Ensuring Financial Sector Resilience

(RBI Gov's speech)

What to do?

① → on part of REs → ethics in governance
- → legal compliance; letter & spirit
- → Pursuit of sustainable business practices
- → Avoidance of constant focus on profits

② → strong governance
- → informed & strategic DM
- → long-term goals
- → Risk mgt

RBI has been supplementing rule-based regulations with principle-based regulations to give REs a degree of flexibility in their business decision-making

③ → sustainability of business models → pro-active measured

eg. RBI acted in advance to slow down credit growth, identifying some evidence of weakened underwriting standards and credit appraisal

④ → Risk-weight Adjustments
- → unsecured loans: 100% → 125%
- → credit card loans: 125% → 150%

Resulted in moderation of credit growth in these segments ⇒ resilience ↑

⑤ → Technology & 3rd party Vendors
- → outsourcing ⇒ due diligence & cont. monitoring of these vendors essential
- → Tech. to meet financial sustainabilities, Technical capabilities, security stds. & regulatory compliance

⑥ → NBFC-bank interconnectedness

NBFC sector accounts for nearly 30% of the total bank credit in India and plays a key role in credit intermediation => risk to NBFC sector spillover into banking sector

- Risks

Highlighted by RBI Gov. in a recent speech

① Inflation vs growth → RBI revised neutral rate of interest in 1.4 - 1.9% range

- → core inflation stable
- → food inflation volatile

② ↑ credit-deposit ratio : 80% + since March 2024

↓

slow deposit growth

The incremental CD ratio of SCBs stood at 90.8% as of May 31, 2024, according to the latest RBI data. ⇒ Banks should improve credit underwriting stds. & risk assessment

Recently, RBI found that some banks & NBFCs aren't following rules about "top-up loans." Top-ups are additional loans that customers can get on top of their existing loans, often on the same collateral.

③ digital frauds → mule acc. (55%)

④ Unsecured portfolio of banks & exposure to NBFCs thru unsecured loans to them → contagion risk

(NBFCs subject to more lenient regulations)

⑤ Concerns of over-financialization: When financial innovation outpaces eco. dev., as seen in the Asian financial crisis, problems arise. Introducing derivatives and single-stock futures is beneficial for a country with our income level but may be premature given current savings habits & capital formation.

⑥ climate change → green washing

Also Green Bonds lackluster performance due to 'Greenium' issue

Reasons for good performance (low NPA of banks, data tum batao):

- -Improved borrower selection
- -Effective debt recovery
- -Heightened debt awareness among large borrowers.

The main reason/issue is the ‘mis-selling of products to achieve short-term profits. Mis-selling remains a significant issue within the insurance sector. Banks and insurance companies are mis-selling their products to achieve short-term profits: Customer complaints also point to this.

Another issue is that GNPA in agri sector is at 6.5% (Mar 2024), improving but higher than avg.