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Roll No..................................... **OPEN BOOK EXAMINATION**

Time allowed : 3 hours ***Maximum marks : 100***

Total number of questions : 6 ***Total number of printed pages : 8***

NOTE : *Answer* ***ALL*** *Questions.*

1. Read the following case study and answer the questions that follows :

BANKING SCENARIO

Several issues facing the Indian Banking Sector have occupied the attention of policy makers in the last few years. Being a regulator and supervisor of the banks, the Reserve Bank stands committed to ensuring a sound and robust banking system in the country. Emergence of new business models and new technology and its application in banking and finance have thrown up new opportunities.

Finance and Banking have emerged as engines of global economic growth. It is argued, that technology has played a pivotal role in the proliferation of financial services. Cheques, Wire Transfers, ATMs and Credit Cards were important innovations of such nature. Fast forward to more recent times, we are already witnessing yet another paradigm shifts in banking on the back of a technological revolution that promises better customer experience, risk management and returns to shareholders.

Global Banking : Emerging Regulatory Trends.

The global financial crisis represents a watershed for the banking sector. It exposed the inherent vulnerabilities of an otherwise formidable international financial system. The crisis paved the way for an overhaul of the regulatory framework. Long lasting changes in the economic and financial environment, and shift in the competitive landscape of financial services industry.

International standard setting bodies like the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB) were prompt on addressing the shortcomings of the pre-crisis regulatory framework. Consequently, many regulatory norms, including leverage, liquidity and capital adequacy were reviewed as a part of the Basel III reforms aimed at making the global financial system more resilient. Given the initiatives taken by the international bodies, policy makers across jurisdictions have been fulfilling their regulatory framework. These policies are expected to pay back in the medium to long run by enhancing the soundness and resilience of the global banking system.

More recently, with the global growth slowdown that began in 2018, credit growth, being pro-cyclical has decelerated across major economies. Thus, in turn, has adversely affected bank profitability. Despite distinct improvement in asset quality, structured weakness continued over reliance on investment in government securities in the Euro area and wholesale funding in many advance economies. Nevertheless, capital position of banks has improved consistently in major advanced and emerging market economics on the back of various regulatory reforms introduced after the global financial crisis.

Indian Scenario :

At the Reserve Bank of India, the Banks have largely complied with Basel Standards. In terms of recent progress, the India banking sector is slowly turning around on the back of improvements in assets quality with enhanced resolutions through the Insolvency and Bankruptcy Code (IBC). Despite the recent decline in impaired assets and a significant improvement in provisioning, profitability of the banking sector remains fragile. Capital position of banks has, however, improved on account of recapitalisation of public sector banks by the Government and Capital raising efforts by private sector banks. Nevertheless, the sector continues to encounter challenges from events like these around the telecom sector. Consequently, the overhang of Non-Performing Assets (NPAs) remains relatively high which is weighing on credit growth. Also in view of subdued profitability and deleveraging by certain corporates, risk averse banks have shifted their focus away from large infrastructure and

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industries loans towards retail loans. This diversification strategy, while helpful in risk mitigation tool, has its own limitations. The banking stability indicator, as reported in RBI's Financial Stability Report of December 2019, shows an improvement.

Emerging Structure of Banking :

While global banking system is still in the process of addressing the gaps exposed by financial crisis, new issues have surfaced and challenged the traditional banking business. Globally banks are facing increasing competition from non-traditional players, which are taking advantages of digital innovation. Banking structures across the globe are adapting to these new impulses. Numerous Fintech Start-ups are spanning the banking financial services industry. Through collaborations with Fintech players, several banks are applying a hybrid model where mobile services interact with banking services.

Banks are not only facing competition from Fintech Companies but also from large technology. Companies (Big Techs) which are entering into financial services industry in a big way. At present, financial services are only a small part of their business globally. But given their size and reach their entry into financial services has the potential to bring about rapid transformation of the financial sector landscape. It may, of course, bring many potential benefits. These developments pose a challenge to banks as well as banking regulators. A very different banking sector is emerging in terms of structure and business model, in the coming years.

So, what would be a possible scenario in India ?

Distinct segments of banking institutions may emerge in the coming years comparing a few large Indian Banks, several mid-sized banking institutions, smaller banks and the digital player who may act as service provider directly to customers or through banks by acting as their agents or associates. The reoriented banking system will of course be characterised by a continuous of banking. The banking space would also include both traditional players with strong customer base and new technology led players.

In the contest of the emerging scenario, a properly worked out consolidation of Public Sector Banks can generate synergies in allocation of workforce and branches as well as streamlining of operations to meet the future challenges.

Ultimately the strength of a banking system depends on the strengths of its corporate governance that fosters a robust and ethics driven compliance culture. In this contest the Reserve Bank has been issuing instructions on corporate governance.

Digital Disruptions :

Besides structural Changes, digital disruption will continue to transform the banking sector, initiatives undertaken by the Government, the Reserve Bank and the Industry have led to a radical shift towards ubiquitous digitalisation, which has provided an impetus to adoption of technology. These is a unique confluence of several positions like demographic dividend, JAM trinity, etc. that would further support rapid digitalisation of financial services in India. With traditional business, banks are expanding into newer areas such as insurance, asset management, brokerages and other services.

In the light of these developments, conventional banking is making way for next generation banking with a focus on digitalisation and modernisation. The movement towards digital payments has also been facilitated by introduction of fast payment system, such as Immediate Payment Service (IMPS), and Unified Payment Interface (UPI), which provide immediate credit to beneficiaries and are available round the clock. There is considerable interest at international fora to understand and learn from Indian experience in furthering digital payments (via NEFT, UPI etc). The National Payment Corporation of India (NPCI) has also decided to set up a subsidiary to focus on taking the UPI model to other countries which will help enhance global outreach of India's payment systems.

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Strengthening Regulation and Supervision

In the contest of ever expanding dimensions of the banking sector in the 21st century, we need to be aware of the extensive regulatory and supervisory reforms essential for ensuring stability and inclusiveness of the banking sector. It has been RBI's endeavour to constantly improve the efficacy of its supervisory and regulatory functions, so that the resilience of the regulated financial entities can be enhanced. A number of steps have been taken on the recent past in this regards. Appropriately recognising the systemic importance of Non-Banking Financial Companies (NBFCs) and their outer linkages with the financial systems, the Reserve Bank has taken necessary steps to ameliorate the concerns relating to their asset quality and liquidity. As regards the co-operative banking segment, Reserve Bank has developed a robust stress testing framework for Urban Cooperative Banks (UCBs) and taken several other measure.

Way Forward :

The changing landscape of the Banking Industry will unfold in the backdrop of a strong regulatory and supervisory regime with increased intensity and tech enabled supervision of banks. The challenge before the banks is to make the best use of technology and innovation to bring down intermediation costs, while protecting their bottom lines. Further Artificial Intelligence (AI), Machine Learning (ML) and Big Data are becoming central to financial service innovations. One of the challenges for policy maker, especially in countries like India, is to ensure that new innovations in banking sector serve the customer by reducing the cost of financial services and enhancing the range and access to products in a manner that is safe. Advanced analytics and real time monitoring of emerging cyber security risks will be critical in detecting potential threats and enabling pre-emptive action.

As the Indian Banking Sector is propelled forward to a higher orbit, banks would have to strive hard to remain relevant in the changed economic environment. The possibilities are enormous. We should be seized of the issues and act in time.

Questions :

(*i*) Many regulatory norms including leverage, liquidity and capital adequacy were reviewed as part of the Basel III reforms aimed at making the global financial system more resilient. Enumerate briefly such Basel III regulatory reforms. To what extent these Basel III reforms were implemented in India ?

(*ii*) What are the major issues facing, the India Banking Sector in recent times ? How to address the issue of NPAs ?

(*iii*) How the technology has played a pivotal role in the proliferation of financial service ? There is evidence that Fintech Companies are acting as enablers in the banking ecosystem. Elucidate.

(*iv*) Distinct segments of banking institutions may emerge in the coming years. What would be a possible scenario in India ? What are likely benefits of consolidation of Public Sector Banks ? Where the focus has to be ?

(*v*) What are the challenges ahead for the Banks ? As the Indian Banking Sector is propelled forward to a higher orbit, banks would have to strive hard to remain relevant in the changed economic environment. How ?

(*10 marks each*)

2. (*i*) The Rimjhim Traders, an Indian Importer Company has to settle an import bill of \$ 1,30,000. The exporter has given two options to the importer :

Pay immediately without any interest charges, or

Pay after three months with interest @ 5% per annum.

The importer's bank charges : 15% per annum on overdraft.

The exchange rates in the market are as follows :

Spot rate for \$ 1	: ₹ 48.35/48.36
3-Months forward rate for \$ 1	: ₹ 48.81/48.83

The importer company seeks your advice. Give your advice with reasons.

(*10 marks*)

(*ii*) Explain the terms Spot Rate, Forward Rate and Cross Rate with reference to foreign exchange.

(*10 marks*)

(*iii*) (*a*) What is hedging ? What purpose does it serve ?

(*b*) Name some instruments for containing risk in foreign exchange transactions.

(*5+5=10 marks*)

3. Elaborate the role of the Board of Directors, Chairman and/or CEO and committees of the Board in Governance matters. List some of the important Committees of the Board constituted in banks for governance.

(*5 marks*)

4. State that in what forms the working capital finance may be granted by the Banks ?

(*5 marks*)

5. Enumerate the important facilitators in the primary market issues ? What is the role of Foreign Institutional Investors (FIIs) and Qualified Institutional Buyers (QIBs) in the financial markets ?

(*5 marks*)

6. State the legal framework enacted for different categories of banks in India.

(*5 marks*)

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