Service Bank** : Offers all three components
- **Wholesale Investment Bank**: Less than 20 branches, lend in niche wholesale markets such as infra and corporates and accept wholesale deposit of Rs.5 cr and above
- **Wholesale Consumer Bank** : Large branch network, lend retail and accept deposit of Rs.5 cr and above

Banking Systems Design – Payments Bank (3.10 / pg.78)

- To provide payment services and deposit products to small business and low-income households
- Restricted to hold a maximum balance of Rs.50k per customer
- To maintain CRR & SLR norms and follow full KYC
- Balance funds to be deployed in SLR securities with duration of not more than 3 months G-secs

Banking Systems Design – Payments Bank (3.10 / pg.78)

- Minimum entry capital requirement – Rs.50 cr and CRAR for market risk and ops risk
- Comply with all the guidelines issued by RBI for SCBs
- Existing PPIs eligible to apply

Banking Systems Design – Wholesale Bank (4.27 / pg.116)

- Primary role is lending and will accept deposits larger than Rs.5 cr
- Minimum entry capital requirement – Rs.50 cr
- 20 or fewer branches - Wholesale Investment Banks
- More than 20 branches – Wholesale Consumer Banks

- Borrowing from other banks be deducted for SLR calculation
- They will be required to comply with all other RBI guidelines in line with SCBs
- Enable transition of eligible NBFCs to this.

Banking Systems Design - Subsidiaries

- Existing SCBs be permitted to create a Payment Bank as a Subsidiary **(3.10 / pg.78)**
- Existing SCBs may be permitted to set up dedicated subsidiaries for Financial Inclusion without RBI prior approval in light of recent relaxation of branch licensing guidelines and the capability to carry out consolidated supervision. **(4.6 / pg.10)**

Banking Systems Design – Questions

1. Will the vertical banking structure recommended in the Report help in achieving the Financial Inclusion and financial deepening?
2. Specifically what is your view on the proposed
 - (i) Payments Bank
 - (ii) Wholesale Bank
3. What is your view on SCBs setting up subsidiaries for same activity that can be done in the main bank?

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Priority Sector Lending

- Additional assets to qualify as PSL
- Transfer of PSL assets
- Sectoral & District Weightage proposal
- Pricing and Reporting

Priority Sector Lending – Additional assets to qualify as PSL

- Investment by banks in bonds of institutions must qualify for PSL where wholesale lending to the same institution qualifies as PSL. *(4.29 / pg.14)*
- Investment by banks in the form of non-fund based limits should also qualify for PSL to the extent of credit equivalent. *(4.31 / pg.14)*
- All loans given to landless laborers and small and marginal farmers should be counted as a part of Direct Agriculture and not merely the wages component of a loan given to a farmer for financing his agricultural production. *(4.28 / pg.14)*

Priority Sector Lending – Additional assets to qualify as PSL

- Within the overall equity investment limits of banks, RBI could permit equity investments by banks in complementary infrastructure such as rural warehouses, market yards, godowns, silos and NBFCs in low financial depth districts, where debt qualifies for PSL, within the purview of PSL guidelines with a multiplier of 4. **(4.32 / pg.14)**
- Equity investments by banks in private companies engaged in the task of installing and operating weather stations or in creating markets for second-hand assets should be eligible for PSL treatment. These investments should also get a multiplier of 4, to reflect the higher risk and the illiquid character of these investments. **(4.48 / pg.16)**

Priority Sector Lending – Transfer of PSL assets

- The stipulation that the all-inclusive interest charged to the ultimate borrower by the originating entity should not exceed the Base Rate of the purchasing bank plus 8% p.a. should be removed. **(4.9 / pg.10)**
- Purchased assets representing agricultural credit may be included in PSL and held in banking book on the basis of declaration of intent. **(pg.124)**
- Credit facilities documented as bonds or Pass-Through Certificates (PTCs) should be permitted to be held in “banking book” based on declared intent. **(4.30 / pg.14)**
- Risk free PSL Certificates may be enabled to achieve PSL compliance amongst banks that wish to do so. **(4.39 / pg.15)**

Priority Sector Lending – Sectoral & District weightage proposal

- Districts and sectors are weighted based on the difficulty in lending to them and a Bank lending to a difficult sector in a difficult to reach district can benefit from a multiplier value based on the specific sector and district. *(4.40 / pg.15)*
- Every sector-district combination has a weight associated with it and the bank will have to reach an adjusted PSL value of 50% taking these weightages into account. *(4.40 / pg.15)*

Priority Sector Lending – Pricing and Reporting

- Banks must be required to freely price farm loans based on their risk models and any subventions and waivers deemed necessary by the government should be transferred directly to the farmers and not through interest subsidies or loan waivers. *(4.5 / pg.9)*
- PSL targets should be applicable on the last reporting Friday during the last month of each quarter in exactly the same manner as it is currently applicable in the month of March, so as to ensure more timely and continuous credit flow into priority sector. *(4.33 / pg.14)*

Priority Sector Lending – Question

1. What are the implications of the proposed recommendations on Priority Sector Lending?

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Branch and BC for banks

- Problems and Strategy
- Rural branch definition
- Distance criteria and risk sharing
- NBFC and Wholesale banks act as BC
- White Label BCs

Branch and BC Model – Problems & Strategy

- Report has identified the problems in BC Model
 - Low financial viability
 - Poor technical support to BCs
 - Low performance by the Customer Service Points (CSPs)
- Core strategy to improve viability
 - Improve revenues by building adjacencies
 - Ensure fair compensation
 - Reduce costs

Rural branch definition for banks be made more flexible

- Minimum services of account opening with e-KYC on an off-line mode, cash-in, cash out, transfer initiative, balance enquiry
- Minimum of 1,000 working hours of operation yearly
- Minimum of 100 days of operations
- Any nature of employment of staff preferred

Branch and BC Model – Rural branch definition

- Ability to directly transact on bank's CBS and to print an account statement
- Any nature of ownership of infrastructure and premises be allowed
- Bank take full responsibility of customer protection

Policy of mandatory rural branching be reviewed regularly and be phased out once the goals specified in the Report for payments services and deposit products have been achieved.

Branch and BC Model – Distance criteria and risk sharing

- The regulator should eliminate the distance criteria (30 km for rural and 5km for urban) between BC and the nearest branch of the sponsor bank. There is no such restriction for ATMs. The regulator should allow the banks to decide the operational criteria in this regard. *(3.5 / pg.8)*
- The decision on the manner in which risk sharing and credit approval arrangements need to be structured between banks and their agents can be left to the judgment of banks. Outsourcing guidelines should be amended to permit this. *(4.7 / pg. 10)*

Branch and BC Model – NBFCs and WB act as BCs

- As the NBFCs are already permitted to own and operate ATMs and POS terminals, the Committee recommends restoring the permission of NBFC-NDs to act as BCs of a bank. *(3.5 / pg.8)*
- The Wholesale Consumer Banks could be permitted to act as BCs for other full service banks. *(4.27 f / pg.14)*

Branch and BC Model– White Label BCs (3.8 / pg.8)

- The regulator should allow high-quality White Label BCs to emerge with direct access to settlement systems subject to certain prudential conditions.
- The White Label BC should be fully inter-operable and will have the ability to work with multiple banks at the back-end.
- The objective of White Label BCs are to utilize the BC infrastructure in an optimal manner and shared by multiple banks.

Branch and BC Model – Questions

1. Will the BC Model become more viable and effective with the proposed recommendations?
2. What are the benefits and risks in White Label BCs and NBFCs-ND and Wholesale bank acting as BCs?
3. What is your view on (i) rural branching definition (ii) distance criteria and (iii) risk sharing?

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Universal access to savings and payments

- Automatic opening of UEBA
- Aadhaar Number as KYC
- Proof of Identity

Universal access to savings and payments

- Automatic opening of a UEBA at the time of receiving Aadhaar number. *(3.1 / pg.7)*
- RBI should issue a circular indicating that no bank can refuse to open an account for a customer who has adequate KYC which specifically includes Aadhaar. *(3.1 / pg.7)*
- RBI should advice banks to insist only Proof of Identity for each and every customer and a documentary proof of one national address. They should waive the requirement of documentary proof for the current address, for the purpose of opening a full-service bank account. *(3.2 / pg.7)*

Universal access to savings and payments – Question

- What would be the implications of the above recommendations?

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- Asset class wise Provisioning Norms
- Portfolio hedging, reporting and disclosures

- The regulator provide specific guidance on differential provisioning norms at the level of each asset class. A bank's overall NPA Coverage Ratio would therefore be a function of its overall portfolio asset mix.
- On standard assets, the provisioning levels as well as asset classification guidelines specified by RBI would need to reflect the underlying level of riskiness of each asset class.
- The regulator also mandate NPA recognition rules at the level of each asset-class and require that all banks conform to these mandates.

Risk Management – portfolio hedging, reporting and disclosure

- Banks be permitted to purchase portfolio level protection against all forms of rainfall and commodity price risks, including through the use of financial futures and options
- Universal reporting to credit bureaus should be mandated for all loans including individual, SME, SHGs, KCC and GCC. *(4.2 / pg.9)*
- All banks should be required to publically disclose the results of their stress tests both at an overall balance sheet level as well as at a segment level, annually. *(4.4 / pg.9)*

Risk Management – Question

- What are the implications for banks in implementing the above mentioned recommendations towards risk management?

Thank you

