Financial Intermediation and Markets

5

CHAPTER

Broader and deeper financial markets will be crucial for mobilizing higher savings and intermediating them efficiently to finance higher investment and growth. India's financial markets continued to gain strength in recent years, in the wake of steady reforms since 1991. Prudent regulations and institutions protected the economy from the recent global financial shocks. And its dynamism is a leading factor in the current recovery.

Year-on-year non--food credit growth was up 24 per cent at the end of December 2010, and financed many sectors more broadly (from the agriculture rebound to third generation [3G] spectrum sales and private infrastructure projects), while the overall credit to gross domestic product (GDP) ratio rose to about 55 per cent, continuing its progress (but still structurally well below potential). Domestic capital markets performed well in 2010, primary markets financing record levels, including the largest-ever initial public offering (IPO) (for Coal India), while secondary markets reached new highs. Record foreign inflows helped support the market. Pensions and insurance gained, with life insurance premium growing nearly 26 per cent and penetration doubling to 5.4 per cent of GDP in 2009, from 2.3 per cent in 2000 when insurance reforms started. Looking to the future, the twin challenges are to continue this progress on gradual financial reform and to modernize regulations and institutions to ensure its continued safety and stability.

The past year saw banking deposit growth slow-down, as real interest rates were depressed, especially compared to returns in other fast-recovering asset markets (real estate, gold, and stock markets). The priority is to considerably extend the reach of banking to help mobilize more savings, add more depth, and more efficiently intermediate opportunities, including those in the traditional 'priority' sectors. To move ahead (1) **financial inclusion** *needs to be accelerated as a next crucial step; innovative solutions will be needed in this regard; (2) similar efforts are needed to deepen* **domestic capital markets** *and the role of non-bank institutions, especially in corporate bond and debt markets; (3) the rapid* **lowering of fiscal deficits is needed to help crowd-in** *such developments; and (4) the Government and Reserve Bank of India (RBI) have already begun a series of essential* **regulatory overhaul**, *aimed at updating the modern legislation underlying financial markets, and improving macro-prudential safeguards and institutions. We need to continue along this path. The rest of the chapter describes this series of developments in the financial sector.*

BANK CREDIT

5.2 Bank credit that started picking up from the last quarter of 2009-10 continued its momentum during 2010-11 as well. The pickup in credit reflected the improved demand conditions associated with stronger industrial recovery and growth. Telecom operators raised credit to pay for 3G/broadband wireless access (BWA) spectrums, which partly contributed to stronger credit growth in the first quarter of 2010-11.

Table 5.1 : Flow of bank credit

As on 17 December, 2010

	Outstanding as in end-March			Outstanding as on		Financial Year so far		Year-on-Year	
	₹ crore					(Percentage variation)			
	2008	2009	2010	17-Dec. 10	18-Dec. 09	2009-10	2010-11	2009-10	2010-11
1. Bank Credit	23,61,914	27,75,549	32,44,788	36,39,866	29,42,279	6.0	12.2	11.3	23.7
(a) Food Credit	44,399	46,211	48,489	62,521	45,037	-2.5	28.9	-13.6	38.8
(b) Non-food Credit	23,17,515	27,29,338	31,96,299	35,77,345	28,97,242	6.2	11.9	11.8	23.5
2. Aggregate Deposit	31,96,940	38,34,110	44,92,826	47,99,789	41,84,358	9.1	6.8	17.9	14.7
(a) Demand Deposits	5,24,310	5,23,085	6,45,610	5,84,713	5,25,516	0.5	-9.4	19.9	11.3
(b) Time Deposits	26,72,630	33,11,025	38,47,216	42,15,076	36,58,842	10.5	9.6	17.6	15.2
3. Investment	9,71,715	11,66,410	13,84,752	14,43,303	13,49,540	15.7	4.2	24.6	6.9
(a) Govt Securities	9,58,662	11,55,785	13,78,395	14,38,268	13,42,383	16.1	4.3	25.2	7.1
(b) Other Approved	13,053	10,625	6,358	5,035	7,156	-32.6	-20.8	-34.5	-29.6

Source : RBI.

5.3 As against an increase of 17.5 per cent in 2008-09, growth in bank credit moderated to 16.9 per cent in 2009-10. Non-food credit during the same period was 17.8 per cent and 17.1 per cent respectively. During 2010-11 credit started picking up in a strong way from early June 2010 and since then the growth in bank credit has shown a continuous increasing trend. During the financial year 2010-11, growth in bank credit extended by scheduled commercial banks (SCBs) stood at 12.2 per cent as on 17 December 2010 as compared to 6.0 per cent for the corresponding period in 2009-10. The year-on-year growth in bank credit as on 17 December 2010 was high at 23.7 per cent as compared to 11.3 per cent for the corresponding period of the previous year. It was in fact above the Reserve Bank's indicative projected trajectory of 20 per cent for the full year as set out in the Second Quarter Review for 2010-11 (2 November). Growth in non-food credit so far in 2010-11 on financial-year basis was much higher at 11.9 per cent as compared to 6.2 per cent in the previous year and 23.5 per cent year-on-year basis as compared to 11.8 per cent for the corresponding period of the previous year. Growth in aggregate deposits so far in 2010-11 have been lower than for the corresponding period of the previous year (Table 5.1). The high expansion in credit relative to lower growth in deposits during 2010-11 has caused increase in the credit- deposit ratio from 72.2 per cent in end-March 2010 to 75.8 per cent on 17 December 2010 (Figure 5.1).

Figure 5.1 Credit deposit ratio

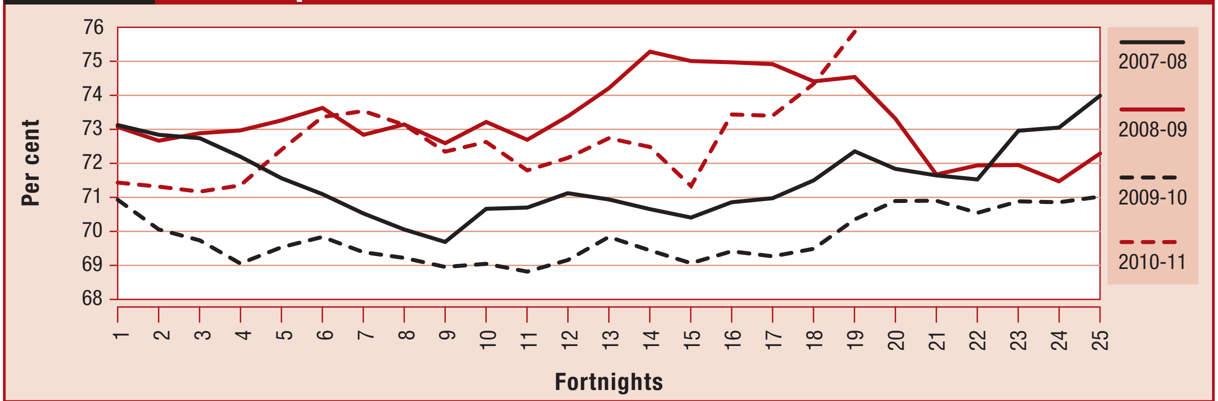
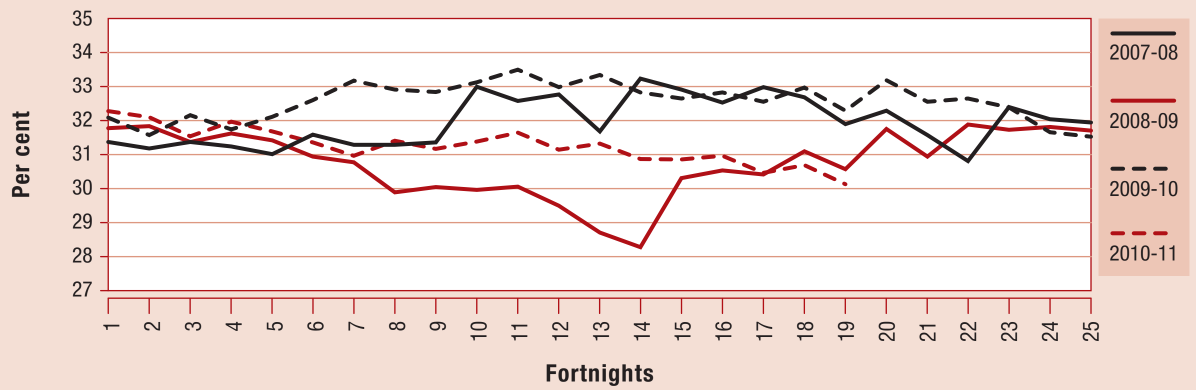


Figure 5.2 Investment deposit ratio



5.4 During the financial year so far, private-sector banks have been faring better in terms of growth in credit extended as compared to public-sector banks (PSBs) and foreign banks. Due to higher credit growth and tight liquidity condition, commercial banks' investment in Government and other approved securities remained low at 27.3 per cent as compared to 29.2 per cent in the previous year. Consequently, the investment-deposit ratio declined from 30.8 per cent in end-March 2010 to 30.1 per cent on 17 December 2010 (Figure 5.2) as the investment and deposit growth of SCBs is lower.

Interest rates

i. Deposit Rates

5.5 Domestic deposit rates of SCBs have moved up so far during 2010-11. Following the RBI's raising of the repo and reverse repo rates by 125 basis points (bps) and 175 bps respectively during March-November 2010, the SCBs increased their deposit rates by 50 bps to 200 bps. Interest rates offered by the PSBs, private-sector banks and foreign banks on deposits of maturity of one to three years changed from the range of 6.00-7.25 per cent, 5.25-7.75 per cent, and 2.25-8.00 per cent respectively in March 2010 to the range of 7.00-8.50 per cent, 7.25-9.00 per cent, and 3.00-8.00 per cent respectively in December 2010 (Table 5.2).

ii. Lending Rates

5.6 The BPL₹ of SCBs remained unchanged from July 2009 till end-June 2010. The base rate system replaced the BPLR system with effect from 1 July 2010. The base rates of PSBs, private-sector banks, and foreign banks were fixed in the range of 7.50-8.25 per cent, 7.00-8.75 per cent, and 5.50-9.00 per cent respectively. Subsequently, several banks reviewed and increased their base rates. The base rate of PSBs and private-sector banks changed to the range of 7.60-9.00 per cent and 7.00-9.00 per cent respectively in December 2010 (Table 5.2). Subsequent to the migration to the base rate system, effective 1 July 2010, we find a large degree of convergence of base rates as announced by banks. Almost 60 banks with a of 97 per cent share in total bank credit have fixed the base rate in the close range of 7.00-8.50 per cent in November 2010.

iii. Interest Rates on Non-resident Indian (NRI)Deposits

5.7 The interest rates on non-resident external term deposits (NRE) and foreign currency non-resident bank account (FCNR[B]) deposits are regulated by RBI. At present, NRE ceiling deposit interest rate stands at LIBOR plus 175 basis points and FCNR(B) ceiling deposit interest rate is at London Interbank offered rate (LIBOR) plus 100 bps.

iv. Interest Rate on Rupee Export Credit

5.8 The validity of the reduction in interest rate ceiling to 250 bps below the BPLR on pre-shipment rupee export credit up to 270 days and post-shipment rupee export credit up to 180 days was extended to 30 June 2010 from 30 April 2010. However, the RBI meanwhile advised the SCBs on 9 April 2010 to replace the BPLR system with a base rate system from 1July 2010. This necessitated changes in the formula in respect of interest rate on export credit. Accordingly, it was decided to deregulate the interest rates on pre-shipment rupee export credit up to 270 days and post-shipment rupee export credit up to 180 days. Banks are, therefore, free to decide the lending rate on export credit at or above the base rate with effect from 1 July 2010.

Table 5.2 : Movements in deposit and lending rates

(per cent)

Interest Rates	Mar.-2009	Mar.-2010	Jun.-2010	Jul.-2010	Sep.-2010	Dec.-2010*
Term Deposit Rates						
PSBs						
a) Up to 1 Year	2.75-8.25	1.00-6.50	1.00-6.25	1.00-6.25	1.00-7.00	1.00-8.00
b) 1 Year up to 3 Years	8.00-9.25	6.00-7.25	6.00-7.25	6.00-7.25	6.75-7.75	7.00-8.50
c) Over 3 Years	7.50-9.00	6.50-7.75	6.50-7.75	6.50-7.75	7.00-7.75	7.00-8.75
Private-sector Banks						
a) Up to 1 Year	3.00-8.75	2.00-6.50	2.00-6.50	2.00-6.50	2.50-7.25	2.50-7.60
b) 1 Year up to 3 Years	7.50-10.25	5.25-7.75	6.25-7.50	6.25-7.75	6.50-8.25	7.25-9.00
c) Over 3 Years	7.50-9.75	5.75-8.00	6.50-8.00	6.50-8.00	6.50-9.00	7.00-9.00
Foreign Banks						
a) Up to 1 year	2.50-8.50	1.25-7.00	1.25-7.00	1.25-7.00	1.25-7.30	1.25-7.00
b) 1 year up to 3 years	2.50-9.50	2.25-8.00	3.00-8.00	3.00-8.00	3.00-8.00	3.00-8.00
c) Over 3 years	2.50-10.00	2.25-8.75	3.00-8.50	3.00-8.50	3.00-8.25	3.00-8.25

Source: RBI.
Notes: * As on 10 December 2010.
2. Benchmark prime lending rate (BPLR).

5.9 The Government of India decided to extend interest subvention of 2 percentage points with effect from 1 April 2010 to 31 March 2011 on pre- and post-shipment rupee export credit for four export sectors, namely handicrafts, carpets, handlooms, and small and medium enterprises (SMEs) subject to the condition that the interest rate after subvention will not fall below 7 per cent, which is the rate applicable to a short-term crop loan under priority-sector lending. With the changeover to the base rate system, the interest rates applicable to all tenors of rupee export credit advances with effect from 1 July 2010 will be at or above base rate in respect of all fresh/ renewed advances. Accordingly, banks may reduce the interest rate chargeable to exporters as per the base rate system in the four sectors by the amount of subvention available. If, as a consequence, the interest rate charged to exporters goes below the base rate, such lending will not be construed to be violative of the base rate guidelines.

Sectoral Deployment of Credit

5.10 Disaggregated data on sectoral deployment of gross bank credit from 47 banks accounting for about 95 per cent of bank credit and non-food credit available up to 19 November 2010 showed that among the major sectors, credit (year-on-year) to agriculture recorded a growth of 20.0 per cent (22.9 per cent in March 2010), while that to industry (medium and large) recorded a growth of 28.9 per cent (as against 24.8 per cent in March 2010). Credit to wholesale trade recorded a growth of 17.0 per cent (as against 28.1 per cent in March 2010).

5.11 Credit to the priority sector grew by 21.0 per cent (year-on-year) in November 2010 as compared to 17.1 per cent in March 2010. Among the priority sub-sectors, credit to micro and small enterprises (MSEs) (including service-sector enterprises) recorded a growth of 21.5 per cent (year-on-year) in November 2010 as compared to 20.8 per cent in March 2010. (Table 5.3).

Priority-sector Lending

5.12 A target of 40 per cent of adjusted net bank credit (ANBC) or credit equivalent amount of off-balance sheet exposures (OBE), whichever is higher, as on 31 March of the previous year, has been stipulated for lending to the priority sector by domestic SCBs, both in the public and private sectors Within this, sub-targets of 18 per cent and 10 per cent of ANBC or credit equivalent amount of OBE, whichever is higher, have been stipulated for lending to agriculture and the weaker sections respectively. However, to ensure that the focus of the banks on the direct category of agricultural advances does not get diluted, the indirect lending

Table 5.3 : Sectoral deployment of gross bank credit

Sl. No. Sector	Outstanding as on (₹ crore)				% Variation		
	27 Mar. 2009	20 Nov. 2009	26 Mar. 2010	19 Nov. 2010	26 Mar./ 2010 Absolute amount	27 Mar. 2009	19 Nov. 2010 / 20 Nov. 2009
Gross Bank Credit (1 + 2)	26,47,368	27,56,861	30,88,569	33,71,551	4,41,201	16.7	22.3
1 Food Credit	45,544	40,645	48,562	56,248	3018	6.6	38.4
2 Non-food Gross Bank Credit (a+b+c+d)	26,01,825	27,16,216	30,40,007	33,15,303	4,38,182	16.8	22.1
a. Priority Sector	932,459	949,287	1,092,179	1,148,808	159,720	17.1	21.0
i. Agriculture & Allied Activities	338,656	343,070	416,133	411,816	77,477	22.9	20.0
ii. Micro & Small Enterprises	309,195	335,655	373,530	407,872	64,335	20.8	21.5
iii. Other Priority Sectors	2,84,608	2,70,562	3,02,516	3,29,120	17,908	6.3	21.6
b. Industry (micro & small, medium and large)	8,85,393	9,69,261	11,05,051	12,49,843	2,19,658	24.8	28.9
c. Wholesale							Trade
(other than food procurement)	67,425	80,922	86,357	94,702	18,932	28.1	17.0
d. Other Sectors	7,16,548	7,16,746	7,56,420	8,21,950	39,872	5.6	14.7
Of Non-food Gross Bank Credit							
1 Housing (including priority-sector housing)	2,79,365	2,91,760	3,00,929	3,27,391	21,564	7.7	12.2
2 Consumer Durables	8187	8028	8294	8928	107	1.3	11.2
3 Commercial Real Estate	92,421	88,581	92,128	1,05,479	(293)	-0.3	19.1
4 Tourism, Hotels, & Restaurants	13,625	15,667	19,410	26,470	5785	42.5	69.0
5 Advances to Individuals against Shares, Bonds, etc.	2287	2347	2863	2935	576	25.2	25.1

Source : RBI.

Note : Date the provisional & relate to select scheduled commercial banks (SCBs) which account for 95 per cent of total bank credit extended by all SCBs.

to agriculture in excess of 4.5 per cent of ANBC or credit equivalent amount of OBE, whichever is higher, are not reckoned for computing performance under 18 per cent target. However, all agricultural advances under the categories 'direct' and 'indirect' are reckoned in computing performance under the overall priority-sector target of 40 per cent of ANBC or credit equivalent amount of OBE, whichever is higher.

5.13 A target of 32 per cent of ANBC or credit equivalent amount of OBE, whichever is higher, has been stipulated for lending to the priority sector by foreign banks having offices in India. Within the overall target of 32 per cent to be achieved by foreign banks, the advances to MSEs and export sectors should not be less than 10 per cent and 12 per cent of the ANBC or credit equivalent amount of OBE, whichever is higher, respectively.

5.14 The outstanding advances granted by PSBs, private-sector banks, and foreign banks to the priority sector as on the last reporting Friday of March 2008, 2009, and 2010 are furnished in Table 5.4. There were shortfalls in the case of a few individual banks in the public and private sectors and foreign banks.

5.15 The outstanding priority-sector advances of PSBs increased from ₹ 7,24,150 crore as on the last reporting Friday of March 2009 to ₹ 8,64,564 crore as on the last reporting Friday of March 2010, showing a growth of 19.39 per cent. Although, PSBs as a group had achieved the overall priority-sector lending target of 40 per cent of ANBC or credit equivalent amount of OBE, whichever is higher, and formed 41.68 per cent of ANBC as on the last reporting Friday of March 2010, three banks, namely State Bank of Mysore, Indian Overseas Bank, and Industrial Development Bank of India (IDBI) Ltd, out of 27 public sector banks did not individually achieve the target.

5.16 The outstanding priority-sector advances of private-sector banks increased from ₹ 1,87,849 crore as on the last reporting Friday of March 2009 to ₹ 2,15,552 crore as on the last reporting Friday of March 2010, showing a growth of 14.74 per cent. Although, private-sector banks as a group had achieved the overall priority-sector lending target of 40 per cent of ANBC or credit equivalent amount of OBE, whichever is higher, and formed 45.99 per cent of ANBC as on the last reporting Friday of

Table 5.4 : Particulars of Priority-sector Advances

A. PUBLIC SECTOR BANKS			(₹ crore)
As on the last reporting Friday of	March 2008	March 2009	March 2010 (provisional)
Total Priority-sector Advances	6,10,450(44.7)	7,24,150(42.8)	8,64,564(41.7)
Total Advances to Agriculture*	2,49,397(18.3)	2,99,415(17.7)	3,70,730(17.3)
Total Advances to MSEs	1,51,137(11.1)	1,91,408(11.3)	2,78,398(13.2)
Advances to Weaker Sections	1,21,740(8.9)	1,65,829(9.8)	2,12,214(10.2)
2. PRIVATE-SECTOR BANKS			
As on the Last Reporting Friday of	March 2008	March 2009	March 2010(provisional)
Total Priority-sector Advances	1,64,068(47.8)	1,87,849(46.2)	2,15,552(46.0)
Total Advances to Agriculture*	58,567(17.0)	76,103(18.7)	89,769(15.6)
Total Advances to MSEs	46,912(13.7)	46,656(11.5)	64,534(13.7)
Advances to Weaker Sections	7152(2.0)	14,262(3.5)	25,690(5.5)
3. FOREIGN BANKS			
As on the Last Reporting Friday of	March 2008	March 2009	March 2010(provisional)
Total Priority-sector Advances	50,254(39.5)	55,483(34.3)	60,290(35.0)
Total advances to MSEs	15,489(12.2)	18,138(11.2)	21,080(12.3)
Total Export Credit (includes SSI export)	28,954(22.7)	31,511(19.4)	35,466(20.7)

Source: RBI

Note: 1. *Indirect agriculture is reckoned only up to 4.5 per cent of the ANBC or credit equivalent of OBE, whichever is higher.

2. The figures in parentheses show percentage of advances to ANBC or credit equivalent amount of OBE, whichever is higher.

March 2010, two banks, namely Bank of Rajasthan Ltd., and State Bank of India (SBI) Commercial Bank, out of 22 private sector banks did not individually achieve the target individually.

5.17 The outstanding priority-sector advances of foreign banks increased from ₹ 55,415 crore as on the last reporting Friday of March 2009 to ₹ 60,290 crore as on the last reporting Friday of March 2010, showing a growth of 8.79 per cent. Foreign banks as a group had also achieved the overall priority-sector lending target of 32 per cent of ANBC or credit equivalent amount of OBE, whichever is higher, and formed 35.09 per cent of ANBC as on the last reporting Friday of March 2010. However, two of the 28 foreign banks, namely Krung Thai Bank and Oman International Bank, did not individually achieve the target. Table 5.4 gives figures of priority-sector advances.

5.18 In order to improve and enhance the flow of credit to the priority sector, the following policy initiatives were taken during 2010-11:

(i) All SCBs were advised to ensure that:

(a) of the total advances to the MSE sector, 40 per cent should go to micro (manufacturing) enterprises having investment in plant and machinery up to ₹ 5 lakh and micro (service) enterprises with investment in equipment up to ₹ 2 lakh;

(b) of the total advances to the MSE sector, 20 per cent should go to micro (manufacturing) enterprises with investment in plant and machinery above ₹ 5 lakh and up to ₹ 25 lakh, and micro (service) enterprises with investment in equipment above ₹ 2 lakh and up to ₹ 10 lakh. (Thus 60 per cent of MSE advances should go to micro enterprises).

(ii) In terms of the recommendations of the Prime Minister's Task Force on Micro, Small and Medium Enterprises (MSMEs) (Chairman: Shri T. K. A. Nair) constituted by the Government of India, banks were advised as follows :

(a) to achieve a 20 per cent year-on-year growth in credit to MSEs to ensure enhanced credit flow;

(b) to achieve the allocation of 60 per cent of the MSE advances to micro enterprises in stages, namely 50 per cent in the year 2010-11, 55 per cent in the year 2011-12, and 60 per cent in the year 2012-13, and;

(c) to achieve a 10 per cent annual growth in number of micro-enterprise accounts.

(iii) In terms of recommendations of the Working Group constituted by the RBI to review the Credit Guarantee Scheme of the Credit Guarantee Fund Trust for Micro and Small Enterprises (Chairman: Shri V. K. Sharma, Executive Director, RBI) banks were advised not to accept collateral security in the case of loans up to ₹ 10 lakh extended to units in the MSE sector.

(iv) The limit for waiver of margin/ security requirements for agricultural loans was enhanced from ₹ 50,000 to ₹ 1 lakh. Thus, at present, all agricultural loans up to ₹ 1 lakh do not require any collateral.

Micro Finance

5.19 RBI guidelines to banks for mainstreaming micro-credit and enhancing the outreach of micro-credit providers, inter alia, stipulated that micro-credit extended by banks to individual borrowers directly or through any intermediary would henceforth be reckoned as part of their priority-sector lending. However, no particular model was prescribed for micro-finance and banks have been extended freedom to formulate their own model[s] or choose any conduit/intermediary for extending micro-credit.

5.20 Though there are different models for purveying micro-finance, the self-help group (SHG)-Bank Linkage Programme has emerged as the major micro-finance programme in the country. It is being implemented by commercial banks, regional rural banks (RRBs) and cooperative banks.

5.21 Under the SHG-Bank Linkage Programme, as on 31 March 2010, 69.53 lakh SHGs held saving bank accounts with total savings of ₹ 6199 crore as against 61.21 lakh SHGs with savings of ₹ 5546 crore as on 31 March 2009. Thus, about 97 million families were associated with banking agencies under the Programme. As on 31 March 2010, commercial banks had the maximum share of SHG savings with 40,52,915 SHGs (58 per cent) and savings amount of ₹ 3674 crore (59 per cent) followed by RRBs with saving bank accounts of 18,20,870 SHGs (26.2 per cent) and savings amount of ₹ 1299 crore (21 per cent) and cooperative banks with saving bank accounts of 10,79,465 SHGs (15.5 per cent) and savings amount of ₹ 1225 crore (19.8 per cent). The share under the Swarnajayanti Gram Swarozgar Yojana (SGSY) in total savings accounts was 16,93,910 SHGs forming 24.3 per cent of the total SHGs having savings accounts in the banks. During the year under review, the average savings per SHG with all banks marginally decreased from ₹ 9060 as on 31 March 2009 to ₹ 8915 as on 31 March 2010. They ranged from a high of ₹ 11,352 per SHG with cooperative banks to a low of ₹ 7136 per SHG with RRBs. As on 31 March 2010, the share of women SHGs in total SHGs with savings bank accounts was 53.10 lakh, i.e.76.4 per cent as compared to last year's share of 79.5 per cent.

5.22 As on 31 March 2010, 48.51 lakh SHGs had outstanding bank loans of ₹ 28,038 crore as against 42.24 lakh SHGs with bank loans of ₹ 22,680 crore as on 31 March 2009 registering a growth of 14.8 per cent in the number of SHGs and 23.6 per cent in bank loans outstanding to SHGs. These figures included 12.45 lakh SHGs (25.7 per cent) with outstanding bank loans of ₹ 6251 crore (22.3 per cent) under the SGSY as against 9.77 lakh SHGs with outstanding bank loan of ₹ 5862 crore as on 31 March 2009. Commercial banks had the maximum share of outstanding bank loans to SHGs with a share of 66.7 per cent followed by RRBs with a share of 22.8 per cent and cooperative banks with a share of 10.5 per cent. As on 31 March 2010, average bank loan outstanding per SHG was ₹ 57,795 as against ₹ 53,689 as on 31 March 2009. It varied from a high of ₹ 62,289 per SHG in the case of commercial banks to a low of ₹ 33,894 in the case of cooperative banks.

5.23 On the basis of the data received from banks by the National Bank for Agriculture and Rural Development (NABARD), the gross non-performing assets (NPAs) in respect of bank loans to SHGs were 2.94 per cent of the bank loans outstanding to SHGs, as on 31March 2010. Table 5.5 provides some figures for the Programme.

5.24 The gathering momentum in the micro-finance sector has brought into focus the issue of regulating the sector. A draft Micro-Financial Sector (Development and Regulation) Bill 2010 is under consideration of the Government.

Table 5.5 : Progress of Micro-finance Programme

Year	New SHGs Financed by Banks					Bank Loan* (₹ crore)
	During the Year		Cumulative during the Year			
	No.(lakh)	Growth (%)	No.(lakh)	Amount (₹ crore)	Growth (%)	Cumulative
2006-07	11.06		28.94	6570.39		12,366.49
2007-08	12.28	11.00	36.26	8849.26	35.00	16,999.90
2008-09	16.09	31.10	42.24	12,256.51	38.50	22,679.85
2009-10	15.87	(-)1.40	48.52	14,453.30	17.90	28,038.28

Source: NABARD.

Note:* Includes repeat loans to existing SHGs.

Rural Infrastructure Development Fund (RIDF)

5.25 The Government of India set up the RIDF in 1995 through contribution from commercial banks to the extent of their shortfall in agricultural lending. The Fund has continued, with its corpus being announced every year in the Budget. Over the years, coverage under the RIDF has been made more broad based in each tranche and, at present, a wide range of 31 activities under various sectors is being financed. The annual allocation of funds for the RIDF announced in the Union Budget has gradually increased from ₹ 2000 crore in 1995–96 (RIDF I) to ₹ 16,000 crore in 2010-11 (RIDF XVI). The aggregate allocations have reached ₹ 1,16,000crore. Further, a separate window was introduced in 2006-07 for funding the rural roads component of the Bharat Nirman Programme, with a cumulative allocation of ₹ 18,500 crore till 2009-10.

Table 5.6 : Sanctions and Disbursements under the RIDF and Bharat Nirman

Region	(As on 30 November 2010) (₹ crore)		
	Sanction	Disbursement	Disbursement as per cent of Sanction
South	29,912	20'502	68.54
West	15,567	11,697	75.14
North	32,880	21,502	65.40
Central	9944	6290	63.25
East	19,788	10,767	54.41
NER & Sikkim	5346	2929	54.79
Sub Total	1,13,437	73,687	64.96
BHARAT NIRMAN	18,500	18,500	100.00
Total	**1,31,937**	**92,187**	**69.87**

Source: NABARD.

5.26 As against the total allocation of ₹ 1,16,000crore, encompassing RIDF I to XVI, sanctions aggregating ₹ 1,13,437 crore have been awarded to various State Governments and disbursements under the Fund amounted to ₹ 73,687 crore up to end November 2010. The National Rural Roads Development Agency (NRRDA) was sanctioned the entire amount of ₹ 18,500 crore (RIDF XII to RIDF XV) and it had fully availed of it by March 2010 (Table 5.6).

5.27 During 2010-11, the disbursement to the States amounted to ₹ 9649 crore till end-November 2010 (Table 5.7).

Table 5.7 : Disbursements during 2010-11

(As on 30 November 2010) (₹ crore)

Region	Disbursement		Achievement (%)
	Target	Achievement	
South	3510	1401	39.91
West	1960	573	29.23
North	4550	1478	32.48
Central	1440	360	25.00
East	3250	1257	38.68
NER & Sikkim	790	179	22.66
Total	15,500	5248	33.86

Source : NABARD.

Note: NER—north-east region.

Agricultural Credit

Flow of Agricultural Credit

5.28 As against the target of ₹ 3,25,000 crore for agricultural credit in 2009-10, the banking system disbursed ₹ 3,84,514 crore to the agricultural sector, thereby exceeding the target by around 18 per cent. Commercial banks and RRBs together extended credit to 77.49 lakh new farmers during 2009-10 and cooperative banks to13.43 lakh, thus taking the total number of farmers brought newly under the banking system to 90.92 lakh. The total number of agricultural loans financed as of March 2010 was 4.82 crore. The total credit flow to agriculture during 2010-11 by commercial banks, cooperative banks, and RRBs up to September 2010 was of the order of ₹ 1,94,392.63 crore, amounting to 52 per cent of the annual target of ₹ 3,75,000 crore (Table 5.8).

Kisan Credit Card (KCC) Scheme

5.29 The KCC Scheme has become a widely accepted mechanism for delivery of credit to farmers. The scheme now also covers borrowers of the long-term cooperative credit structure. In order to safeguard the interests of KCC holders, NABARD has allowed banks the discretion to opt for 'any insurance company of their choice'. The banks have to keep in mind the guiding principles of the Personal Accident Insurance Scheme **(**PAIS), especially the premium-sharing formula and coverage, while negotiating with insurance companies.

5.30 With a view to making the KCC more user-friendly, NABARD has enlarged its scope to cover term loans for agriculture and allied activities, including a reasonable component for consumption needs, besides the existing facility of providing crop

Box 5.1 : Recommendations of Task Force 'to look into the issue of a large number of farmers, who had taken loans from private moneylenders, not being covered under the loan waiver scheme'

i. Financial literacy and counselling campaigns be undertaken to increase awareness among farmers on the KCC.

ii. Banks be encouraged to educate their rural branch staff about the KCC.

iii. Banks use farmers' cooperatives and SHG federations as banking correspondents to increase outreach.

iv. The coverage of new farmers in the command areas of bank branches and new areas be ensured through meaningful and purposeful conduct of *gram sabhas* and kisan credit camps at regular intervals.

v. Bankers who have already been advised by the RBI to lend without any collateral, up to Rs1 lakh per farmer, put such advice into more widespread practice through joint liability groups (JLGs) of tenant farmers, sharecroppers, and oral lessees.

vi. State governments exempt agricultural loan agreements from stamp duty.

vii. The KCC be technology enabled, including the conversion to a smart card with withdrawals and remittances enabled at automated teller machines (ATMs), points of sale(PoS), and through hand-held machines; banks need to have core banking solutions (CBS) in place at the earliest, to enable technology to benefit the farmer.

viii. The KCC limit be fixed for five years, based on the banker's assessment of total credit needs of the farmer for a full year, and that the limit be operated by the borrower as and when needed, with no sub-limits for kharif and rabi, or for stages of cultivation.

ix. Each withdrawal under the KCC be allowed to be liquidated in twelve months without the need to bring the debit balances in the account to zero at any point of time.

x. There be automatic renewal and annual increase on credit limit linked to inflation rate.

Table 5.8 : Flow of Institutional Credit to Agriculture and Allied Activities

(₹ crore)

Sl. No.	Agency	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11*
1.	Co-operative Banks**	39,786	42,480	48,258	36,762	63,492	29,450
	Share (%)	22	18	19	13	17	15
2.	RRB	15,223	20,435	25,312	26,724	35218	19141
	Share (%)	8	9	10	9	9	10
3.	Commerc-ial Banks	1,25,477	1,66,486	1,81,088	2,28,951	2,85,799	14,5801
	Share (%)	70	73	71	78	74	75
	Total	1,80,486	2,29,401	2,54,658	2,92,437	3,84,514	1,94,392

Source: NABARD.

Notes* Up to 30 September 2010. **Including Others.

loan limit. Crop loans disbursed under the KCC Scheme for notified crops are covered under Rashtriya Krishi BimaYojana (National Crop Insurance Scheme), a crop insurance scheme introduced to protect the interests of the farmer against loss of crop yield caused by natural calamities, pest attacks, etc. The KCC has thus become a single window for a comprehensive credit product. The major policy recommendations of the Task Force 'to look into the issue of a large number of farmers, who had taken loans from private moneylenders, not being covered under the loan waiver scheme' under the chairmanship of Shri Umesh Chandra Sarangi, constituted by the Ministry of Agriculture, Government of India, are given in Box 1.1.

5.31 The banking system has issued 955.77 lakh KCCs involving a total sanctioned credit limit of ₹ 4,37,241 crore as on 31 August 2010. The share of commercial banks stood at 44.4 per cent of the total number of cards issued by the banking sector followed by cooperative banks (40.9 per cent) and RRBs (14.7 per cent). The year-wise and agency-wise break-up of the KCCs issued is given in Table 5.9.

Agriculture Debt Waiver and Debt Relief (ADWDR) Scheme 2008

5.32 NABARD is the nodal agency for implementing the Scheme in respect of cooperative credit institutions and RRBs. The Bank has released of ₹ 24,994.89 crore towards debt waiver and ₹ 3005.11 crore towards debt relief claims. The agency-wise break-up of the releases under the ADWDR is given in Table 5.10.

Table 5.10 : Release under ADWDR

(₹ crore)

Agency	Debt Waiver	Debt Relief	Total
State Cooperative Banks	15,540.63	2062.02	17,602.65
SCARDB	3409.06	248.41	3657.47
RRBs	6045.19	694.68	6739.87
Total	**24,994.89**	**3005.11**	**28,000.00**

Note: SCARDB—State Cooperative Agriculture and Rural Development Bank.

Financial Performance of Banks

5.33 The consolidated balance sheet of the SCBs in India during 2009-10 showed relatively sluggish growth performance, marked mainly by slow deposit growth. The growth in profits of SCBs too was lower in 2009-10 than in the previous year. Further, there was a rise in the NPA ratio of SCBs in 2009-10. Though asset quality emerged as a concern for the banking sector, its capital adequacy remained fairly robust during the year, providing cushion for any future losses.

5.34 The overall growth in the consolidated balance sheet of SCBs in 2009-10 was 15.0 per cent, which was lower than the 21.1 per cent during the previous year. Moreover, the decline in growth could be seen across all bank groups with the notable exception of new private-sector banks. The working results of SCBs under different bank groups are given in Table 5.11.

5.35 The major factor contributing to the slowdown in growth of banks' balance sheets was deposits. The growth in deposits of SCBs decelerated to

Table 5.9 : Agency-wise KCCs Issued and Amount Sanctioned

(As on 31 August 2010)

Agency	Cards Issued (lakh)					Amount Sanctioned (₹ crore)				
	2007-08	2008-09	2009-10	2010-11	Total*	2007-08	2008-09	2009-10	2010-11	Total*
Co-operative Banks	20.91	13.44	17.43	12.31	391.19	19,991	8428	7606	5164	1,45,758
RRBs	17.73	14.15	19.49	6.73	140.94	8783	5648	10,132	4329	58,293
Commer-cial Banks	46.06	58.34	53.13	—	423.64	59,530	39,009	**39,940**	—	2,33,190
Total	**84.70**	**85.93**	**90.05**	**19.04**	**955.77**	**88,264**	**53,085**	**57,678**	**9493**	**4,37,241**

Source: NABARD

Note:*Since inception of the scheme (1998). —: Not available.

Table 5.11 : Working Results of SCBs

Items	PSBs		Foreign banks		Old pvt. sector banks		New pvt. sector banks		All SCB	
	2008-09	2009-10	2008-09	2009-10	2008-09	2009-10	2008-09	2009-10	2008-09	2009-10
	(₹ Crore)									
A Income	3,15,554	3,54,876	45,216	36,341	21,572	23,649	81,360	79,405	4,63,702	4,94,271
(i) Interest Income	2,73,088	3,06,488	30,322	26,390	18,790	20,565	66,282	62,310	3,88,482	4,15,752
(ii) Other Income	42,466	48,388	14,894	9951	2782	3084	15,078	17,095	75,220	78,519
B Expenditure	2,81,182	3,15,619	37,706	31,600	19,163	21,337	72,901	68,606	4,10,952	4,37,162
(i) Interest Expended	1,93,447	2,11,940	12,819	8938	12,834	14,076	44,123	37,130	2,63,223	2,72,084
(ii) Intermediation Cost (operating expenses)	55,504	65,991	12,298	11,102	3939	4715	17,840	17,960	89,581	99,769
(iii) Provisions and Contingencies	32,231	37,688	12,589	11,560	2390	2545	10,937	13,516	58,147	65,310
C Operating Profit (A - Bi - Bii)	66,604	76,945	20,098	16,301	4799	4858	19,396	24,315	1,10,897	1,22,419
D Net Profit (A-B)	34,373	39,257	7510	4741	2409	2312	8459	10,799	52,750	57,109
E Net Interest Income (spread) (Ai - Bi)	79,642	94,548	17,503	17,452	5956	6489	22,158	25,180	1,25,258	1,43,669
F Total Assets	37,65,757	44,41,114	4,45,129	4,33,219	2,32,292	2,68,977	7,95,464	8,81,831	52,38,642	60,25,141
G Net Income(Aii + E)	1,22,108	1,42,936	32,397	27,403	8738	9573	37,236	42,275	2,00,479	2,22,188
As per cent of Total Asset										
A Income	8.38	7.99	10.16	8.39	9.29	8.79	10.23	9.00	8.85	8.20
(i) Interest Income	7.25	6.90	6.81	6.09	8.09	7.65	8.33	7.07	7.42	6.90
(ii) Other Income	1.13	1.09	3.35	2.30	1.20	1.15	1.90	1.94	1.44	1.30
B Expenditure	7.47	7.11	8.47	7.29	8.25	7.93	9.16	7.78	7.84	7.26
(i) Interest Expended	5.14	4.77	2.88	2.06	5.52	5.23	5.55	4.21	5.02	4.52
(ii) Intermediation Cost (operating expenses)	1.47	1.49	2.76	2.56	1.70	1.75	2.24	2.04	1.71	1.66
(iii) Provisions and Contingencies	0.86	0.85	2.83	2.67	1.03	0.95	1.37	1.53	1.11	1.08
C Operating Profit (A - Bi - Biii)	1.77	1.73	4.52	3.76	2.07	1.81	2.44	2.76	2.12	2.03
D Net Profit (A-B)	0.91	0.88	1.69	1.09	1.04	0.86	1.06	1.22	1.01	0.95
E Net Interest Income (spread) (Ai - Bi)	2.11	2.13	3.93	4.03	2.56	2.41	2.79	2.86	2.39	2.38

Source: RBI.

17.0 per cent in 2009-10 from 22.4 per cent in 2008-09. Further, credit growth constrained by a slowdown in deposits growth was placed at 16.6 per cent in 2009-10 as compared to 21.1 per cent in 2008-09. The deceleration in credit growth was accentuated on account of an overall slowdown of the economy in the aftermath of the global financial turmoil. However, while bank credit growth witnessed a slowdown on a year-on-year basis, bank credit in general and credit to industry in particular, showed distinct signs of recovery from October 2009 onwards as economic recovery became more broad-based. The credit-deposit ratio at the end of March 2010 was 73.6 per cent, marginally lower than that at the end of March 2009. There was an increase in the proportion of current and savings accounts (CASA) in 2009-10 in contrast to a declining trend noted in the recent past.

5.36 On a year-on-year basis, the major drivers of non-food bank credit in 2009-10 were industry and agriculture. There was considerable slowdown in the growth in personal loans and also credit to the services sector during the year.

5.37 The growth in investments of banks decelerated to 18.6 per cent in 2009-10 from 23.1 per cent in 2008-09. Also, there were notable changes in the investment portfolio of banks. The percentage contribution of investments in approved securities declined in 2009-10 in contrast to an increase in 2008-09, which was mainly due to banks' preference to park their funds in low-risk instruments against the backdrop of prevailing global uncertainties. Consequently, the percentage contribution of investments in non-SLR(statutory liquidity ratio) securities by banks showed an increase in 2009-10 driven mainly by an increase in investments in mutual funds.

5.38 Similar to the slowdown in growth in balance sheets, there was a moderation in the financial performance of SCBs in 2009-10. The growth in both income and expenditure of the SCBs slowed down leading to a deceleration in the growth of operating and net profits of SCBs. Every indicator of profitability also showed a decline in 2009-10. The most salient indicator of profitability, return on assets (RoA), declined to 1.05 per cent in 2009-10 from 1.13 per cent in 2008-09. Further, return on equity (RoE) too declined to 14.3 per cent in 2009-10 from 15.4 per cent in 2008-09.

5.39 After abstaining during 2008-09, banks started resorting to the capital market for raising resources in 2009-10. The resources raised from the capital market by banks were in the form of both public issues and private placement in 2009-10.

Capital Adequacy Ratio

5.40 One of the major indicators of growing financial soundness of the Indian banking system was the improvement in the capital to risk-weighted assets ratio (CRAR). The CRAR of all SCBs under Basel I framework improved to 13.6 per cent by end-March 2010 from 13.2 per cent a year earlier, thus remaining significantly above the stipulated minimum of 9.0 per cent. As all commercial banks in India excluding RRBs and local area banks became Basel II compliant as on 31 March 2009, it is essential to also look at the capital adequacy position under this framework. Under the Basel II framework too, the CRAR of SCBs showed an increase in 2009-10; the CRAR improved to 14.5 per cent at the end of March 2010 from 14.0 per cent at the end of March 2009. At the bank group level, every bank group reported CRAR, on an average, of over 13 per cent under the Basel II framework.

NPAs of the Banking Sector

5.41 The NPAs of SCBs emerged as a major area of concern in 2009-10. Gross NPAs as percentage of gross advances of SCBs had remained unchanged during 2008-09, when the global financial crisis intensified. However, in 2009-10, the gross NPA ratio increased to 2.39 per cent from 2.25 per cent in 2008-09. The total amount recovered and written off in 2009-10 was ₹ 49,210 crore. This was lower than the fresh NPAs added during 2009-10, which were to the tune of ₹ 65,674 crore. The sectoral distribution showed a growing proportion of priority-sector NPAs in 2009-10. Among the various channels of recovery available to banks for dealing with non-performing loans, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act has been by far the most important channel. However, in 2009-10, there was a decline in the amount of NPAs recovered under the SARFAESI Act as a per cent of total amount of NPAs involved under this channel.

5.42 Among bank groups, the gross NPA ratio of PSBs increased to 2.19 per cent in 2009-10 from 1.97 per cent in the previous year. The most notable increase in NPA ratio in 2009-10 could be seen in the case of foreign banks. The NPA ratio of foreign banks increased to 4.29 per cent in 2009-10 from 3.80 per cent in 2008-09.

Technological Developments in Banks

5.43 Banks in India are using information technology (IT) not only to improve their own internal processes but also to increase facilities and services to their customers. Efficient use of technology has facilitated accurate and timely management of the increased volumes of transactions of banks, consistent with a larger customer base. Of the total number of PSB branches, 97.8 per cent were fully computerized at the end of March 2010.

5.44 ATMs, particularly off-site ATMs, act as substitutes for bank branches in offering a means of anytime cash withdrawal to customers. Growth of ATMs, which had generally been steadily rising in recent years, was observed to be 37.8 per cent in 2009-10. More importantly, the growth in off-site ATMs too was comparably high at 44.6 per cent during the year. At the end of March 2010, the percentage of off-site ATMs to total ATMs stood at 45.7 per cent for all SCBs.

5.45 Another important technological development in 2009-10 was a significant increase in the percentage of PSB branches implementing CBS from 79.4 per cent at the end of March 2009 to 90 per cent at the end of March 2010. The percentage of branches under CBS was much larger for the SBI group as compared to nationalized banks.

5.46 With computerization in general, and CBS in particular, having reached near completion, it is important to leverage this technological advancement to look at areas beyond CBS that can help in not just delivering quality and efficient services to customers but also generating and managing information effectively. With regard to the second aspect of information management, a system of receiving data from banks by the RBI in an automated manner without any manual intervention is under examination.

5.47 Going forward, there are a number of issues with regard to development of banking technology that need to be addressed. These relate to further improvement in back office management in the form of streamlining the management information system (MIS), strengthening centralized processing, customer relationship management (CRM), and IT Governance. Back office technological advancement would help divert banks' resources more towards front office management, thereby increasing the customer focus of their services and supporting greater financial penetration and inclusion.

Non-banking Financial Institutions (NBFIS)

Financial Institutions (FIs)

5.48 As at the end of March 2010, four institutions, namely Export Import Bank of India (Exim Bank), NABARD, the National Housing Bank (NHB), and the Small Industries Development Bank of India (SIDBI) were regulated by the RBI as all-India FIs. In the wake of recovery in the global as well as Indian economy during 2009-10, the RBI issued the following instructions to roll back the liquidity support measures initiated for FIs during 2008-09 for on-lending to housing finance companies (HFCs)/NBFCs/micro-finance institutions (MFIs) and exporters:

(i) The refinance facility of ₹ 7,000 crore, ₹ 5,000 and ₹ 4,000 crore for SIDBI, Exim Bank and NHB, respectively, under the relevant provisions of the Reserve Bank of India Act, 1934 sanctioned in December 2008 have been withdrawn with effect from the close of business on 31st March, 2010.

(ii) The ceiling on aggregate resources raised including the funds mobilised under 'umbrella limit' by SIDBI, NHB and EXIM Bank was raised subject to conditions, with effect from December 8, 2008, for a period of one year. On a review, the relaxation allowed in December 2008 to select FIs (SIDBI, NHB and EXIM Bank) in resource raising norms for FIs has been co-terminated with refinance facility. Accordingly, outstanding borrowings of FIs should be within the normal prudential limit *i.e.* ceiling on aggregate resources at 10 times of net owned fund (NOF) and umbrella limit at one time of NOF with effect from 31st March, 2010.

5.49 The guidelines regarding lending under consortium arrangements/ multiple banking arrangements, provisioning coverage for advances, prudential norms on creation and utilization of floating provisions, additional disclosures in notes to accounts, and prudential norms on income recognition, asset classification and provisioning pertaining to advances—computation of NPA levels and projects under implementation—issued to banks have been mutatis mutandis applied to select FIs. Further, the guidelines regarding know your customer (KYC) norms/ anti-money laundering (ALM) standards/ combating of financing of terrorism (CFT) and sale of investments held under Held to Maturity category issued to banks are also applicable to select FIs.

5.50 Resources raised by FIs during 2009-10 were considerably higher than those during the previous year. While the long-term resources raised witnessed a sharp climb during 2009-10 as compared to the previous year, the short-term and foreign currency resources raised increased marginally. SIDBI mobilized the largest amount of resources, followed by Exim Bank and NHB (Table 5.12).

5.51 Total sources/deployment of funds of FIs increased modestly by 1.8 per cent to ₹ 3,02,610 crore during 2009-10. A major part of the funds of FIs was raised internally (51.8 per cent), followed by external sources (41.9 per cent); 'other sources' formed only a small part. The funds raised from internal sources declined by 18.9 per cent, while those from external sources rose by 38.8 per cent over the year 2009-10 mainly due to recovery in the global financial markets during 2009-10. A large part of the funds raised was used for fresh deployments (56.8 per cent), followed by repayment of past borrowings (38.0 per cent). Other deployments

Table 5.12 : Resources Mobilized by FIs

(₹ Crore)

Financial Institutions	Total Resources Raised									
	Long-term		Short-term		Foreign Currency		Total		Total Outstanding (as at the end of March)	
	2008-09	2009-10	2008-09	2009-10	2008-09	2009-10	2008-09	2009-10	2009	2010
Exim Bank	3197	8150	8905	5052	3800	5193	15,902	18,395	37,202	40,509
NABARD	4252	16	3494	12,330	-	-	7746	12,346	26,867	24,922
NHB	3124	7518	16,881	10,306	-	-	20,005	17,824	16,503	10,598
SIDBI	5625	13,253	8811	11,500	1361	987	15,797	25,740	24,487	30,186
Total	**16,198**	**28,937**	**38,091**	**39,188**	**5161**	**6,180**	**59,450**	**74,305**	**1,05,059**	**1,06,215**

Source: Respective FIs.

Notes:-: (i) Nil/Negligible. (ii) Long-term rupee resources comprise borrowings by way of bonds/ debentures; and short-term resources comprise commercial papers (CPs), term deposits, certificate of deposits (CDs),

including interest payments formed only a small part of the funds of FIs. The repayment of past borrowings recorded a sharp increase of 103.2 per cent, while fresh deployment registered a decline of 11.7 per cent over the year (Table 5.13).

Non-Bank Finance Companies (NBFCs)

5.52 NBFCs as a whole account for 11.2 per cent of assets of the total financial system. With the growing importance assigned to financial inclusion, NBFCs have come to be regarded as important financial intermediaries particularly for the small-scale and retail sectors. There are two broad categories of NBFCs based on whether they accept public deposits, namely deposit-taking NBFCs (NBFCs-D) and non-deposit-taking NBFCs (NBFCs-ND).

5.53 The total number of NBFCs registered with the RBI, consisting of NBFCs-D and NBFCs-ND, declined from 12,740 in end-June 2009 to 12,630 in end-June 2010. The number of NBFCs-D declined from 336 to 308 during the same period, mainly due to the exit of many NBFCs-D from deposit- taking activity, while non-deposit-taking systemically important NBFCs (NBFCs-ND-SI with asset size ₹ 100 crore and above) increased from 234 to 260 during the same period. Under the NBFCs-D category there are two residuary non-banking companies (RNBCs) (Table 5.14)

Table 5.13 : Pattern of Sources and Deployment of Funds of FIs*

(Amount in ₹ crore)

Item	2008-09	2009-10	Percentage Variation in 2009-10
Sources of Funds (i+ii+iii)	2,97,296	3,02,610	1.8
	(100.0)	(100.0)	
(i) Internal	1,93,294	1,56,733	-18.9
	(65.0)	(51.8)	
(ii) External	91,314	1,26,813	38.8
	(30.7)	(41.9)	
(iii) Others**	12,688	19,065	50.3
	(4.3)	(6.3)	
Deployment of Funds (i+ii+iii)	2,97,296	3,02,610	1.8
	(100.0)	(100.0)	
(i) Fresh Deployment	1,94,711	1,71,922	-11.7
	(65.5)	(56.8)	
(ii) Repayment of Past Borrowings	56,592	1,15,015	103.2
	(19.0)	(38.0)	
(iii) Other Deployment	45,993	15,673	-65.9
	(15.5)	(5.2)	
of which: Interest Payments	8809	16,561	88.0
	(3.0)	(5.5)	

Source: Respective FIs
Notes:* Exim Bank, NABARD, NHB, and SIDBI.
****Includes cash and balances with banks and balances with the RBI and other banks. Figures in parentheses are percentages to the totals.**

Table 5.14 : Number of NBFCs Registered with the RBI

End June	Number of Registered NBFCs	Number of NBFCs-D	Number of NBFCs-ND-SI
2005	13,261	507	-
2006	13,014	428	149
2007	12,968	401	173
2008	12,809	364	189
2009	12,740	336	234
2010	12,630	308	260

Source: RBI.

5.54 The ratio of deposits of reporting NBFCs to aggregate deposits of SCBs dropped to 0.36 per cent in end-March 2010 from 0.53 per cent in end-March 2009, mainly due to the decline in deposits of reporting NBFCs.

5.55 Total assets of NBFCs-D (including RNBCs) increased to ₹ 1,09,324 crore during 2009-10 from ₹ 97,408 crore in the preceding year. Public deposits held by NBFCs-D and RNBCs together recorded a decline to ₹ 17,247 crore in end-March 2010 from ₹ 21,566 crore in end-March 2009. Net-owned funds (NOFs) witnessed a growth of 18.8 per cent during 2009-10 and stood at ₹ 16,178 crore.

5.56 Total assets/liabilities of NBFCs-D (excluding RNBCs) expanded at the rate of 21.5 per cent during 2009-10 as compared to 3.4 per cent during 2008-09. Borrowings, which are the major source of funds for NBFCs-D, increased by 23.6 per cent during the year, while public deposits increased by 38.4 per cent largely due to the increase in public deposits of three NBFCs-D. On the assets side, the major components—hire purchase assets and loans and advances—witnessed growth of 7.6 per cent and 42.7 per cent respectively during 2009-10 as compared to 6.8 per cent and 14.7 per cent during the previous year. Total investments of NBFCs-D increased by 23.3 per cent during 2009-10 primarily on account of rise in non-SLR investments.

5.57 Among NBFCs-D, asset finance companies (AFCs) held the largest share in total assets/liabilities (74.5 per cent) while loan companies accounted for 25.5 per cent in end-March 2010. The increase in assets/liabilities of AFCs was mainly on account of reclassification of NBFCs, which was initiated in December 2006. Of the total deposits held by all NBFCs-D, asset finance companies held the largest share of 83.2 per cent, followed distantly by loan companies with a 16.8 per cent share.

5.58 The asset size of NBFCs-D varies significantly between less than ₹ 25 lakh to above ₹ 500 crore. The asset-holding pattern remained skewed, with 15 NBFCs-D with asset size of 'above ₹ 500 crore' holding 97.5 per cent of total assets of all NBFCs-D, while the remaining 213 held about 2.5 per cent in end-March 2010.

5.59 The financial performance of NBFCs-D witnessed moderate deterioration as reflected in the decline in their operating profits during 2009-10. This decline was mainly on account of higher growth in expenditure than income of these institutions. The decline in operating profits along with marginal increase in tax provision resulted in a decline in net profits in 2009-10. The cost to income ratio deteriorated from 74 per cent in 2008-09 to 81.8 per cent in 2009-10. Non-interest cost at 97.4 per cent continued to constitute the dominant share in total cost of the NBFCs-D during 2009-10 while interest cost accounted for a smaller share.

5.60 There was a decline in the gross NPAs to gross advances ratio of NBFCs-D in 2009-10 in continuation of the trend observed in the recent past. Classification-wise, Gross NPA and net NPA ratios of AFCs and loan companies declined during 2009-10 as compared to the previous year. Asset quality of AFCs as reflected in various categories of NPAs (substandard, doubtful, and loss) shows sharp improvement.

5.61 Capital to risk-weighted assets ratio (CRAR) norms were made applicable to NBFCs-D in 1998, whereby every NBFC-D is required to maintain a minimum capital, consisting of Tier I and Tier II capital, not less than 12 per cent (15 per cent in the case of unrated deposit-taking NBFCs) of its aggregate risk-weighted assets. As at the end of March 2010, 212 out of 216 reporting NBFCs-D had CRAR of more than 12 per cent as against 221 out of 225 in end-March 2009. It may be pointed out that the NBFC sector has been witnessing a consolidation process in the last few years, wherein the weaker NBFCs are gradually exiting, paving the way for a stronger sector.

Profile of NBFCs-ND-SI

5.62 The balance sheet of NBFCs-ND-SI stood at ₹ 5,63,476 crore in end-March 2010 as compared to ₹ 4,82,907 crore in end-March 2009 thereby registering a growth of 16.7 per cent during 2009-

10. This significant increase in balance sheet size of NBFCs-ND-SI is mainly attributed to sharp increase in owned funds, debentures, bank borrowings, commercial paper, and other liabilities. Owned funds (which accounted for 25.8 per cent of total liabilities) increased by 11.3 per cent during 2009-10. Total borrowings (secured and unsecured) by NBFCs-ND-SI increased by 19.6 per cent to ₹ 3,81,850 crore and formed 67.7 per cent of total liabilities. During the period ended June 2010, total borrowings further increased by 8.3 per cent to ₹ 4,13,476 crore.

5.63 The pattern of deployment of funds by NBFCs-ND-SI in the year ended March 2010 remained broadly in line with that witnessed during the previous year. Secured loans continued to constitute the largest share (44.3 per cent of total assets), followed by unsecured loans (17.8 per cent), hire purchase assets (7.4 per cent), investments (17.4 per cent), cash and bank balances (4.5 per cent),and other assets (8.4 per cent) during the year ended March 2010.

5.64 The financial performance of the NBFCs-ND-SI sector improved marginally as reflected in the increase in net profit of ₹ 10,897 crore during 2009-10 over the previous year. However, their net profit to total assets declined during the same period.

5.65 Gross and net NPAs ratios of the NBFCs-ND-SI sector deteriorated marginally during the year ended March 2010. However, these ratios showed some improvement in the quarter ended June 2010. Similarly, there was further diminution in value of investments between March 2009 and March 2010.

Policy Initiatives

5.66 The regulatory and supervisory framework of NBFCs continued to focus on prudential regulations with specific attention to the systemically important non-deposit-taking companies (NBFC-ND-SI). Some of the important developments in chronological order are as follows:

(i) Instances of NBFCs having made overseas investments without regulatory clearance of the Department of Non-Banking Supervision, RBI,which is a violation of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations 2004 and attracts penalty, were observed. Accordingly, it was reiterated that all NBFCs desirous of making any overseas investment must obtain 'No Objection' certificates (NoCs) from the Department of Non-Banking Supervision of RBI before making such investment.

(ii) NBFCs-ND-SI engaged predominantly in infrastructure financing had represented to the RBI that there should be a separate category of infrastructure financing NBFCs in view of the critical role played by them in providing credit to the infrastructure sector. As advised in the Second Quarter Review of Monetary Policy 2009-10, it was decided to introduce a fourth category of NBFCs as infrastructure finance companies(IFCs) satisfying certain criteria like a minimum of 75 per cent of their total assets in infrastructure loans, net owned funds of ₹ 300 crore or above, minimum credit rating 'A' or equivalent of CRISIL, FITCH, CARE, ICRA or equivalent rating by any other accrediting rating agency, and CRAR of 15 per cent (with a minimum Tier I capital of 10 per cent). Such NBFCs would be allowed to exceed credit concentration norms of lending to single/group borrowers by 5 per cent above that of other infrastructure loans.

(iii) NBFCs-ND-SI were advised to submit Statement of Interest Rate Sensitivity [NBS-ALM3] within 20 days of the close of the half year to which it related. They were also advised that eligible companies could file the ALM returns on-line.

(iv) While granting finance to housing/ development projects, NBFCs were advised to stipulate as a part of the terms and conditions that:

(a) the builder / developer / owner / company disclose in the pamphlets / brochures / advertisements the name(s) of the entity to which the property is mortgaged.

(b) the builder / developer / owner / company indicate in the pamphlets / brochures, that they would provide NOC / permission of the mortgagee entity for sale of flats / property, if required. Funds were would not be released unless the above requirements were fulfilled.

(v) NBFCs having foreign direct investment (FDI) are required to submit certificates from their statutory auditors on half-yearly basis certifying compliance with existing terms and conditions of FDI. NBFCs were advised that such certificates may be submitted not later than one month from the close of the half year to which the certificate pertained.

(vi) In terms of the third proviso of para 18 of the Non-Banking Financial (Non- Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions 2007, NBFCs were advised that any NBFC-ND-SI not accessing public funds, either directly or indirectly, may make an application to the Bank for modifications in the prescribed ceilings with regard to concentration of credit / investment norms. NBFCs-ND-SI may also be issuing guarantees and devolvement of these guarantees might require access to public funds. Accordingly it was advised that any NBFC-ND-SI not accessing public funds either directly or indirectly or not issuing guarantees may approach the Regional Office of the Department of Non-Banking Supervision, RBI in whose jurisdiction the registered office of the company is located, for appropriate dispensation.

(vii) NBFCs were advised that there should be no discrimination in extending products and facilities including loan facilities to physically/ visually challenged applicants on grounds of disability.

(viii) All NBFCs excluding RNBCs may participate in the designated currency futures and options exchanges recognized by the Securities and Exchange Board of India (SEBI) as clients, subject to RBI (Foreign Exchange Department) guidelines in the matter, only for the purpose of hedging their underlying forex exposures. With appropriate disclosures in their balance sheets.

(ix) According to the Repo in Corporate Debt Securities (Reserve Bank) Directions 2010, dated 8 January 2010 issued by the RBI, NBFCs registered with the RBI (other than Government companies as defined in Section 617 of the Companies Act 1956) are eligible for participation in repo transactions in corporate debt securities. NBFCs participating in such repo transactions were advised to comply with the Directions and accounting guidelines issued by RBI.

(x) As announced in the Annual Policy 2010-2011, draft guidelines on core investment companies (CIC) were placed on the RBI website on 21 April 2010. Based on feedback received from the market participants, the regulatory framework for CICs was announced. In order to bring more clarity in the interest of the system it was decided that investing in shares of other companies, even for the purpose of holding stake should also be regarded as carrying on the business of acquisition of shares in terms of Section 45I(c) (ii) of the RBI Act. CICs with an asset size of ₹ 100 crore or more would be considered systemically important core investment companies (CICs-ND-SI) and would be required to obtain Certificate of Registration (CORs) from the RBI under Section 45-IA of the RBI Act even if they had in the past been advised that registration was not required. Capital requirements, leverage ratio to be maintained, etc. have been prescribed for CICs-ND-SI. Certain exemptions from maintenance of statutory minimum NOF, prudential norms including requirements of capital adequacy, and exposure norms have been prescribed for those CICs-ND-SI. CICs-ND-SI were advised to submit annual certificates from their statutory auditors regarding compliance with these guidelines within one month from the date of finalization of their balance sheet.

(xi) In view of sub section (2) of Section 17 of the Credit Information Companies (Regulation) Act 2005, and Regulation 10 (a) (ii) of the Credit Information Companies Regulations 2006, NBFCs were advised that those NBFCs which had become member/ members of any new credit information company / companies may provide them the current data in the existing format. Such NBFCs may also provide historical data in order to enable the new credit information companies to validate their software and develop a robust database. However, care should be taken to ensure that no wrong data / history regarding borrowers is given to credit information companies.

BOX 5.2 : CORPORATE BOND MARKETS

Economic vibrancy coupled with sophisticated state-of the- art financial infrastructure has contributed to rapid growth in the equity markets in India. In terms of market features and depth the Indian equity market ranks among the best in the world. In parallel, the Government securities market has also evolved over the years and expanded given the increasing borrowing requirements of the Government. In contrast, the corporate bond market has languished both in terms of market participation and structure. Non-bank finance companies are the main issuers and very small amounts of finance are raised by companies directly. There are several reasons for this:

(i) Pre dominance of banks loans;

(ii) FII's participation is limited;

(iii) Pensions and insurance companies and household are limited participants because of lack of investor confidence; and

(iv) Crowding out by Government bonds.

The corporate bond market as a result is only about 14 per cent of the total band market; and market liquidity and infrastructure remain constrained. With the intervention of the Patil Committee recommendations, the corporate bond market is slowly evolving.

With bank finance drying up for long- term infrastructure projects in view of asset liability problems faced by banking system, the need for further development of a deep and vibrant corporate bond market can hardly be overemphasised. The following table shows the status of corporate bond market in India:

Private placement of corporate bonds listed on NSE and BSE

Year	No. of Issues	Amount (₹ Crore)
2007-08	744	118,485
2008-09	1041	173,281
2009-10	1278	212,635
2010-11(till Nov-10)	929	147,400

Source: SEBI (includes NBFCs)

The following table gives details of bond issuance in some of the emerging markets including India:

(in US$ billion)

Region/Countries		2007	2008	2009
Latin America	Argentina	3.4	0.1	0.5
	Brazil	9.9	6.7	10.1
	Chile	0.3	0.1	3.0
	Mexico	6.3	4.5	15.5
Emerging Europe	Hungary	4.1	5.3	3.0
	Poland	4.1	3.8	10.2
	Russia	30.2	22.1	10.8
Asia	China	2.1	2.1	3.3
	India	7.5	1.4	2.2
	Indonesia	1.8	4.2	5.5
	Malaysia	0.9	0.4	0.1
	Philippines	1.0	0.4	5.4.
	Thailand	0.8	0.5	-

Source: IMF, GFSR, April 2010

Earlier initiatives taken for development of corporate bond market in India

- Regulatory jurisdiction over corporate bond market has been clearly defined and placed under SEBI. SEBI (Issue and Listing of Debt Securities) Regulations, 2008 simplified disclosures and listing requirements. A minimum market lot criterion has been reduced from ₹ 10 lakhs to ₹ 1 lakh to encourage retail investors.
- The limit of FIIs investment in corporate bonds has been increased to USD 20 billion from the existing limit of USD 15 billion and the incremental limit of USD 5 billion has to be invested in corporate bonds with residual maturity of over five years.
- BSE, NSE and FIMMDA have set up reporting platforms. Aggregate data reported on these platforms is disseminated to the public. Summary data is available on SEBI website. Repos in corporate bonds have been permitted, following RBI guidelines, since March 2010. Exchange traded interest rates futures were introduced in August 2009.

- Draft Credit Default Swap, (CDS) guidelines have been released by RBI in July, 2010.
- The Finance Act, 2008 (with effect from 01/06/2008) mandated that no TDS (tax deduction at source) would be deducted from any interest payable on any security issued by a company, where such security is issued in dematerialised form and is listed on a recognised stock exchange in India. The stamp duty on items in central list (debentures and bonds in the nature of promissory note) have been brought down and made uniform.
- Clearing and settlement through clearing corporations have been mandated for trades between specified entities namely mutual funds, foresight institutional investors, venture capital funds etc. Clearing and settlement is on DvP I basis.

Suggested initiatives to be taken for further development of corporate bond market[1]

- Clearing and settlement on DvP (Delivery versus Payment) III basis. Market making with primary dealers. Enabling Credit Default Swap. Allowing banks to do credit enhancement -Guaranteeing of corporate bonds by banks. Relaxing norms on short selling of Government bonds .(RBI).
- Relaxing norms for use of shelf prospectus -requires amendment to Section 60 of Companies Act (MCA).
- Empowering bond holder under SARFAESI (Department of Financial Services, RBI).
- Creating of a comprehensive bond data base (RBI, SEBI, FIMMDA).
- Amendment to Section 9 of the Stamp Act to lower stamp duties across states and make them uniform (Department of Revenue).

[1] **Agency responsible is indicated in bracket**

Major Policy Changes—Securitization Companies/ Reconstruction Companies (SCs/RCs)

5.67 On 21 April 2010, the RBI modified the guidelines issued to SCs/RCs on various aspects to bring in more transparency and market discipline.

Capital Markets

Primary Market

5.68 The year 2010-11 has seen the Indian capital market put the worst behind and move towards strong growth. The cumulative amount mobilized as on 30 November 2010-11 through initial public offers (IPOs), follow on public offers (FPOs) and rights issues stood at ₹ 46,701 crore as compared to ₹ 46,737 crore in 2009-10. During 2010-11, so far, 40 new companies (IPOs) were listed both at the NSE and BSE amounting to ₹ 33,068 crore as against 39 companies amounting to ₹ 24,696 crore in 2009. The mean IPO size for the current financial year is ₹ 827 crore as compared to ₹ 633 crore in the previous financial year, showing an increase of 30.6 per cent. Further, ₹ 2197 crore was mobilized through debt issue as compared to ₹ 2500 crore in 2009-10. The amount of capital mobilized through private placement in 2010-11 (as on 30 November 2010) is ₹ 1,47,400 crore as compared to ₹ 2,12,635 crore in 2009-10. Table 5.15 sums up these figures.

Table 5.15 : Resource Mobilization through the Primary Market

(₹ crore)

Mode	2007-08	2008-09	2009-10	2010-11*
1. Debt	0	1500	2500	2197
2. Equity	54,511	2082	46,737	46,701
of which IPOs	42,595	2082	24,696	33,068
Number of IPOs	85	21	39	40
Mean IPO Size	501	99	633	827
3. Private Placement	1,18,485	1,73,281	2,12,635	1,47,400
4. Euro Issues (ADR/GDR)	NA	NA	NA	NA
Total (1+2+3+4)	**2,16,176**	**1,79,066**	**2,87,240**	**2,30,233**

Source: SEBI and RBI (for Euro Issues).

Notes: NA indicates Not Available. * As on 30 November 2010

Table 5.16 : Trends in Resource Mobilization (net) by Mutual Funds

(₹ crore)

Sector	2006-07	2007-08	2008-09	2009-10	2010-11*
1. UTI	7326	10,677	-3659	15,653	-5237
2. Public	7621	9820	9380	12,499	-2956
3. Private	79,038	1,33,304	-34,018	54,928	20,378
Total (1+2+3)	**93,985**	**1,53,802**	**-28,296**	**83,080**	**12,185**

Source: SEBI.

Note: *As on 30 November, 2010

Resource Mobilization by Mutual Funds

5.69 During 2010-11 (as in November 2010), mutual funds mobilized ₹ 12,185 crore from the market as compared to ₹ 83,080 crore in 2009-10. The market value of assets under management stood at ₹ 6,65,282 crore as on 30 November 2010 compared to ₹ 6,13,979 crore as on 31March 2010, showing an increase of 8.4 per cent. Table 5.16 puts gives details in this regard:

Secondary Market

5.70 As on 31 December 2010, Indian benchmark indices, the BSE Sensex and Nifty, increased by 17.0 per cent and 17.9 per cent respectively over the closing value of 2009-10. Nifty Junior and BSE 500 also increased by 17.8 per cent and 15.1 per cent respectively over their values in the previous financial year. (Figure 5.3)

5.71 The free float market capitalization of Nifty, the Sensex, Nifty Junior, and BSE 500 stood at

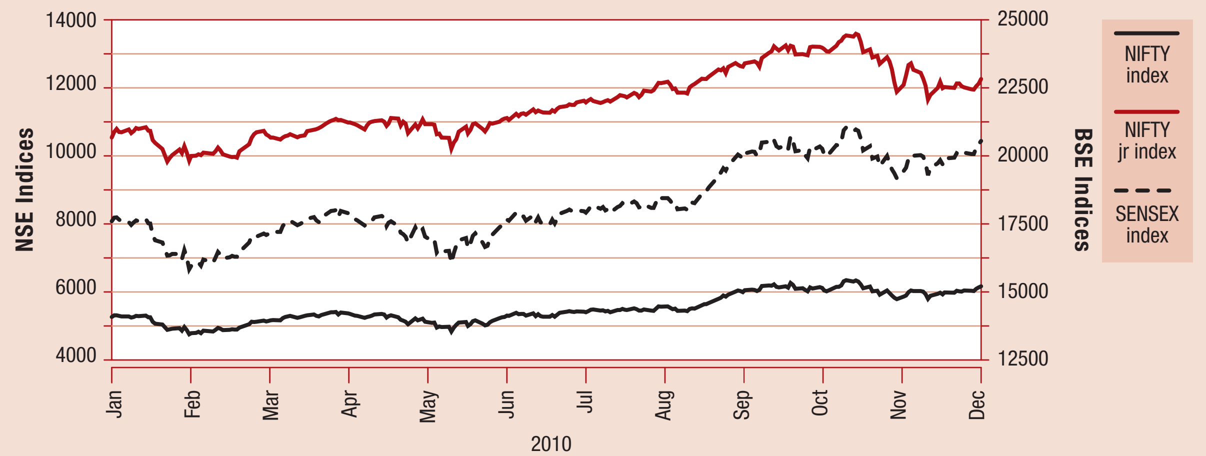
Table 5.17 : Index Returns, Volatility, Market Capitalization, and P/E ratio

Index	2006-07	2007-08	2008-09	2009-10	2010-2010-$
Nifty					
Return (per cent)	12.3	23.9	-36.2	73.8	17.9
Market Capitalization (Rscrore)	9,27,089	12,40,071	7,71,483	15,25,162	18,27,097
Daily Volatility	1.8	2.0	2.6	1.9	1.0
P/E Ratio	18.4	20.6	14.3	22.2	24.5
Nifty Junior					
Return (per cent)	7.3	16.0	-45.6	148.4	17.8
Market Capitalization (₹ crore)	13,76,826	2,02,809	1,13,523	2,92,316	3,37,573
Daily Volatility	2.0	2.4	2.8	2.0	1.1
P/E Ratio	18.5	16.7	8.7	15.8	17.6
BSE Sensex					
Return (per cent)	15.9	19.7	-37.9	80.5	17.0
Market Capitalization (Rscrore)	8,31,033	10,71,940	6,95,152	13,28,862	16,32,236
Daily Volatility	1.8	1.9	2.8	1.9	1.0
P/E Ratio	20.3	20.1	13.7	21.3	23.6
BSE 500					
Return (percent)	9.7	24.3	-42.8	96.4	15.1
Market Capitalization (‘ crore)	14,56,632	19,96,839	11,68,850	24,44,151	29,52,135
Daily Volatility	1.7	2.0	2.6	1.8	1.0
P/E ratio	17.7	20.0	13.7	20.4	21.4

Sources: BSE and NSE.

Note: $ As on 31 December 2010

Figure 5.3 **Movement of indices of NSE and BSE**



₹ 18,27,097 crore, ₹ 16,32,236 crore, ₹ 3,37,573 crore, and ₹ 29,52,135 crore respectively, showing an increase of 19.8 per cent, 22.8 per cent, 15.5 per cent and 20.8 per cent respectively over their values in financial year 2009-10.

5.72 The price to earnings (P/E) ratios of Nifty, the Sensex, Nifty Junior, and BSE 500 as on 31 December 2010 were 24.5, 23.6, 17.6 and 21.4 respectively, indicating an increase of 10.1 per cent, 10.5 per cent, 11.6 per cent and 4.5 per cent respectively over their 2009-10 values.

5.73 The details in respect of index return, volatility Market Capitalisation and P/E ratio are given in table 5.17.

5.74 In the capital market segment, the total turnover of the BSE stood at ₹ 8,93,839 crore and of the NSE at ₹ 27,87,862 crore as on 31 December 2010 as compared to ₹ 13,78,809 crore and ₹ 41,38,024 crore respectively in 2009-10. Table 5.18 displays these trends in the secondary market.

Equity Derivative

5.75 In the equity derivative segment, the NSE witnessed a total turnover of ₹ 2,05,99,192 crore as on 31 December 2010 as compared to ₹ 1,76,63,665 crore during 2009-10. Similarly, the total turnover in the equity derivative segment of BSE stood at ₹ 35 crore in 2010-11 (so far) as compared to ₹ 234 crore during 2009-10. Table 5.18. shows these trends while Table 5.19 shows the volatility of weekly returns on Indian equity markets.

Table 5.19 : Volatility of weekly returns on Indian equity markets (standard deviation)

Index	2008-09	2009-10	2010-11*
Nifty	5.5	3.8	2.2
Nifty Junior	6.6	4.5	2.5
Sensex	5.8	3.6	2.2
BSE 500	5.7	3.9	2.2

Source: BSE and NSE.
Note: *As on 31December 2010.

Table 5.18 : Market Turnover (₹ crore)

Market	2006-07	2007-08	2008-09	2009-10	2010-11*
BSE					
Cash	9,56,185	15,78,670	11,00,074	13,78,809	8,93,839
Equity Derivatives	59,007	2,42,308	12,268	234	35
NSE					
Cash	19,45,285	35,51,038	27,52,023	41,38,024	27,87,862
Equity Derivatives	73,56,242	1,30,90,478	1,10,10,482	1,76,63,665	2,05,99,192

Sources: BSE and NSE.
Note: *As on 31 December 2010.

Table 5.20 : Currency Futures

Year	NSE		MCX- SX		USE	
	2009-10	2010-11$	2009-10	2010-11*	2009-10	2010-11*
No. of Contracts	37,86,06,983	50,02,21,743	40,81,66,278	61,93,53,844	NA	11,87,44,133
Trading Value (₹ crore)	17,82,608	23,04,219	19,44,654	28,89,445	NA	5,37,836
Average Daily Trading Value (₹ crore)	7428	14,045	8103	17,636	NA	7504

Source: NSE, MCX-SX, and USE.
Note: * As on 30 November 2010.

Currency Derivative

5.76 The turnover at the MCX Stock Exchange (MCX-SX) in the currency derivatives segment stood at ₹ 28,89,445 crore in 2010-11 (as on 30 November,2010) as against ₹ 19,44,654 crore in 2009-10. The NSE, witnessed a turnover of ₹ 23,04,219 crore in 2010 (as on 30 November 2010) as compared to ₹ 17,82,608 crore in 2009-10. Further, the USE, which began operations in the currency derivatives segment on 20 September 2010, witnessed a turnover of ₹ 5,37,836 crore as on 30 November 2010. (Table 5.20)

Interest Rate Derivative

5.77 Trading in interest rate futures started at the NSE on 31 August 2009. During 2010-11 (as on 30 November 2010), the NSE witnessed a total turnover of ₹ 53 crore in this segment as compared to ₹ 2975 crore in 2009-10. (Table 5.21)

FIIs

5.78 The number of registered FIIs increased to 1718 as on 31 December 2010 from 1713 on 31 March 2010. The number of registered sub-accounts also increased to 5503 from 5378 during the same period.

5.79 In the Indian equity market, FIIs invested ₹ 1,12,622 crore during 2010-11 (as on 31 December 2010) as compared to ₹ 1,10,221 crore in 2009-10.

Table 5.21 : Interest Rate future at NSE

Year	2009-10	2010-11$
No. of Contracts	1,60,894	2,864
Trading Value (₹ crore)	2975	53
Average Daily Trading Value (Rscrore)	21	0.3

Source: NSE.
Note:* As on 30 November 2010.

Further, in the debt segment, FIIs invested ₹ 24,839 crore in 2010-11 (as on 31 December 2010) as compared to ₹ 32,438 crore in 2009-10. So far during 2010-11, total investment in equity and debt by FIIs stood at ₹ 1,37,461 crore as compared to ₹ 1,42,658 crore in 2009-10.(Table 5.22)

International Comparison

5.80 The trend in major emerging markets alongwith P/E ratios are given in table 5.23 and 5.24 respectively. Table 5.23 displays gains/losses posted by global indices over their 2003 levels from 2004 to 2010.

Market Movements

5.81 The year 2010 has been one of strong growth for the Indian capital markets . Bulls tossed off the markets in the year 2010 to a net gain of 18per cent, following global recovery and with FIIs pumping money in to the market on account of solid domestic growth coupled with a resurging corporate sector. Indices achieved record highs during the special one-hour *muhurut* trading on 5 November 2010 with the Sensex touching 21004.96 and Nifty 6312.45. As on 31 December 2010, the markets stand just 3 per cent away from this alltime peak and closed at 20509.09 (+ 17.43 per cent from 31 December 2009 for the Sensex-) and 6134.5 (+ 17.95 per cent for Nifty).

5.82 Indian markets have been making gains for eight quarters in a row, their longest winning run in at least 20 years. While 2009 was basically a year of recovery from the crisis year of 2008, 2010 was one of consolidation of gains. From 9647 on 31st Dec 2008, the Sensex climbed to 17464.81 on 31 December 2009 and further consolidated its rally at 20509.09 on 31 December 2010. The total market capitalization as on 31 December 2010 stands at ₹ 72,96,725 crore compared to ₹ 60,81,308 crore as on 31 December, 2009.

Table 5.22 : Transactions of FIIs

Transactions	Calendar year		
	2008-09	2009-10	2010-11*
Number of FIIs (actual)	1635	1713	1718
Number of Sub-accounts (actual)	5015	5378	5503
1. Equity Market Activity (Rscrore)			
Gross Buy	5,54,585	7,05,523	6,03,406
Gross Sell	6,02,292	5,95,302	4,90,785
Net	-47,706	1,10,221	1,12,622
2. Debt Market Activity (Rscrore)			
Gross Buy	59,993	1,40,914	1,54,081
Gross Sell	58,098	1,08,477	1,29,241
Net	1,895	32,438	24,839
3. Total Activity (Rscrore)			
Gross Buy	6,14,579	8,46,437	7,57,487
Gross Sell	6,60,389	7,03,779	6,20,026
Net	-45,811	1,42,658	1,37,461

Source: SEBI.
Note: *As on 31 December 2010.

Table 5.23 : Cumulative Change in Movement of Global Indices*

Index	Cumulative Change over end-2003 Level (%)						
	2004	2005	2006	2007	2008	2009	2010
BSE Sensex, India	13.1	61	136.1	247.4	65.2	199.1	251.2
Hang Seng Index, Hong Kong	13.2	18.3	58.8	121.2	1.1	74.2	83.2
Jakarta Composite Index, Indonesia	44.5	68.1	161	296.8	35.5	264.1	435.3
Nikkei 225, Japan	7.6	50.9	61.3	43.4	-22.9	-5.3	-4.2
Kospi Index, South Korea	10.5	69.7	76.8	133.9	25.6	104.4	153.0
Kuala Lumpur Comp. Index, Malaysia	14.2	13.4	38	82	-3.3	58.7	-
TSEC weighted Index, Taiwan	4.2	11.2	32.8	44.4	-25.2	32.3	35.3
SSE Composite Index, China	-15.4	-22.4	78.7	251.5	43.7	116.9	87.6

Source: Derived from various country sources.
Note: * End-year closing.

Table 5.24 : P/E Ratios in Select Emerging Markets

Country	Index	2008-09	2009-10	2010-11*
Korea	Kospi	25.7	11.1	14.8
Thailand	SET	15.7	12.3	15.0
Indonesia	Jakarta Composite	20.1	16.6	20.9
Malaysia	Kuala Lumpur Comp.	15.0	18.9	17.4
Taiwan	TSEC weighted	65.7	19.1	15.7
India	BSE Sensex	13.7	21.3	23.6
India	S&P CNX Nifty	14.3	22.3	24.5

Source: BSE, NSE, and Bloomberg.
Note:* As on 31 December 2010.

5.83 In terms of month-on- month movement, indices witnessed a consolidation phase till September 2010. While individual stocks saw many ups and downs, the indices were mostly range bound. The maximum monthly gains were recorded in September when the Sensex and Nifty made 11.67 per cent and 11.62 per cent respectively against the closing price in August. Compared globally, while the Jakarta Composite in Indonesia gained the most among indices with about 45 per cent rise, US' Dow Jones and UK's FTSE 100 have each risen by around 11 per cent and 9 per cent respectively. NASDAQ composite Index was up 16.91 per centwhile S&P rose by 13 per cent. However, Japan's Nikkei 225 and China's Shanghai Composite dipped 3 per cent and 14 per cent respectively during the year, reflecting the rising yen and monetary tightening in the respective countries.

Reasons For Market Movements

5.84 Markets are riding on the strong health of the Indian corporate sector; Also advance tax payments by India's top 100 corporate taxpayers rose by 18.7 per cent in December from a year ago, indicating better corporate performance in the third quarter, reinforcing the belief in fundamentals in the market sphere. India's April-November tax mop-up was estimated to be ₹ 4.18 trillion compared to ₹ 3.296 trillion a year ago, indicating the healthy fundamentals of the economy. India's economy is likely to surpass the Government's 8.5 percent growth target for the fiscal year, giving further fillip to bourses on the domestic front.

FII Flows at Historical levels: Historically low yields in developed markets due to accommodative monetary policies and weak economic prospects have pushed FII inflows to emerging markets to record highs.

The primary market got a new lease of life this calendar year with Indian companies raising ₹ 69,192 crore through IPOs and FPOs. This was 3.5 times higher than the previous year (₹ 19,567 crore) and 53 per cent higher than the earlier record of ₹ 45,142 crore in 2007. Over 72 per cent of the year's total mobilization was accounted for by public-sector units (PSUs). The year also witnessed the largest ever IPO in India—of ₹ 15,199 crore—from Coal India, which single-handedly accounted for 22 per cent of the year's total mobilization.

5.85 Global recovery also resulted in an upsurge in the markets. Boosting sentiments across the globe, the US economy expanded at a 2.6 per cent annual rate in the third quarter, marking a pickup in growth that may extend into 2011 as consumers and companies gain confidence to spend. Chinese manufacturing growth remains at relatively high levels amidst inflation. Global attention is on Chinese growth as it is considered the driver of global growth in 2011. China´s manufacturing sector grew at the weakest pace in three months in December after the Government tightened monetary policy to restrain inflation and closed factories to meet energy-efficiency targets. It is widely believed that following China, the rest of the central banks in emerging markets are also tightening their economies to safeguard them from inflation, making less cash available for equities.

5.86 Globally, leaders are striving to keep the pace of growth intact. Most European and Asian share indices rose as investors' concerns over the Eurozone's debt crisis were allayed by an 85 billion euro ($113bn; £72bn) bailout package for Ireland by the European Union and the International Monetary Fund on 28 November). Greece, which was the first to be hit, had received a 110 billion euro rescue package in May, which saved it from bankruptcy. The Monetary Policy Committee of the Bank of England voted to carry forward its £200 billion quantitative easing programme. The withdrawal of the programme set up by the US Federal Reserve to ease the strain from Europe's debt crisis, was extended from January to August. Amid signs of recovery, the US Federal Reserve introduced the policy of buying $ 600 billion in US Treasury bonds and keeping short-term interest rates near zero. The US Govt. also extended all Bush-era tax cuts. All these developments have created positive vibes in the market. While the measures to rescue the Irish banking system are in place, there is now growing concern about the other two countries in the euro group called PIGS (Portugal, Ireland, Greece, and Spain) dampening sentiments across the globe.

Major Policy Developments

Equity Finance For Small And Medium Enterprises (SMEs)

5.87 In recognition of the need for making finance available to needy SMEs, the SEBI Board in its meeting held on 25 October 2007 had agreed upon the creation of a separate exchange for SMEs. Accordingly, in May 2008 a discussion paper was brought out on the issue. Based on the feedback received, the SEBI Board in its meeting held on 6

October 2008 decided to encourage promotion of either dedicated exchanges and/or dedicated platforms of the existing exchanges for listing and trading of securities issued by SMEs. On 9 November 2009, the SEBI Board took a decision on the operational aspects of the exchanges/ platforms of stock exchanges for SMEs. Accordingly, SEBI has permitted setting up of a stock exchange/ trading platform for SMEs by a recognized stock exchange with nationwide trading terminals and has also issued guidelines for market making for the specified securities listed on the SME exchange. Further, necessary amendments to the SEBI regulations have been carried out. Based on the finalized regulations, applications have been received by SEBI for setting up SME platforms.

Financial Sector Legislative Reforms Commission (FSLRC)

5.88 The Government in its Budget 2010-11 announced the setting up of the FSLRC with a view to rewriting and cleaning up financial-sector laws to bring them in tune with current requirements.

5.89 The remit of the Commission will be to review, simplify, and rewrite legislation focusing on broad principles. It will evolve a common set of principles for governance of financial-sector regulatory institutions. The Commission will also examine the case for greater convergence of regulation and will streamline the regulatory architecture of financial markets.

Financial Stability And Development Council (FSDC)

5.90 With a view to strengthening and institutionalizing the mechanism for maintaining financial stability and development, the Government set up an apex-level body—the FSDC. The Chairman of the Council is the Finance Minister of India and its members include heads of the financial-sector regulatory institutions. Without prejudicing the autonomy of regulators, this Council will monitor macro prudential supervision of the economy, including the functioning of large financial conglomerates, and address inter-regulatory coordination issues. It will also focus on financial literacy and financial inclusion. The Council will have one Sub-Committee headed by the Governor, RBI. The Secretariat of the said Council will be in the Department of Economic Affairs, Ministry of Finance. The notification constituting the FSDC was issued on 30 December 2010 and its first meeting was held on 31December 2010.

External Commercial Borrowing (ECB) Policy

5.91 A prospective borrower can access ECBs under two routes, automatic and approval routes. A corporate, other than a financial intermediary, registered under the Companies Act,1956, can access ECBs under the automatic route up to US $ 500 million in a financial year both for rupee expenditure and / or foreign currency expenditure for permissible end uses. Borrowers in the services sector, namely hotels, hospitals, and software companies can access ECBs under the automatic route up to US$ 100 million in a financial year for import of capital goods and for rupee and / or foreign currency capital expenditure and NGOs engaged in micro finance activities up to US$ 5 million in a financial year. ECBs which are not covered by the automatic route are considered under the approval route on a case-by-case basis by the RBI. The ECB policy is operationalized through notifications issued by the RBI under the Foreign Exchange Management Act 1999. These can be accessed on RBI's website. The norms applicable to ECBs are also applicable to FCCBs in all respects, except in the case of HFCs for which criteria will be notified by the RBI.

5.92 Some aspects of the ECB policy modified recently in 2010-11 are summarized as follows:

(a) As per extant norms, infrastructure finance companies (IFCs), i.e. NBFCs categorized as IFCs by the RBI were permitted to avail of ECBs for on-lending to the infrastructure sector, as defined in the extant ECB policy, under the approval route. After a review undertaken in April-May 2010, as a measure of liberalization of the existing procedures, it has been decided to permit the IFCs to avail of ECBs, including outstanding ECBs, up to 50 per cent of their owned funds under the automatic route, subject to their compliance with the prudential guidelines already in place. ECBs by IFCs above 50 per cent of their owned funds would require the approval of the RBI and, therefore, be considered under the approval route.

(b) As per the extant policy, using ECBs to refinance domestic rupee loans was not permitted. However, keeping in view the special funding needs of the infrastructure sector, it has been decided to put in place a scheme of take-out finance arrangement

Table 5.25 : ECBs Registered with the RBI

(US$ million)

Details	2009-10 (April-March)	2009-10 (Apr-Nov.)	2010 -11 (Apr-Nov.)
ECB	17,602	8632	11,617
FCCB	4076	3633	960
Total	21,678	12,265	12,577
Automatic Route	13,924	7445	7683
Approval Route	7754	4820	4894

through ECBs, under the approval route, for refinancing of rupee loans availed of from domestic banks by eligible borrowers in the sea port and airport, roads including bridges, and power sectors for the development of new projects, subject to conditions stipulated by the RBI.

Indian companies were allowed to buy back their FCCBs under the approval route, up to 30June 2010. Based on a review of policy and in view of the representations received from the issuers of FCCBs, it has been decided to consider applications, under the approval route, for buyback of FCCBs until 30 June 2011, subject to the issuers complying with all the terms and conditions of buyback / prepayment of FCCBs.

(c) At present, entities in the services sectors, namely hotels, hospitals, and software are allowed to avail of ECBs up to US$ 100 million per financial year under the automatic route, for foreign currency and/or rupee capital expenditure for permissible end-uses. After a review it has been decided to consider applications from corporates in the hotel, hospital, and software sectors to avail of ECBs beyond US$ 100 million under the approval route. ECBs Registered with the RBI is given in Table 5.25.

FII Investments In Government Securities and Corporate Bonds

5.93 At present, FIIs registered with SEBI are permitted to invest in Government securities and corporate bonds up to US$ 5 billion and US$ 15 billion respectively. After a review in the context of India's evolving macroeconomic situation, its increasing attractiveness as an investment destination, and need for additional financial resources for India's infrastructure sector while balancing its monetary policy, it was decided to increase the limit of FII investment both in Government securities and corporate bonds by US $ 5 billion each, raising the cap to US$ 10 billion and US$ 20 billion respectively. The incremental limit of US$ 5 billion has, however, to be invested in securities with residual maturity of over five years and corporate bonds with residual maturity of over five years issued by companies in the infrastructure sector.

Report of the Working Group on Foreign Investment In India

5.94 With a view to rationalizing the present arrangements relating to foreign portfolio investments by FIIs/ non- resident Indians (NRIs) and other foreign investments like foreign venture capital investor (FVCI) and private equity entities, the Government set up a working group to look at various types of foreign flows, which are taking advantage of arbitrage across the respective stand-alone regulations, and generate recommendations to the Government. The group submitted its report to the Finance Secretary on 30 July 2010.

5.95 The group examined the structure of regulation and the ways in which practices, institutions, and procedures inflect and shape these policy decisions. It looked at foreign exchange law with regard to listed and unlisted equity, corporate and government securities, and derivatives as well as tax policy related to these matters. It did not look at FDI policy except in areas where FDI policy and portfolio investment were intertwined. The group's report also offers, alongside economic policy contextualizing capital flows in relation to the Indian and global economies, close scrutiny of the structures and incentives created by the law in the main areas of the report's mandate: foreign exchange controls with regard to listed and unlisted equity, corporate and government securities regulation, and derivatives trading. The focus of the group has been to identify procedures and practices which can help avoid uncertainty, delay, or unequal treatment and to recommend measures which could simplify the portfolio investment environment, at the same time laying a strong emphasis on KYC norms. A copy of the report is available on the Finance Ministry website at the following link: http://finmin.nic.in/reports/WGFI.pdf

Financial Action Task Force (FATF)

5.96 The FATF is an inter-Governmental body, responsible for setting global standards on anti-money laundering (AML) and combating the financing of terrorism (CFT). India became Observer at the FATF in the year 2006. Since then, India has been working towards full-fledged membership of the FATF.

As part of its membership, a joint FATF / Asia Pacific Group Mutual Evaluation Team visited India in November-December 2009 for on-site assessment of India's compliance with the 40+9 Recommendations of the FATF.

5.97 The Mutual Evaluation Report on India and India's membership issues were discussed in the third meeting of the FATF Plenary-XXI held in Amsterdam the Netherlands from 23to 25 June 2010. The FATF Plenary adopted the Mutual Evaluation Report on India on 24 June 2010 and on 25 June 2010 admitted India as 34th Country Member of the FATF.

5.98 FATF membership is very important for India in its quest to become a major player in international finance. It will help India build the capacity to fight terrorism and trace terrorist money and to successfully investigate and prosecute offences related to money laundering and terrorist financing. The FATF process will also help us in coordination of AML/CFT efforts at international level.

India's Membership of the Eurasian Group On Anti-money Laundering And Combating The Financing Of Terrorism (EAG)

5.99 On 15 December 2010 India gained membership of the EAG which is an FATF-style regional body, responsible for enforcing global AML and CFT standards. The support for India's membership was unanimous. India is the ninth member of the group. The other members are Russia, China, Turkmenistan, Serbia, Tajikistan, Uzbekistan, Belarus, and Kazakhstan. The group also has 16 nations and 15 organizations as observers.

India's Sovereign Rating

5.100 Presently, India is rated by six international credit rating agencies, namely Standard and Poor's (S&P), Moody's Investor Services, FITCH, Dominion Bond Rating Service (DBRS), the Japanese Credit Rating Agency(JCRA), and the Rating and Investment Information Inc., Tokyo(R&I). Information flow to these credit rating agencies has been streamlined.

5.101 In the calendar year 2010, S&P upgraded India's foreign currency outlook from negative to stable, FITCH upgraded its local currency outlook from negative to stable, and Moody's upgraded its local currency outlook from Ba2 to Ba1. Credit ratings issued by other agencies maintained status quo.

Financial Stability Board (FSB)

5.102 The Financial Stability Forum (FSF) was established by the G7 finance ministers and central bank governors in 1999 to promote international financial stability through enhanced information exchange and international cooperation in financial market supervision and surveillance. It decided at its plenary meeting in London on 11-12 March 2009 to broaden its membership and invite as new members the G20 countries that were not initially in the FSF. These included Argentina, Brazil, China, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, South Africa, and Turkey. In order to mark a change and convey that the FSF would play a more prominent role in this direction in the future, the FSF was relaunched as the Financial Stability Board (FSB) on 2 April 2009, with an expanded membership and broadened mandate to promote financial stability.

5.103 The current FSB comprises national financial authorities (central banks, supervisory authorities, and finance ministries) from the G20 countries, as well as international financial institutions, international regulatory and supervisory groupings, committees of central bank experts, and the European Central Bank.

Financial Stability Assessment Programme

5.104 India's Financial Sector Assessment Programme (FSAP) was made by the IMF/World Bank in 2000-2001 but it was not made public as it was part of a pilot FSAP assessment of 12 countries. The Committee on Financial Sector Assessment (CFSA) – chaired by the Deputy Governor, RBI and Finance Secretary had done a self-assessment in 2009. The results are in the public domain (RBI website).

FSB Members have committed to undergoing periodic peer reviews. As a member, India has requested IMF/World Bank to conduct such a review by way of a full-fledged FSAP. India's FSAP is scheduled for the calendar year 2011.

INSURANCE AND PENSION FUNDS

Insurance Sector

5.105 The insurance sector was opened for private participation with the enactment of the Insurance Regulatory and Development Authority Act 1999. While permitting foreign participation in ventures set up by the private sector, the Government restricted participation of the foreign joint venture partner through the FDI route to 26 per cent of the paid-up equity of the insurance company.

Box 5.3 : Financial Inclusion and Literacy

Financial inclusion plays a crucial role in inclusive development and sustainable prosperity as is being increasingly recognised and acknowledged globally. Large segments of population need to be part of formal payment system and financial markets. Financial inclusion would also broaden and deepen financial savings and lead to higher economic development.

Previous initiatives: While financial sector policies in India have long been driven by the objective of increasing penetration and outreach, the goal of inclusion has eluded us. About 41 per cent of adult population remains unbanked and the number of loan accounts covers only 14 per cent of adult population. The previous initiatives included (i) the expansion of network of co-operative banks to provide credit to agriculture and saving facilities in rural areas, (ii) nationalization of banks in 1969 and expansion of branches and (iii) creation of an elaborate framework of priority sector lending with mandated targets as part of a strategy to meet the savings and credit needs of large sections of the Indian population who had no access to institutional finance. Given the sheer enormity of the challenge, however, the outcomes of these efforts have so far been mixed.

Recent initiatives/out of box approaches: Recent initiatives include (i) "no frill" account for retail purpose; (ii) simplified KYC (Know Your Customer) (iii) Credit counselling centre (GCC) facilities; (iv) use of NGOs and formation of SHGs; (v) Kisan credit cards services and (vi) extension of Smart cards. The Finance Minister in his Budget Speech of 2007-08 also laid down provisions for funding of financial inclusion goals. The Rangarajan Committee also spelt out priorities for meeting financial inclusion objectives. Two of the more important approaches in the recent times included the use of technology such as smart cards and mobile telephone banking. The potential for their spread can be vast especially in combination with banking correspondence approach launched recently.

New entry and Competition: In addition, new competition and entry also play crucial roles as evident from the global experience. Two particular initiatives have included the role of Micro Financial Institutions (MFIs) and Non- Bank Finance Companies (NBFCs). MFI activities have surged in recent years, but has come under scrutiny and regulation (see Chapter 2). Services expanded at a fast rate, providing access on better terms than the alternatives of traditional money lenders. However, better regulation is also needed. On NBFCs, gold pawn establishments have also provided alternate access and are fast expanding in urban and semi-urban settings. As far as caps on interest rates are concerned, as in case of other products, "subsidies" in the form of low interest rates are often an inhibitor of access to services because of rationing and misuse.

What we need today, therefore, are new approaches to financial inclusion that build on the lessons of the past but also involve trying out newer approaches and instruments. Importantly, this also requires a change in the mindset on the part of policymakers, practitioners and other stakeholders alike to figure out and put in place effective ways of reaching out to the hitherto un-reached and under-reached segments of our population.

Financial Literacy: Any policy initiative seeking to afford greater access to financial services to a large segment of the population must necessarily address bridging the existing k**nowledge gap** in financial education and literacy. Over the last decade or so, researchers all over the world, especially in the developed countries, have, therefore, started to study and explore whether individuals are well-equipped to make financial decisions. Financial education and literacy assumes urgency in any given scenario. No wonder policymakers all over are increasingly taking note of this and directing their efforts to address it. In the UK, the Financial Services Authority has launched a big campaign to improve the financial skills of the population and enable a better appreciation of risks and rewards inherent in financial instruments and transactions. The US Treasury, which established its Office of Financial Education in 2002, is working to promote access to the financial education tools. The Financial Literacy and Education Commission, established by Congress in 2003 was created to improve financial literacy and education. In Australia, the Government established a National Consumer and Financial Literacy Taskforce in 2002. In Malaysia, the Financial Sector Master Plan, launched in 2001, includes a 10-year consumer education programme. The Monetary Authority of Singapore has launched a national financial education programme (Money SENSE). A nationwide, coordinated effort was also required in India and the Financial Stability and Development Council (FSDC) is a step forward in this direction. It is expected that this new initiative will help adequately address the challenge of financial inclusion and literacy.

Idioms and metaphors of development economics keep on changing from time to time. Today, new financial sector initiatives in a country like ours - be it in the form of prompt and innovative policy responses from the Government, central bank, other authorities or be it in the form of implementation efficiency and inventiveness from the varied players - need to explicitly prioritize both *financial inclusion* and *financial education and literacy*.

New entrants in the insurance sector

5.106 Since the opening up of the sector, the number of participants has gone up from six insurers (including LIC of India, four public-sector general insurers, and the General Insurance Corporation as national reinsurer) in the year 2000 to 48 insurers operating in the life, non-life, and reinsurance segments (including specialized insurers, namely the Export Credit Guarantee Corporation [ECGC] and Agricultural Insurance Company [AIC]). Three of the general insurance companies, namely Star Health and Alliance Insurance Company, Apollo DKV, and Max Bupa Health Insurance Company Ltd., function as standalone health insurance companies.

5.107 Of the 22 insurance companies that have set up operations in the life segment post opening up of the sector, 20 are in joint ventures with foreign partners. Of the 18 (including stand alone health insurance companies) insurers who have commenced operations in the non-life segment, 16 are in collaboration with foreign partners. The three standalone health insurance companies have been set up in collaboration with foreign joint venture partners. Thus, as on date, 36 insurance companies in the private sector are operating in the country in collaboration with established foreign insurance companies from across the globe.

Life insurance

5.108 The post-liberalization period has been witness to tremendous growth in the insurance industry, more so in the life segment. In 2009-10, even after the outcome on account of the financial meltdown, the life insurance segment saw an upward trend. The first-year premium, which is a measure of new business secured, underwritten by the life insurers during 2009-10 was ₹ 1,09,894.02 crore as compared to ₹ 87,331.09 crore in 2008-09, registering a growth of 25.84 per cent. In terms of linked and non-linked business during the year 2009-10, 54.53 per cent of the first-year premium was underwritten in the linked segment while the remaining 45.47 per cent was in the non-linked segment as against 51.13 and 48.87 respectively in the previous year.

Non-life insurance

5.109 Non-life insurers in India (excluding specialized institutions like the Export Credit Guarantee Corporation and Agriculture Insurance Corporation and the standalone health insurance companies) underwrote premiums of ₹ 34,620 crore in 2009-10, as against ₹ 30,352 crore in 2008-09.

Insurance Penetration

5.110 Insurance penetration is defined as the ratio of premium underwritten in a given year to the GDP. Insurance penetration in the year 2000 when the sector was opened up to the private sector was 2.32 (life 1.77 and non-life 0.55) and it has increased to 5.39 in 2009 (life 4.73 and non-life 0.66). The increase in levels of insurance penetration has to be assessed against the average growth of over 8 per cent in the GDP in the last five years.

Initiatives taken by the Authority in the Insurance Sector

5.111 The initiatives taken by the authority in the insurance sector include the following:

1) **Amendment to Insurance Legislation:** The Insurance Laws (Amendment) Bill 2008 introduced in Parliament recently proposes to amend the Insurance Act 1938, the Insurance Regulatory and Development Authority (IRDA) Act 1999, and the General Insurance Business (Nationalization) Act 1972. The amendments to the Insurance Act and the IRDA Act focus on the current regulatory requirements; the proposed changes provide for greater flexibility in operations and are aimed at deletion of clauses that are no longer relevant in the present context. The amendments also provide for enhancement of enforcement powers and levy of stringent penalties.

2) **Micro Insurance: The** IRDA has formulated the Micro Insurance Regulations to distribute insurance products that are affordable to the rural and urban poor and to enable micro insurance to become an integral part of the country's wider insurance system. The main thrust of these regulations is to provide low income people with affordable insurance products as a hedge against unforeseen risks. Total premium income in the micro insurance portfolio of life insurers for the year 2009-10 is ₹ 402 crore. Fourteen life insurers have so far launched 28 micro insurance products and by the end of March 2010 there were 8676 individual micro insurance agents in India.

3) **Guidelines on the AML Programme:** The IRDA issued guidelines on the AML Programme to the insurance industry on 31 March 2006, whereby insurers were advised to put a proper AML policy framework in place in case of life insurance

companies and non-life insurance companies effective from 1 August 2006 and 1 January 2007 respectively. An updated master circular on Anti-Money laundering/Counter-financing of terrorism has been issued by the Authority on 24 September 2010. The AML/CFT guidelines were reviewed by the Authority to align certain stipulations with those of the 40 +9 recommendations of the FATF and additional stipulations/clarifications were issued to insurers vide circular dated 12 November 2010 to be complied with by 31 December 2010.

4) Data Warehouse: The IRDA has initiated steps to design, build, and manage a data warehouse for the insurance industry recognizing that data will help the insurers design new products and allow scientific underwriting, further calculations of actuarial risks, price setting, and various aspects relating to claims settlement, management of hazards, etc. As a first step, the IRDA has designed a data set relating to health and motor vehicle insurance. The IRDA also proposes to put in place a formal data warehouse to enable access by various stakeholders across the industry.

5) Consumer Grievance Redressal Cell: The Grievance Redressal Cell of the IRDA looks into complaints from policyholders. Complaints against life and non-life insurers are handled separately. This Cell plays a facilitative role by taking up complaints with the respective insurers.

6) Public Awareness Campaigns/Programmes: The IRDA's strategy for consumer awareness/ education includes campaigns through external media, i.e. mass media, mainly print, television and the Internet, and internal initiatives such as an exclusive consumer education web page and sample booklets on various insurance-related topics, containing generic information, which insurers would also be advised to publish and distribute.

7) Cap on Unit-linked Insurance plans (ULIP) Charges: The insurance industry has introduced ULIPs which have found favour with customers in India. These products prescribe certain charges which are deducted either from contributions or from the fund. In order to simplify and to ensure that the charges are reasonable, relevant to the services being provided, and clear to customers, the IRDA has mandated an overall cap on all charges put together. Care has been taken to ensure that the insurers have freedom to distribute charges across the term of the policy. This also imparts flexibility and facilitates product innovation.

8) Corporate Governance guidelines: Corporate governance guidelines have been rolled out for insurance companies, effective from 1 April 2010. The objective of the guidelines is to ensure that the structure, responsibilities, and functions of the Boards of Directors and senior management of companies fully recognize the expectations of all stakeholders as well as those of the regulator. The guidelines broadly cover major structural elements of corporate governance.

9) Initiatives in the area of Policyholders Grievances Redressal

a) Grievance redressal guidelines effective from 1 August 2010 specific to both life and general insurance companies have been issued by the IRDA fixing the turnaround time for various grievances.

b) The IRDA has during July 2010 inaugurated the nationwide toll-free grievance call centre no.'155255' for policyholders to lodge complaints against insurance companies. The Grievance Redressal Cell of the IRDA looks into complaints from policyholders. This Cell plays a facilitative role by taking up complaints with the respective insurers for speedy disposal.

c) Guidelines have been issued by the IRDA effective from 1 June 2009 on renewability of health insurance policies clearly defining the procedure while declining a renewal or imposing a loading and also regarding upfront disclosures in Prospectuses. Insurers were also guided tocondone delay in renewal up to 15 days.

d) The IRDA has also instructed insurers on the terms and conditions of health insurance to senior citizens and made it mandatory for products filed after the circular date to allow entry at least till 65 years of age. The IRDA vide its circular dated 2 September 2009 has also advised insurers to provide a 'free look period' for health insurance policies with term three or more years.

e) The IRDA is in the process of developing the new Integrated Grievance Management system (IGMS) which will not only facilitate policyholders to register/track their complaints online with insurance companies but also facilitate the IRDA to monitor the grievance redressal procedure of insurance companies

f) The IRDA being in receipt of several complaints from policyholders relating to agency identification and servicing, keeping the interests of policyholders in view, has directed all insurers to display the agency code, agency name, and nobile number (landline if mobile number not available) and other contact details prominently on the first page of the policy document to be implemented on or before 1 November 2010.

g) In respect of medical insurance policies, if there is a change in Preferred Provider of Network (PPN) of Hospitals, the insurers have been directed on 24 August 2010 to inform the policyholders at all times of the nearest possible alternative hospitals where the cashless facility is available and the conditions thereof.

h) Guidance notes have been issued by the IRDA on 28 June 2010 on recent regulatory changes on ULIPs.

10) For the Orderly Growth of Insurance and Reinsurance industry:

(i) As the inter-company balances in reinsurance and coinsurance are growing, the IRDA, noting that these balances can have serious implications for the liquidity of several entities in the insurance sector, has decided to induce insurers and brokers to move over to a computer system of administration and settlement of accounts in respect of all inter-company transactions.

(ii) The IRDA (Sharing of Database for Distribution of Insurance Products) Regulations 2010 have been issued and all insurers advised to terminate all the referral arrangements entered into prior to the coming into effect of these regulations that are not in conformity with the provisions of these regulations.

(iii) The IRDA (Insurance Advertisements and Disclosures) (Amendment) Regulations 2010 have been issued to ensure the orderly growth of the insurance industry.

(iv) The IRDA (Treatment of Discontinued Linked Insurance Policies) Regulations 2010 have been issued detailing the procedure on policy discontinuance and imposing a cap on charges on policy discontinuation.

(v) Authority revamped its present agency licensing portal with a new Agency portal in order to widen the scope of the portal and to integrate the various stakeholders with the agency licensing system. The portal commenced its operations on 5/1/2010.

11) Credit Insurnace : New guidelines on trade credit insurance policies have been issued by the IRDA effective from 13 December 2010, with a view to standardizing the features of these products. All insurers have to revise their products in line with file & use guidelines and trade credit insurance guidelines. These guidelines specify that a policyholder should necessarily be a supplier of goods and services and his loss should be by non-receipt of trade receivables and can only be issued on whole turnover basis covering all buyers.

12) Variable Insurance products: Guidelines have been issued by the IRDA on variable insurance products (VIP) on 23 November 2010. As per these guidelines, all VIP products shall only be offered under non-unit-linked platform either as participating or non-participating and shall not be permitted under unit-linked platform. Benefit is payable on these policies either on death or maturity and only regular premiums with minimum policy and payment terms of five years are allowed. Single premium, limited premium, and group insurance contracts are not allowed under these products.

13) Consumer Education: Consumer education and policyholder protection being two sides of the same coin, the Regulator encourages and supports consumer bodies to conduct seminars on insurance, thereby not only educating the consumer but also providing a platform for the consumer to interact with representative(s). The IRDA itself conducts/ participates in and supports national-level seminars on different topics and is also proposing to launch a consumer portal shortly.

14) Persistency of Life Insurance Policies: In order to increase persistency in the interests of the insurance industry and to create professionalism amongst agents and encourage them to build a long-term career, the IRDA has issued an exposure draft to set certain minimum standards and requirements for agents and mandate insurers to review the performance of agents periodically.

These proposals would be a step forward in protecting the interests of policyholders, who in the ultimate analysis stand to gain if persistency is high, both in terms of protection of life and profitability of the life insurance business which would benefit them in the long run.

15) IPO Guidelines: Several insurance companies will be completing 10 years of their operations shortly, after which they may be allowed by the Regulator to go in for an IPO. It is essential that the investors be made fully aware of the financial performance, company profile, financial position, risk exposure, elements of corporate governance in place, and the management of such insurance companies. The IRDA is participating in the meetings of the Standing Committee on Disclosures and Accounting Issues (SCODA) set up by SEBI to finalize the disclosure requirements for insurance companies in their prospectus documents. While laying down the stipulations on disclosure requirements, the IRDA has drawn on international best practices. It is proposed that the disclosure requirements for life and non-life companies would be separately mandated given the nature of their respective businesses.

16) Other activities: The IRDA along with National Disaster Management Authority (NDMA) has conducted a seminar on Disaster Management in New Delhi on 11 August 2010 to lay down a plan for devising products for catastrophe perils and also to discuss the collective role of the Government, NDMA, and IRDA representing insurance companies, on disaster management.

Pension Sector

Highlights

5.112 Pension reforms in India have evolved primarily in response to the need of reform in the Government pension system. This had been designed to make a shift from defined-benefit to defined-contribution by putting a cap on Government's liability towards civil servants' pension. As a result of implementation of the New Pension System (NPS), all employees of the Central Government and Central autonomous bodies, with the exception of the armed forces, are now covered by this defined-contribution scheme with effect from 1 January 2004. Subsequently, 27 State Governments have notified and joined the NPS for their employees. As of now, the subscriber base for the mandatory Government sector has crossed 1.1 million with a corpus approaching to ₹ 70 billion. With opening up of the NPS to all citizens of India from 1 May 2009, on voluntary basis, the challenge is to spread the message of the NPS and old age income security to people in the unorganized sector across the country. This involves spreading the NPS distribution network such that NPS is easily accessible to all, and there is adequate awareness about it for people to decide voluntarily to open pension accounts.

NPS Design

5.113 The NPS architecture essentially involves a set of financial institutions, called points of presence (PoP), which are authorized to open NPS accounts and receive contributions; the Pension Fund Managers (PFMs), or the PFMs, which are appointed by the Pension Funds Regulatory and Development Authority (PFRDA) and are authorized to manage the pension corpus of the subscribers; and the Central Recordkeeping Agency (CRA), which does the record keeping. A centralized record keeping for the NPS ensures that the individual pension account is completely portable across the country, professions, and employment. The management of the NPS is highly technology driven; the transmission of information and funds is done in an electronic environment ensuring speed, accuracy, and efficiency. The investment of the pension funds is done in accordance with prescribed norms which specify different categories of investment instruments along with prudential limits on the quality and quantity of investments. The pension fund managers manage three separate scheme, consisting of three asset classes, namely (i) equity, (ii) Government securities, and (iii) credit risk- bearing fixed income instruments, with the investment in equity subject to a cap of 50 per cent. In the equity scheme, the fund managers will invest only in index funds that replicate either the BSE Sensex or NSE Nifty 50 index. The subscriber will have the option to decide the investment mix of his pension wealth. In case the subscriber is unable or unwilling to exercise any choice regarding asset allocation, his contribution will be invested in accordance with the 'auto choice' option with a predefined portfolio.

Recent Initiatives

5.114 Although the NPS is perhaps one of the cheapest financial products available in the country, in order to make it affordable for economically disadvantaged people, the PFRDA has recently introduced a lower cost version of the NPS, known as NPS-Lite, which enables groups of people to join the NPS at substantially reduced cost. The PFRDA has so far authorized nine aggregators to implement NPS-Lite. One of the distinguishing features of NPS has been unstinted Government support in popularizing the concept of old age income security. In this regard, the announcement of the Swavalamban scheme in budget 2010 by the Finance Minister was significant. Swavalamban is an incentive scheme for the NPS. Under this any citizen in the unorganized sector, who joins NPS in 2010-11, with a minimum annual contribution of ₹ 1000 and maximum of ₹ 12,000 will receive a Government contribution of ₹ 1000 in his NPS account. With this announcement, the Government of India has become a direct stakeholder in the old age income security of every citizen. The scheme is presently available for another three years beyond 2010-11 and will go a long way in promoting pension culture in the country. Efforts are under way to expand the reach of the NPS to new segments like Central and State autonomous bodies and the organized sector. The PFRDA is in dialogue with several State Government autonomous bodies and undertakings for extending the NPS to their employees.

Performance of the NPS

5.115 In the unorganized sector, nearly 34,000 subscribers had jointed the NPS as of December 2010 on voluntary basis. The subscriber base in the newly launched NPS-Lite is around 5000. For all citizens including workers of the unorganized sector, the NPS is currently available through nearly 5000 service provider branches of 35 PoPs.

5.116 Despite all its good features, popularization of the NPS remains a challenge. To address this challenge, the PFRDA has appointed an expert committee, called the Committee to Review implementation of Informal Sector Pension (CRIISP), to look into a range of issues connected with the NPS, such as reasons of sluggish public response, viability of the NPS as a financial product, ways and means of marketing/proper popularizing of the NPS and the agency best suited to perform this role, a sustainable and viable economic incentive model for the NPS, and the role of NPS fund managers in the entire NPS architecture, and suggest remedial measures. Important challenges before the PFRDA are to expand the distribution network of the NPS so that it is available within easy reach of all citizens, educate the citizens to take appropriate investment decisions based on their risk and return profiles, and contribute to improving financial literacy levels. The PFRDA is doing every bit to ensure that the complete distribution network of the NPS is fully galvanized so that access to the NPS is improved It is expected that the success of pension reforms will not only help in facilitating the flow of long-term savings for development, but also help establish a credible and sustainable social security system in the country.

Challenges and Outlook

Licensing for new banks, recapitalization of banks

5.117 Providing access to banking facility to all citizens is one of the main objectives of the inclusive development agenda in India. While providing banking access, the issue of regulatory robustness for the banking sector should not be compromised. Therefore, the issue of providing eligibility norms for new entities to operate as banks is of paramount importance.

5.118 Minimum capital requirement for banks should be graded. Having two types of licences, namely one for providing basic banking to fulfil the obligation of financial inclusion and the other for full banking encompassing all activities of a commercial bank could be considered.

5.119 As regards allowing industrial houses, business houses, and NBFCs to promote banks, they may be allowed full banking licence with provision for avoiding conflict of interest issues. MFIs and NBFCs should be considered for being given licences for basic banking. It is very essential that the basic banking functions are clearly and objectively defined.

5.120 The issue of the requirement for foreign promoters in banking needs to be addressed and foreign promoters with credible banking experience, may be considered provided they meet the fitness criteria. Also the principle of reciprocity could be applied to countries that have allowed Indian banks to expand in their jurisdictions.

5.121 There is another important issue relating to minimum and maximum caps on promoter shareholding and other shareholders. One view is that as the bank grows in business, the promoter's control should decline and the bank managed more professionally and independently.

Human Resource Issues in PSBs

5.122 One of the most daunting tasks for banks in the near future is going to be HR management. The market in the financial sector and especially in banking is seeing growth driven by new products and services that include opportunities in credit cards, consumer finance, and wealth management on the retail side and in fee-based income and investment banking on the wholesale side. These require new skills in sales and marketing, credit, and operations. Furthermore, given the demographic shifts resulting from changes in age profile and household income, consumers will increasingly demand enhanced institutional capabilities and service levels from banks. PSBs need to fundamentally strengthen institutional skill levels especially in sales and marketing, service operations, risk management, and overall organizational performance.

5.123 Banks may aggressively use technology/ business process re-engineering to reduce the gap created by shortage of staff and improve overall manpower efficiency. In addition, a pool of talent for occupying leadership positions could be built up by banks by training and preparing promising officers to assume future leadership roles.

Pension Reforms

5.124 In a paradigm shift wherein a defined-benefit pension system was replaced by defined-contribution basedone, the NPS has been introduced by the Government of India and made mandatory for all new recruits to the Government (except armed forces) with effect from 1 January 2004. The NPS was opened to all citizens of India from 1 May 2009 on voluntary basis. Twenty-seven State Governments have notified and joined the NPS for their employees. As of now, the subscriber base for the mandatory Government sector has crossed 1.1 million with a corpus approaching ₹ 70 billion. However, covering the majority of the population from the unorganized sector for whom the system was designed remains a challenge. Many new initiatives have been taken by the pension regulator PFRDA to address the issue of distribution. There is no doubt that the NPS is designed very attractively with many consumer friendly features and a low cost structure. Therefore, the basic structure of the pension scheme need not be altered. Government has also provided a direct co-contribution of ₹ 1000 per account from last year under the Swavlamban scheme.But in a distributor- and supply-driven market, Government intervention is required in creating awareness amongst potential investors in the pension product. There is also need to consider passage of the long pending Pension Fund Regulatory and Development Authority Bill in order to give a fillip to regulatory robustness in the pension sector.

Financial Inclusion and Literacy

5.125 With proliferation in the number and complexity of financial products, risk is being transferred to the household. Investors and market players are being exposed to formal banking and financial products, as well as new sales practices, for the first time. All these require a base level of understanding of money, its management and use. The lack of this understanding has the potential of frittering away economic gains made at aggregate level by nations, resulting in wealth transfer from the financially illiterate to a small segment of the financially literate. Many researches have shown that a financially literate population promotes economic growth and well-being by expanding the quality of available financial services and by enhancing the ability of individuals to more effectively use the services in their best interests. Work on the topic by financial literacy scholar Annamaria Lusardi, Professor of Economics at Dartmouth College and Research Associate at the National Bureau of Economic Research (NBER), shows that individuals with low levels of financial literacy tend not to plan for retirement and borrow at high rates of interest. No wonder, there is a rush to make citizens financially literate.

5.126 With a household saving rate of 34 per cent, the merits of saving over current consumption are well understood in India. Unlike many developed countries, where getting people to save is an issue, the need in India is for the efficient conversion of this saving into investment. A large part of this money is in low-yielding assets like bank deposits and traditional insurance but there is a clear trend of individuals preferring security-based investments as they move upwards in income level. Therefore it is a big challenge for Indian policymakers to prepare an effective strategy to for financial literacy of these new savers, investors, and consumers to holistically plan for their financial well-being.

5.127 Simultaneously, as one segment of the population, due to advantages of birth, location, and education has benefited from the growth spurt in the Indian economy the other has been unable to reap the benefits due to exclusion from the financial system. It is another policy challenge to reach out to this financially uncovered segment. Government has already made its commitment clear by announcing its intention of providing banking facility to all areas including rural by 2012. Widespread use of new and cost-effective technology could be made to achieve this goal.

Macro Prudential Regulations and Financial Stability : Real Estate Sector

5.128 In recent times and especially after the global financial crisis, the issue of financial stability has drawn great attention mainly due to transmission of its impact on the real sector of the economy. The slowdown in the real sector has compounded the need for policymakers to consider steps for maintaining financial stability. One of the steps considered and taken worldwide has been to firstly consider and re look at existing macro prudential regulations in the financial sector and then to introduce such regulations if they donot exist. As the financial crisis had its origin in the housing and real sector in the US, a very close look is required at the need for robust macro prudential regulations in this sector. In India also the RBI has recognized this and initiated steps in this direction in its quarterly monetary policy review of 2 November 2010. The steps include increasing the risk weights for housing loans and also increasing the loan to value ratios for such loans. Such macro prudential regulations are required in every segment of financial markets in India. The advantage of such regulations is that they are concentrated in the targeted segment and are not embedded in monetary policy so as to spread any negative impact over the entire economy.