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'Synergies for Bolstering Development in South India'

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Introduction:

Six years after the global financial crisis of 2008, India continues to witness slow growth rates, more on account of high interest rates and soaring inflation. Corporate India, because of high interest rates and the slowdown in economic activity is finding it difficult to sustain their growth. This is reflected in the increasing NPAs of banks driven largely by their corporate clients rather than their retail clients. While the industry looks to revitalize its growth by taking advantage of the small green-shoots of economic activity, it is equally imperative for the financial sector to grow in tandem to meet the growing needs of corporate India. As industry grows and expands across the nation, many financial institutions are now expanding their base to beyond traditional metropolitan cities.

South India is a telling example. With property prices increasing in Delhi and Mumbai, many industries have relocated their headquarters to any of the five states of Andhra Pradesh, Karnataka, Kerala, Tamil Nadu and Telangana. The Chennai – Bengaluru and the Bengaluru – Mumbai industrial corridors are further attractions. This has resulted in the burgeoning of many financial sector companies in the south. While corporate India's requirements of the financial sector are by and large the same, some of the demands, depending on the sectors and the region, may be a little more nuanced.

It is in this context that the Federation of Indian Chambers of Commerce and Industry (FICCI) organized this two-day Financial Sector Conclave. In this 2nd edition of Annual Conclave the intellectuals have pool in their thoughts on the critical issues regarding the financial sector and the way forward for economy, as a whole, in this country. It brought together the decision makers of corporate India, CMDs and MDS of banks and other financial institution, regulators and top ministry officials to deliberate on how to work in tandem to bring about a more streamlined and inclusive path to development that will help India once again achieve an 8 per cent growth rate.

Sessions:

Day 1	Day 2
• Inaugural Speech: Shri Etela Rajender, Hon'ble Finance Minister, Government of Telangana ➢ Re-Insurance • Special Address: Shri R Gandhi, Deputy Governor, Reserve Bank of India ➢ Financing of Agri Value Chain ➢ Role of Credit Rating Agencies ➢ Expert Analysis of 'Budget 2014-15'	• Inaugural Speech: Shri K. T. Rama Rao, Hon'ble Minister, for Panchayat Raj & IT, Government of Telangana ➢ PSL in Banking Sector ➢ Infrastructure Financing ➢ Governance and Regulation of Micro Finance Institutions (MFIs) • Special Address: Justice (Retd.) B N Srikrishna, Hon'ble Judge (Retd.), Supreme Court ➢ Financial Markets and Consumer Protection

Day 1

Inaugural Speech:

Shri Etela Rajender, Hon'ble Finance Minister, Government of Telangana

The hon'ble Finance Minister shared the vision and priorities of the newly formed government in the 40 day old state of Telangana. The government though shall have overall development of the region and the people but has three primary agendas which it plans to address on priority basis. As, around 70% of the population still lives in the rural areas, for any state to claim balanced growth it becomes extremely important to keep the development of the rural areas at the epitome of any state plan. Secondly, recognizing the importance of agriculture, it would be the second priority of the government. Also, education is a critical indicator and primary driver of growth in any state, so 'KG to PG education' will be the third priority of the government. Emphasizing on the importance of holistic education he mentioned the words of Shri A.P.J. Abdul Kalam that a teacher and a parent can alone eradicate all corruption, poverty and several such social ailments. Apart from this he drew the attention of the crowd towards the state of MSMEs, quoting that the monopoly of the large industries is one of the significant reasons for the high mortality of the MSMEs. So, for sustainable development of the MSMEs in the state, government is ready provide incubation support. To fulfill the ambitious agenda, the government should be a big facilitator with its stability and positive outlook Further, , the government feels it would be able to replicate the same growth, based on positive experiences from the state dichotomies in the past as witnessed in the growth trajectory of newer states, post division. He also requested the captains of the industry to take their share of responsibility in this agenda of growth, balance restoration and to take advantage of the positive and productive environment that the state is offering.

To emphasize on the problem of increasing gap between the rich and the poor in the society he used Dr. B. R. Ambedkar's words that development without equal distribution is in a manner deviating from the very essence of our constitution. At last, to let begin the rounds of discussion, he left everybody with a critical question to contemplate upon, that even after several decades of independence, have we moved towards being more progressive or regressive and what shall be the further course.

Session 1: REINSURANCE

"The only thing certain in this life is its uncertainty." Starting the session with this quote the speakers drew public's attention towards the increase in accidents, natural catastrophes, market uncertainties and all such unpredictable events. Insurance is a powerful tool to protect the business, assets and life against these uncertainties, . These risky events may be unpredictable and inevitable but what insurance does is, it makes sure that things could be brought back to normalcy by helping with an adequate compensation for the loss occurred. At the business end it allows the entrepreneurs to take risks. Also signifies the importance of insurance sector as a whole, is a study which roughly shows that 1% growth in the insurance sector cause 2% growth in the GDP.

Talking in Indian context, 60% of landmass prone to earthquake, 8000 Km of coastline, 60% of the area being draught prone and 1/3rd of the population exposed to multiple calamities makes India a disaster prone land. The other side of this is, that it's been over a decade since the opening up of the industry but the market penetration is still very low i.e. less than 10%. Even Asia as a whole in the last decade, accounted for 44% of the total economic losses due to calamities but had only 7% of these losses insured. An interesting example in support of this argument would be that as we know, motor insurance in India is mandatory by law but there are only 55 million insurance subscriptions against over a 100 million outstanding vehicles. Today, 99% of the houses in India are uninsured; health insurance is just 8 per cent in the overall health sector and a significant proportion of people in India still travel without travel insurance. The major reason behind this is people's perception, that they won't really need insurance and until and unless they witness an event of such sort closely, they find it hard to relate themselves to the benefits of an insurance product. In the immediate aftermath of Tsunami that struck in 2004, there was several folds increase in the demand of the house insurance in the affected areas. However, the phenomenon was short-lived as with the passage of time, people reverted back to being complacent. So not only proper marketing of these products but an overall awareness program is needed for the consumers.

In addition to bolstering awareness about utility of insurance products, there is a need to put in place another set of reforms targeted at improving the state and efficiency of distribution of these products. In rural areas the cost of distribution is very high and hence, in certain products it does not incentivizes the efforts of an agent adequately. Now, for instance, if the cost of two wheeler insurance is around INR 800-900, the margin out of this fee may not encourage the agents to sell these products. Further, we need new products that are simple in the sense that "we sell what you buy" and more relevant to Indian socio economic backdrop. For example, with a culture of joint families still prevalent in a large proportion of homes, especially in rural India, there is a phenomenon of strong interdependence and risk sharing. This ability to bear and share risk amongst the family members, substitutes for insurance.

The gap between the protection that that we require and the protection we buy is huge in India (estimated to be 3 Trillion $). One of the reasons of which is that people firstly do not feel the need of an insurance product and those who do, do not perceive insurance as a risk product. So they expect

returns over the risk premium they pay and end up buying more of saving product which inadequately covers the risk.

The insurance market across the globe varies significantly across geographies, due to changing factors like governmental push, culture, market dynamics, level of awareness, risk indicators and the their level and purchasing power etc. When we talk of the Indian Insurance sector every aspect is codified and the definitions are strict and hard. But UK is one such market where such constraining primary laws are not present, so they have the liberty and room for more dynamic secondary laws. There, the market is principle based and not rule based.

On contrary to this the reinsurance market across the globe is not very different and in fact to a large extent links insurance markets of different geographies. Reinsurance as a product could be roughly summed up as 'insurance for insurance companies.' Reinsurance as a product essentially requires the risk o being transferred to an external party. This is because if the insuring and reinsuring parties both belong to the same risk zone it will just be accumulation of the risk and will just create a risk circular dependence.

To increase the penetration in the Indian market we need to make insurance more affordable. One way of doing this is increasing the scale of business and the per customer coverage and volume. In UK the overall coverage in terms of volume per customer is 40 times that of India. Also the risk profiling of the customer has to become more accurate to correctly price a risk. Also, like banks even the insurance companies can use to arrive at a particular borrower's risk profile. Also the risk environment in different regions is different geographies varies for different risks such as the accident rate of the insured vehicles in India is estimated to be at three times that in United Kingdom.

The Reinsurance market from the Insurance market is different also in terms of the different reception of the same risks by the two. Some risks that are viewed as unfavorable by insurance companies' point of view are excellent from the point of view of a Reinsurer. Hence, there is a need for the reinsurance market to open up globally and let those who are willing to share risk from across the geographies, come in and participate. This will require a lot of changes at the legislative end as well. One of the enabling move could be the approval of the insurance bill struck in Parliament for 6 years which can further liberalize the insurance market. Also there is need to bring insurance at par with other financial products, where it could become a tradable instrument.

Special Address:

Shri R. Gandhi, Deputy Governor, Reserve Bank of India

Shri R. Gandhi began his address to the delegates with a stress on need to mobilize funds and the migration of locked resources to avenues which can provide fruitful returns. He highlighted the role of banks in the redeployment of funds and also the increasing correlation between the growth of the banking sector and the economy as whole. The basic objective should be to take the funds to those who do not have access to the conventional means of finance.

He also drew a comparison on how South India in just three decades with a growth rate lesser than country's average has reversed the situation. On every parameter in these three decades South India has grow in leaps and bounces. For instance, in Andhra Pradesh the Deposit to GDP ratio was 28.1% and the Credit to GDP ratio was 21.1% in 1980s, which grew to 52% and 58% respectively in 2000, and even the other states are above the country's average. In total, there are 995 NBFCs in South India and approximately 75% of the total deposits taken by NBFCs come from Tamil Nadu alone. The performance is very similar in the rest of the Southern India. These statistics reflect the depth and penetration of the financial sector in South India.

The South India market presents itself with a strong appetite and high growth potential, and with adequate support from the banks can produce exceptional results in financial inclusion. The credit to deposit ratio for the region is more than 100%, so the banks will have to balance this demand from the rest of the country. Along with banking and financial services, there is a need for insurance sector to match the pace of the growth, and rise accordingly. The risk appetite in consumers in South India has traditionally been higher than the rest of the India and hence, the market calls for additional caution at all times to maintain an appropriate risk return balance.

On the Gold loan markets he said that it certainly helps in monetizing the otherwise not so useful resource but it distorts the monetary policy transmission and disturbs the risk reward relation at times. Though he added that accumulation of gold as such is not what is promoted and the RBI would want people to move towards more formal ways of finance in the long run. Also he praised the efforts in the development of SHGs in the region and regarded this development as the platform for running any microfinance model in the region. Further, he stressed that without effort to improve financial literacy, the target of holistic development cannot be achieved and so should always remain an area of equal importance.

Session 2: Financing of Agri Value Chains (AVCs)

Even though as a sector, the share of agriculture in the national GDP has been declining, yet it still continues to be one of the most critical sectors given that 50% of our country's population still depends on it. Today the agriculture production from its conventional realms has moved towards more sophisticated value chains i.e. AVCs, where every link in it thrives to maximize the value of the produce at its level. But even today, when it comes to AVC financing, there is no financing product specific to it that exists for it. The agri production credit and the agri investment credit are given at different stages and to different entities in the chain separately. Although the finance and the support is dispersed, but the government has recognized the potential of this model of agri production and today in Andhra Pradesh (as per pre division stats) alone there are more than 4000 warehouses. One the reasons for this is channelizing of subsidies from the government to the AVC entities.

Gujarat's 'Wadi' program is one example where the farmers were settled on the farms itself to closely monitor and drive the AVC production. Small lands were used for orchards and the larger ones for crops and other plantations. This scientific and planned way of forming AVC resulted in sustainable source of income for all the entities in the chain. Once the production side of the AVC was stabilized the marketing initiatives were taken, 'Vasundhara Products' is a live example of Agri Marketing. The same program is started in Andhra Pradesh (as per pre division stats) also and today there are more than 80 'Wadi' programs all over the state, though currently most of the farmers are small and marginal ones.

To ensure the sustainability of income for the farmers and to transfer the burden of selling and marketing of produce on specialized entities, SPVs (special Purpose Vehicles) are formed which form procurement to marketing and selling takes cares of everything. Such initiatives are seen in Himachal Pradesh for Apples and in Maharashtra and West Bengal for Potatoes. This also addresses somewhere the problem of storage of goods as every year 15-20% of produce is wasted just due to improper and insufficient storage facilities. NABARD Consultancy Services has made recommendations in this regards along with address to other issues like friction between various government and non government agencies involved.

Although with huge potential of development, in current state our AVCs are long and unorganized, also unaligned at certain places and where every link appears to be a weak link. The market for the warehouse receipts too has to be developed and then the liquidity with the farmers remains a concern. One of the suggestions that came up during the discussion was integrating Information, Insurance and other extension services in one product. This will help the AVC entities to reach the formal funding institutes which otherwise perceive them as high risk endeavors. Also with the integration of activities and products the lenders will get the scale advantage which could be passed on the other stakeholders in the AVC.

Initiatives like NCDEX (National Commodity and Derivatives Exchange) and NAIS (National Agriculture Insurance Scheme) will play a vital role in taking the agriculture sector to the next level of sophistication. NCDEX not only allows the producers to sell in bulk and processors to procure in bulk but it also give the agri produce fungability and liquidity to move in the market. NIAS on the other hand gives assurance to the borrowers and their dependents against the market and natural adversities.

A different dimension of lending which came out of the discussion was moving away from asset based lending to cash flow based lending, a possible Inspiration for the lenders could come from the IT industry. Just two decades back most of the banks refused to lend to IT companies as it does not produce any tangible asset and without which the conventional appraisal process may never regard it as a lendable venture. But most of those companies today have turned into multinational giants and a mostly debt free. This shows that the approach of same size fits all from the financial institutes isn't the right way to go and we possibly require a different model of lending for the AVCs.

Amidst the discussion of production and marketing rose the problems of cyclicality, with frequent fluctuation in prices and natural harshness, endangering the perishable produce. To counter such problems we need large scale development of infrastructure of cold chains, warehouses and adequate logistics which might not be possible to achieve without support and investment from large corporate. In the investment structure at one end we need long term funds and at the other end, equity pooling needs to be done. Obviously for this scenario to materialize, AVCs as a complete chain have to become an attractive area of putting funds.

The current capacity of warehouses is 60-65 million tones, which is neither sufficient nor up to its full utilization. So one of the recommendations with regard to warehouses was that of developing a 'Hub and Spoke' model. Where a large warehouse, possible a state governed warehouse could act as a hub and the other smaller warehouses can draw all the requisite support from it. NABARD has already tied up with a top collateral management company to build a model in this direction.

The discussion then moved towards the idea of intelligent sowing. Inspirations were drawn from Australia where the farmers check and use the price trend analysis to help their decision of sowing. This rational way of choosing which crop to be sown in which area at what point of time if can replace the currently prevalent intuitive choice of the crop to be sown in India, can significantly cut down on the market uncertainties.

With the opening up of markets and transfer of goods possible with nominal duty, today the price neutralization has become possible. To increase the depth of the market for the agri produce, the Banks and other Financial Institutes should be allowed to open demat account in NCDEX. NCDEX's basic purpose is to ensure a fair price discovery for the benefit of farmers and the irony is that farmers have the least participation the exchange. As a result, in Andhra Pradesh (as per pre division stats), some agri warehouses through agri societies have linked themselves to NCDEX.

Session 3: Role of Credit Rating Agencies CRAs

The CRAs have been playing a critical role in enabling the process of taking lending decisions by Banks and Financial institutions. In this collaboration, their rating and assessing expertise has seasoned over the years and the rating models too are highly developed. But when it comes to unconventional sectors of credit like Film financing, vineyard finance, art and culture finance and SME (Small Medium Enterprise) finance etc., the rating models are yet to completely evolve in their fully developed form. One issue of which the lenders have always complained is that the models used for rating in these unconventional sectors are not completely customized as per the nature and traits of the sector specific entities and its more of the conventional models being used with some recalibration and minor changes.

CRAs follow a different scale of rating for SMEs than that for the corporate. Say for instance a CRA for SMEs uses a scale of 1a-5c where 1a being the best. But only around 10% of the entities rated, make it above 2b and of this is what the lenders complain. They think on a lot of instances even their best of the performing entities get low rating and this is where they think that a model dedicated for SME rating is yet to completely evolve. There are two categories of SME customers, the 1st generation entrepreneurs and the 2nd generation ones or those 1st generation startups which are at least two decades old. Most of the SMEs are run single handedly by their promoters. These factors make it difficult to judge an SME on the Management grades in a conventional model. Almost all of these entities are not listed and the financials are mostly not very reliable. To worsen the situation, even SMEs which are able to present reasonable level and quality of financial information, are actually dependent on other SMEs (Chartered Accountant firms) to facelift their financial reporting. Other than the typical problems, SMEs also face daily challenges relating to Working Capital, Capital Structure, Customer delinquency, dependence on other parties, order failures etc. These fundamental challenges with SMEs make them riskier than corporate. So , while a lender willing to lend to an SME but looks out for a one with a higher rating is not left with too many options. There are basically two questions which needs to be answered while assessing a borrower entity, “can he repay?” and “will he repay?” As the former is answered by our discussion in the paragraph above, for the latter there was a suggestion that popped up and it’s the use of Psychometric Analysis for judging the credibility and willingness of a borrower. It can be judged by two parametric processes, Cultural Relevance and Gaming. The yard sticks for the process outcome would be loyalty, smartness and wisdom etc. The weights of which will change as the context and geography in every case will change. Although this idea is in preliminary stage but, if implemented can certainly enhance and supplement the lending decisions in the future.

In certain aspects, SMEs portray a common set of risks with corporates. So, an alert system/mechanism for the SMEs constantly guiding them to areas to look into and how to reduce risks shall be immensely useful. One alternate to the collateral based lending for the SMEs is borrowing against order. But again, it’s for the SMEs to decide whether to go ahead with this or not as it may be risking the entire net worth on the basis of one order. So before going ahead with the borrowing decision the borrower

needs to assess its own risk profile. The credit rating agencies, if we could simplify, want to arrive at the default point for an SME entity and then to find out how far is the entity from it. The farther it is the better it is.

In India due to the other markets not being vibrant enough, bank finance is almost synonymous to debt and this makes it the most important driver of our economy. Film Finance is one more such lending area where is relatively newer and is underdeveloped. The problem with it is that because it does not produce any tangible asset and even this intangible asset has a short life, it becomes very hard to appraise a project like this. Also the question that to actually define the success of a project of this sort becomes critical. The revenue dynamics have changed in the film sector over the years. So instead of a credit rating model for the film project we can rather go for dynamic risk profiling of the entity itself. For this the industry too will have to adopt a standard production model where production houses with high credit worthiness can be easily funded. Also the 1st timers who are even non worthy in the eyes of the lender could be converted to worthy borrowers; given the project is a genuine business case.

Another unconventional sector that can benefit immensely from ratings is the renewable energy sector. Just one decade back banks had insignificant exposure in their books on the renewable sector. Today banks are ready to lend them, not only because they have identified the potential in the sector but also to diversify their own portfolio. In India though the lending in this sector has been very conservative still our NPAs in this sector are very less. Take Germany for instance it's NPA in this sector are around 15 out of every 115.

Another problem in this sector is sudden policy shift and market uncertainty. For instance, a project starts under a protective government policy but by the time the infrastructure is ready the policy is changed, the secured prices too are changed, which makes the project all of a sudden an infeasible venture. Same unfavorable shift in the policy has happened in the past, in case of several thermal and biogas projects in India. So the tariff should be stable and secured and also the financing horizon should increase.

We need different scales, models and teams for rating of these unconventional projects and also parameters to first distinguish between different sectors and within those sectors, different class of entities. Say one could be size, large entities are more resilient in economic downturns and adversities in majority of the cases. Although this may not be a thumb rule as say a smaller firm is better protected against macroeconomic changes due to its limited presence it is more insulated. A related issue that emerges, is the aligning and standardizing the industry practice for various CRAs. For example, an entity rated by two CRAs with very different benchmarks and model, may result in a wide variation in ratings, thus making a comparison between the two difficult. Also we need to rate the rating agencies also, as their credibility forms the crux of a lending decision.

Session 4: Expert Analysis of 'Budget 2014-15'

One of the most talked about announcements in this budget was the GST (Goods and services tax), a positive step in the direction of tax consolidation. Although there were concerns shown for bringing down the fiscal deficit further but the steps taken were not concrete, according to the panelists. Also there were no major initiatives to draw foreign investments. This budget has brought some additional saving opportunities for tax payers. Although on net basis whatever savings it offers, the government in an indirect manner wishes to bring back to the economy, say a provision of saving tax via buying government policies. This will bring the multiplier effect in the economy and will create an ecosystem of growth. Also, the critics of the budget need to understand that 50 days are too less for any government to understand the complex financial system with several peculiarities.

Roughly, only 15% of Indians have taken loan, but a number roughly five times than this is actually indebted. As we go into rural markets, this situation becomes more complex and so we need rural banks with sophistication of rural markets. Banks are under the pressure of raising capital and the difficulty is higher for PSB (Public Sector Banks). For example the balance sheet size of a large PSB is four times that of a Private Sector Bank but the market capitalization of this PSB is lesser than that of the Private Sector Bank. One mechanism to steer the banks and specially PSBs out of this problem is by reducing the share in these entities and raising public capital. Also, as a prudent measure, the government should largely restrict its role to that of a regulator and let people manage their own PSBs. The current value of the PSBs and PSUs is at reasonably high levels and hence, time might be suitable to consider disinvestment in some of them. As, it's not the ownership that matters but how we manage the entity.

The government has kept high revenue targets and depends on disinvestment to achieve them. One of the reasons for which is that we don't have buoyancy in our tax collection system and its one of the lowest in the world. On the other hand the rate at which the tax is collected is highest in the world and around 65-70% of the people do not pay taxes.

There were also issues raised during the discussion on the demand of the policy and regulations' revision in certain areas. Say for an instance, one could put the entire 2% of the mandatory CSR in PM's Relief fund and also can get 1200% tax deduction benefit. But this leads to deviation from the very purpose of CSR. Also there should be a change in the practice of public borrowing. It should be market based and not captive market based i.e. the government should also borrow from the public at market rate and then should focus on its efficient use.

Day 2

Introduction:

Mr. R. Raghuttama Rao, Managing Director, IMaCS

For an efficient market to exist there should be wide variety in the services and products. As the risk appetite, investment horizon, return expectations and overall needs of every customer is different; the products required too shall be different. Also at times customers need liberty to design and manage their products. The cost of intermediation in India is very high (3-4%) and is almost double of what it is internationally. This shows that that the efficiency is less and for a country thriving for Financial Inclusion this is unaffordable.

An explanation to the inherent instability of the financial markets could be the psychological feelings that chase the financial market and the greed & fear which drive it. This creates an inevitable risk but what we need to see is that is the risk allocation fair and is it priced wisely.

Development of any market is not possible without innovation and innovation contradicts stability. Also innovation tends to run ahead of regulation. The line of legitimacy and regulation keep converging and diverging. So it's a critical question that how do regulators balance the regulation and innovation. The role of the IT in the BFS (Banking and Financial sector) is huge and this sector is the largest user of it. Most of the innovations that we see today in BFS are technology driven. It has completely changed the design and delivery of the market products. But this rage of innovations may also scare the regulators as it new and untested. The regulators sometime tend to adopt the ostrich view in fear of the inbuilt risks with these innovations.

As the capitalism increases the inequality increases but as the economy develops the bottom of the pyramids get the thrust to come up. These are two contradicting concepts and in a developing economy tend to overrun each other. Today South India has 19% of geographical coverage but 1/3rd of financial services are consumed by this region. It has around 25% of GDP share and around 30% of the employment is created here. In several such indicators South India is ahead of the national average but still the demographic dividend is low. Financial entities chase vibrant markets and with sincere efforts South India could be the financial hub of South Asia.

Inaugural Speech:

Shri K. T. Rama Rao, Hon'ble Minister, for Panchayat Raj & IT, Government of Telangana

The Minister while sharing the preparation of the government to take the state at new heights of development, told that instead of a centralized regime administration a bottom up approach of development would be followed. The policy of 'our village our plan, our Mandal our plan and our state our plan' will be followed where the expectations of the villages will be aligned into planning at all levels. The mission is to make Hyderabad the second financial capital of India. The city is already ahead in IT, Pharmaceuticals and Biotech industries from the rest of the nation. Development of the largest data center in Asia i.e. 'Control S', is one of the recent achievements of the city. But the IT sector too needs reforms, as to meet the growing demand and to bring the cost down we need to shift from established infrastructure model to 'on demand' infrastructure model. The financial sector too is vibrant and developed in Hyderabad and already most of the top financial institutions in the world have their offices in the city.

SERP (Society for Eliminating Rural Poverty) has taken initiatives in the state to alleviate poverty. But some unfortunate incidences in the recent past draw our attention towards the need of better planning at one end and more stringent regulations on the institutions at the other end. One such initiative which is committed to socio economic empowerment of women and their upliftment is 'Strinidhi'. The state already has 47 Lakh women under the coverage of various SHGs and now initiatives like Strinidhi will help them avail collateral free borrowing. The recovery rate of 99.6% shows how healthy these SHGs are.

To fulfill the dream of Mahatma Gandhi i.e. of Gram Swaraj, the rural masses need a sense of responsibility and the Panchayat Raj needs to be strengthened. This will give Banks and FIs more scope to connect to the common masses and work closely to them. The State government had promised a loan waiver to the poorest of the poor. But the government will make sure that the financial system remains unshaken in fulfilling this commitment and hence it's in discussion with RBI and Banks to figure out a way.

Session 5: Priority Sector Lending PSL

For an economy like India PSL (Priority Sector Lending) it is extremely important but the Institutions are reluctant to lend in these areas, until compelled. So the government has to figure out a way so that PSL makes sense from a economic and business point of view. Making PSL a profitable proposition is possible, is proven by some banks which have done well in the sector. The regulator also should let other financial institutions, insurance agencies and NBFCs to join this movement. Today NBFCs do not fund SMEs as much as the banks do because the Banks have got protection under CGTMSE, which should also be extended for the NBFCs so that they can freely lend SMEs.

To show how achieving PSL targeting is more about will rather than business environment, there was an example quoted. Just two years back a large PSB was found 9% behind its PSL targets (which amounted somewhere between INR 3 and 4 thousand Crore) and was made to invest in the RIDF bonds (with a mere return of 6%) as penalty. In a span of less than a year this bank not only met its PSL targets but had done exceedingly well in this direction. So it showed that with proper planning and willingness it’s not hard. A suggestion in regard to PSL came up and it was the inclusion of Export finance in the PSL list, which initially was also there. It would not only help banks but even our economy needs this desperately. So banks believe that though it’s necessary to keep PSL mandatory but certainly, its structure and content could be given a second thought. Also the RIDF funds can be used in indirect agri lending; this will not only help banks to achieve the PSL targets but also will fill in the fund gaps in this direction.

It’s a proven fact now that ‘PSL is not profitable’ is a myth. A PSB being the leader of the SLBC, after some suicides in Kerala, took over all the loans above 50 thousand Rs. from the local money lenders. If institutions can support the poor on time and in adequate manner, the poor proves to be more creditworthy than other borrowers. The poor survives on that finance and if the adversities do not prevail, he may never cheat. A lot of state governments lend at subsidized rates to their farmer and so the banks find it difficult to lend at market rate. This is another reason which makes achieving PSL targets difficult.

Before being withdrawn in 2011, the credit to NBFCs for on lending to MFIs had PSL status. Even today the industry isn’t united in its view, was it a correct decision or not. Some time back the growth in Banks’ credit to NBFCs was as high as 55%. This was wrongly taken as alarming as more than 50% of this growth figure was accounted by the government NBFCs only. Ideally the Banks and the NBFCs should have wholesaler-Retailer relationship. The NBFCs are different from Banks in terms of the indicators on which they are judged and the models which they use for lending. The NBFCs follow and have developed capabilities for heavy retail oriented lending model.

India is a country where 5% of people have everything and 70% has next to nothing. It used to be an economic problem but now it’s a growing social problem, as it’s the driver of growing crime, unrest, militancy etc. To create more economic opportunities and tackle poverty, maybe the banks can be

allowed to charge a little higher because it’s better to have costly credit rather than not having at all. Also the appraisal norms and lending criterions can be further relaxed for certain sectors as someone critically quoted in the discussion that “the easiest way of getting a bank loan in this country is by proving that you don’t need it.”

The brick and mortar model of banks cannot take the outreach to the farthest of the places as it’s costly and our resources are limited. For this Business Correspondent model is one good alternate but for this to succeed, educating the Business correspondents in banking operations is extremely important. The banks too have realized the importance of training and capacity building but struggle to develop means of catering to the requirement, givens that majority of them are already over-burdened with their core function and high volume. In this context, other institutions like RRBs (Regional Rural Banks) can play a proactive role in imparting training for capacity building in business correspondents and banks can delegate their responsibility on these RRBs.

We are still looking for the right model to address the issue of PSL. The institutions have to be profitable under any circumstance and also the borrowers can’t be charged what they can’t afford. So one set of changes in the model could be the ‘ABC’ change.

- Automation: Our lending mechanism is people driven and if we want to increase the outreach we need automated and standarised methodologies like scoring.
- Bureau: The lenders should pool in the information regarding all critical points in a lending process, in a Bureau. This Bereau can track the credit record of the entities and also will act as a data consortium. It may save the lender from the problems like overleveraging and multiple loans in the borrowers.
- Credible Comprehensive Collection System: Finding right regulatory structure and system to do this. Following systems which are backed by technology.

‘Sampoorna Vitteeya Samavesh’ SVS is a financial inclusion program which instead of inclusiveness of the villages addresses the inclusiveness of the households. It says that one lady in each household should be given compulsory overdraft. NABARD too will extend its support in this direction and will make sure that the banks are not afraid to make clean overdrafts.

Session 6: Infrastructure Lending

Over the past few years, the private sector share in the infrastructure sector has gone up and the share of the infrastructure sector in the overall GDP has gone up, which are good signs. But the gross capital formation in India has gone negative and there is high pressure on the interest rates. Today, 17% of the total NPAs and restructured assets are from infrastructure lending with NPAs as high as 34% in the power sector, up from just 14% over 5 years back.. A significant portion of these NPAs though could be attributed to global economic downturn, but still we need to understand that we have also missed on our part of doing. The government needs to improve on the coal and fuel availability, logistics, price clarifications, creating time bound environment, forest clearances, simplifying land clearances and off take tariffs etc. Support developers in relieving balance sheet strains, in dispute resolution (by independent regulatory bodies) and allowing early exit options to the developers. Also some larger legislative steps will be required on the part of government like coherent working of various government agencies and even consolidation of ministries like Coal, Mining and Power into one, for better functioning.

Around 60% of the Infrastructure funds come through banks. Whereas banks due to their Asset Liability mismatch find it difficult to lend for more than 10-12 years. IIFCL (India Infrastructure Finance Company Limited) has sanctioned more than 300 projects in road, power, ports and airports etc and the important distinction is that IIFCL can lend for longer duration that the other consortium members. So we need more dedicated agencies like this for infrastructure projects.

In every project 10-12% of the cost is accounted for by the equipments and the machines. So we need financers for the operators who use these machines and equipments in the large projects, like Shri Ram Equipment Finance. Today the urban population counts for 31% of the country's total, and our government thrives to take it at the level of any developed country. When this will happen, the demand of infrastructure will go up tremendously. The rising vehicle to population ratio, growing e-commerce sector, tourism and many other such factors are putting pressure on the existing road infrastructure. To be able to fulfill this increasing demand, the infrastructure funding, needs to be addressed with highest priority.

By an assessment, 26 trillion Rs would be the demand for investment in this sector. If say 18 Trillion we can manage by debt, the rest has to be from the bond market. So we need a deep and developed bond market, which is currently underdeveloped. We need policies for alleviating credit quality pressure as the bond markets demand for higher credit quality. We need more off-takers, partial guarantees and take off facilities to ease the pressure on the Banks. We need a mechanism to let banks exit the project and allow a SPV to take out their portion of financing. This will also release banking funds for new projects.

The rating agencies currently consider the ability of the operator (promoter) to factor the price fluctuations and price movement trends in the project formulation in its rating process. Although a better way of rating could be by incentivizing the risk mitigants like a Hedge.

Session 7: Governance and Regulation of Micro Finance Institutions (MFIs)

After the 2010 Andhra Pradesh (pre division) MFI crisis a lot of critical questions were raised about who is regulating these MFIs, RBI, NABARD or any other body. During 2010 crisis SKS MFI had to curtail its INR 4000 crore Portfolio to INR 1800 crore, even though the collection remained 95%. Even the sector as a whole shrank to Rs 14000 Cr from Rs 28000 Cr, amidst all the anguish and haphazard, RBI announced that there will be strong steps taken to prevent such crisis happening again and there shall be reforms. In 2011 when the reforms came, it meant that the size of the borrower entity, ticket size, tenure, interest rate and all such factors will be now directly controlled by RBI. This crisis turned out to be an event of constructive destruction. Learning from which today we have proper infrastructure and regulatory network with regard to MFIs. We now also have the 1st credit bureau for the MFIs.

In the Malegam committee's report in 2011, It was concluded that the regulations need more teeth and protection of the excluded ones needed further strengthening. Also, we need to make our MFIs more robust plus we need to appreciate whatever till now we have achieved in this direction. Information asymmetry is the highest barrier in the MFI lending. Lenders and investors should have enough information before they put their money in the venture. So one solution for raising money in this situation could be pooling of like institutions' portfolio, doing credit enhancements and securitizing. Also the MFIs should be encouraged to get listed as then the regular audits and periodic reporting will further regulate the MFIs.

An interesting comparative study was discussed during the session in which an MFI (Spandana) opened its branch in a slum and a similar slum was identified which did not have any branch. After some time the when the comparison was done it was found that the branch had only 26% as the take up rate. The reason of this was surprisingly the shortage of demand. Here the demand is actually, the demand for a price at which it is economically feasible to consume. The initial euphoria of MFIs was to provide high interest rate capital to push the low income grade consumers for entrepreneurship. But these are very small customers and the scope for risk taking is very less, which is the essence of entrepreneurship. Giving loans for other than business activities is important but should be for some constructive purpose like house building or education and not mere consumption. It is difficult to limit the moral hazard on the part of the borrowers and MFIs themselves will have to be cautious of this. Instead of complex models MFI can continue to do business with simple and established thumb rules.

The MFI investment vehicles give initial thrust capital but the FDI norms forced them to arrange for domestic capital only. Also, the ECBs are opened to them but still due to the cap, raising debt is still difficult. So there is room for legislative reforms in this direction. Information gap is another impediment in the path of MFIs raising funds. For investors to invest in MFI, they will need to have access to complete and reliable information. In this the credit information bureaus can come in handy, as the investors can get information on the parameters like the collection efficiency and credit quality of the portfolio of a particular MFI. Providing for IPOs and secondary sale as the exit option for MFI

funders has to be another focus area, as these investors may not be willing to let the money be locked, in projects like these for long.

The MFIs are the best was to address the problem of last mile connectivity in India. Banks have limited outreach but the MFIs have the outreach and also the skills for delivery in the farthest areas. 'Business Correspondent' has come up as an instrument of confluence between the Banks' lending ability and the MFIs' skills and outreach. Any other infrastructure requirement with this regard could be addressed by development institutions like IDBI, ICICI or IFCI etc.

To address the problem of multiple funding which was majorly responsible for the AP crisis today there are regulations like:

- Not more than 2 MFIs can lend to one borrower.
- 50 thousand is the maximum aggregate borrowing for any borrower.
- For funding greater than 15 thousand the tenure should be more than 2 years.

Apart from these other safeguards are like all the discussions are done in public places except when the borrower has defaulted on two consecutive payments. This is still a nascent and immature sector and the data too is a problem, its scattered, missing at a number of places and is not digitized. But we have started in this direction and today we have credit bureau with database of around 9 Cr borrowers with granularity of as much as 27 data points on each borrower.

Special Address:

Justice (Retd.) B N Srikrishna, Hon'ble Judge, Supreme Court

Justice B. N. Srikrishna started his speech directly by pointing at those regulators which do not have the correct understanding of what consumer protection is, which in turn has led to imprecise definition of the consumer protection itself. In the rush of just implementing consumer protection the regulators have either applied it with lower threshold and a very high threshold. Before getting into implementation or even before formulation, the regulator needs to raise this fundamental question and answer it and only then, would it be able to form open and governable laws.

The report on FSLRC (Financial Sector Legislative Reforms Commission) is out but the work is still not complete. The consequences of the buyer-giver approach are in front of us. There could be an over kill by banning the entire sector i.e. throwing the baby away with the bath water, as he quoted. The FSLRC recommended all regulators to build clear and relevant exposures that can be taken. The regulation requires care, attention and expertise and only specialized bodies should be entrusted with this task.

The regulators in a state, themselves act as mini states rather than working on behalf of the people for whom they are established. Three simple functions in which the entire duties of a regulator could be clubbed are writing regulations, investigating in case of violations and adjudicating wherever necessary. Where adjudication again should be a function separate from the other two and would have a body with the regulator separate from it, with a dedicated neutral staff. The accused parties should get patient hearing and checks and balances should be placed on the adjudicating bodies as well.

The regulator must be able to justify its action to the courts (HC and SC) and even to the internal tribunals, against the regulated entities. The regulatory system should be able to make the provider unmask the product in front of the consumer for greater transparency. Arrangements which were once best practices have now become the only way to do it. So in order to prevent the regulations from becoming brittle and rigid there should be continuous review and amendment of the regulatory system.

Session 8: Financial Markets and Consumer Protection

Consumer protection is best practiced in financial markets where its customer centric rather than regulator driven. For this to happen, customer awareness and financial literacy becomes extremely important. Also the customer should not be given an overdose of disclosures and information as these can be counterproductive. For instance just imagine, who would read a 45 page disclosure before buying two wheeler insurance. Disclosures are huge and may get beyond the comprehensibility of the consumers so the sellers should produce a precise information memorandum.

Consumer protection should be at the heart of any financial system and something which every service provider should keep in mind. Mere intermediation may be a primitive way of consumer protection and prove to be expensive in long run. We need accountable regulators which can balance between development and protection. Regulators too can be of different nature and different entrusted areas of regulation. SEBI is a close to a pure financial regulator when compared to RBI which is entrusted with a wide variety of tasks. Having multiple regulators may lead to boundary issues and hence, considering the unification of some regulators may not be a bad idea. Further, the products these days are so complex that may come under the purview of more than one regulator, so a consolidated regulator would have an overall view of the product. There are other critical questions that we need to find answer for. Like, should the banks be selling insurance products, as in the rush of increasing fee based income the seller at the counter may sell a product with highest margin and not the one which the consumer needs.

Moving the regulatory regime from its current state towards the vision of the FSLRC would require changes at all the ends i.e. legislative, executive and judiciary. The enforcing power should be given to the regulator but with accountability on it, maybe by FSATs (Financial Sector Appellate Tribunals). Every regulator tends to justifies its own actions in any regard and plus there are broad regulations under which the regulator may take shelter. Like “The regulator may take any deemed action in the interest of the people and the market it is regulating” is a generic regulation present in the mandate of almost every regulator, which gives them a blanket power. But does this serve the purpose of consumer protection. So it again drives towards a larger debate on the architecture of the regulatory system and other questions like decentralization or unification and if unification, then who merges into whom.

There are more abstract questions like can the virtue be legislated. Can mere formulation of law make everyone virtuous? Also do we have to wait for the legislation to arrive and only then can we go ahead with the consumer protection or can we manage with subordinate laws. Humans are driven by greed and we can’t change this nature by law. But by educating them we can give them necessary understanding of the game and can make it as fair as possible.

Due to complexity of the financial markets the financial entities spread across the purview of several regulators and if they are smart enough, may dodge all the regulators at the same instance. To

elaborate more on this, the simile out of a great Indian epic was used. Where the regulated party is 'Hirankashyap' who has safeguarded himself under all possible complex events which makes him impossible to be caught by any single entity, for any act, and wishes to take advantage of the tied hands of God. Where the Regulator is the God in this case and conceives the idea of 'Narsimha' who still manages to find out a way to catch hold of the culprit.

There may be lack of clarity on several ends with the law but we need to understand that this is a learning curve and only when something happen, then do we think that this should have been included in the law. Independence of regulators maybe wrongly interpreted as autocracy, where it actually means independence from government intervention and independence within the sphere of law only. Also, both appointment and the acts of the regulator should be checked by appropriate authority.

When a market is created, so many regulations are put upfront and at times this prevents the market itself from developing and so care should be taken before applying regulations on a developing market. The investigating officer should not be the one hearing for the grievances in order to avoid conflicts. Also the penalty should create a punishing potential, instead of being a namesake judgment. Unbiasedness should one of the founding traits in a regulator and it should see all regulated entities with same eyes. In a country like India where the regulators mostly come out of the ministries, many regulators are still attached to the umbilical cord of their parent ministries and so it is important that the dichotomy is clear and neat for the regulator to be independent and unbiased.