Financial Intermediation and Markets

5

CHAPTER

Financial markets in India have acquired greater depth and liquidity over the years. Steady reforms since 1991 have led to growing linkages and integration of the Indian economy and its financial system with the global economy. Weak global economic prospects and continuing uncertainties in the international financial markets therefore, have had their impact on the emerging market economies. Sovereign risk concerns, particularly in the euro area, affected financial markets for the greater part of the year, with the contagion of Greece's sovereign debt problem spreading to India and other economies by way of higher-than-normal levels of volatility.

The funding constraints in international financial markets could impact both the availability and cost of foreign funding for banks and corporates. Since the Indian financial system is bank dominated, banks' ability to withstand stress is critical to overall financial stability. Indian banks, however, remain robust, notwithstanding a decline in capital to risk-weighted assets ratio and a rise in non-performing asset levels in the recent past. Capital adequacy levels remain above the regulatory requirements. The financial market infrastructure continues to function without any major disruption. With further globalization, consolidation, deregulation, and diversification of the financial system, the banking business may become more complex and riskier. Issues like risk and liquidity management and enhancing skill therefore assume greater significance.

Bank Credit

5.2 During 2010-11, credit growth continued its momentum to reach the peak rate of 24.2 per cent by end December 2010. The pick-up in credit reflected the improved demand conditions associated with stronger industrial recovery and growth. Since January 2011, credit growth, however, has been decelerating, though it remained above the Reserve Bank of India's indicative trajectory of 20 per cent for the year.

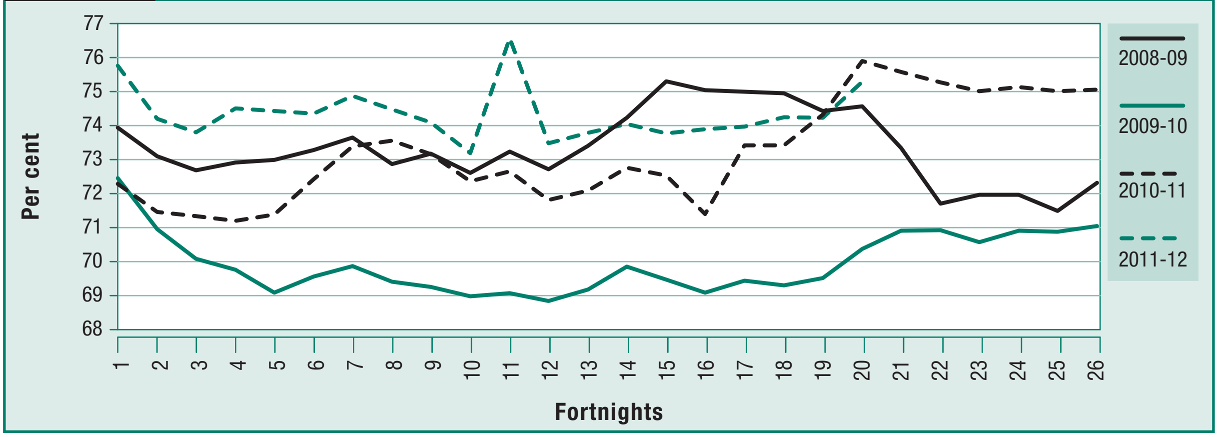
5.3 During financial year 2011-12, growth in bank credit extended by scheduled commercial banks (SCBs) stood at 8.2 per cent as on 16 December 2011 (12.3 per cent in the corresponding period of previsous year). The year-on-year growth was at 17.1 per cent as on 16 December 2011 (23.9 per cent in the corresponding period of the previous year). During the same period, growth in non-food credit stood at 7.9 per cent (12.1 per cent in the previous year). On year-on-year basis, growth moderated from 23.6 per cent at mid-December 2010 to 16.8 per cent as on 16 December 2011. This is below the RBI's indicative projected rate of 18 per cent for 2011-12 (Second Quarter Review of 2011-12 dated 25 October 2011), reflecting the combined effect of a slowing economy and increasing risk aversion of banks. In the Third Quarter Review of Monetary Policy for 2011-12 (24 January 2012), the RBI scaled down the indicative growth projection of non-food credit to 16.0 per cent for the full year. Growth in aggregate deposits during 2011-12 was higher at

Table 5.1 : Flow of bank credit

	Outstanding as on end-March (₹ crore) 2009	2010	2011	Outstanding as on 16-Dec. 2011	17-Dec. 2010	Financial Year so far (Percentage variation) 2010-11	2011-12	Year-on-Year (Percentage variation) 2010-11	2011-12
1. Bank Credit	2775549	3244788	3942083	4266982	3644569	12.3	8.2	23.9	17.1
(a) Food credit	46211	48489	64283	82905	62521	28.9	29.0	38.8	32.6
(b) Non-food credit	2729338	3196299	3877800	4184077	3582048	12.1	7.9	23.6	16.8
2. Aggregate deposit	3834110	4492826	5207969	5672592	4806227	7.0	8.9	14.9	18.0
(a) Demand deposits	523085	645610	641705	559935	578514	-10.4	-12.7	10.1	-3.2
(b) Time deposits	3311025	3847216	4566264	5112657	4227714	9.9	12.0	15.5	20.9
3.Investment	1166410	1384752	1501619	1678851	1445544	4.4	11.8	7.1	16.1
(a) Govt securities	1155785	1378395	1497148	1675247	1440782	4.5	11.9	-6.8	16.3
(b) Other approved	10625	6358	4471	3605	4761	-25.1	-19.4	50.3	-24.3

Source : RBI.

Figure 5.1 **Credit deposit ratio**



18.0 per cent vis-à-vis 14.9 per cent during the corresponding period of 2010-11(Table 5.1). Consequently, there has been a moderation in the credit-deposit ratio between end-March 2011 and December, 2011 (Figure 5.1).

5.4 During financial year 2011-12, private-sector banks have been faring better in terms of growth in credit extended as compared to public-sector and foreign banks. Due to lower credit offtake, commercial banks' investment in government and other approved securities was higher at 11.8 per cent as compared to 4.4 per cent in the previous year. Consequently, the investment-deposit ratio increased from 28.8 per cent at end March 2011 to 29.6 per cent on 16 December 2011 (Figure 5.2).

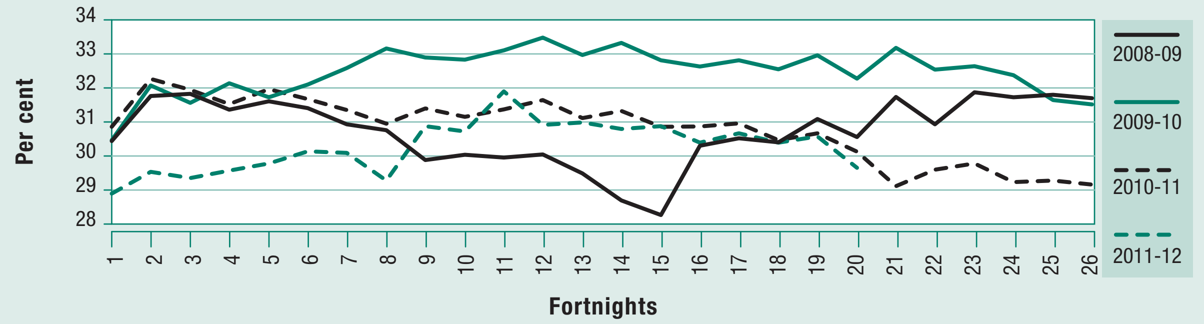
Interest rates

i. Deposit Rates

5.5 As part of a calibrated exit from its expansionary monetary policy and to combat inflation, the RBI increased the repo rate 13 times cummulatively by 375 basis points (bps) since March 2010. In response to the increase in policy rate by the RBI, banks have been raising their deposit and lending rates.

5.6 During 2011-12 (up to end December 2011), deposit rates of SCBs have increased across various maturities (Box 5.1). Interest rates offered by SCBs on deposits of one to three year maturity were placed in the 3.50-10.50 per cent range in December 2011, as compared to 3.50-10.10 per cent in March 2011,

Figure 5.2 **Investment deposit ratio**



while those on deposits of maturity of above three years were placed in the 4.25-10.10 per cent range as compared to 3.50-10.00 per cent in March 2011(Table 5.2).

ii. Lending Rates

5.7 The base rate system, introduced since 1 July 2010, has improved the transparency in lending rates and also enabled a more informed assessment of the transmission of monetary policy impulses to banks' lending rates. The base rates of SCBs were placed in the 6.25-11.25 per cent range in December 2011 as compared to 6.25-10.00 per cent in March 2011 (Table 5.2).

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

5.8 With a view to provide greater flexibility to banks in mobilizing non-resident deposits and considering prevailing market conditions in the recent months, interest rates on both savings and term deposits of maturity of one year and above under non-resident (external) rupee (NRE) accounts, and savings deposits under ordinary non-resident (NRO) accounts were deregulated (interest rates on term deposits under NRO accounts were already deregulated),

Table 5.2 : Movements in deposit and lending rates

(per cent)

Interest rates	Dec.- 2010	Mar.- 2011	Jun. -2011	Sept.-2011	Dec.-2011
I. Domestic deposit rates					
(i) Public Sector Banks					
(a) Up to 1 year	1.00-8.25	1.00-9.75	1.00-9.15	1.00-9.55	1.00-9.55
(b) 1 - 3 years	7.00-8.50	8.00-9.75	8.25-9.75	8.55-9.75	8.55-9.75
(c) Above 3 years	7.00-8.75	7.75-9.75	8.00-9.75	8.00-9.50	8.00-9.50
(ii) Private Sector Banks					
(a) Up to 1 year	2.50-8.50	2.50-9.30	2.50-9.30	3.00-9.40	3.00-9.25
(b) 1 - 3 years	7.25-9.00	7.75-10.10	8.00-10.50	8.00-10.50	8.00-10.50
(c) Above 3 years	7.00-9.25	7.00-10.00	8.00-10.00	8.00-10.00	8.00-10.10
(iii) Foreign banks					
(a) Up to 1 year	1.25-8.00	2.30-9.00	2.50-9.25	3.00-10.00	3.50-10.00
(b) 1 - 3 years	3.50-8.50	3.50-9.10	3.50-10.00	3.50-9.75	3.50-9.75
(c) Above 3 years	3.50-8.50	3.50-9.10	3.50-9.50	4.25-9.50	4.25-9.50
II. Base Rate					
(i) Public-sector banks	7.60-9.00	8.25-9.50	9.25-10.00	10.00-10.75	10.00-10.75
(ii) Private-sector Banks	7.00-9.00	8.25-10.00	8.50-10.50	9.70-11.00	10.00-11.25
(iii) Foreign Banks	5.50-9.00	6.25-9.50	6.25-9.50	6.25-10.75	6.25-10.75
III. BPLR					
(i) Public-sector banks	12.00-14.00	13.00-14.50	13.50-15.00	14.25-15.75	14.25-15.75
(ii) Private-sector banks	13.00-18.00	13.50-19.25	13.75-19.75	13.75-20.50	14.75-21.00
(iii) Foreign banks	10.50-16.00	10.50-16.00	10.50-16.00	10.50-16.50	10.50-16.50

***Source* : RBI.**

***Note* : BPLR is benchmark prime lending rate.**

Box 5.1 : Deregulation of Interest Rate on Savings Bank Deposits

A major component of the financial sector reform process pursued by India has been deregulation of a complex structure of deposit and lending interest rates. On the deposit side, the only interest rate that remained regulated was the savings deposit interest rate. Keeping in view progressive deregulation of interest rates, in the Second Quarter Review of Monetary Policy 2010-11, the RBI proposed that a discussion paper on 'Deregulation of Savings Bank Deposit Interest Rate' would be prepared. After carefully weighing the pros and cons of deregulation of savings bank deposit interest rate, effective 25 October 2011, the RBI deregulated savings bank account interest rates, wherein banks will have to keep a uniform rate of interest for savings accounts with deposits up to ₹ 1 lakh, while differential interest rates could be set for savings bank deposits over ₹ 1 lakh.

The deregulation is expected to improve the transmission of monetary policy. It is also expected to enhance the attractiveness of savings accounts and encourage thrift behaviour in the economy by bringing the savings deposit rate in sync with the changing market conditions.

effective 16 December 2011. Following this, a large number of banks raised their NRE term deposit interest rates.

5.9 Interest rates on Foreign Currency Non-Resident [FCNR(B)] deposits continue to remain regulated by the RBI. At present, the prescribed ceiling interest rate on FCNR(B) deposits stands at LIBOR *plus* 125 bps effective 23 November 2011.

iv. Interest Rate on Rupee Export Credit

5.10 The median interest rates (at which more than 60 per cent of business is contracted) on rupee export credit for pre-shipment credit (up to 180 days) of SCBs were in the 10.40-12.63 per cent range in September 2011 (9.13-11.50 per cent in March 2011). Those on rupee export credit for post-shipment credit (up to 180 days) were in the 8.88-12.75 per cent range in September 2011, as compared to 8.75-12.25 per cent in March 2011. The increase in rupee export credit rates may be seen in the context of a general rise in interest rates.

Sectoral Deployment of Credit

5.11 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 18 November 2011 showed that

Table 5.3 : Sectoral deployment of gross bank credit

Sl. No.	Sector	Outstanding as on (₹ crore) 26 Mar. 2010	19 Nov. 2010	25 Mar. 2011	18 Nov. 2011	Variation Mar. 2011/ Mar. 2010 Absolute amount	Per cent	Variation Nov. 2011/ Nov. 2010 Absolute amount	Per cent
	Gross Bank Credit (1 + 2)	**3088569**	**3371551**	**3731466**	**3950275**	**642897**	**20.8**	**578724**	**17.2**
1.	**Food Credit**	**48562**	**56248**	**64111**	**77890**	**15549**	**32.0**	**21642**	**38.5**
2.	**Non-food Credit (a to d)**	**3040007**	**3315303**	**3667354**	**3872386**	**627347**	**20.6**	**557083**	**16.8**
a.	**Priority Sector**	**1092179**	**1148808**	**1239386**	**1253947**	**147207**	**13.5**	**105139**	**9.2**
i.	Agriculture & Allied Activities	416133	411816	460333	441841	44200	10.6	30025	7.3
ii.	Micro & Small Enterprises	373530	407872	454995	473573	81465	21.8	65701	16.1
iii.	Other Priority Sector	302516	329120	324058	338533	21542	7.1	9413	2.9
b.	**Industry (Medium and Large)**	**1105051**	**1249843**	**1391747**	**1526358**	**286696**	**25.9**	**276515**	**22.1**
c.	**Wholesale Trade (other than food procurement)**	**86357**	**95002**	**103584**	**112747**	**17227**	**19.9**	**17745**	**18.7**
d.	**Other Sectors**	**756420**	**821650**	**932637**	**979334**	**176217**	**23.3**	**157684**	**19.2**
	of Non-food Gross Bank Credit								
1.	Housing (including Priority Sector Housing)	300929	327391	346110	372503	45181	15.0	45112	13.8
2.	Consumer Durables	8294	8928	10156	8168	1862	22.4	-760	-8.5
3.	Commercial Real Estate	92128	105479	111836	116670	19708	21.4	11191	10.6
4.	Tourism, Hotels & Restaurants	19410	26470	27729	30260	8319	42.9	3790	14.3
5.	Advances to individuals against shares, bonds, etc.	2863	2935	3613	3612	750	26.2	677	23.1

Source **: RBI.**

Note **: Data are provisional and relate to select SCBs which account for 95 per cent of total bank credit extended by all SCBs.**

among the major sectors, credit (year-on-year) to agriculture recorded a growth of 7.3 per cent (10.6 per cent in March 2011), while that to industry (medium and large) 22.1 per cent as against 25.9 per cent in March 2011. Credit to wholesale trade recorded a growth of 18.7 per cent as compared to 19.9 per cent in March 2011.

5.12 Credit to the priority sector grew by 9.2 per cent (year-on-year) in November 2011 as compared to 13.5 per cent in March 2011. Among the priority sub-sectors, credit to micro and small enterprises (MSEs) (including service-sector enterprises) recorded a growth of 16.1 per cent (year-on-year) in November 2011 as compared to 21.8 per cent in March 2011 (Table 5.3).

Priority-sector Lending

5.13 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 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.

5.14 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 micro and small enterprises and the export sector should not be less than 10 per cent and 12 per cent respectively of the ANBC or credit-equivalent amount of OBE, whichever is higher.

5.15 The outstanding advances granted by public-sector, private-sector, and foreign banks to the priority sector as on the last reporting Fridays of March 2009, 2010, and 2011 are presented in Table 5.4. There were shortfalls in achieving the targets in the case of a few public, private, and foreign banks.

Table 5.4 : Particulars of Priority-sector Advances

(₹ crore)

As on the last reporting Friday of	March 2009	March 2010	March 2011(P)
1. PUBLIC SECTOR BANKS			
Total priority sector advances	724150 (42.8)	863777 (41.55)	1028614 (41.25)
Total advances to agriculture#	299415 (17.7)	372463 (17.28)	414991 (16.53)
Total advances to micro & small enterprises	191408 (11.3)	276318 (13.3)	376625 (15.1)
Advances to weaker sections	165829 (9.8)	211376 (10.17)	246316 (9.88)
2. PRIVATE-SECTOR BANKS			
Total priority sector advances	187849 (46.2)	214669 (45.8)	248827 (46.64)
Total advances to agriculture#	76103 (18.7)	90737 (15.58)	92135 (15.75)
Total advances to micro & small enterprises	46656 (11.5)	64824 (13.83)	87856 (16.47)
Advances to weaker sections	14262 (3.5)	25532 (5.44)	5989 (5.64)
3. FOREIGN BANKS			
Total priority sector advances	55483 (34.3)	59959 (36.03)	66527 (38.61)
Total advances to micro & small enterprises	18138 (11.2)	21147 (12.70)	21500 (12.48)
Total Export credit (includes SSI export)	31511 (19.4)	35167 (21.13)	42486 (24.66)

Source **: RBI.**

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

Figures in parentheses show percentage of advances to ANBC or credit-equivalent amount of OBE, whichever is higher.

P : Provisional.

5.16 The outstanding priority sector advances of public sector banks increased from ₹ 8,63,777 crore as on the last reporting Friday of March 2010 to ₹ 10,28,614 crore as on the last reporting Friday of March 2011, showing a growth of 19.1 per cent. Although public-sector banks as a group had achieved the overall priority-sector lending target as on the last reporting Friday of March 2011, seven out of 27 banks could not individually achieve the target.

5.17 The outstanding priority sector advances of private sector banks increased from ₹ 2,14,669 crore on the last reporting Friday of March 2010 to ₹ 2,48,827 crore on the last reporting Friday of March 2011, showing a growth of 15.9 per cent. Private-sector banks as a group had achieved the overall lending target on the last reporting Friday of March 2011 and only one of the 21 could not individually achieve the target.

5.18 The outstanding priority sector advances of foreign banks increased from ₹ 59,959 crore on the last reporting Friday of March 2010 to ₹ 66,527 crore on the last reporting Friday of March 2011, showing a growth of 11.0 per cent. Foreign banks as a group also achieved the overall priority sector lending target on the last reporting Friday of March 2011. However, three of the 30 foreign banks did not individually achieve the target.

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. Under the SHG-Bank Linkage Programme as on 31 March 2011, 74.62 lakh SHGs held savings bank accounts with total savings of ₹ 7,016 crore as against 69.53 lakh SHGs with savings of ₹ 6,199 crore as on 31 March 2010. By December 2011, another 2.98 lakh SHGs have come under the ambit of the Programme, taking the cumulative number of savings-linked groups to 77.60 lakh SHGs.

5.21 As on 31 March 2011, 47.87 lakh SHGs had outstanding bank loans of ₹ 31,221 crore, as against 48.5 lakh SHGs with bank loans of ₹ 28,038 crore as on 31 March 2010. This represents a decline of 1.3 per cent in the number of SHGs and a growth of 11.4 per cent in bank loans outstanding to SHGs (Table 5.5). During 2011-12 (up to December 2011), 4.51 lakh SHGs have been financed with an amount of ₹ 6,791.46 crore. As per NABARD data, as on 31 March 2011, gross non-performing assets (NPAs) in respect of SHGs were 4.7 per cent of the bank loans outstanding.

RURAL INFRASTRUCTURE DEVELOPMENT FUND (RIDF)

5.22 The annual allocation of funds under the RIDF has gradually increased from ₹ 2,000 crore in 1995-96 (RIDF I) to ₹ 18,000 crore in 2011-12 (RIDF XVII). Aggregate allocations have reached ₹ 1,34,000 crore.

Table 5.5 : Progress of Micro-finance Programme

Year	New SHGs Financed by Banks During the Year			Bank Loan* Outstanding as on 31 March 2011		
	No. (lakh)	Amount (₹ crore)	Growth (%)	No.(lakh)	Amount (₹ crore)	Growth (%)
2007-08	12.28	8,849.26	-	36.26	16,999.90	-
2008-09	16.09	12,256.51	38.50	42.24	22,679.85	33.41
2009-10	15.87	14,453.30	17.90	48.52	28038.28	23.62
2010-11	11.96	14,547.73	0.65	47.87	31221.17	11.35

Source **: National Bank for Agriculture and Rural Development (NABARD).**
Note **: * Includes repeat loans to existing SHGs.**

Box 5.2 : Bank Loans to Micro-finance Institutions (MFIs) : Priority-sector Status

The RBI set up a committe to study issues and concerns in the micro-finance sector (Chairman: Shri Y. H. Malegam). Based on its recommendation, all SCBs have been advised by the RBI that bank credit to MFIs extended on, or after, 1 April 2011 for on-lending to individuals and also to members of SHGs / joint-liability groups (JLGs) will be eligible for categorization as priority-sector advance under the categories agriculture, MSE , and micro credit (for other purposes), as indirect finance, provided not less than 85 per cent of total assets of the MFI (other than cash balances with banks and financial institutions, government securities, and money market instruments) are in the nature of 'qualifying assets'. In addition, the aggregate amount of loan, extended for income-generating activity, should not be less than 75 per cent of the total loans given by MFIs.

The above commitee recommended that the existing guidelines on bank lending to the priority sectors be revisited. Accordingly, the Reserve Bank of India set up a Committee, under the Chairmanship of Shri M. V. Nair, CMD, Union Bank of India, to re-examine the existing classification and suggest revised guidelines with regard to priority-sector lending classification and related issues.

In addition, 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 2010-11.

Table 5.6 : Sanctions and Disbursements under the RIDF and Bharat Nirman (Rural Roads Components)

(As on 31 December 2011) (₹ crore)

Region	Sanction	Disbursement	Disbursement as per cent of Sanction
South	34573	23618	68
West	19211	13325	69
North	38416	26447	69
Central	10988	6779	62
East	23250	12960	56
NER & Sikkim	6369	3501	55
Sub Total	**132808**	**86631**	**65**
Bharat Nirman (Rural Roads Component)	18500	18500	100
Grand total	**151308**	**105131**	**69**

Source : NABARD.
Note : NER is the north-east region.

Table 5.7 : Disbursements under the RIDF during 2011-12

(As on 31 December 2011) (₹ crore)

Region	Disbursement Target	Disbursement Achievement	Achievement (%)
South	3200	1711	53
West	2060	514	25
North	4510	2254	50
Central	1080	411	38
East	3540	1014	29
NER & Sikkim	610	214	35
TOTAL	**15000**	**6118**	**41**

Source : NABARD.

5.23 As against the total allocation of ₹ 1,34,000 crore, encompassing RIDF I to XVII, sanctions aggregating ₹ 1,32,808 crore have been accorded to various state governments and an amount of ₹ 86,631 crore disbursed up to end December 2011. The National Rural Roads Development Agency (NRRDA) had been disbursed the entire ₹ 18,500 crore sanctioned for it (under RIDF XII-XV) by March 2010 (Table 5.6). During 2011-12, ₹ 6,118 crore was disbursed to the states under the RIDF up to end December 2011(Table 5.7).

Agricultural Credit

Flow of Agricultural Credit

5.24 The Indian banking system disbursed credit of ₹ 4,46,779 crore to the agricultural sector as against a target of ₹ 3,75,000 crore in 2010-11, thereby exceeding the target by around 19 per cent. Commercial banks and RRBs together extended credit to 104.96 lakh new farmers during 2010-11 and cooperative banks to 22.30 lakh new farmers, thus taking the total number of new farmers brought under the banking system to 127.26 lakh. The total number of agricultural loan accounts financed as of March 2011 was 5.50 crore. The credit flow to agriculture during 2011-12 by commercial banks, cooperative banks, and RRBs together was ₹ 2,62,129 crore till October 2011, amounting to 55 per cent of the annual target of ₹ 4,75,000 crore (Table 5.8).

Kisan Credit Card (KCC) Scheme

5.25 The banking system has issued 1,078.36 lakh KCCs involving a total sanctioned credit limit of

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

(₹ crore)

Sl. No.	Agency	2006-07	2007-08	2008-09	2009-10	2010-11^	2011-12*
1.	Co-operative banks[$]	42480	48258	46192	63497	70105	53187
	Share (%)	18	19	15	17	16	20
2.	RRBs	20435	25312	26765	35218	43968	29073
	Share (%)	9	10	9	9	10	11
3.	Commercial banks	166485	181088	228951	285799	332706	179869
	Share (%)	73	71	76	74	74	69
Total (1+2+3)		229400	254658	301908	384514	446779	262129

Source : NABARD.

Notes : $: Including others, ^: Provisional, *: Up to 30 October 2011.

₹ 5,27,052 crore as on 31 October 2011. The share of commercial banks stood at 45.6 per cent of the total number, followed by cooperative banks at 39.4 per cent, and RRBs at 15.1 per cent. The year-wise and agency-wise position of the KCCs issued is given in Table 5.9.

Agriculture Debt Waiver and Debt Relief (ADWDR) Scheme 2008

5.26 NABARD is the nodal agency for implementing the Agriculture Debt Waiver and Debt Relief (ADWDR) Scheme 2008 in respect of Co-operative Credit Institutions and Regional Rural Banks. NABARD has

Table 5.9 : Agency-wise KCCs Issued and Amount Sanctioned

(As on 31 October 2011)

Agency	Cards Issued (lakh)					Amount Sanctioned (₹ crore)				
	2008-09	2009-10	2010-11	2011-12	Total#	2008-09	2009-10	2010-11	2011-12	Total#
Co-operative banks	13.44	17.43	28.12	17.58	424.57	8428	7606	10719	7461	158775
RRBs	14.15	19.50	17.74	10.57	162.53	5648	10132	11468	6568	71998
Commercial banks	58.34	53.13	55.83	11.79*	491.26*	39009	39940	50438	12652*	296279*
Total	**85.92**	**90.06**	**101.69**	**39.94**	**1078.36**	**53085**	**57678**	**72625**	**26681**	**527052**

Source : NABARD

Notes : #: Since inception of the scheme in 1998. *: Up to 30 June 2011.

Box 5.3 : Interest Subvention Relief to Farmers

Consequent upon the announcement by the Union Finance Minister in Budget Speech 2006-07, public-sector banks, regional rural banks and rural co-operative credit institutions were advised that with effect from Kharif 2006-07, Government would provide interest rate subvention of 2 per cent per annum in respect of short-term production credit up to ₹ 3.0 lakh. This subvention was available to public sector banks, regional rural banks and rural co-operatives on the condition that they made short-term credit available at 7 per cent per annum. In case of RRBs and rural cooperatives, this was applicable only to short-term production credit disbursed out of their own funds and did not include such credit supported by NABARD refinance.

Pursuant to the Union Budget announcement of 2010-11, it was decided to provide interest subvention of 1.5 per cent per annum for short-term agriculture loans up to ₹ 3.0 lakh disbursed by public-sector Banks, cooperatives, and RRBs. The additional subvention for prompt repayment has been enhanced to 2 per cent per annum so that the effective interest rate charged to such farmers is 5 per cent per annum up to ₹ 3.0 lakh. In the 2011-12 Budget, the Government of India proposed to provide interest subvention of 1.5 per cent per annum for short term agriculture loans up to ₹ 3.0 lakh disbursed by Public Sector Banks, co-operatives and RRBs. The additional subvention for prompt paying farmers is proposed to be enhanced to 3 per cent per annum so that the effective interest rate charged to these farmers is 4 per cent per annum upto ₹ 3.0 lakh.

Table 5.10 : Release under ADWDR

(as on 31 December 2011) (₹ crore)

Agency	Debt Waiver	Debt Relief	Total
State Cooperative Banks	15636.59	2650.57	18287.16
SCARDB	3424.40	418.05	3842.45
RRBs	6052.93	917.40	6970.33
Total	**25113.92**	**3986.02**	**29099.94**

Source **: NABARD.**
Note: SCARDB: State Cooperative Agriculture and Rural Development Bank. RRB: Regional Rural Bank

released ₹ 25,113.92 crore towards debt waiver and ₹ 3,986.02 crore towards Debt Relief claims as on 31 December, 2011. The agency-wise position of release under ADWDR is given in Table 5.10.

Financial Performance of Banks

5.27 Despite the demanding operational environment, the Indian banking sector demonstrated continued revival from the peripheral spill over effects of the recent global financial turmoil in 2010-11. This was evident in the higher credit growth, deposit growth, better return on assets, sound capital to risk-weighted assets ratio and improvement in gross non-performing assets ratio, among others. However, certain concerns continued to persist in the Indian banking sector.

Table 5.11 : Working Results of SCBs

Items	PSBs		Foreign banks		Old pvt. sector banks		New pvt. sector banks		All SCBs	
	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011
	(₹ Crore)									
A Income	354876	414183	36341	39494	23649	26328	79580	91225	494446	571230
(i) Interest income	305983	366318	26390	28522	20497	23299	62309	73528	415179	491667
(ii) Other income	48893	47865	9951	10972	3152	3029	17271	17697	79267	79563
B Expenditure	315619	369282	31600	31775	21336	23226	68782	76614	437337	500897
(i) Interest expended	211940	231153	8938	10622	14076	14768	37130	42347	272084	298890
(ii) Operating expenses	66075	82965	11102	12558	4715	5600	18136	22006	100028	123129
(iii) Provisions and contingencies	37604	55164	11560	8595	2545	2858	13516	12261	65225	78878
C Operating profits (A - Bi - Bii)	76861	100065	16301	16314	4858	5960	24314	26872	122334	149211
D Net profit (A - B)	39257	44901	4741	7719	2313	3102	10798	14611	57109	70333
E Net interest income (Spread) (Ai - Bi)	94043	135165	17452	17900	6421	8531	25179	31181	143095	192777
F Total assets	4440827	5293817	435362	491528	268905	309011	881831	1089165	6026925	7183521
G Net income (Aii + E)	142936	183030	27403	28872	9573	11560	42450	48878	222362	272340
	As percentage of total assets									
A Income	7.99	7.82	8.35	8.03	8.79	8.52	9.02	8.38	8.20	7.95
(i) Interest income	6.89	6.92	6.06	5.80	7.62	7.54	7.07	6.75	6.89	6.84
(ii) Other income	1.10	0.90	2.29	2.23	1.17	0.98	1.96	1.62	1.32	1.11
B Expenditure	7.11	6.98	7.26	6.46	7.93	7.52	7.80	7.03	7.26	6.97
(i) Interest expended	4.77	4.37	2.05	2.16	5.23	4.78	4.21	3.89	4.51	4.16
(ii) Operating expenses	1.49	1.57	2.55	2.55	1.75	1.81	2.06	2.02	1.66	1.71
(iii) Provisions and contingencies	0.85	1.04	2.66	1.75	0.95	0.92	1.53	1.13	1.08	1.10
C Operating profits (A - Bi - Bii)	1.73	1.89	3.74	3.32	1.81	1.93	2.76	2.47	2.03	2.08
D Net profit (A - B)	0.88	0.85	1.09	1.57	0.86	1.00	1.22	1.34	0.95	0.98
E Net interest income (Spread) (Ai - Bi)	2.12	2.55	4.01	3.64	2.39	2.76	2.86	2.86	2.37	2.68

Source **: Statistical Tables Relating to Banks in India 2010-11.**

5.28 Overall growth in the consolidated balance sheet of SCBs in 2010-11 was 19.2 per cent, higher than the 15.0 per cent growth during the previous year. Moreover, growth in balance sheets could be seen across all bank groups except the old private sector banks. The working results of SCBs under different bank groups are given in Table 5.11. On the liability side of the balance sheet, growth was driven mainly by borrowings, capital, and other liabilities and provisions. Deposits also witnessed higher growth in 2010-11 as compared to the previous year. Growth in deposits of SCBs accelerated to 18.3 per cent in 2010-11 from 16.8 per cent in 2009-10. On the asset side of the balance sheet, growth was primarily driven by loans and advances. Credit growth was placed at 22.9 per cent in 2010-11 as compared to 16.6 per cent in 2009-10. The credit-deposit ratio at end March 2011 was 76.5 per cent, higher than the ratio of 73.6 per cent at end March 2010.

5.29 During 2010-11, the major drivers of credit growth were the services sector and personal loans. Growth of credit to the agriculture and industry sectors witnessed moderation during 2010-11 in comparison with the previous year.

5.30 Growth in investments by banks decelerated to 10.8 per cent in 2010-11 from 19.3 per cent in 2009-10. In 2010-11, almost three-fourths of total investments of the banking sector were in government securities, mainly to meet the statutory liquidity ratio (SLR) requirements and raise funds from the short-term money market. However, investments of the banking sector in government securities recorded lower growth in 2010-11 as compared to the previous year. The non-SLR investments of SCBs witnessed a decline in March 2011 as compared to the corresponding period of the previous year.

5.31 The consolidated net profits of the banking sector recorded higher growth in 2010-11, in contrast to the deceleration experienced in 2009-10, primarily because of higher growth in interest income. The most salient indicator of profitability, Return on Assets (ROA) improved to 1.10 per cent in 2010-11 from 1.05 per cent in 2009-10. Further, return on equity (ROE) too improved to 14.96 per cent in 2010-11 from 14.31 per cent in 2009-10.

5.32 Resources raised by banks through public issues witnessed substantial increase in 2010-11, particularly during March 2011 when 70 per cent of the total was raised. Resources raised by banks through private placements declined by 40 per cent in 2010-11 over the previous year, mainly on account of private-sector banks, which registered a decline of over 64 per cent.

Capital Adequacy Ratio

5.33 The Capital to risk-weighted assets ratio (CRAR) of all bank groups both under Basel I and II remained well above the stipulated regulatory norm of 9 per cent in 2010-11. The CRAR of SCBs under Basel I was placed at 13.0 per cent and under Basel II at 14.2 per cent as at end-March 2011.

Non-performing Assets (NPAs) of the Banking Sector

5.34 The asset quality of the banking sector improved in 2010-11 over the previous year. The gross NPAs (GNPAs) to gross advances ratio declined to 2.3 per cent in 2010-11 from 2.4 per cent in the previous year. The GNPAs, however, increased in absolute terms in 2010-11 over the previous year, though at a lower rate. The improvement in asset quality was visible in both private sector banks and foreign banks. Public-sector banks, however, witnessed deterioration in asset quality in 2010-11. During 2010-11, the banking sector has written off almost 10 per cent of the outstanding gross non-performing loans (at end March 2010), which helped in limiting their growth of gross non-performing loans.

Technological Developments in Banks

5.35 In recent years, the pace and quality of banking have changed with the adoption of technological advancements. The adoption of technological solutions is particularly useful in expanding the banking network in a cost-effective manner. It is also being utilized to design and provide innovative banking services that enhance the efficiency and help reduce the cost of financial intermediation. Accordingly, the RBI has been encouraging banks to leverage upon the latest available technology to expand and handle their business in a cost effective manner.

5.36 Computerization as well as the adoption of core banking solutions has been a major step in improving the efficiency of banking services. Presently almost 98 per cent of the branches of public sector banks are fully computerized, of which almost 90 per cent are on the core banking platform.

5.37 Introduction of automated teller machines (ATMs) has enabled customers to do banking without visiting the bank branch. In 2010-11 the number of

ATMs witnessed a growth of 24 per cent over the previous year. More than 65 per cent of the total ATMs belonged to public sector banks at end March 2011. During 2010-11, the number of debit cards grew at the rate of 25 per cent over the previous year. In sync with the trend observed in case of ATMs, nearly three-fourths of the total debit cards were issued by public sector banks at end March 2011.

Reform of the Payment System in India

5.38 The Payment system architecture in India is based on international benchmarks, and guiding principles. The Payment and Settlement System Act, 2007 provides a comprehensive legal framework for payment and settlement services in India for subjects like authorisation of payment system operators, netting and finality of payment and settlement. The payment system objectives of having a safe, sound, cost effective and wide distribution network of the system infrastructure are being met in so far as the large value and countrywide payment and settlement systems are concerned. The grand vision is that cash dominant economy may transit to a predominantly non-cash dominant economy with non-cash transactions primarily in electronic mode, which is the international norm. The existing payment system is being constantly reviewed to suggest an action plan for orderly growth of the payment systems.

Capital Assistance to PSBs

5.39 As capital is a key measure of bank's capacity for generating loan assets and is essential for balance sheet expansion, Government of India has regularly been investing additional capital in the PSBs to support their growth and keep them financially sound and healthy so as to ensure that the growing credit needs of economy are adequately met. A sum of ₹ 12,000 crore has been provided in the Revised Estimates 2011-12, under plan, for capital infusion in Public Sector Banks to enable them to maintain a minimum Tier I CRAR at 8 per cent as on 31 March, 2012 and also to increase shareholding of the Government of India in the PSBs to 58 per cent. For the year 2012-13 also, the Government is committed to keep all the PSBs adequately capitalised so that the growth momentum of economy is sustained. Further, the Government has appointed a High Level Committee headed by Finance Secretary, to assess the need for capitalisation of various PSBs for the next 10 years keeping in view various challenges the PSBs have to face due to the impending implementation of Basel III norms and the credit needs of the fast growing economy; and to explore various options to raise resources to capitalize the PSBs and analyse various suggested / preferred modes of capitalisation. The Committee has submitted its report to the Government which is under consideration.

Initiatives to Increase Efficiency in PSBs

5.40 Government is signing Memorandum of Understandings (MoUs) with the PSBs whereby capital infusion will be linked to achieving the targets by PSBs on various key parameters on productivity, including Return on Assets, Net Profit Per employee and Cost to Income Ratio. MOUs spanning over a period of four years, 2011-12 to 2014-15, have since been finalized with all the PSBs excluding SBI Associate Banks. SBI will be entering into MOU with its Associate Banks on similar parameters. Government has put in place a mechanism of Statement of Intent on Annual Goals (SOI) to monitor the performance of the PSBs on various performance parameters. In order to have greater focus on efficiency parameters and also to have a more realistic view of the quality of assets of PSBs, SOI parameters have been revised during 2011-12.

Financial Inclusion

5.41 The objective of Financial Inclusion is to extend financial services to the large hitherto unserved population of the country to unlock its growth potential. In addition, it strives towards a more inclusive growth by making financing available to the poor in particular. Government of India has been actively pursuing the agenda of Financial Inclusion, with key interventions in four groups, viz. expanding banking infrastructure, offering appropriate financial products, making extensive and intensive use of technology and through advocacy and stakeholder participation.

5.42 Of the about 73,000 habitations having a population of over 2000 identified by banks for extending banking facilities by March, 2012 through Business Correspondents (BCs)/ Business Correspondent Agents (BCAs)/ Bank branches, about 55,000 villages have been provided with banking facilities till December 2011. Out of 81 unbanked blocks in the country as on 31 March 2011, with the persistent efforts of the Government, banking facilities have been provided in 39 blocks from April 2011 to November 2011. Banks have been further directed by the Government to provide banking facilities in all the unbanked blocks by March, 2012.

5.43 Detailed Strategy and Guidelines on Financial Inclusion have been issued by the Government to banks on 21 October 2011 which inter-alia provide emphasis on: (i) setting up more brick and mortar branches with the objective to have a bank branch within a radial distance of 5 km; (ii) to open bank branches by Sept 2012 in all habitations of 5,000 or more population in under banked districts and 10,000 or more population in other districts; (iii) to provide a Business Correspondent within a radial distance of 2 km; (iv) to cover villages of 1,000 and more population in 10 smaller States/UTs by September 2012; (v) to consider Gram Panchayat as a unit for allocation of area under Service Area Approach to bank branch and BC etc.

Box 5.4 : Pilot Project on Mewat on Financial Inclusion

A Pilot Project on Financial Inclusion (FI) in Mewat district was also undertaken by all the public sector banks and the Gurgaon Gramin Bank functioning in the district. Banking facilities are now available in all the 95 FI villages, either through a brick and mortar branch or a business correspondent. 77 Ultra Small Branches are being set up by various banks. Training on e-payment was imparted to all the bank officials. Campaign to issue KCC to all eligible non defaulter farmers and GCC to non-farmers was organized. Wide publicity and financial literacy measures were initiated through broadcasting financial inclusion messages in the local Mewati language on the community radio, display of graffiti at prominent places, organization of Kisan Goshtis, mobilization of progressive farmers to form farmers clubs etc. A proof of concept in inter-operability between the Business Correspondents of different banks was also done. Syndicate Bank has tied up with SBI Life for providing micro insurance cover of ₹ 25,000 with a nominal premium of ₹ 32/- per annum. Solar Home Lighting Systems were popularized and 1500 loans have been given to establish Solar Home Lighting System.

5.44 Banks have also been advised to transfer subsidies through Electronic Benefit Transfer (EBT) under 32 schemes which are in operation and, funded by the Government of India, so that benefit gets credited directly to the account of the beneficiaries. Banks are also required to ensure that 25 per cent branches in the Annual Branch Expansion Plan (ABEP) should be in unbanked Tier 5 and Tier 6 centres (upto population of 9,999).

Non-banking Financial Institutions (NBFIS)

Financial Institutions (FIs)

5.45 At end-March 2011, there were four institutions, namely the Export Import Bank of India (EXIM Bank), National Bank for Agriculture and Rural Development (NABARD), the National Housing Bank (NHB), and Small Industries Development Bank of India (SIDBI), regulated by the RBI as all-India FIs. The outstanding of total resources mobilized at any point of time by an FI, including funds mobilized under the 'umbrella limit', as prescribed by the RBI, should not exceed 10 times its net owned funds as per its latest audited balance sheet. However, in view of the difficulties expressed by the NHB and EXIM Bank,

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)	
	2009-10	2010-11	2009-10	2010-11	2009-10	2010-11	2009-10	2010-11	2010	2011
EXIM Bank	8150	11132	5052	1538	5193	11456	18395	24126	40509	47192
NABARD	16	9741	12330	15882	-	48	12346	25671	24922	34034
NHB	7518	7537	10306	3380	-	-	17824	10917	10598	22765
SIDBI	13253	11744	11500	5958	987	1700	25740	19402	30186	39269
Total	28937	40154	39188	26758	6180	13204	74305	80116	106215	143260

Sources **: Respective FIs.**

Notes **: -: Nil/Negligible.**

Long-term rupee resources comprise borrowings by way of bonds/ debentures; and short-term resources comprise commercial papers (CPs), term deposits, indexed certificates of deposit (ICDs), certificates of deposit (CDs) and borrowing from term money. Foreign currency resources largely comprise bonds and borrowings in the international market.

their aggregate borrowing limit has been enhanced to 11 times of their net owned funds (NOF) for one year (for NHB up to 30 September 2012 and for EXIM Bank up to 31 March 2012, subject to review).

5.46 Resources raised by FIs during 2010-11 were considerably higher than those during the previous year. While long-term resources and foreign currency resources raised witnessed a sharp rise during 2010-11, short-term resources raised declined substantially. NABARD mobilized the largest amount of resources, followed by EXIM Bank and SIDBI (Table 5.12).

5.47 Total sources/deployment of funds of FIs decreased modestly by 1.6 per cent to ₹ 2,97,784 crore during 2010-11. A major part of the funds was raised internally (54.8 per cent), followed by external sources (40.0 per cent) and other sources (5.2 per cent). A large part of the funds raised was used for fresh deployments (58.7 per cent), followed by repayment of past borrowings (28.2 per cent). Other deployments including interest payments formed a comparatively small part of the funds of FIs (Table 5.13).

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

(Amount in ₹ crore)

Item	2009-10	2010-11	Percentage Variation in 2010-11
A) Sources of funds (i+ii+iii)	**302610** (100.0)	**297784** (100.0)	**-1.6**
(i) Internal	156733 (51.8)	163197 (54.8)	4.1
(ii) External	126813 (41.9)	119072 (40.0)	-6.1
(iii) Others@	19065 (6.3)	15515 (5.2)	-18.6
B) Deployment of funds (i+ii+iii)	**302610** (100.0)	**297784** (100.0)	**-1.6**
(i) Fresh deployment	171922 (56.8)	174674 (58.7)	1.6
(ii) Repayment of past borrowings	115015 (38.0)	83971 (28.2)	-27
(iii) Other deployment	15673 (5.2)	39139 (13.1)	149.7
of which: Interest payments	16561 (5.5)	14227 (4.8)	-14.1

Source **: Respective FIs.**

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

Non-banking Financial Companies (NBFCs)

5.48 NBFCs account for 12.3 per cent of assets of the total financial system. 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). Total number of NBFCs registered with RBI, consisting of NBFCs-D and NBFCs-ND, declined from 12,630 at end June 2010 to 12,409 at end June 2011. The number of NBFCs-D declined from 308 to 297, 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 260 to 330 during the same period. Under the NBFCs-D category there are two residuary non-banking companies (RNBCs) (Table 5.14).

5.49 The ratio of deposits of reporting NBFCs (including RNBCs) to the aggregate deposits of SCBs dropped to 0.21 per cent as on 31 March 2011 from 0.36 per cent in the previous year, mainly due to decline in deposits of RNBCs.

5.50 Total assets of NBFCs-D (including RNBCs) increased to ₹ 1,16,897 crore as on 31 March 2011 from ₹ 1,12,131 crore in the preceding year. Public deposits held by NBFCs-D and RNBCs together declined by 31.1 per cent to ₹ 11,964 crore as on 31 March 2011 from ₹ 17,352 crore in the previous year. Net owned funds (NOF) witnessed 9.4 per cent

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	13261	507	-
2006	13014	428	149
2007	12968	401	173
2008	12809	364	189
2009	12740	336	234
2010	12630	308	260
2011	12409	297	330

Source **: RBI.**

growth for the year ended March 2011 and stood at ₹ 17,975 crore.

5.51 The consolidated balance sheet of NBFCs-D (excluding RNBCs) recorded 11.9 per cent growth for the year ended March 2011 (22.2 per cent in the previous year). Borrowings, which is the major source of funds for NBFCs-D, increased by 9.0 per cent during the year, while public deposits increased sharply by 43.5 per cent largely due to increase in public deposits of three NBFCs-D. On the assets side, loans and advances witnessed a growth of 9.5 per cent while investments increased by 14.1 per cent (primarily on account of increase in SLR investments) for the year ended March 2011.

5.52 Asset finance companies (AFCs) held the largest share in total assets/liabilities (70.2 per cent) of NBFCs-D (excluding RNBCs), while loan companies accounted for 29.8 per cent for the year ended March 2011. The increase in assets/liabilities of AFCs was mainly on account of reclassification of NBFCs, initiated in December 2006. Of the total deposits held by all NBFCs-D, AFCs held the largest share of 89.3 per cent, followed distantly by loan companies with a 10.7 per cent share.

5.53 CRAR norms were made applicable to NBFCs-D in 1998, according to which every NBFC-D is required to maintain a minimum capital, consisting of Tier I and Tier II capital, of not less than 12 per cent (15 per cent with effect from 31 March 2012) of its aggregate risk-weighted assets. As on 31 March 2011, 202 out of 204 reporting NBFCs-D had CRAR of more than 12 per cent as against 272 out of 275 NBFCs-D in the previous year. 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 NBFC sector.

Profile of NBFCs-ND-SI

5.54 The balance sheet size of the NBFCs-ND-SI sector increased by 24.0 per cent to ₹ 7,30,366 crore as on 31 March 2011 (against ₹ 5,88,806 crore on 31 March 2010). Significant increase in balance sheet size of the NBFCs-ND-SI sector is mainly attributed to sharp increase in owned funds, debentures, and bank borrowings. Owned funds (which accounted for 25.4 per cent of total liabilities) increased by 13.6 per cent during 2010-11. Total borrowings (secured and unsecured) of the sector increased sharply by 29.9 per cent to ₹ 5,00,938 crore and formed 68.6 per cent of total liabilities as on 31 March 2011. During the period ended June, 2011, total borrowings further increased by 4.7 per cent to ₹ 5,24,823 crore.

5.55 The pattern of deployment of funds by the NBFCs-ND-SI sector for the year ended March 2011 remained broadly in line with the pattern witnessed in the previous year. Secured loans continued to constitute the largest share (45.5 per cent of total assets), followed by unsecured loans with a share of 17.2 per cent, hire purchase assets (6.8 per cent), investments (18.6 per cent), cash and bank balances (4.1 per cent) and other assets (7.7 per cent) during the year ended March 2010.

5.56 The financial performance of the NBFCs-ND-SI sector improved as reflected in the increase in net profit of ₹ 15,619 crore during 2010-11 (as compared to ₹ 12,231 crore in the previous year). ROA (net profit as a percentage to total assets) of the sector stood at 2.1 per cent as on 31 March 2011.

5.57 Gross and net NPA ratios of the NBFCs-ND-SI sector improved for the year ended March 2011 indicating overall improvement in asset quality of the sector. Gross NPA ratio of the sector stood at 1.8 per cent for the year ended March 2011 (2.8 per cent in the previous year), while net NPA ratio was 0.7 per cent (1.2 per cent in the previous year).

5.58 CRAR norms were made applicable to NBFCs-ND-SI with effect from April 2007. In terms of the extant instructions, every NBFC-ND-SI is required to maintain a minimum capital, consisting of Tier I and Tier II capital, of not less than 15 per cent of its aggregate risk-weighted assets. As on March 2011, barring a few, most of the reporting companies maintained the stipulated minimum of 15 per cent CRAR.

Major Policy Initiatives

5.59 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 are given below:

(i) The RBI had earlier-issued guidelines on core investment companies(CICs) in August 2010 where CICs were defined and it was advised that systemically important CICs (CICs-ND-SI), i.e. CICs with asset size of ₹ 100 crore and above, are required to get registered with the RBI. Subsequently these guidelines were issued with slight modifications by means of a notification on 5 January 2011.

(ii) In the interest of counter cyclicality and also to ensure that NBFCs create a financial buffer to protect them from the effects of economic downturns, provisioning for standard assets was introduced to NBFCs at 0.25 per cent of outstanding standard assets.

(iii) To align the minimum capital ratio of all deposit-taking NBFCs with that of systemically important non-deposit—taking NBFCs, all deposit-taking NBFCs were advised to maintain a minimum capital ratio consisting of Tier I and Tier II capital at 15 per cent of their aggregate risk-weighted assets on balance sheet and risk-adjusted value of off-balance sheet items with effect from 31 March 2012.

(v) It was clarified that the term 'infrastructure loan' would now include 'telecom towers' also as an infrastructure facility for availing of credit facility. Further, NBFCs were also advised that only credit-rating agencies (CRAs) approved by the RBI can assign rating to infrastructure finance companies (IFCs).

(vi) Keeping in view the risks involved in NBFCs associating themselves with partnership firms, it was decided to prohibit NBFCs from contributing capital to any partnership firm or to be partners in partnership firms. In cases of existing partnerships, NBFCs were advised to seek early retirement from the partnership firms.

(vii) In partial modification of the guidelines for entry of NBFCs into insurance business, it was clarified that in case more than one company (irrespective of doing financial activity or not) in the same group as the NBFC wishes to take a stake in the insurance company, the contribution by all companies in the same group shall be counted for the limit of 50 per cent prescribed for the NBFC in an insurance JV. In this context the terms companies in the same group, subsidiary – parent, associate, promoter-promotee, related party, and common brand etc were also defined.

(viii) A Sub-Committee of the Central Board of the RBI (Chairman : Shri Y. H. Malegam) was constituted to study issues and concerns in the MFI sector. It was announced that the broad framework of regulations recommended by the Committee had been accepted by the Bank and it had been decided to create a separate category of NBFCs, viz; Non Banking Financial Company-Micro Finance Institution (NBFC-MFI). Consequently there would be seven categories of NBFCs namely Asset Finance Company (AFC), Investment Company (IC), Loan Company (LC), Infrastructure Finance Company (IFC), Core Investment Company (CIC), Infrastructure Debt Fund- Non- Banking Financial Company (IDF-NBFC) and Non-Banking Financial Company - Micro Finance Institution (NBFC-MFIs). Directions to such companies were issued on 2 December 2011. An NBFC-MFI is defined as a non-deposit taking NBFC (other than a company licensed under Section 25 of the Companies Act, 1956) that fulfils the conditions like (i) Minimum Net Owned Funds of ₹ 5 crore, (For NBFC-MFIs registered in the North Eastern Region of the country, the minimum NOF requirement shall stand at ₹ 2 crore), (ii) not less than 85 per cent of its net assets are in the nature of 'qualifying assets'

(ix) Entry-point norms, prudential norms for capital requirement, and asset classification and provisioning norms have been prescribed for NBFCs-MFI. NBFCs- MFI were also advised about pricing of credit, i.e. to maintain an aggregate margin cap of not more than 12 per cent. The interest cost will be calculated on average fortnightly balances of outstanding borrowings and interest income is to be calculated on average fortnightly balances of outstanding loan portfolio of qualifying assets. Interest on individual loans will not exceed 26 per cent per annum and will be calculated on reducing balance basis. Processing charges shall not be more than 1 per cent of gross loan amount. Processing charges need not be included in the margin cap or interest cap. Instructions related to fair practices in lending and transparency in interest rates were also issued.

(x) Multiple-lending, over-borrowing and ghost borrowers have been prohibited. NBFCs-MFI have been advised to follow non-coercive methods of recovery of loan. Further, corporate governance related instructions have also been issued. NBFC-MFIs have been advised to review their back office operations and make the necessary investments in information technology and systems to achieve better control, simplify procedures, and reduce costs.

Box 5.5 : Setting up of Infrastructure Debt Funds (IDFs)

Broad guidelines have been issued vide a press release dated 23 September 2011 for setting up of IDFs to facilitate flow of funds into infrastructure projects. The IDF will be set up either as a trust or as a company. A trust-based IDF would normally be a mutual fund (MF), while a company-based IDF would normally be an NBFC. An IDF- NBFC would raise resources through issue of either rupee- or dollar-denominated bonds of minimum five-year maturity. The investors would be primarily domestic and off-shore institutional investors, especially insurance and pension funds which would have long-term resources. An IDF-MF would be regulated by the Securities and Exchange Board of India (SEBI) while an IDF-NBFC would be regulated by the RBI. Detailed guidelines were issued on 21 November prescribing the regulatory framework for NBFCs to sponsor IDFs which are to be set up as Mutual Funds (MFs) and NBFCs. Such entities would be designated as "Infrastructure Debt Fund – Mutual Funds (IDF-MF) and "Infrastructure Debt Fund – Non-Banking Financial Company (IDF-NBFC)". All NBFCs, including Infrastructure Finance Companies (IFCs) registered with the bank may sponsor IDFs to be set up as MFs. However, only IFCs can sponsor IDF-NBFCs.

Eligibility parameters for NBFCs as sponsors of IDF-MFs include a minimum NOF of ₹ 300 crore; CRAR of 15 per cent; net NPAs less than 3 per cent; the NBFC to have been in existence for at least five years and earning profits for the last three years in addition to those prescribed by SEBI in the newly inserted Chapter VI B to the MF Regulations.

Only NBFC-IFCs can sponsor IDF-NBFCs with prior approval of the RBI and subject to the following conditions: the sponsor IFC would be allowed to contribute a maximum of 49 per cent to the equity of the IDF-NBFC with a minimum equity holding of 30 per cent of the equity of IDF-NBFC, post investment, in the IDF-NBFC; the sponsor NBFC-IFC must maintain minimum CRAR and NOF prescribed for IFCs; there are no supervisory concerns with respect to the IFC. The IDF is granted relaxation in credit concentration norms and in risk weights.

(xi) For off-balance sheet items already contracted by NBFCs, risk weights shall be applicable with effect from the financial year beginning 1 April 2012. For all new contracts undertaken including credit default swaps, the new risk weights shall be applicable from 26 December 2011.

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

5.60 Pursuant to the announcement made by the Finance Minister in Budget 2011-12, the Government of India notified the establishment of the Central Registry. The objective of setting it up is to prevent frauds in loan cases involving multiple lending from different banks on the same immovable property. The Central Registry of Securitization Asset Reconstruction and Security Interest of India (CERSAI), a government company licensed under Section 25 of the Companies Act 1956 has been incorporated for the purpose of operating and maintaining the Central Registry under the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act).

Capital Markets

Primary Market

5.61 During financial year 2011-12 (up to 31 December 2011) resource mobilization through the primary market witnessed a sharp decline over the year 2010-11 (Table 5.15). The cumulative amount mobilized as on 31 December 2011 through equity public issues stood at ₹ 9,683 crore as compared to

Box 5.6 : Credit Default Swaps (CDS) for Corporate Bonds

The objective of introducing CDS for corporate bonds is to provide market participants a tool to transfer and manage credit risk in an effective manner through redistribution of risk. CDS as a risk management product offers the participants the opportunity to hive off credit risk and also to assume credit risk which otherwise may not be possible. Since CDS have benefits like enhancing investment and borrowing opportunities and reducing transaction costs while allowing risk transfers, such a product would increase investors' interest in corporate bonds and would be beneficial to the development of the corporate bond market in India.

Guidelines on Credit Default Swaps for Corporate Bonds were issued by the RBI on 23 May 2011, outlining broad norms including the eligible participants and other requirements. It was also indicated that market participants would have to follow the capital adequacy guidelines for CDS issued by their respective regulators. Subsequently, guidelines have been issued stating that NBFCs shall participate in CDS market only as users. As users, they are permitted to buy credit protection only to hedge their credit risk on the corporate bonds they hold. They are not permitted to sell protection and hence not permitted to enter into short positions in the CDS contracts. However, they are permitted to exit their bought CDS positions by unwinding them with the original counterparty or by assigning them in favour of the buyer of the underlying bond.

Table 5.15 : Resource Mobilization through the Primary Market

(₹ crore)

	Mode	2008-09	2009-10	2010-11	2011-12#
1.	Debt	1500	2500	9451	4791
2.	Equity	2082	46736	48654	9683
	of which IPOs	2082	24696	35559	5043
	Number of IPOs	21	39	53	30
	Mean IPO size	99	633	671	168
3.	Private placement	173281	212635	218785	188530
4.	Euro issues (ADR/GDR)	NA	NA	NA	NA
	Total (1+2+3+4)	**176864**	**261871**	**276890**	**203005**

Source : SEBI and RBI (for Euro Issues).
Notes : NA indicates not available. Equity issue consists of only public issue.
as on 31 December 2011. Current financial figures are provisional.

₹ 48,654 crore in 2010-11. During 2011-12, (up to 31 December 2011), 30 new companies (initial public offers—IPOs) were listed at the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) amounting to ₹ 5,043 crore as against 53 companies amounting to ₹ 35,559 crore listed in 2010-11. The mean IPO size for the year 2011-12 was ₹ 168 crore as compared to ₹ 671 crore in 2010-11. Further, only ₹ 4,791 crore was mobilized through debt issue as compared to ₹ 9,451 crore in 2010-11. The amount of capital mobilized through private placement in corporate debt in 2011-12 (April-December) was ₹ 1,88,530 crore as compared to ₹ 2,18,785 crore in 2010-11.

Resource Mobilization by Mutual Funds

5.62 During 2011-12 (up to 30 November 2011), MFs mobilized ₹ 1,00,338 crore from the market as compared to ₹ 49,406 crore liquidation in 2010-11 (Table 5.16). The market value of assets under management stood at ₹ 6,81,655 crore as on 30 November 2011 compared to ₹ 6,65,282 crore as on 31 March 2011, indicating an increase of 2.5 per cent.

Secondary Market

5.63 As on 31 December 2011, Indian benchmark indices, BSE Sensex and Nifty, decreased by 20.4 per cent and 20.7 per cent respectively over the closing value of 2010-11. Nifty Junior and BSE 500 also decreased by 22.6 per cent and 26.1 per cent respectively during the same period (Table 5.17 and Figure 5.3).

5.64 The free float market capitalization of Nifty, Sensex, Nifty Junior, and BSE 500 stood at ₹ 14,05,066 crore, ₹ 12,66,639 crore, ₹ 2,47,531 crore, and ₹ 21,66,947 crore respectively in 2011-12 (upto 31 December 2011), indicating a decrease of 20.0 per cent, 18.6 per cent, 21.8 per cent, and 22.0 per cent, respectively over 2010-11.

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

(₹ crore)

	Sector	2007-08	2008-09	2009-10	2010-11	2011-12#
1.	UTI	10677	-3659	15653	-16636	5323
2.	Public	9820	9380	12499	-13555	3035
3.	Private	133304	-34018	54928	-19215	91980
	Total (1+2+3)	**153802**	**-28296**	**83080**	**-49406**	**100338**

Source : SEBI.
Note : # As on 30 November, 2011.

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

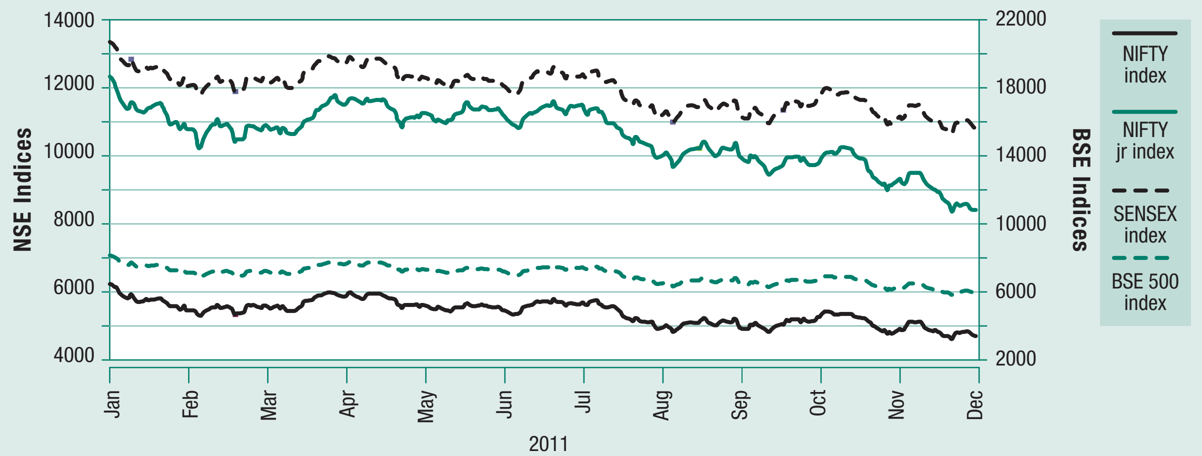


Table 5.17 : Index Returns, Volatility, Market Capitalization and P/E ratio

Index	2007-08	2008-09	2009-10	2010-11	2011-12#
Nifty					
Return (per cent)	23.9	-36.2	73.8	11.1	-20.7
Market capitalization (₹ crore)	1240071	771483	1525162	1755468	1405066
Daily volatility	2.0	2.6	1.9	1.1	1.3
P/E ratio	20.6	14.3	22.3	22.1	16.8
Nifty Junior					
Return (per cent)	16.0	-45.6	148.4	4.7	-26.1
Market capitalization (₹ crore)	202809	113523	292316	316529	247531
Daily volatility	2.4	2.8	2.0	1.2	1.1
P/E ratio	16.7	8.7	15.8	17.6	13.5
BSE Sensex					
Return (per cent)	19.7	-37.9	80.5	9.9	-20.4
Market capitalization (₹ crore)	1071940	695152	1328862	1555322	1266639
Daily volatility	1.9	2.8	1.9	1.1	1.3
P/E ratio	20.1	13.7	21.3	21.2	16.4
BSE 500					
Return (per cent)	24.3	-42.8	96.4	6.5	-22.6
Market capitalization (₹ crore)	1996839	1168850	2444151	2776847	2166947
Daily volatility	2.0	2.6	1.8	1.1	1.2
P/E ratio	20.0	13.7	20.4	19.2	16.2

Sources **: BSE and NSE.**
Notes **: Market Capitalization is calculated on free float basis.P/E ratio is price-earnings ratio.**
 # as on 31 December2011.

5.65 The P/E ratios of Nifty, Sensex, Nifty Junior, and BSE 500 as on 31 December 2011 were 16.8, 16.4, 13.5, and 16.2 respectively, indicating a decrease of 24.2 per cent, 23.4 per cent, 22.4 per cent, and 15.9 per cent respectively over 2010-11.

5.66 In the capital market segment, during 2011-12 (up to 31 December 2011), the total turnover of the BSE stood at ₹ 4,88,133 crore and of the NSE at ₹ 19,73,730 crore as compared to ₹ 11,05,027 crore and ₹ 35,77,410 crore respectively in 2010-11 (Table 5.18).

Table 5.18 : Market Turnover (₹ crore)

Market	2007-08	2008-09	2009-10	2010-11	2011-12#
BSE					
Cash	1578670	1100074	1378809	1105027	488133
Equity derivatives	242308	12268	234	154	58173
NSE					
Cash	3551038	2752023	4138024	3577410	1973730
Equity derivatives	13090478	11010482	17663665	29248221	23715138

Sources : BSE and NSE.
Note : # As on 31 December 2011.

Equity Derivative

5.67 In the equity derivative segment, the NSE witnessed a total turnover of ₹ 2,37,15,138 crore during 2011-12 (April-December) as compared to ₹ 2,92,48,221 crore during 2010-11. The total turnover in the equity derivative segment of the BSE stood at ₹ 58,173 crore in 2010-11 (April-December) as compared to ₹ 154 crore during 2010-11. Table 5.19 shows the volatility of weekly returns on Indian equity markets.

Currency Derivative

5.68 So far during financial year 2011-12, the NSE has witnessed a turnover of ₹ 37,02,389 crore in the currency derivatives segment as compared to ₹ 34,49,788 crore in 2010-11. The turnover in the currency futures segment of the Multi-Commodities Exchange (MCX-SX) stood at ₹ 29,99,176 crore in 2011-12 (April-December) as against ₹ 41,94,017 crore in 2010-11. The United Stock Exchange of India Limited was launched on 20 September 2010. The United Stock Exchange (USE) witnessed a turnover of ₹ 14,69,293 crore during the same period as compared to ₹ 7,62,501 crore in 2010-11 (November 2010-March 2011) (Table 5.20).

Interest Rate Derivative

5.69 Trading in interest rate futures (IRF) contracts on 91-day Government of India (GoI) treasury bills (T-Bill) was introduced at the NSE on 4 July 2011.

Table 5.19 : Volatility of weekly returns on Indian equity markets

Index	2008-09	2009-10	2010-11	2011-12#
Nifty	5.5	3.8	2.5	3.1
Nifty Junior	6.6	4.5	2.7	2.7
Sensex	5.8	3.6	2.5	3.1
BSE 500	5.7	3.9	2.4	2.8

Source : BSE and NSE.
Note : # As on 31 December 2011.

Table 5.21 : Trends in Interest Rate Futures

Year	2009-10	2010-11	2011-12#
No. of contracts	160894	3348	215200
Trading value (₹ crore)	2975	62	3959
Average daily trading value (₹ crore)	21	0	24.9

Source : NSE.
Note : # As on 31 December 2011.

Table 5.20 : Trends in Currency Derivatives

Year	NSE		MCX- SX		USE	
	2010-11	2011-12#	2010-11	2011-12#	2010-11	2011-12#
No. of contracts	749602075	782233920	903185639	626686064	167772367	309903126
Trading value (₹ crore)	3449788	3702389	4194017	2999176	762501	1469293
Average daily trading value (₹ crore)	13855	20569	16843	16662	5733	8163

Source : NSE, MCX-SX, and USE.
Note : * As on 31 December 2011.

Table 5.22 : Transactions of FIIs

Transactions	2009-10	2010-11	2011-12#
Number of FIIs(actual)	1635	1722	1767
Number of sub-accounts (actual)	5015	5686	6278
1. Equity market activity (₹ crore)			
Gross buy	554585	771565	442898
Gross sell	602292	661444	443112
Net	-47706	110121	-213
2. Debt market activity (₹ crore)			
Gross buy	59993	221034	221907
Gross sell	58098	184717	191319
Net	1895	36317	30590
3. Total activity (₹ crore)			
Gross buy	846438	992599	664805
Gross sell	703780	846161	634431
Net	142658	146438	30376

Source **: NSE, MCX-SX, and USE.**
Note **: # As on 31 December 2011.**

During 2011-12 (April-December), the NSE witnessed a total turnover of ₹ 3,959 crore as compared to ₹ 62 crore in 2010-11 (Table 5.21).

Foreign Institutional Investors (FIIs)

5.70 At the end of December 2011, there were 1,767 registered FIIs as compared to 1,722 on 31 March 2011. The number of registered sub-accounts also increased to 6,278 from 5,686 during the same period. In the Indian equity market, FIIs withdrew ₹ 213 crore during 2011-12 (April-December) compared to ₹ 110,121 crore investment in 2010-11. During the same period they invested ₹ 30,590 crore in the debt segment as compared to ₹ 36,317 crore in 2010-11. During 2011-12, (up to 31 December 2011), total investment in equity and debt by FIIs stood at ₹ 30,376 crore as compared to ₹ 146,438 crore in 2010-11 (Table 5.22).

International Comparison

5.71 Among selected Asian Indices, the Jakarta Composite Index posted a maximum cumulative return of 419.5 per cent in 2011-12 (April-December) over 2003-04 followed by the BSE Sensex Index (176.4 per cent), S&P CNX Nifty Index (161.0 per cent), Kospi Index (107.4 per cent), Kuala Lumpur Comp Index (69.7 per cent), Hang Seng Index (45.4 per cent), SSE Composite Index (26.3 per cent), and TSEC weighted Index (8.4 per cent). The trend in major emerging markets and P/E ratios are presented in Tables 5.23 and 5.24 respectively.

Market Movements

5.72 As on 30 December 2011, the markets stood 26 per cent down from the all-time peak achieved during the special one-hour *muhurut* trading on 5 November 2010 when the Sensex had touched 21004.96 and Nifty 6312.45. The indices closed at 15454.92 (-24.64 per cent for the Sensex) and 4624.3 (- 24.62 per cent for Nifty) in the calendar year. During financial year 2011-12 (up to 30 December 2011), the decline stood at 20.73 per cent in case of Nifty and 20.52 per cent for the Sensex.

Reasons for Market Movement

5.73 Subdued FII inflows into the country led to a decline in Indian markets and contributed to the sharp depreciation of the rupee in the forex market, though much of the depreciation was due to 'flight to safety' by foreign investors, given the troubled European and inflation-hit emerging market economies. Moderation in the growth rate of the economy has also affected market sentiments. This moderation in growth is on account of several factors, including the uncertainty in the global environment and lag effect of monetary policy tightening. Monetary tightening in India has led to some correction in stock markets, just as it happened in other emerging market economies as their central banks tightened their grips.

5.74 Globally, the deepening European debt crisis and a historic downgrade of the US by S&P triggered

Table 5.23 : Cumulative Change in Movement of Selected Global Indices

Index	Cumulative Change over March 31, 2004							
	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12#
BSE Sensex	16.1	101.8	133.8	179.8	73.7	213.5	247.8	176.4
S&P CNX Nifty	14.9	92.0	115.7	167.2	70.5	196.2	229.2	161.0
Hang Seng	6.6	24.6	56.1	80.2	7.1	67.5	85.5	45.4
Jakarta Composite	46.8	79.8	148.9	232.7	94.9	277.5	400.0	419.5
Nikkei 225	-0.4	45.6	47.6	6.9	-30.8	-5.3	-16.7	-27.8
Kospi	9.7	54.4	65.0	93.5	37.0	92.3	139.3	107.4
Kuala Lumpur Comp.	-3.4	2.7	38.3	38.3	-3.2	46.4	71.3	69.7
TSEC weighted	-7.9	1.4	20.9	31.4	-20.1	21.4	33.1	8.4
SSE Composite	-32.2	-25.5	82.8	99.4	36.3	78.5	68.1	26.3

Source **: Bloomberg.**
Note **: # As on 31 December, 2011.**

Table 5.24 : P/E Ratios in Selected Emerging Markets

Index	2008-09	2009-10	2010-11	2011-12#
Kospi	25.7	11.1	13.8	26.3
SET	15.7	12.3	13.2	12.6
Jakarta Composite	20.1	16.6	13.8	26.3
Kuala Lumpur Comp.	15.0	18.9	15.8	16.0
TSEC weighted	65.7	19.1	17.0	16.4
BSE Sensex	13.7	21.3	21.2	16.4
S&P CNX Nifty	14.3	22.3	22.1	16.8

Source **: BSE, NSE and Bloomberg.**
Note **: # As on 31 December, 2011.**

fears of another recession. The euro zone imbroglio kept the global markets fluctuating throughout the year. Unless the crisis in Europe is settled, volatility in global markets including India will tend to persist. However, the Indian economy has been less affected as compared to other major indices in the world. Further, the resilience of Indian markets is evident from the ratings given by some of the investment banks and financial firms.

Major Policy Initiatives

Increasing Access to Indian Capital Markets

Direct Investment by QFIs in Indian Equity Markets

5.75 QFIs were allowed to directly invest in the Indian equity market in January 2012. This was done to widen the class of investors, attract more foreign funds, reduce market volatility, and deepen the Indian capital market. The QFIs shall include individuals, groups, or associations, resident in a foreign country that is compliant with the Financial Action Task Force (FATF) and that is a signatory to International Organisation of Secruities Commissions (IOSCO's) multilateral memorandum of understanding (MoU). QFIs do not include FIIs/ sub-accounts. Earlier, only FIIs/sub-accounts and non-resident Indians (NRIs) were allowed to directly invest in the Indian equity market. Under this arrangement, a large number of QFIs, in particular a large set of diversified individual foreign nationals who were desirous of investing in the Indian equity market, did not have direct access to it. The RBI and SEBI have issued the relevant circulars on 13 January 2012 to operationalize this scheme.

Qualified Foreign Investor (QFI) scheme

5.76 In order to further liberalize the portfolio investment route, the Budget for 2011-12 permitted SEBI-registered MFs to accept subscriptions for equity schemes from foreign investors who meet the KYC requirements. The scope of the Budget announcement has now been expanded to allow SEBI-registered MFs to accept subscriptions from QFIs for debt schemes in the infrastructure sector. The QFI scheme has been operationalized on 9 August 2011.

FII investments in Government Securities and Corporate Bonds

5.77 In November 2011, the government reviewed the policy in the context of India's evolving macroeconomic situation and the need for enhancing capital flows and making available additional financial resources for the corporate sector and decided to (i) increase the current limit of FII investment in government securities by US $ 5 billion, raising the cap to US $ 15 billion (the incremental limit of US $ 5 billion can be invested in securities without any residual maturity criterion); and (ii) increase the current limit of FII investment in corporate bonds by US $ 5 billion, raising the cap to US $ 20 billion (the incremental limit of US $ 5 billion can be invested in listed corporate bonds). The investment limit in long-term infrastructure corporate bonds, however, has been kept unchanged at US$ 25 billion. With this, overall limit for FII investment in corporate bonds and government securities now stands at US$ 60 billion.

External Commercial Borrowings (ECB) Policy

5.78 A prospective borrower can access ECBs under two routes, namely the automatic route and approval route. ECBs not covered under the automatic route are considered on case-by-case basis by the RBI under the approval route. The High Level Committee on ECB took a number of decisions on 15 September 2011 to expand the scope of ECBs. These include:

i. High networth individuals (HNIs) who fulfil the criteria prescribed by SEBI can invest in IDFs.

ii. IFCs have been included as eligible issuers for FII investment in the corporate bonds long-term infra category.

iii. ECB would be permitted for refinancing of rupee loans of infrastructure projects on the condition that at least 25 per cent of such ECBs shall be used for repayment of the said rupee loan and 75 per cent invested in new projects in the infrastructure sector. This would be permitted only under the approval route.

iv. Refinancing of buyer's/supplier's credit through ECBs for the purchase of capital goods by companies in the infrastructure sector was approved. This would also be permitted only under the approval route.

v. ECBs for interest during construction (IDC) that accumulates on a loan during the project execution phase for companies in the infrastructure sector would be permitted. This would be subject to the condition that the IDC is capitalized and is part of the project cost.

vi. Renminbi (RMB) was approved as an acceptable currency for raising ECBs subject to a limit of US$ 1 billion within the existing ECB ceiling. Such borrowings shall be allowed only through the approval route.

vii. The existing ECB limits under the automatic route were enhanced from US$ 500 million to US$ 750 million for eligible corporates as per the extant ECB guidelines. For borrowers in the services sector, the limit has been enhanced from US$ 100 million to US$ 200 million and for NGOs engaged in micro-finance activities from the existing US$ 5 million to US$ 10 million. All other conditions will apply as per the extant ECB guidelines.

viii. INR–denominated ECBs would be permitted from foreign equity holders to 'all eligible borrowers' except in the case of ECBs availed of by NGOs as per extant ECB guidelines under the automatic route.

5.79 In November 2011, ECB policy was modified keeping in view the developments in global financial markets and macro-economic conditions. The all-in-cost ceiling was enhanced and the proceeds of ECBs raised abroad for Rupee expenditure in India should be brought immediately. The change in the all-in-cost ceiling came into force on November 23, 2011 and is applicable up to 31 March 2012, subject to review thereafter.

Financial Stability and Development Council (FSDC)

5.80 In pursuance of the announcement made in the Budget 2010–11, with a view to strengthening and institutionalizing the mechanism for maintaining financial stability and enhancing inter-regulatory coordination, an apex-level Financial Stability and Development Council under the Chairmanship of the Finance Minister has been set up. A sub-committee of the FSDC has also been set up under the chairmanship of the Governor RBI. So far, three meetings of the Council and five meetings of its sub-committee have been held in which a range of financial-sector stability and development issues have been discussed and decided. Under the aegis of the FSDC, two empowered Technical Groups (i.e. Technical Group on Financial Literacy and Financial Inclusion and Inter-Regulatory Technical Group) have been formed.

Financial Sector Legislative Reforms Commission (FSLRC)

5.81 In pursuance of the announcement made in Budget 2010-11, the government set up the FSLRC with a view to rewriting and harmonizing financial-sector legislation, rules, and regulations to address the contemporaneous requirements of the sector. The Commission will examine financial-sector legislations, including subordinate legislations. It engaged two technical/research teams and decided to constitute various Working Groups (WG), each chaired by a Member of the Commission. Two WGs on Pensions, Insurance, PFs, and Small Savings and on Payment Systems have been set up. Other WGs on Securities, Banking, and Debt Management are being set up. The WGs will follow the broad principles and approaches approved by the Commission and examine sector-specific details, produce reports, draft laws thereon, and report to the Commission.

Financial Action Task Force (FATF)

5.82 The FATF is an inter governmental policymaking body that has a ministerial mandate to establish international standards for combating money laundering and terrorist financing. India joined the FATF as its 34th member in June 2010. At present the FATF has 36 members comprising 34 countries and two organizations, namely the European Union and Gulf Cooperation Council. India participated in the FATF plenary and WG meetings held in Mexico from 20-24 June 2011. The FATF assessment team that came in April 2011 appreciated India for being on course for fulfilment of its medium-term commitment plan due in March 2012.

Sovereign Credit Rating of India

5.83 The strong macroeconomic fundamentals of the Indian economy have been recognized by domestic and international investors. In the financial year, while most of the advanced economies are facing uncertain growth prospects and attendant difficulties in maintaining their credit ratings, two international sovereign credit rating agencies (DBRS and Moody's) have upgraded the outlook for and sovereign credit rating of India. S&P, Fitch Rating, and R&I have, however, maintained their previous ratings.

5.84 In December 2011, Moody's has upgraded the rating on long-term government bonds denominated in domestic currency from Ba1 to Baa3 (from speculative to investment grade). The long-term country ceiling on foreign currency bank deposits has been upgraded from Ba1 to Baa3 (from speculative to investment grade). The last time Moody's had upgraded any Indian long-term sovereign debt instrument from speculative to investment grade was in 2004. In addition, Moody's has upgraded short-term government bonds denominated in domestic currency from NP to P-3 (from speculative to investment grade). This short-term rating has been upgraded for the first time since it was newly assigned in 1998. Further, in January 2012, Moody's has confirmed the upgrade in the short-term country ceiling on foreign currency bank deposits from NP to P-3 (from speculative to investment grade).

5.85 Moody's has recognized that the 'diverse sources of Indian growth (no one industrial or service sector dominates) have enhanced its resilience to global shocks' and that '[India's] growth, product mix and destinations of Indian exports reflect improved international competitiveness, another source of economic resilience'. The present slowdown in growth rates 'could reverse some time in FY 2012/13, as inflation cools from current 9% levels'. Moody's has emphasized that the structural drivers of India's growth momentum will not be damaged by the present cyclical downturn.

5.86 Moody's report was preceded by DBRS's report in June 2011. DBRS upgraded the trend of India's long-term foreign and local currency debt ratings from BBB (low) Negative to Stable outlook. DBRS appreciated, inter-alia, the efforts of the government towards fiscal consolidation by noting that 'since early 2010, India's authorities have shown renewed commitment for reducing both its fiscal deficit and debt'. In addition, in June 2011, while affirming its existing ratings, Fitch has also appreciated the management of the economy by Indian authorities by pointing out that 'India's fiscal and monetary policy response to the global credit crisis helped restore the economy to a path of higher growth'.

Financial Sector Assessment Programme (FSAP)

5.87 India's FSAP was initially completed by the IMF/World Bank in 2000-01 but it was not made public, as it was part of the pilot FSAP assessment of 12 countries. The Committee on Financial Sector Assessment (CFSA) – co-chaired by Deputy Governor RBI and Secretary, Department of Economic Affairs, Ministry of Finance – completed a self-assessment in 2009. Subsequently, in May 2010, India requested the IMF/World Bank to conduct a full-fledged FSAP. Accordingly, India's FSAP was conducted during 2011. The IMF/World Bank scoping mission visited the Ministry of Finance on 1 February 2011 to conduct an FSAP Update. The FSAP's two missions visited India from 14-27 June 2011 and from 3-18 October 2011. Findings and recommendations of the mission are in final stages of discussion. The FSAP process is likely to be completed by March 2012.

Insurance and Pension Funds

Insurance Sector

5.88 A healthy and developing insurance sector is of vital importance to every modern economy. It encourages the savings habit, provides a safety net to rural and urban enterprises and productive individuals, and generates long-term funds for infrastructure development. The insurance industry plays a significant role in India's modern economy. Insurance is necessary to protect enterprises against risks such as fire and natural disasters. Individuals require insurance services in such areas as health care, life, property and pension. Development of insurance is therefore necessary to support continued economic transformation. Social security and pension reforms also benefit from a mature insurance industry.

5.89 Since its opening up, the number of participants in the Insurance industry has gone up from seven insurers (including the Life Insurance Corporation of India [LIC], four public-sector general insurers, one specialized insurer, and the General Insurance Corporation as the national re-insurer) in 2000 to 49 insurers as on 30 September 2011 operating in the life, non-life, and re-insurance segments (including specialized insurers, namely Export Credit Guarantee Corporation and Agricultural Insurance Company [AIC]). Three of the general insurance companies, namely Star Health and Alliance Insurance Company, Apollo Munich Health Insurance Company, and Max BUPA Health Insurance Company function as standalone health insurance companies. Of the 23 insurance companies that have set up operations in the life segment post opening up of the sector, 20 are in joint venture with foreign partners. Of the eighteen private insurers who have commenced operations in the non-life segment, sixteen are in collaboration with foreign partners. Thus 36 insurance companies in the private sector are operating in the country in collaboration with established foreign insurance companies from across the globe as on 31 March 2011.

Life Insurance

5.90 From being the sole provider for life insurance till financial year 1999-2000, LIC is today competing in an industry with 23 private-sector insurers who have commenced operations over the period 2000-10. The industry which reported an annual growth rate of 19.8 per cent during the period 1996-97 to 2000-01 has, post opening up of the sector, reported an annual growth rate of 24.3 per cent during 2001-02 to 2010-11. There has been an average growth of 34 per cent in the first year premium in the insurance sector between 2001-02 and 2010-11.

5.91 The life insurers underwrote new business of ₹ 1,26,381 crore during financial year 2010-11 as against ₹ 1,09,894 crore during the year 2009-10, recording a growth of 15.0 per cent. Of the new business premium underwritten, LIC accounted for ₹ 87012.35 crore (68.9 per cent market share) and private insurers accounted for ₹ 39368.65 crore (31.1 per cent market share). The market share of these insurers was 65.1 per cent and 34.9 per cent respectively in the corresponding period of 2009-10.

Non-Life Insurance

5.92 The industry which reported a growth rate of around 10 per cent during the period 1996-97 to 2000-01 has, post opening up of the sector, reported average annual growth of 15.85 per cent over the period 2001-02 to 2010-11. In addition, the specialized insurers Export Credit Guarantee

Corporation and Agriculture Insurance Company (AIC) are offering credit guarantee and crop insurance respectively. AIC, which was initially offering coverage under the National Agriculture Insurance Scheme (NAIS), has now started providing crop insurance cover on commercial lines as well. It has introduced several innovative products such as weather insurance and specific crop-related products.

5.93 The premium underwritten by the non-life insurers during 2010-11 was ₹ 42,576 crore as against ₹ 34,620 crore in 2009-10. The growth was satisfactory, particularly in view of the across the broad cuts in the tariff rates. The private insurers underwrote premium of ₹ 17,424.6 crore as against ₹ 13,977 crore in 2009-10, reporting growth of 24.7 per cent vis-a-vis 13.4 per cent in 2009-10. The public-sector insurers, on the other hand, underwrote a premium of ₹ 25,151.8 in 2010-11 as against ₹ 20,643.5 crore in 2009-10, i.e. a growth of 21.8 per cent as against 14.5 per cent in 2009-10. The non-life insurers underwrote a premium of ₹ 42,576 crore in financial year 2010-11 as against ₹ 35,620 crore in 2009-10, recording a growth of 23.0 per cent. The market share of the public and private insurers at 60 and 40 per cent in 2010-11 remained the same as in the previous year.

Insurance Penetration

5.94 The growth in the insurance sector is internationally measured based on the standard of insurance penetration. Insurance penetration is defined as the ratio of premium underwritten in a given year to the gross domestic product (GDP). Likewise, insurance density is another well-recognized benchmark and is defined as the ratio of premium underwritten in a given year to total population (measured in US dollars for convenience of comparison). The Indian insurance business has in the past remained under-developed with low levels of insurance penetration. Post liberalization, the sector has succeeded in raising the levels of insurance penetration from 2.3 (life 1.8 and non-life 0.7) in 2000 to 5.1 (life 4.4 and non-life 0.7) in 2010.

Major Policy Initiatives

1) **Initiatives on Health Insurance: The Insurance Regulatory Development Authority (**IRDA) has been taking a number of proactive steps as part of the initiatives for the spread of health insurance. It had set up a National Health Insurance Working Group in 2003, which provided a platform for the various stakeholders in the health insurance industry to work together and suggest solutions on various relevant issues in the sector. During the last decade, the premium from health insurance products has grown from ₹ 675 crore in 2001-02 to ₹ 11,480 crore in 2010-11. The IRDA is also co-ordinating with and supporting insurance industry initiatives in standardizing certain key terminology used in health insurance documents, for better comprehension and in the interest of policyholders. The General Insurance Council, comprising all non-life insurers, evolved a consensus on a uniform definition of 'pre-existing diseases' and its exclusion wording, which has earlier been an expression with many definitions, still more interpretations, and certainly a whole lot of grievances. Such standardization, effective 1 June 2008 will help the insured by minimizing ambiguity and also by better comparability of health insurance products. Also, with effect from 1 October 2011, portability in health insurance has been started in which an insured, if not happy with services or the product of the existing insurer, can change to another insurer whilst enjoying the benefits (especially that of pre-existing diseases) of her/his existing policy.

2) **Micro Insurance:** Micro insurance regulations issued by the IRDA have provided a fillip to propagating micro insurance as a conceptual issue. With the positive and facilitative approach adopted under the micro insurance regulations, it is expected that all insurance companies would come out with a progressive business approach and carry forward the spirit of regulations thereby extending insurance penetration to all segments of society. There are 10,482 micro insurance agents operating in the micro insurance sector as at the end of 2010-11. In micro-insurance-life, the new business premium in the year was ₹ 130.4 crore under 36.5 lakh policies and the group business amounted to ₹ 155.2 crore premium under 1.5 crore lives. In micro-insurance-non-life the gross written premium was ₹ 393.4 crore in 2010-11 as compared to ₹ 193.1 crore in 2009-10.

3) **Insurance Laws (Amendment) Bill 2008:** The government introduced the Insurance Laws (Amendment) Bill 2008 in the Rajya Sabha on 22 December 2008. The Bill aimed to amend

the Insurance Act 1938, the General Insurance Business (Nationalisation) Act 1972, and the Insurance Regulatory and Development Authority Act 1999. The Standing Committee on Finance has submitted its report to the Parliament on 13 December 2011. The report of the Committee is under examination by the government.

Amendments to the LIC Act 1956: The LIC (Amendment) Bill, 2011 was passed by Parliament on 12 December 2011 by the Lok Sabha and on 14 December 2011 by the Rajya Sabh). The amendments will enable the LIC to raise its equity capital from ₹ 5 crore to ₹ 100 crore and create a reserve fund to be used for its business expansion and meeting its corporate social responsibility.

Pension Sector

5.95 The corpus being managed under the New Pension System (NPS) is ₹ 12,407.4 crore. From 1 May 2009, the NPS was opened up for all citizens in India to join on a voluntary basis. 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 Pension Fund Regulatory and Development Authority (PFRDA) in September 2010 introduced a lower cost version of the NPS, known as 'Swavalamban', which enables groups of people to join the NPS at a substantially reduced cost.

Recent Initiatives

5.96 The Government is extremely concerned about the old age income security of the working poor and is focused on encouraging and enabling them to join the NPS. To encourage workers in the unorganized sector to save voluntarily for their old age, an initiative called the Swavalamban Scheme was launched on 26 September 2010. It is a co-contributory pension scheme whereby the central government would contribute a sum of ₹ 1,000 per annum in each NPS account opened having a saving of ₹ 1,000 to ₹ 12,000 per annum.

5.97 The Swavalamban Scheme was initially announced for three years for beneficiaries who enrolled themselves in 2010-11. It has now been extended to five years for beneficiaries enrolled in 2010-11 and 2011-12. Recently the incentive on per subscriptions basis for aggregators and Points of Presence (PoPs) has been increased. A total of 3,01,920 subscribers during 2010-11 and 90,256 during 2011-12 (up to 30 December 2011) have been enrolled under the scheme.

Performance of the NPS

5.98 Several state governments, autonomous bodies, and undertakings are in dialogue with the PFRDA for extending the NPS to their employees. In the non-government NPS segment, clearly NPS-Lite/Swavalamban has emerged as the vehicle of choice. 'Swavalamban' and concerted efforts from 24 aggregators can play a significant role in financial inclusion. The PFRDA had appointed an expert Committee to Review implementation of Informal Sector Pension (CRIISP) to look into a range of issues connected with the NPS, such as reasons for sluggish public response, viability of the NPS as a financial product, ways and means of marketing/popularizing 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 the Pension Fund Managers (PFMs) in the entire NPS architecture, and suggest remedial measures. Step-by-step implementation of the recommendations of the Committee is in process.

Challenges and Outlook

5.99 An important reason India emerged largely unscathed from the global crisis of 2008 is the strict ECB policy that places all-in-cost, end-use, and maturity restrictions on foreign borrowings by corporates. As a result, India's external debt to GDP ratio declined from 38.7 per cent in 1991-92 to 17.8 per cent in 2010-11, while the debt service ratio declined from 30.2 per cent to 4.2 per cent. Corporates were therefore not exposed to balance sheet recession that could have happened due to excessive foreign borrowings. The liberalization of ECB policy, as a result, has to keep in view the need to maintain sustainable levels of external debt ratios. This is more important because of the fact that high levels of external debt ratios contributed to the BOP crisis of the early 1990s.

5.100 Infrastructure development is the key to long-term sustainable growth of the economy. However, infrastructure finance remains a constraining factor with heavy dependence on bank financing. Development of the corporate bond market therefore is the key to infrastructure development. While, the introduction of CDS is expected to help in the process, innovative steps are needed to bring the corporate bond market centre stage of infrastructure financing.

5.101 The recent regulatory prescriptions for European banks have raised fears of deleveraging. Indian banks are not expected to bear any direct impact on account of their negligible exposure to the troubled zone. However, they could be indirectly affected on account of funding pressures. The scope for countercyclical financial policy could be explored in financial regulations in order to minimize negative impact of accumulated financial risks. This will go a long way in providing needed stability to the financial system.

5.102 Pension reform is important. It will not only facilitate the flow of long-term savings for development but also help establish a credible and sustainable social security system in the country. Lower levels of financial literacy, particularly among workers in unorganized sector, non-availability of even moderate surplus, and lukewarm response so far from most of the state/UT governments to a co-contributory Swavalamban Scheme are the major challenges to universal inclusion of poorer sections of Indian society into the pension network.

5.103 The development of the financial sector is critically dependent on financial inclusion, which is seen as an important determinant of economic growth. Banks need to take into account various behavioural and motivational attributes of potential consumers for a financial inclusion strategy to succeed. Besides, access to financial products is constrained by lack of awareness, unaffordable products, high transaction costs, and products which are not customized and are of low quality. A major challenge in the times ahead would be to meet financing requirements, particularly of the unorganized sector and the self-employed in the micro and small business sector.

5.104 Internationally, the insurance and pension segments, in view of their typically long-term-long-only investment style, are believed to contribute to financial stability. The Indian insurance sector is well capitalized but significantly exposed to the banking system. Inter-linkages between the insurance and banking sectors are a matter of concern, with many insurance companies being part of financial conglomerates. Any financial stability issue regarding banks in the conglomerate may have an amplifying effect on the insurer. Efforts therefore have to be made towards building firewalls to prevent contagion from one sector to another, especially in times of stress. The ability to raise capital and adequate reinsurance capacity are expected to be important determinants for the insurance sector's continued stability.