RECOMMENDATIONS FOR
MODERNISING INDIA'S BANKING SECTOR

A quick summary of recommendations from IFMR Finance Foundation's latest research note titled ***"Modernisation of India's Banking Sector"***. Read more at http://bit.ly/modernisebanking

Reimagine Universal banks as no longer engaged as risk originators but rather as risk aggregators who undertake active rebalancing of portfolios and diversification as a strategy

- Tools like the Generalised Herfindahl-Hirschman Index will come in handy

BOND
DEBENTURE

Permit banks to move away from an exclusive originate-and-hold-till-maturity strategy

- One way to do this is to gradually document all their loans using debenture / bond documentation so that the liquidity of their balance sheets improve

To reveal the true costs of originating loans, banks need to undertake better risk-based pricing of loan assets through frameworks that can:

- reveal the true cost of funds - Matched Fund Transfer Pricing
- reveal transaction costs - Activity Based Costing
- help to know the cost of equity - Risk-Adjusted Performance Measurement

SCORE

Moving away from providing detailed instructions in its Monitorable Action Plan, RBI must shift towards specifying targeted risk scores for each bank based on its unique risk position

RBI must provide differential provisioning & asset classification norms that reflect riskiness of each asset class

Place greater disclosure requirements on banks regarding concentration levels to each segment/sector, largest counterparties, results of stress tests, so that these banks compete with each other on the strengths of their balance sheets alone – no one entity can unduly find favour due to lesser disclosure requirements on them

RBI must require banks to demonstrate IFRS parallel run on their books; also ensure that new licensees are IFRS compliant from the start

Banks must equip themselves with instruments such as credit derivatives for better risk management of portfolios

- Permitting the use of CDSs for loans held on banks' books would make them much more useful as a risk management tool. For instance, regional banks can purchase CDSs from large banks as the latter are much better placed to warehouse such risks

Permit banks to hedge commodity price risks on agri lending portfolios and offer such hedges to customers as an Over-The-Counter offering

To guard against large scale defaults from catastrophic events, banks must work with insurance companies to purchase bank-wide portfolio level insurance - and no longer rely on government payouts