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PNB CASE

New tech and strong corporate governance needed to check frauds

CHANDRAJIT BANERJEE

THE CASE of the Punjab National Bank (PNB) fraud has again brought to center stage the state of India's banking sector. Many dimensions of the sector need to be tackled. One set of measures is required to address the problems being faced by banks, while another should be targeted to enhance and strengthen corporate governance among companies.

The PNB incident, which apparently has been underway for some years, exposes the vulnerabilities of banks with respect to supervision and monitoring. The letters of undertaking (LoUs) issued by PNB without proper backing have impacted other banks, implying systemic risk to the entire banking sector. In turn, lending may be curtailed and normal trade credit might suffer as banks take remedial action.

This is an appropriate time to delve into the structure of India's banking sector, which includes public sector banks (PSBs) and private banks as well as smaller regional rural banks and cooperative banks. The transformation brought by technology advance requires a new response. Brick-and-mortar banks are no longer the need of the hour and online banking facilities are available on mobile devices.

Banks, especially PSBs, require a systemic overhaul related to ownership, management, and regulation. PSBs account for about 70 per cent of the banking assets and almost three-quarters of deposits of all scheduled commercial banks. As such, they are prone to higher malfeasance risks. Their non-performing assets (NPAs) have deteriorated in recent years, with gross NPAs as a proportion of total assets rising from 4.6 per cent in March 2015 to 9.6 per cent in March 2017. This is set to grow further as per the Reserve Bank of India's new resolution framework. Given that high NPAs restrict bank lending capacity, the government has sought to infuse capital into stressed PSBs. Recapitalisation exercises have been conducted every year with the amount going up in recent years, peaking at a proposed Rs 2.11 lakh crore for 2017-18.

These are welcome measures. The government proposes to reduce its holdings in PSBs to 52 per cent. This should be accompanied by consolidation of PSBs to create fewer but stronger institutions of global scale. This would help professionalise management and bring in operational efficiencies with better risk management. More banks in the private sector could also be considered.

Steps to strengthen due processes and professional management systems would help improve the internal operations regarding credit decisions and money transfers for all banks — public and private. Today, new technologies are available that can reduce human interface with in-built security processes. Smart technologies such as blockchain, big data analytics, and artificial intelligence should be encouraged, so that risk management is facilitated.

Where human interventions are necessary, adequate checks and balances and staffing solutions such as regular rotation of staff, double-checking of procedures, and appropriate level of clearances must be instituted. Again, technology can be an enabler for scanning and monitoring transactions or aggregating them into different risk levels for better monitoring. Some banks are working on blockchain technologies that can strengthen the entire backend system.

Banks, especially public sector banks, require a systemic overhaul related to ownership, management, and regulation. PSBs' gross NPAs have risen from 4.6% in March 2015 to 9.6% in March 2017

Corporate governance needs to be strengthened. Integrity and ethics have to be inculcated in the DNA of an organisation, related to its internal systems as also to its dealings with stakeholders, including customers, employees, investors, vendor partners, government and society. Third-party accountability has to be made integral to operations and internalised as a vital governance constituent. Early detection system of frauds as a part of fraud management, usage of digital technology and focus on cyber security, encouragement to whistle blowing, rigorous business approval processes and accountability, anti-bribery mechanisms, risk management, and strict vendor and customer governance are all aspects that need to be built into the system.

CII has evolved various corporate governance Codes aimed to assist companies in building their systems to meet regulatory standards and better transparency.

Keeping in mind the leadership position the Indian economy is looking at, organisations have to continue to work towards ensuring that business priorities are embedded with governance initiatives and actions. The new wave of self-regulation has to usher in greater responsibility, greater accountability and larger role for the leadership.

The PNB incident is yet another wake-up call for all stakeholders. It is time that we collectively build the institutions and industry that will propel us into the next growth trajectory.

The writer is director general, Confederation of Indian Industry