"Banking, Insurance and Financial Sector—A vision of the Future"

By Shri G.N. Bajpai, Chairman, Securities and Exchange Board of India On January 4, 2002 At 15th All India Conference of Chartered Accountants-2003 New Delhi, India

Tommorrow, the most precious word in the Banking, Insurance and Financial Services World would be the "Integration"; Integration of the opportunity zones to unleash the values buried in their interlinkages.People would talk more and more about outsourcing, strategic alliances, leveraging and networking……

Introduction:

Financial markets are a part of the changing business paradigms, across the globe. In fact, the financial markets are the first to unleash the creativity and imagination and lead the revolution. Today, globalization of competencies, thinking and perspectives has been the part of Strategic Action Plan of all the major players in the financial markets, globally.

The cut throat competition across the market operators and the pressure to perform by the stakeholders has resulted in competition being fiercer than ever before. I think, both the business landscape and chemistry of the competition has changed significantly over the period of time. All around, there is a fresh thinking on the financial products, structure of market players and possibilities for value creation. I would say Financial Markets are being redefined, reinvented and reconfigured on a persistent basis.

Changing paradigms of the Banking, Insurance and Financial Services

Today, Financial Markets are turbulent, globally. Traditional business models when businesses were clearly differentiated- Banks conducted banking, insurance companies offered risk covers and securities companies offered investment opportunities, have become the footnotes of the finance literature. Today, insurance companies are exploring values in the banking and investment products and vice versa. It is no more a bank competing with another bank and insurance company competing with another insurance company, but an insurance competing with bank and what not. Hence, to my mind, the most precious word today is the "convergence" of the opportunity zones in Financial Markets from concept to culmination.

It may be observed that the competitive dynamics of market has changed phenomenally. Today, players in the market compete in one segment and co-operate in other segment. Strategic alliances of the competing banks on the ATM infrastructure is a live example of that. Today, Mutual Funds compete with the Banks on deposits, as they too provide the cheque facility with certain limitations. Revolutionary waves have gone to the extent of providing the ATM facility to the Mutual Funds investors. It is very interesting to observe the competition mounting across the opportunity zones because that encourages people to improve and deliver better values to the market leading to growth of overall productivity of the nation.

Another example here is that of the insurance products. You would observe that the buyer of the insurance products also looks at them as the investment products. This is an issue of conditioning over the period of time and therefore, the customers of the insurance products are both the customers of the risk protection and the investment products. That leads to the insurance sector competing with the other avenues of the investment including banks, financial institutions and investment companies.

The structure of the players in different opportunity zones is also changing on continuous basis. Corporate marriages, exchange's mergers, clearing corporations alliances, regulator's integration, globally, bear testimony to it. Convergence of the financial products is also apparent, everywhere.

As an example, let us look at the securities brokers. They are no more securities brokers, they are the brokers exploring opportunities across different dimensions of the economy. Similarly, enterprises in the finance are talking about one stop shop offering all the products ranging from commodities to securities to currencies under one roof. This change in business models is necessitated by the values buried in the interlinkages of the opportunity zones, emerging from economies of scale and economies of scope.

On exchanges side, more and more products are migrating to the exchanges for trading. Globally, availability of all sorts of financial products (both money market and capital market) on the exchanges is driven by the benefits like transparency, better price discovery, wider dissemination of information and large investing community. Mergers of the exchanges is adding to all these dimensions, globally. Creation of the Euronext (merger of Amsterdam Stock Exchange, Paris Stock Exchange and Brussels Stock Exchange), Singapore Exchange Ltd. (merger of Stock Exchange Singapore and Singapore Mercantile Exchange (SIMEX)) and OneChicago (alliance of Chicago Mercantile Exchange (CME), Chicago Board of trade (CBOT) and Chicago Board Options Exchange (CBOE) are the live examples.

Similar trend may be observed on the clearing and settlement side. Merger of the two major clearing corporations at the global level, Cedel International and Deutsche bourse clearing corporations to form Clearstream, is an example of that. Concept of single clearing corporation supporting large number of trading platform with clearing and settlement facility is being acknowledged at the global level, purely based on its value creating capabilities. Ratings of the Clearing corporations has also added a fuel to the business dimension and players in the market are exploring the opportunities to become strong through strategic alliance.

On regulators side, deeper co-ordination has become a respectable word. Creation of the Financial Services Authority by merger of all the regulators in the economy, in U.K., has set the precedent in itself. Now, number of countries, across the globe, are thinking on these lines. Recently, Germany has joined the U.K. through creation of the Financial Services Supervisor, a combined regulatory authority for the banking, securities and insurance. Logic is simple- Integration of the opportunities zone demands for a flexible, efficient and effective supervisory regime. This can be accomplished either through the effective co-ordination among the regulators of the creation of single regulatory body. Some economies are choosing the first and some second.

Further, Financial innovation is becoming ubiquitous. Availability of the financial products, linked to the temperature, earthquake, snow fall, rain fall, hailstorm and what not communicates that there is huge room for creativity in this area. Today, anything and everything is being traded in the market. Emergence of the areas like credit derivatives, real options, securitizations is paving an entirely fresh set of opportunities for the market. There is a huge room for the Structured and Synthetic Products in the Indian Market. To me it appears, Market is in for an exciting phase, in terms of the financial innovations.

Today, investors are to be perceived as not just the investors but buyers of the financial solutions to perceived and even envisioned problems. Therefore, the philosophy of customer being king is driving the financial markets as well. Accordingly, it is no more customers chasing the products; it is the appropriateness of options chasing the customers. Today, financial institutions are co-designing the products/services with their customers and striving to provide them with global solutions. Simplification of the customers' life is being priced by the market. Look at what Virgin Bank is doing. It provides all the services to its customers including checking account to savings account to housing loan to car loan to credit card etc… with single bank account. I think, it is pretty interesting.

Technology is also helping market players redefine the way they have been operating in the market. See today, banks are taking ATM machines to the customers – indeed a noble concept. Availability of the concepts like phone banking, anytime banking etc. has been possible because of the technological developments only.

Adding to all I said earlier, strategic alliances between the market participants across the segments is quite apparent in the market. You may see a real estate products provider having alliance with both, banks for the financing and insurance companies for the risk management products, for his customers. The good dealers are providing both the finances and insurance to their customers. The case in example is airline's tickets having insurance embedded in it. Latest and very interesting phenomenon is that Holiday Inn is building a hotel in Texas, wherein entry to the room will be through the credit card. The idea is that when the credit card can get the customers cash, why not let them have entry to the hotel through credit card-absolutely hassle free check in and check out. Are not markets undergoing a profound fundamental changes.

Imperatives for success:

In this era of fierce competition, it has become extremely imperative for all of us to weave clear out strategy to deal wit these changing dimensions of the business landscape in Financial Services. We need to strengthen each link in the value chain and move with a clear cut vision to deliver values in the market. Therefore, I would feel we need to be competitive at all the levels individual, corporate, economy and regulatory.

Competitiveness at the individual level- It may be apparent that nothing but the change is stable in the world. It offers both the opportunities and the challenges to the

individuals. It is for the individuals to choose what do they look at. According to me, change is nothing but an exciting opportunity to reposition oneself. Understand that the driving force behind any repositioning is change. This repositioning may be because of the survival crisis created by the unanticipated change or the excitement offered by the change in terms of the unlimited opportunities not visible with the naked eyes.

We all need to appreciate that future is never the extrapolation of the past. It is absolutely unpredictable, discontinuous and non-linear. That is where the excitement lies to the leading professionals in the market. They understand that the future is what they shape up now. That is why they don't talk about predicting future, they talk about imagining future and having imagined creating it. They create future in the literal sense. Leaders also appreciate that there is nothing called sustainable leadership in this ever changing world and they have got to be extraordinarily competitive to sustain and lead the revolution on the persistent basis.

In this increasingly competitive and complicated business environment, it is imperative for individuals to primarily focus on value creation through the continuous improvement in their own competence levels. They also need to cultivate and nurture leadership and ethical practices. Only an appropriate mix of the competence, leadership and ethical practices would ensure the long term growth of individuals, add value to their contribution, keep them relevant to emerging ethos and save them from getting buried in the debris of obsolescence.

Competitiveness at the corporate level- I would convey to the corporates to do fewer things but do them better than the best, globally. Corporates need to appreciate that no one can internalize the versatility of competencies. Hence, it would be imperative for them to leverage, outsource, network and create strategic alliances with others. Further, they need to think without precedents as precedents create risk of traditional thinking and withhold the imagination from running radical and development of fundamentally great and different products and services. They need to be different faster than being better and be better faster than being smaller. They need to go beyond known paradigms to be the path-breakers and secure a place at the international platform.

Today, businesses are no more businesses, these are battles of competencies. Indeed, there is a competition for the competence in the market. Fortunately or unfortunately, success or failure of a market player, in this battle for competence determines his potential for growth and the competitive differentiation. Hence, companies need to strategize and re-strategize almost on the continuous basis. They need to persistently strengthen their existing knowledge and acquire/create new knowledge, compatible with the existing one, as quickly and as inexpensively as possible, to continue leading in the opportunity zones. Tomorrow, their competitive position in market place would depend on the speed with which they run on the learning curve, discover the new frontiers of the knowledge in all dimensions of their operations and then think creatively and imaginatively on the strategic ways to transform this accumulated knowledge into the value delivering proposition. It should be understood that the existence of knowledge does not ensure success; corporations must also possess the capabilities to leverage on that knowledge to create values.

Competitiveness at the regulators level – In this changed business ethos, regulations too demand a in-jaundiced perspective. Regulators can not deal with the complexities of the 21st century business environment with the 20th century rules, regulations and rudimentary perspective. We can not shoot a moving target with a static gun position. Therefore, in this era of revolution across the globe, regulations should be enterprising, forward looking and evolutionary in nature.

I believe regulators' must cast off the myopic view. Regulators' focus should shift from the regulations to the Development of the Markets. In my view, Regulations just happen to be incidental to the development. This change in the regulators' focus would bring in the paradigm shift in their approach, which would facilitate their transition from being enforcement oriented, reactive, adversarial, incident driven and hard to compliance, partnership oriented, preventive, problem solving and soft.

What I am suggesting is that the regulations should define the broad framework/ parameters for the game and within that framework, market participants should be allowed to operate without any intervention. This approach is all about having the confidence in the market and systems. Now, the challenge is to ensure that the people don't play foul with the game. Protection of the system's integrity through architecting proper risk management system is another challenge before the regulators. This demand regulators to make tactical choices with regard to the tools, best time intervention and regulatory style to fit the audience.

Further, the convergences of the financial activities and the emergence of new age one stop financial institutions have resulted in a titanic challenge to the regulators, internationally. They need to co-operate at a level more than ever before. They need to strike an intelligent balance between the safety of the markets, under their reg-

ulatory jurisdiction, and the creative initiatives of the market participants. No matter what, market should be given a fair opportunity to explore the avenues for the expansion and growth because that would result in the competition in various opportunity domains and thus emergence of better values to the ultimate customers. The capabilities of the regulatory infrastructure and competencies of the human resources have necessarily to keep pace with the regulatees.

Competitiveness at the economy level- We all heed to strategize to position "India Incorporation" at the Global level. According to me, we need to come out of the thinking of being a developing country because 'developing' is a mind-set. There are areas where India is globally competitive. Our biggest strength is the educated, trained and skilled man-power- the scientific minds. We have proved that by exhibition of resilience of Indian economy even in the midst of global meltdown stemming out of collapse of far eastern economics and troubled Latin American economies. We need to focus on our strengths and identify the weak links in the economy chain an dent them with determination. We have entrepreneurial acumen to make India a giant figure at the global canvas. I strongly believe, we have potential to do so. A perception is steadily growing about India being a dynamic market among the emerging economies.

Conclusion:

To conclude, I would say that the opportunity zones in Financial Markets are contracting somewhere and at the same time expanding elsewhere. Change and the pace of change in the financial markets, both would be different, tomorrow. Continuous exploration of scopes and exploitation of values would demand a brilliant focus on emerging opportunities, competence building, strategies for the leadership position in the opportunity zones and principles centered business practices. Therefore, we need to create a culture, which embraces change and move ahead with an objective to lead. ■

Notification

DBOD.No.BP.BC.44/21.04.048/2002-2003

November 30, 2002
All Scheduled Commercial Banks
(excluding RRBs and LABs)

Dear Sir,

Prudential norms on income recognition, asset classification and provisioning – agricultural loans affected by natural calamities

Please refer to our Rural Planning and Credit Department's circular No.RPCD. PLFS.BC.46/05.04.02 (DROUGHT)/2002-2003 dated November 15, 2002 advising banks not to effect recovery of any amount either by way of principal or interest during the current financial year in respect of Kharif crop loans in the districts affected by failure of the South-West monsoon as notified by the State Governments. Further, the principal amount of crop loans in such cases should be converted into term loans and will be recovered over a period of minimum 5 years in case of small and marginal farmers and 4 years in case of other farmers. Interest due in the current financial year on crop loans should also be deferred and no interest should be charged on the deferred interest.

2. In view of the above, we advise that in such cases of conversion or reschedulement of crop loans, the term loans may be treated as current dues and need not be classified as NPA.

3. The asset classification of these loans would thereafter be governed by the revised terms and conditions and would be treated as NPA if interest and/or instalment of principal remain unpaid for two harvest sessons, not exceeding two half years, as indicated in our circular DBOD.No.BP.BC.59/21.04.048/2001-2002 dated January 22, 2002.

4. Please acknowledge receipt

Your faithfully
(B.Mahapatra)
General Manager