Banking System in India-I

A commercial bank is a type of financial intermediary. It is a financial intermediary because it mediates between the savers and borrowers. It does so by accepting deposits from the public and lending money to businesses and consumers. Its primary liabilities are deposits and primary assets are loans and bonds.

"Commercial bank" has to be distinguished from another type called "investment bank". Investment banks assist companies in raising funds in the capital markets (both equity and debt), as well as in providing strategic advisory services for mergers, acquisitions and other types of financial transactions. It is also called merchant bank.

The commercial banking system in India consists of public sector banks; private sector banks and cooperative banks.

Currently, India has 88 scheduled commercial banks (SCBs) - 26 public sector banks (that is with the Government of India holding majority stake) that include SBI and its associates and the IDBI Bank; there are private banks and foreign banks also. Public sector banks hold over 75 percent of total assets of the banking industry, with the private and foreign banks holding 18.2% and 6.5% respectively

Public Sector Banks

They are owned by the Government- either totally or as a majority stake holder.

- State Bank of India and its five associate banks called the State Bank group
- 19 nationalised banks(earlier there were 7 associate banks but recently 2 were merged with SBI- SB of Saurashtra and Indore)
- Regional Rural Banks mainly sponsored by Public Sector Banks

Private Sector Banks include domestic and foreign banks

Co-operative Banks are another class of banks and are not considered as commercial banks as they have social objectives and profit is not the motive. (Explained later)

Reserve Bank of India lays down the norms for banking operations and has the final supervising power.

Development Banks

Development Banks are those financial institutions which provide long term capital for industries and agriculture : Industrial Finance Corporation of India (IFCI) ;Industrial Development Bank of India (IDBI) ;Industrial Credit and Investment Corporation of India (ICICI) that was merged with the ICICI Bank in 2000 ;Industrial Investment Bank of India (IIBI) ;Small Industries Development Bank of India (SIDBI) ;National Bank for Agriculture and Rural Development (NABARD) ;Export Import Bank of India ; National Housing Bank(NHB).

The commercial banking network essentially catered to the needs of general banking and for meeting the short-term working capital requirements of industry and agriculture. Specialised development financial institutions (DFIs) such as the IDBI, NABARD, NHB and SIDBI, etc., with majority ownership of the Reserve Bank were set up to meet the long-term financing requirements of industry and agriculture. To facilitate the growth of these institutions, a mechanism to provide concessional finance to these institutions was also put in place by the Reserve Bank.

The first development bank in India- IFCI- was incorporated immediately after Independence in 1948 under the Industrial Finance Corporation Act as a statutory corporation to pioneer institutional credit to medium and large-scale. Then after in regular intervals the government started new and different development financial institutions to attain the different objectives and helpful to five-year plans.

Government utilized these institutions for the achievements in planning and development of the nation as a whole. The all India financial institutions can be classified under four heads according to their economic importance that are:

- All-India Development Banks
- Specialized Financial Institutions(SIDBI)
- Investment Institutions (The Industrial Reconstruction Corporation of India Ltd., set up in 1971 for rehabilitation of sick industrial companies)
- State-level institutions(SFC)

S.H.Khan committee appointed by RBI(1997) recommended to transform the DFI (development finance institution) into universal banks that can provide a menu of financial services and leverage on their assets and talent.

Bank Nationalization

In 1969 and again in 1980, Government nationalized private commercial banking units for channelizing banking capital into rural sectors; checking misuse of banking capital for speculative purposes; to shift from `class banking' to `mass banking'(social banking); and to make banking into an integral part of the planning process of socio-economic development in the country. Today, no other developing country can boast of a banking system comparable to India's in terms of geographic coverage, operational capabilities, range of services and technological prowess.

Commercial Banks

Today banks are broadly classified into two types - Scheduled Banks and Non-scheduled Banks

Scheduled banks are those banks which are included in the Second Schedule of the Reserve Bank Act, 1934. They satisfy two conditions under the Reserve Bank of India Act

- paid-up capital and reserves of an aggregate value of not less than Rs 5 lakh
- it must satisfy RBI that its affairs are not conducted in a manner detrimental to the depositors.

The scheduled banks enjoy certain privileges like approaching RBI for financial assistance, refinance etc and correspondingly, they have certain obligations like maintaining certain cash reserves as prescribed the RBI etc. The scheduled banks in India comprise of State Bank of India and its associates (8), the other nationalised banks (19), foreign banks, private sector banks,co-operative banks and regional rural banks. Today, there are about 300 scheduled banks in India having a total network of 79,000 branches among them.

Non-scheduled banks are those banks which are not included in the second schedule of the RBI Act as they do not comply with the above vriteria and so they do not enjoy the benefits either.

There are only 3 non-scheduled commercial banks operating in the country with a total of 9 branches.

In sum, all banks which are included in the Second Schedule to the Reserve Bank of India Act, 1934 are Scheduled Banks. These banks comprise Scheduled Commercial Banks and Scheduled Co-operative Banks.
Scheduled Commercial Banks in India are categorised into five different groups according to their ownership and / or nature of operation. These bank groups are (i) State Bank of India and its Associates, (ii) Nationalised Banks, (iii) Private Sector Banks, (iv)Foreign Banks, and (v) Regional Rural Banks. In the bank group-wise classification, IDBI Bank Ltd. has been included in Nationalised Banks.

Cooperative Banks

Co-operative Banks are organised and managed on the principle of co-operation, self-help, and mutual help. They function with the rule of "one member, one vote" and on "no profit, no loss" basis. Co-operative banks, as a principle, do not pursue the goal of profit maximisation.

Co-operative bank performs all the main banking functions of deposit mobilisation, supply of credit and provision of remittance facilities.

Co-operative Banks provide limited banking products and are functionally specialists in agriculture related products. However, co-operative banks are now provide housing loans also.

Urban Co-operative Banks (UCBs) are located in urban and semi-urban areas. These banks, till 1996, were allowed to lend money only for non-agricultural purposes. This distinction does not hold today. Earlier, they essentially lent to small borrowers and businesses. Today, their scope of operations has widened considerably. Urban CBs provide working capital, loans and term loan as well.

Co-operative banks are the first government sponsored, government-supported, and government-subsidised financial agency in India. They get financial and other help from the Reserve Bank of India, NABARD, central government and state governments. RBI provides financial resources in the form of contribution to the initial capital (through state government), working capital, refinance.

Co-operative Banks belong to the money market as well as to the capital market- they offer short term and long term loans.

Primary agricultural credit societies provide short term and medium term loans. State Cooperative Banks (SCBs) and CCBs (Central Cooperative Banks at the district level) provide both short term and term loans. Land Development Banks (LDBs) provide long-term loans.

Long term cooperative credit structure comprises of state cooperative agriculture and rural development bank (SCARDB) at the state level and primary PCARDBs or branches of SCARDB at the decentralised district or block level providing typically medium and long tem loans for making investments in agriculture, rural industries, and lately housing. The sources of their funds (resources) are ownership funds

- deposits or debenture issues.
- central and state government
- Reserve Bank of India
- NABARD
- other co-operative institutions

Some co-operative bank are scheduled banks, while others are non-scheduled banks. For instance, SCBs and some UCBs are scheduled banks (included in the Second Schedule of the Reserve Bank of India Act)

Co-operative Banks are subject to CRR and SLR requirements as other banks. However, their requirements are less than commercial banks.

Although the main aim of the co-operative bank is to provide cheaper credit to their members and not to maximize profits, they may access the money market to improve their income so as to remain viable.

Prakash Bakshi Committee

In August 2012, Reserve Bank of India constituted a committee to suggest ways to strengthen the rural co-operative credit structure.The panel, headed by Nabard Chairman Prakash Bakshi, will review the existing short-term co-operative credit structure (STCCS), focussing on structural constraints in the rural credit delivery system. It will also explore ways to strengthen the rural co-operative credit architecture. The seven-member panel will make an in-depth analysis of the STCCS, and examine various alternatives with a view to reducing the cost of credit.The STCCS targets the credit requirement of the small and marginal farmers in the country.It will mainly assess the role played by State and district cooperative banks in fulfilling the requirement of agriculture credit.

Commercial banks and their weaknesses by 1991

The major factors that contributed to deteriorating bank performance upto the end of eighties were

- high SLR and CRR locking up funds
- low interest rates charged on government bonds
- directed and concessional lending for populist reasons
- administered interest rates and
- lack of competition.

The reforms to set the above problems right were

- Floor and cap on SLR and CRR removed in 2006
- interest rates were deregulated to make banks respond dynamically to the market conditions. Even SB rates were deregulated in 2011
- near level playing field for public, private and foreign banks in entry

- adoption of prudential norms- Reserve Bank of India issued guidelines for income recognition, asset classification and provisioning to make banks safer
- Basel norms adopted for safe banking
- VRS for better work culture and productivity
- FDI upto 74% is permitted in private banks

One of the sectors that has been subjected to reforms as a part of the new economic policy since 1991 consistently is the banking sector. The **objectives of banking sector reforms** have been:

- to make them competitive and profitable
- to strengthen the sector to face global challenges
- sound and safe banking
- to help them technologically modernize for customer benefit
- make available global expertise and capital by relaxing FDI norms.

Narasimham Committee

Banking sector reforms in India were conducted on the basis of Narasimham Committee reports I and II (1991 and 1998 respectively). The recommendations of Narasimham committee 1991 are

No more nationalization

- create a level playing field between the public sector, private sector and foreign sector banks
- select few banks like SBI for global operations
- reduce Statutory Liquidity Ratio(SLR) as that will leave more resources with banks for lending
- reduce Cash Reserve Ratio(CRR) to increase lendable resources of banks
- rationalize and better target priority sector lending as a sizeable portion of it is wasted and also much of it turning into non-performing asset
- introduce prudential norms for better risk management and transparency in operations
- deregulate interest rates
- Set up Asset Reconstruction Company(ARC) that can take over some of the bad debts of the banks and financial institutions and collect them for a commission .

Most of these reforms are implemented except priority sector lending which is welfare-based and relates to agriculture. SLR is 23% today and CRR is 4.75%. Bank rate is aligned with MSF.(2012)

Divestment in public sector banks led to their listing on the stock exchanges and their performance has improved.

NPAs

Non-performing assets are those accounts of borrowers who have defaulted in payment of interest or installment of the principal or both for 90 days at least.

In 2003, NPAs stood at 9% and came down to 2.5% in 2008 but rose as economy slowed down since 2011.

Reflecting the stress in India Inc, net non-performing assets (NPAs) of banks at the aggregate level rose to Rs 60,100 crore at the end of March 2012.

One of the main reasons for this sharp jump in NPAs is the loans due to state electricity boards and also Air India. On the sectoral front, metals, textiles and infrastructure sectors were among the major ones to contribute to this slide.

The sharp rise in NPAs in the banking system, although was expected, has taken a toll on the stock prices of most of these banks.

PSU banks have seen their loans go bad at a faster rate than their private sector peers, the latter have been steadily improving their asset quality over the years.

RBI rules require that banks should set aside certain amount of money(provisioning) for the NPAs. Gross NPAs include the amount due along with the amount provisioned. Net NPAs include only the amount due.

NPAs are largely a fallout of banks' credit appraisal system, monitoring of end-usage of funds and recovery procedures. It also depends on the overall economic environment like the global recession since 2008, the business cycle and the legal environment for recovery of defaulted loans. Wilful default; priority sector problems among the poor etc are also responsible.

High levels of NPAs means: banks' profitability diminishes; precious capital is locked up; cost of borrowing will rise as lendable assets shrink; stock prices of banks will go down and investors will lose; investment suffers etc.

NPAs are classified as sub-standard; doubtful and loss making assets for provisioning requirements.

The following are the RBI guidelines for NPAs classification and provisioning:
Sub Standard Assets – These are those accounts which have been classified as NPAs for a period less than or equal to 18 months.

Doubtful Assets –These are those accounts which have remained as NPAs for a period of 12 months.

Loss Assets – Such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value. But a loss asset has not been written off, wholly or partly.

What is being done

- provisioning
- CAR norms
- norms
- one time settlement
- debt recovery tribunals
- securitization law
- foreclosure
- interest waiver
- writeoffs

Foreclosure means taking over by the lender of the mortgaged property if the borrower does not conform to the terms of mortgage.

Securitization is the process of pooling a group of assets, such as loans or mortgages, and selling securities backed by these assets.

SARFAESI Act 2002

To expedite recovery of loans and bring down the non-performing asset level of the Indian banking and financial sector, the government in 2002 made a new law that promises to make it much easier to recover bad loans from willful defaulters. Called the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002(SARFAESI) , the law has given unprecedented powers to banks, financial institutions and asset reconstruction/securitization companies to take over management control of a loan defaulter or even capture its assets.

Asset Reconstruction Company

Normally banks and FIs themselves recover the loans. But in the case of bad debts (sticky loans), it is outsourced to the ARCs who have built-in professional expertise in this task and who handle recovery as their core business. ARCs buy bad loans from banks and try to restructure them and collect them. Arcs were recommended by Narasimham committee II. ARCIL- the first asset reconstruction company was set up recently.

Prudential Norms

Prudential norms relate to

- income recognition
- asset classification
- provisioning for NPAs
- capital adequacy norms(capital to risk-weighted asset ratio, CRAR).

A proper definition of income is essential in order to ensure that banks take into account income that is actually realized(received) . It helps in classifying an asset as NPA in certain cases. Once classified as NPA, funds must be set apart to balance the bank's operations so as to maintain safety of operations in case of non-recovery of NPAs.Thus, income recognition, asset classification and provisioning norms are inter-related.

Prudential norms make the operations transparent, accountable and safe.

Prudential norms serve two primary purposes: bring out the true position of a bank's loan portfolio and help in prevention of its deterioration.

Basel Norms

Banks lend to different types of borrowers and each carries its own risk. They lend the deposits of public as well as money raised from the market- equity and debt. The intermediation activity exposes the bank to a variety of risks. Cases of big banks collapsing due to their inability to sustain the risk exposures are readily available. Therefore, banks have to keep aside a certain percentage of capital as security against the risk of non-recovery. Basel committee provided the norms called Basel norms to tackle the risk.

Basel is a city in Switzerland. It is the headquarters of Bureau of International Settlement (BIS), which fosters co-operation among central banks with a common goal of financial stability and common standards of banking regulations. Every two months BIS hosts a meeting of the governor and senior officials of central banks of member countries. Currently there are 27 member nations in the committee. Basel guidelines refer to broad supervisory standards formulated by this group of central banks - called the Basel Committee on Banking Supervision (BCBS). The set of agreement by the BCBS, which mainly focuses on risks to banks and the financial system are called Basel accord. The purpose of the accord is to ensure that financial institutions have enough capital on account to meet obligations and absorb unexpected losses. India has accepted Basel accords for the banking system. In fact, on a few parameters the RBI has prescribed stringent norms as compared to the norms prescribed by BCBS.

In 1988, BCBS introduced capital measurement system called Basel capital accord, also called as Basel 1. It focused almost entirely on credit risk. It defined capital and structure of risk weights for banks. The minimum capital requirement was fixed at 8% of risk weighted assets (RWA). RWA means assets with different risk profiles. For example, an asset backed by collateral would carry lesser risks as compared to personal loans, which have no collateral. India adopted Basel 1 guidelines in 1999.
In June '04, Basel II guidelines were published by BCBS, which were considered to be the refined and reformed versions of Basel I accord. The guidelines were based on three parameters, which the committee calls it as pillars. - Capital Adequacy Requirements: Banks should maintain a minimum capital adequacy requirement of 8% of risk assets - Supervisory Review: According to this, banks were needed to develop and use better risk management techniques in monitoring and managing all the three types of risks that a bank faces, viz. credit, market and operational risks - Market Discipline: This need increased disclosure requirements. Banks need to mandatorily disclose their CAR, risk exposure, etc to the central bank.

Basel III
In 2010, Basel III guidelines were released. These guidelines were introduced in response to the financial crisis of 2008. A need was felt to further strengthen the system as banks in the developed economies were under-capitalized, over-leveraged and had a greater reliance on short-term funding. Also the quantity and quality of capital under Basel II were deemed insufficient to contain any further risk.

More
- CRAR at 9 percent of the risk weighted assets is prescribed by Basel norms. It is the capital that is required to be set aside for absorbing risks. It is not to be provisioned from deposits raised but has to be additionally provided from debt, equity, reserves etc.

Presently the Basel II norms are being complied with by Indian banks as follows:

Basel 2 norms are 8% of CRAR.RBI made it 9% for greater security.

Basel-II aims to strengthen Basel I.

Not only credit risk but also market risk and operational risk are covered.

Credit risk

A bank always faces the risk that some of its borrowers may not repay loan, interest or both. This risk is called credit risk, which varies from borrower to borrower depending on their credit quality. Basel II requires banks to accurately measure credit risk to hold sufficient capital to cover it.

Market risk

As part of the statutory requirement, in the form of SLR (statutory liquidity ratio), banks are required to invest in liquid assets such as cash, gold, government and other approved securities. For instance, Indian banks are required to invest 24 per cent of their net demand and term liabilities in cash, gold, government securities and other eligible securities to comply with SLR requirements (2008-09).

Such investments are risky because of the change in their prices. This volatility in the value of a bank's investment portfolio in known as the market risk, as it is driven by the market.

Operational risk

Several events that are neither due to default by third party nor because of the vagaries of the market. These events are called operational risks and can be attributed to internal systems, processes, people and external factors.

Thus, Basel II uses a "**three pillars**" concept

Pillar 1 Specifies includes more types of risk- credit risk ,market risk and operational risk.

Pillar 2 Enlarges the role of banking supervisors.

Pillar 3 Defines the standards and requirements for higher disclosure by banks on capital adequacy, asset quality and other risk management processes.

Capital -Tier1 And Tier 2

Capital adequacy norms divide the capital into two categories. Tier one capital is used to absorb losses while the Tier 2 capital is meant to be used at the time of winding up.

Tier I Capital: Actual contributed equity plus retained earnings.

Tier II Capital: Preferred shares plus 50% of subordinated debt (junior debt)

Subordinated debt figures between debt and equity – coming after the first in terms of eligibility for benefits like compensation.

Recapitalization is lending to the bank the resources needed to conform to the capital adequacy norms which stand at 8% today – minimum level.

One of the problems perceived in Basel 1 and 2 norms was that all sovereign debt, in general, was given a risk weight of zero, while all corporate debt was given similarly an equal weight irrespective of the difference in risk of the corporate concerned. The Eurozone sovereign debt crisis taught us lessons.

The risk weights led to some curious behaviour in lending. Banks started preferring to lend to governments, which required no capital addition, while even risk-free corporates, which had good rating, demanded additional capital provisioning under adequacy norms. Thus, one size fits all approach brought in distortions in lending.

Basel 3 norms: RBI Guidelines

The draft guideline norms announced by the RBI in mid-2012 will come into effect fully by 31 March 2018.

The key capital adequacy parameter has been stipulated at 9% higher than the international norm of 8%, and unchanged from what the regulator requires in India currently.

These guidelines mean that Indian banks would require a huge amount of capital in the next six years, about $30 billion to $40 billion. Some banks may find it difficult.

That would impose a heavy financial burden on the government, which will need to infuse capital in line with its holdings in the state-owned banks.

Under Basel III norms, a countercyclical capital buffer is prescribed: keep aside capital that can be used when the cycle turns down and the loans may turn bad.
Swap line for banks under the ECB route introduced by the RBI in mid-2013. (Discussed in the class)

BIS

The Bank for International Settlements (BIS) is an international organization of central banks which fosters international monetary and financial cooperation and serves as a bank for central banks." It also provides banking services, but only to central banks, or to international organizations. Based in Basel, Switzerland, the BIS was established by the Hague agreements of 1930.

As an organization of central banks, the BIS seeks to make monetary policy more predictable and transparent among its 55 member central banks. The BIS' main role is in setting capital adequacy requirements to safeguard bank's operations.

Shadow banks

NBFCs are largely refered to as shadow banking system or the shadow financial system. They have become the major financial intermediaries. As seen in the note on NBFCs elsewhere, shadow institutions do not accept demand deposits and therefore are not subject to the same regulations. Familiar examples of shadow institutions included Bear Stearns and Lehman Brothers. Hedge funds, pension funds, mutual funds and investment banks are some examples.

Shadow institutions are not as effectively regulated as banks and so carry higher risk of failure.

Universal Banking in India

Universal banking in India was recommended by the second Narasimham Committee (1998) and the Khan Committee (1998) reports. It aims at widening and integration of financial activities.

Universal Banking is a multi-purpose and multi-functional financial supermarket.' Universal banking' refers to those banks that offer a wide range of financial services, beyond the commercial banking functions like Mutual Funds, Merchant Banking, Factoring, Credit Cards, Retail loans, Housing Finance, Auto loans, Investment banking, Insurance etc. This is most common in European countries.

Benefits to banks from universal banking are that , since they have competence in the related areas, they can reduce average costs and thereby improve spreads(difference between cost of borrowing and the return on lending) by diversification. Many financial services are inter-linked activities, e.g. insurance, stock broking and lending. A bank can use its instruments in one activity to exploit the other, e.g., in the case of project lending to the same firm which has purchased insurance from the bank. To the customers, 'one-stop-shopping' saves transaction costs.

However, one drawback is that universal banking leads to a loss in specialisation. There is also the problem of the bank indulging in too many risky activities. ICICI(Industrial Credit and Investment Corporation of India) merged with its subsidiary-ICICI Bank in a reverse merger(parent merging with the subsidiary, the ICICI Bank). Other banks are also emerging as universal banks which are popular in Europe.

The compulsions for the DFIs like ICICI, IDBI, IFCI etc to become UBs is the following:

Earlier in the sixties and seventies, the DFIs specialized in project finance for the industries with long term capital needs. But the industries of late are mobilizing the finances from external sources or from the stock market and so the DFI business suffered. The cheap Government funds that were available in the earlier pre-liberalization era also are not available today.Banks and DFIs are having to compete for the same clients. Banks have an advantage in that they have a deposit base but the DFIs do not have same.

BANKING SYSTEM IN INDIA-II

Financial inclusion

Many people, particularly those living on low incomes, cannot access mainstream financial products such as bank accounts and low cost loans. This financial exclusion forces them to borrow from the moneylenders at high cost. Therefore, financial inclusion has been the goal of government's policy since late sixties.

Financial inclusion or taking banking services to the common man was the main driver of bank nationalization in 1969 and 1980 powered by three priority areas

- access to banking
- access to affordable credit, and
- access to free face-to-face money advice.

Thus, financial inclusion is the delivery of banking services at an affordable cost to the vast sections of disadvantaged and low-income groups. The Government of India's rationale for creating Regional Rural Banks (RRBs) in the years in 1975 following the nationalization of the country's banks was to ensure that banking services reached poor people.

The branches of commercial banks and the RRBs grew from 8,321 in 1969 to about 70,000.

Priority sector credit under which 40% of all bank advances should go to certain specified areas like agriculture is a form of directed credit that is aimed at financial inclusion.

Micro-finance (savings, insurance and lending in small quantities) and self-help groups are another innovation in financial inclusion.

Differential rate of interest; kisan credit cards; no-frills account (allowing opening of account with very little or no minimum balances) etc are examples of financial inclusion.

Scaling-up access to finance for India's rural poor, to meet their diverse financial needs (savings, credit, insurance, etc.) through flexible products at competitive prices is the goal of financial inclusion.

The total number of no-frill accounts opened over a two-year period (April 1, 2007 to May 30, 2009) stands at 25.1 million.

While it is beyond doubt that financial access of the people has significantly improved in the last three-and-a-half decades, and even more so in the last two years, the focus now should be on how to accelerate it as financial inclusion is important for economic growth, equity and poverty alleviation.

Unique identification number has some advantages for financial inclusion KYC (know your customer) bottlenecks will be dramatically reduced. Millions of new customers will become bankable. Growth will get a boost. Risk management will undergo a paradigm shift. Credit histories will be available on tap. Profitability will improve and so will customer service. We could finally have a technology initiative to extend financial inclusion.

Bank consolidation

Merging public sector banks to form big and globally aspiring banks is bank consolidation. It is expected to bring about financial stability and was recommended by the Narasimham Committee-II (1997) on financial sector reform.

State Bank of Saurashtra's merger with SBI has been achieved and the remaining six are to be merged. Government says that bigger banks can take on competition; can raise more than smaller banks;

Rationalising the manpower and branch network after bank mergers is a challenge and the criticism also includes that the bigger banks will be so much more bureaucratized. Bigness also does not reduce chances of failure as seen in the west in the current meltdown.

India has more than 175 commercial banks, out of which 26 state-owned banks account for the majority of the banking sector's assets followed by private sector banks and foreign banks, which have a tiny share.

Financial stability

Financial stability is a situation where the financial system operates with no serious failures or undesirable impacts on development of the economy as a whole, while showing a high degree of resilience to shocks.

Financial stability may be disturbed both by processes inside the financial sector leading to the emergence of weak spots like excessive of leverage; dealing in doubtful products like collateralized debt options(CDS) etc. It can also be undermined through regulatory lapses and inadequate safeguards prescribed by law.

In India, the banking system was not impacted badly by the world financial crisis as Indian banks are well-regulated through proper supervision. They are also well capitalized through capital adequacy ratio according to the Bank of International Settlements (Basel, Switzerland).
Calibrated globalization also meant that we would open upon only on achieving the strength to compete successfully.

RBI and Financial Stability

Traditional role

Recent global financial crisis is largely attributed to the financial sector recklessness due to lack of quality regulation. The lesson to draw from the crisis is to provide for good regulation- need not be more regulation- by the Central bank so that there is financial stability. In India, RBI has performed the role by the following instruments

- Licensing of banks
- Deciding on who can set up a bank, expand etc
- SLR, CRR norms
- CAR rules
- Lender of last resort
- Laying down prudential norms

- Supervisory functions

RBI Governor heads the HLCC- High Level Coordination Committee of financial regulators of SEBI, PFRDA and IRDA.

RBI defines from time to time NPA norms; allows or limits or banks credit to certain sectors like real estate in order to make banking operations safe and stable. Interest rates are also changed through repo and reverse repo rates to caution the borrowers and consumers.

Post-Lehman

Maintaining and monitoring financial stability has always been a key objective of monetary policy. However, it was only from the middle of 2009(post-Lehman) that the government and the RBI sought to institutionalise the process, making financial stability "an integral driver of the policy framework."

RBI tracks the following parameters in its quest to maintain financial stability: excessive volatility in interest rates, exchange rates and asset prices; signs of excess leverage (borrowings) in the financial sector, companies and households; and the unregulated parts of the financial sector.

RBI set up a Financial Stability Unit in 2009 and started presenting periodical reports since March 2010. The first report found the banking system to be broadly healthy and well-capitalised, but noted that global economic shocks, inflation, the slow pace of fiscal consolidation and the unsettlingly large capital inflows posed significant risks to financial stability. According to the second FSR, many of the positive features are intact. Growth has rebounded strongly and the financial conditions are stable. Despite intermittent volatility in the foreign exchange and equity markets, the financial sector has been risk-free. New risk assessment measures are introduced by the RBI — such as the Financial Stress Indicator and the Banking Stability Index.

Risks to financial stability are: the widening current account deficit; volatile capital inflows and the persistently high inflation.

The asset quality of banks and their asset-liability mismatch need to be constantly monitored.

Recent developments in the microfinance institutional structure cause serious concern.

Given the increasing correlation between global economic growth and that in emerging markets, the possibility of certain exogenous risks materialising is strong.

Banking Stability Index

It has been devised by the RBI in 2009. This index is simple average of five sub indices chosen for banking stability map that RBI has constructed. Banking Stability Map has used five key risk dimensions like operational efficiency, asset-quality, liquidity and profitability. These are based on capital adequacy ratio, cost-to-income ratio, nonperforming loans to total loans ratio, liquid assets to total assets ratio and net profit to total assets ratio.

Words

PLR
Prime Lending Rate (PLR) is the rate at which banks lend to the best customers. About 15% today. (2009)

Basis point
Changes in interest rates and other variables are expressed in terms of basis points to magnify and express the importance of changes. One basis point is 1% of 1%.

Weak Bank – Narasimham Committe – II
A 'Weak Bank' has been defined by the committee as follows: Where total accumulated losses of the bank and net NPA amount exceed the net worth of the bank.

Narrow banking
For restoring weak banks to strength, restructuring is needed. Such restructuring is generally attempted by operating the bank(s) as narrow bank(s), among other things. Narrow banking would restrict banks to holding liquid and safe government bonds. It prevents bank run.

Bank run
A bank run is a type of financial crisis. It is a panic which occurs when a large number of customers of a bank fear it is insolvent and withdraw their deposits.

Subordinated debt
It is also known as junior debt. It is a finance term to describe debt that is unsecured or has a lesser priority than that of other debt claim on the same asset. This means that if the party that issued the debt defaults on it, people holding subordinated debt get paid after the holders of the "senior debt". A subordinated debt therefore carries more risk than a normal debt. Subordinated debt has a higher expected rate of return than senior debt due to the increased inherent risk.

Core banking
Core Banking is normally defined as the business conducted by a banking institution with its retail and small business customers. Many banks treat the retail customers as their core banking customers, and have a separate line of business to manage small businesses. Larger businesses are managed via the Corporate Banking division of the institution. Core banking basically is depositing and lending of money.

World bank recapitalization
Government of India has made an assessment that the public sector banking system would need as much as Rs.35,000 crore worth of Tier-1 capital by 2012, given projections of how much their business needs to expand. Past divestment of equity has significantly reduced the government's shareholding in many public sector banks. Hence, it is argued, if 51 per cent government ownership has to be maintained to secure the public sector character of these banks, this recapitalisation has to be in the form of new government equity capital. Since the government is strapped for funds

for this purpose, it has decided to use this requirement as the basis for opting for a sector-specific $2 billion World Bank loan.

Banks stress tests

A **stress test** is an assessment or evaluation of a bank's balance sheet to determine if it is viable as a business or likely to go bankrupt when faced with certain recessionary and other stress situations- whether it has sufficient capital buffers to withstand the recession and financial crisis. European banks were recently subjected to such stress tests.

Financial sector reforms

Reforming the financial sector - banking, insurance, capital market, pensions- is crucial to make them generate resources; gain efficiencies; innovate new products and serve the economy and people well. It involves adoption of best practices in regulation and other areas like micro finance etc. The need is particularly felt in the wake of the global financial crisis brought about essentially by the financial sector that ruined the real economy related to production.

Some recent initiatives in this sector relate to introduction of private banks and foreign banks being given a level playing field with Government banks; deregulation of interest rates; reduction reserve requirements; pensions system being reformed ; base rate for banks; setting up of Financial Stability and Development Council; business correspondent model for financial inclusion.

There is a need however to improve the regulation of the NBFCs as they borrow from banks and lend which means if they are not properly regulated, the whole financial system is vulnerable.

Crr and slr have been freed from floor and cap to make banking more flexible.

Consolidation of banks is taking place so that benefits of scale can push Indian banks to global heights. State Bank of Saurashtra is merged with SBI and State Bank of Indore is also merged. Bank of Rajasthan has been acquired by ICICI Bank and merged with the latter.

However, in the insurance sector, reforms are still due. The Insurance Laws (Amendment) Bill provides for enhancement of share holdings by a foreign company from 26% to 49%. The Bill is not made into law as there ar differences among the political parties.

Pension Fund Regulatory and Development Authority (PFRDA) Bill that wants r FDI in this sector is also not approved.

The government was finding it difficult to manage its rising pension liability because of the defined-benefit system, under which the pension paid to employee was based on their last salary drawn.

In 2004, it shifted to a defined contribution system, which required employee to save for retirement from their earnings.

Towards this end, it set up a new pension system (NPS) for those joining government service after January 2004 and subsequently set up the Interim Pension Fund Regulatory and Development Authority to oversee the scheme that already managed the retirement savings of lakhs of state and central government employees.

The NPS was later extended to private individuals. The government now hopes to establish the NPS as the premier retirement savings scheme.

The pension bill seeks to give statutory or legal powers to the PFRDA, and set the framework for the regulation of pension fund schemes, including the ones being currently offered.

Debt market: The bond market in India remains limited in terms of nature of instruments, their maturity, investor participation and liquidity. Recent reforms include raising of the cap on investment by foreign institutional investors, or FIIs. Infrastructure debt fund etc.

Regulatory reforms- setting up of the FSDC is crucial for better supervision and clear demarcation of the jurisdiction.

The roadmap for financial sector reforms has been defined by the RH Patil, Percy Mistry & Raghuram Rajan reports.

The Banking Laws (Amendment) Act 2012

The Act would strengthen the regulatory powers of Reserve Bank of India (RBI) and to further develop the banking sector in India. It will also enable the nationalized banks to raise capital by issue of preference shares or rights issue or issue of bonus shares. It would pave the way for new bank licenses by RBI resulting in opening of new banks and branches. This would not only help in achieving the goal of financial inclusion by providing more banking facilities but would also provide extra employment opportunities to the people at large in the banking sector.

The salient features of the Bill are as follows:

- To enable banking companies to issue preference shares subject to regulatory guidelines by the RBI;
- To increase the cap on restrictions on voting rights;
- To create a Depositor Education and Awareness Fund by utilizing the inoperative deposit accounts;
- To provide prior approval of RBI for acquisition of 5% or more of shares or voting rights in a banking company by any person and empowering RBI to impose such conditions as it deems fit in this regard;
- To empower RBI to collect information and inspect associate enterprises of banking companies;
- To empower RBI to supersede the Board of Directors of banking company and appointment of administrator till alternate arrangements are made;
- To provide for primary cooperative societies to carry on the business of banking only after obtaining a license from RBI;
- To provide for special audit of cooperative banks at instance of RBI; and
- To enable the nationalized banks to raise capital through "bonus" and "rights" issue.

Bhartiya Mahila Bank (BMB)

It is an Indian financial services banking company based in New Delhi, India. Prime Minister Manmohan Singh inaugurated the bank on 19 November 2013 on the occasion of the 94th birth anniversary of former Indian Prime Minister Indira Gandhi.Although initially reported as a bank exclusively for women, the bank will allow deposits to flow from everyone, but lending will be predominantly for women. It has employees other than women too.

In India, only 26% of women have an account with a formal financial institution, compared with 46% of men. That means an account in either a bank, a co-operative, post office or a microfinance institution, according to a study by the World Bank. Also, for women, per capita credit is 80 per cent lower than males.

Furthermore, the results of a study using a global dataset covering 350 Microfinance Institutions (MFIs) in 70 countries indicates that more women clients is associated with lower portfolio-at-risk, lower write-offs, and lower credit-loss provisions.

The bank will place emphasis on funding for skills developments to help in economic activity. Moreover, the products will be designed in a manner to give a slight concession on loan rates to women.

The bank shall also aim to inspire people with entrepreneurial skills and, in conjunction with NGOs, plans to locally mobilize women to train them in vocations like toy-making or driving tractors or mobile repairs.

One of the other objectives of the bank is to promote asset ownership amongst women customers. Studies have shown that asset ownership amongst women reduces their risk of suffering from domestic violence.

The Bank's initial capital consists of Rs 1,000 crores. The government plans to have 25 branches by the end of March 2014 and 500 branches by 4th year of operation (2017).

Initially the bank will have a board of directors consisting of eight women.

How Indian banks survived the global crisis

Even though many banks failed and some survived on huge bailouts in the west due to the global financial crisis, Indian banking is almost unscathed for the following reasons

- Public sector banks- 27- dominate
- FDI is 74% in private banks but voting rights are only 10%
- We adopted capital account convertibility in a measured manner
- RBI has been conservative and regulated the banks well. Banks were not allowed to invest in risky instruments like credit default swaps(CDS)
- Basel norms, SLR and CRR levels were well maintained
- Prudential norms also saved the Indian banks from recklessness.

Financial Inclusion

Access to finance by the poor and vulnerable groups is a prerequisite for poverty reduction and social cohesion. This has to become an integral part of our efforts to promote inclusive growth. Financial inclusion means delivery of financial services at an affordable cost to the vast sections of the disadvantaged and low-income groups. The various financial services include credit, savings, insurance and payments and remittance facilities. The objective of financial inclusion is to extend the scope of activities of the organized financial system to include within its ambit people with low incomes.

NSSO data reveal that 45.9 million farmer households in the country (51.4%), out of a total of 89.3 million households do not access credit, either from institutional or non-institutional sources. Further, despite the vast network of bank branches, only 27% of total farm households are indebted to formal sources (of which one-third also borrow from informal sources). The poorer the group, the greater is the exclusion.

While financial inclusion can be substantially enhanced by improving the supply side or the delivery systems, it is also important to note that many regions, segments of the population and sub-sectors of the economy have a limited or weak demand for financial services. In order to improve their level of inclusion, demand side efforts need to be undertaken including improving human and physical resource endowments, enhancing productivity, mitigating risk and strengthening market linkages.

JLBs are proposed by the Rangarajan committee on financial inclusion 2008.JLB is like the SHG but is confined to farming operations mainly. A Joint Liability Group (JLG) is an informal group comprising preferably of 4 to10 individuals coming together for the purposes of availing bank loan either singly or through the group mechanism against mutual guarantee. The JLG members are expected to engage in similar type of economic activities like crop production.

Micro Finance Institutions (MFIs) could play a significant role in facilitating inclusion, as they are uniquely positioned in reaching out to the rural poor. The committee feels that legislation to regulate the microfinance sector is essential.

Important additional data for financial inclusion

- The first major breakthrough in financial inclusion came through when MYRADA, an NGO working in Karnataka developed the self-help group (SHG) methodology to link the unbanked rural population to the formal financial system through the local bank branches. Thanks to the efforts of the Reserve Bank of India (RBI), Nabard, state governments and numerous civil society organisations , about 8.6 crore households now have access to banking through SHGs. There are 61 lakh saving-linked SHGs with Rs 5,545.6 crore aggregate savings and 42 lakh credit-linked SHGs with loan outstanding of Rs 22,679.8 crore as on March 31, 2009.
- The business correspondent (BC) model advocated by the RBI is another pertinent example of potential frugal innovation in the financial inclusion space. The use of BCs enables banks to extend banking services to the

hinterland without setting up a brickand-mortar branch, which is often an unviable proposition. Banks use various types of hand-held devices, (aptly nicknamed microATMs) to authenticate micro-transactions at the BC location and to integrate the same with bank's main database.

- Unique Identification Authority of India (UIDAI

RBI as a regulator (Can be constructed from above)

Basics of Base Rate

What is the base rate (BR)?

It is the minimum rate of interest that a bank is allowed to charge from its customers. Unless mandated by the government, RBI rule stipulates that no bank can offer loans at a rate lower than BR to any of its customers.

How is the base rate calculated?

A host of factors, like the cost of deposits, administrative costs, a bank's profitability in the previous financial year and a few other parameters, with stipulated weights, are considered while calculating a lender's BR. The cost of deposits has the highest weight in calculating the new benchmark. Banks, however, have the leeway to take into account the cost of deposits of any tenure while calculating their BR. For example, SBI took costs of its 6-month deposits into account while calculating its BR, which it has fixed at 7.5%.

When did the base rate come into force?

It is effective from Thursday, July 1. However, all existing loans, including home loans and car loans, continue to be at the current rate. Only the new loans taken on or after July 1 and old loans being renewed after this date are be linked to BR.

How is it different from bank prime lending rate?

BR is a more objective reference number than the bank prime lending rate (BPLR) -- the current benchmark. BPLR is the rate at which a bank lends to lend to its most trustworthy, low-risk customer. However, often banks lend at rates below BPLR. For example, most home loan rates are at sub-BPLR levels. Some large corporates also get loans at rates substantially lower than BPLR. For all banks, BR will be much lower than their BPLR.

How often can a bank change its BR?

A bank can change its BR every quarter, and also during the quarter.

What does it mean for corporate borrowers?

Under the BPLR system, large corporates who enjoyed rates as low as 4-6% will be hit.

What are its benefits?

Makes the lending rates transparent. Monetary policy changes will find genuine transmission. Cross subsidation of the corporate at the expense of MSMEs will stop and MSMEs will get credit more affordably.

What are the exceptions?

Educational loans, export credit, credit to weaker sections can be given at sub-base rate.

Securities and Insurance Laws (Amendment) and Validation Act, 2010

United Linked Invest Plans(Ulips) are the insurance products in which payment is made partly for premium(insurance) and rest of it invested in the capital market like a Mutual Fund investment. It led to jurisdictional disputes between Sebi and Irda. Sebi says that a huge amount of Ulip is invested in stock market. Government promulgated an ordinance to set up a mechanism to regulate such jurisdictional disputes.

Financial sector is inter-related. Banks keep money that is invested in stock market. Insurance companies have stock market related products like Ulips.Pension funds are becoming popular in the stock market. These players can have mutual problems of jurisdiction as seen in the case of Ulips. Therefore, there is a need for a `super regulator'.

Parliament passed a Bill- Securities and Insurance Laws (Amendment) and Validation Bill, 2010 -that provides a mechanism, headed by the finance minister, to resolve disputes between financial regulators as an ad-hoc arrangement. It has representations from the four financial sector regulators and the Finance Ministry-Sebi, Irda, Rbi and Pfrda.

The Act states that the Reserve Bank Governor will be the vice-chairman of the joint committee. The joint body can entertain only jurisdictional issues. Even here, forst the involved parties should settle it between them

However, there were apprehensions expressed by RBI over its autonomy.

The government is still working on a permanent body to settle the inter-regulator disputes such as the SEBI-IRDA turf war.

The criticism is that there is already a Hligh level Coordination Committee with Rbi Governor heading it and there is no need for the current mechanism. It has lead to politicization.

Swabhimaan 2011

The government has launched 'Swabhimaan' – a programme to ensure banking facilities in habitation with a population in excess of 2,000, by March 2012. The programme will use various models and technologies, including branchless banking through business correspondents. The government has decided to pay banks Rs 140 for every no frills account they open as part of the financial inclusion plan.

The initiative would enable small and marginal farmers obtain credit at lower rates from banks and other financial institutions. This would insulate them from exploitation of the money lenders

The government has actually decided to give Rs 500 million to banks fo helping them open no frills accounts in the fiscal year 2011-2012.

Once banking access increases, it is hoped that it enables government subsidies and social security benefits to be directly credited to the accounts of the beneficiaries, enabling them to draw the money from the business correspondents in their village itself.

Given the size of the un-banked population in the country, the ongoing project can be considered a "significant beginning". Only a little more than a third of India's population has access to banking services at present. Among the bank-supported initiatives, self-help groups (SHGs) also have a role to play, the government's FI project is reliant more on Banking Correspondent (BCs} and technology to reduce the capital-intensity of expanding the banking cover.

There should at the same time be focus on financial literacy so as to take full benefit for the inclusion. This is particularly true in a context of rapid development of branchless banking, with newly banked people being exposed to non-bank intermediaries, therefore with no possibility to directly interact with experienced bankers.

Financial inclusion should not only be about reaching high numbers of unbanked or underserved groups. It should equally be about the provision of quality financial services and products. This means that access to safe, adapted, accessible, affordable and usable financial services and products should be offered.

The Insurance Regulatory and Development Authority's (IRDA) latest Annual Report indicates life insurance penetration at just 4.6 per cent and general insurance penetration at 0.6 per cent. Majority of the people do not have bank accounts, and even though RBI mandates have ensured the opening of 50 million no-frills accounts, hardly 11 per cent are active.

Innovations in financial products and technology-based delivery methods can expand the reach of financial services and create new opportunities to provide essential services to the poor. Financial products targeting the poor, such as money transfer services, microloans, microinsurance, or weather and catastrophic risk insurance, micropensions, can all have an important transformative effect. Deepening the financial system and widening its reach is crucial for both accelerating growth and for equitable distribution, given the present stage of development of our country.

One of the key features of the National Rural Livelihoods Mission (NRLM) is to work towards achieving universal financial inclusion, beyond basic banking services to all the poor households, SHGs and their federations. The key lies in linking access to financial services with livelihood options and leveraging the same to achieve poverty eradication. The end purpose of financial inclusion is and must be poverty alleviation.

Priority sector: Nair Committee recommendations

The RBI committee under the current Union Bank Chairman MV Nair has come out with their recommendations on lending to priority sector. It has reviewed the existing guidelines on lending to priority sector categories including agriculture, MSME and export. Its recommendations are

- Priority sector targets for public sector and private sector banks could be retained at the current level of 40% of the net credit to the sector.
- It has recommended severe changes should be made to exposure of foreign banks. Foreign banks' priority sector target should be increased from 32% to 40%.
- Special treatment should be given to small and marginal farmers and housing loans below Rs 2 lakhs should be classified under priority sector.

RBI acted on these recommendations

The Reserve Bank of India (RBI) in July 2012 said that foreign banks having 20 or more branches in the country will be brought on par with domestic banks for priority sector targets in a phased manner over a maximum period of five years starting April 1, 2013.

Foreign banks with less than 20 branches will have no sub-targets within the overall priority sector lending target of 32 per cent. This is expected to allow them to lend as per their core competence to any priority sector category.

The RBI said that the revised guidelines aim at implementing the essence of recommendations of Nair Committee without dismantling the established and accepted structure of priority sector lending.

The overall target under priority sector lending is retained at 40 per cent as suggested by the Nair Committee. The targets under direct and indirect agriculture are retained at 13.5 per cent and 4.5 per cent, respectively while refocusing the direct agricultural lending to individuals, self help groups (SHGs) and joint liability groups (JLGs) directly by banks.

The RBI said that loans to micro and small service enterprises up to Rs.1 crore; all loans to micro and small manufacturing enterprises up to Rs.25 lakh and for housing in metropolitan centres above Rs.10 lakh and at other centres Rs.15 lakh would form part of priority sector lending as per the revised guidelines. Loans to food and agro processing units and individuals for educational purposes, including vocational courses up to Rs.10 lakh in India and Rs.20 lakh abroad would also be part of priority sector lending.

Loans for housing projects exclusively for economically weaker sections and low-income groups, provided the cost does not exceed Rs.5 lakh per dwelling unit, loans to distressed farmers indebted to non-institutional lenders, loans to state sponsored organisations for scheduled castes and scheduled tribes, loans to individuals for setting up of off-grid solar and other off-grid renewable energy solutions for households and loans to individuals other than farmers up to Rs.50,000 to prepay their debt to non- institutional lenders would also be part of priority sector lending.

Investments by banks in securitised assets, outright purchases of loans and assignments to be eligible for classification under priority sector provided the underlying assets qualify for priority sector treatment and the interest rate charged to the ultimate borrower by the originating entity does not exceed Base Rate of such bank plus 8 per cent per annum.

Savings bank rate deregulation

The Reserve Bank of India (RBI) in 2011 deregulated savings bank rates .

A savings deposit one where the depositor can earn interest like an FD and can withdraw from the account like a current account. The savings rate was fixed at 3.50% from 2003 to 2011 and waslater raised to 4%.

However, during the period, the RBI changed both repo and reverse repo rates many times but the same was not reflected in the interest rates that the normal household gets. There was a huge gap between savings and term deposit rates. Thus, the depositors in SB account suffered.

After deregulation, it is expected that savings rate would move in tandem with the RBI monetary policy, thus, making the policy more effective.

NBFC-MFI

RBI decided to create a separate category of NBFCs viz; Non Banking Financial Company-Micro Finance Institution (NBFC-MFI) and notified norms in 2012.

Foreign banks: WOS vs Branch

The global financial crisis of 2008 has shown that the growing complexity and interconnectedness of financial institutions have compromised the ability of home and host authorities to cope with the failure of too big to fail (TBTF) institutions. The lessons learnt during the crisis lean in favour of domestic incorporation of foreign banks as wholly owned subsidiaries (Wos)

In general, following are the main advantages of local incorporation:

- It creates separate legal entities, having their own capital base and local board of directors;
- It ensures that there is a clear delineation between the assets and liabilities of the domestic bank and those of its foreign parent and clearly provides for ring fenced capital and assets within the host country;
- It imparts clarity and certainty with respect to applicability of the laws of country of incorporation on the locally incorporated subsidiary;
- A locally incorporated bank has its own board of directors and these directors are required to act in the best interests of the bank, to prevent the bank from carrying on business in a manner likely to create a risk of serious loss to the bank's creditors/depositors;
- Provides effective control to the regulator

A number of jurisdictions, therefore, impose requirement of local incorporation for foreign banks mainly for (i) protecting local retail depositors and (ii) affording greater regulatory comfort.

Considering the capital required to fuel economic growth, foreign banks have to play a significant role along with new private sector banks to cater to growing credit demand.

In a bid to better regulate them and avoid 2008-type crisis, RBI in November 2013 said that foreign banks with complex structures which do not provide adequate disclosure would have to operate in India only through wholly-owned subsidiaries (WOS).

The guidelines incentivise foreign banks operating in the country with 'near national treatment' if they become WOS, enabling them to open branches anywhere at par with other public and private sector banks.

The regulator also allowed foreign banks to list their subsidiaries on the local stock exchanges.

They can also acquire local banks.

Corporate guidelines for the WOS include a proviso that not less than 50 per cent of the directors should be Indian nationals/NRIs/PIOs.
Further, not less than two-thirds of the directors should be non-executive directors and a minimum of one-third of the directors should be independent of the subsidiary.
There are 45 foreign banks in India with a network of 333 branches as of 2013, most of which are held by the top three -- StanChart (100 branches), HSBC (50) and Citi (40).

Their market share stood at 6.5 percent of total banking assets in FY13.

The initial minimum paid-up equity capital or networth for a WOS should be Rs 500 crore, RBI had said.

Differences between branch and Wos models: To set up a branch, it needsto get RBI approval. Tax rate is high (40% as against domestic companies rate which is 30%) Advantage: Repatriation of money back to foreign country is easier.
If it is a wholly owned subsidiary, it becomes an independent entity - less RBI intervention, less tax rate and the rest outlined above.
Both however are subject to priority sector norms as mentioned above.

CDR

There are occasions when corporates find themselves in financial difficulties because of factors beyond their control and also due to certain internal reasons. For example; the global financial crisis and the recession that followed since 2008 along with the infrastructural investments being stalled in India for a variety of reasons. For the revival of such corporates as well as for the safety of the money lent by the banks and financial institutions, timely support through restructuring of genuine cases is called for. In India, a Corporate Debt Restructuring System was evolved and detailed guidelines were issued by Reserve bank of India early 2001.

It may be emphasized here that, in no case, the requests of any corporate indulging in fraud or misfeasance, even in a single bank, can be considered for restructuring under CDR System.

In a growing sign of companies facing difficulties in meeting their financial obligations, banks were approached for debt restructuring in a record 126 cases during 2012 for a collective amount of Rs 84,000 crore.

Debt restructuring is a process that allows a private or public company – or a sovereign entity – facing cash flow problems and financial distress, to reduce and renegotiate its delinquent debts in order to improve or restore liquidity and rehabilitate so that it can continue its operations.

Replacement of old debt by new debt when not under financial distress is referred to as refinancing.

NPAs 2013

Net non-performing assets (NPAs) or bad loans of 40 listed banks jumped by 38% or around Rs 35,424 crore in the first six months of financial year ended September 30, 2013.

As on March 31, 2013, net NPAs of 40 listed banks were Rs 93,109 crore, which rose to Rs 1,28,533 crore as on September 30, 2013.