India-EU FTA

Banking Services Liberalization: An Indian Perspective

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European Banks in India

- The potential impacts of India-EU FTA on Indian banking sector would be far reaching than other FTAs (India-SG/India-Japan) because EU-based banks are the biggest foreign banks in the India.

European banks control 65% of total assets of foreign banks in India.

Out of top 10 foreign banks, 6 are EU-based.
Out of top 4 foreign banks, 3 are EU-based (SC, HSBC and RBS).

- For UK-based Standard Chartered, India is the largest contributor in global profits. 20% of its global profits come from India. In India, it earned 1.2 billion (Rs.6000 crore) in profits in 2010.

- In 2010, HSBC earned $769 million (about Rs 3800 crore) in profits from Indian operations. In the US, HSBC is selling its 195 branches but in India it is expanding and bought all the retail business of RBS.
“The market access for the services sector (like banking and insurance) is very essential to conclude the free trade agreement between EU and India.”

– Daniele Smadja, Former Head of EU Delegation to India, 20.9.2010

EU Banks’ Agenda: European Services Forum and others.

• Removal of caps on bank ownership (public and private).

• Full National Treatment of WoS.

• Removal of various restrictions on branch licenses.

• Removal of priority sector lending on locally-incorporated EU banks.

• Allow EU banks to raise deposits from PSE.
The real push for banking services is coming from UK. Financial services account for 11 per cent of UK’s GDP, more than twice of that in Germany and France.

The UK trade surplus is largely on account of financial services exports. Its trade balance in manufactured goods is negative.

“**If you said ‘choose one country in the world that you could expand into’ that would be India. We have not had the opportunities to make major investments in India. We are hungry to invest in India.’”

– Douglas Flint, Chairman, HSBC

Why European Banks are interested in India?

■ Unlike China and other Asian economies which are export-driven and investment-driven, Indian economy is consumption-driven. The domestic consumption accounts for 57% of our GDP.

■ Indian economy is growing at 6-8% for the past several years.

■ The demand for investment banking, advisory services and mergers and acquisitions is booming.

■ Favorable demographics and rising consumer demand in India.

■ Indian companies are investing abroad so European banks have a competitive edge than local banks to facilitate such international investments.
Indian domestic banks are not much involved in investment banking, securitization and trading in fancy instruments such as derivatives. European banks have a competitive edge in these instruments.

At present, foreign banks have a limited presence in the Indian markets. 8%. They are very keen to increase their share in Indian banking system.

There is financial stability in India. India is among few countries whose financial system was not badly affected from the GFC. Indian banks are not highly leveraged. The leverage ratio is 6.6%, much lower than Western banks.

Post-crisis, financial stability has become very important criteria for investments by big international banks.

All these factors push EU-based banks to seek greater presence in India despite that fact that foreign banks are taxed higher (42.02%) than local banks (32.45%) in India because they operate through a branch model.
Financial Inclusion: A Challenging Task Ahead

- Financial inclusion has become a key development policy objective in India. There are 500 million citizens who lack access to banking services.

India has more mobile phones than bank accounts. Out of 1000 person, only 99 had a credit account and 600 had a deposit account in 2010.

- Now the question is: If India gives European banks greater market access under the FTA, would they promote financial inclusion?

- Would European banks open bank branches in rural and remote areas?

- Would they provide small-sized loans to farmers, small scale industries, artisans, small retailers and informal sector?

- Do they have any expertise and experience in providing banking services to poor people, informal sectors and SMEs?
“Cherry Picking”

The big European banks are looking for 3 niche market segments in India:

1. Up-market consumer retail finance.

2. Investment banking, structured finance products (such as derivatives), financing mergers and acquisitions, lending to capital markets and real estate.

3. Wealth management services and private banking services to rich Indians. India has got 153,000 dollar millionaires in 2010. There are more dollar billionaires in India than Germany. These banks wish to serve the new rich and super-rich Indians.

But if they take away the most profitable clients and businesses, our local banks would be left with less creditworthy customers, thereby affecting the financial performance of local banks.
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“Class Banking”

- The EU-based banks are essentially based in metros but they don’t serve the urban poor living in metros.

There is no regulatory ban on EU-based banks to serve 90 million urban poor population in India. Therefore it is not the regulations or lack of market which is hindering European banks to serve the un-banked population in India. The problem is with their business model which is based on class banking.

- The European banks tend to follow “class banking” instead of “mass banking.”

Most of their corporate clients are big business houses and TNCs.

- European banks charge higher fees from consumers than local banks.
Some Disturbing Trends in Indian Banking

The Share of SME Credit in Total Bank Credit

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<td>2006</td>
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<td>2007</td>
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Source: Reserve Bank of India.
## The Share of SME Credit in Total Credit

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<td>2007</td>
<td>4.6</td>
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The bank credit to agriculture is declining since the 1990s.

Bank branches in rural areas are being closed down to meet the profitability criteria. As many as 1967 branches in rural areas were closed down between 2004-06.

The agricultural sector received only 13% of total credit in 2010-11.

### Bank Credit to Agriculture (in %)

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</table>
All foreign banks in India together operate just 1073 credit accounts related to agriculture sector.

Out of which, 110 bank accounts are related to direct lending while the rest 963 belong to indirect lending.

EU banks are highly concentrated in few market segments.

The bulk of lending by European banks is in services sector followed by personal loans (consumer finance) and real estate.

The off-balance-sheet exposure of foreign banks (e.g., forward exchange contracts) is very high.

If there is a major default, it could affect the soundness of the Indian banking system.
Composition of Off-Balance Sheet (OBS) Exposures of Indian Banking Sector 2010-11

- Foreign Banks: 67.2%
- State-owned Banks: 15.8%
- Private Banks: 17.0%

- Forward Exchange Contracts: 86.8%
- Acceptance: 12.5%
- Guarantees: 0.7%
Off-Balance Sheet Exposures (OBS) and Balance Sheet Assets (BA) 2010-11

![Bar Chart](chart.png)

- **SBI Group**: Blue and Red bars
- **NBs**: Blue and Red bars
- **NPRBs**: Blue and Red bars
- **OPRBs**: Blue and Red bars
- **Foreign Banks**: Blue and Red bars

**In Rs. crore**

- OBS
- BA
Benefits of European Banks: Four Myths

■ Large presence of EU banks will increase financial inclusion.

■ Large presence of EU banks will increase efficiency of Indian banking system. This argument lacks evidence. In reality, Indian banks are more efficient than foreign banks despite the fact Indian banks have a large presence in rural and remote areas where transaction size is very small. Take any indicator (RoE, RoA, DAE), Indian banks perform better than EU banks.

■ EU banks will offer new products and new services to consumers in India.

At present most Indian banks provide all kinds of products and services including internet banking, phone banking, mobile banking, door-to-door banking and other kinds of products and services.

Much of the technology used by European banks (such as ATMs/CBS) are provided by Indian IT companies.
It is claimed that European banks follow “best practices” so they will improve performance and risk management of Indian banking system.

The ongoing global banking crisis has shown that UK and European banks were following bad risk management models and practices.

Several big European banks transmitted financial shocks across countries during the GFC.

In Russia and Czech Republic, European banks used local subsidiaries to mobilize liquidity in order to support their headquarters. So there was repatriation of funds uphill from subsidiaries to HQ.

Because of global liquidity pressures, foreign banks can reduce credit. In India, foreign banks drastically reduced credit (20%) during the GFC.

So it were Indian banks (state-owned) who came to rescue. They increased lending to stimulate our domestic economy.
Foreign Banks: Fair-Weather Friends?

- There is a fundamental difference between local and foreign banks. Unlike local banks, foreign banks can pack up and leave.

In India, Deutsche Bank moved out of retail banking in 1996 because of recessionary conditions. But they again came back in 2005 to benefit from India’s growth story. Same is the case with ANZ Grindlays who sold its 50 branches network in India to SC in 2000 but returned back to India in 2011.

- Foreign banks can leave a country if their parent bank is in trouble. In India, RBS has sold its all operations because the parent bank in the UK is in trouble. Despite the fact that Indian operations of RBS were hugely profitable.

- Foreign banks can also leave if there is a financial crisis in the host country.

In Argentina, many foreign banks left the country when a financial crisis erupted in 2001.
Thank You