Report on Trend and Progress of Banking in India 2014-15

Report on Trend and Progress of Banking in India 2014-15,
submitted to Central Government in terms of
Section 36(2) of the Banking Regulation Act, 1949

REPORT ON TREND AND PROGRESS OF BANKING IN INDIA 2014-15

RESERVE BANK OF INDIA

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LETTER OF TRANSMITTAL

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December 23, 2015
Pausha 02, 1937 (Saka)

Shri Ratan P. Watal
Finance Secretary
Department of Expenditure
Government of India
Ministry of Finance
North Block
New Delhi – 110 001

Dear Shri Watal,

In pursuance of the provisions of Section 36(2) of the Banking Regulation Act, 1949, I have pleasure in transmitting herewith two copies of the Report on Trend and Progress of Banking in India 2014-15.

With warm regards,

Yours sincerely,

Raghuram G. Rajan

(Raghuram G. Rajan)

Encl: as above.

केन्द्रीय कार्यालय भवन, शहीद भगतसिंह मार्ग, मुम्बई - 400 001, भारत
फोन: +91 22 2266 0868 / 2266 1872 / 2266 2644 फैक्स: +91 22 2266 1784 ई-मेल: governor@rbi.org.in
Central Office Building, Shahid Bhagat Singh Marg, Mumbai - 400 001, India
Tel: +91 22 2266 0868 / 2266 1872 / 2266 2644 Fax: +91 22 2266 1784 E-mail: governor@rbi.org.in

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List of Select Abbreviations

AFC	Asset Finance Company
AIFI	All India Financial Institution
ATM	Automated Teller Machine
BC	Business Correspondent
BCBS	Basel Committee on Banking Supervision
BSBDA	Basic Savings Bank Deposit Account
CASA	Current Account and Saving Account
CRAR	Capital to Risk-Weighted Assets Ratio
DCCB	District Central Co-operative Bank
D-SIB	Domestic Systemically Important Bank
ECB	External Commercial Borrowing
EME	Emerging Market Economy
EXIM Bank	Export Import Bank of India
FB	Foreign Bank
FI	Financial Institution
FIP	Financial Inclusion Plan
FSB	Financial Stability Board
GNPA	Gross Non-Performing Advances
G-SIB	Global Systemically Important Bank
IFRS	International Financial Reporting Standards
JLF	Joint Lenders' Forum
KPI	Key Performance Indicator
KYC	Know Your Customer
LAB	Local Area Bank
LC	Loan Company
LCR	Liquidity Coverage Ratio
LRE	Leverage Ratio Exposure
NABARD	National Bank for Agriculture and Rural Development
NBFC	Non-Banking Financial Company
NBFC-D	Non-Banking Financial Company - Deposit Taking
NBFC-ND-SI	Non-Banking Financial Company – Non-Deposit Taking – Systemically Important
NBFC-MFI	Non-Banking Financial Company – Micro Finance Institution
NBFC-IFC	Non-Banking Financial Company – Infrastructure Finance Company
NBFI	Non-Banking Financial Institution
NHB	National Housing Bank
NIM	Net Interest Margin
NPA	Non-Performing Advances
PACS	Primary Agricultural Credit Society
PCARDB	Primary Co-operative Agriculture and Rural Development Bank
PD	Primary Dealer
PMJDY	Pradhan Mantri Jan Dhan Yojana
PPI	Pre-paid Payment Instrument
PSB	Public Sector Bank
PVB	Private Sector Bank
RoA	Return on Asset
RoE	Return on Equity
RNBC	Residual Non-Banking Financial Company
RRB	Regional Rural Bank
RWA	Risk Weighted Asset
SCB	Scheduled Commercial Bank
SCARDB	State Co-operative Agriculture and Rural Development Bank
SIDBI	Small Industries Development Bank of India
SMA	Special Mention Account
SFB	Small Finance Bank
StCB	State Co-operative Bank
SLCC	State Level Coordination Committee
SLR	Statutory Liquidity Ratio
TLAC	Total Loss Absorbing Capacity
UCB	Urban Co-operative Bank

Chapter I

Perspective and Policy Environment

Introduction

1.1 The risks to global financial stability continued to remain at elevated levels, with global growth witnessing a fragile and multi-paced pattern of recovery. In the meanwhile, the global macro-financial risks shifted from advanced to emerging economies with the latter facing pressures from weakening prospects of growth, falling commodity prices and strengthening of the dollar.[1] Within the emerging world, however, the Indian economy appeared quite resilient, given a modest recovery in the economy, declining inflation and buoyant capital flows that helped in maintaining the external sector balance.

1.2 The performance of the Indian banking sector during the year, however, remained subdued. First, the banking sector experienced a slowdown in balance sheet growth in 2014-15, a trend that had set in since 2011-12. The slowdown was most notable in the case of bank credit, which dipped to a single-digit figure during the year. Second, while profits of the banking sector turned around from an absolute decline in the previous year, this positive growth was on account of a decline in the growth of operating expenses rather than a rise in the growth of income of the banks. Third, notwithstanding the increase in profit growth, the return on assets (RoA), a common indicator of financial viability, did not show any improvement in 2014-15. In particular, the profitability of public sector banks (PSBs) diminished with their RoA declining significantly in recent years. Fourth, the deterioration in the asset quality of banks in general, and PSBs in particular, continued during the year with rise in volume and proportion of stressed assets.

1.3 The other constituents of the banking sector, namely Regional Rural Banks (RRBs) witnessed deceleration in profit growth. However, Local Area Banks (LABs) recorded an improvement in their profitability.

1.4 The operations of urban and rural credit cooperatives, another major segment of the Indian financial landscape, are fraught with concerns arising out of multiple regulatory control and governance. There has been a steady progress towards resolving these concerns by instituting appropriate regulatory changes, a process which continued even in 2014-15. These measures have by and large helped in improving the financial performance of these institutions during the recent years; the improvement, however, has been slow-paced and limited to certain segments of the cooperative system. Illustratively, while there has been a turnaround in the financial stability indicators of the state level short-term co-operative credit institutions, asset quality concerns remain for the long-term institutions.

1.5 Finally, the balance sheet and financial performance of non-banking financial companies (NBFCs), which play a vital role in catering to various niche demands in financial services, were at variance with the commercial banking sector in some respects while mirroring the sector in other respects in 2014-15. The growth in credit from NBFCs was higher than the bank credit and this also showed an increasing trend on a year-on-year basis. However, like commercial banks, the asset quality of NBFCs also deteriorated.

1.6 In sum, the operations of the banking sector and the NBFC sector for the year 2014-15, exhibited several weak spots. However, when compared with the global banking trends in profitability, asset quality and capital positions, the Indian banking sector did not appear to be an exceptional under-performer. Furthermore, the regulatory steps initiated in 2014-15 as well as in the earlier years are expected to address

[1] Global Financial Stability Report – April 2015, IMF.

many of the short-term concerns afflicting the sector, while paving way for medium to long-term reforms in this sector.

1.7 Some of the major regulatory steps taken during the year and the perspectives about how these steps would help in reforming the Indian banking sector are as follows:[2]

De-stressing the banking sector

1.8 As decline in asset quality has been a key area of concern for the banking sector in general and PSBs in particular, several regulatory measures to de-stress banks' balance sheets have been taken in the recent years, including in the year 2014-15. The basic Framework for Revitalising Distressed Assets in the Economy was released by the Reserve Bank in January 2014. Following this, several regulatory steps were taken which were aimed at instituting a mechanism for rectification, restructuring and recovery of stressed assets. These involved the preparation of a corrective action plan by the Joint Lenders' Forum (JLF) for distressed assets, periodic refinancing and fixing a longer repayment schedule for long-term projects as part of flexible structuring, extension of the date of commencement of commercial operations in the case of project loans to infrastructure sector without these loans being labelled as non-performing advances (NPAs) subject to certain conditions, strategic restructuring of debt involving the provision to convert debt into equity, issuance of guidelines about classification of wilful defaulters and non-cooperative borrowers, among others.

Reforming the public sector banks (PSBs)

1.9 The PSBs have contributed significantly to expand the outreach of Indian banking geographically and sectorally. Furthermore, they have been instrumental in providing credit support to the mammoth infrastructural needs of the country. However, the PSBs have been presently affected by several immediate concerns relating to profitability, asset quality and many long-standing issues about capital positions and governance.

1.10 A need was, thus, felt to initiate certain reform measures for PSBs. Accordingly, the government announced regulatory reforms relating to PSBs as part of 'Indradhanush' (a seven-point action plan) package in August 2015. This included a number of recommendations made by the Committee to Review the Governance of Boards of Banks in India (Chairman: Dr. P. J. Nayak) in May 2014.

1.11 The salient reforms under this package involved a restructuring of the appointment process of whole-time directors and non-executive chairmen of the PSBs while the bifurcation of the post of Chairman and Managing Director of PSBs into executive Managing Director and non-executive Chairman was done in December 2014. Both these steps would imbibe professionalism in the operation of banks' boards and improve their efficiency in the decision making process.

1.12 A fresh plan for recapitalisation was also introduced as part of the seven-point plan with the proposed capital infusion in PSBs, following a performance and need-based approach to the tune of ₹700 billion till 2019. This capital support would be vital for PSBs in light of their weakening capital positions and would enable them to adopt the Basel III framework. Furthermore, a framework for accountability for PSBs was also introduced based on Key Performance Indicators (KPI) that measured the performance of these banks using quantitative and qualitative indicators. This would improve the overall functioning of PSBs and make them more accountable to their stakeholders.

Improving monetary policy transmission

1.13 In 2014-15, following the recommendations of the Expert Committee to Revise and Strengthen the Monetary Policy Framework (Chairman: Dr. Urjit

[2] For a detailed chronology of policy measures relating to the banking sector, see the *RBI Annual Report* – 2014-15.

R. Patel), the Reserve Bank adopted a flexible inflation targeting approach in monetary policy formulation, aimed at making it more transparent and predictable. However, some of the structural rigidities within the credit market tend to impede the transmission of the monetary policy. The stickiness of the base rate system itself has been identified as an impediment to an effective transmission. Hence, in 2014-15, the Reserve Bank allowed banks to revisit their base rate methodology on a more frequent basis and also encouraged them to use marginal cost of funds instead of average cost of funds to calculate the base rate. Going forward, banks will be encouraged to move to marginal cost pricing and then to using market benchmarks.

Strengthening the liquidity standards of banks

1.14 While the Indian banks are in the process of migrating to capital standards as prescribed under the Basel III framework, the implementation of liquidity standards marks the second important step in implementing the package of reforms suggested by the Basel Committee on Banking Supervision (BCBS). Following the final guidelines from the Reserve Bank, the liquidity coverage ratio (LCR) was made operational as part of the Basel III framework on liquidity standards on January 1, 2015. The compliance to this ratio has been made easier for banks as a part of their Statutory Liquidity Ratio (SLR) investments has been deemed eligible to be classified as high quality liquid assets. Furthermore, the Reserve Bank also prescribed liquidity monitoring tools and liquidity disclosures for strengthening the liquidity management by banks.

Monitoring the build-up of leverage in the banking system

1.15 India has been in the forefront in terms of adopting capital adequacy norms as per the Basel III framework and has in fact stipulated a higher Capital to Risk-Weighted Assets Ratio (CRAR) than what is recommended by the BCBS. In January 2015, it also introduced a simple, back-stop, non-risk based measure of leverage in the form of an indicative Leverage Ratio of 4.5 per cent as part of a parallel run till the final norms for the same are prescribed by the BCBS. This ratio is expected to supplement the risk-based CRAR in monitoring excessive risk-taking and build-up of on and off-balance sheet leverage by banks.

Dealing with the concern of too-big-to-fail

1.16 The Financial Stability Board (FSB) has issued the final Total Loss-Absorbing Capacity (TLAC) standard for global systemically important banks (G-SIBs) on November 9, 2015 as part of its reforms agenda to deal with 'too-big-to-fail' for banks. The standard has been designed to ensure that the G-SIBs would have sufficient loss-absorbing and recapitalisation capacity available for implementing an orderly resolution that minimises impact on financial stability, maintains the continuity of critical functions, and avoids exposing public funds to loss.

1.17 The standard would be implemented in all FSB jurisdictions. G-SIBs would be required to meet the TLAC requirement alongside the minimum regulatory requirements set out in the Basel III framework. They would be required to meet a minimum TLAC requirement of at least 16 per cent of the resolution group's risk-weighted assets (RWAs) (TLAC RWA Minimum) from January 1, 2019 and at least 18 per cent from January 1, 2022. Minimum TLAC must also be at least 6 per cent of the Basel III leverage ratio denominator (TLAC Leverage Ratio Exposure (LRE) Minimum) from January 1, 2019, and at least 6.75 per cent from January 1, 2022. G-SIBs headquartered in emerging market economies (EMEs) would be required to meet the 16 per cent RWA and 6 per cent LRE Minimum TLAC requirement no later than January 1, 2025, and the 18 per cent RWA and 6.75 per cent LRE Minimum TLAC requirement no later than January 1, 2028. This conformance period will be accelerated if, in the next five years, the aggregate amount of the EME's financial and non-financial corporate debt securities or bonds outstanding exceeds 55 per cent of the EME's GDP. Monitoring of implementation of the TLAC standard would be done by the FSB and a review of the technical implementation would be done by the end of 2019.

1.18 Though there are 17 G-SIBs operating in India, none of these is headquartered in India. The identification of Domestic-Systemically Important Banks (D-SIBs) and designing an additional capital charge for these institutions would be an important step in preserving systemic stability of the Indian banking sector. While the framework for regulatory treatment of G-SIBs has been designed by the FSB, the Reserve Bank has framed the guidelines for the D-SIBs. Accordingly, the list of D-SIBs was released in August 2015 highlighting the names of the two largest banks, one each from the public and private sector. This list would be updated each year in August and the identified banks have to meet the additional Tier I capital requirements.

Convergence with the international accounting standards

1.19 An important component of the ongoing global reforms for the banking sector is the accounting reforms such that banks prepare their financial statements in a standardised and internationally acceptable manner. The issue of convergence of the current accounting framework under the Indian Accounting Standards with the International Financial Reporting Standards (IFRS) has been under consideration since 2006. Towards this objective, a roadmap was proposed by the Reserve Bank for implementing IFRS which would enable both the Scheduled Commercial Banks (SCBs) and the NBFCs to migrate to the IFRS from 2018-19 onwards.

Minimising the regulatory arbitrage between banks and non-banks

1.20 A major component of the reforms envisaged by the FSB relates to treatment of shadow banking sector. In the Indian context, NBFCs are considered as shadow banks. However, the concerns that afflict shadow banks in other countries do not exist much in India as they are well regulated and do not undertake any complex financial transactions.

1.21 In 2014-15, the regulations governing NBFCs were further strengthened to minimise the scope for regulatory arbitrage between these institutions and banks. Accordingly, a calibrated strengthening of the norms for provisioning and asset classification was prescribed for NBFCs. Furthermore, like commercial banks, the NBFCs were directed to disclose their large credits and create a special sub-category of assets as Special Mention Accounts (SMAs) to detect incipient signs of stress in their loan books. Along with the regulatory requirements to step up the capital base and seek credit rating for any further deposit mobilisation for deposit taking NBFCs, these recent measures would place the entire non-banking sector on a sound regulatory footing.

Reviving the licensing and expansion of urban co-operative banks

1.22 Urban Co-operative Banks (UCBs) have played an important role in extending financial inclusion in India since their inception in the early 20th century and more so, after they were brought under the purview of the Banking Regulation Act (as applicable to co-operative societies) in 1966. However, given the rapid growth of these banks and increasing concerns about their financial soundness, the Reserve Bank initiated the process of voluntary consolidation of these institutions in 2005. This process was aimed at encouraging the growth of financially stronger UCBs and non-disruptive exit of the weaker ones. Consequently, the issuance of fresh licenses to the UCBs was also put on hold.

1.23 However, with a considerable progress made regarding the consolidation of this sector, the issue of licensing was revisited by two recent committees: the Expert Committee on Licensing of New UCBs (Chairman: Shri Y. H. Malegam) and the High Powered Committee on UCBs (Chairman: Shri R. Gandhi). The latter has suggested the timing and terms for licensing of new UCBs taking into account the concerns relating to financial stability, financial inclusion, existing legal framework and business considerations of individual UCBs. The Committee has suggested that a UCB with business size of ₹200 billion or more may be eligible to convert to a commercial bank. Further, smaller UCBs can voluntarily convert to Small Finance Banks (SFBs) irrespective of the threshold limit, provided they fulfill all the eligibility criteria and given the availability of licencing window to the SFBs.

Making the banking sector more inclusive

1.24 Financial inclusion ranks high in the list of priorities of the Reserve Bank. Accordingly, banks were encouraged by the Reserve Bank to pursue Board-approved three-year Financial Inclusion Plans (FIP) since 2010. With the inception of the Pradhan Mantri Jan Dhan Yojana (PMJDY) in August 2014, the Government of India has accorded top priority to the pursuit of financial inclusion.

1.25 Many of the measures taken by the Reserve Bank in 2014-15 have reaffirmed its commitment to financial inclusion. The salient ones among these were: the licensing of two universal banks in August 2014 identified on the basis of their business plan to achieve financial inclusion; 10 differential licenses for payments banks and 11 licenses for SFBs catering to small payments/finance needs in the economy; revising the priority sector guidelines with a specific focus on small and marginal farmers and micro-enterprises and further simplification of the Know-Your-Customer (KYC) guidelines for low risk customers. Further, to work out a medium-term (five year) measureable action plan for financial inclusion, the Reserve Bank has constituted a Committee on Medium-term Path on Financial Inclusion (Chairman: Shri Deepak Mohanty).

1.26 To conclude, a competitive, sound and inclusive banking system is *sine-qua-non* for a growing economy like India that aspires to be globally competitive. Despite the fact that the year 2014-15 posed several challenges for the Indian banking sector, various proactive and forward-looking policy measures were taken. These policies would enable banks to face the challenges relating to asset quality and profitability in the short-term and would also support them to meet the diverse and largely unmet needs of banking services, while successfully competing with global players, in the long-term.

Chapter II

Operations and Performance of Scheduled Commercial Banks

Consolidated operations[1]

2.1 The slowdown in growth in the balance sheets of banks witnessed since 2011-12 continued during 2014-15. The moderation in assets growth of scheduled commercial banks (SCBs) was mainly attributed to tepid growth in loans and advances to below 10 per cent (Chart 2.1). Growth in investments also slowed down marginally. The decline in credit growth reflected the slowdown in industrial growth, poor earnings growth reported by the corporates, risk aversion on the part of banks in the background of rising bad loans and governance related issues. Further, with the availability of alternative sources, corporates also switched part of their financing needs to other sources such as external commercial borrowings (ECBs), corporate bonds and commercial papers. On the liabilities side, growth in deposits and borrowings also declined significantly. Bank-group wise, public sector banks (PSBs) witnessed deceleration in credit growth in 2014-15; private sector banks (PVBs) and foreign banks (FBs), however, indicated higher credit growth.

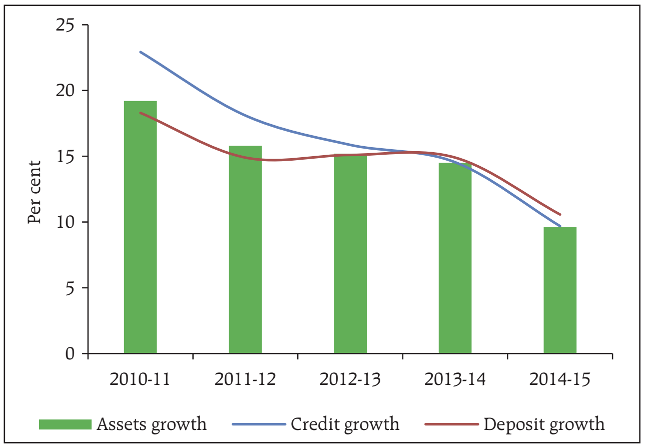
CASA deposits

2.2 Growth in current account and saving account (CASA) deposits moderated due to decline in saving deposits which in turn got reflected in deceleration in overall deposit growth (Chart 2.2). Bank-group wise, PSBs recorded decline in CASA deposits while PVBs and FBs recorded higher growth during 2014-15.

Credit-deposit ratio

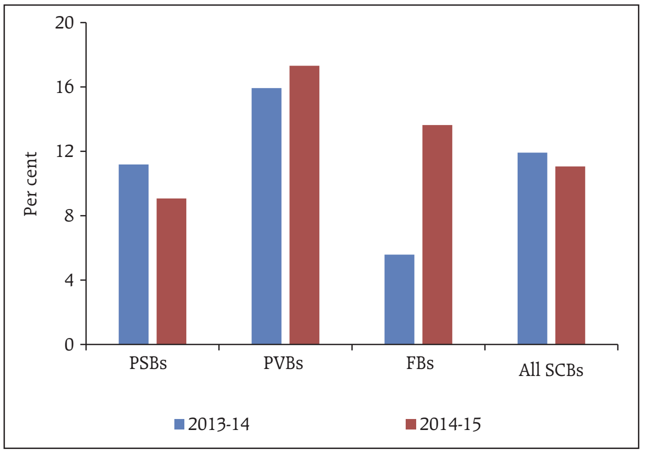
2.3 Credit-Deposit (C-D) ratio of the SCBs stood at around 78 per cent, same as that of previous year. Among the bank-groups, the C-D ratio of the private sector banks improved marginally with the other constituents recording a decline (Chart 2.3).

Chart 2.1: Movement in assets, credit and deposit growth of the SCBs



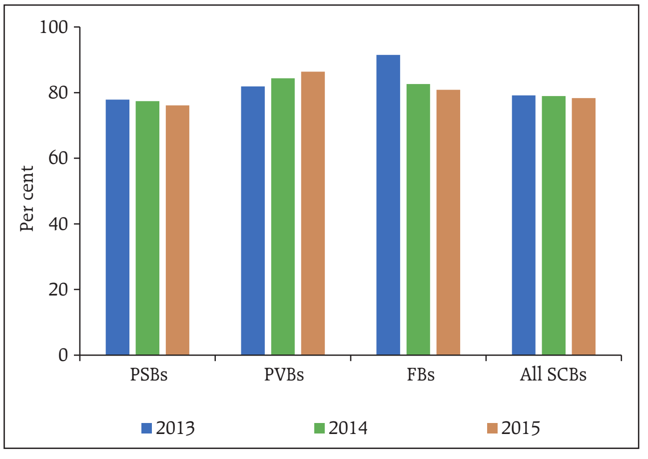
Source: Annual accounts of banks and RBI staff calculations.

Chart 2.2: Growth in CASA deposits of the SCBs



Source: Annual accounts of banks and RBI staff calculations.

Chart 2.3: Trends in outstanding C-D ratio, bank-group wise – position as on March 31



Source: Annual accounts of banks and RBI staff calculations.

[1] Including overseas operations.

Maturity profile of liabilities and assets

2.4 The maturity profile of liabilities of the SCBs witnessed an improvement during 2014-15 as the proportion of short-term liabilities declined and that of long-term liabilities increased. On the assets side, share of long-term assets declined and the share of short-term assets increased marginally (Chart 2.4). This can be seen in the light of risk aversion on the part of banks in the backdrop of rising share of non-performing loans. The proportion of long-term loans and advances declined to 27.3 per cent in 2014-15 from 28.9 per cent in the previous year (Chart 2.5).

2.5 The PSBs, however, had 52 per cent of their investments in more than 5 year maturity bracket during 2014-15 while investments of the PVBs and FBs in that tenor, aggregated 30.4 per cent and 5.6 per cent, respectively.

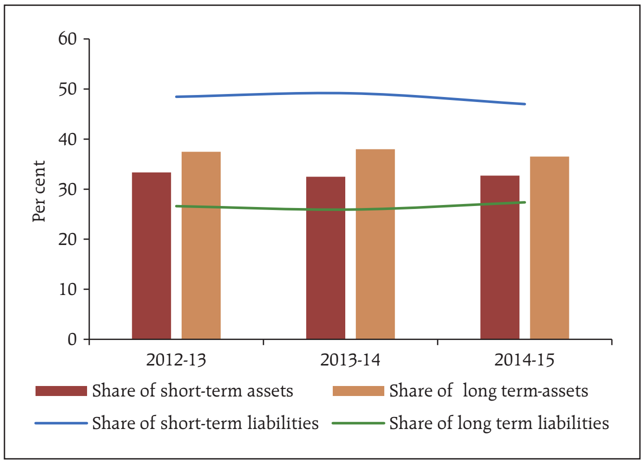
Off-balance sheet operations

2.6 Off-balance sheet liabilities (notional) of banks showed some resilience on the back of a lukewarm growth in the previous year and the deceleration in the growth of balance sheet operations of the banks. This was mainly driven by contingent liabilities on account of outstanding forward exchange contracts, which has the largest share in off-balance sheet operations of banks (Chart 2.6). Bank group-wise analysis revealed that, off-balance sheet exposure (notional) as percentage of on-balance sheet liabilities remained significantly higher for foreign banks as compared with other bank groups, due to their higher exposure to forward contracts, guarantees and acceptance/endorsements.

Financial performance of the SCBs

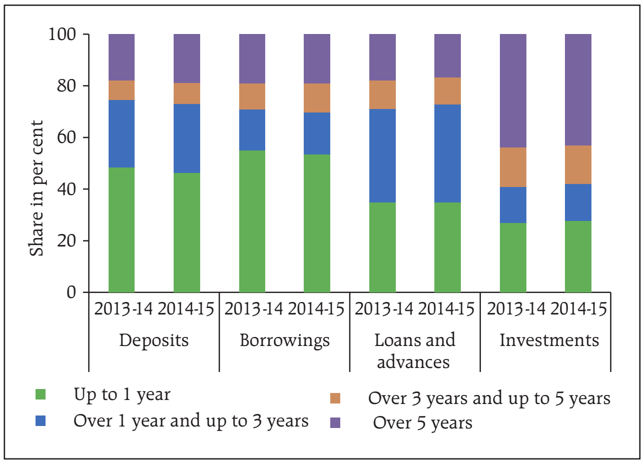
2.7 Both interest earnings and interest expended recorded a lower growth during 2014-15 as compared to the previous year. Interest earnings reflected the impact of slower credit growth. However, decline in interest income was marginally higher than interest expended. As a result, net interest income grew less

Chart 2.4: Trend in maturity profile of assets and liabilities



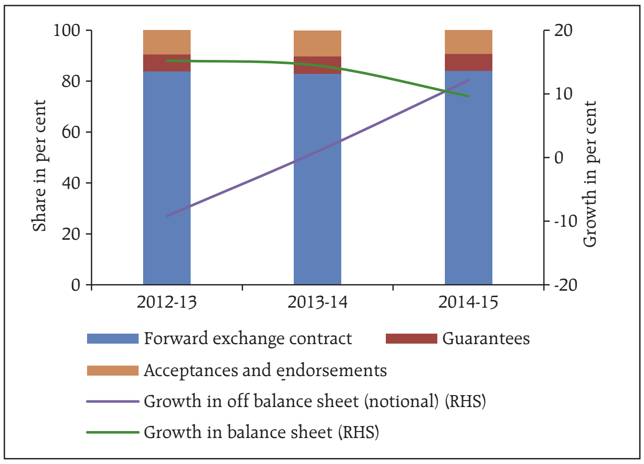
Note: Short-term is maturity upto 1 year while long-term is maturity of more than 3 years.
Source: Annual accounts of banks and RBI staff calculations.

Chart 2.5: Maturity profile of select liabilities / assets of the SCBs



Source: Annual accounts of banks and RBI staff calculations.

Chart 2.6: Composition and growth of off-balance sheet liabilities of SCBs



Source: Annual accounts of banks and RBI staff calculations.

than the previous year despite an improvement in the operating expenses (through reduction in the growth of wage bill). Also, the pace of increase in provisions and contingencies due to delinquent loans declined sharply. This led to an increase in net profits at the aggregate level by 10.1 per cent during 2014-15 as against a decline in net profits during the previous year (Chart 2.7).

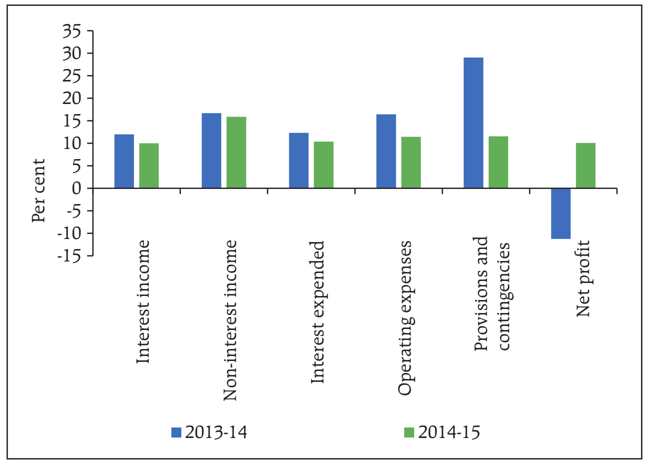
2.8 Following the trend in the recent past, both net interest margin (NIM) and spread (difference between return and cost of funds) witnessed marginal decline (Chart 2.8).

2.9 During 2014-15, return on assets (RoA) remained at the same level as previous year, however, return on equity (RoE) dipped marginally (Table 2.1). At the bank-group level, the RoA of PSBs declined though that of PVBs and FBs showed an improvement.

Priority sector credit

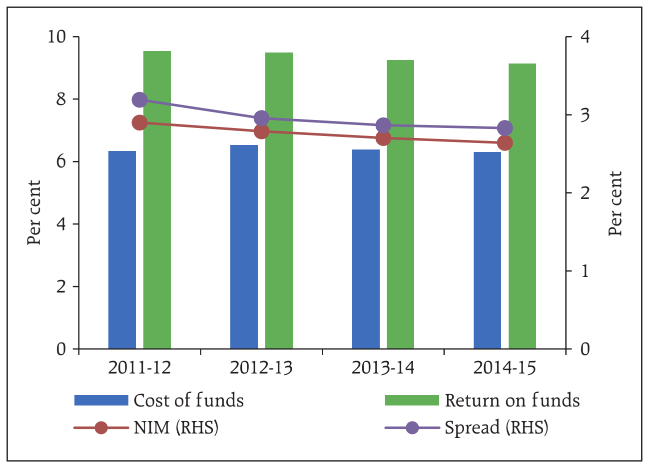
2.10 Following the overall trend, credit growth to priority sector also declined during 2014-15 (Chart 2.9) and this decline was spread over all the sub-sectors with growth in credit to agriculture declining to 12.6 per cent from 30.2 per cent in the previous year. Credit to priority sectors by PSBs, PVBs and FBs was 38.2 per cent, 43.2 per cent and 32.2 per cent (of adjusted net bank credit (ANBC)/credit equivalent of off-balance sheet exposure, whichever is higher) respectively, during the year. Thus, PSBs indicated a

Chart 2.7: Growth of select items of income and expenditure



Source: Annual accounts of banks and staff calculations.

Chart 2.8: Financial performance of SCBs



Notes: Cost of Funds= (Interest paid on deposits + Interest paid on borrowings) / (Average of current and previous year's deposits + borrowings).

Return on Funds = (Interest earned on advances + Interest earned on investments) / (Average of current and previous year's advances + investments).

Net Interst Margin = Net Interest Income / Average total Assets.

Spread = Difference between return and cost of funds.

Source: Annual accounts of banks and RBI staff calculations.

Table 2.1: ROA and ROE of SCBs – Bank-group wise

(per cent)

Sr. no	Bank group	Return on assets		Return on equity	
		2013-14	2014-15	2013-14	2014-15
1	Public sector banks	0.50	0.46	8.47	7.76
	1.1 Nationalised banks*	0.45	0.37	7.76	6.44
	1.2 State Bank group	0.63	0.66	10.03	10.56
2	Private sector banks	1.65	1.68	16.22	15.74
3	Foreign banks	1.54	1.87	9.03	10.24
4	**All SCBs**	**0.81**	**0.81**	**10.68**	**10.42**

Notes: Return on Assets = Net profit/Average total assets.
Return on Equity = Net profit/Average total equity.
* : Nationalised banks include IDBI Bank Ltd.
Source: Annual accounts of banks and RBI staff calculations.

shortfall from the overall target of 40 per cent.[2] Within priority sector credit, both PSBs (16.5 per cent) and PVBs (14.8 per cent) had a shortfall in advances to agricultural sector against the target of 18 per cent.

Retail credit

2.11 Retail loan portfolio of the banks continued to grow at around 20 per cent during 2014-15 even though there was deceleration in the total credit growth of banks. Housing loans (constituted around half of the total outstanding retail loans) and credit card receivables grew by more than 20 per cent. Auto-loans also recorded a recovery (Chart 2.10).

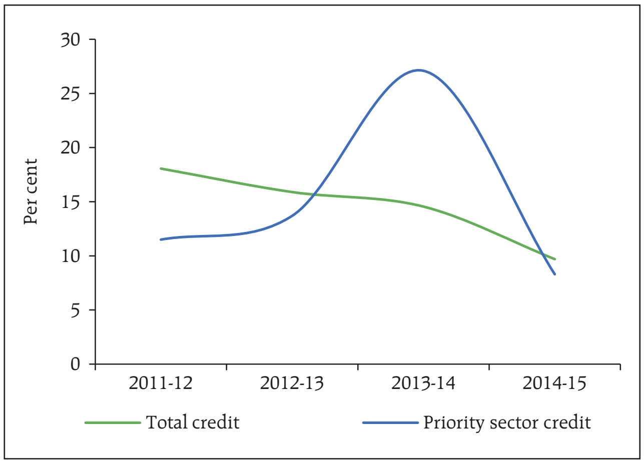
Credit to sensitive sectors

2.12 Capital market, real estate market and commodities market have been classified as sensitive sectors as fluctuations in prices of underlying assets in these sectors could adversely affect the asset quality of banks. In 2014-15, sensitive sectors accounted for 18.5 per cent of the total loans and advances of banks. Within these sensitive sectors, more than 90 per cent comprised lending to real estate market. However, in line with overall trend, credit growth to sensitive sectors also witnessed a decline on account of lower growth in lending to real estate market.[3] Neverthless, lending to capital market recorded higher growth during 2014-15. At the bank group level, in both the sectors, FBs' exposure was highest followed by PVBs (Chart 2.11).

Ownership pattern of SCBs

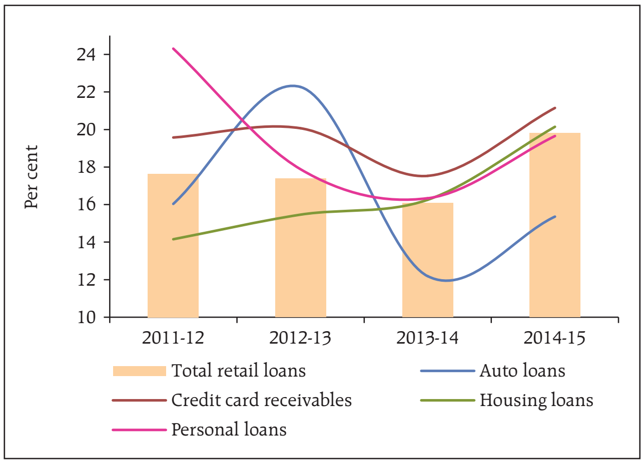
2.13 The banking sector in the country remained predominantly in the public sector with the PSBs accounting for 72.1 per cent of total banking sector assets, notwithstanding a gradual decline in their share in recent years. However, despite substantive share in total assets, the PSBs accounted for only 42.1 per cent in total profits during 2014-15, with the PVBs

Chart 2.9: Trend in growth in priority sector and total credit



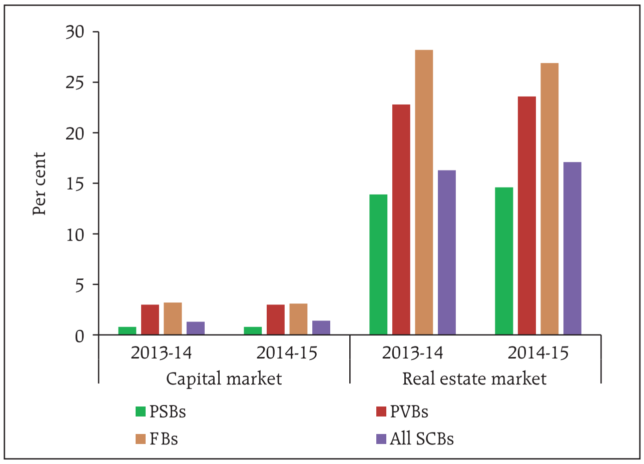
Source: RBI Supervisory Returns and RBI staff calculations.

Chart 2.10: Growth in retail loans



Source: RBI Supervisory Returns.

Chart 2.11: Share of lending to sensitive sectors



Source: Annual accounts of banks and RBI staff calculations.

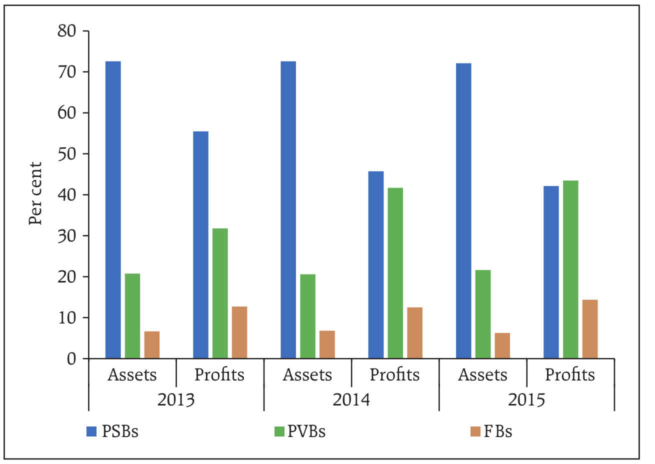
[2] For foreign banks, priority sector target is 32 percent of ANBC or credit equivalent amount of off-balance sheet exposure, whichever is higher.

[3] Please refer to Table 9 of *Statistical Tables Relating to Banks in India, 2014-15.*

surpassing the PSBs in the share of total banking sector profits (Chart 2.12).

2.14 The Government of India continued to have more than the stipulated 51 per cent shareholding in all the public sector banks, despite decline in the stake in some of them in recent years. The maximum foreign shareholding in the case of PSBs was around 17 per cent as at end-march 2015 (20 per cent is regulatory maximum prescribed by the Reserve Bank). In case of the PVBs, the maximum non-resident shareholding was 73.4 per cent (74 per cent is regulatory maximum prescribed by the Reserve Bank).[4]

Chart 2.12: Bank-group wise share in total assets and profits of banking sector – position as on March 31



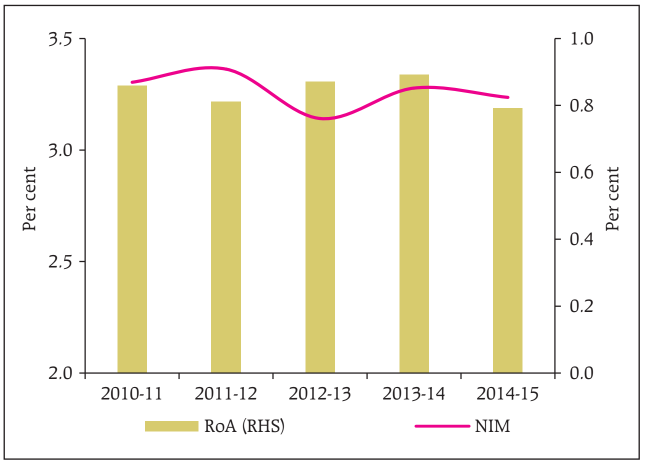
Source: Annual accounts of banks.

Regional rural banks (RRBs)

2.15 The number of RRBs declined to 56 from 57 during the year 2014-15 due to amalgamation. Following the trend in line with SCBs, the loans and advances of RRBs also recorded a deceleration in growth to 11.7 per cent during 2014-15 as against 15.2 per cent in the previous year. Investments also recorded a slower growth. On the liabilities side, deposit growth remained flat at around 14 per cent.

2.16 During 2014-15, both interest income and interest expended of RRBs recorded a lower growth as compared to previous year with the former registering a larger decline in growth. This led to marginal decline in net interest margin (NIM). Further, RRBs witnessed sharp deceleration in profits growth to 1.9 per cent in 2014-15 as against 18.5 per cent in the previous year. This resulted in decline in RoA of RRBs during the year (Chart 2.13).

Chart 2.13: Financial performance of RRBs



Source: NABARD.

Local area banks

2.17 Local Area Banks (LABs) were established in 1996 as local banks in the private sector with jurisdiction over two or three contiguous districts to enable the mobilisation of rural savings by local institutions and make them available for investments in the local areas. Presently, four LABs are in

[4] See Table 15 of *Statistical Tables Relating to Banks in India, 2014-15.*

operation. Out of these, Capital Local Area Bank Ltd. accounted for 72.9 per cent of the total assets of LABs as at end-March 2015.

2.18 Assets of the LABs grew by 22.2 per cent during 2014-15 while net interest income grew by 16.4 per cent. However, RoA witnessed a marginal decline as compared to previous year (Chart 2.14).

2.19 With the Capital Local Area Bank Ltd. getting the Reserve Bank's 'in-principle' approval for the license for Small Finance Bank (SFB), share of the LABs in the total banking assets will get further reduced.

Customer service

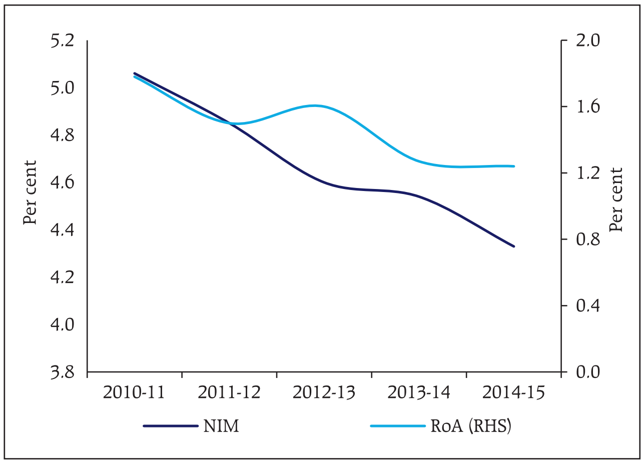
2.20 PSBs accounted for more than 70 per cent of the complaints received during 2014-15 and in all major categories, the share of PSBs was more than 60 per cent. However, the PVBs accounted for more than 25 per cent of complaints relating to ATMs, credit/debit cards and non-observance of fair practices code (Chart 2.15).

Technological Developments in Scheduled Commercial Banks

Growth in automated teller machines (ATMs)

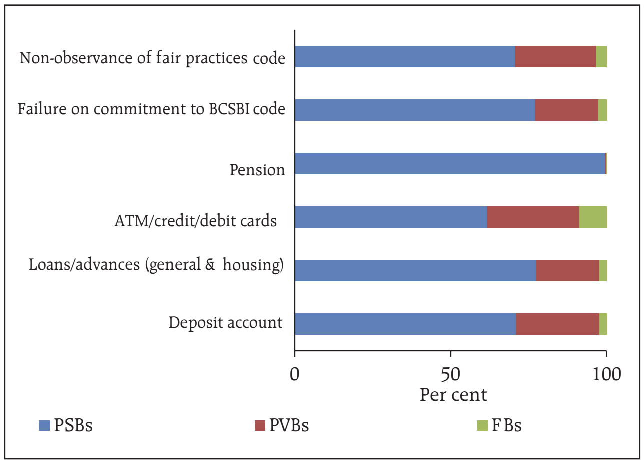
2.21 The banks increased their penetration further with the total number of ATMs reaching 0.18 million in 2015. However, there was a decline in growth of ATMs of both PSBs as well as PVBs. PSBs recorded a growth of 16.7 per cent during 2014-15 maintaining a share of around 70 per cent in total number of ATMs. FBs continued to record a negative growth in number of ATMs (Chart 2.16).

Chart 2.14: Return on assets and net interest margin of LABs



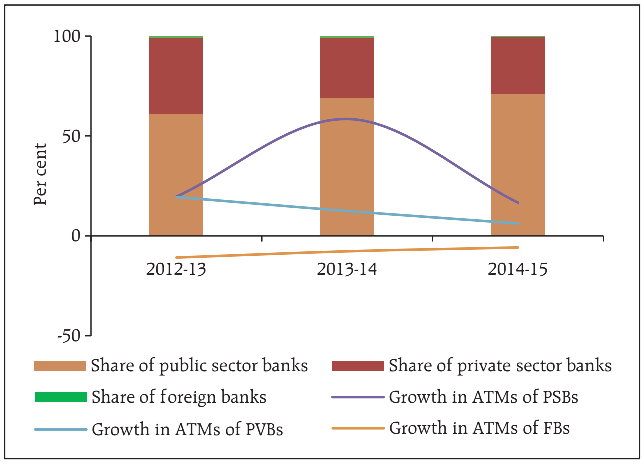
Source: RBI supervisory returns.

Chart 2.15: Bank-group wise break-up of major complaint types: 2014-15



Source: RBI.

Chart 2.16: Growth and composition of ATMs



Source: RBI.

Population group-wise distribution of ATMs

2.22 In recent years, the shares of ATMs in rural and semi-urban area have been rising, though urban and metropolitan centres still dominate. In 2015, about 44 per cent of the ATMs were located in rural and semi-urban centres (Chart 2.17).

Off-site ATMs

2.23 The share of off-site ATMs in total ATMs increased to 50.9 per cent as at end-March 2015 from 47.9 per cent in the previous year. The increase in share of off-site ATMs of public sector banks played a major role, which increased to 45.7 per cent in 2015 from 40.3 per cent in 2014. The share of private sector and foreign banks was already more than 60 per cent (Chart 2.18).

White label ATMs

2.24 Looking at the efficiency and cost-effectiveness of off-site ATMs, non-bank entities were allowed to own and operate ATMs called 'White Label ATMs (WLA)' by the Reserve Bank in 2012. As on October 31, 2015, 10,983 WLAs were installed.

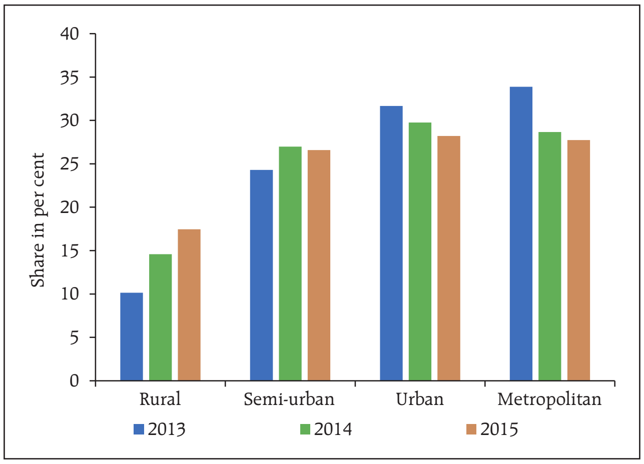
Debit cards and credit cards

2.25 Issuance of debit cards is much higher as compared to credit cards and they remain a preferred mode of transactions. In 2012, there were 6.3 credit cards for every 100 debit cards, which declined to 3.8 in 2015 (Chart 2.19). PSBs maintained a lead over PVBs and FBs in issuing debit cards. As on March 31, 2015 approximately 83 per cent of the debit cards were issued by PSBs, while around 80 per cent of the credit cards were issued by the PVBs (57.2 per cent) and FBs (22.4 per cent).

Prepaid payment instruments

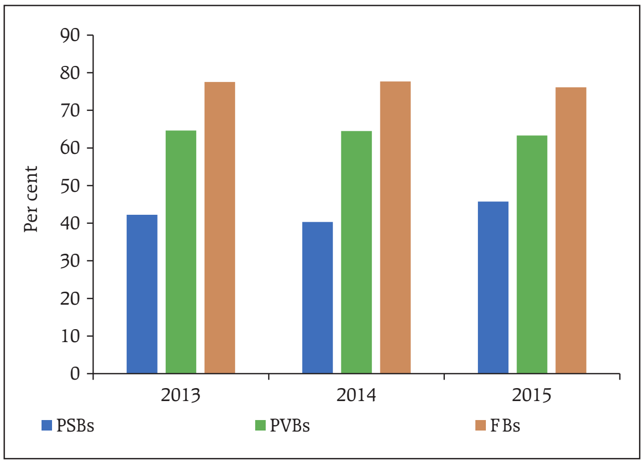
2.26 Pre-paid payment instruments (PPIs) are payment instruments that facilitate purchase of goods and services, including funds transfer, against the value stored on such instruments. The value stored on such instruments represents the value paid for by the holders by cash, by debit to a bank account, or by credit card. In the past few years, PPIs have emerged

Chart 2.17: Geographical distribution of ATMs



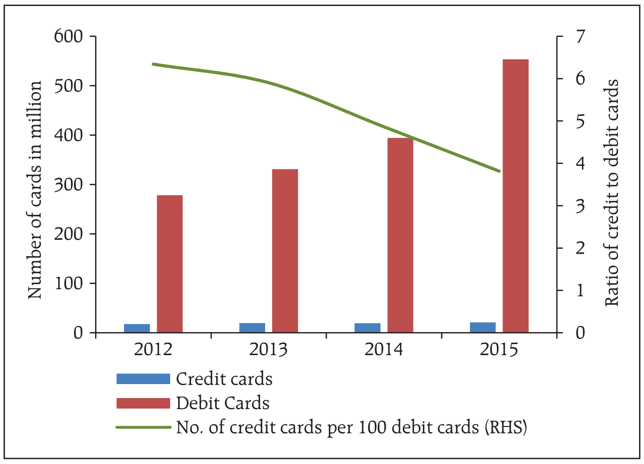
Source: RBI.

Chart 2.18: Share of off-site ATMs



Source: RBI.

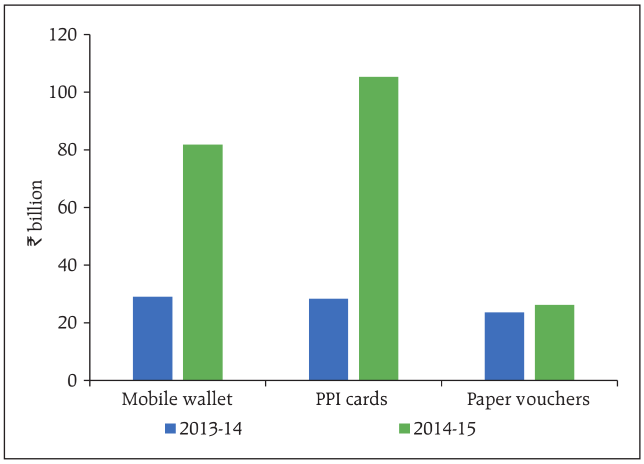
Chart 2.19: Issuance of debit and credit cards



Source: RBI.

as an easy alternative to cash for performing day to day small value payment transactions. Value of PPIs has increased from ₹79.2 billion in 2012-13 to ₹213.4 billion in 2014-15. Among the PPI instruments, PPI card has been the most popular one (Chart 2.20), with non-bank PPIs having fuelled most of this growth.

Chart 2.20: Progress of pre-paid instruments (value)

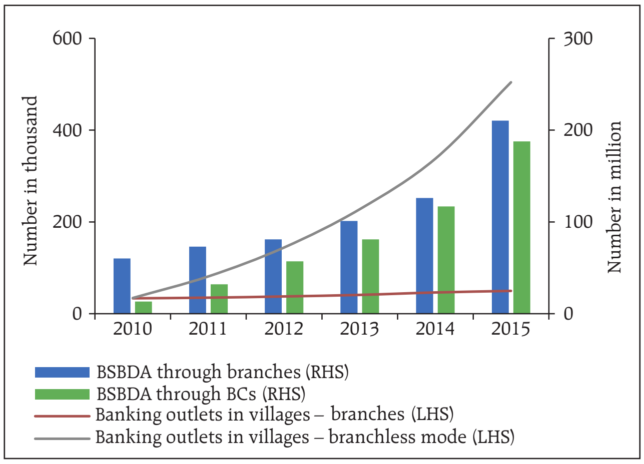


Source: RBI.

Financial inclusion initiatives

2.27 The Reserve Bank continued its efforts towards universal financial inclusion. Given the boost provided by the Pradhan Mantri Jan Dhan Yojana (PMJDY) during the period, considerable banking penetration has occurred, particularly in rural areas. However, significant numbers of banking outlets operate in branchless mode through business correspondents (BCs)/facilitators (Chart 2.21). Dominance of BCs in the rural areas can be gauged from the fact that almost 91 per cent of the banking outlets were operating in branchless mode as on March 31, 2015.

Chart 2.21: Progress of banking outlets and basic savings bank deposit accounts (BSBDA)



Source: RBI.

2.28 As on December 9, 2015, 195.2 million accounts have been opened and 166.7 million RuPay debit cards have been issued under PMJDY. The scheme was launched on 28th August, 2014 with the objectives of providing universal access to banking facilities, providing basic banking accounts with overdraft facility and RuPay Debit card to all households, conducting financial literacy programmes, creation of credit guarantee fund, micro-insurance and unorganised sector pension schemes. The objectives are expected to be achieved in two phases over a period of four years up to August 2018. Banks are also permitted to avail of Reserve Bank's scheme for subsidy on rural ATMs. The objectives of the financial inclusion plan (FIP), spearheaded by the Reserve Bank and PMJDY are congruent to each other.

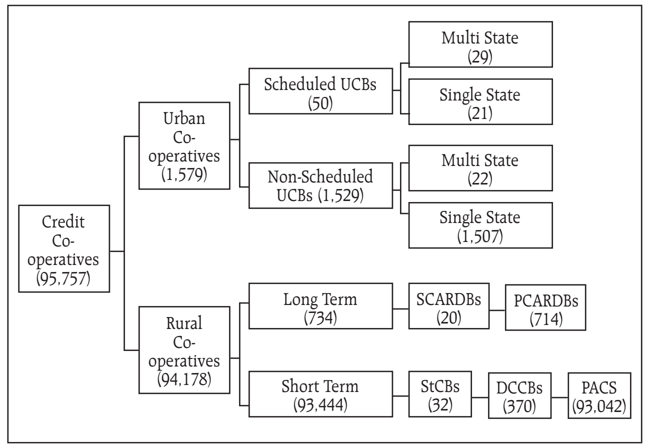
2.29 To further strengthen the financial inclusion efforts and increase the penetration of insurance and pension coverage in the country, the Government of India has launched some social security and insurance schemes, *i.e.*, Pradhan Mantri Jeevan Jyoti Bima Yojana, Pradhan Mantri Suraksha Bima Yojana and Atal Pension Yojana in May 2015. As on December 16, 2015, 92.6 million beneficiaries have been enrolled under the Pradhan Mantri Suraksha Bima Yojana and 29.2 million have been enrolled under Pradhan Mantri Jeevan Jyoti Bima Yojana. Further, 1.3 million account holders have been enrolled under Atal Pension Yojana.

Chapter III

Developments in Co-operative Banking

3.1 As at end-March 2015, India's co-operative banking sector comprised of 1,579 Urban Co-operative Banks (UCBs) and 94,178 Rural Co-operative Credit Institutions, including short-term and long-term credit institutions (Chart 3.1). During 2014-15, the UCBs witnessed a moderation in their asset growth and an increase in their net profits. During 2013-14, the balance sheets of all rural co-operative banks, except the short-term State Co-operative Banks (StCBs), witnessed either deceleration or reversal in growth. The state level short term and long-term rural co-operatives witnessed a decline in net profits.

Chart 3.1: Structure of co-operative credit institutions in india – position as on March 31, 2015



DCCBs: District Central Co-operative Banks; PACS: Primary Agricultural Credit Societies; SCARDBs: State Co-operative Agriculture and Rural Development Banks; PCARDBs: Primary Co-operative Agriculture and Rural Development Banks.

Notes: 1. Figures in parentheses indicate the number of institutions at end-March 2015 for UCBs and at end- March 2014 for rural co-operatives.

2. For rural co-operatives, the number of co-operatives refers to reporting co-operatives.

Source: RBI.

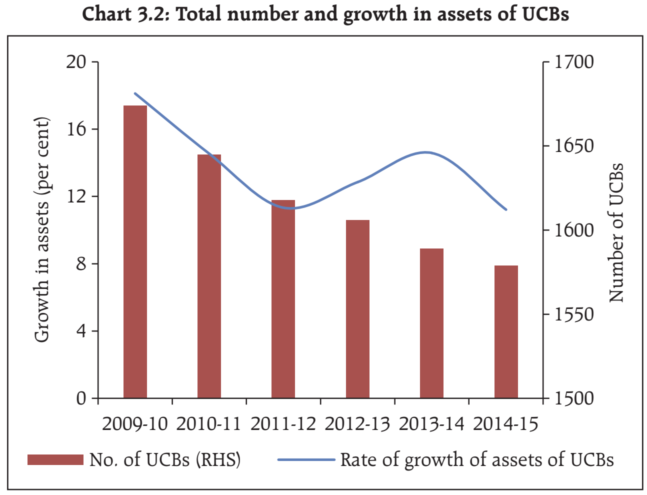
Urban co-operative banks

3.2 The consolidation of the UCBs continued as the number of UCBs came down from 1,606 in 2013 to 1,579 in 2015 (Chart 3.1). The Reserve Bank had ordered closure of six UCBs in September 2014 on account of charges of money laundering.

Performance of UCBs

3.3 Growth in assets of UCBs witnessed moderation during 2014-15 as compared to the previous year (Chart 3.2). Slowdown in growth of assets was led by lower growth in 'other assets' of UCBs. Loan & advances grew by about 12 per cent and contributed significantly to the total increase in assets in 2014-15.

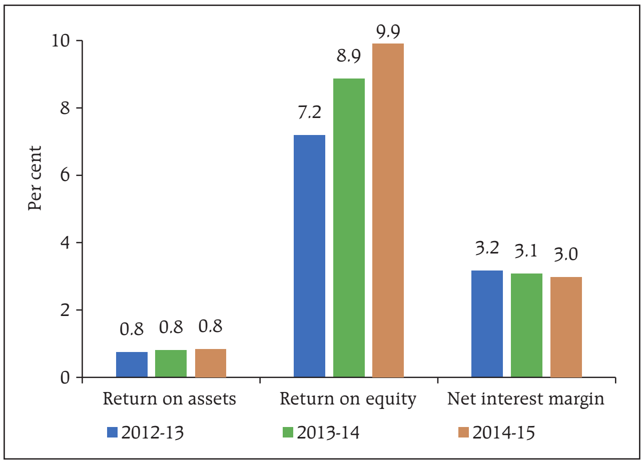
Chart 3.2: Total number and growth in assets of UCBs



Note: Data for 2014-15 are provisional.

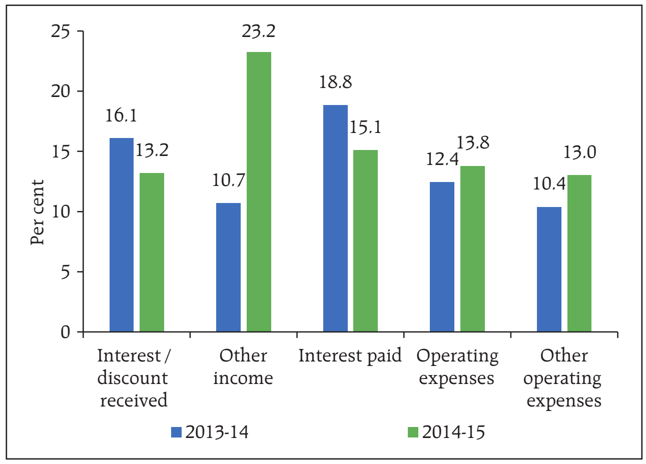
Source: RBI supervisory returns and staff calculations.

Chart 3.3: Select indicators of profitability of UCBs



Source: RBI supervisory returns and staff calculations.

Chart 3.4: Income and expenses of UCBs – variation in per cent



Source: RBI supervisory returns and staff calculations.

3.4 The UCBs performed well in terms of return on equity (RoE). Net interest margin (NIM), however, marginally moderated (Chart 3.3). There was a deceleration in growth of both interest income and interest expense while the growth in other income and other operating expenses increased during 2014-15 (Chart 3.4).

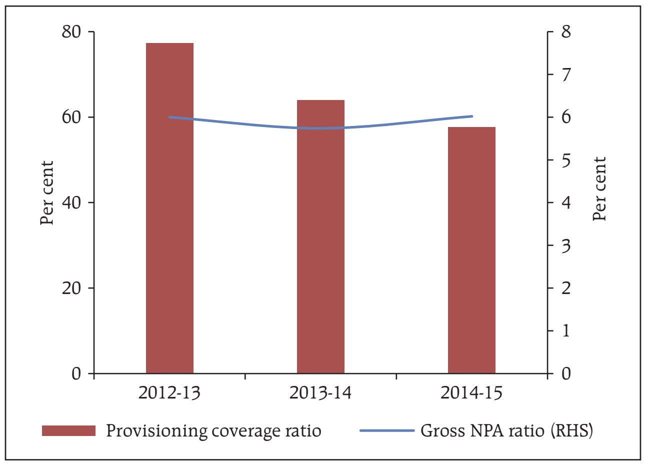
Asset quality

3.5 The gross non-performing advances (GNPAs) ratio witnessed an increase in 2014-15 over the previous year (Chart 3.5) with the GNPA ratio rising to 6.0 per cent at end-March 2015 from 5.7 per cent at end-March 2014. Net NPA ratio also increased from 2.2 per cent to 2.7 per cent during the same period. At end-March 2015, provisions grew at a lower rate than the increase in gross NPAs (Chart 3.6) resulting in a lower provisioning coverage ratio as compared to the previous years.

Developments with regard to UCBs

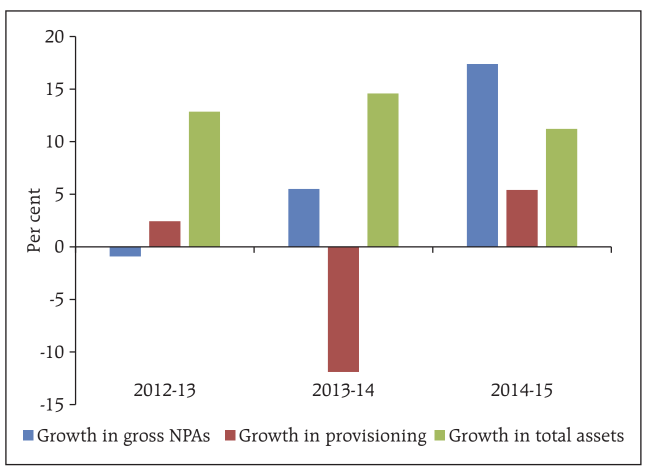
3.6 The High Powered Committee on Urban Co-operative Banks (Chairman: Shri R. Gandhi) recommended, *inter alia*, that the UCBs registered under Multi-state Co-operative Societies Act, 2002 and with business size (deposits plus advances) of ₹200 billion or more may be considered for conversion into commercial banks while UCBs of smaller size willing to convert to small finance banks (SFBs) can apply to

Chart 3.5: Non-performing advances of UCBs



Source: RBI supervisory returns and staff calculations.

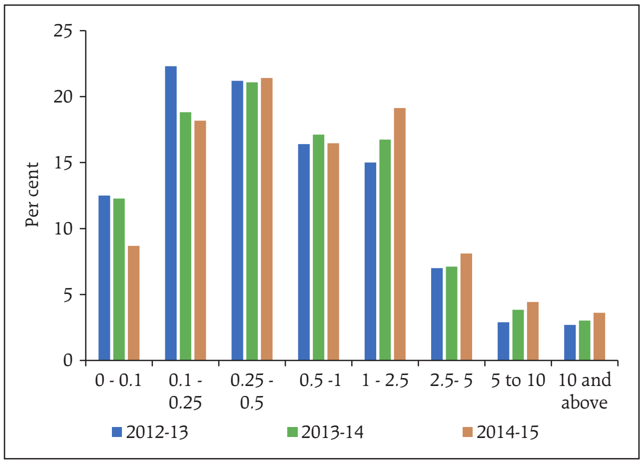
Chart 3.6: Growth in assets, NPAs and provisions



Source: RBI supervisory returns and staff calculations.

Chart 3.7: Distribution of UCBs based on deposit size-position as on March 31

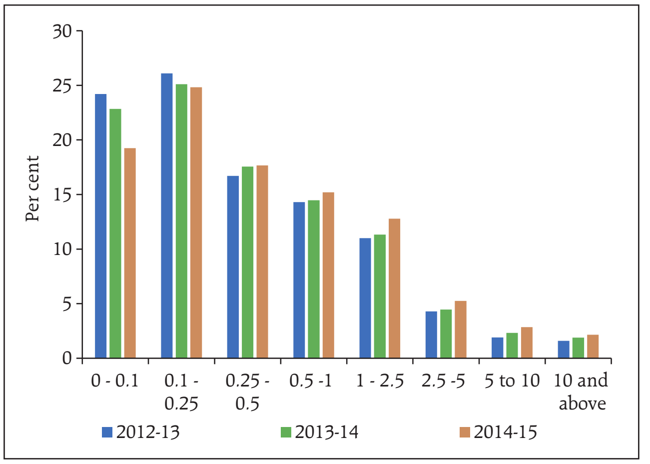
(₹ billion)



Source: RBI supervisory returns and staff calculations.

Chart 3.8: Distribution of UCBs based on size of advances - position as on March 31

(₹ billion)



Source: RBI supervisory returns and staff calculations.

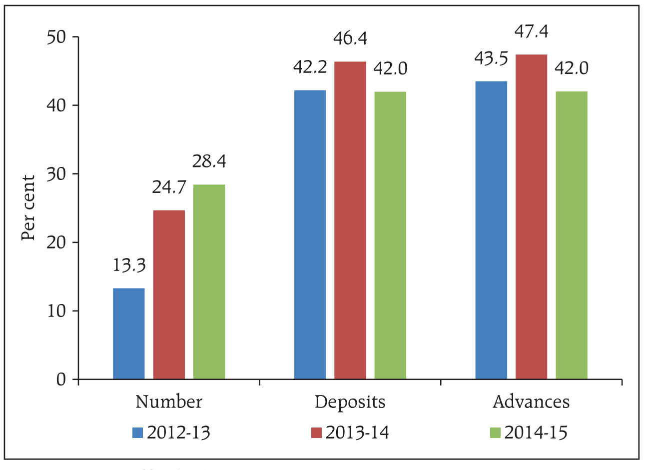
the Reserve Bank for conversion if they fulfill all the eligibility criteria and the selection process prescribed by the Reserve Bank and if the licensing window for SFBs[1] is open. In line with the committee's observation on the growing deposits and advances of the UCBs, it is noteworthy that while the number of UCBs have fallen due to the mergers and amalgamations, the number of Tier II UCBs have been on the rise (from 412 at end March 2013 to 442 at end-March 2014 and further to 447 at end-March 2015).[2]

3.7 There has been a perceptible increase in the size of deposits and advances of UCBs (Charts 3.7 and 3.8). The capital base of the scheduled UCBs has also been increasing and six of the UCBs in 2014 qualified as per the minimum paid-up equity capital criteria for becoming small finance banks in 2014. The number of such UCBs stood at eight as at end-March, 2015.

3.8 The share of UCBs in the best rated category under the CAMELS model, 'A', increased from 24.7 per cent in 2013-14 to 28.4 per cent in 2014-15. However, the share of banking business under this category recorded a decline during 2014-15 (Chart 3.9).

Chart 3.9: Share of UCBs in rating category A - number and business size

(position as on March 31)



Source: RBI staff calculations.

[1] This Committee was constituted on Jan 30, 2015 by the Reserve Bank and the Committee submitted its report on July 30, 2015. The Committee also made the following recommendations:-

- Licenses may be issued to financially sound and well-managed co-operative credit societies having a good track record of minimum 5 years which satisfy the regulatory prescriptions set by the Reserve Bank as licensing conditions.
- A Board of Management (BoM) should be put in place in addition to Board of Directors (BoD), as mandatory licensing condition for licensing of new UCBs and expansion of existing ones.

[2] Tier-I UCBs were defined as UCBs with:

- Deposit base below ₹1 billion operating in a single district.
- Deposit base below ₹1 billion operating in more than one district provided the branches were in contiguous districts, and deposits and advances of branches in one district separately constituted at least 95 per cent of the total deposits and advances, respectively, of the bank.
- Deposit base below ₹1 billion, whose branches were originally in a single district but subsequently became multi-district due to re-organisation of the district.

All other UCBs are defined as Tier-II UCBs.

3.9 The credit to deposit ratio has remained flat during the year. However, the investment to deposit ratio for all UCBs, has declined for two consecutive years (39.2 per cent in 2013 to 36.3 per cent in 2014 and further to 34.7 per cent in 2015). The SLR investment has witnessed a moderation while the non-SLR investments have witnessed an improved position over the previous year (Chart 3.10).

Scheduled UCBs

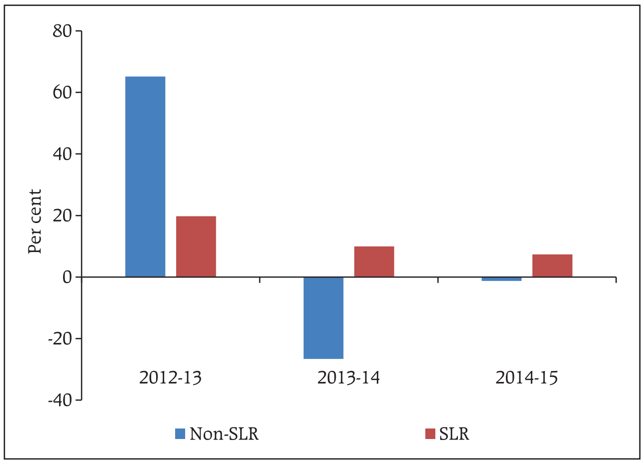
3.10 There were 50 scheduled UCBs at end-March 2015 and their share in total assets of all UCBs increased, albeit marginally, over the years (Chart 3.11).

3.11 The balance sheet of scheduled UCBs expanded by 12 per cent in 2014-15 as against 15 per cent in 2013-14. While growth in deposits and loans and advances contributed the most in balance sheet expansion in 2013-14, the slow-down in 2014-15 was led by lower growth in other assets and liabilities.

3.12 Expenditure growth remained relatively higher than growth in income in 2014-15. Contribution of interest expenses to expenditure growth fell from 81.4 to 77.7 per cent in 2014-15.

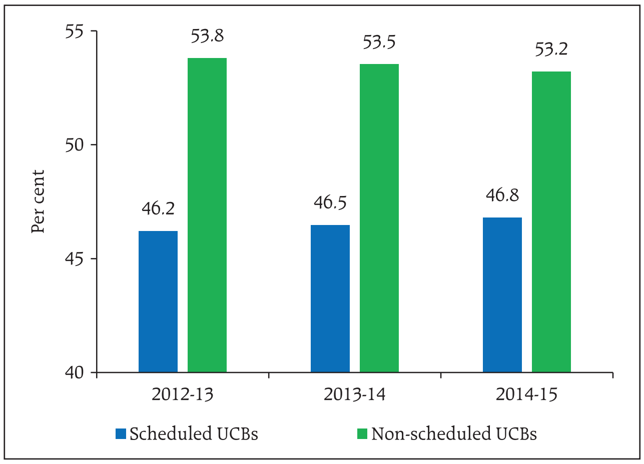
3.13 The profitability indicators of scheduled UCBs remained stable during the period 2013-15 (Chart 3.12).

Chart 3.10: SLR and non-SLR investments – variations in per cent



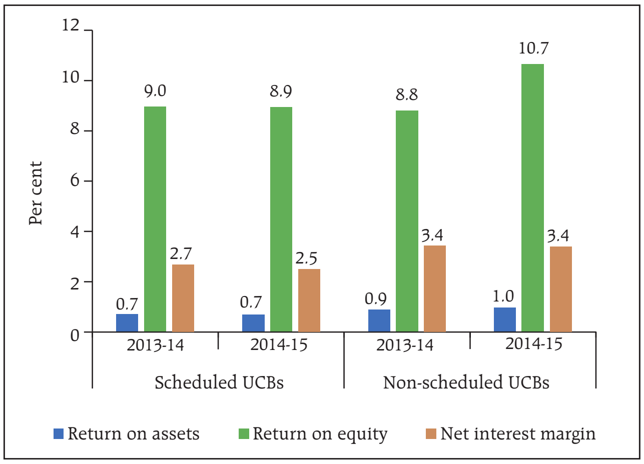
Source: RBI supervisory returns and staff calculations.

Chart 3.11: Scheduled and non-scheduled UCBs-share in total assets-position as on March 31



Source: RBI supervisory returns and staff calculations.

Chart 3.12: Profitability indicators of UCBs-by type



Source: RBI supervisory returns and staff calculations.

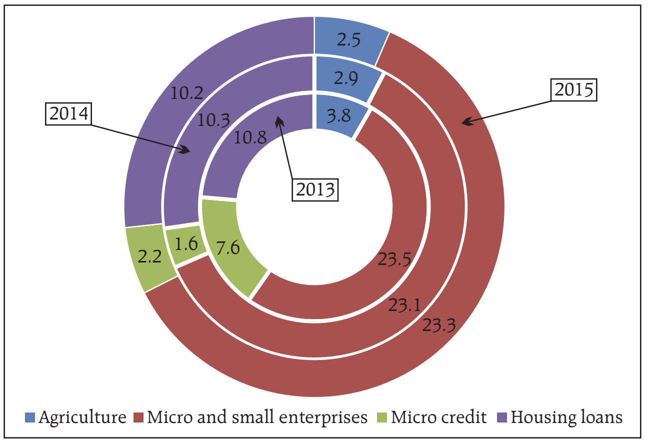
Priority sector advances of UCBs

3.14 Priority sector advances of UCBs have increased from 48.9 per cent in 2013-14 to 49.4 per cent of their total advances during the period 2014-15. Credit to small enterprises and housing of the UCBs increased from the 2013 levels and continues to dominate the priority sector advances of these co-operatives with an urban focus. Advances to the agricultural sector continued to decline (Chart 3.13). However, the percentage of priority sector advances directed toward weaker sections (micro credit and micro and small enterprises) have improved during 2014 - 2015, indicating enhanced commitment to financial inclusion (Chart 3.14).

Rural co-operative banks

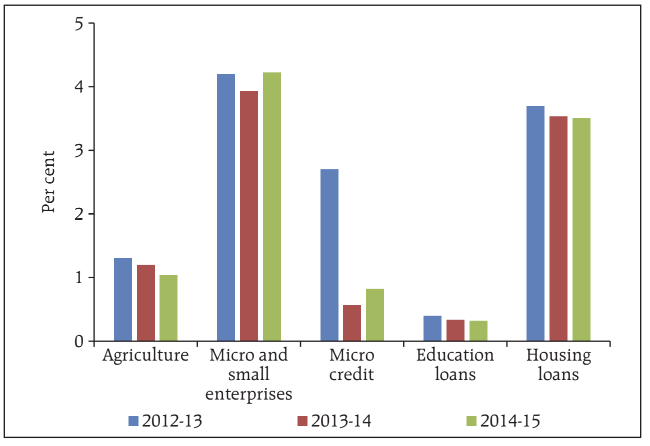
3.15 The share of short-term credit co-operatives, comprising StCBs, District Central Co-operative Banks (DCCBs) and Primary Agricultural Credit Societies (PACS), stood at about 93 per cent of the total assets of the rural co-operative credit institutions as on March 31, 2014 while the long-term credit co-operatives accounted for the remaining (Table 3.1).

Chart 3.13: Percentage distribution of credit to select priority sectors by UCBs



Source: RBI.

Chart 3.14: Priority sector advances by UCBs to weaker sections



Source: RBI.

Table 3.1: A profile of rural co-operatives (as on March 31, 2014) (₹ billion)

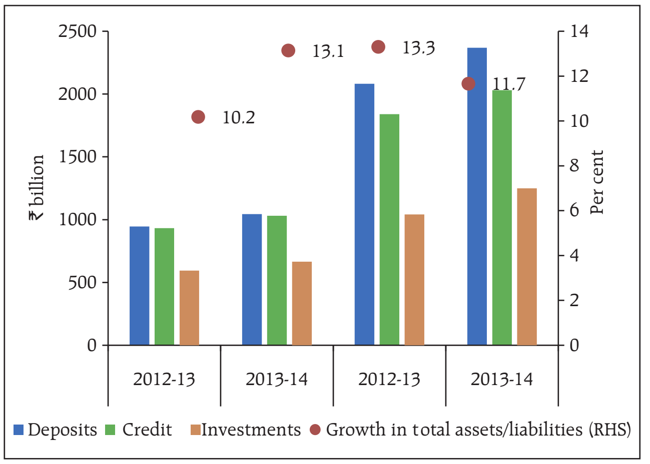
Item	Short-term			Long-term	
	StCBs	DCCBs	PACs	SCARDBs	PCARDBs
1	2	3	4	5	6
A. Number of Cooperatives	**32**	**370**	**93042**	**20**	**714**
B. Balance Sheet Indicators					
i. Owned Funds (Capital +Reserve)	129.9	273.7	189.2	68.7	53.0
ii. Deposits	1043.7	2368.9	819.0	15.4	7.4
iii. Borrowings	610.0	726.9	958.4	157.5	144.4
iv. Loans and Advances	1031.2	2030.03	1300.5*	204.0	128.9
v. Total Liabilities/Assets	1904.1	3734.6	2124.3+	310.3	279.7
C. Financial Performance					
i. Institutions in Profits					
a. Number	26	331	43327	8	372
b. Amount of Profit	9.8	15.2	110.5	1.6	2.7
ii. Institutions in Loss					
a. Number	6	36	37662	11	340
b. Amount of Loss	0.9	3.5	91.2	5.1	5.1
iii. Overall Profits (+)/Loss (-)	8.9	11.7	19.3	-3.5	-2.4
D. Non-performing Assets					
i. Amount	57.0	209.0	296.3++	72.6	48.1
ii. As percentage of Loans Outstanding	5.5	10.3	22.8	35.6	37.3
E. Recovery of Loans to Demand Ratio (Per cent)	**82.5**	**78.3**	**NA**	**33.3**	**43.9**

Note: * Loans & advances outstanding, + working capital, ++ total overdues, NA= not available
Source: NABARD and NAFSCOB.

Short term rural credit – StCBs and DCCBs

3.16 The balance sheet of both state and district co-operatives expanded during 2013-14, however, the expansion slowed down in 2013-14 for the DCCBs (Chart 3.15). This moderation has been on account of a fall in reserves. Income of StCBs in 2013-14 grew by 9.7 per cent as against an increase of 13 per cent in their expenditure during the same period. Major component that contributed to the variation in expenditure was a steep increase in provisioning and contingencies. The growth in net profits of DCCBs has decelerated sharply during 2013-14 on account of growth in both interest and non-interest expenses. The NPAs of DCCBs increased during the year 2013-14. In terms of financial stability indicators, the StCBs outperformed the DCCBs (Table 3.2).

Chart 3.15: Select balance sheet indicators of StCBs



Source: NABARD.

3.17 During 2013-14, the NPA ratio of StCBs fell across all regions except the southern region. The southern region showed an increase in NPA ratio (4.3 to 5.4 per cent) although the recovery ratio for the region increased as well.

3.18 At the district level, the DCCBs in the southern region saw a marginal increase in NPA ratio in 2013-14 and the recovery ratio at the district level also declined during the year. During 2013-14, the recovery ratio fell at the district level across all regions except western (71.4 to 75.2 per cent) and central regions (63.5 to 70.8 per cent).

Table 3.2: Soundness indicators of rural co-operative banks (short-term)

(₹billion)

Item	StCBs				DCCBs			
	As at end-March		Percentage Variation		As at end-March		Percentage Variation	
	2013	2014P	2012-13	2013-14P	2013	2014P	2012-13	2013-14P
1	2	3	4	5	6	7	8	9
A. Total NPAs (i+ii+iii)	56.3	57.0	4.1	1.2	180.5	209.0	12.1	15.8
i. Sub-standard	20.6 (36.6)	20.7 (36.3)	28.7	0.5	78.7 (43.6)	100.2 (47.9)	25.0	27.3
ii. Doubtful	19.9 (35.4)	26.1 (45.9)	-17.1	31.2	76.2 (42.2)	86.9 (42.6)	7.3	14.0
iii. Loss	15.8 (28.1)	10.2 (17.9)	5.3	-35.4	25.6 (14.2)	21.9 (10.5)	-5.2	-14.4
B. NPA-to-Loans Ratio (%)	6.1	5.5			9.9	10.3		
C. Recovery-to-Demand Ratio (%) (as on 30 June of previous year)	94.8	82.5			80.0	78.3		

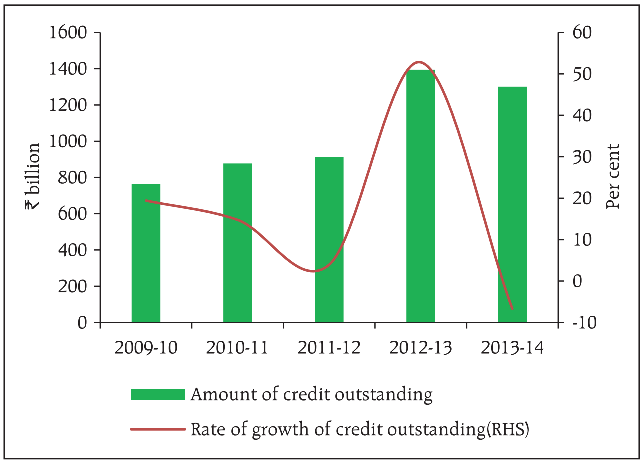
P : Provisional.

Notes: 1. Figures in parentheses are percentages to total NPAs.

2. Due to conversion of figures in ₹ billion the total figures may not add up to exact total.

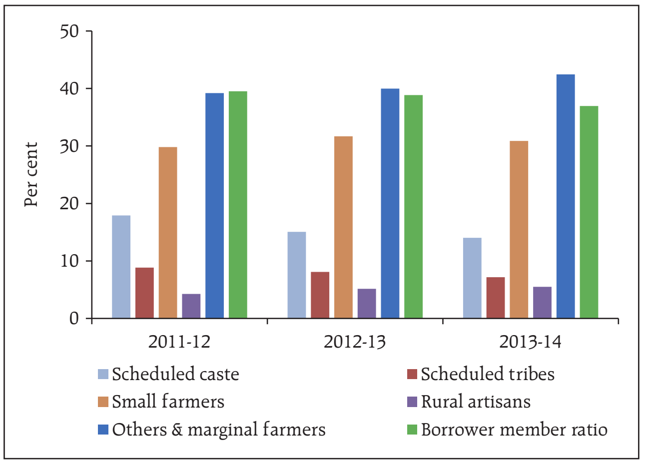
Source: NABARD.

Chart 3.16: Growth in credit outstanding from PACS



Source: NAFSCOB.

Chart 3.17: Group-wise share in membership of PACS and overall borrower member ratio



Source: NAFSCOB.

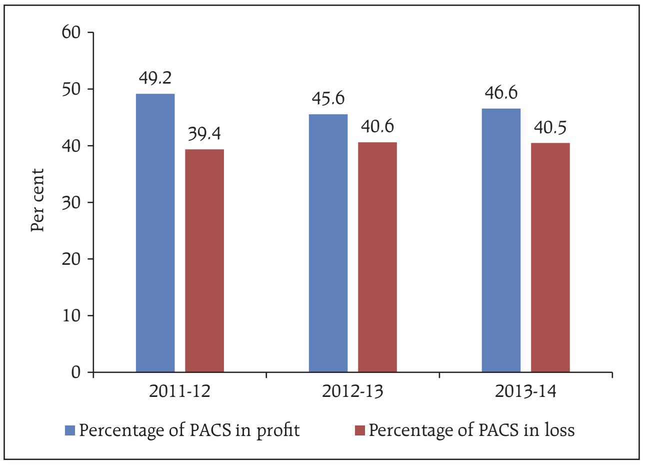
Primary agricultural credit societies (PACS)

3.19 After witnessing a growth in credit outstanding in 2012-13, the rate of credit growth of PACS slowed down in 2013-14 (Chart 3.16).

3.20 The overall borrower to member ratio, which is a useful indicator of access to credit from PACS, continued to fall from 2011-12 levels. Farmers – small and marginal–remain the majority members of the PACS and also have the highest borrower to member ratio among all groups. The borrower-member ratio has declined over the previous three years (Chart 3.17).

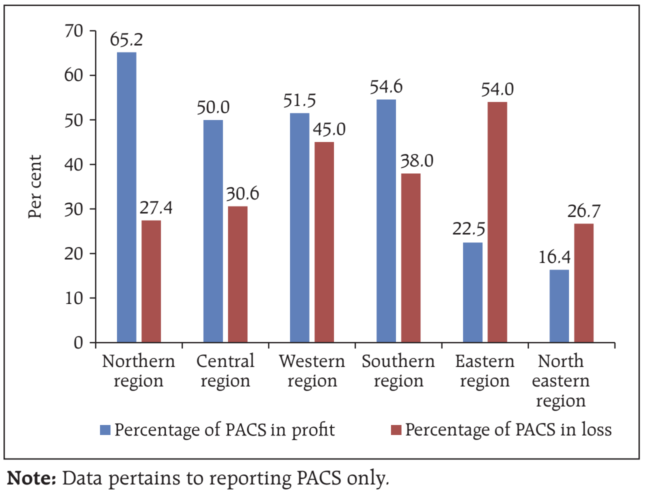
3.21 During 2013-14, the percentage of loss-making PACS remained stable and the percentage of PACS making profits increased marginally to 46.6 per cent (Chart 3.18). The eastern region, followed by the north-eastern region, continue to remain the weakest performing region with the loss-making PACS outnumbering the profit-making PACS (Chart 3.19). The northern and the central region continue to remain the strongest as the number of profit-making PACS are much higher than that of the loss-making PACS.

Chart 3.18: Percentage of PACS in profit and loss – all India



Note: Data pertains to reporting PACS only.
Source: NAFSCOB.

Chart 3.19: Percentage of PACS in profit and loss – regional level as on March 31, 2014



Note: Data pertains to reporting PACS only.
Source: NAFSCOB.

Long term rural credit – state co-operative agriculture and rural development banks (SCARDBs)

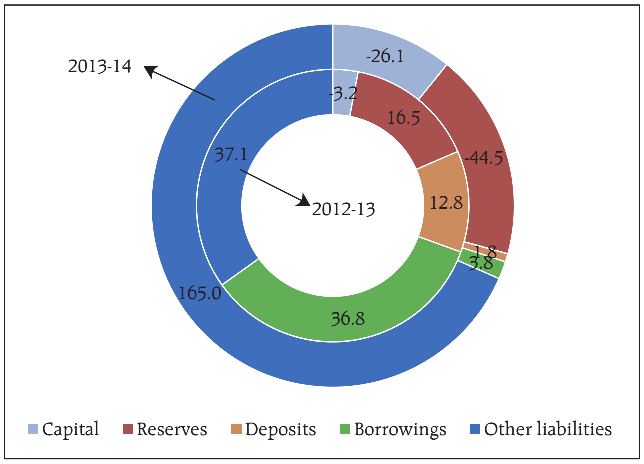
3.22 Balance sheet growth for SCARDBs decelerated from eight per cent in 2012-13 to about one per cent in 2013-14. The growth in reserves and loans and advances has been outweighed by negative growth in 'other liabilities' and 'other assets'. Among expenses, the share of operating expenses has fallen on account of fall in non-wage expenses that has off-set the increase in the wage expenses.

Long term rural credit – primary co-operative agriculture and rural development banks (PCARDBs)

3.23 The balance sheet contraction in 2013-14 as opposed to balance sheet expansion during 2012-13, was broad based on account of fall in 'other liabilities', loans and advances and 'other assets' (Charts 3.20 and 3.21).

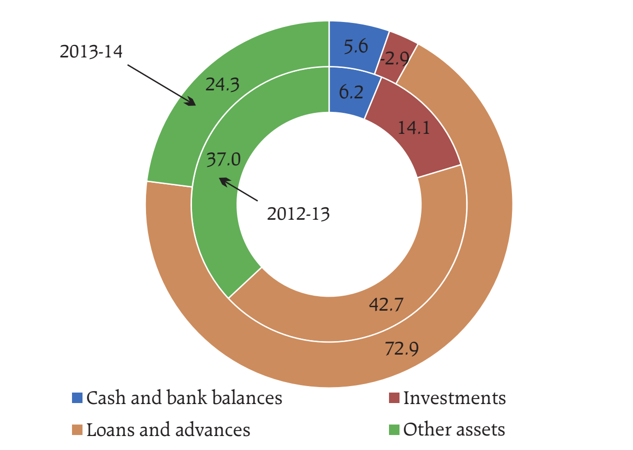
3.24 In 2013-14, income of PCARDBs increased at a higher rate than their expenditure. The NPA ratio of SCARBDs declined marginally while that of PCARDBs remained almost stable in 2013-14. However, the recovery ratio for both SCARDBs and PCARDBs has shown improvement (Table 3.3).

Chart 3.20: Percentage contributions of components to variation in total liabilities - PCARDBs



Source: NABARD.

Chart 3.21: Percentage contributions of components to variation in total assets – PCARDBs



Source: NABARD.

Table 3.3: Soundness indicators of rural co-operative banks (long-term)

(₹ billion)

Item	SCARDBs				PCARDBs			
	As at end-March		Percentage Variation		As at end-March		Percentage Variation	
	2013	2014P	2012-13	2013-14P	2013	2014P	2012-13	2013-14P
1	2	3	4	5	6	7	8	9
A. Total NPAs (i+ii+iii)	67.5	72.6	4.9	7.5	49.8	48.1	7.7	-3.4
i. Sub-standard	28.2 (41.7)	31.0 (42.8)	-4.9	10.3	23.2 (46.6)	22.1 (46.0)	10.6	- 4.7
ii. Doubtful	38.1 (56.4)	41.4 (57.0)	10.5	8.7	26.2 (52.6)	25.6 (53.3)	5.0	-2.2
iii. Loss	1.2 (1.8)	0.1 (0.2)	602.2	-91.7	0.43 (0.9)	0.37 (0.8)	27.7	-14.0
B. NPA-to-Loans Ratio (%)	36	35.6			37.7	37.3		
C. Recovery-to-Demand Ratio (%) (as on 30 June of previous year)	32.3	33.3			41.7	44.0		

P : Provisional.
Notes: 1. Figures in parentheses are percentages to total NPAs.
2. Due to conversion of figures in ₹ billion the total figures may not add up to exact total.
Source: NABARD.

Chapter IV

Non-Banking Financial Institutions

Introduction

4.1 All India Financial Institutions (AIFIs), Non-Banking Financial Companies (NBFCs) and Primary Dealers (PDs) form three important segments of the Non-Banking Financial Institutions (NBFIs) sector in India that are regulated and supervised by the Reserve Bank. AIFIs constitute institutional mechanism entrusted with providing sector-specific long-term financing. NBFCs comprising mostly private sector institutions, provide a variety of financial services including equipment leasing, hire purchase, loans, and investments. Primary dealers (PDs) play a crucial role in fostering both the primary and secondary government securities markets. The operational and financial performance of NBFIs sector is presented in this chapter.

All India financial institutions (AIFIs)

4.2 Currently, the four AIFIs regulated and supervised by the Reserve Bank are Export-Import Bank of India (EXIM Bank), National Bank for Agriculture and Rural Development (NABARD), National Housing Bank (NHB) and Small Industries Development Bank of India (SIDBI). They play a salutary role in the financial markets through credit extension and refinancing operation activities and cater to the long-term financing needs of the industrial sector.

Financial performance

Balance sheet of AIFIs

4.3 The consolidated balance sheet of the AIFIs expanded by 9 per cent during 2014-15 reflecting moderation from double-digit expansion in the previous couple of years (Table 4.1). Loans and advances posted a growth of 11.3 per cent while deposits and borrowings increased by 17 and 9.7 per cent, respectively during 2014-15. AIFIs, during the year, raised short-term funds mainly by floating commercial papers, which are capped under the umbrella limit[1].

Table 4.1: Liabilities and assets of AIFIs

(₹million)

Item	2014	2015	Percentage Variation
Liabilities			
1. Capital	93594 (2.06)	109594 (2.21)	17.1
2. Reserves	520298 (11.45)	566533 (11.44)	8.9
3. Bonds and Debentures	1141801 (25.13)	1059890 (21.41)	-7.2
4. Deposits	1865420 (41.05)	2183064 (44.09)	17.0
5. Borrowings	659456 (14.51)	723318 (14.61)	9.7
6. Other Liabilities	263486 (5.80)	308423 (6.23)	17.0
Total Liabilities or Assets	**4544054**	**4950822**	**9.0**
Assets			
1. Cash and Bank Balances	73364 (1.61)	78213 (1.58)	6.7
2. Investments	243345 (5.36)	256028 (5.17)	5.2
3. Loans and Advances	3911090 (86.07)	4352598 (87.92)	11.3
4. Bills Discounted/ Rediscounted	58385 (1.28)	21067 (0.43)	-64.0
5. Fixed Assets	6253 (0.14)	6586 (0.13)	5.3
6. Other Assets	251617 (5.54)	236330 (4.77)	-6.1

Notes: i. Data pertain to four FIs, *viz.*, EXIM Bank, NABARD, NHB and SIDBI. Data for EXIM Bank, NABARD and SIDBI for end March, while end June for NHB.
ii. Figures in parentheses are percentages to total liabilities or assets.

Source: Audited OSMOS Returns of EXIM Bank, NABARD and SIDBI for end-March 2014 and 2015, respectively.
Audited OSMOS Returns of NHB end June 2014 and 2015, respectively.

[1] AIFIs are allowed to mobilise resources within the overall 'umbrella limit', which is linked to the net owned funds (NOF) of the FI concerned as per its latest audited balance sheet. The umbrella limit is applicable for five instruments *viz.*, term deposits, term money borrowings, certificates of deposits (CDs), commercial papers (CPs) and inter-corporate deposits.

Table 4.2: Financial performance of all India financial institutions

(₹ million)

	2013-14	2014-15	Variation	
			Amount	Percentage
A) Income (a+ b)	**325765**	**350113**	**24348**	**7.5**
a) Interest Income	308887 (94.82)	333694 (95.31)	24807	8.0
b) Non-Interest Income	16878 (5.18)	16419 (4.69)	- 459	- 2.7
B) Expenditure (a+ b)	**236803**	**262646**	**25843**	**10.9**
a) Interest Expenditure	219322 (92.62)	243332 (92.65)	24010	10.9
b) Operating Expenses	17480 (7.38)	19314 (7.35)	1834	10.5
of which Wage Bill	12257	13624	1367	11.1
C) Profit				
Operating Profit (Profit Before Tax)	61330	78339	17009	27.7
Net Profit (Profit After Tax)	41751	52930	11179	26.7

Note: (i) Figures in parentheses are percentages to total income/expenditure.
(ii) Absolute figures rounded-off.
Source: 1. Audited OSMOS Returns of EXIM Bank, NABARD and SIDBI for end March 2014 and 2015, respectively.
2. Audited OSMOS Returns of NHB for end June 2014 and 2015, respectively.

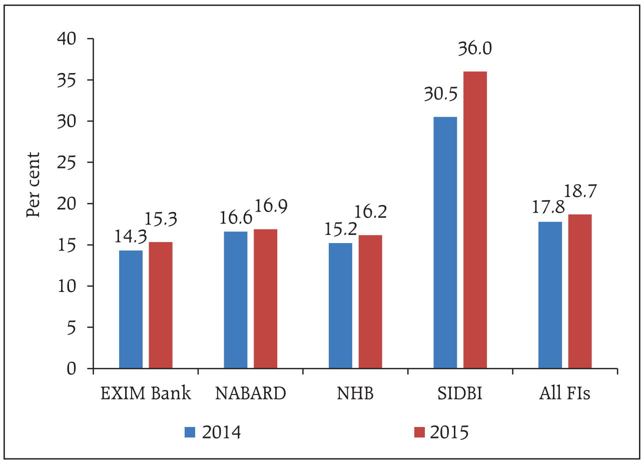
Financial indicators

4.4 AIFIs posted modest growth in income during 2014-15 owing to low growth in interest income and decline in non-interest income even while income from bill discounting/ rediscounting shrunk substantially (Table 4.2). However, AIFIs fared better on the profitability front as both their operating profit and net profit increased significantly during the year.

4.5 AIFIs maintained capital in excess of the stipulated norm and their capital adequacy position comparatively improved during the year (Chart 4.1).

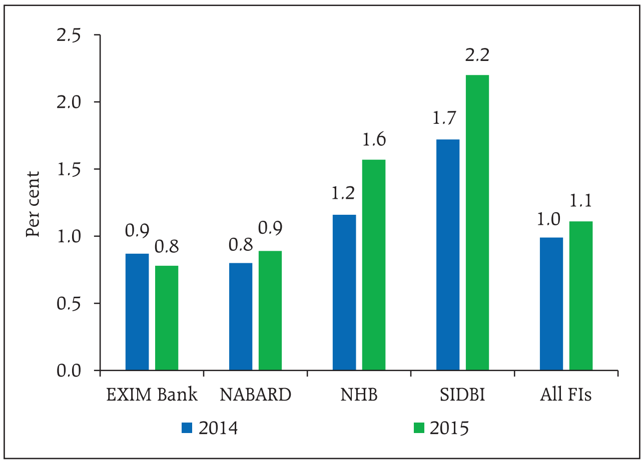
4.6 On the whole, the FIs enjoyed higher returns on their assets during the year barring EXIM Bank whose return on assets was marginally lower (Chart 4.2).

Chart 4.1: Capital to risk (weighted) assets ratio (CRAR) of AIFIs - position as on March 31



Source: RBI supervisory returns.

Chart 4.2: Average return on assets of AIFIs



Note: Data for NHB for end-June.
Source: RBI supervisory returns.

4.7 The asset quality of FIs deteriorated marginally and net non-performing advances (NPAs) as percentage to loans increased from 0.19 per cent in 2013-14 to 0.26 per cent in 2014-15 (Chart 4.3). Nevertheless, the stressed asset position of these four FIs remained comparatively better than that of the commercial banks and other NBFCs.

Non-banking financial companies (NBFCs)

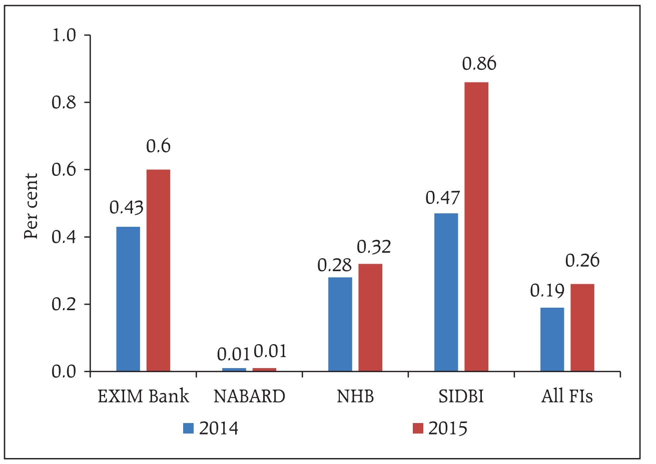
4.8 Based on their liability structure, the NBFCs are classified into two broad categories: (a) Deposit taking NBFCs, and (b) Non-deposit taking NBFCs. As on March 31, 2015, there were 11,842 NBFCs registered with the Reserve Bank; out of which 220 were deposit-taking (NBFCs-D) and 11,622 were non-deposit taking (NBFCs-ND) entities. The two existing residual Non-Banking Finance Companies (RNBCs)[2] are in the process of winding up their businesses.

4.9 The role of NBFC sector in the Indian financial system has become critical in terms of its size, spread and niche areas of operations. Many of the larger NBFCs have grown bigger and become more connected with other financial entities, necessitating periodical review of the regulatory framework for this sector. During the year, the Reserve Bank, with a view to addressing the regulatory gaps, arbitrage and risks associated with NBFCs, initiated a host of measures to strengthen regulation and supervision of NBFCs and harmonise their regulations with those of the banks in a phased manner as also to foster financial stability.

Deposit-taking NBFCs (NBFCs-D)

4.10 The Reserve Bank, as part of deliberate policy, has been discouraging the NBFCs from engaging in deposit mobilisation activities, with a view to protecting depositors' interests as also fostering financial stability. The regulations for the NBFCs-D have been strengthened so that only the sound and well-functioning entities remain in business.

Chart 4.3: Net NPAs/net loans of AIFIs – position as on March 31



Note: Data for NHB for end-June.
Source: RBI supervisory returns.

Financial performance

Balance sheet of deposit-taking NBFCs

4.11 The balance sheet of NBFCs-D expanded by 2.1 per cent during the year (Table 4.3). Loans and advances, which constituted close to three-fourth of

Table 4.3: Consolidated balance sheet of NBFCs-D (as on March 31)

(₹ billion)

Items	2014	2015 P	Percentage Variation
1. Share Capital	33	32	-0.7
2. Reserves and Surplus	274	276	0.9
3. Public Deposits	260	275	5.8
4. Debentures	417	408	-2.1
5. Bank Borrowings	520	551	5.8
6. Borrowings from FIs	16	16	2.6
7. Inter-Corporate Borrowings	1	2	32.7
8. Commercial Paper	93	78	-16.6
9. Borrowings from Government	38	38	-1.0
10. Subordinated Debts	79	78	-2.2
11. Other Borrowings	153	170	11.1
Total Liabilities/Assets	**1885**	**1925**	**2.1**
1. Loans and Advances	1585	1601	1.0
2. Hire Purchase and Lease Assets	46	39	-14.8
3. Investments	58	77	32.8
4. Other Assets	195	205	5.1

P: Provisional.
Note: Absolute figures rounded-off. Percentage variation is based on precise numbers.
Source: Quarterly returns of NBFCs-D.

[2] RNBCs in the process of winding up are: Peerless General Finance and Investment Ltd. and Sahara India Financial Corporation Ltd. (SIFCL).

their assets, rose marginally whereas investment activities of NBFCs-D witnessed a sharp rise during the year. On the liability side, the expansion was mainly in terms of public deposits, and bank borrowings. Borrowings from banks still constituted the largest source of funding for NBFCs-D. Mobilisation of funds through debentures, which constituted the second biggest source of funding, declined during the year. Borrowing through commercial papers also declined sharply during the year.

Financial indicators

4.12 As compared to the previous year, growth in profitability declined during 2014-15 which *inter alia* may be attributed to increased interest payment burden and higher operating expenses (Chart 4.4).

Asset quality of NBFCs-D

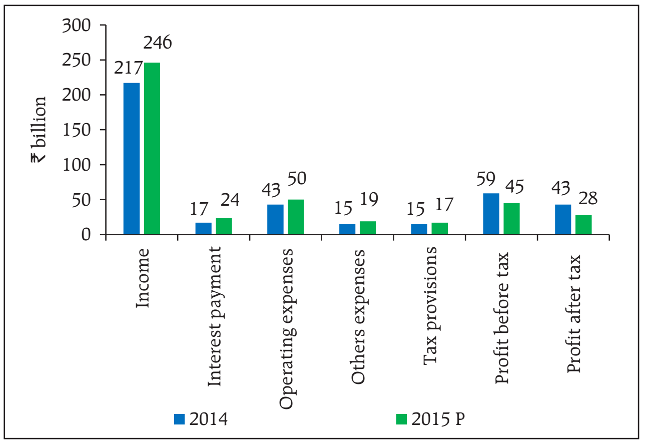
4.13 Asset quality of NBFCs-D deteriorated as both gross and net NPAs increased during 2014-15 (Chart 4.5). Category-wise, deterioration in asset quality was more in respect of the Asset Finance Companies (AFCs) as compared to the Loan Companies (LCs)[3].

Non-deposit taking systemically important NBFCs (NBFCs-ND-SI)

Financial performance

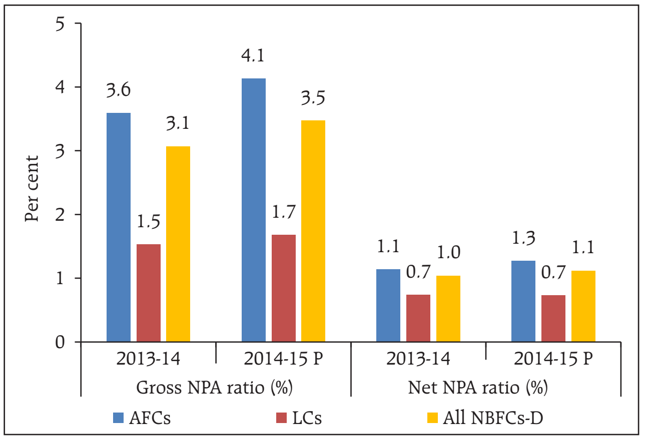
4.14 Non-deposit taking NBFCs with an asset size of ₹1 billion or more were being classified as systemically important NBFCs (NBFCs-ND-SI) till November 2014. Since then, an upward revision in the asset size criterion for classifying NBFCs-ND-SI[4] has been effected, which now stands at ₹5 billion. During 2014-15, the balance sheet of NBFCs-ND-SI expanded significantly on the back of marked growth in disbursement of loans and advances on the asset side and sharp rise in borrowings on the liability side (Table 4.4).

Chart 4.4: Select financial parameters of NBFCs-D – position as on March 31



Source: RBI supervisory returns.

Chart 4.5: Gross NPA and net NPA of NBFCs-D



Source: RBI supervisory returns.

Table 4.4: Consolidated balance sheet of NBFCs-ND-SI-position as on March 31

(₹ billion)

Item	2014	2015 P	Variation (Per cent)
1	2	3	4
1. Share Capital	638	685	7.4
2. Reserves and Surplus	2311	2613	13.1
3. Total Borrowings	8669	10177	17.4
4. Current Liabilities and Provisions	608	691	13.6
Total Liabilities/ Total Assets	**12226**	**14166**	**15.9**
1. Loans and Advances	8273	9555	15.5
2. Hire Purchase Assets	895	985	10.1
3. Investments	1888	2267	20.1
4. Other Assets	1170	1359	16.2

P: Provisional.
Note: Data presented here pertain to 418 entities, which have consistently reported data for end March 2014 and 2015 respectively and accounted for more than 95 per cent of the total assets of the NBFCs-ND-SI sector.
Source: Monthly returns of NBFCs-ND-SI (₹1 billion and above).

[3] Asset finance company (AFC): AFC is a non-bank financial company, carrying on the principal business of financing of physical assets. Investment company. Loan company (LC): LC is non-bank financial company, carrying on the principal business of providing loans or advances for any activity other than its own but does not include AFC.

[4] For the sake of comparability, however, in the present analysis, old definition of NBFCs-ND-SI has been considered.

4.15 Loans and advances extended by NBFCs-ND-SI posted significant growth at 15.5 per cent during 2014-15, in contrast to the slowdown in commercial bank's non-food credit during the same period (Chart 4.6). Strong growth in credit extended by the NBFC - Infrastructure finance companies (IFCs), microfinance companies and loan companies contributed to sturdy growth in the loan portfolio of NBFCs-ND-SI. Among the sectors, infrastructure, medium and large-scale industries, and the transport sectors contributed to strong growth in credit off-take of the NBFCs-ND-SI.

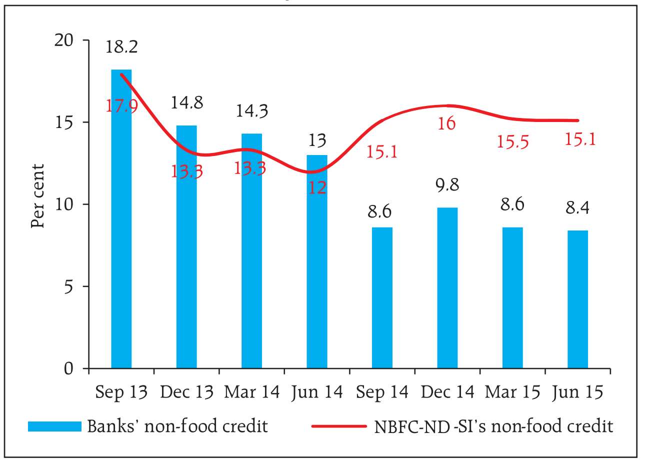
4.16 During 2014-15, NBFCs-ND-SI raised funds mainly through debentures and commercial papers. Borrowings from banks, which earlier constituted the main source of funding, has been progressively reduced. A notable feature is the rising exposure of mutual funds to the financial instruments floated mainly by the NBFC-IFCs, LCs and NBFC-Micro Finance Institutions (NBFC-MFIs).

Financial indicators

4.17 Profitability of the NBFCs-ND-SI improved significantly as at end-March 2015 (Chart 4.7). Net profit as a ratio to total income remained in double-digits and higher than last year's level.

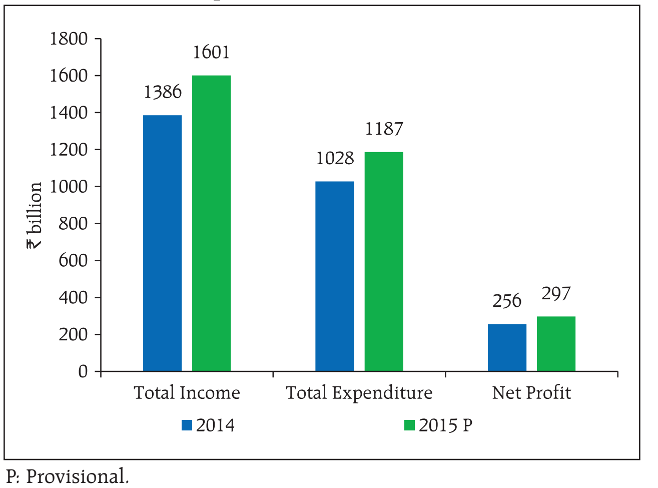
4.18 Nevertheless, asset quality of systemically important NBFCs continued to deteriorate and the NPA ratio rose marginally compared to the previous year (Chart 4.8). Amongst the NBFCs-ND-SI, LCs accounted for the major chunk of NPAs followed by NBFC-IFCs and AFCs as at end-March 2015. The asset quality of the NBFC-MFIs witnessed some improvement *albeit* it still remained at an elevated level.

Chart 4.6: Comparative growth (y-o-y) in credit extended by banks and NBFCs



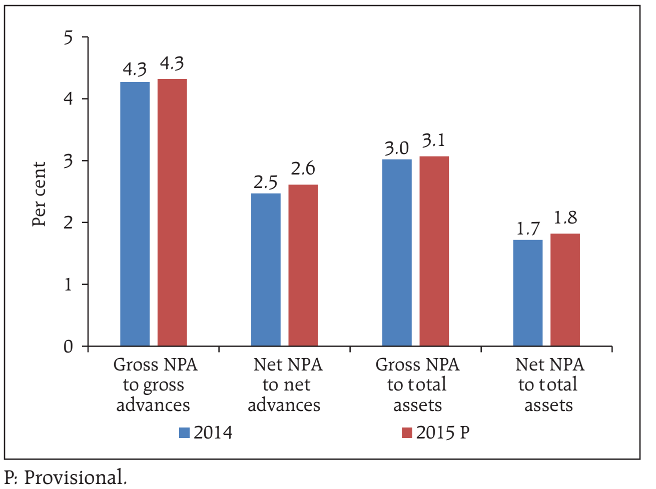
Note: Data pertains to NBFCs-ND-SI with asset size of ₹1 billion and above.
Source: RBI.

Chart 4.7: Financial performance of NBFCs-ND-SI - position as on March 31



P: Provisional.
Source: RBI supervisory returns.

Chart 4.8: NPA ratios of NBFCs-ND-SI – position as on March 31



P: Provisional.
Source: RBI supervisory returns.

4.19 NPAs of the NBFCs-ND-SI sector were primarily concentrated in infrastructure sector, transport operator segment, and medium and large scale industries. However, the systemically important NBFCs remained well-capitalised. The capital adequacy ratio of these entities remained far above the mandated level of 15 per cent.

Primary dealers (PDs)

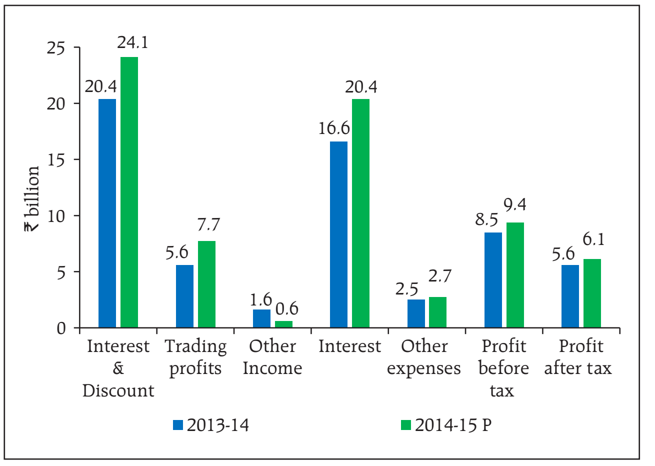
4.20 As on March 31, 2015, 20 Primary Dealers (PDs) were operating in Indian financial market. Of these, 13 were bank-PDs while seven were standalone PDs. All the PDs achieved a higher success ratio (bids accepted to bidding commitment) than the previous year and this remained way above the mandated ratio of 40 per cent during 2014-15. In the auctions of dated securities, the share of the PDs (bids accepted to the securities issued) increased marginally during 2014-15 to 51.8 per cent. Devolvement pressure on the PDs remained comparatively lower during the year. Partial devolvement on the PDs took place on two instances involving ₹52.7 billion during 2014-15 as compared to 12 instances for ₹174.5 billion during 2013-14.

Financial performance of standalone primary dealers (PDs)

4.21 All the seven standalone PDs posted profit during 2014-15. Profitability increased due to softening of yields during the year. (Chart 4.9).

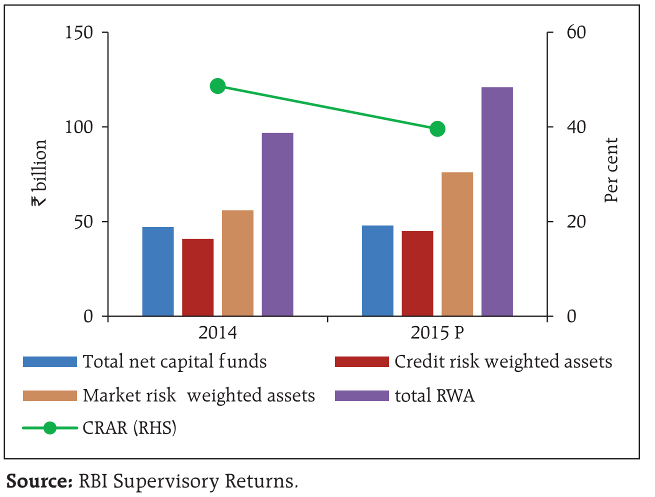
4.22 Standalone PDs held more risk-weighted assets during the year (Chart 4.10). The capital adequacy position of the PDs declined during the year to 39.6 per cent from 48.7 per cent as at end of March 2014. However, their capital adequacy position was well above the regulatory stipulation of 15 per cent. The PDs were able to meet all their primary and secondary market regulatory requirements during the period.

Chart 4.9: Financial performance of standalone PDs



P: Provisional.
Source: RBI supervisory returns.

Chart 4.10: Capital and risk weighted asset position of standalone PDs – position as on March 31



Source: RBI Supervisory Returns.

Overall assessment

4.23 The dynamics of the NBFCs sector is reflective of its evolving role in niche areas of specialised services. Operationally, the sector remained relatively stronger *vis-à-vis* the commercial banks in terms of capital adequacy and profitability. There has also been certain amount of consolidation in the NBFCs space, with some larger-sized NBFCs having grown bigger and becoming well-connected with other financial entities, which has financial stability implications. Asset quality of the entire NBFIs sector also suffered deterioration in recent years.

4.24 In order to address the issue of recovery of bad loans, bigger NBFCs, with an asset size of ₹5 billion and above, have been proposed to be brought under the SARFAESI Act, 2002[5]. With a view to address the regulatory gaps and arbitrage owing to differentiated regulation for the NBFCs *vis-à-vis* commercial banks and risks associated with NBFCs, the Reserve Bank has revised regulatory framework. The revised regulatory framework, put in place in November 2014, aimed at addressing gaps in regulations of NBFCs and harmonising regulation with that of the commercial banks. Some of the important changes *inter alia* include raising of net owned funds (NOF) for the NBFCs to ₹10 million by March 2016 and ₹20 million by March 2017, rating requirement for all unrated deposit-taking AFCs by March 31, 2016 for being eligible for acceptance of public deposits, fixing of threshold of ₹5 billion for all the NBFCs-ND for being considered systemically important, and harmonisation of the asset classification norms for NBFCs-ND-SI and NBFCs-D in line with that of banks, in a phased manner. The entire regulatory framework was revised with a view to transforming over time to an activity-based regulation of NBFCs while ensuring that NBFCs having low risk profiles would be lightly regulated.

4.25 Notwithstanding such interventions, bringing the credit intermediation activities of a number of small entities, organised and unorganised, which operate as shadow banking entities outside regulatory oversight, within the regulatory jurisdiction remains a challenge. The Reserve Bank has been, from time to time, through its outreach, sensitisation programmes and public notices, sensitising public not to fall prey to such entities. To deal with delinquent and unauthorised entities, State Level Coordination Committee (SLCC) was reconstituted in May 2014 with active state level intervention to facilitate regular sharing of market intelligence and effective coordinated timely action.

[5] Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.