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Impact of Covid-19 on Indian banking

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Abstract.
During 2019-20, scheduled commercial banks (SCBs) registered a robust performance characterised by improved asset quality, stronger capital and provision buffers, and return to profitability after a gap of two years. These improvements continued in H1:2020-21 even in the face of the pandemic, aided by the moratorium, the standstill in asset classification and restrictions on dividend pay-outs. While the Insolvency and Bankruptcy Code (IBC) remained the dominant mode of recovery, recovery rate of the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI) channel also improved. Going forward, with gradual rollback of policy measures, deterioration in asset quality may pose challenges, although build-up of buffers like COVID-19 provisions and capital raising from market may help alleviate the stress.

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I. INTRODUCTION

In 2019-20, India's commercial banking sector consolidated the gains achieved after the turnaround in 2018-19. Financial performance was shored up in H1:2020-21 by the moratorium and the standstill in asset classification. The overhang of stressed assets declined, and fresh slippages were reined in. With improvement in margins and recoveries of delinquent loans, the banking system turned profitable after a gap of two years. At the same time, capital buffers were strengthened, partly aided by recapitalisation of public sector banks (PSBs) and capital raising in the market. The immediate impact of lockdowns on the financial performance of commercial banks was mitigated through timely policy actions by the Reserve Bank. Going forward, although the risks to the banking sector remain tilted upwards, much hinges around the pace and spread of the economic recovery that is gradually gaining traction in H2:2020:21.

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1. Balance Sheet Analysis The consolidated balance sheet of SCBs has grown in 2020-21 after a deceleration in 2019-20 on account of subdued economic activity, deleveraging of corporate balance sheets and muted business sentiment impacting credit supply. On the liabilities side, slowdown in deposit growth contributed to banks' financial weakness. The recovery in 2020-21 (so far) has been driven by investments and deposit growth in spite of the COVID-19 pandemic.

2. Liabilities.SCBs' deposit growth remained elevated throughout the first three quarters of 2019-20 relative to the period since September 2017. During the last quarter, i.e., January-March 2020, however, deposit growth especially in private sector banks (PVBs) decelerated. Currency with public surged in response to the COVID-19 induced dash for cash while solvency issues related to a private sector bank also brought about some reassignment of deposits.During 2020-21 so far, deposits with PSBs grew at a higher pace than usual, partly reflecting perception of their safe haven status. Term deposits contributing almost 60% of total deposits moderated, reflecting the easing of interest rates and the lure of returns on competing asset classes. Term deposit growth of PVBs decelerated sharply even as it quadrupled in PSBs. Foreign banks aggressively raised lowcost current and saving account (CASA) deposits, although their share in total deposits is low. Subdued credit growth and relatively robust deposit growth for most part of the year resulted in a decline in borrowing requirements of banks, except for PVBs.

After a gap of two consecutive years, SCBs' loan growth decelerated in 2019-20, reflecting both risk aversion and tepid demand. During the current financial year so far, this was accentuated by the COVID-19 pandemic. The loan book of PVBs was affected disproportionately relative to their counterparts on asset quality concerns and higher provisioning requirements. Credit expansion was at a higher pace among PSBs during March, June and September, 2020 quarters, after three consecutive quarters of deceleration.

Another positive development was the robust credit growth in rural areas. Although the share of rural credit in the total has been hovering between 8 and 9 per cent, its growth surpassed that of other categories in 2019-20, after a gap of four years. While the share of PSBs in rural credit has gradually fallen, PVBshave been making inroads.

The credit-GDP ratio declined consistently throughout year 2010, partly reflecting availability of alternate avenues to raise resources. During 2019-20, however, the ratio declined even further and the incremental credit to GDP ratio also ebbed. The outstanding creditdeposit ratio declined across all bank groups.

Muted credit offtake prompted PSBs to lean in favour of investments. Riskfree liquid statutory liquidity ratio (SLR) securities were their instruments of choice amidst the prevailing uncertainties. On the other hand, investment portfolio of PVBs and FBs decelerated due to profit booking in their trading books as yield on G-Secs softened significantly during the course of the year.Till end-August 2020, banks were permitted to exceed the limit of 25 per cent of total investments under the held to maturity (HTM) category, provided the excess comprises only of SLR securities and total SLR securities held in the HTM category are not more than 19.5 per cent of net demand and time liabilities (NDTL). With the headroom available for PSBs and PVBs for further investment in SLR securities under the HTM category getting exhausted and in view of heavy government borrowing programme for 2020-21, the 19.5% limit was raised to 22% of NDTL up to March 31, 2022, for securities acquired between September 1, 2020 and March 31, 2021.

3. Flow of Funds to the Commercial Sector.Subdued credit demand conditions were reflected in a sharp moderation in flow of credit to the commercial sector in 2019-20, from both bank and non-bank sources. The moderation in non-bank funding was lower as compared with bank funding. Corporates raised higher resources

from foreign sources such as foreign direct investment (FDI), external commercial borrowing (ECB) and foreign currency convertible bonds (FCCBs). Rationalisation of ECB guidelines, prudent and tighter single-group exposure norms, low interest rates in origin countries and the relatively stable exchange rate created an enabling environment to raise more resources from foreign sources. Within domestic non-bank sources, acceleration in resources raised from the capital market public and rights issues as well as private placements – coupled with the investment of Life Insurance Corporation of India (LIC) in corporate debt provided a silver lining.The flow of funds to commercial sector has been higher during 2020-21 so far. Flows from banks, domestic non-bank sources – notably private placements; commercial paper (CP) issuances; and credit by housing finance companies (HFCs) – have picked up, compensating for lower flows from foreign sources like ECB/FCCB and short-term credit from abroad

4. Maturity Profile of Assets and Liabilities. Asset-liability management (ALM) profiles have direct implications for liquidity and profitability of banks. Rate Sensitive Assets (RSAs) and Rate Sensitive Liabilities (RSLs) directly impact banks' net interest income. The decision to hold a positive (RSAs > RSLs) or negative gap (RSLs > RSAs) depends on a bank's expectations on interest rates and its overall business strategy. In an environment of declining interest rates during 2019-20, the negative gap in the maturity bucket of up to one year and positive gap in higher maturity buckets moderated.While liabilities like deposits and borrowings in the maturity bucket of up to one year declined, assets – specifically, investments picked up, led by PSBs and PVBs. On the other hand, borrowings and investments in the maturity bucket of over five years dipped. At the same time, deposits and loans and advances edged up. FBs continued to focus mainly on short-term borrowings and investments.

5. International Liabilities and Assets. During 2019-20, total international liabilities of banks located in India declined due to a drop in short-term borrowings from abroad. Divestment by non-residents in banks, particularly PVBs, also contributed to this decline. On the other hand, international assets of banks rebounded from a decline in the previous year, largely driven by an upsurge in NOSTRO balances and placements abroad. However, claims arising out of outstanding export bills sharply declined due to slackening of international trade. This resulted in an uptick in the ratio of international claims to international liabilities. The ratio of international liabilities of banks to India's total external debt declined due to an increase in external debt during the year. The consolidated international claims of banks declined across both short-term and long-term maturities and shifted away from the non-financial private sector and banks towards non-bank financial institutions (NBFIs). Consolidated international claims of banks also underwent geographical changes favouring Germany, Singapore and the United Arab Emirates (U.A.E.) at the cost of Hong Kong, the United Kingdom (U.K.) and the United States (U.S.)

6. Offbalance Sheet Operations. During 2019-2020, offbalance sheet liabilities of PVBs and FBs decelerated, while those of PSBs contracted, suggesting prudent behaviour in the face of elevated credit risk. At end-March 2020, foreign banks' contingent liabilities were as high as 10 times their balance sheet assets, while PVBs (1.2 times) and PSBs (0.31 times) had relatively lower off-balance sheet exposures.

7. Financial Performance. Net profits of SCBs turned around in 2019-20 after losses in two consecutive years . Although PSBs incurred losses for the fifth year in a row, the amount of losses shrank. PBs could not break even as they incurred high initial capital expenditure and wage bills.The improvement in financial performance also reflected an increase in trading income on profit booking in the light of favourable yield movements.

In line with the increasing share of PVBs in banking assets, their share in operating profits also increased to 43.4% in 2019-20 at the cost of PSBs.Both interest income and interest expended by banks decelerated; however, banks managed to register higher net interest margin (NIM) with the growth in interest income. The gap between NIM of PVBs and PSBs enlarged as the former managed to lend at comparatively higher rates while reducing their deposit rates.Banks' spreads increased, with SFBs commanding the highest spread followed by FBs, PVBs and PSBs in that order. SFBs which characteristically have a larger share of microfinance portfolio than peers face higher cost of deposits and borrowings. This was, however, more than compensated by higher lending rates.Provisions especially those of PVBs – accelerated on account of higher NPAs as well as to meet regulatory requirements post-loan moratorium provided as COVID-19 relief measure. Although banks are required to make general provisions of not less than 10% of the total outstanding on accounts that were in default as on February 29, 2020 and where moratorium / interest deferment and the consequent asset classification benefit was extended, it was allowed to be spread over Q4:2019-20 and Q1:2020-21. Against the backdrop of a regulatory ban on banks that prevent them from distribution of dividends, many PVBs earmarked the entire required provision or even more in the March 2020 quarter itself. As a result, the provision coverage ratio (PCR) of SCBs improved to 66.2 per cent in end-March 2020 and further rose to 72.4% by end-September 2020. This also impacted profitability of banks in varying degrees.

7. Soundness Indicators. During 2019-20, SCBs strengthened their capital buffers, improved their asset quality and raised liquidity coverage ratios (LCR), although the leverage ratios marginally declined. Despite the COVID-19 pandemic, these improvements in soundness indictors continued till September 2020 due to

moratorium on loans till August 2020 and continuing asset classification standstill. However, an increase in the restructured advances ratio to 0.43% at endSeptember 2020 from 0.36 in March 2020 may be indicative of incipient stress.

8. Capital Adequacy.The consistent improvement in the capital to risk-weighted assets ratio (CRAR) of SCBs since March 2015 continued throughout 2019-20 and 2020-21 so far, reaching 15.8 per cent by end-September 2020 (Although at the system level, the capital position exceeded the regulatory minimum [10.875 per cent inclusive of capital conservation buffer (CCB)], a few banks breached the regulatory minimum. Mergers helped improve the capital position of constituent banks due to pooling of resources for various operations and other scale economies. Deferred implementation of the last tranche of CCB as a regulatory response to potential impact of COVID-19 on capital position of banks also helped. The decline in GNPAs and fresh slippages, improved profitability and restriction on dividend pay-out by banks contributed to strengthening of capital position of banks.There has been a visible shift in the CRAR distribution of banks between 2008 (onset of the global financial crisis) and 2020 (onset of COVID-19 pandemic). The median CRAR has increased from 12.3 in March 2008 to 13.3 in March 2020. Although Indian banks had comparatively stronger capital buffers while entering the global financial crisis (GFC), they have significantly weaker capital position in comparison to their global counterparts in the COVID-19 pandemic[4]. In terms of distance from regulatory minimum CET-I ratio (5.5% plus capital conservation buffer of 1.875% i.e., 7.37%) banks are concentrated at the lower end the distribution

. Effects of Merger on Indian Banking System. Ten public sector banks were merged into four banks with effect from April 1, 2020 with the objective of creating next generation banks with strong national and global presence. Notwithstanding some initial hiccups, factors like government ownership, similar pay structure and career progression avenues for staff, and common core banking solutions helped smoothen the operationalisation of the merger.The equity swap ratio between merged entities was another issue that was widely discussed but was settled ahead of the merger.The merged entities can now reap benefits of synergy, especially in the case of branch network presence across regions. For example, United Bank of India, which had a large presence in the eastern region, will now benefit from the more diversified branch network of Punjab National Bank which had vast network in northern and central region before the merger. Similarly, Indian Bankwith concentrated presence in the southern part of the country can now expand its reach in central and eastern parts due to its alliance with Allahabad BankWith capital infusion by the Government, PSBs improved their CRARs despite the increase in risk weighted assets (RWAs). With the budgeted capital infusion of ₹70,000 crores in 2019-20, the Government has infused ₹3.16 lakh crore in the last five years in these banks. SCBs shored up their capital position to strengthen loss-absorption capacity against imminent COVID-19 induced loan delinquencies. Apart from internal capital generation and recapitalisation (in case of PSBs) by the Government, banks raised capital from the market through public issues, preferential allotment, qualified institutional placement (QIP) and by selling non-core assets. PSBs abstained from public issues due to depressed valuations.

Going forward, almost all major banks have announced plans to raise capital in 2020-21 either through debt or through equity or a combination of the two. A few major PVBs have taken a lead in raising capital but smaller lenders, especially the ones with already weak balance sheets, are conspicuous by their absence, partly reflecting uncertainty as to whether or not they will be able to raise resources in prevailing market conditions.During 2019-20, the amount raised by PSBs through QIP and bond issuances on a private placement basis was almost double that of a year ago. Both PSBs and PVBs raised higher capital through private placements during 2020-21 so far (up to November) than a year ago Many of these bonds come under the category of Basel III compliant tier II bonds, which help shore up banks' capital positions.

1. Leverage and Liquidity. The Leverage ratio, defined as the ratio of Tier I capital to total exposure, serves as a supplement to risk-based capital ratios to constrain the build-up of leverage. By end-March 2020, the leverage ratio declined marginally to 6.5% from 6.6 per cent a year ago, driven by foreign banks (FBs) whose derivative exposure rose sharply. However, leverage ratio of SCBs again rose to 7.0% by September 2020. Despite the reduction in regulatory requirements, effective October 2019, the leverage ratio of PSBs and PVBs witnessed a marginal uptick on improvement in capital positions while their total exposure remained stable Of the two standards for funding liquidity prescribed by the Basel Committee, LCR has been effective in India since January 1, 2015 (the implementation of the net stable funding ratio (NSFR) has been deferred to April 1, 2021). As at end-March 2020, LCRs of SCBs rose to 159.1% from 128.9 per cent in the previous year, given the low credit off-take and risk aversion among banks. Despite the regulatory relaxation given to banks to maintain LCR at a lower rate of 80% since April 17, 2020, the system-wide LCR was maintained at 171% as at end September 2020.

2. Non-performing Assets.The moderation in the GNPA ratio, which started after the peak in March 2018, continued through 2019-20 and 2020-21 so far, to reach 7.5 per cent by end-September 2020. The improvement was driven by lower slippages which declined to 0.74% in September 2020 and resolution of a few large

accounts through the Insolvency and Bankruptcy Code (IBC). Fresh slippages remained the highest among PSBs.The modest GNPA ratio of 7.5% at end-September 2020 veils the strong undercurrent of slippage. The accretion to NPAs as per the Reserve Bank's Income Recognition and Asset Classification (IRAC) norms would have been higher in the absence of the asset quality standstill provided as a COVID-19 relief measure Given the uncertainty induced by COVID-19 and its real economic impact, the asset quality of the banking system may deteriorate sharply, going forward.The rapid credit growth during 2005-12, coupled with absence of strong credit appraisal and monitoring standards and wilful defaults, are responsible for sizeable asset impairments in subsequent years.

Source: BSE, NSE and Merchant Bankers.
The quantum of GNPAs of SCBs declined for the second consecutive year. With substantial increase in provisioning, the net NPA ratio of SCBs moderated to 2.8% by end-March 2020. According to Supervisory Returns with the Reserve Bank, the net NPA ratio of SCBs further declined to 2.2% by end-September 2020.The reduction in NPAs during the year was largely driven by write-offs. NPAs older than four years require 100 per cent provisioning and, therefore, banks may prefer to write them off. In addition, banks voluntarily write-off NPAs in order to clean up their balance-sheets, avail tax benefits and optimise the use of capital. At the same time, borrowers of written-off loans remain liable for repayment.With these developments, the share of standard assets in total advances increased in SCBs except for PVBs and SFBs during 2019-20. Concomitantly, the share of doubtful assets declined while Large borrowable accounts (exposure of ₹5 crore and above) constituted 79.8 per cent of NPAs and 53.7 per cent of total loans at end-September 2020. During 2019-20, PSBs' GNPA ratio as well as the ratio of restructured standard assets to total funded amounts emanating from larger borrowable accounts trended downwards. On the contrary, PVBs experienced an increasing share of NPAs in respect of such accounts. The share of special mention accounts (SMA-0) witnessed a sharp rise in September 2020. This may be an initial sign of stress after lifting of moratorium on August 31, 2020. However, the share of other categories of SMAs i.e., SMA-1 and SMA-2 remained at a relatively lower level.
3. Recoveries. Insolvency and Bankruptcy Code (IBC), under which recovery is incidental to rescue of companies, remained the dominant mode of recovery. However, the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI) channel also emerged as a major mode of recovery in terms of the amount recovered as well as the recovery rate. With the applicability of the SARFAESI Act extended to co-operative banks, recovery through this channel is expected to gain further traction. Going forward, insolvency outcomes will hinge around uncertainties relating to COVID-19. The government has suspended any fresh initiation of insolvency proceedings in respect of defaults arising during one year commencing March 25, 2020 to shield companies impacted by COVID-19.Apart from recovery through various resolution mechanisms, banks also clean up balance sheets through sale of NPAs to assets reconstruction companies (ARCs) for a quick exit. During 2019-20, asset sales by SCBs to ARCs declined which could probably be due to SCBs opting for other resolution channels such as IBC and SARFAESI. The acquisition cost of ARCs as a proportion to the book value of assets declined suggesting lower realisable value of the assets. The share of security receipts (SRs) subscribed to by banks steadily declined, reaching 66.7% by end-March 2020 from 80.5% at endMarch 2018 as ARCs were incentivised to increase skin-in-the-game and diversify the investor base by bringing in other financial institutions.
4. Frauds in the Banking Sector. Operational risk has emerged as a major source of risk. Although 98 per cent of frauds in terms of value were related to loans, their occurrence was spread over several previous years There was a concentration of large value frauds, with the top fifty credit-related frauds constituting 76% of the total amount reported as frauds during 2019-20.Further, the banking relationship and date of sanction of credit facility in many of these accounts were much older. For instance, the majority of frauds reported till September 2020 both in terms of number. (Source: BSE, NSE and Merchant Bankers**.)**
.Sectoral Bank Credit: Distribution and NPAs. The deceleration in credit growth during 2019-20 and 2020-21 so far (up to September) was spread across sectors but was pronounced in the case of industry and services partly reflecting elevated levels of sectoral NPAs. Low credit demand, coupled with corporate deleveraging, also played a role. The pick-up in resolution and decline in slippages helped alleviate stress in large accounts. NPAs in the micro, small and medium enterprises (MSME) sector were contained by the facility to restructure their loans · Slowdown in credit to NBFCs was partly offset by banks' investment in their debt papers, incentivised by targeted long-term repo operations (TLTRO) Scheme of the Reserve Bank.Construction and power sectors were saddled with problems related to land acquisition, delay in getting various clearances, long gestation periods, contractual issues and cost overruns, and consequently had high NPA levels. In the gems and jewellery sector, NPAs increased with the exports declining during 2019-20.PVBs have been the engine of credit growth during the last few years. In a reversal during 2019-20, however, their loan growth decelerated across sectors. Lending to industry and agriculture sector by PVBs and PSBs also slowed down or declined. The

aggressive credit growth of PVBs to services and retail segments in the last few years which surpassed 30% mark in 2018-19 came down sharply, even as PSBs managed to hold on to market shares in the retail segment

1. Unsecured Loans. The share of unsecured lending in the portfolio of both banks and non-banks has increased sharply over the last three years. In recent years, SCBs have been reorienting their loan book away from the industrial sector and towards retail loans in view of lower delinquency rates of the latter. The growing share of unsecured credit card loans of SCBs – up from 3.1% to 5.2% within a span of five years – does not, however, augur well for their risk profile.

2. Priority Sector Credit. Priority sector credit decelerated across constituent categories as well as across bank groups during 2019-20. The deceleration in agricultural credit was led by Kisan Credit Card loans. In the case of priority sector education loans (amount less than ₹10 lakh), the retrenchment, reflecting their high NPAs, is in sharp contrast with non-priority sector education loans, which have continued to grow.During 2019-20, although all the bank-groups managed to achieve the overall priority sector lending (PSL), several sub-targets like those for agriculture, micro enterprises, small and marginal farmers (SMF) and non-corporate individual farmers were not achieved by some of them. The revised priority sector lending guidelines issued in September 2020 are expected to increase lending to small and marginal farmers (SMFs) and weaker sections as targets prescribed for these categories are being raised in a phased manner. The guidelines are also expected to boost credit to start-ups, renewable energy, and health infrastructure in line with emerging national priorities.The Reserve Bank had introduced Priority Sector Lending Certificates (PSLCs) in April 2016 as a market mechanism to incentivize banks to lend to the priority sector. Under this mechanism, over-achievers can issue PSLCs against the surplus in respect of a target/sub-target. Four types of certificates viz. PSLC General, PSLC-Agriculture (A), PSLC-Micro Enterprises (ME) and PSLC-Small and Marginal farmer (SMF) can be traded on the Reserve Bank's e-Kuber platform. The total trading volume of PSLCs increased by 42.8% to ₹4,67,789 crore during 2019-20 as against 74.6% growth during 2018-19. In H1:2020-21, trading volume increased by 20.7% from a year ago. Trading volumes tend to spike at the end of each quarter as buyers vie with each other to meet quarterly priority sector targets. Among the four PSLC categories, the highest trading was recorded in PSLC-General and PSLC-SMF.During the year, priority sector areas where lending is comparatively more challenging were rewarded by higher premiums for PSLCs, e.g., the PSLC-SMF category commands almost four times higher premium than PSLC-ME and PSLC-General. Commensurately, the growth in organic lendingby banks to the SMF category was highest among all categories.

PSBs that carry a strong agriculture lending portfolio, have benefitted from the high premiums in PSLC-A and PSLC-SMF categories. After introduction of PSLCs, PVBs have increased their lending to micro enterprises exceeding their sub-target, although they are net buyers of PSLCs in agriculture and SMF sub-categories FBs are net buyers and SFBs are net sellers across all the sub-categories of PSLCs.PSBs and PVBs are the largest buyers as well as sellers of PSLCs on account of their larger loan books. On a net basis, PSBs which were net sellers till the previous year, turned buyers due to lending shortfalls in respect of overall priority sector and sub-target for lending to micro enterprises.At end-March 2020, the GNPA ratio relating to priority sector loans increased to 8.3% from 7.6% in the previous year, driven primarily by delinquencies in agricultural and micro and small enterprises lending.

3. Credit to Sensitive Sectors. Banks' exposure to the capital market and real estate is reckoned as sensitive in view of risks inherent in fluctuation in prices. While banks generally slowed down such lending. PSBs, in particular, reduced advances against collateral of shares/debentures as a precautionary measure due to excess leveraging of corporates

.Foreign Banks' Operations in India and Overseas Operations of Indian Banks. During 2019-20, the number of branches of FBs increased due to scaling up of operations by two wholly owned subsidiaries of FBs. On the other hand, Indian PSBs continued to reduce their overseas presence for the third consecutive year with a view to rationalising their overseas operations and increasing cost efficiency by shutting down less profitable operations. On the contrary, Indian PVBs increased their overseas presence marginally.

1.Digital Payments. In line with earlier years, large value credit transfers through RTGS dominated the overall digital payments landscape in the year 2019-20, accounting for 80.8% of the total value of digital transactions. In terms of volume however, credit transfers via multiple channels such as the Unified Payments Interface (UPI), National Electronic Funds Transfer (NEFT) and Immediate Payment Service (IMPS) were the leaders. In case of card payments, the value of debit card transactions registered a growth of 35.6% as against 21.1% for credit cards. The social distancing requirements during the pandemic led to the digital mode of transactions being preferred over cash, although the value and volume of the former were somewhat depressed on account of the slowdown in economic activity ahead of the outbreak. The trajectory of growth in UPI-based transactions as well as overall retail digital transactions has been impressive both in value and volume terms

2. Financial Inclusion. Sound financial inclusion policies have a multiplier effect on economic growth reducing poverty and income inequality, while also being conducive for financial stability. The latest Financial Access Survey (FAS) data of the IMFshow that various initiatives taken by the Reserve Bank and the Government in

the direction of financial inclusion have borne fruit. The number of bank branches per 100,000 adults rose to 14.6 in 2019 from 13.6 in 2015, which is higher than Germany, China and South Africa. With a strong government push to increase bank account among unbanked adults through Pradhan Mantri Jan Dhan Yojana (PMJDY), the number of persons with deposit accounts at banks significantly increased, becoming comparable with emerging economy peers and even some of the advanced economies. Even in terms of access to credit, noticeable progress has been made, although, it remains much lower than its peers. In terms of use of digital payments too, India made noteworthy progress due to various Government initiatives and promotion of usage of digital medium for payments. Between 2015 and 2019, the number of mobile and internet banking transactions per 1,000 adults has increased to 6,184 in 2019 from 183 in 2015. In order to systematically accelerate the level of financial inclusion in the country in a sustainable manner, the National Strategy for Financial Inclusion (NSFI) 2019-24 was released in January 2020. Further, with a view to align the Reserve Bank's policies with the vision outlined in the NSFI document, the Financial Inclusion Plan (FIP) template has been revised and rechristened as 'Monitoring Progress of Financial Inclusion (MPFI)' to capture more granular data and qualitative aspects at the ground level.The new branch authorisation policy of 2017 – which recognises Business Correspondent (BCs) that provide banking services for a minimum of four hours per day and for at least five days a week as banking outlets – coupled with emphasis on digitisation and modernisation of technological infrastructure has progressively obviated the need to set up brick and mortar branches. As has been observed for the last few years, during 2019-20 also, branch expansion in rural areas remained subdued as BC model made further inroads in villages with population more than 2,000. The BC phenomenon did not remain restricted to rural areas alone and model gained popularity even in urban areas. Further, the growth in the number of Basic Savings Bank Deposit Accounts (BSBDAs) and deposits mobilised through BCs remained higher than BSBDAs in physical bank branches Based on experience gained during the COVID-19 pandemic, the BC model is likely to strengthen further as physical access to banks is constrained

4. Pradhan Mantri Jan Dhan Yojana (PMJDY). In six years of its implementation, the total number of accounts opened under PMJDY reached 41.4 crore, with ₹1.30 lakh crore of deposits as of December 2, 2020. Of these accounts, nearly two-third are operational in rural and semi-urban areas. As on September 2020, more than 60% of PMJDY accounts were with PSBs. However, usage of these accounts remains a concern, with lacklustre growth in the average balance in these accounts

5. New Bank Branches by SCBs. The decline in the number of new bank branches during 2019-20 was mainly due to SFBs, RRBs and PBs. PVBs and SFBs maintained the lead in opening new branches as part of their business expansion strategy. During the year, more than half of the new branches were opened in Tier I centres, although fewer branches were opened in other higher tier centres 11.3 ATMs**.** The deceleration in the total number of ATMs (on-site and off-site) operated by banks reversed during the year, aided by all categories of banks, except PSBs and FBs and Appendix Table Interestingly, SFBs operated more than twice the number of ATMs operated by FBs as at end-March 2020, despite their smaller balance sheet size. The high growth of white label ATMs (WLAs) for the second consecutive year was fuelled by regulatory support such as permission to source cash directly from the Reserve Bank and permission to offer non-bank services. More than 82 per cent of the WLAs are located in rural and semi-urban areas with high unmet demand for ATMs. Data available for 2020-21 so far indicate that the growth in WLAs continued as the rural economy was not as severely impacted as the urban areas due to the lockdown associated with COVID-19.The geographical distribution of ATMs across rural and urban areas remained broadly similar in 2019-20 to that in the previous year. The concentration of ATMs remains tilted towards urban customers 11.4 Microfinance ProgrammeSteady progress was made in the delivery of micro-credit through self-help groupsand joint liability groups . During 2019-20, 31.5 lakh new SHGs were credit-linked with banks and loans of ₹ 77,659 crore (including repeat loans) were disbursed to these SHGs. During the year, the number of Joint Liability Group and loan amounts disbursed by banks grew by 161 per cent and 169 per cent, respectively. The NPA ratio of the SHG loans declined to 4.9% from 5.2% in the previous year.

6. Credit to Micro, Small and Medium Enterprises (MSMEs). The number of MSME accounts and credit growth decelerated across PVBs and PSBs in 2019-20. PSBs' share in total credit to Micro, Small and Medium Enterprises decreased from 65% in 2017-18 to 55 per cent in 2019-20. Although the number of accounts with PVBs was more than double that with PSBs in 2019-20, the average amount of loans extended by PVBs was ₹2.39 lakh – much lower than ₹8.12 lakh by PSBs

7. Trade Receivables Discounting System. The Trade Receivables Discounting Systemconceived by the Reserve Bank in 2014 is an electronic platform on which receivables of Micro, Small and Medium Enterprises drawn against buyers (large corporates, PSUs, Government departments) are financed by multiple financiers through a competitive auction process. To widen the scope of Trade Receivables Discounting System and to incentivise more players to be part of this platform, banks' exposures were brought under priority sector lending in 2016. Three entities (example, Receivables Exchange of India Ltd., Trade Receivables Discounting System, and Mynd Solutions) licensed by the Reserve Bank have been operating the platform for more than three years.

In October 2019, the Reserve Bank had allowed 'on-tap' authorisation to entities desirous of providing platforms for . During Trade Receivables Discounting System 2019-20, the number and amount of invoices uploaded and financed through the platform almost doubled, however, the success ratewas marginally lower 11.7 Regional Banking Penetration.Despite recent strides in banking penetration across various geographies, significant inter-regional inequality remains in terms of the share of different regions in credit, deposits and branches The average population served per bank branch remains substantially higher in eastern, central and north-eastern regions than in other parts

8. Regional Rural Banks(RRBs). Regional Rural Banks bring together the rural orientation of credit co-operatives and professionalism of commercial banks to address the credit needs of the rural economy. With a view to enabling Regional Rural Banks (RRBs) to minimize their overhead expenses, optimize the use of technology, enhance the capital base and area of operation, and increase their exposure, the Government has initiated a structural consolidation of RRBs in three phases. In the ongoing third phase of amalgamation based on the principle of 'one state–one RRB' in smaller states and reduction in number of Regional Rural Banks (RRBs) in larger states, the number of RRBs declined to 45 by end-March 2020. Three RRBs were amalgamated, reducing the total number of RRBs to 43 with effect from April 1, 2020. In order to recapitalise RRBs with CRAR below 9%, the Government extended the process of recapitalisation up to 2020-21 and earmarked ₹670 crore as the central government's share in their recapitalization. This amount is equivalent to 50% of the planned recapitalization support of ₹1,340 crore, subject to the condition that the sponsor banks release their proportionate shares.

9. Balance Sheet Analysis. The acceleration in the consolidated balance sheet of Regional Rural Banks during 2019-20 was driven by capital expansion, fuelled by recapitalisation, as well as expansion of term deposits. On the assets side, RRBs resorted to parking their funds in investments as the loans and advances growth was subdued. Accumulated losses of more than Regional Rural Banks an doubled during 2019-20. RRBs are mandated to provide 75% of their total outstanding advances as on the corresponding date of the previous year for priority sector lending. During 2019-20, RRBs overachieved this mandate with 96 per cent. Agriculture lending topped the list of RRB credit portfolio (70%), followed by exposure to MSMEs (12.0%) and housing (7.8%) Financial Performance of Regional Rural Banks With acceleration in provisioning due to elevated NPAs and a sharp increase in operating expenses largely attributed to higher wage bills on account of implementation of pension scheme RRBs reported net losses for the second consecutive year. Their operating profits also declined, despite robust growth in both interest and non-interest income. Provisioning for pension liability and deteriorating asset quality led to erosion in capital positions of RRBs NPAs of RRBs are concentrated in the eastern, north-eastern and central regions which together accounted for 74% of the loss making RRBs

. Local Area Banks. In line with SCBs, the consolidated balance sheet of LABs decelerated in 2019-20. Contrary to SCBs, however, the deceleration was led by deposits while gross advances surged Reflective of this, the outstanding credit-deposit ratio of LABs increased from 75 per cent in the previous year to 81 per cent in 2019-20, unlike SCBs which experienced decline.

1. Financial Performance of LABs. In an environment characterised by low interest rates, the acceleration in interest income of LABs was moderate, while non-interest income increased substantially as these banks diversified their business. Slower increase in expenditure as compared to income led to increase in their profitability

2. Small Finance Banks. Small Finance Banks (SFBs) were set up in 2016 to provide basic banking services such as accepting deposits and lending to the unserved and the under-served sections of society, including small businesses, marginal farmers, micro and small industries, and the unorganised sector. At end-March 2020, ten SFBs were operational.

3. Balance Sheet of SFBs.In keeping with development over the last couple of years, SFBs' dependence on bank borrowings declined further in 2019-20 with deposits contributing more than 60 per cent of liabilities. On the assets side, however, balance sheet growth was led by investments as loans and advances decelerated

4. Priority Sector Lending of SFBs.The share of SFBs' lending to the priority sector declined for the third year in a row in 2019-20 with a quarter of total advances coming under non-priority sector as at end-March 2020. Within priority sector, their focus remained on MSMEs, followed by agriculture. There was an increase in the share of housing as a proportion to total advances

5. Financial Performance of SFBs.During 2019-20, the asset quality of SFBs improved, leading to a significant contraction in provisions and contingencies requirements even as their CRAR improved

. Payments Banks. Payments Banks (PBs) are niche banks that leverage technology for financial inclusion and are aimed at small businesses and low-income households. Their business model focuses on small remittances which are stored in digital wallets that can, in turn, be used for purchases of goods and services. Being a nascent business model that requires heavy overhead costs especially at the beginning, most of these banks are yet to turn profitable.

1. Balance Sheet. At end-March 2020, the number of operational PBs declined to six as compared with seven in the previous year as one bank surrendered its licence. The consolidated balance sheet of PBs increased in 2019-20 on a hefty increase in deposits with their share in liabilities more than doubling to 27.4% from 12.3% in 2018-19, despite the cap of ₹1 lakh per account. As these banks are not permitted to lend, their asset side growth was due to spurt in investments and balances with banks.

2. Financial Performance. Notwithstanding improvement in both interest income and non-interest income, the consolidated balance sheet of PBs ended the financial year 2019-20 with losses due to high operating expenses. The limited operational space of these banks, coupled with high initial costs in setting up of the infrastructure, implied that the initial years would be invested in expanding their customer base and they will take time to break even.

3. Inward and Outward Remittances. In 2019-20, inward and outward remittances through the UPI occupied the largest share in the total remittance business of payments banks in terms of both value and volume. In fact, more than 46% of inward and 37% of outward remittances in terms of value were made through the UPI channel. The second place was occupied by the IMPS channel, with 9.3% of inward and 24.5% of outward remittances flowing through this channel. The RTGS channel recorded strong growth with its share increasing to 13.2% of outward flow and 22.2% of inflow coming through it

II. CONCLUSION

The macroeconomic and financial environment, as it were characterised by a sharp deceleration in economic activity and weakening investment demand was suddenly exacerbated by COVID-19. Although, banks' financial conditions improved on lower slippages and higher capital buffers and provisions, subdued economic conditions amplified risk aversion and dragged down credit off-take. During 2020-21 so far, the safe haven appeal of banks led to a sharp accretion to deposits. With credit demand remaining anaemic, as the deleterious effects of COVID-19 played out on the economy, banks preferred to park funds in safer G-Secs to partially offset the impact of low lending. In anticipation of higher loan delinquencies, banks have announced ambitious plans to shore up their capital bases to adhere to regulatory requirements and to be lending-ready as and when credit demand bounces back.

The Reserve Bank initiated timely measures to relieve stress on bank balance sheets, corporates and households in the wake of the pandemic. With the moratorium coming to an end, the deadline for restructuring proposals is fast approaching and with the possible lifting of the asset quality standstill, banks' financials are likely to be impacted in terms of asset quality and future income. Going forward, banks will have to adapt and adjust to the rapidly evolving economic landscape due to these challenges and also the entry of niche players and emerging financial technologies.

Recent Technological and Other Developments in Banking Sector:

India's economic development and financial sector liberalization have led to a transformation of the Indian banking sector over the past two decades. Asset quality and profitability have improved significantly and the system has become more commercially oriented. Indian banks were not much impacted by the financial crisis, helped by their relative isolation and some counter-cyclical measures implemented by the Reserve Bank of India in the mid-2000s, but asset quality deterioration led to some proactive loan restructuring. Over the past years Indian banks have encountered more headwinds as high inflation led to tightening monetary policy, putting pressure on borrowers, especially in weaker sectors. Funding and liquidity are relatively strong features of the Indian banking system as the loans/deposits ratio is under 80 percent and the banks are required to hold large amounts of Indian government bonds. Their access to off-shore funding is constrained by India's just investment grade sovereign rating. Capital is also adequate in aggregate but some banks, including large public sector banks, are in need of core capital. Developments in the field of information technology (IT) strongly support the growth and inclusiveness of the banking sector thereby facilitating inclusive economic growth. IT not only 4 enhances the competitive efficiency of the banking sector by strengthening back-end administrative processes, it also improves the front-end operations and helps in bringing down the transaction costs for the customers. It has the potential of furthering financial inclusion by making small ticket retail transactions cheaper, easier and faster for the banking sector as well as for the small customers. The Reserve Bank has thus been actively involved in harnessing technology for the development of the Indian banking sector over the years. Information technology revolution in the Indian economy has made steady inroads into the banking institutions and has brought about a significant change in many aspects in the form of computerization of transactions and new delivery channels such as Internet Banking, Phone Banking, ATMs, EFT, ECS and EDI etc.. With migration of traditional paper-based funds movements to quicker and more efficient electronic mode, funds transfers have become easy and efficient to perform. 2.1 Bank Computerization: The most fundamental way in which technology has changed the face of the

Indian banking sector has been through computerization. Entry of new private sector banks and foreign banks offering most modern technology banking has forced public sector banks (PSBs) to address computerization problems more seriously in recent years. The pace of computerization has remained slow even though opposition from staff unions has softened. The Central Vigilance Commission wants 100 percent computerization in Indian banks to check frauds, delays, etc. The general perception is that in recent years, the prime focus of bank computerization has been less on the number of branches computerized but more on better connectivity, say, between the head office and regional offices of a bank with select branches. These are usually banks that handle large corporate borrowing accounts on one side and those that are in high deposit zones, on the other. While the private sector banks have been upgrading technology simultaneously with branch expansion, many of the top PSBs have completed automating their branches in the urban areas. The next step to total branch automation is networking of these branches. PSBs need to frame a strategy to choose the branches that have to be included in their networking scheme. Since it would be a daunting task for them to connect all the 64,000 branches spread across the country, as a first step, they are following the 80-20 thumb rule. It assumes that 80 percent of bank's business is carried out by only 20 percent of its branches. It is the branches with substantial business, most of which lie in the urban areas, that are initially 5 targeted for interconnection. A major problem PSBs have to face, once IT implementation reaches its optimum level, is staff retention. While the private sector banks have been recruiting trained and experienced IT professionals, it may not be possible for PSBs to do likewise. They will have to train their existing staff to function effectively in the new environment. And once the requisite skills are acquired by employees, they may have trouble retaining staff. PSBs can only allocate limited capital resources to computerization. They will have to choose between high cost of computerization at metro and urban centers and low cost computerization at rural, semi-urban branches. Also, they will have to factor in returns on IT assets, and growth and productivity improvements. Newly opened private sector banks, foreign banks, and a few other Indian banks have started Electronic Money activities, which open up business opportunities but carry risks that need to be recognized and managed prudently. The Basel Committee on Banking Supervision has raised issues of critical importance to banking authorities in this regard. There is no evidence that these aspects are being looked into in India, yet there is a need for auditing firms to be aware of this issue. Despite recapitalization, the overall performance of PSBs continues to lag behind those of private sector and foreign banks. Questions of ownership, management, and governance are central to this issue. Under public ownership, it is almost impossible to draw a distinction between ownership responsibility and managerial duty. For this reason, Government-owned banks cannot insulate themselves from interference. Inevitably, some PSBs are overregulated and over administered. A central concern is that banking operation flexibility, which is essential for responding to changing conditions, is difficult to implement. Under public control, the efficiency objective in terms of cost, profitability, and market share is subordinated to the vaguely defined public interest objective. Moreover, it is not only difficult to inject competition between PSBs since they have a common ownership, but government-imposed constraints have also meant that they have not been able to effectively compete with private sector banks. India still has to find a middle path of balancing divergent expectations of socio-economic benefits while promoting competitive capitalism. Political sensitivities can make privatization difficult but the government aims to bring down its holdings to 51 percent. When that happens, a great stride will be completed. In 1998, announcements have been made on corporatization of IDBI and reduced government holdings in Bank of Baroda, Bank of India, Corporation Bank, Dena Bank, IDBI, Oriental Bank of Commerce, and SBI. Of the total number of public sector bank branches, 97.81

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