FICCI

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Views, Reflection and Erudition

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Next Phase of Banking Reforms

FEDERATION OF INDIAN CHAMBERS OF COMMERCE AND INDUSTRY

Industry's Voice for Policy Change

About FICCI

Established in 1927, FICCI is the largest and oldest apex business organisation in India. Its history is closely interwoven with India's struggle for independence, its industrialization, and its emergence as one of the most rapidly growing global economies.

A non-government, not-for-profit organisation, FICCI is the voice of India's business and industry. From influencing policy to encouraging debate, engaging with policy makers and civil society, FICCI articulates the views and concerns of industry. It serves its members from the Indian private and public corporate sectors and multinational companies, drawing its strength from diverse regional chambers of commerce and industry across states, reaching out to over 2,50,000 companies.

FICCI provides a platform for networking and consensus building within and across sectors and is the first port of call for Indian industry, policy makers and the international business community.

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Preface

'Financial Foresights', FICCI's flagship quarterly journal is in its sixth year of publication now. The periodical has endeavored to provide a forum to the Industry, policy makers and other stakeholders, enabling exchange of ideas and views on various important aspects concerning the financial sector of India. The current issue of the publication focuses on the topic: 'Next Phase of Banking Reforms' and presents some interesting suggestions and recommendations for the same in the form of insightful write-ups contributed by eminent players from the industry.

The quality of assets has been an issue of concern for the Indian Banking sector in recent times. The problem of poor asset quality is more intense in case of public sector banks. Taking cognizance of this fact, both RBI and Government have been taking measures to strengthen the Indian banking system. Prominent among these remedial measures adopted so far has been the introduction of a Strategic Debt Restructuring (SDR) mechanism which enabled banks to collectively take a 51% equity stake in the company and find a new buyer over an 18 month moratorium period and restructure a loan.

Further, the Government in August 2015 unleashed the second generation banking reforms with a rainbow (Indradhanush) of measures for Indian Public Sector Banks. The seven elements included appointments, board of bureau, capitalization, de-stressing, empowerment, framework of accountability and governance reforms. The Indradhanush framework for transforming the PSBs represents the most comprehensive reform effort undertaken since bank nationalization in the year 1970.

In the recent budget FY16-17, the Finance Minister outlined the capitalization plan for banks as well as indicated the operationalization of the much awaited Banks Board Bureau that would amongst other things focus on drawing a roadmap for bank consolidation. We also heard the government indicating its desire to bring down its share in IDBI Bank to below 51%. This is a significant announcement and could pave the way for similar moves for other banks in the future.

FICCI welcomes the above measures and expects the government to continue with its banking sector reform initiatives in the future as well. The sector plays a central role in the Indian economy and therefore it is critical to restore it to good health to facilitate its effective participation in the country's economic recovery and growth. We hope that with these reforms, our PSBs will be ready to compete and flourish in a fast-evolving financial services landscape. In this context, the current issue has taken a closer look at the 'Next Phase of Banking Reforms'.

The issue, with inputs from leading names in India's financial sector, has attempted to analyse the efficacy of the recent reform measures in addressing the issue of stressed assets and has proposed further measures to improve the implementation of these as well as outline the next steps in reforms.

We look forward to your views and suggestions to help us improve the content of the digest and make it more relevant and informative.

Dr. A. Didar Singh
Secretary General
FICCI

Industry Insights

Reforms an Immediate Agenda for Public Sector Banks

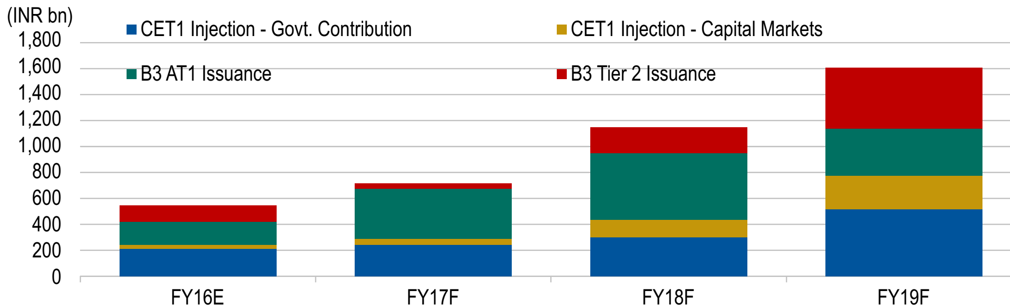
Abhishek Bhattacharya,
Co-Head - Banks and FI rating,
India Ratings & Research

The Indradhanush plan announced by the government in August 2015 signalled its clear intent to work towards a revamp of public sector banks (PSBs), however there are steep challenges ahead for these lenders accounting for over 65% of the system credit in India. The sheer quantum of growth capital needed from the equity and bond markets puts a lot of onus on improving the market valuations for these PSBs. This consequently brings to the forefront the need to improve not only immediate returns but also the outlook on sustainability of these returns, all of which makes reforms an immediate agenda.

While de-stressing and capitalisation are well understood as important cogs of the reform wheel, the softer aspects such as management empowerment and improving governance are equally important. Effective tenor management, de-clogging regulatory bottlenecks in capital raising, and proactive recognition and resolution of stressed assets are some of the critical ingredients of a transformation strategy for PSBs.

Quantum and Urgency of Capital Requirement Makes Reforms Imperative: Ind-Ra expects the incremental Tier 1 capital requirement to be INR2.9trn till FY19, towards the Basel III transition, which includes INR1.5trn in common equity Tier I (CET1) and around INR1.4trn in Additional Tier-1 (AT1) bonds.

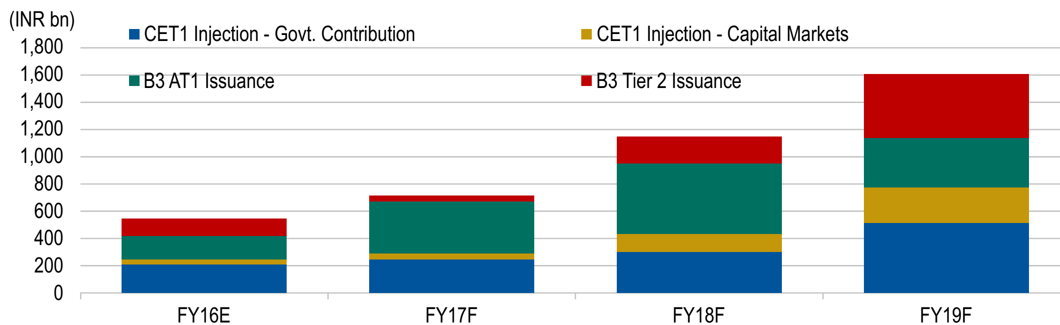
Indian Banks: Capital Projections for Basel III Transition



Source: India Ratings Estimates. Study includes all government and eleven private banks.

The above estimate considers only the growth capital needed, assuming 13%-14% CAGR in risk weighted assets over the next three years. Ind-Ra further estimates the potential haircut needed to bring large stressed corporates to a viable debt level at around INR1trn. Also, the lack of appetite for AT1 bonds by insurance companies and pension funds may add to the overall equity raising requirements of banks.

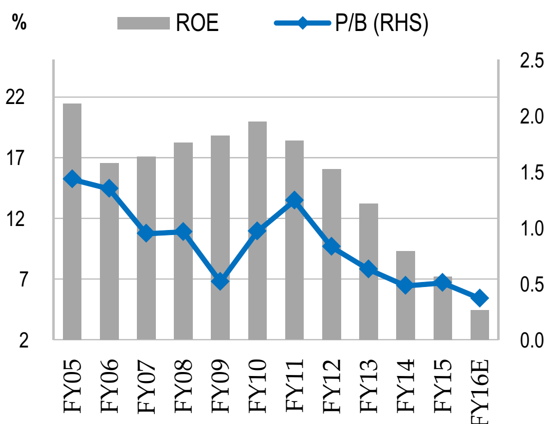
Indian Banks: Capital Projections for Basel III Transition



Source: India Ratings Estimates. Study includes all government and eleven private banks.

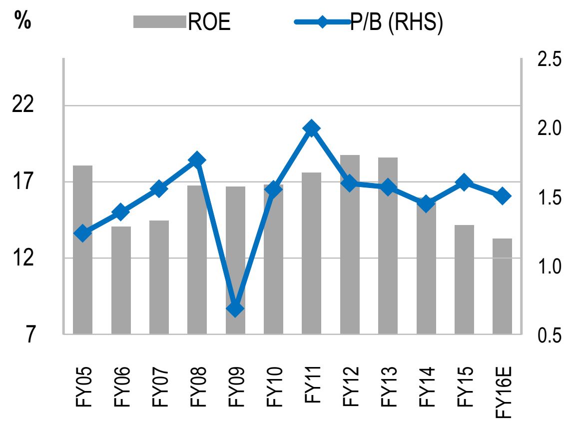
The Indradhanush plan proposes an infusion of INR700bn into PSBs over FY16-FY19 and some contribution is likely from quasi-sovereign entities such as Life Insurance Corporation as well, a large gap will need to be filled by capital market issuances over the next three years. At the current market valuation, the median dilution needed for PSBs could be 40%-50% of their March 2016 net worth, which in a few cases entails even doubling the current equity base to manage the mandated Basel-III ratios by March 2019.

Median ROE vs P/B PSBs



Source: Bloomberg, Ind-Ra Estimates

Median ROE vs P/B Private

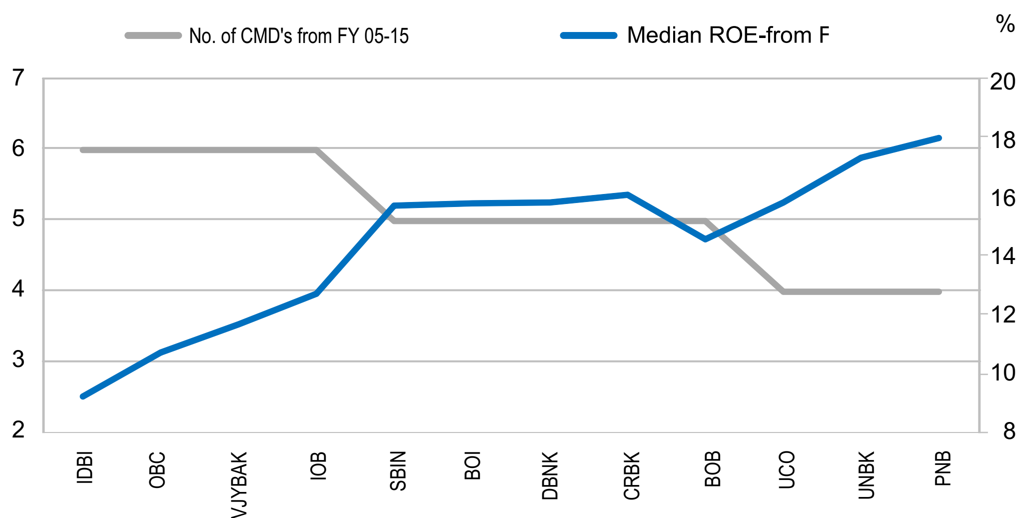


Source: Bloomberg, Ind-Ra Estimates

Comparing banks' key valuation ratios - the trailing price to book ratios (P/B) - against their respective return on equity (RoE) parameters throws two interesting insights. The decline in P/B for PSBs has a high correlation with the fall in their return generation over the last few years. But more interestingly, private sector banks have been able to sustain higher valuation ratios even at comparable RoEs over the years. Clearly, this reflects how the market perceives the growth prospects and sustainability of returns for PSBs in relation to private sector banks.

Effective Tenor Management - an Elemental Step of Reform: The Indradhanush plan envisages an independent board, empowered management and an objective accountability framework to drive reforms from the top. However, a clear starting point when driving a turnaround will be to have a focussed top management with sufficient visibility of tenor to make tougher and more structural decisions with a longer payback period.

Correlation between management tenor and return

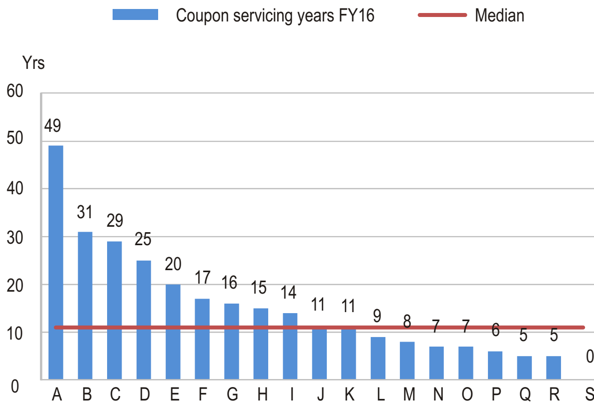


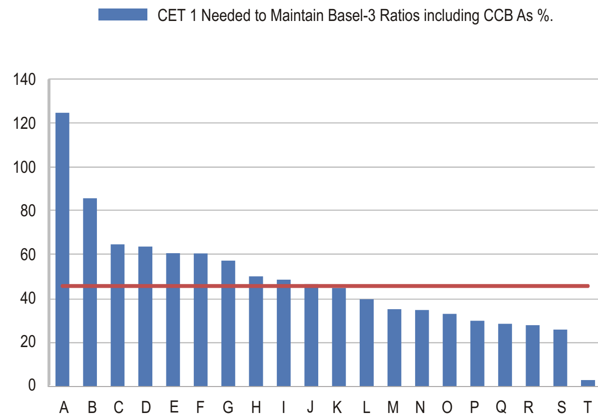
Source: Ind-Ra; Bloomberg

A strong correlation between a longer effective tenor and superior returns was observed when Ind-Ra plotted large PSBs' median RoEs against the number of top management changes from FY05 through FY15. For example, a very large PSB was able to execute a successful liability transformation strategy, leading to a significant reduction in its cost of funds, benefiting from the full five-year tenor of its CMD. Also, large private sector banks in India have visibly benefitted from the proactive leadership of their long-serving CEOs. The clear need of the hour is to provide a full tenor (at least five years) to the CEO/MD to drive tougher transformation strategies.

De-clogging Regulatory Bottlenecks for Hybrid Bonds:– As highlighted, Indian banks especially PSBs need INR1.4trn in AT1 bonds by March 2019. Against this, till date, only instruments worth INR170bn have been raised by 15-16 issuers. RBI's tweaked norms for bonds issued under Basel III in September 2014 which included temporary write-downs and five-year call option has helped improve investor interest marginally, but insurance firms and provident funds have largely remained absent from this market. Both Insurance Regulatory and Development Authority and Pension Fund Regulatory and Development Authority have advised their regulated entities to maintain the rating floor at AA, which Ind-Ra believes shuts the market on 60%-70% of the possible issuances. Discussions with the Employees' Provident Fund Organisation put the investible amount into AT1 under the current guidelines as low as INR20bn, compared to their annual incremental corpus of INR1trn-INR1.2trn, while the absence of an active secondary market has kept the mutual funds and insurance companies away from these instruments. Even recent placements which took place on a bilateral basis have not helped in increasing the investor appetite.

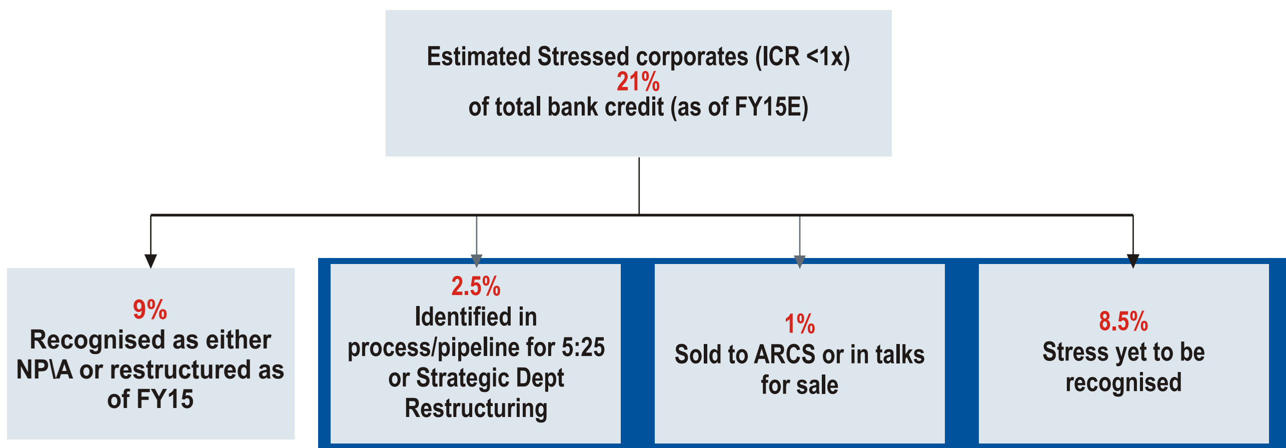
Some relaxation may be needed on the part of the regulators to attract insurance and pension funds to the AT1 market. One such suggestion may be to lower the regulatory requirement from the current rating floor and open up the market for price discovery. Ind-Ra has an objective rating criterion for these bonds, which considers the standalone credit profile of the issuer, the discretionary component of these bonds, the ability to service coupons through available earnings and reserves, and the probability of a write-down based on the capital requirements through the transition.





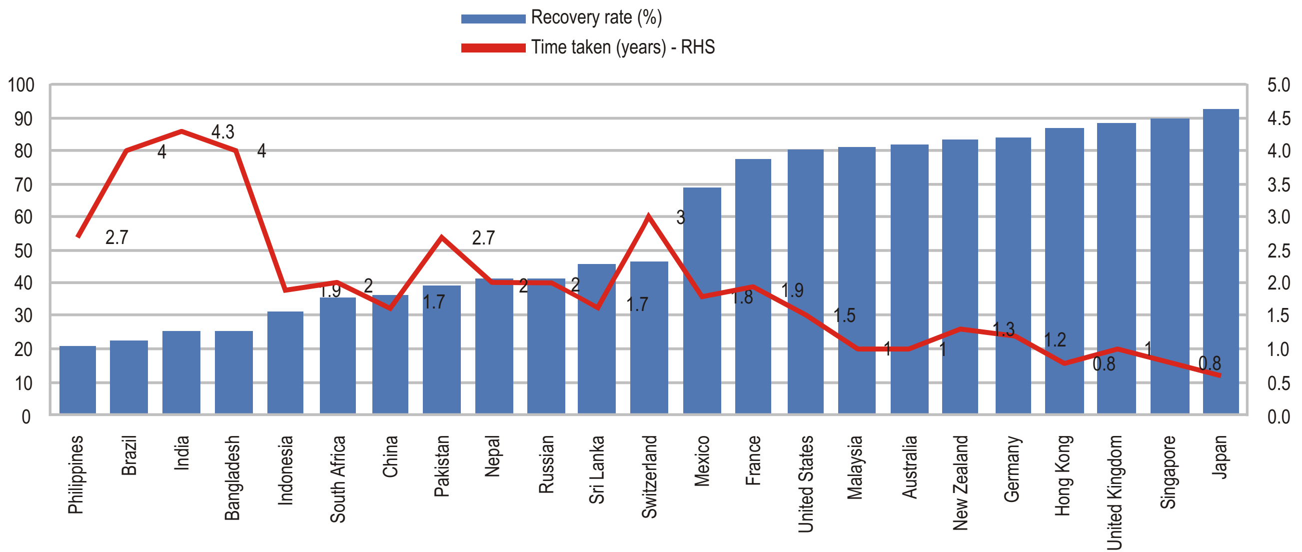
Also, the regulators could prescribe a separate investment category, with a small limit recommended for such hybrid instruments which have features of both debt and equity. The easing of these limits in the Indian market will be the starting point to facilitate constructive discussions between market participants and banks and would accelerate price discoveries needed for the evolution of an active market for these bonds. Given the front-loaded requirement of these AT1 bonds, any delay in pick up in appetite for these bonds would exacerbate the equity requirement situation. A few options to explore the retail appetite for these bonds are currently underway, but some regulatory hurdles need to be overcome for aligning institutional demand with the potential requirement.

Enabling Proactive Recognition of Stressed Assets and Empowering Speedier Resolution: Ind-Ra estimates one third of the corporate sector's bank borrowings to be deeply stressed currently (totalling to 21% of bank credit) of which just over 50% has been recognised as impaired in the books (non-performing and restructured).



In the aftermath of the recent asset quality review prescribed by RBI, Ind-Ra believes that a large proportion of stressed assets (about 10% of bank credit) remain in the system, where leverage is at an unviable level. Ind-Ra's assessment of the potential haircut that banks may face to revive the financial viability of these accounts is around INR1trn or 1.7% of risk weighted assets for PSBs. While schemes such as 5/25 and Strategic Debt Restructuring have provided some interim relief on provisioning for some of these accounts, banks will face the viability gap and a possible haircut for a significant number of accounts which are classified as standard presently. In this context, the issue of empowerment needs to be broadened beyond lending and hiring decisions to enable speedier decisions on the recognition of stressed assets. Recent efforts around setting up a pricing panel involving an empowered group of experts who understand valuation and regulatory requirements is a welcome move, as it may kick start decision-making once again.

Time Taken to resolve insolvency and recovery Rate



Source: World Bank

The progress towards a bankruptcy code is a welcome step to accelerate stressed asset resolution. The World Bank data as of June 2015 indicates that India lags behind most of the emerging market economies in the time taken to resolve cases of insolvency (4.3 years compared to a median of 1.5-2 years). The proposed framework recently approved by the Lok Sabha prescribes filing of bankruptcy applications within three months (earlier six month) along with the provisions to disqualify those declared bankrupt from holding public office, which would go a long way in separating politics from business.

Given the Basel-III deadlines, and the likelihood of crowding of capital requirement as we get closer to March 2019, PSBs need to start the reform journey now. But it would need immediate support from all the stakeholders including the government and the regulators.

Abhishek Bhattacharya
Co-Head - Banks and FI rating, India Ratings & Research

Abhishek Bhattacharya is Co-head, Banks and FI ratings in India Ratings & Research, A FITCH Group Company.

Prior to joining the Fitch Group, Abhishek worked with Nomura Securities and with BNP Paribas Securities as the lead analyst covering banking sector and NBFC stocks.

Abhishek is an engineering graduate from the Indian Institute of Technology, Delhi, and received his MBA from the Indian Institute of Management, Indore.

Quo Vadis, Indian Banking?

Mr. Hemant Kanoria
Chairman & Managing Director,
Srei Infrastructure Finance Limited

It is a serendipitous confluence of factors which have once again brought India right under the global spotlight - we have global economy limping along for several years now, a sharp downturn in commodity cycle, muted global demand, and then we have the Indian economy with a 7% plus GDP growth, low inflation, a comfortable fiscal situation, and more importantly, we have a pro-reform union government seriously trying to take the economy on to a higher growth trajectory. Every investor around the world is now following the India Story keenly. Thus, this was the ideal time for Indian economy to press on the pedal and surge ahead of its competitors taking a decisive lead. But to what extent we will be able to take advantage of such a unique advantageous position now is a question mark because of the burgeoning stressed assets in our banking system, especially public sector banks (PSBs).

Banking Stress

PSBs now account for close to 70% market share of banking assets in India, but as on September 2015 their stressed assets formed 14.1% of their gross assets. The **PSBs have so far accounted for the lion's share of credit delivery for all economic activities**. With such mounting stressed assets, they need to make more provisions and at the same time set aside capital for conforming to

Basel II norms by 2019. Naturally, **they are severely constrained to carry on and expand their lending activity**. Their balance sheet growth has slowed down and bank credit expansion has come down to single digit. It is therefore **difficult to figure out how the new economic activity will be financed.**

The Findings & Direction Ahead

In recent years, the Reserve Bank of India (RBI) has combined the statutory Report on Trend and Progress of Banking in India (T&P) and the Financial Stability Report (FSR) to analyse the status of the entire Indian financial sector against the backdrop of global developments. The general findings are - PSBs have piled up bad loans, share of foreign banks in Indian banking has been shrinking, and a handful of relatively well-off private banks are not fully equipped to meet the diverse and growing needs of the economy. RBI realises that pulling down the barriers between development financial institutions (DFIs) and commercial banks to encourage **universal banking has not quite delivered the desired results**. Besides working on how to resolve the banking crisis, **RBI is now also experimenting with new banking models which can cater to niche segments**. Licenses for Payment Banks and Small Finance Banks have been given out. RBI will soon come out with a discussion paper on new concepts like Wholesale Banks, Custodian Banks and Investment Banks.

The Problems

However, for the time being the **focus has to be on addressing the stressed assets problem**. Bulk of the bad loans of PSBs originated in sectors like infrastructure, power, telecom, steel, cement, sugar, etc. Proper domain-specific project appraisals before disbursement of loans have not been the forte of PSBs as they do not have enough in-house experience to undertake such exercises. In addition, they often did not have enough long-term resources to support such loans. Also, despite the SARFAESI Act, the process by which banks enforce the borrower's obligations in terms of security and guarantee is expensive, exhausting and time-consuming.

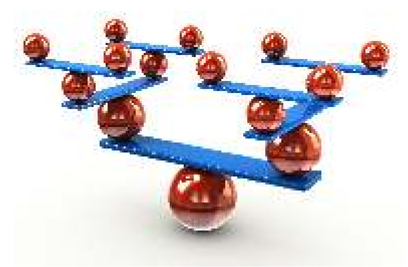
Proposed Solution

Government and RBI have taken cognisance of these factors and have come up with the **Indradhanush initiative** in August 2015 which proposes a 7-pronged strategy covering :

- Appointments
- Banks Board Bureau
- Capitalisation
- De-stressing PSBs
- Empowerment
- Framework of accountability
- Governance reforms

However, Indradhanush needs to be implemented in a time-bound manner. **Independence of the Banks Board Bureau should be a non-negotiable pre-condition** and should be strictly adhered to. Appointment of key senior officials should be done by banking professionals. That would ensure quality recruitment and induction of necessary talent.

A **capital infusion of Rs. 70,000 crore into PSBs between 2015-16 and 2018-19** has been envisaged under Indradhanush. If the banks do not



learn from their past mistakes and do not reform themselves, the money given to them will simply be wasted and sometime in the future they will again find themselves in a similar situation. We have seen this already happening for the state power distribution companies. **Structural reforms and reorganisation of management style, especially in areas of risk and credit assessment, recruitment, technology up-gradation, etc. should be made strict pre-conditions for PSBs** to become eligible for this package. PSBs need to be prodded to re-invent themselves. PSBs will need to review their business models and examine strategic decisions like capital structure and dividend policy. They also need to seek complementarities in their strengths in order to go for mergers. In fact, there is a strong case for amalgamation of PSBs based on their geographic coverage so as to avoid duplication of their delivery infrastructure.

However, the **Indradhanush does not** quite **address** the problem of **recovery of NPAs** and hardly anything has been suggested to strengthen the recovery process through Debt Recovery Tribunals (DRTs) and SARFAESI Act. Such laws have only helped banks to transfer their bad loans to Asset Reconstruction Companies (ARCs), but it has meant that assets just get transferred from one bucket to another.

Bankruptcy Code

Government has to ensure a speedy passage of the Bankruptcy Code Bill

so that banks are sufficiently empowered to get their money back without being trapped in judicial processes, which many wilful defaulters hide behind. Bankruptcy Code will also provide sick companies an exit route.

ARCs & Their Limitations

However, while the Bankruptcy Code is still pending parliament approval and thus will take some time to materialise, for the time any chance of turning around stressed businesses principally hinges on the ability of the existing 15 Asset Reconstruction Companies (ARCs). However, the **number of ARCs is inadequate vis-à-vis the need**. These ARCs typically have low capital base and their methodology towards addressing needs of troubled companies has an overt financial focus.

ARCs are not aggressively buying stressed assets. One of the reasons for that is the **RBI norm** which has raised the **minimum investment from 5% to 15% in the so-called security receipts (SRs) or pass-through certificates** that are issued against such assets. ARCs usually levy higher discounts when they buy loans offering cash, but when they offer SRs for buying loans, the discount drops. ARCs get management fees of 1.5-2%, but the fees are now linked to the net asset value (NAV) of the assets, and not the outstanding value of the SRs. So, any shortfall in the recovery of bad loans lowers their fees. Six months after buying bad loans, ARCs are required to get the SRs rated, and based on the rating (which takes into account the progress in recovery), the NAV is calculated.

All ARCs, so far, only have a strong **focus on financial re-structuring and financial re-engineering** as the stakeholders in an ARC are mostly financial players. ARCs' methodology has a strong financial bias and the

focus is more on how much of the remaining value of the distressed company can be recovered. Very little attention is paid towards resolving the issues pertaining to the business management side or towards revisiting the business to revive or restructure it. A troubled company cannot be turned around only with financial re-engineering. The **mindset of business management is also important**. Currently, this dual approach is missing. Therefore, companies or professionals with expertise in business management and insights to the specific sectors should also be part of ARCs so that a proper analysis and evaluation of the problems of a distressed company can be done before embarking on any revival plan.

There is **never unanimity between banks and ARCs on the issue of pricing for the sale of bad assets**. There is no clarity on the fair value of a bad asset put up for sale. One way to address it is **to go for a recovery rating of such assets before they are sold**, instead of rating those six months later. Recovery ratings reflect a fundamental analysis of the underlying relationship between financial claims on an entity and potential sources to meet those claims. The pricing can be based on such ratings and even if the banks are required to offer high discounts, they will not be afraid of being hounded by investigative agencies later on.

However, selling off of distressed assets at steep discounts should not be the automatic choice. **If a change in management can help in reviving the asset, that can lead to a win-win situation for all**. There are specialist players who can try to turn around such accounts. Innovative methods of engaging such players need to be worked out. Especially in **case of infrastructure projects**, even if a project has suffered time and cost overruns, the **underlying assets seldom go bad**. If a change in management can revive the project, that is for the greater good of the society. Specialist players like Infrastructure Finance Companies (IFCs) need to be roped in for such exercises.

Talks of creating a **National Asset Management Company / 'Bad Bank'** are on. The aim is to enable banks focus on lending rather than going for recovery of stressed assets. Consolidation of bad loans can simplify resolutions. It has been seen that consortiums make things complicated. But will a new organization be able to do what 15 ARCs could not in a decade? I guess we need to first start by addressing the ARC-specific issues that I have already touched upon.

Suggestions for PSBs

Two things which I feel RBI should take into account are :

- There needs to be room for **flexibility in recognising the loss on sale of NPA**. Instead of the present 2-year period for that, let the loss be recognised over a 5-year period.
- **Stress testing' of banks** should become **an annual exercise** and the findings should be made public.

Conclusion

The bank debt tsunami may have come at an inappropriate time thus depriving the Indian economy a

golden opportunity to surge ahead. However, this situation has created a platform to launch a number of long overdue banking sector reforms. 'Cleaning the augean stables' once and for all is indeed an imperative because not only does our PSBs need to shape up fast but they also need to get ready for the future. Banking sector, and for that matter the entire financial sector, is about to experience tectonic shifts as technology is fast re-shaping the global financial architecture and changing the rules of the game.

Mr. Hemant Kanoria
Chairman & Managing Director, Srei Infrastructure Finance Limited

A pioneer in the field of infrastructure, Hemant Kanoria has reshaped India's infrastructure landscape with innovative ideas and a strong passion for excellence.

Under his leadership, "Srei" was conceptualised in 1989 as an initiative marking the entry of private sector in the field of infrastructure, a domain hitherto restricted to public sector. In the last two decades, Srei has been developed into one of India's largest holistic infrastructure institutions with an asset base of around USD 5.5 billion. Srei's shares are listed on the leading stock exchanges of India and also on the London Stock Exchange. Today, Srei is one of India's leading Public Financial Institutions.

With an aim to bridge the urban-rural digital divide, a unique business model "Sahaj" focusing on rural entrepreneurship has been created which, through a IT platform, makes e-governance, e-commerce and e-learning services accessible to millions of rural people. This has opened up revenue opportunities for thousands of village level entrepreneurs who provide such services through IT-enabled internet-connected centres in the villages of nine states.

Hemant is also the Chairman of India Power Corporation Limited ("IPCL") - formerly known as DPSC Limited, which has become one of the leading integrated power utilities in the country. The company has actively forayed into a diversified portfolio, with renewable and conventional modes of power generation, distribution and power trading.

He is also the Trustee of the Kanoria Foundation which, under its umbrella, has entities with a total asset base of about USD 10 billion. The group is at the vanguard of thought leadership in the country, especially in the area of infrastructure development and financing.

Hemant has over three decades of experience in industry, trade and financial services. He is currently serving as Board Member in both Indian Institute of Information Technology, Guwahati and Neotia University and is also a Member in the Board of New Delhi Institute of Management. He has held several prestigious positions like President of Calcutta Chamber of Commerce, Chairman of the FICCI National Committee on Infrastructure and served on the Board of Governors of Indian Institute of Management Calcutta (IIM-C) besides being a Member of the Regional Direct Taxes Advisory Committee, Government of India.

2016: Defining Year for India's Banking Sector

Mr. Rana Kapoor
MD & CEO, YES BANK and
Chairman, YES Institute

India's domestic macroeconomic situation has improved significantly over the past two years, but the banking sector has continued to face challenges due to lack of any meaningful recovery in asset quality, growth oriented capital constraints and sluggish profitability. However, I firmly believe that 2016 will be the inflexion year for the banking and finance sector with support from the policy and regulatory environment, as improvement in macros starts to manifest in balance sheets of corporates.

Revitalizing public sector banks (PSBs) has been a key focus area for the policymakers. The Reserve Bank of India (RBI) and the central government have put in place key enabling measures in the *Indradhanush* scheme, and are working in unison on expeditious resolution of distressed assets, cleaning-up balance sheets of PSBs, improving overall operational efficiency and ensuring that banks have adequate capital for growth and expansion within the overall budget constraints.

India: Brightest Spot on Cloudy Global Horizon

With GDP growth of 7.3%, in 2014-15, India's economy is firmly on the path of economic revival. India is the brightest spot on the global map, with GDP Growth expected to rise to 7.9% in 2017-18. India is well positioned to withstand near-term global head-winds and the high volatility in global financial markets due to reduced external vulnerabilities, a strengthening domestic business and

investment cycle, and a supportive policy environment. Most recently, even the IMF has maintained its GDP growth projection of 7.3% in 2015-16 and 7.5% in 2016-17, even as it cut projections for overall global output.

The transition from a state of crisis of confidence in 2013 to a bright spot in 2015 is not by chance but by design. The past few months in particular, have seen even renewed energy from the Government to enforce key reforms, and revive industrial sentiment. Going forward, the upcoming Budget Session of Parliament will be very important in the current scheme of things, to create short & medium term wins.

Boosting Savings in India

Most importantly, there is a need to boost savings in the economy to enhance the inherent economic strength of the financial sector. It will be worthwhile to adopt of the structural GEAR (Growth, Efficiency, Attractiveness, Reach) approach, as elaborated below, to augment the savings rate in the economy:

1) Enhance economic GROWTH to increase per capita incomes: Towards this end, it will be important to increase disposable incomes by relaxing personal income tax slabs to INR 5 lakh from the current level of INR 2.5 lakh - this could be a one-time correction and this could thereafter be linked to inflation and reviewed every three years. This will provide an immediate thrust to household incomes, part of which will be diverted to financial savings.

2) Focus on EFFICIENCY in financial transactions: Use of plastic currency and e-transactions (via internet/ mobile) will not only improve ease of transactions but also enhance saving propensity

among citizens. Every 1% reduction in currency in circulation is likely to add 0.4% to the savings rate. More importantly, this could also help in curbing the flow of black money.

3) Make financial savings ATTRACTIVE: Financial savings must be promoted by improving tax incentives. One of the enabling measures for this will be to enhance 80C limits to INR 3,00,000 from current level of INR 1,50,000 - this will also deepen the mutual fund and equity markets. Secondly there is a need to increase inflation adjusted post tax returns for bank deposits, by reducing lock in period eligible for tax rebate to 1 year from 5 years; and enhancing the threshold for mandatory TDS on interest income to INR 50,000 a year from the current level of INR 10,000. It will also be useful to roll back TDS on Recurring Deposits to encourage wider adoption, as this is a product that promotes the habit of regular saving. Further, pension products like EPF and PPF continue to enjoy 'EEE' tax status whereas the National Pension Scheme (NPS) are subject to 'EET', which involves tax obligation at the withdrawal stage. To create a level playing field and prevent cannibalization, NPS needs to get 'EEE' tax status to make it more attractive.

4) Expand financial REACH: The Government could consider converting India Post into Postal Bank of India, a full-fledged Payments and SAVINGS bank, to leverage its rural penetration for greater financial inclusion. Internationally, there are a few countries which have tapped the postal institution for extending financial inclusion.

Next Generation of Reforms

On the back of the *Indradhanush* Reforms for 2016, I believe India's top priorities should include passage of GST, rationalizing direct taxes further, tax sops for Start Ups and introducing key structural reforms in terms of real estate, labor and MSMEs. The farm sector too needs significant focus on irrigation and technological support.

With the global economy expected to remain mired in volatility in 2016, strengthening the domestic economy will also help to ring-fence India against global headwinds. While micro measures will help, the Banking & Finance sector also needs the next generation of reforms. I am hopeful that economic clairvoyance will triumph over political myopia in 2016 and GST will see the light of the day. The Bankruptcy Bill will also turn out to be a game changer for spurring economic activity and confidence. This Budget presents a Golden Chance to usher in Fiscal Measures to make 2016 India's Year.

Making 2016 India's Year

While micro measures will help, the banking and finance sector also needs the next generation of reforms to enable it to finance India's aspiration of 9-10% GDP growth on a sustainable basis. I am hopeful that economic

clairvoyance will triumph political myopia in 2016 and GST will see the light of the day. While this will truly enhance India's growth potential in the medium term, the Bankruptcy Bill could turn out to be a game changing reform for spurring economic activity and confidence in the near term.

I believe that the advent of the JAM Trinity is a silent revolution that will transform India in the coming years. While PMJDY will further the objective of financial inclusion, the Aadhaar platform will furnish the much needed basic digital intelligence and mobile phones will leverage this through innovative payment system like the IMPS. As JAM mobilizes further mass in 2016, the market for e-finance will provide one of the biggest opportunity for the banking and financial system.

The primacy of economic development in governance and progressive reforms to facilitate investments has been the hallmark of the Narendra Modi-led government. I am confident that the right mix of fiscal and monetary policy action, coupled with the turnaround in the global economy, will boost India's economic and industrial growth to the next level, and make 2016 India's year.

Mr. Rana Kapoor
MD & CEO, YES BANK and
Chairman, YES Institute

Rana Kapoor is the Managing Director & CEO of YES BANK, India's fifth largest private-sector bank and Chairman of YES Institute.

Besides being a visionary business leader and professional entrepreneur, Rana Kapoor has been a Change Agent, ushering positive change and development across community, society and at National level.

Rana Kapoor has received numerous awards and accolades for his exemplary contributions towards fostering Entrepreneurship in India, strengthening key growth sectors including Financial Services, Agribusiness and Tourism, amongst others, as well as promoting bilateral relations with strategic partner countries. Mr. Kapoor was recently felicitated as “Role Model Entrepreneur” by IIT Bombay at their Entrepreneurship Summit 2016.

Under his dynamic leadership, YES BANK has launched its practicing think-tank YES Institute, which also focuses on Design, Innovation, Creativity & Entrepreneurship towards achieving India's socio-economic transformation.

Next Phase of Banking Reforms

Dr. Rajat Kathuria
Director and Chief Executive, Indian Council for Research on International Economic Relations (ICRIER)

Among the many challenges that lie ahead to sustain high economic growth and thereafter to boost it to double digit levels, banking sector reform will perhaps be fundamental. Non-performing assets (NPAs) or more appropriately non-performing loans (NPL) of the banking sector, particularly for public sector banks (PSBs) have risen sharply over the last decade. In part, the weakening bank balance sheets mirror weaknesses in the economy. But in part, they reflect a mix of festering regulatory and incentive deficiencies in the sector. Corporate governance frailties and imprudent lending by banks during the high growth years have been recognized by the government itself as cause of growing NPLs of PSBs and as such remedial action has been initiated. This is good news for the sector but the optimism as always is mitigated by the manifest probability of implementation bottlenecks.

Although reducing slowly over time, a major share of financial savings continue to be intermediated through the PSBs. They have been and still are the dominant providers of loan finance for infrastructure and manufacturing. As of March 2015, PSBs had a share in total deposits of about 73% and a share in total advances of 71.6%. Private Banks (holding about one-quarter of banking system assets) are better capitalized, more profitable, and have lower NPLs and limited exposure to troubled sectors.[1]

[1] 2015 Article IV Consultation for India – IMF Country Report No. 15/61

Thus relative performance of PSBs when compared to private sector banks has been wanting, but that does not in any way imply that private sector banks have set standards to beat in risk management, transparency and customer protection. The focus on PSBs public sector has shifted the spotlight away from private banks, but 'caveat emptor' is always useful advice when incentives of top management are linked to 'reporting' of performance. Nevertheless, it is PSBs losses and performance that merit immediate attention since their gross NPLs are 6.2% versus 2.2% for private sector banks; the corresponding numbers for restructured assets are 7.9% versus 2.4% respectively. Of course, there is significant variation in performance across public sector banks but that is largely irrelevant for the purpose of this piece.[2] The asset quality and capital adequacy positions of PSBs are significantly lower than private sector banks. Given their diminished profitability, PSBs need to need to improve their capital base in order to maintain and improve capital adequacy ratios (CAR).

Thus a specific challenge around banking in India is to resource public sector banks to meet the problem of stressed and restructured assets to meet the imminent Basel III requirements on capital adequacy. Recapitalization requirements for public sector banks have been estimated to range from Rs. 4.8 lakh crore to about Rs. 10 lakh crore depending on the assumptions on forbearance and the ratio of restructured assets turning into NPLs.[3] The Reserve Bank of India (RBI) commissioned PJ Nayak Committee that reported in May 2014 diagnosed the problem as one of lack of autonomy in decision making and absence of a strategic vision at the highest level. It argued persuasively for reduction in government shareholding below 50 per cent, to free the banks from scrutiny of the Central Vigilance Commission (CVC) and from government constraints on employee compensation. The committee found that the dual regulation of public sector banks by Finance Ministry and RBI imposes governance difficulties. It also argued that the boards are disempowered, and the selection process for directors is increasingly compromised. The Committee's recommendations need serious consideration subject of course to the political economy constraints –the aim must be to allow PSBs to function more efficiently and effectively and on commercial considerations.

All reports find reasons for poor performance. To many, including authors of the report (and somewhat contentiously for some others) government ownership is perhaps the most plausible explanation since it reduces profit maximization to a subordinate objective. This narrative of the cause of decline of PSBs is contested by those who claim that PSBs in particular and PSEs in general were created as instruments for development to aid capital flows in sectors that were of strategic importance and subject to market failure. Ergo, private banks were nationalised to inter alia achieve development goals.

While the Nayak committee has not recommended outright privatisation, it has called for reduction in govern-

Bank Group	No. of Offices	DEPOSITS		CREDIT	
		No. of Accounts	Amount	No. of Accounts	Amount Outstanding
	1	2	3	4	5
State Bank of India and its Associates	23947 (18.4)	388034612 (26.9)	19552169.7 (21.9)	26928225 (18.7)	14808717.7 (21.5)
Nationalised Banks	65764 (50.4)	708285313 (49.2)	45472836.3 (51.0)	52921946 (36.7)	34474392.7 (50.1)
Foreign Banks	332 (0.3)	3541847 (0.2)	3944052.4 (4.4)	5303666 (3.7)	3355086.6 (4.9)
Regional Rural Banks	20005 (15.3)	181882984 (12.6)	2678906.6 (3.0)	22228383 (15.4)	1812305.0 (2.6)
Private Sector Banks	20434 (15.7)	158147527 (11.0)	17573147.0 (19.7)	36857416 (25.6)	14334223.2 (20.8)
All Scheduled Commercial Banks	**130482 (100.0)**	**1439892283 (100.0)**	**89221112.1 (100.0)**	**144239636 (100.0)**	**68784725.2 (100.0)**

Source: RBI

[2] RBI: A Profile of Banks accessed from http://www.rbi.org.in/scripts/AnnualPublications.aspx?head=A%20Profile%20of%20Banks

[3] Report of The Committee to Review Governance of Boards of Banks in India, May 2014

ment shareholding in PSBs to below 50 per cent to allow for more autonomy and to reduce government's role in decision making. It is unlikely that equity dilution below 50 per cent will be done soon and repealing the Bank Nationalisation Acts of 1970 and 1980, together with the SBI Act and the SBI (Subsidiary Banks) Act is a long term political call the government will have to take. In any case, the stresses on existing balance sheets and the current state of the equity market make divestment a suboptimal option in the present. In last three years LIC has lent crucial support to stressed PSBs by significantly raising the stake in them. For now therefore, the task is to find ways to improve governance and restore PSBs to health.

The newly created Banks Board Bureau in April 2016 is tasked precisely with this mandate. In the current budget, the government has earmarked Rs. 25,000 crores for recapitalisation but it needs much more. In the so called Indradhanush scheme of 2015, the government estimated that the extra capital needed in the next four years up to fiscal 2019 would be about Rs.1,80,000 crores. Part of this will come from government coffers but a large part should and will need to come from improved valuations. Allowing mergers and consolidation is part of that process already begun with State Bank of India's move to absorb five subsidiaries and Bharatiya Mahila Bank, a bank for women set up in 2013. But giving greater autonomy to PSBs remains a challenging yet essential ingredient of reform. For example, a litmus test would be if a PSB can refuse to participate in the government's development initiative if it does not consider it to be profitable. This is not to suggest that the government's development agenda be abandoned –just that a PSB operating in a competitive market place may not be the best way to deliver it.

Competition to traditional banking from new and potentially disruptive entities makes it all the more necessary to insulate PSBs from political pressure. The magic of the public sector worked well when these banks were insulated from the forces of Schumpeterian competition. Disruption and competition need not spell death, as IBM has shown but it needs reinvention. As the Jan-Dhan-Aadhar-Mobile (JAM) trinity leads the disruptions in the traditional banking and payments market in India, the financial landscape has been altered by RBIs decision to grant licenses to 11 payment banks in August 2015: the first instance of differentiated licensing in India's banking history. Of these, 3 have already surrendered their licenses citing intense competition as one of the reasons. Technology causes displacement and there are clear implications for competitiveness in the sector as these entities take over some of the functions of traditional banks and help facilitate otherwise costly micro-transactions. The list of licensees includes corporate giants such as Bharti Airtel, Reliance Industries Limited (RIL), Vodafone m-pesa etc, in addition to the Department of Posts. Both these categories of entrants have the advantage of leveraging an expansive and far-reaching customer base as well as existing infrastructure to address the problem of last-mile access to financial services: a deficiency that traditional banks have so far been unable to overcome. The new entrants have the flexibility to engage in price competition and price discrimination and are likely to pose real challenges to traditional banking. Recognizing the need to keep up with these innovations, some traditional banks have already decided to collaborate with these niche banks. The State Bank of India has partnered with RIL with an equity share of 30%. This is part of their reinvention strategy but it will need to be complemented by the manner in which PSBs are governed and managed. Else the amounts needed for recapitalisation of PSBs will pose severe challenges to the governments own agenda of fiscal consolidation.

For the bad loans on PSB books, speedy implementation of the Insolvency and Bankruptcy Code, 2016 should be top priority. Willful defaulters have often been protected by the judicial process in India that placed a premium on protecting assets and jobs. The courts that granted stays in winding down cases effectively prevented banks from recovering the 'bad' loans. Through the new code, banks will try and recover some but more importantly if the code is successfully implemented, significantly reduce the moral hazard that has plagued such transactions.

It is therefore heartening that revival of PSBs is one of the main priority areas for this government, in addition to job creation. India has the unenviable task of creating a million jobs a month for the next decade. In some sense, the two agendas are tied at the hip. A strong banking sector is intimately connected with the real sector. Among economists the general consensus is that financial development, of which banking sector is an integral part, acts as a catalyst in the overall growth and development of an economy. Significant empirical research has been done to strengthen the argument that development of a strong and sound financial system contributes to economic growth. Thus restoring banks to health is vital for not only for the sake of the banking sector, but for lending and for investment and to help create jobs for the million young Indians who join the labour market each month. The steps that need to be taken immediately are clearly articulated in the Nayak Committee report. Save the one that recommends dilution of equity to below 50 percent, all others relating to governance and autonomy are politically achievable and have been initiated. The government should now follow through with quick implementation. Even equity dilution, given the right timing, should remain on the active agenda of the government. The government would still have control along with the benefit of a more nimble and responsive banking sector.

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Rajat Kathuria is Director and Chief Executive at Indian Council for Research on International Economic Relations (ICRIER), New Delhi. He has over 20 years experience in teaching and 15 years experience in economic policy, besides research interests on a range of issues relating to regulation and competition policy. He has taught undergraduate economics at the University of Maryland and is currently on leave from the International Management Institute (IMI), New Delhi where he teaches Managerial Economics and International Trade. He has worked with the World Bank, Washington DC as a Consultant and carried out project assignments for a number of international organizations, including ILO, UNCTAD, LirneAsia, World Bank and ADB. He has published in international and national journals, besides in popular magazines and newspapers. He is founder member of Broadband Society for Universal Access and served on the Board of Delhi Management Association. He currently is an independent director on the Microfinance Institutions Network (MFIN) and on several government committees. He is also on the research advisory council of SBI. He has an undergraduate degree in Economics from St. Stephens College, a Masters from Delhi School of Economics and a PhD degree from the University of Maryland, College Park.

Public Sector banks- a spectrum of reforms, a few shades brighter

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The IMF released its World Economic Outlook in April 2016 which predicted that India's GDP would continue to grow at above 7 per cent. The warranted enthusiasm over this statistic must however, be tempered by another figure from the IMF report- those relating to non-performing assets **("NPAs")**, which demonstrates that banks in India continue to struggle even as the country is the world's fastest growing economy. The IMF report puts NPAs in India at 6 per cent of all loans, which is the highest of all Asian countries, and this is even without reckoning restructured assets. Coupled with the fact that the report also indicated that Indian banks have the lowest ratio of regulatory tier-1 capital to risk weighted assets demonstrates that banks in India may not have the capital cushion for the bad assets on their balance sheets.

In India, state owned banks dominate the banking landscape- statistics issued by the Reserve Bank of India **("RBI")** India's central bank and regulator of banks show that they have 73.3 per cent of the market share in credit and are therefore especially exposed to the risks on account of NPAs and a low capital base. Any stress in PSBs has wider implications, since they are financed through deposits of small savers and their equity is owned by through retail investors either directly on the stock market or aggregated through institutional investors like insurance companies, mutual funds and pension funds. PSBs being state-

owned, their capital come directly from taxpayers who bear equity risk directly. The Minister of Finance, Mr Arun Jaitly, in response to a question in Parliament on May 3, 2015 stated that the totally amount due to public sector banks **("PSBs")** is INR 66190 crore. Willful defaulters have been defined by the RBI as borrowers who have the ability to repay loans but do not repay, on account of siphoning off funds, diversion of funds etc. This statistic is therefore symptomatic of the extent of the problem in PSBs as well as of a deeper malaise in the PSBs. It underscores the need for a comprehensive insolvency code to tackle distress but also for a more systematic reform of PSBs' governance structures and ownership.

Both houses of Parliament recently passed the Insolvency and Bankruptcy Code, 2016 which could help with the quick and efficient recovery of NPAs, permitting lenders to replace recalcitrant management, imposing penalties for egregious behavior, enables the resolution of distress by strengthening creditors' ability to supervise the running of the debtor as a going concern and facilitating liquation of assets where no resolution is possible.

The crisis of NPAs is far deeper, however, particularly in relation to PSBs, where it is linked to governance and human resource issues as well as the capitalization and ownership structure of PSBs. Therefore, more systemic reforms will be required to tackle the source of the problem.

On August 14, 2015, the Department of Financial Services, Ministry of Finance unveiled a vision document that set out a plan for reforms in PSBs in a range of hues entitled "Indradhanush". The proposed reforms generate hope but could be sharpened improve their efficacy. While privatisation and change in ownership structure are important medium to long term goals, other internal reforms can be important 'small steps' or incremental reforms that could yield significant results.

Better Bank Boards

The centrality of bank boards in the governance of banks as well as its implications for asset quality is evidenced through anecdata. For instance, last year, the chairman and managing director of large PSB was arrested for taking a bribe to extend a loan to a steel manufacturing company. Charges have been framed under the Prevention of Corruption Act, 1988 and the Indian Penal Code. Later, the loan was which disbursed with adequate credit checks (and it is believed, that such checks were obviated on account of integrity issues with the lender's management) was defaulted on and classified as non-performing, requiring the provisioning of capital and disclosure. Regardless, it was refinanced and restructured for a period of twenty five years, when other recovery, collateral enforcement or liquidation options could've been explored instead. The importance of integrity and competence in the boards of banks cannot therefore be overstated. The appointment of bank boards and senior management, has however, been mired in controversy thus far and there has not been any systematized process for this.

The concept of the Bank Boards Bureau **("BBB")** was first mooted in report of the RBI constituted Committee to Review Governance of Boards of Banks in India chaired by Mr. PJ Nayak (**"Nayak Committee"**). The Nayak Committee recommended, as an interim measure the set up of a BBB to professionalize the manner of appointments in PSBs. The Finance Minister in his budget speech also announced that the BBB would be an interim measure until the set up of a Bank Investment Company (**"BIC"**). The BBB was set up in February 2016 with the Mr Vinod Rai as its chairman and is expected to begin functioning. The precise terms of reference of the BBB however remain unclear. It also does not have the force of law as yet.

The BBB should have statutory backing for it to function with efficacy. The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and 1980 (**"Bank Nationalisation Acts"**) and the SBI Act 1955 and SBI Subsidiary Banks Act 1959 must be amended to incorporate the concept of BBB for the appointment of top management of PSU banks as well as the composition of the BBB itself, to insulate it from political interference. The Prime Minister mentioned that there would not be "political interference" in PSBs post in his speech following the Gyan Sangam in 2015, but it is imperative to codify it. The Nayak Committee has

an interim solution for a scheme and rules under the existing acts for the constitution of the BBB which could potentially be adopted.

In terms of the selection of the BBB itself, it currently comprises the Governor of the RBI, secretary DFS and Secretary Ministry of Personnel. It may be useful to have more independent experts to ensure that it will be staffed by independent individuals. The government could consider including in the BBB senior commercial bankers as recommended in the Nayak Committee.

Further, the BB should help address the issue of duality of control between the government and the RBI. The BBB to exercise powers as an owner / professional investor acting on behalf of the Government of India, rather than exercising any developmental or regulatory oversight over the PSBs.

Mr Rai, the Chairman of the BBB recently stated that an intermediate mechanism for NPAs is presently being worked on. The terms of reference of the BBB should specify that it controls internal governance issues relating to corporate governance as well professionalizing the management of banks. It could also help with internal policies for dealing with better lending practices and dealing with NPAs on an ongoing basis.

The appointment and set up of boards of banks by the BBB may also require amendments to specific acts, since some of them have granular details about board membership – including each category of director. As an example, the SBI Act has 7 different categories of directors, the IDBI Act 5 categories and Bank Nationalisation Act 8 categories. BBB should be permitted to streamline some of these to ensure smaller and better quality boards staffed with people with requisite expertise. The mandate of the BBB should ensure the de-politicization of the appointments of heads of PSBs which would permit high quality talent to be attracted and retained. For this, the BBB should also be empowered to bring the pay grades at least in line with the caps specified by the RBI for private banks rather than the current scales.

The BBB should also inculcate better human resource (**"HR"**) practices in banks and have HR practices that engender better lending practices. The framework for accountability setout in the Indradhanush document could be supplemented with additional measures. The BBB could require the inclusion of non-performance of loans disbursed as part of **performance metrics of management and senior management**. While Mr rai recently said that bank senior management will not be penalized for NPA resolution measures undertaken by them, staff should in fact be penalizes for non performance of loans, particularly if such non-performance can be shown to be due to negligence at the time of disbursement, under-collateralization or weak covenants rather than a cyclical downturn. There should be policies in place to hold up promotions for deterioration in quality of loans; and promotions should be linked to recoveries. The BBB could also consider peer scrutiny and 360 degree feedback which would bring a culture of accountability in PSBs. This coupled with the Whistle blower Act could act as an early warning signal for potential malfeasant behavior within banks.

The BBB should endeavor to put in place HR policies that hold management responsible for loans disbursed in their time if they go bad even after they are transferred.

Consolidate, Concentrate

The consolidation of PSBs has also been in the news following the proposal of the merger of the State bank of India with its associate banks as well as the Bharatiya Mahila Bank. Consolidation is a welcome measure, given that there are far too many PSBs, most with very similar business models and tend to cannibalize each other. That being said, it is also critical to prevent any one bank becoming a behemoth and too big to fail. Consolidation could therefore be between smaller banks dispersed across geographies.

At the same time, some PSBs should change their business to find a specific niche. The RBI has started granting differentiated banking licenses -presently for payment banks and small finance banks, but it was announced in the Annual Policy statement that several more specialized bank licenses are being considered. BBB should therefore consider PSBs seeking specialized licenses to develop a niche to concentrate on a particular business model and/or a geography.

The opportunity of crises

The annual results posted by various PSBs recently are being seen as the banking crisis having magnified proportions. However, each crisis presents and opportunity and we should use this one to undertake deeper reforms of PSBs to set the stage to more financial deepening and and a better foundation of higher growth.

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Richa Roy is a lawyer whose focal practice areas are banking and financial services, microfinance, private equity and venture capital funds, foreign direct investment law, corporate governance, anti corruption and anti bribery. She has been involved in several public policy and regulatory reform initiatives. She was recently part of the drafting team for the Insolvency and Bankruptcy Code, 2016 (one of the flagship reforms of the present government) proposed by the Bankruptcy Law Reform Committee, Ministry of Finance, Government of India. She is on a Ministry of Corporate Affairs Committee to draft rules for functioning of the newly constituted National Company Law Tribunal. Previously, she has advised the Reserve Bank of India (**"RBI"**) on regulations relating to differentiated licenses (payment banks and small banks); consumer protection and conduct of business regulation for financial firms, prudential regulation for non banking finance companies (NBFCs), micro finance, and revitalizing stressed assets.

She has advised several international banks on their India entry strategy, the Indian regulatory framework and structuring their products and services for the Indian market and Indian private sector banks on structured finance, project finance, corporate finance and retail finance transactions. She has also represented several state owned banks on structuring and documenting loans extended by them to corporations. She regularly advises banks on prudential norms and capital adequacy requirements applicable to them and on dealing with non-performing assets, including debt restructuring, enforcement of security interest and potentially triggering bankruptcy proceedings against borrowers.

Richa also has a strong microfinance practice and pro bono practice, advising several NGOs, civil society organisations and social enterprises, including some of the world's largest on a range of issues including fund raising domestically and internationally and scale up strategy. She is also involved in thought leadership and PERSONAL PROFILE RICHA ROY

policy initiatives in the social enterprise space. For instance, she collaborated with Grameen Capital India to jointly advice the Securities and Exchange Board of India (**"SEBI"**) on the introduction the new category of "**social venture funds**" – hybrid funds that invest patient capital in social enterprises for multiple bottom line returns.

She was previously the Group Head for International Private Banking, Corporate Legal Group at ICICI Bank Limited, where she headed a team that set up a compliance program and internal controls for the bank's private wealth management business in 50 countries across the world. She also advised the bank on the launch of its global investment banking business in India, Singapore, UK and Dubai. She has advised on the structuring and setting up of several investment funds and feeder structures investing in listed and unlisted equity, in India and drafted and negotiated key documentation in this regard. She has represented international and domestic private equity investors on their investments across several sectors including financial services, infrastructure, renewable energy logistics and consumer goods.

She has published on bankruptcy reforms, banking reforms, corporate governance and cross bornder anti-corruption statutes, among other issues.

Richa took her B.A.LLB (Hons.) from the National Law School of India University, Bangalore and began her career at ICICI Bank Limited, Mumbai, in the same year. Since 2008 she has been with AZB & Partners.

Indradhanush to benefit public sector banks; but capitalisation to be a key challenge

Ashu Suyash
Managing Director & Chief Executive Officer of CRISIL

Introduction

India's banking sector is undergoing transformational changes that would have far-reaching and structural implications. The Reserve Bank of India (RBI) is opening up the sector by granting differentiated banking licences that also further the cause of financial inclusion, and increasing systemic transparency.

The government has been doing its bit to help public sector banks come out of the asset quality quagmire they have been stuck in for the past few years. Non-performing assets (NPAs) of public sector banks are estimated at 7%, and expected to increase to 9.8% by March 2017. Overall weak assets[1] of public sector banks are seen rising to ~11.3%. This will stress the 'Tier- 1' capital position of these banks and increase their capital requirements going forward. CRISIL estimates the capital requirement of public sector banks to be Rs 2.6 lakh crore capital between 2015 and 2019.

The Indradhanush plan

Recognising the problem of bad loans and the need for sweeping reforms, the government announced Indradhanush, a seven-point plan for

[1] CRISIL defines weak assets as gross non-performing assets + 40% of restructured standard assets + 75% of investments in security receipts + 15% of assets structured under 5/25 scheme

these banks. It aims to address performance constraints such as governance reforms-especially accountability, and capitalisation. Success, however, will depend on relentless implementation, and staying the course no matter the obstacles. What¡¦s encouraging is that the government has hit the ground running.

Indradhanush has the following objectives:

- Improve governance by splitting the post of chairman and managing director to build checks and balances in decision-making, and the formation of a Banks Board Bureau that would have oversight on appointment of whole-time directors and formulation of strategies.
- Strengthen operating environment by empowering banks to take independent decisions, ensure robust risk control mechanisms and disclosures, and making managements accountable for performance.
- Mitigate stress through policy actions for troubled sectors and provide capital to meet Basel III regulations.

Indradhanush takes cognisance of factors that influence performance. The endogenous ones are governance, efficiencies and a performance evaluation framework that incentivises management focus on capital conservation and credit rating. The exogenous ones are linked to legal, recovery and dispute resolutions such as coercing promoters to sell non-core assets, setting up fraud resolution processes and six new Debt Recovery Tribunals, and enhancing the role of asset reconstruction companies.

The plan will also rely on efforts made by the Reserve Bank of India (RBI) such as increasing transparency through the Central Repository of Information on Large Credits and the Joint Lenders' Forum, its guidelines on reporting Special Mention Accounts, 5/25 structuring, strategic debt restructuring and the willful defaulter framework.

We have already seen some action towards achieving Indradhanush's objectives such as professionals from private banks being inducted to some large public sector banks and the Banks Board Bureau being set up with a team of eminent professionals. As for strengthening the operating environment, there have been steps from the RBI and banks to improve disclosure of weak assets and increase provisioning for them. Banks have also sought to use mechanisms available to find better solutions for accounts under stress by working closely with co-lenders and borrowers.

The government has also been proactive in identifying and offering solutions for specific sectors that are under severe stress due to exogenous factors. These include auctioning of coal mines to improve the availability of feedstock to implementing the Ujwal Discom Assurance Yojana (UDAY) to de-stress the power sector. Initial steps including providing quicker clearances have helped improve the visibility of progress in the roads sector. Finally, supporting the domestic steel sector through imposition of minimum import pricing and other excise duties has helped stem the rot in the sector.

Capitalisation - A key challenge for public sector banks

However, capital adequacy is what still requires close and continued attention from the government. Indradhanush makes a realistic assessment of the capital needs of public sector banks, but it also makes them highly dependent on the market for raising money. Which means these banks will have to gain the market's confidence by materially improving performance, which, in turn, will be a slow, multi-year process.

Given the weakness in asset quality and further deterioration expected in the current fiscal, and the pressure on pre-provisioning profit, capitalisation will be in the spotlight. Due to deterioration in top accounts, we expect overall slippages of public sector banks to remain high at 4.8% - or Rs 2.8 lakh crore - for the current fiscal, and see gross NPAs rising to 9.8% - or Rs 6.2 lakh crore.

This will require greater provisioning (1.6% of assets) for this fiscal, which will neutralise the profits of many public sector banks, and equal the pre-provisioning profit of the public sector bank system as a whole.

Capital-raising will be the biggest challenge going forward. Only 10 out of 26 public sector banks may have some capital cushion over the regulatory minimum by end of March 2017, compared with 25 out of 26 as of end of fiscal 2015.

Public sector banks will require Rs 2.6 lakh crore of capital till fiscal 2019 of which Tier I capital will constitute the lion's share of around Rs. 1.7 lakh crore. As against this, the government's current plan is to infuse Rs. 70,000 crore of capital under the Indradhanush plan. Despite witnessing a sharp fall in profitability, overall capital requirement of public sector banks has not increased compared with CRISIL's earlier estimate because of slower-than-expected credit growth. While overall capital requirement between 2015 and 2019 has remained ~Rs 2.6 lakh crore, the need for equity capital and overall Tier 1 capital has increased compared with CRISIL's earlier estimate (see table below).

Total capital requirement of PSBs till 2019 to meet regulatory requirements (Rs lakh crore)	CET 1	AT 1	Total Tier 1	Tier	Total Capital
Previous estimate	0.45	0.85	1.3	1.3	2.6
Revised estimate	0.85	0.85	1.7	0.9	2.6

** These estimates factor in benefits derived from revised regulations that afford the inclusion of certain portions of deferred tax assets, revaluation reserves and foreign currency translation reserves in Common Equity Tier 1, or CET 1, capital. This adds about ~Rs 37,000 crore to capital. And release of capital from the implementation of power sector reforms under the UDAY scheme will add another ~Rs 12,000 crore.*

The government has infused ~Rs 20,000 crore and public sector banks have raised Rs 6,000 crore Additional Tier 1, or AT 1, capital, and Rs 14,000 crore Tier 2 capital in 2015-16. They will require another Rs 1.44 lakh crore Tier 1 capital and Rs 76,000 crore Tier 2 capital till end of fiscal 2019. Overall, the cushion in Tier 1 capital is low for public sector banks, which leaves them vulnerable to external shocks.

The regulatory relaxation, allowing a part of revaluation reserves, deferred tax assets and foreign currency translation reserves as CET 1 has helped ease the pressure, but equity infusion by the government remains critical. The ability of public sector banks to generate capital from internal accrual has significantly diminished, as also from external sources because of poor valuations and low market appetite as of now for higher-risk AT 1 instruments.

The AT1 instruments under Basel III regulations are quasi-equity by nature with loss-absorption capacity. The RBI guidelines allow for their treatment as 'Tier 1' capital when calculating capital position. These instruments possess features that can pose a higher level of risk, and are very different from traditional bonds.

Among other things, these bonds may not pay interest if the bank has insufficient revenue reserves in a year when it makes losses, or should the bank's equity capital fall below the regulatory threshold. With a number of public sector banks having reported a loss in the previous fiscal and may continue to report a loss in the current fiscal, bulk of their revenue reserves have the potential to be completely wiped off due to these losses.

Investor appetite, therefore, for AT1 issuances could be low thereby making banks highly dependent on government capital support.

Conclusion

While raising capital will be key to improvement in the health of public sector banks, CRISIL believes three more steps can be explored to help build additional confidence in the banking sector: 1) A 'surgical' response to the challenge of NPAs by creating a central large asset reconstruction company; 2) Signalling the government's determination to change the game through a disproportionately higher upfront capital infusion, and, 3) Addressing emerging human resources challenges at the mid-to-senior level in public sector banks.

Given the large capital requirements of public sector banks till 2019 and on an on-going basis to fund growth, the government could look to implement the holding company structure that it had mooted, though there has been limited progress on this front as yet. The holding company could invest in non-equity issuances of public sector banks and, in turn, tap the capital market -- both equity and debt -- at competitive rates, given its quasi-government status. The investment by the holding company in AT1 issuances could also build investor confidence in such instruments over a period of time.

While steps taken by the government to structurally strengthen the public sector banking system have been noteworthy, sustainability and sharp focus on each of these initiatives through the path to complete rejuvenation will play a vital role in improving the credit profiles of public sector banks over the medium to long term. In the interim, capital cushioning, building human resource capabilities to address extant challenges would be the key.

Ashu Suyash
Managing Director &
Chief Executive Officer of CRISIL

Ashu Suyash is responsible for CRISIL's domestic and global businesses, leading its efforts to deliver high-quality analyses, opinions and solutions to a rich and diversified client base including large corporations, small enterprises, investors, financial institutions, governments and policymakers.

She has over 28 years of experience in the financial services sector. Prior to joining CRISIL, she served as the Chief Executive Officer of L&T Investment Management Ltd and L&T Capital Markets Ltd. Earlier, Ashu was the Managing Director & Country Head of Fidelity's Indian asset management business. She has also worked with Citibank India for 15 years holding several key positions across the Consumer, Corporate and Investment Bank. Over the years, Ashu has been recognised among the Top 50 Women in business in India and in Asia by various publications.

She is on the Advisory board of Chartered Institute for Securities & Investment and PFRDA's Pension Advisory Committee. Ashu has a keen interest in the education sector and is associated with the Board of Studies at NMIMS, with N M College and is on the advisory board of Aseema Charitable Trust, an NGO with a mission to provide education to the underprivileged children.

Ashu is a commerce graduate from Mumbai University (N.M. College) and a Chartered Accountant.

FICCI – Data Centre

Economy Watch

State of the Economy

Highlights

Global recovery continues to be sluggish, with pace of growth remaining divergent across countries and consolidation yet to shape up. According to IMF's latest World Economic Outlook released in April 2016, world output is expected to grow by 3.2 percent in 2016, a downward revision by 0.2 percent points from the January update. Downside risks remain imminent and can dent growth prospects going ahead. Nonetheless, India's growth projection has been kept intact. As per IMF's latest projection, India is projected to grow at 7.5 percent in 2016. Even though our macro-economic fundamentals have strengthened over the course of past two years; but we are still to embark on the course of sustainable recovery.

The growth in industrial activity as indicated by Index of Industrial Production (IIP) remains volatile. Though latest numbers for the month of February 2016 report an uptick in IIP growth after three consecutive months of decline, the manufacturing activity is yet to find solid ground. Manufacturing sector reported a growth of 0.7 percent in February 2016. Further, the capital good segment continued to report negative growth for the fourth consecutive month in February 2016.

With respect to prices, both WPI and CPI based prices remain benign. The pressure on prices seen arising from the food segment in the beginning of year indicated signs of waning. Further, the recent meteorological forecast indicates a normal rainfall this year which will be a huge positive and is expected to keep any strain arising on account of food prices under check.

The Reserve Bank of India's move to cut the repo rate in the first bi-monetary policy announced on April 5, 2016 was a welcome move. Further, various steps announced to ease liquidity should allow for effective transmission into lending rates by the banks. The expectation of a normal monsoon this year and inflation remaining range bound provides enough room for further accommodation in the policy rates. A further cut in the repo rate would be an encouraging signal to the industry.

Gross Domestic Product (GDP)

World Economic Outlook (WEO), IMF-April 2016

	2015e	2016f	2017f	Diff from Jan'16 update	
World	3.1	3.2	3.5	-0.2	-0.1
US	2.4	2.4	2.5	-0.2	-0.1
Euro Area	1.6	1.5	1.6	-0.2	-0.1
Japan	0.5	0.5	-0.1	-0.5	-0.4
China	6.9	6.5	6.2	0.2	0.2
India	7.3	7.5	7.5	0.0	0.0
ASEAN-5*	4.7	4.8	5.1	0.0	0.0

ASEAN-5: Indonesia, Malaysia, Philippines, Thailand, Vietnam*

WEO: Policy prescription for India

- Continue fiscal consolidation, revenue reforms and further reduction in subsidies
- Labor market reforms
- Dismantling infrastructure bottlenecks, especially in the power sector

Source: IMF

- The latest IMF World Economic Outlook released in April 2016 estimates world output to grow by 3.2 percent in 2016, a downward revision by 0.2 percent points from the January 2016 update. According to the report the 'global economy has been growing too slow for too long' leaving growth prospects exposed to significant downside risks.
- The outlook is marred by risk factors- including return of financial turmoil, a protracted period of low oil prices impacting oil exporting countries, a further slowdown in China, and geopolitical risks- that are anticipated to become more pronounced. Advanced economies are expected to grow by 2.0 percent in 2016, with recovery expected to be held back by weak demand, low productivity and strained balance sheets. Further, prospects for emerging markets remains scattered and outlook for growth consolidating in immediate future remains weak.
- Amidst the current scenario, growth outlook for India has been kept intact. India is projected to grow by 7.5 percent in 2016 and the same momentum is expected to be maintained in 2017 as well. One of the biggest challenges for India has been the weak demand situation–both domestic and global. Consequently, private investments are not picking up and companies are operating at sub optimal capacities. Nonetheless, our

macro-economic fundamentals remain stable and continued momentum on reforms is expected to ensure India's growth potential is realised.

- The report points out that countries should be ready to undertake collective measures to better manage the potential risks; suggesting a three pronged approach - structural reforms, fiscal support (with growth-friendly composition of revenue and spending) and monetary policy measures – to support and raise growth to a higher tangent.

Index of Industrial Production (IIP)

New Investments projects announced		
	Government (Rs.million)	Private (Rs.million)
Mar-15	460,079.4	1,657,397.4
Jun-15	562,082.1	593,589.9
Sep-15	685,958.3	1,766,792.0
Dec-15	378,381.9	902,457.9
Mar-16	**838,557.8**	**2,343,747.3**

Source: CMIE

Industrial Performance- Monthly (% Y-o-Y)					
% growth rate	Feb-15	Nov-15	Dec-15	Jan-16	Feb-16
Index of Industrial Production	4.8	-3.4	-1.2	-1.5	2.0
Economic Activity wise					
Mining	1.7	1.7	2.7	1.5	5.0
Manufacturing	5.1	-4.6	-2.2	-2.8	0.7
Electricity	5.9	0.8	3.2	6.6	9.6
Use-base industry classification					
Basic goods	4.9	-0.5	0.5	2.1	5.4
Intermediate goods	1.2	-1.5	1.3	2.8	5.7
Capital goods	8.3	-24.4	-19.1	-20.9	-9.8
Consumer durable goods	-3.8	12.2	16.4	5.8	9.7
Consumer non-durable goods	10.6	-4.9	-3.0	-3.1	-4.2

Source: CMIE

- Index of Industrial Production reported an uptick in the month of February 2016 after contracting for three consecutive months. The index registered a growth of 2.0 percent during the month on the back of robust performance in the mining and electricity segments. On a cumulative basis, the index was seen growing at 2.6 percent over the period April-February 2015-16, which was a tad lower than 2.8 percent growth noted in the corresponding period previous year.

- Mining witnessed a growth of 5.0 percent in February 2016, higher than 1.5 percent growth noted in the previous month and 1.7 percent growth in February last year. Likewise, electricity segment witnessed a growth of 9.6 percent in February 2016 as compared to 5.9 percent growth noted in the corresponding month previous year and 6.6 percent growth noted in January this year. Manufacturing growth rebounded in February 2016 after staying in the negative zone for three months. The sector grew by 0.7 percent in February 2016, vis-à-vis (-) 2.8 percent growth noted in the previous month. Sixteen out of twenty two manufacturing sub-segments posted positive growth in February 2016 as compared to same month previous year.

- As per use based classification, basic goods, intermediate goods and consumer goods noticed an improved performance in February 2016. The segments reported a growth of 5.4 percent, 5.7 percent and 0.8 percent respectively during the month. However under the consumer goods segment, consumer durables grew by 9.7 percent while growth of consumer non-durables contracted by 4.2 percent. The growth rates were largely driven by base effects which were seen favorable in case of consumer durables and unfavorable for consumer non durables. Capital goods, however, continued to contract in the month of February 2016.

- New project announcements, both by the government and private sector were seen picking up in the fourth quarter of 2015-16 after slowing down in the previous quarter. However, industry is still cautious of any large scale expansion. With overall economic conditions by and large conducive and reforms likely to be implemented, we expect the domestic capex cycle and demand to pick up in months ahead.

Core Sector- Growth (%)					
	Feb-2015	Nov-2015	Dec-2015	Jan-2016	Feb-2016
Overall	2.3	-1.3	0.9	2.9	5.7
Coal	10.8	3.5	6.1	9.1	3.9
Crude Oil	-1.9	-3.3	-4.1	-4.6	0.8
Natural Gas	-8.2	-3.9	-6.1	-15.2	1.3
Refinery Products	-1.0	2.5	2.2	4.9	8.1
Fertilizers	-0.4	13.4	13.0	6.2	16.3
Steel	-0.6	-8.5	-4.5	-2.8	-0.5
Cement	2.3	-1.8	3.2	9.1	13.5
Electricity	5.9	0.0	2.7	6.0	9.2

Source: CMIE

- Index of the eight core industries registered fifteen month high growth of 5.7 percent in February 2016 as a result of noticeable improvement in the electricity, refinery products, fertilizers and cement segments. The

four segments add up to a weight of about 20 percent out of the total of about 38 percent. The overall index noted a growth of 2.9 percent in January 2016 and 2.3 percent in February 2015.

- Electricity generation registered a five month high growth of 9.2 percent in February 2016 vis-à-vis a growth of 6.0 percent noted in the previous month. Improvement in fuel availability and increase in installed capacity aided growth in generation. Growth in output of coal, however, slowed down to 3.9 percent vis-à-vis 9.1 percent growth reported in the previous month.
- Oil and gas industry reported improvement in growth numbers in the month of February 2016. Output of crude oil grew by 0.8 percent in February 2016 after contracting for five consecutive months. Output of refinery products surged to a fifteen month high growth of 8.1 percent in February 2016 as compared to 4.9 percent growth recorded in the previous month. Output of natural gas grew by 1.3 percent in February 2016 following a decline for four consecutive months.
- Production of fertilizers noted double digit growth of 16.3 percent in February 2016 as against 6.2 percent growth noted in the previous month.
- Output of cement reported a robust growth of 13.5 percent in February 2016. The growth in January 2016 was 9.1 percent and 2.3 percent in February 2015. Steel was the only segment that noted contraction, growing by (-) 0.5 percent in February 2016.

Inflation

Wholesale Price Index (WPI) – Growth Rate (% YoY)

	Mar-15	Jan-16	Feb-16	Mar-16
All commodities	-2.3	-1.1	-0.9	-0.8
Primary articles	-0.2	4.3	1.6	2.1
Food articles	6.3	6.5	3.4	3.7
Vegetables	9.3	12.7	-3.3	-2.3
Pulses	13.2	45.0	38.8	34.5
Fuel and power	-12.2	-9.9	-6.4	-8.3
Manufactured products	-0.2	-1.2	-0.6	-0.1

Source: CMIE

Consumer Price Index (CPI) – Growth Rate (% YoY)

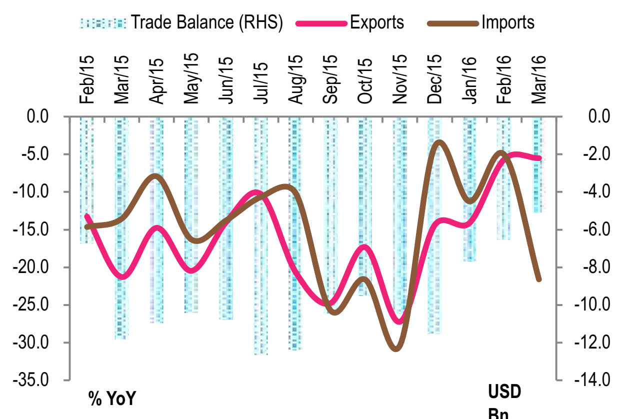
	Mar-15	Jan-16	Feb-16	Mar-16
All commodities	5.3	5.7	5.3	4.8
Food and beverages	6.3	6.7	5.5	5.3
Vegetables	11.1	6.4	0.7	0.5
Pulses	11.5	43.3	38.5	34.2
Clothing & footwear	6.3	5.7	5.6	5.5
Housing	4.8	5.2	5.3	5.3
Fuel & light	5.2	5.3	4.6	3.4

Source: CMIE

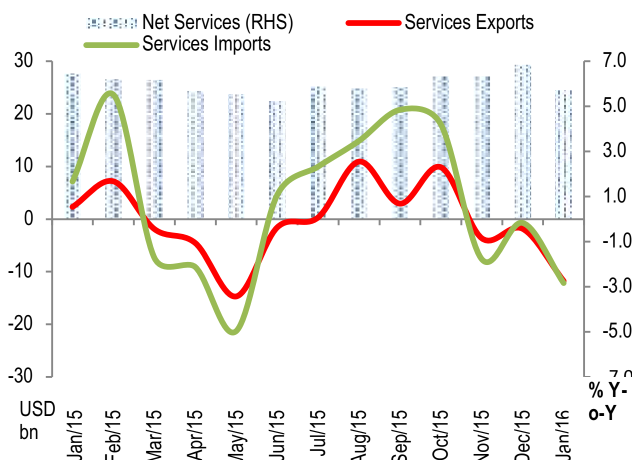
- Latest inflation numbers for the month of March 2016 reported prices remaining benign. WPI inflation rate at (-) 0.85 percent in March 2016 was in the negative terrain for seventeenth consecutive month. Further, CPI based retail prices for March 2015 witnessed moderation. CPI inflation rate stood at 4.8 percent in March 2016, vis-à-vis 5.3 percent inflation noted in February this year.
- The decline in CPI was led by a moderation noted in prices for food and beverages and fuel and light segment. Food and beverages prices increased by 5.3 percent in March 2016, vis-à-vis 5.5 percent growth noted in February this year and 6.3 percent growth in March 2015. However, in case of CPI the prices of services such as personal care, education, recreation & amusement and health continued to remain sticky.
- The decline in WPI mirrored the trend of persistently subdued global commodity prices. Both fuel and manufacturing commodity segment, which constitute 80 percent of the WPI index, continued to report negative inflation. Global crude oil prices have softened considerably and prices of commodities like basic metal, rubber products, chemicals also remained in the negative territory reflecting persistently weak demand conditions.
- Even for WPI based inflation the pressure which was seen arising from the food segment seems to be moderating. In case of both WPI and CPI, prices of vegetables and fruits reported a decline. Prices of pulses continued to register double digit growth; however the pace of increase was slower. Food grains and protein rich food items did note an increase in prices in the month of March 2016.
- Further, the recent meteorological prediction indicates expectation of normal rainfall this year which is a huge positive and is expected to keep any strain arising on account of food prices under check.
- Current inflation trajectory combined with positive monsoon forecast provides enough room for further accommodation in the policy rates which is critical for reviving the capex cycle in the economy.

Foreign Trade

Trend in India's Merchandise Trade



Trend in India's Serevices Trade

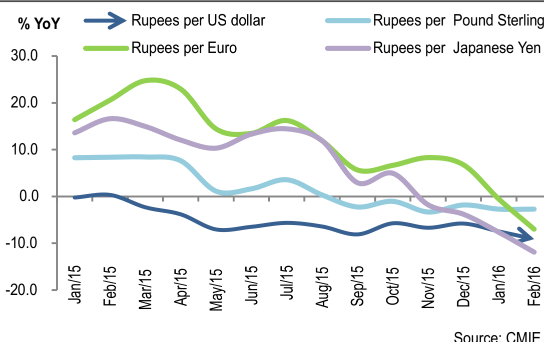


Source: CMIE

- According to the latest trade data, merchandise exports and imports remained on a downtrend for the sixteenth consecutive month in March 2016. Merchandise exports declined by 5.5 percent y-o-y in March 2015 and stood at USD 22.7 billion. The decline in exports in the month of February 2016 was to the tune of 5.9 percent. Further, the fall in imports in March 2016 has been discernibly steep. Merchandise imports reported a fall by (-) 21.6 percent in March 2016, vis-à-vis (-) 5.5 percent decline observed in February 2016. The steep decline in imports came on the back of plunge in oil imports (by (-) 35.3 percent). Non-oil imports also declined by (-) 17.9 percent in March 2016 led by fall in gold, coal, non-ferrous metals, iron and steel imports.
- As a result, trade deficit for the month of February stood at USD 5.1 billion, lowest in about five years. The corresponding figure in February 2016 was USD 6.5 billion and USD 11.4 billion in March 2015.
- Further, India's service trade also reported a passive performance. Receipts from India's service exports declined by 12.6 percent y-o-y in February 2016, while our payment for service imports plummeted by about 9.0 percent y-o-y in the same month.

Exchange Rate

Rupee Exchange Rate vis-à-vis major currencies (y-o-y)



Source: CMIE

Economic Affairs and Research Division

- Rupee noted depreciation with respect to all major currencies in the month of February 2016.
- The average Rupee-Euro exchange rate slipped to 75.8 noting a depreciation of 7.0 percent y-o-y in February 2016. The Rupee-Pound Sterling exchange rate stood at 97.7 during the month, 2.7 percent lower than the corresponding month of previous year.
- Rupee also noticed depreciation (y-o-y) with respect to Japanese Yen. The exchange rate depreciated by 11.9 percent y-o-y and was pegged at 59.4 in February 2016.
- The Rupee-US Dollar exchange rate noted 9.0 percent depreciation y-o-y during the month of February 2016. The Rupee-US Dollar exchange rate as on April 18, 2016 was pegged at 66.7.

Foreign Investment

	(Net) Foreign Direct Investment (USD Million)	(Net) Portfolio Investment (USD Million)	Total Foreign Investment Inflows (USD Million)
Feb-15	3,215	3,774	6,989
Mar-15	1,588	3,308	4,897
Apr-15	3,810	4,300	8,109
May-15	4,074	-1,907	2,167
Jun-15	2,201	-2,169	32
Jul-15	1,876	484	2,360
Aug-15	2,109	-2,468	-360
Sep-15	2,583	-1,384	1,198
Oct-15	4,645	5,034	9,679
Nov-15	2,630	-3,228	-597
Dec-15	3,510	-2,016	1,494
Jan-16	4,135	-1,465	2,669
Feb-16	2,473	-2,375	98
Apr-Feb 2014-15	29,664	38,896	68,560
Apr-Feb 2015-16	34,046	-7196	26,850

Source: RBI

- Total foreign investments inflows were valued at USD 98 million in the month of February 2016 vis-à-vis inflows equivalent to USD 2.7 billion noted in the previous month. The fall in overall foreign investment inflows was led by decline in portfolio investments.
- Portfolio investments reported net outflows for the fourth consecutive month in February 2016. Outflows equivalent to USD 2.4 billion were reported during the month. Growing concerns about global recovery, China's weak performance and United States announcing an increase in interest rates saw investors moving funds out of emerging markets.
- Net foreign direct investment inflows also witnessed moderation during February 2016. Foreign direct investment inflows reported a fall by 40.2 percent in February 2016 on an m-o-m basis. Further, inflows declined by 23.1 percent y-o-y in February 2016.

- Over the cumulative period April-February 2015-16, net foreign direct investment inflows noted an increase by 14.8 percent y-o-y. However, net portfolio investments declined conspicuously, from USD 38.9 billion (Apr 14-Feb 15) to (-) USD 7.2 billion (Apr 15-Feb 16). Consequently, total foreign investment inflows over the first eleven months of 2015-16 declined to USD 26.9 billion, vis-à-vis USD 68.7 billion over the same period last year.

Foreign Exchange Reserves

	Total foreign exchange reserves (USD Bn)	Foreign Currency Assets (USD Bn)	Gold (USD Bn)	SDRs (USD Bn)	Reserve Tranche Position (USD Bn)
Mar-15	341.6	317.3	19.0	4.0	1.3
Apr-15	351.9	327.2	19.3	4.1	1.3
May-15	352.5	327.8	19.3	4.0	1.3
Jun-15	356.0	331.5	19.1	4.1	1.3
Jul-15	353.5	329.9	18.3	4.0	1.3
Aug-15	351.4	328.1	18.0	4.1	1.3
Sep-15	350.3	326.8	18.2	4.1	1.3
Oct-15	354.2	330.1	18.7	4.0	1.3
Nov-15	350.2	327.5	17.5	4.0	1.3
Dec-15	350.4	327.8	17.2	4.0	1.3
Jan-16	349.6	326.6	17.7	4.0	1.3
Feb-16	348.4	325.0	19.3	1.5	2.6
Mar-16	360.2	336.1	20.1	1.5	2.5
			Change in USD billion		
Mar-16 vis-à-vis Feb-16	11.8	11.1	0.8	0.0	-0.1
Mar-16 vis-à-vis Mar-15	18.6	18.8	1.1	-2.5	1.2

Source: RBI

- Total foreign exchange reserves at the end of March 2016 stood at USD 360.2 billion, USD 11.8 billion higher than the amount recorded at the end of February 2016. Foreign exchange reserves equivalent to USD 18.6 billion have been added since March 2015.
- Foreign currency assets increased by USD 11.1 billion in the month of March 2016 vis-à-vis February 2016 and stood at USD 336.1 billion. In total, USD 18.8 billion was added to the foreign currency assets since March 2015.
- Gold reserves in March 2016 were valued at USD 20.1 billion, USD 0.8 billion higher than that recorded in the previous month. Gold reserves rose by USD 1.1 billion y-o-y during March 2016.
- SDRs and Reserve Tranche position stood at USD 1.5 billion and USD 2.5 billion respectively at the end of March 2016.

Fiscal Position

Indicators	Revised Estimate 2015-16	Actuals up to February 2016	% of Actuals to Revised Estimates Current	% of Actuals to Revised Estimates COPPY
	Rs. Crore	Rs. Crore	In %	In %
Revenue Receipts	1206084	947050	78.5	72.5
Tax Revenue (Net)	947508	735778	77.7	71.7
Non-Tax Revenue	258576	211272	81.7	75.7
Total Receipts	1250301	983001	78.6	73.3
Non-Plan Expenditure	1308194	1158656	88.6	87.2
Plan Expenditure	477197	397217	83.2	85.8
Total Expenditure	1785391	1555873	87.1	86.8
Fiscal Deficit	535090	572872	107.1	117.5
Revenue Deficit	341589	390810	114.4	133.3
Primary Deficit	92469	193387	209.1	253.1

Source: Controller General of Accounts
COPPY- corresponding period previous year

- Over the cumulative period April-February 2015-16, fiscal deficit stood at Rs. 5.7 lakh crore, which was 107.1 percent of the revised estimate figure of Rs. 5.4 lakh crore for 2015-16. Fiscal deficit declined by 4.9 percent during April-February 2015-16 as compared to the same period previous year.
- Over the cumulative period April-February 2016, revenue receipts stood at Rs. 9.5 lakh crore which was 16.0 percent higher than the amount in the corresponding period previous year. Tax revenue collections grew by 13.0 percent y-o-y and stood at Rs. 7.4 lakh crore at the end of first eleven months of the fiscal year 2015-16. Non-tax revenue collections registered a y-o-y growth of 28.1 percent during April-February 2015-16. Total receipts up to February 2016 were 78.6 percent of the revised estimate for the entire fiscal year 2015-16.
- Total expenditure of the government rose by 6.6 percent y-o-y and stood at Rs. 15.6 lakh crore for the period April-February 2015-16. Total expenditure till February 2016 was 87.1 percent of the total revised estimate for the entire fiscal. Plan expenditure declined by 1.0 percent, while non plan expenditure grew by 9.5 percent at the end of the first eleven months of the fiscal year 2015-16.

Key Policy Announcements – April 2016

- **RBI cuts repo rate by 25 bps to 6.5%; raises reverse repo**

  The Reserve Bank cut the repo rate by 0.25 per cent on April 5, 2016 and introduced a host of measures to smoothen liquidity supply so that banks can lend to the productive sectors and indicated accommodative stance going ahead. Accordingly, the repo rate has come down to 6.5 per cent. the end of the first eleven months of the fiscal year 2015-16.

- **Metal withdrawal eased in gold monetization plan**

  In a major relaxation in the gold monetization scheme, the Reserve Bank of India (RBI) allowed redeeming gold under the scheme when the deposit is for the medium or long term. So far, the provision of redeeming gold deposits under the scheme in the form of the metal or returning it on maturity was allowed only for short-term deposits of one-three years.

- **RBI notifies 49% FDI under automatic route in insurance**

  Reserve Bank notified 49 per cent foreign direct investment (FDI) under automatic route in insurance sector. "The extant FDI policy for insurance sector has since been reviewed by the Government of India and accordingly it has been decided to enhance the limit of foreign investment in insurance sector from 26 to 49 percent under the automatic route subject to certain terms and conditions which have been notified on March 30," RBI said in a notification.

- **Host of banks lowers lending rates**

  A host of banks, including State Bank of India, HDFC Bank and Bank of Baroda, have announced their new lending rates for various tenors. For example, the new one-year benchmark lending rate ranges from 9.20 to 9.85 per cent compared with the existing base rate of 9.30 per cent to 9.95 per cent. The announcements came in the wake of the Reserve Bank of India asking scheduled commercial banks (excluding regional rural banks) to price all loans with reference to the marginal cost of funds-based lending rate (MCLR) with effect from April 1.

- **Government tightens standards of PSU review**

  To further professionalize state-owned enterprises, the Government has come out with a new set of parameters to judge the performance of central public sector enterprises (CPSEs). These standards, in force from the current year, are said to be more comprehensive and stronger than those of previous years. The assessment forms contain a number of new parameters, including measuring capacity utilization; actual tangible outcomes from research and development (R&D); leveraging of net worth through capital spending or borrowings; cost and time over-run in projects, inventory or loan book; and financial parameters such as dividends disbursed as a percentage of profit after tax (PAT) and net worth.

- **Cabinet clears Finance Commission recommendations on state government deficits**

  The government has approved fiscal deficit target of 3 per cent for states, as recommended by the 14th Finance Commission for the 2015-20 period. FFC has adopted the fiscal deficit threshold limit of 3 per cent of Gross State Domestic Product (GSDP) for states. It has also provided for year-to-year flexibility for additional deficit. The Cabinet, chaired by Prime Minister Narendra Modi, gave approval to recommendations with two flexibility options, an official statement said. FFC provided additional headroom to a maximum of 0.5 per cent over and above the normal limit of 3 per cent in any given year to states that have had a favorable debt-GSDP ratio and interest payments-revenue receipts ratio in the previous two years.

- **Govt eases norms for foreign firms to set up branch offices in India**

  The government has relaxed the approval process for foreign firms to set up their branch, liaison and project offices in the country. Except for defence, telecom, private security, information & broadcasting, and non-government organization sectors, such approvals can now be given by designated banks. Earlier, the Reserve Bank of India was the approving authority. "Further, anyone who has been awarded a contract for a project by a government authority/PSU (public sector unit) would be automatically given approval to open a bank account," the finance ministry stated. Companies in sensitive sectors such as defence will continue to require RBI approval.

- **Online sales to foreign buyers get exports tag**

  The government has said that all sales by Indian sellers to foreign buyers through digital platforms would be classified as export.

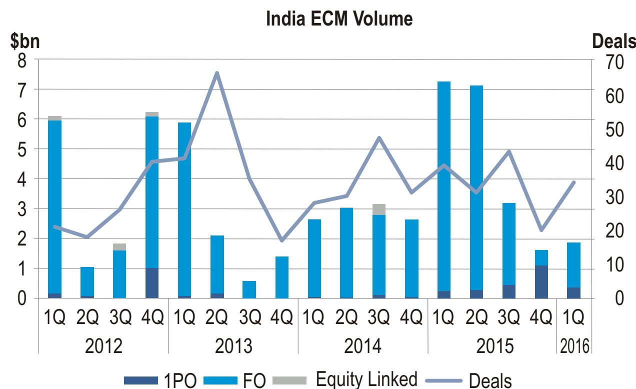
  All domestic sellers who supply goods and services to foreign buyers would be classified as exporters. It will allow them to claim benefits under the Merchandise Exports from India Scheme (MEIS), which provides financial incentives. A notification put out by the Directorate General of Foreign Trade (DGFT) introduced the definition of e-commerce into the Foreign Trade Policy, 2015-2020, which governs the norms for India's international trade.

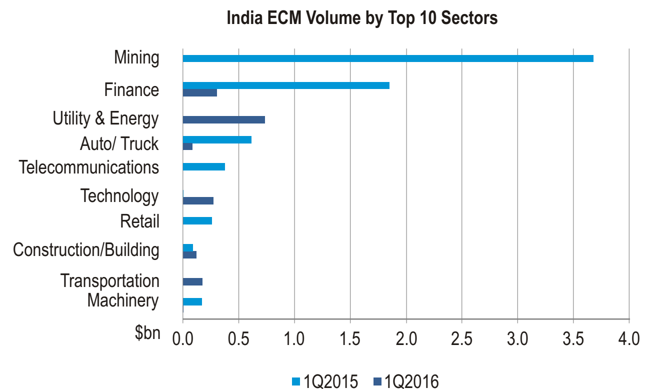
Source: Various press articles

Equity Capital Markets

- **Indian ECM** volume stood at $1.9bn (via 34 deals) for 1Q 2016, down 74% on the $7.2bn (via 39 deals) raised in 1Q 2015
- **IPO** volume totaled $381m (via 22 deals) for 1Q 2016, compared to $263m (via 13 deals) for 1Q 2015. There were no convertibles issued for 1Q 2016
    - **Follow-on** volume for 1Q 2016 decreased 79% to $1.5bn (via 12 deals) from the $7.0bn (via 26 deals) for 1Q 2015
- **NTPC Ltd's** $732m follow■n via book runners **SBI, ICICI, Edelweiss and Deutsche Bank** is the largest ECM transaction for 1Q 2016

In association with





Top 10 ECM Deals-FY 2015					
Date	**Issuer**	**Sector**	**Deal Type**	**Deal Value ($m)**	**Bookrunners**
24-Feb	NTPC Ltd	Utility & Energy	FO	732	SBI, ICICI, Edelweiss, DB\
29-Feb	Kotak Mahindra Bank	Finance	FO	301	Citi
10-Mar	Container Corp of India Ltd (Concor)	Transportation	FO	174	Kotak, ICICI, Citi
10-Mar	Infosys Ltd	Technology	FO	128	Citi
23-Mar	Healthcare Global Enterprises Ltd - HCG	Healthcare	IPO	102	Kotak, Edelweiss, GS, IDFC, IIFL Holdings, Yes Bank
29-Jan	Engineers India Ltd	Construction/Building	FO	95	SBI, ICICI, Edelweiss, DB
13-Feb	Quick Heal Technologies Ltd	Technology	IPO	71	ICICI, Jefferies, JPM
28-Mar	Infibeam Inc Ltd	Technology	IPO	71	SBI, Elara Capital
5-Feb	Team Lease Services Ltd	Professional Services	IPO	63	IDFC, CS, ICICI
1-Feb	Precision Camshafts Ltd	Auto/Truck	IPO	60	SBI, HDFC, IIFL Holdings

Equity Capital Market Tables

Asia Pacific ECM Volume by Nation 1Q 2016				
Pos.	Nationality	Deal Value ($m)	No.	% Share
1	China	43,487	161	72.5
2	Japan	6,627	57	11.1
3	South Korea	3,869	33	6.5
4	India	1,872	34	3.1
5	Hong Kong	1,601	48	2.7
6	Australia	1,369	122	2.3
7	Taiwan	456	24	0.8
8	Malaysia	173	11	0.3
9	Vietnam	139	1	0.2
10	Singapore	118	6	0.2

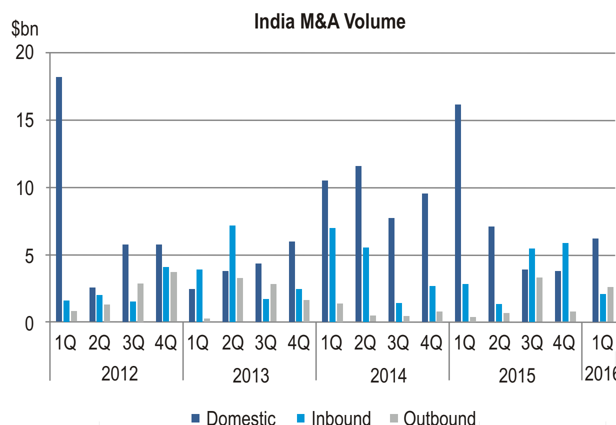
India ECM Volume 1Q 2016				
Pos.	Bookrunner Parent	Deal Value ($m)	No.	% Share
1	Citi	487	3	26.0
2	ICICI Bank	309	5	16.5
3	State Bank of India	262	4	14.0
4	Edelweiss Financial Services Ltd	224	3	12.0
5	Deutsche Bank	207	2	11.0
6	Kotak Mahindra Bank Ltd	75	2	4.0
7	IIFL Holdings Ltd	43	3	2.3
8	IDFC Securities Ltd	38	2	2.0
9	Elara Capital plc	35	1	1.9
10	Fortune Financial Services (India)	29	2	1.6

India IPO Volume 1Q 2016				
Pos.	Bookrunner Parent	Deal Value ($m)	No.	% Share
1	State Bank of India	55	2	14.6
2	ICICI Bank	45	2	11.7
3	IDFC Securities Ltd	38	2	10.0
4	IIFL Holdings Ltd	37	2	9.8
5	Elara Capital plc	35	1	9.3
6	Jefferies LLC	24	1	6.2
6	JPMorgan	24	1	6.2
8	Credit Suisse	21	1	5.5
9	HDFC Bank	20	1	5.3
10	Edelweiss Financial Services Ltd	17	1	4.5

India FO and Conv. Volume 1Q 2016				
Pos.	Bookrunner Parent	Deal Value ($m)	No.	% Share
1	Citi	487	3	32.6
2	ICICI Bank	265	3	17.8
3	Deutsche Bank	207	2	13.9
4	Edelweiss Financial Services Ltd	207	2	13.9
5	State Bank of India	207	2	13.9
6	Kotak Mahindra Bank Ltd	58	1	3.9
7	Fortune Financial Services (India)	29	2	2.0
8	JM Financial Ltd	22	1	1.5
9	IIFL Holdings Ltd	6	1	0.4
10	Systematix Corporate Services	2	1	0.1

Mergers & Acquisitions

- **India** slipped to the fifth targeted nation in **Asia Pacific** region for 1Q 2016 with $8.3bn, down 57% on the $19.3bn announced for 1Q 2015
- India Outbound **M&A** volume increased significantly to $2.6bn for 1Q 2016 compared to $358m for 1Q 2015
- India Inbound **M&A** volume dropped to $2.1bn for 1Q 2016 from the $2.8bn for 1Q 2015
- Domestic **M&A** volume dropped 62% to $6.2bn for 1Q 2016, compared to $16.2bn for 1Q 2015
- **Aditya Birla Group's** acquisition of **Jaiprakash Associate Ltd.'s (Cement business)** for $2.4bn is the largest Indian M&A transaction for the first quarter of 2016

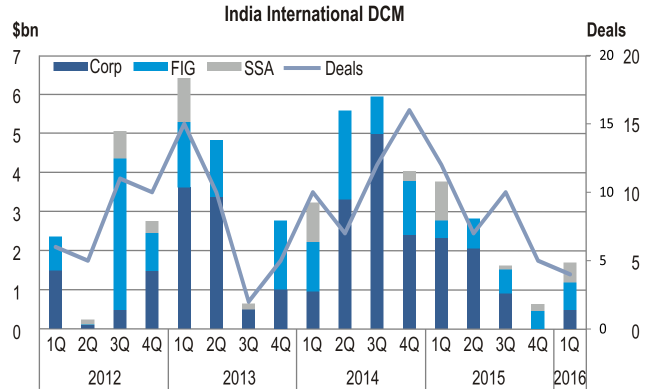


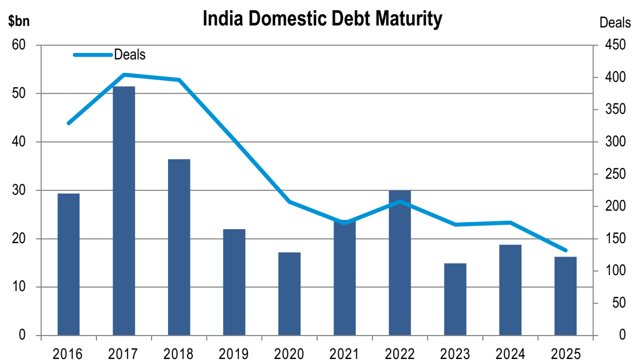
India Announced M&A Advisory Ranking 1Q 2016				
Pos.	**Advisor**	**Value $m**	**# Deals**	**% Share**
1	ICICI Bank	2,381	1	28.8
2	Axis Bank	892	6	10.8
3	State Bank of India	706	1	8.5
3	Morgan Stanley	706	1	8.5
5	Citi	435	3	5.3
6	Goldman Sachs	390	2	4.7
7	Ernst & Young	331	4	4.0
8	Bank of America Merrill Lynch	323	1	3.9
9	KPMG Corporate Finance	116	3	1.4
10	Kotak Mahindra Bank Ltd	114	4	1.4

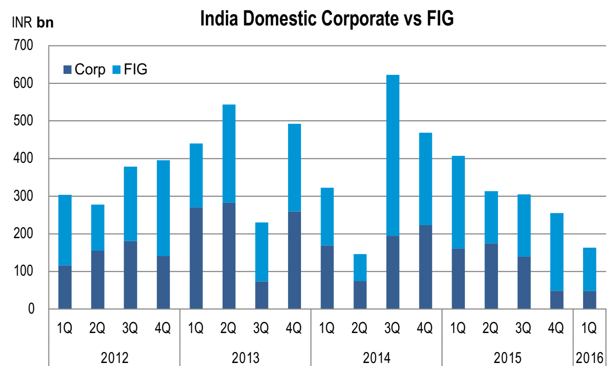
India Announced M&A Attorney Ranking 1Q 2016				
Pos.	**Attorney**	**Value $m**	**# Deals**	**% Share**
1	Vaish Associates Advocates	2,381	1	28.8
2	J Sagar Associates	852	5	10.3
3	Nishith Desai Associates	765	2	9.3
4	AZB & Partners	732	18	8.9
5	Cyril Amarchand Mangaldas	623	4	7.5
6	Shardul Amarchand Mangaldas & Co	618	7	7.5
7	Shearman & Sterling	500	3	6.1
8	Khaitan & Co	460	15	5.6
9	Allen & Overy	300	1	3.6
10	O'Melveny & Myers	100	1	1.2

Debt Capital Markets

- **India DCM** issuance for 1Q 2016 reached $5.8bn (via 78 deals), down 59% on the $14.1bn (via 107 deals) raised in 1Q 2015
- **Corporate IG** and **Agency** bonds accounted for 60% and 26% of the total DCM volume with $3.5bn and $1.5bn, respectively for 1Q 2016
  - **ICICI Bank Ltd.** led the offshore issuer table for 1Q 2016 with a 41.7% share, while **LIC Housing Finance Ltd.** topped the domestic issuer ranking with a 12.8% share
- India Domestic DCM volume reached INR278.8bn for 1Q 2016, down 57% on the INR642.5bn raised in 1Q 2015. Activity decreased to 74 deals during 1Q 2016 from the 95 recorded for 1Q 2015
- International issuance for 1Q 2016 reached $1.7bn, down 55% on the 1Q 2015 volume of $3.8bn. Activity decreased to 4 deals compared to 12 deals for 1Q 2015

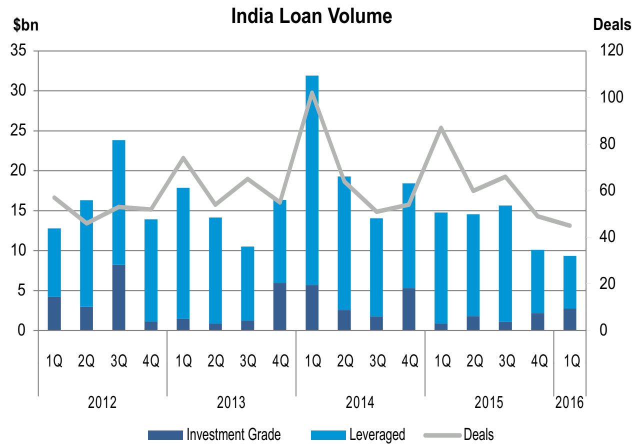


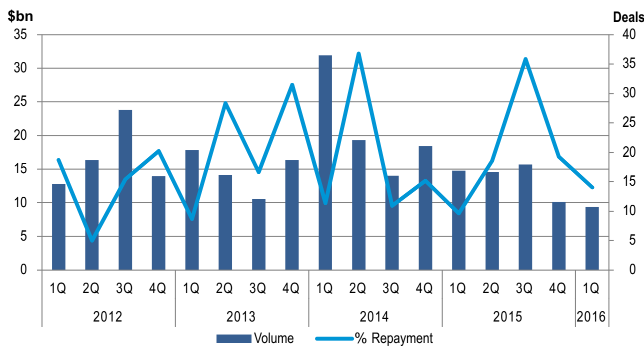


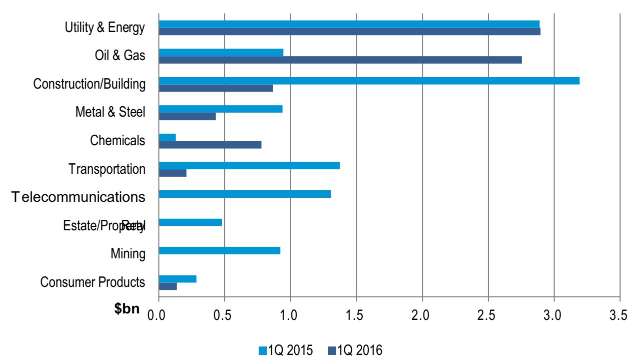


Loan Markets

- **India loan** volume reached $9.4bn (via 45 deals) for 1Q 2016, down 37% on the $14.8bn (via 87 deals) for 1Q 2015
  - **Leveraged** loan volume decreased drastically to $6.6bn via 43 deals, compared to $13.9bn (via 79 deals) for 1Q 2015
  - **Investment grade** loan volume increased considerably to $2.8bn (via 2 deals) versus $883m (via 8 deals) for 1Q 2015
- Among the corporate borrowers, **Utility & Energy** sector topped the industry ranking for 1Q 2016 ($2.9bn) with a 33.6% share
- **ONGC Ltd.'s** $1.8bn investment grade deal in March arranged by **Bank of Tokyo Mitsubishi, Citi, Mizuho** and Sumitomo **Mitsui Banking Corp** is the largest loan transaction for 1Q 2016







Project Finance

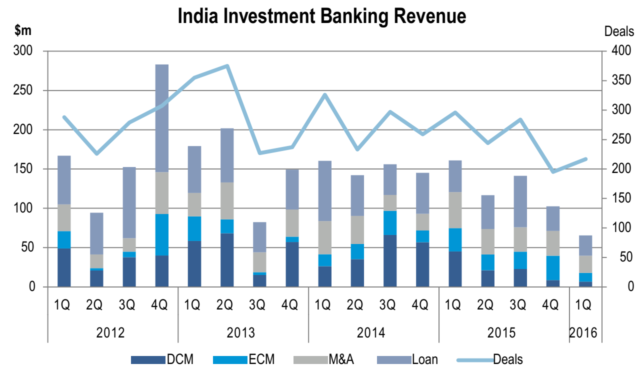
India Project Finance Loans Ranking FY 2015				
Pos.	Mandated Lead Arranger	Value $m	# Deals	% Share
1	State Bank of India	1,124	6	43.3
2	Axis Bank Ltd	573	7	22.1
3	Rural Electrification Corp Ltd	254	1	9.8
4	HDFC Bank Ltd	183	1	7.1
5	ICICI Bank Ltd	180	2	6.9
6	IDBI Bank Ltd	130	1	5.0
7	Kotak Mahindra Bank Ltd	78	1	3.0
8	Export Import Bank of India	42	1	1.6
9	Saraswat Co-operative Bank	28	1	1.1
10	Union Bank of India	4	1	0.2

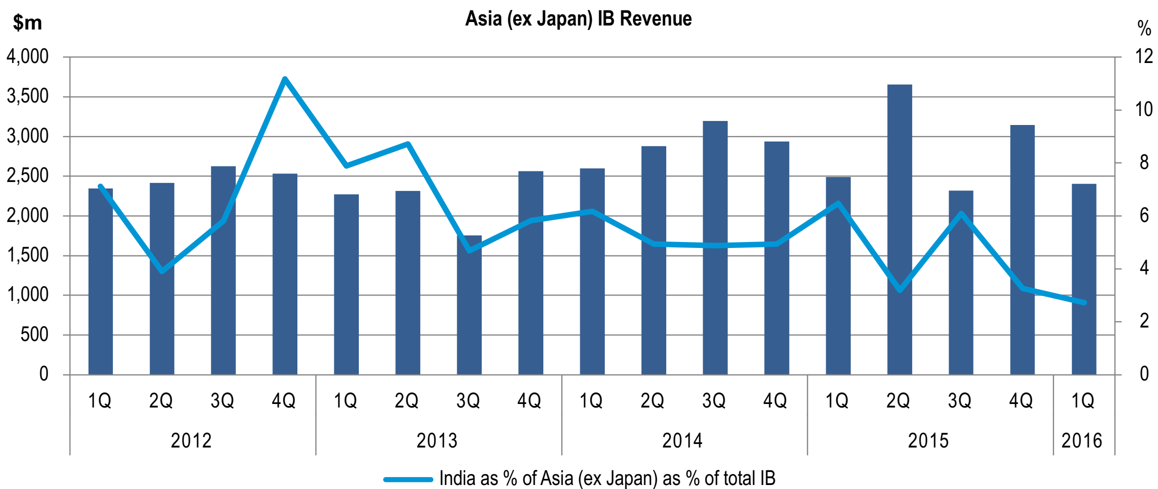
India Sponsor Ranking for Project Finance FY 2015				
Pos.	Sponsor	Value $m	# Deals	% Share
1	Chambal Fertilisers & Chemicals Ltd	708	1	16.8
2	Mytrah Energy Ltd	402	1	9.5
3	Hinduja Energy (India) Ltd	336	2	8.0
4	Hindustan Construction Co Ltd	252	2	6.0
5	Era Infra Engineering Ltd	226	1	5.4
6	Gangavaram Port Ltd	187	1	4.4
7	State of West Bengal	180	1	4.3
8	Diligent Power Pvt Ltd	173	1	4.1
9	Gayatri Projects Ltd	160	1	3.8
10	Hero Wind Energy Pvt Ltd	157	1	3.7

Top 10 Indian Project Finance Deals FY 2015				
Financial Close Date	Borrower	Project Name	Sector	Value $m
5-Mar	Chambal Fertilisers & Chemicals Ltd	Chambal Fertilizer Plant Expansion Project	Petrochemical/Chemical Plant	708
13-Jan	Bindu Vayu Urja Pvt Ltd	Mytrah Energy Wind Farm Portfolio Refinancing	Wind Farm	402
20-Jan	NCC Power Projects Ltd	Andhra Pradesh 1320MW Power Plant Cost Overrun	Power	400
3-Feb	Hinduja National Power Corp Ltd	Hinduja National Power Plant Additional Financing 6	Power	247
8-Mar	Bareilly Highways Project Ltd	Bareilly Highway PPP Project Additional Financing	Road	226
23-Feb	Gangavaram Port Ltd India	Gangavaram Port Expansion PPP Refinancing II	Port	187
7-Jan	West Bengal State Electricity Distribution Co Ltd	West Bengal Power Distribution Working Capital	Power	180
4-Mar	DB Power (Madhya Pradesh) Ltd	Chhattisgarh Thermal Power Plant Phase II Cost Overrun Financing	Power	173
29-Feb	Clean Wind Power (Ratlam) Pty Ltd	Ratlam Wind Power Project Additional Financing	Wind Farm	157
13-Jan	Coastal Gujarat Power	Mundra Ultra Mega Power Project Refinancing	Power	145

IB Revenue

- **India IB revenue** reached $65m for 1Q 2016, down 59% on 1Q 2015 ($161m). Revenue this quarter was also down by 36% compared with 4Q 2015 ($103m)
- **Syndicated Loan fees** accounted for 40% of total India IB revenue for 1Q 2016 with $26m which is down by 36% on the $40m for 1Q 2015
- **DCM revenue** accounted for 10% of total India IB revenue for 1Q 2016 with $7m which is down by 85% on the $45m for 1Q 2015
- **M&A fees** accounted for 33% of the total India IB revenue for 1Q 2016 with $22m which is down by 53% on $46m for 1Q 2015
- **ECM fees** accounting for 17% of the total India IB revenue, decreased 63% to $11m in 1Q 2016 from the $30m for 1Q 2015





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