Chapter IV

Financial Institutions

Introduction

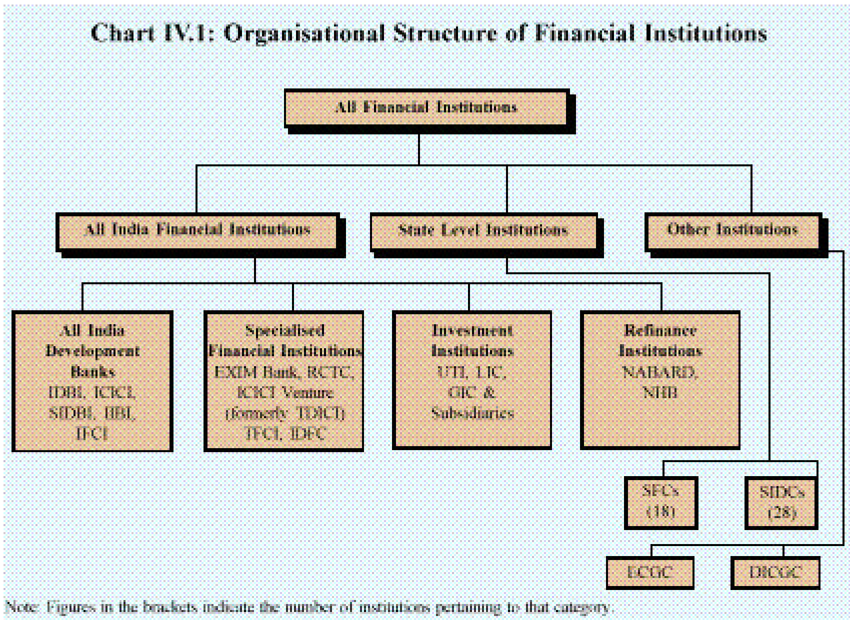
The financial system in India has witnessed a significant transformation in the post-liberalisation era. On the demand side, the drying up of assured sources of long-term funds has led to an intensification of competition for resources for both banks and financial institutions. At the same time, with banks entering the domain of long-term financing and financial institutions making a foray into disbursing short-term loans, the competition for supply of funds has also increased. In spite of these developments, it is being widely recognized that, until the long-term debt market in India witnesses an improvement, in terms of both depth and liquidity, the financial institutions do have a special role in meeting the capital requirements of large as well as medium-sized corporate houses. And importantly enough, given the comparative advantage of the financial institutions in project appraisal and other techniques associated with term financing, and of banks in assessing working capital requirements, it would take some time for each of them to specialize in the skills of the other. Judged thus, the role of financial institutions in the present financial setup and in the immediate future is critical from the viewpoint of financial and real sector development. This chapter reviews mainly the major developments relating to the select all-India financial institutions[1] and mutual funds during 1998-99.

4.2 All-Financial Institutions comprise of All-India Financial Institutions (AIFIs), state level institutions and other institutions. AIFIs, in turn, consist of All-India Development Banks (AIDBs), specialised financial institutions and investment institutions. The state level institutions consist of state financial corporations (SFCs) and state industrial development corporations (SIDCs). Other institutions comprise Export Credit and Guarantee Corporation (ECGC) and Deposit Insurance and Credit Guarantee Corporation (DICGC). The organisational structure of the financial institutions is presented in Chart IV.1.

4.3 Both sanctions and disbursements by AIFIs registered a significant growth during 1998-99 (April-March). While the growth in sanctions was 19.2 per cent, their disbursements grew by 7.6 per cent. The increase in sanctions and disbursements was recorded by both term-lending institutions as well as investment institutions. The increase in disbursements by AIDBs was particularly higher, exceeding the figures for the preceeding three years. It may be mentioned that during 1997-98, sanctions and disbursements by AIFIs showed increases of 44.4 per cent and 28.9 per cent, respectively, over the previous year.

4.4 Some amount of buoyancy in the capital market was evident during 1998-99. New capital raised from the primary market from 51 issues (including 9 mega issues[2]) aggregated Rs.9,365 crore, which was more than double the amount of Rs.4,657 crore mobilised during 1997-98 from 107 issues (including 7 mega issues). During 1998-99, financial institutions raised Rs.4,352 crore which formed 46.5 per cent of the total capital raised from the market.

4.5 The resource mobilisation by the mutual funds industry declined during 1998-99 due primarily to redemption pressures faced by the Unit Trust of India (UTI) in respect of its US-64 scheme. Excluding this scheme, which has a significant share in the total resource mobilisation by the mutual funds segment, the performance of the mutual funds industry was distinctly better as compared with the previous year. The budgetary measures for the mutual funds sector, as announced in the Union Budget 1999-2000, along with the incentives offered to Money Market Mutual Funds (MMMFs) in the Monetary and Credit Policy for the year 1999-2000 have created a favourable environment for greater resource mobilisation by the mutual funds industry in the current year.



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1. Select all-India Financial Institutions comprise IDBI: Industrial Development Bank of India; ICICI; IFCI: Industrial Finance Corporation of India Ltd.; IIBI: Industrial Investment Bank of India Ltd.; SIDBI: Small Industries Development Bank of India; TFCI: Tourism Finance Corporation of India Ltd.; EXIM Bank, IDFC: Infrastructure Development Finance Company Ltd.; NABARD: National Bank for Agriculture and Rural Development; NHB: National Housing Bank.

2. Issue size of Rs. 100 crore and above.

2. Financial Assets of Financial Institutions

4.6 The aggregate financial assets of financial institutions and banks registered a lower growth of 12.2 per cent during 1998-99 as compared with 16.9 per cent in the preceding year [Appendix Table IV.1(A)]. At the disaggregated level, financial assets of financial institutions registered a growth of 8.1 per cent during 1998-99 as against a rise of 18.8 per cent registered during 1997-98. The growth in the financial assets of financial institutions was driven primarily by the significant growth in assets of all-India term-lending institutions (16.0 per cent in 1998-99 on top of a rise of 22.5 per cent in 1997-98) [Appendix Table IV.1(B)]. Financial assets of investment institutions, on the other hand, recorded a low growth of 1.9 per cent in 1998-99 as against a growth of 17.3 per cent during 1997-98. The financial assets of banks, on the other hand, witnessed a significant growth of 14.7 per cent, which was, however, lower than 15.9 per cent registered during the preceding year. As a result, the share of financial institutions in aggregate financial assets witnessed a decline from 37.2 per cent in 1997-98 to 35.8 per cent in 1998-99

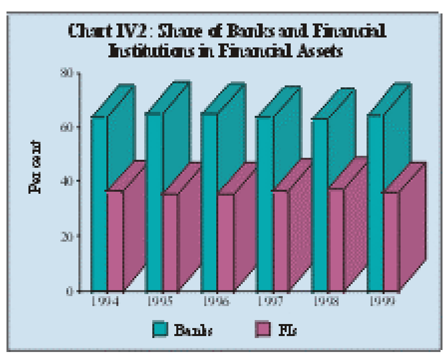
(Chart IV.2).

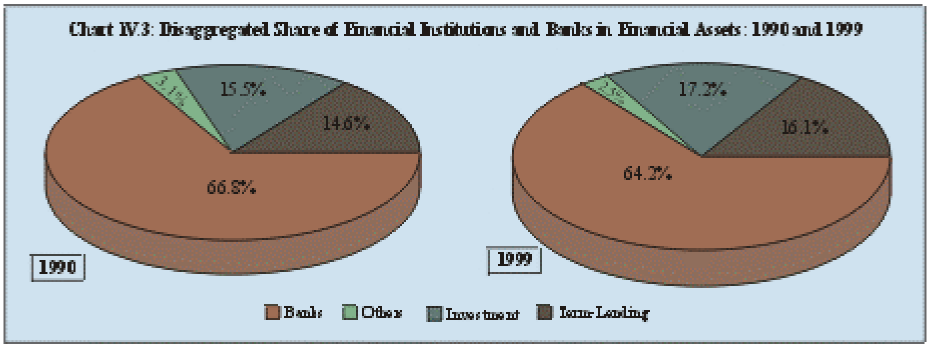
4.7 It is interesting to note that, at the disaggregated level, while the share of term-lending institutions in total assets has witnessed an increase from 14.6 per cent in 1990 to 16.0 per cent in 1999, that of investment institutions has increased from 15.5 per cent to 17.2 per cent over the same period. The share of other institutions (comprising state-level institutions, ECGC and DICGC) has posted a marginal decline over the same period (Chart IV.3). The share of commercial banks too has declined from 66.8 per cent to 64.2 per cent during this period.

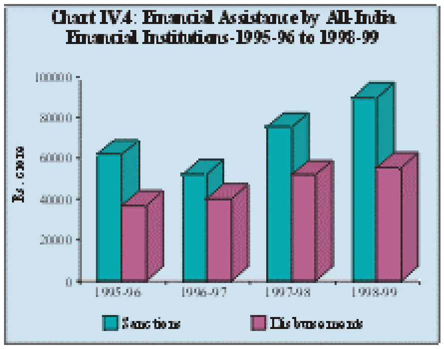
3. Term Lending and Investment Institutions

Financial Assistance

4.8 During the financial year 1998-99 (April-March), financial assistance (net of inter-institutional flows) sanctioned by the AIFIs amounted to Rs.90,040 crore, showing a noticeable increase of 19.2 per cent on top of a sharp increase of 44.4 per cent in the previous year. During the same period, disbursements amounted to Rs.55,854 crore, reflecting an increase of 7.6 per cent as compared with that of 28.9 per cent in 1997-98 (Appendix Table IV.2 and Chart IV.4). The deceleration in sanctions and disbursements by the AIFIs could be attributed to the slowdown of the economy in general and that of the industrial sector, in particular. During 1998-99, while sanctions for infrastructure projects by the AIDBs increased by 32.2 per cent, their disbursements declined by 5.6 per cent. It may be recalled that during 1997-98, both sanctions and disbursements for infrastructure projects increased sharply by 204.1 per cent and 111.7 per cent, respectively, over the previous year, reflecting the considerable amount of funds that have already been earmarked/expended for such projects. In contrast, incremental credit disbursed by commercial banks to infrastructure amounted to Rs.2,782 crore, accounting for 15.4 per cent of the total incremental credit disbursed to industry.







4.9 During 1998-99, financial assistance sanctioned and disbursed by the AIDBs, *viz*., IDBI, ICICI, IFCI, SIDBI and IIBI stood at Rs.79,513 crore and Rs.46,352 crore, respectively. These figures were higher by 20.6 per cent and 7.7 per cent, respectively, over the previous year (Appendix Table IV.2). During the same period, sanctions and disbursements by investment institutions (UTI, LIC and GIC and its subsidiaries) registered increases of 11.1 per cent and 7.8 per cent, respectively. In the case of specialised financial institutions, *viz*., RCTC, ICICI Venture and TFCI, both sanctions and disbursements declined by 33.7 per cent (from Rs. 352 crore to Rs.233 crore) and 33.3 per cent (from Rs.225 crore to Rs.150 crore), respectively

4.10 While financial assistance sanctioned by AIDBs showed moderate to sizeable increases, their disbursements failed to keep pace with the growth in sanctions. In particular, during 1998 99, disbursements by IDBI and IFCI showed noticeable declines of 5.1 per cent and 15.9 per cent, respectively, over the previous year. The share of IDBI and IFCI in financial assistance disbursed has come down during the period 1996 97 to 1998-99, while that of ICICI has shown marked increase from 40.2 per cent in 1996-97 to 50.1 per cent in 1998-99. However, the disbursements of these three institutions have remained steady at around 70 per cent over the last three years (Table IV.1).

Table IV.1: Disbursements of Select Financial Institutions: 1996-97 to 1998-99

(Amount in Rs. crores)

Year / Institution	1996-97		1997-98		1998-99		Percentage variation	
	Amount	Per cent Share	Amount	Per cent Share	Amount	Per cent Share	Col. (4) over (2)	Col. (6) over (4)
1	2	3	4	5	6	7	8	9
Disbursements								

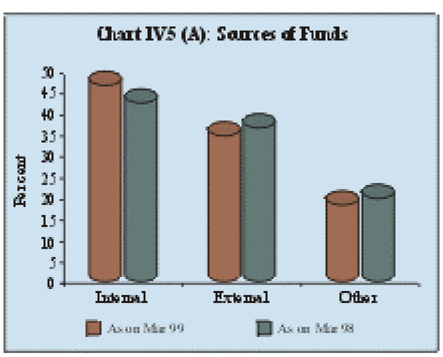
IDBI	11,467.7	41.2	15,170.0	41.4	14,403.4	37.5	32.3	-5.1
ICICI	11,180.9	40.2	15,806.9	43.2	19,225.1	50.1	41.4	21.6
IFCI	5,157.1	18.6	5,650.4	15.4	4,749.5	12.4	9.6	-15.9
A. Total	27,805.7	100.0	36,627.3	100.0	38,378.0	100.0	31.7	4.8
B. All-India FIs	40,291.4		51,918.9		55,854.3		28.9	7.6
C. A as per cent of B	69.0		70.5		68.7			

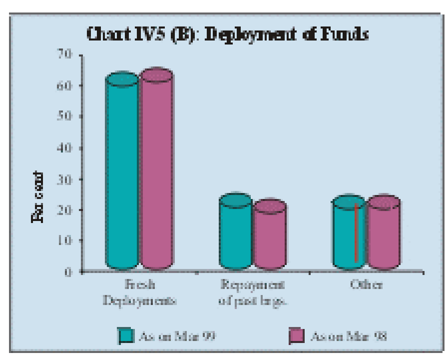
Sources and Uses of Funds of Financial Institutions

4.11 Sources of funds of financial institutions can be classified under two broad heads *viz*. internal and external. Of this, internal sources of funds comprise mainly the increase in capital, sale/redemption of past investments, repayments of past borrowings, dividends and interest on investments. External sources of funds, on the other hand, arise primarily from fresh market borrowings (both rupee and foreign currency).

4.12 During 1998-99, internal sources of funds of select financial institutions accounted for 37.6 per cent (37.4 per cent in 1997-98 and 42.2 per cent in 1996-97) of total funds, while the share of external sources amounted to 42.6 per cent (41.9 per cent in 1997-98 and 44.5 per cent in 1996-97). During the same period, the share of 'other sources’ of funds has decreased marginally from 20.7 per cent to 19.8 per cent. Over the two years 1997-98 to 1998-99, the share of internal sources has increased from 42.7 per cent to 46.4 per cent. During the same period, the relative share of external sources of funds has decreased from 37.2 per cent to 35.2 per cent (Appendix Table IV.3) (Chart IV.5(A)).

4.13 Uses of funds falls under three broad heads: (a) fresh disbursements; (b) repayment of past borrowings; and (c) others. Fresh deployment consists of new loans and advances, investments etc., whereas repayment of past borrowings include redemption of bonds/debentures issued in the past and repayment of Rupee and foreign currency loans. Over the period March 1998 to March 1999, the share of fresh deployment has moved down marginally from 60.8 per cent to 60.2 per cent. During the same period, the relative share of repayments of past borrowings has increased from 18.7 per cent to 20.4 per cent and that of 'other deployment’ has declined from 20.6 per cent to 19.4 per cent (Appendix Table IV.3)(Chart IV.5(B)); of which, the interest payments component has increased from 12.0 per cent to 12.8 per cent.





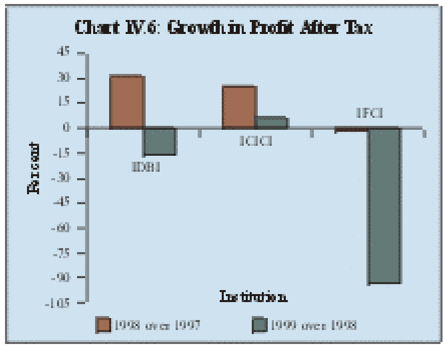
Income and Expenditure of Major Financial Institutions

4.14 The total income in respect of the three major financial institutions (IDBI, ICICI and IFCI) witnessed a significant increase over the period 1997-98 to 1998-99, with ICICI maintaining the highest rate of growth in total income in both the years. While IDBI witnessed a lower increase in 'income from operations' during the same period, the increase in the case of IFCI was significant. On the expenditure side, all the three institutions have witnessed a sharp increase in interest expenses over the period under consideration, driven primarily by the high cost of servicing past borrowings. The interest expense of IFCI, in particular, more than doubled from 10.2 per cent during 1997-98 to 21.1 per cent during 1998-99. This aspect has had the effect of placing an upward pressure on expenditures, so that, profit after tax (PAT) for IDBI and IFCI witnessed a significant decline over the period 1997-98 to 1998-99 (Table IV.2) (Chart IV.6).

Prime Lending Rates of FIs

4.15 The lending rate structure since April 1998 of select all-India financial institutions viz., IDBI, ICICI and IFCI has been set out in Table IV.3. As is observed from the Table, the lending rates have been influenced primarily by the cost of funds of the respective institutions as well as the general movement in interest rates. The major financial institutions had introduced a two-tier PLR for medium and long-term loans in mid-1997. ICICI had added one more tier, the short-term PLR with variable maturity of interest rate to be reset annually in July 1997. In April 1998, with the reduction in the Bank Rate and easing of liquidity conditions, the financial institutions had effected a downward revision in their PLRs. The Short-term Prime Lending Rate (STPLR) of ICICI, which was 14.5 per cent in January 1998, was reduced to 14.0 per cent in April 1998. The Long-term Prime Lending Rate (LTPLR) and Medium-term Prime Lending Rate (MTPLR), which were 14.0 per cent and 14.25 per cent, respectively, were also reduced to an uniform level of 13.5 per cent. In the case of IDBI, the STPLR for working capital loans of less than three years was reduced from the range of 13.5-17.0 per cent in January 1998 to 13.0-16.5 per cent in April 1998. The LTPLR was also reduced from the range of 14.5-18.0 per cent to 14.0-17.5 per cent. The STPLR for working capital loans with a maturity upto three years for IFCI was also pared down from the range of 13.5-17.0 per cent in January 1998 to 13.0-16.5 per cent, while the LTPLR, which was in the range of 14.5-18.0 per cent was reduced to 14.0-17.5 per cent in April 1998. Owing to increase in the cost of funds, IDBI subsequently increased its LTPLR from 14.0 per cent to 14.35 per cent in July 1998. However, in March 1999, in response to the easy money conditions and declining interest rates, financial institutions reduced their STPLR and MTPLR. IDBI brought down its MTPLR and STPLR by 50 basis points each from 14.0 per cent to 13.5 per cent and from 13.0 per cent to 12.5 per cent. ICICI also reduced its MTPLR from 13.5 per cent to 13.0 per cent and STPLR from 14.0 per cent to 13.0 per cent, whereas IFCI reduced its STPLR from 13.0 per cent to 12.5 per cent.

Chart IV.6: Growth in Profit After Tax



Resource Raised by Select Financial Institutions

Issue of Bonds/Debentures by FIs

4.16 A level-playing field in the matter of resource mobilisation by the select all-India financial institutions was permitted. In particular, these institutions were allowed to issue bonds with maturity period of 5 years and above without prior approval, provided they had registered such issuance procedure with the Reserve Bank. Certain pre-conditions however, had to be satisfied, *viz*, (a) the bonds were to be *Vanila* instruments (i.e., without options *etc*.,); and (b) the interest rate on such bonds, at the time of their issuance, should not exceed 200 basis points over the yield on Government of India securities of equal residual maturity.

Funds Raised by Major Financial Institutions

4.17 Given the gradual phasing out of traditional sources of funds in the form of National Industrial Credit (Long-term Operations)[NIC(LTO)], financial institutions have been resorting to rupee and foreign currency borrowings for fulfilling major portion of their resource requirements. In the case of rupee borrowings, financial institutions are raising funds through the issue of various types of innovatively structured bonds and debentures both by way of public issues and private placements, dovetailed to meet the requirements of investors. During the year 1998-99 (April–March), the three major all-India financial institutions (IDBI, ICICI and IFCI) mobilised Rs.24,094.5 crore by way of bonds and debentures which was marginally lower by 1 per cent than Rs.24,344.5 crore raised during the same period of the previous year (Table IV.4). It is observed from the table that public issues registered a substantial increase of 50.1 per cent, whereas the growth in funds raised by way of private placements witnessed a deceleration of 11.2 per cent from Rs.20,295.6 crore in 1997-98 to Rs.18,018.5 crore in 1998-99.

Table IV.2: Income and Expenditure of Select Financial Institutions: 1996-97 to 1998-99

(Amount in Rs. crore)

Year / Institution		1996-97	1997-98	1998-99	Percentage variation	
					Col. (3) over(2)	Col. (4) over(3)
1		2	3	4	5	6
1.	**Income from Operations**					
	IDBI	5,578.4	6,531.0	7,052.5	17.1	8.0
	ICICI	4,439.7	5,689.0	7,278.1	28.1	27.9
	IFCI	2,568.4	2,585.1	2,801.9	0.7	8.4
2.	**Other Income**					
	IDBI	385.4	400.6	411.9	3.9	2.8
	ICICI	31.4	47.2	45.1	50.6	-4.6
	IFCI	13.9	16.6	86.6	19.3	422.2
3.	**Total Income (1+2)**					
	IDBI	5,963.8	6,931.6	7,464.4	16.2	7.7
	ICICI	4,471.0	5,736.3	7,323.2	28.3	27.7

IFCI	2,582.4	2,601.7	2,888.5	0.7	11.0
4. Interest Expenditure					
IDBI	4,153.3	4,733.5	5,724.6	14.0	20.9
ICICI	3,103.1	3,932.1	5,184.1	26.7	31.8
IFCI	1,775.6	1,956.5	2,368.4	10.2	21.1
5. Other Expenditure					
IDBI	328.2	397.8	439.1	21.2	10.4
ICICI*	511.5	780.9	1,043.2	52.7	33.6
IFCI*	344.2	190.7 #	496.6 ##	-44.6	160.4
6. Profit Before Tax (3-4-5)					
IDBI	1,482.3	1,800.3	1,300.7	21.5	-27.8
ICICI	856.5	1,023.3	1,095.8	19.5	7.1
IFCI	462.6	454.5	23.5	-1.8	-94.8
7. Tax Provisions					
IDBI	401.0	299.0	75.0	-	-
ICICI	104.3	82.0	95.0	-	-
IFCI	84.0	84.0	0.0	-	-
8. Profit After Tax (6-7)					
IDBI	1,144.2 **	1,501.3	1,258.9	31.2	-16.1
ICICI	752.2	941.3	1,000.8	25.1	6.3
IFCI	378.6	370.5	23.5	-2.1	-93.7

Notes : 1. ***** Including provisions for bad and doubtful debts.

** Includes excess income tax provision of earlier years written back to the extent of Rs.25 crore and lease equalization adjustment of Rs. 38 crore.

Includes provision for depreciation, interest tax and bad and doubtful investment less appropriations from Special Reserve u/s 36(1)(viii) of Income Tax Act, 1961.

Includes provision for depreciation, interest tax and bad and doubtful investments.

2. The financial statements for the year ended March 31, 1999 for ICICI Ltd. reflect the merger of Anagram Finance Ltd. with ICICI Ltd., effective from April 01, 1999.

Source: Published Balance Sheet of the respective Financial Institutions.

Table IV.3: Lending Rate Structure of Select Financial Institutions

(Per cent per annum)

Institution	IDBI	ICICI #	IFCI
1	2	3	4
April 1998			
LTPLR	14.0-17.5	13.5	14.0-17.5
MTPLR	14.0-17.5	13.5	-
STPLR	13.0-16.5	14.0	13.0-16.5
July 1998			
LTPLR	14.35-17.35	13.5	14.0-17.5
MTPLR	14.0-17.5	13.5	-
STPLR	13.0-16.5	14.0	13.0-16.5
January 1999			

LTPLR	14.7-17.7	13.5	14.0-17.5
MTPLR	14.0-17.5	13.5	-
STPLR	13.0-16.5	14.0	13.0-16.5
March 1999			
LTPLR	14.7-17.7	13.5	13.5-17.0
MTPLR	13.5-16.5	13.0	-
STPLR	12.5-15.5	13.0	12.5-15.5

Notes:
1. # No band is specified, however, they are also subject to a maximum margin of 3 per cent set by RBI.
2. Interest rates indicated are the range/band which includes Prime Lending Rates also.
3. LTPLR: Long-term Prime Lending Rate (for term-loans exceeding 3 years) STPLR: Short-term Prime Lending Rate (for term-loans below 3 years). In case of ICICI, the STPLR is of variable maturity with interest rates reset annually. MTPLR: Medium-term Prime Lending Rate (applicable for ICICI for loans with maturity exceeding 1 year).
4. All interest rates are exclusive of interest tax unless stated otherwise.

Policy Developments Relating to Select Financial Institutions

Provision on Standard Assets

4.18 The Report of the Committee on Banking Sector Reforms (Chairman: Shri. M. Narasimham) had recommended that financial entities should make a general provision of 1 per cent on standard assets. Accordingly, in the Mid-Term Review of Monetary and Credit Policy for1998-99, it was announced that financial institutions should make a general provision of a minimum of 0.25 per cent on standard assets for the year ending March 31, 2000.

Table IV.4: Funds Raised by Major Financial Institutions: 1997-98 and 1998-99

(Rs. crore)

Institution	IDBI		ICICI		IFCI		Total	
1	2	3	4	5	6	7	8	9
	1997-98	**1998-99**	**1997-98**	**1998-99**	**1997-98**	**1998-99**	**1997-98**	**1998-99**
Public Issue of Bonds/ Debentures	984.9	4,342.0	3,064.0	1,734.0	0.0	0.0	4,048.9	6,076.0
Private Placement of Bonds/ Debentures	7,186.5	8,341.0	9,742.0	6,132.0	3,367.1	3,545.5	20,295.6	18,018.5
Total	**8,171.4**	**12,683.0**	**12,806.0**	**7,866.0**	**3,367.1**	**3,545.5**	**24,344.5**	**24,094.5**

Asset Classification and Provisioning Norm in respect of Government Guaranteed Advances

4.19 Presently, Government guaranteed advances in respect of which guarantee has been invoked are treated as standard assets for the purpose of provisioning. However, in order to strengthen the efforts of financial institutions to recover such advances, which are invoked, but not honoured by the State Governments and to discourage the practice of delay of honouring guarantees by the State Governments, necessary changes have been introduced in the provisioning requirements. Against the advances guaranteed by State Governments which stood invoked as on March 31, 2000 to March 31, 2003, it was decided that over the next four years, a minimum of 25 per cent should be provided each year.

Risk Weight on Government and Other Approved Securities

4.20 At present, investments in Government and other approved securities carry zero risk weight for purpose of CRAR. In order to provide for the market risk impacting on the prices of such securities, a risk weight of 2.5 per cent has been assigned to the investments in Government and other approved securities effective March 31, 2000.

4.21 Similarly, from the financial year 2000-2001, a risk weight of 20 per cent has been assigned on investments in Government guaranteed securities that do not form part of the approved market borrowing programme. The financial institutions will be permitted to account for the risk weight on the outstanding stock of such securities in their portfolio as on March 31, 2000 in two phases of 10 per cent each, in 2001-2002 and 2002-2003, respectively.

4.22 With a view to correcting the present anomaly of differential risk weights being assigned to the bonds/debentures issued by different public financial institutions (PFIs), effective December 3, 1998, it has been advised that the investments in bonds and debentures issued by the PFIs (listed by the Reserve Bank) would be assigned a uniform risk weight of 20 per cent.

Risk Weight for Government Guaranteed Advances

4.23 At present, loans and advances guaranteed by Government of India and State Governments carry zero risk weight. In cases in which the guarantee has been invoked and the concerned State Government has remained in default as on March 31, 2000, a risk weight of 20 per cent on such advances should be assigned. In the case of the State Governments which continue to remain in default in respect of such invoked guarantees even after March 31, 2001, a risk weight of 100 per cent should be assigned. Table IV.5 provides the risk-weights on the assets.

Reduction in the time-frame for Sub-standard Assets

4.24 With a view to moving closer to the international best practice in regard to the provisioning norms, effective March 31, 2001, the time frame to recognize an asset as doubtful has been reduced from 24 months to 18 months. Financial institutions have however, been permitted to achieve these norms for additional provisioning in phases. In other words, financial institutions have been directed to provide not less than 50 per cent on the assets that have become doubtful on account of the new norms by March 31, 2001; the balance 50 per cent of the provisions, in addition to the provisions needed, should be made by March 31, 2002.

Limits on Cross-Holding in Sub-ordinated Debt Instruments

4.25 It was observed that the banks and financial institutions have substantial cross-holdings in the sub-ordinated debt issued by each other, which effectively does not always result in an increase in the total financial assets in the system. In view of this, the Monetary and Credit Policy for the year 1999-2000 announced that the aggregate investment by a financial institution in such tier II bonds (issued by the banks and FIs) shall be permitted upto a ceiling of 10 per cent of the total capital of the investing financial institution. The total capital for this purpose will be the same as that reckoned for the purpose of capital adequacy.

4.26 In addition to the above, the financial institutions have also been advised to put in place a comprehensive risk management mechanism to prevent and minimize the emergence of fresh NPAs, to ensure an effective loan review mechanism for larger loans soon after sanctions are made, and to closely and continuously monitor the accounts and initiate corrective actions, if need be, if any weakness develops in the accounts. Financial Institutions have also been advised to adhere strictly to the prudential norms and avoid the practice of 'evergreening'.

Soundness and Capital Adequacy of Financial Institutions

4.27 It is widely recognized that the quality of assets of financial institutions would be a critical factor for maintaining as well as improving the existing levels of profitability. Accordingly, financial institutions have been making a pro-active effort to keep their NPAs at manageable levels. However, the lower contribution of the industrial sector to GDP during 1998-99 coupled with the process of restructuring and repositioning as witnessed in several industries has adversely affected the asset quality of several institutions as evidenced by the fact that the net NPAs of most of the financial institutions have shown an increasing trend during 1998-99 (Table IV.6).

4.28 In line with international best practice, the minimum CRAR of 8 per cent has been enhanced to 9 per cent of their total risk-weighted assets effective March 31, 2000. Judged from this perspective, the CRAR of all financial institutions is well above the 9 per cent benchmark as brought out in Table IV.7.

4.29 Non-cumulative preference shares permissible under the Companies Act issued for a maximum period of 20 years have been assigned the 'grant equivalent' status and would form part of tier I capital for the purpose of arriving at the CRAR subject to the following conditions:

Table IV.5: Prudential Norms for Financial Institutions

Nature of Asset	Risk weight		Effective from the year ending
	Existing	Revised	
Government Securities.	0	2.5	March 31, 2000
Other Approved Securities Guaranteed by Central/ State Government.	0	2.5	March 31, 2000
Other securities where payment of interest and repayment of principal are guaranteed by Central Government.	0	2.5	March 31, 2000
Other Securities where payment of interest and repayment of principal are guaranteed by State			

Governments (in case of default in interest/ principal by State Government, FIs should assign100 per cent risk weight on investments in securities of the concerned State Government.	0	2.5	March 31, 2000
Government guaranteed Securities of Govt. undertakings which do not form part of the approved market borrowings programme.	0	20	To account for the risk weight on the outstanding securities in the portfolio as on March 31, 2000 in two phases of 10 per cent each in 2001-02 and 2002-03.
Other approved Securities where payment of interest and repayment of principal are not guaranteed by Central/State Government.	0	20	With immediate effect
Claims on Banks and Public Financial Institutions(PFIs)[3.]	20	20	With immediate effect
Bonds issued by other banks/PFIs.	100	20	With immediate effect
Securities which are guaranteed by banks or PFIs as to payment of interest and repayment of principal.	100	20	With immediate effect
Sub-ordinated debt in the form of tier-II bonds issued by other banks/FIs.	100	100	With immediate effect
All Other Investments.	100	100	With immediate effect

(a) The concerned financial institution will create a corpus to be invested in the Government securities having maturity coinciding with the maturity of such preference shares to eliminate the reinvestment risk. The corpus should be of such minimum amount, the investment of which, on maturity, would become equal to or be above the amount of such preference shares.

(b) The amount in the corpus has to be valued every year in order to provide for changes in the tax rates. Shortfall in the corpus, if any, has to be provided for, from the reserves. Similar transfers are to be effected every year for the changes in the interest rate differential i.e., difference between the yield on Government of India securities at the time of the initiation of the corpus and the yield at which the interest proceeds are reinvested each year.

(c) The amount of corpus so created should be maintained separately and would not be available to the financial institution for its normal operations.

(d) The amount and purpose of the corpus should be disclosed separately in the balance sheet, prospectus for raising resources, etc. The amount of preference shares less the amount of corpus created as above will only be considered as tier I capital.

Table IV.6: Asset Classification of Select Financial Institutions: 1998 and 1999

(Amount in Rs. crore)

Institution	Standard		Sub-standard		Doubtful		Loss		Total		Net NPA# / Total loans (per cent)	
	1998	1999	1998	1999	1998	1999	1998	1999	1998	1999	1998	1999
1	2	3	4	5	6	7	8	9	10	11	12	13
IDBI	45,181	47,375	3,516	4,185	1,585	2,305	-	-	50,282	53,865	10.1	12.0
ICICI	34,167	42,695	1,813	2,174	1,021	1,449	-	-	37,001	46,318	7.7	7.8
IFCI	16,890	16,122	1,416	2,644	1,247	1,587	-	-	19,553	20,353	13.6	20.8
SIDBI	12,572	13,901	223	138	40	55	-	-	12,835	14,094	2.0	1.4
NABARD	22,335	25,053	308	1,072	23	22	-	-	22,666	26,147	1.5	4.2
NHB	2,469	3,093	-	-	-	-	-	-	2,469	3,093	Nil	Nil
IIBI	1,898	2,942	156	268	131	212	-	-	2,186	3,422	13.1	14.0

Notes: 1. # Net of provisioning and write-offs.
2. The figures presented in the statement are subject to verification by the RBI.

Source: Figures as reported by respective Financial Institutions.

Table IV.7: Capital Adequacy Ratio of Select Financial Institutions: 1997 to 1999

(Per cent)

Institution		As on March 31,		
		1997	1998	1999
	1	2	3	4
1.	IDBI	14.7	13.7	12.7
2.	ICICI	13.3	13.0	12.5
3.	IFCI	10.0	11.6	8.4
4.	SIDBI	25.7	30.3	26.9
5.	IIBI	10.6 *	12.8	11.7
6.	EXIM Bank	31.5	30.5	23.6
7.	NABARD	40.4	52.5	53.3
8.	IDFC	-	-	235.5
9.	NHB**	-	16.7	17.3

Notes: 1. * As on March 26, 1997.
** Relate to general fund.
2. Capital as per cent of risk weighted assets.

Source: Figures as reported by respective Financial Institutions.

Exposure Norms

4.30 In case of exposure norms, for purposes of definition, investments made by banks in bonds and debentures of corporates which are guaranteed by a PFI will be treated as banks' exposure on the PFI and not on the corporates. Guarantees issued by the PFI to the bonds/ debentures of the corporates will be treated as an exposure by the PFI to the corporates to the extent of 50 per cent being a non-fund facility, whereas the exposure to banks on the PFI will be 100 per cent. Before the guarantee, the PFI should take into account the overall exposure of the guaranteed unit to the financial system.

Lending to NBFCs

4.31 In order to meet the credit needs of the transport sector, it has been advised that the financial institution may rediscount bills discounted by NBFCs arising from the sale of commercial vehicles, including light commercial vehicles (LCVs), subject to normal lending safeguards.

Recovery of Debts Due to Financial Institutions

4.32 A Working Group was set up by the Reserve Bank in May 1998 to review the functioning of Debt Recovery Tribunals (DRTs) and suggest measures for their effective functioning (Chairman: Shri. N.V. Deshpande). The Group submitted its recommendations to the Reserve Bank in August 1998. Based on the recommendations of the Group, financial institutions were informed that:

(a) it should be their responsibility and obligation to ensure that notices to the defendants are properly served and the matter is not prolonged merely because summons are not serviced by the parties.

(b) the management of the institutions should actively interact with the Unions/Federations for expeditious recovery proceedings.

Y2K Compliance

4.33 In order to pro-actively address the emerging concerns of Year 2000 (Y2K), a group has been set up in the Reserve Bank to monitor the progress made in the implementation of the strategies adopted by the FIs for tackling the millenium bug. A Monograph "Year 2000 Preparations in the Banking and Financial Sector" was brought out by the Reserve Bank in December 1998. This was followed by an update on Y2K compliance in the banking and financial sector as of end-May 1999. It is an effort to build confidence in the minds of the agents involved in different economic activities. These publications give an account of the initiatives taken by the Reserve Bank and the financial sector in achieving Y2K compliance. Financial institutions have been advised to prepare contingency plans and keep up-to-date printed hard copies of books of accounts and customer accounts as part of a contingency plan. Financial institutions have reported 100 per cent Y2K compliance by end August 1999.

Asset-Liability Management System

4.34 Risk management is emerging as an important area on which financial entities will need to focus attention in view of the growing integration of financial markets. Consequent upon the liberalisation of domestic markets, various categories of risks have begun to have a bearing on the balance sheets of financial institutions. This is more so in respect of liquidity and interest rate risks as the interest rates have been made market-related both on borrowing and lending sides. In order to address the problem, the Reserve Bank has already issued guidelines on Asset-Liability Management (ALM) to banks in February 1999. As financial institutions are also equally exposed to similar risks, they have been issued draft guidelines on ALM for eliciting their views and the likely difficulties that would be experienced by them. In the light of the suggestions/comments received from the financial institutions, a full-fledged ALM would be made operational by April 1, 2000.

Income Recognition, Asset Classification and Provisioning-Concept of Commencement of Commercial Production

4.35 The Monetary and Credit Policy for the year 1999-2000 provided operational flexibility to banks and financial institutions in deciding the date of commercial production. In accordance with the above, financial institutions have been provided with the flexibility to decide whether the assisted unit has stabilised commercial production. The primary deciding factor, would be whether the assisted unit has achieved cash break-even in order to service the loan. If the bottleneck in achieving regular commercial production was of a temporary nature, in which case the financial institutions have been allowed to reschedule the loan and treat the asset as standard. However, the lead time would normally not exceed one year from the schedule of commencement of commercial production as indicated in the terms of sanction.

Discussion Paper on Harmonisation of the Role and Operations of DFIs and Banks

4.36 In the light of the transformation in the financial system in terms of structure, performance and participants, and in view the need to evolve a vibrant financial system, the Reserve Bank had constituted a Working Group in December 1997 for Harmonising the Role and Operations of DFIs and Banks (Chairman: Shri. S.H. Khan). The Group submitted its Report in May 1998. In the light of the recommendations made by the Group, the Reserve Bank of India prepared a 'Discussion Paper' (DP) in January 1999 for wider public debate on the issue of universalisation of banking and eliminating the specific functional role of specialized financial institutions. The architecture for the financial system in India, as delineated in the 'Discussion Paper' has been briefly summarized in the following paragraph.

4.37 The DP observed that the approach to universal banking in India should be guided by the twin considerations of international experience and domestic requirements and contended that the transformation of a DFI should ideally be considered after a reasonable period of time has elapsed; in the interim, DFIs could tailor their needs to become either a NBFC or a bank, depending on institution-specific considerations and their comparative advantages. The options to pursue banking activity could be explored and such a process could occur either through a process of mergers and acquisitions, thus enabling DFIs to reap the economies of a branch network through a full-fledged subsidiary as part of a conglomerate. The transitory arrangements in the process of evolution could be worked out, after a detailed examination by the Reserve Bank, on a case-by-case basis, in view of the unique position of each financial institution as part of its progress towards universal banking practices. In view of the special role of banks in the financial sector, any such conglomerate, in which a bank is present, should be subject to a consolidated approach to supervision and regulation, while ensuring consistency with monetary policy and prudential standards (Box IV.I). The DP, however, recognized that, till such time as the long-term debt market improves in terms of depth and liquidity, there would be a definitive role for the DFIs in providing long-term development finance.

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3. These include, ICICI, IDBI, IFCI, IIBI, TFCI, RCTC, ICICI Venture (formerly TDICI), Power Finance Corporation Ltd., NHB, SIDBI, Rural Electrification Corporation Ltd., Indian Railways Finance Corporation Ltd., NABARD, EXIM Bank, IDFC and HUDCO.

4. Reserve Bank Assistance to Financial Institutions

4.38 During 1998-99 (July-June), no long-term assistance was sanctioned by the Reserve Bank to any financial institution. Under Section 17(4A)/ (4BB) of the Reserve Bank of India Act, 1934, the Reserve Bank sanctioned borrowing limits amounting to Rs.156.3 crore to 15 State Financial Corporations (SFCs) during the year 1998-99 (July-June) at the Bank Rate for a period of one year against ad-hoc bonds guaranteed by respective State Governments/Union Territories.

Box IV.I: Universal Banking: Supervisory and Regulatory Aspects

The reforms in the financial sector have ushered in significant changes in the operating environment of banks and financial institutions. The deregulation of interest rates, emergence of disintermediation pressures arising from a liberalised capital market and increasing participation by banks in project finance significantly altered the operating environment of banks. With DFIs, in turn, making forays into the realm of working capital financing, the traditional operational division between banks and DFIs became increasingly blurred. In the light of these developments, the Reserve Bank appointed a Working Group (Chairman: Shri S.H. Khan) in December 1997 to examine and suggest policy measures for harmonising the role and operations of DFIs and banks. With regard to the regulatory and supervisory framework, the Group recommended, among others, (a) the development of a function-specific regulatory framework that is institution-neutral with regard to the regulatory treatment of identical services rendered by any participant in the financial system, (b) a system of consolidated supervision of financial entities, (c) a focus on off-site supervision based on periodic reporting by banks/ DFIs, (d) the establishment of a 'super-regulator' to supervise and co-ordinate the activities of the multiple regulators, and (e) speedy legal reforms in the debt recovery areas of banks and financial institutions. In the light of these recommendations, the Reserve Bank prepared a Discussion Paper in January 1999 to address the various issues concerning the universalisation of banking and elimination of the specific functional role of specialized financial institutions. Some of the major issues addressed in the Discussion Paper are delineated here:

The Discussion Paper stated that the issue of transformation of a DFI into a bank should ideally be considered after a reasonable period of time has elapsed; in the interim, DFIs could tailor their needs to become either a bank or a NBFC, depending on institution-specific considerations and their comparative advantages. If the DFI chooses to become a bank or an NBFC, then it should be prepared to fully conform to the entire gamut of prudential, regulatory and supervisory norms applicable to banks/NBFCs. However, until the long-term debt market improves, in terms of liquidity and depth, there is a special role for DFIs in the financial system. Large and medium-sized firms continue to depend on DFIs for long-term financing. DFIs have acquired special skills in project appraisal, an area in which banks are yet to fully specialize.

Secondly, following the publication of the Core Principles of Banking Supervision by the Bank for International

Settlements (BIS) and the establishment of the 'Willard Group' of countries to examine the synergies between supervision in the home and the host country, there has been a growing recognition of the need for a system of consolidated supervision. The same point was also reiterated by the new Consultative Paper on Capital Adequacy issued by BIS in June 1999. It is widely recognized that the risks of failures of large universal banks might engender serious repercussions throughout the financial system. Recognizing the merit of this point, the Discussion Paper observed that, in view of the increasing diversification of ownership of public sector banks, it would only be over a period of time that a move towards a consolidated balance sheet in respect of each public sector bank (consolidated reporting already exists for private sector banks) could take place.

Thirdly, as the Discussion Paper observed, the supervisory regime has been made uniform for both banks and NBFCs with the introduction of a system of on-site supervision, off-site monitoring and periodic external auditing. It is observed that, for purposes of regulation, a formal legally tenable and clearly identifiable regulatory framework of the Reserve Bank is available basically for banks and non-bank financial companies. DFIs as a category are still loosely defined as indicated in the Discussion Paper and are in a way an amalgam of State/Central level, company/corporate forms, with different degrees of public sector ownership and with different forms and orders of direct finance, refinance and other functions. The Discussion Paper provided an approach to bring the DFIs under a transparent framework as suggested by the Narasimham Committee.

On the issue of having a 'super-regulator', the Discussion Paper observed that the question of whether the supervisory responsibility should lie solely with the Board for Financial Supervision (BFS) or with a separate supervisory system to be devised for the purpose, would need to be considered in due course. The view was also reinforced in a recent Discussion Paper on Corporate Governance, which stressed that financial institutions should be brought fully under the regulatory and supervisory ambit of the Reserve Bank and that suitable tools/norms need to be devised for regulation/ supervision of these institutions consistent with the nature of their operations. However, the efficacy of the common supervisory mechanism would require not only strengthening internal controls and ease of monitoring by focusing on a few identifiable parameters, but would also necessitate stricter auditing and disclosure standards.

It is instructive in this context to examine the regulatory and supervisory arrangements of universal banks in other countries. In Japan, large banks often own equity in non-financial firms and become actively involved in assisting firms that are threatened with bankruptcy. They often replace existing management with their own officers, write new business plans, take a larger equity stake and negotiate with the firm's other creditors (Hoshi *et.al.*, 1991). Several authors have examined the issue of whether universal banking was successful in reducing financing costs in the United States *vis-à-vis* Germany during the second industrial revolution. The findings reveal that stringent regulatory restrictions on banks in U.S. as compared to those of Germany not only limited the opportunities for banks to lend directly to industry, but also raised the cost of underwriting and placing securities, leading to higher overall finance costs. In Germany, directors of universal banks are often on the supervisory boards of the firms' in which they have stakes[1] and take part in management on an ongoing basis, becoming especially active in situations of financial distress. On the other hand, more recent experiences in both the countries suggest that these arrangements have worked less well in practice than in theory.

In EC, on the other hand, banks are allowed to engage in commercial and investment banking activities but not insurance activities; a bank is limited to 10 per cent of its own equity as a stake in an individual commercial firm, with the total investment in commercial firm equity not exceeding 50 per cent of bank capital.

In spite of the gradual harmonisation in the regulatory framework governing financial entities in India, several issues remain to be addressed. First, the competition between these financial entities is not uniform: for example, banks have to bear increased regulatory costs in the form of higher CRR on their deposits, while DFIs do not have any such pre-emptions on their resources. However, once the reserve requirements are brought down, it would become easier for the DFIs to move towards universal banking. Secondly, although instrument-specific restrictions on resource mobilisation on DFIs by way of term deposits, term-money borrowings, CDs as well as inter-corporate deposits have been replaced with umbrella limits, DFIs do not have the advantage of branch network for fund mobilisation. It is expected that, in the near future, the options to pursue banking activity to the DFIs, either through a process of mergers and acquisitions, thus enabling DFIs to reap the economies of a branch network or alternately, through setting up of a full-fledged subsidiary as part of a conglomerate, will impart them with greater flexibility to meet the demands of universal banking. Thirdly, it has been suggested that reserve requirements should be applicable only to cash and cash-like liabilities in respect of banks. Put differently, reserve requirements are to be linked to the maturity profile of liabilities. This suggestion has large systemic implications and consequently, its validity as a prudential measure needs a thorough examination before implementation. Fourthly, with the larger part of the new loans going to capital-intensive projects, the DFIs would need to extend loans with longer maturities. However, the interest rate scenario makes it attractive to raise more of short-term resources. Given the profile of their past borrowings, the mismatch is still in their favour. However, this raises a challenge for the DFIs to manage their maturity mismatches on an on-going basis. It therefore remains to be seen how far the case for financial diversification, based on economies of scope and competitive equality, prevails over arguments that emphasize potential conflicts of interests and the systemic risk that is associated with securities business undertaken within the financial sector.

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1. German banks, through voting shares that they own or hold in custody, account for 36 per cent of the votes in the top 100 companies (Steinherr and Huveneers, 1992).

4.39 The outstanding long-term borrowings by IDBI, SIDBI, EXIM Bank and IIBI under NIC(LTO) Fund facility as at end-June 1999 stood at Rs.4,927 crore. This amount was lower by 6.1 per cent as compared with the position as at end-June 1998. The outstanding long-term borrowings by NHB from the NHC(LTO) Fund as at end-June 1999 stood at Rs.875 crore. There was no outstanding medium/short term credit by IDBI as at end- June 1999. The outstanding borrowings by SFCs as at end-June 1999 amounted to Rs.7 crore as compared with Rs.10 crore as at end-June 1998 (Appendix Table IV.4).

5. Infrastructure Development Finance Company

4.40 In December 1998, Infrastructure Development Finance Company (IDFC) as the dedicated financing agency mandated to support infrastructure development has been included in the list of All-India Financial Institutions. Since it started operation in January 1997, it has completed its first full year of operations. During the year 1998-99, IDFC provided assistance to 13 companies, 6 in the power sector, 4 in the roads sector and 3 in the telecom sector. Total approvals for the financial year 1998-99 aggregated Rs.2,282 crore, whereas total disbursements aggregated Rs.724 crore. Presently, IDFC has 17 projects in the pipeline of which 10 are in the power sector.

Financial Results

4.41 The financial results of IDFC for the year ended March 31, 1999 reveals that the company has registered a total income of Rs.231.2 crore and expenses of Rs.39.9 crore. After allowing for tax provisions of Rs.62.5 crore, the company's profit after tax was Rs.128.8 crore.

Policy Advisory Group

4.42 As part of IDFC's policy advisory mandate, a Policy Advisory Group has been constituted which has been working on rationalising the policy, legal and regulatory framework, with the final objective of provision of efficient infrastructure services. As part of the process, the Group has delineated four concordant operating processes consisting of (a) identification of best practices, (b) institution of policy advisory boards, (c) support of relevant research and (d) promotion of policy dialogue.

4.43 Under identification of best practices, the Group reviewed the developments in each of the infrastructure sectors and also focused on assimilating international experiences, so as to distill the common set of principles that apply across the entire range of infrastructure business, which seem to underpin the relatively successful reform programmes. Under institution of policy advisory boards, policy advisory boards were constituted in the areas of power and ports. Based on the discussions of the boards, the Policy Advisory Group is in the process of finalising 'vision papers' for these sectors, highlighting the future framework for these sectors and the set of principles that would lead to the achievement of the ultimate objective. Under support of relevant research, the Group is collaborating with research institutions that can provide the background research on the issues pertinent to infrastructure. The research is sought to be supplemented through the promotion of policy dialogue so as to initiate a consultative process of public dialogue on areas requiring further action.

6. Mutual Funds

4.44 Mutual funds in India have emerged as a critical institutional linkage among the various financial segments like the money and capital markets, with which the household and corporate sectors interface. Mutual funds have provided a direction to the flow of personal savings and have enabled small and medium investors in remotely accessible places to reap benefits of their investments. Mutual funds have therefore been playing a crucial role in resource mobilisation and allocation and are becoming increasingly vibrant in India.

4.45 During 1998-99, a number of policy measures were initiated aimed at providing flexibility to the mutual funds sector. The SEBI (Mutual Funds) Regulations were amended to permit mutual funds to trade in derivatives for the purpose of hedging and portfolio balancing. In view of the problems encountered by UTI's flagship scheme, US-64, a High Level Committee (Chairman: Shri. Deepak Parekh) was constituted by the Government to review the objectives and working of the scheme. The Committee recommended several measures including, among others, infusion of at least Rs.500 crore as unit capital by the principal sponsors and conversion of US-64 scheme into a Net Asset Value (NAV) driven scheme over a period of three years. Out of the 19 major recommendations made by the Committee to UTI, 9 have already been implemented and the remaining have been taken up for implementation (Box IV.2).

4.46 The Union Budget for 1999-2000 announced several measures in order to boost the capital market, in general, and in particular, the mutual funds industry. The Government granted tax exemptions for a period of three years for US-64 scheme and for all open-ended equity-oriented schemes of UTI and other mutual funds with more than 50 per cent investment in equity. It also announced exemption from income tax of all income from UTI and other mutual funds received in the hands of investors. Subsequently, the Monetary and Credit Policy for the year 1999-2000 permitted Money Market Mutual Funds (MMMFs) to offer 'cheque writing' facility to the investors through a designated bank, thus providing a boost to the development of the MMMF segment of the mutual funds industry.

4.47 As detailed in the last year's Report, several assured return schemes witnessed difficulties in meeting their redemption benefits. These included both bank-sponsored as well as FI-sponsored mutual funds. In all these cases, the sponsors of mutual funds, which were to meet the commitment, infused additional resources to meet the shortfall.

4.48 Pursuant upon the decision of the Government of India to regulate entities which issue instruments such as agro bonds, plantation bonds, etc., and as such schemes would be treated as Collective Investment Schemes (CIS) coming under the provisions of SEBI Act 1992, SEBI had constituted a Committee (Chairman: Shri S.A. Dave) to formulate the draft regulations for the purpose. The regulations, submitted to SEBI in December 1998, aim to promote legitimate investment activity through the structure of CIS as well as to address the issue of investor protection.

4.49 Total resources mobilised by the mutual funds industry posted a decline during 1998-99. The performance of the largest mutual fund, i.e., UTI suffered a setback during 1998-99 because of severe redemption pressures in respect of its US-64 scheme. Other mutual funds in the private and public sector, however, witnessed better performance as compared with the previous year. The net resource mobilisation by UTI under all domestic schemes was of the order of Rs.170 crore (including reinvestment sales) in comparison with Rs.2,875 crore during the previous year (Table IV.8). Funds mobilised by the public sector mutual funds (other than UTI) aggregated Rs.830 crore as compared with Rs.449 crore in the previous year, registering an increase of 85.0 per cent, while those by the private sector mutual funds increased by more than 200 per cent to Rs.2,090 crore from Rs.678 crore in 1997-98 (Appendix Table IV.5). Funds mobilised by all mutual funds put together under all schemes aggregated Rs.3,090 crore, lower than that of Rs.4,002 crore mobilised during the previous year (Chart IV.7).

Box IV.2: Report of Deepak Parekh Committee on US-64

Recently, a widespread concern developed among the investors of the Units Scheme 1964 (US-64) following the announcement by the Unit Trust of India (UTI) that the reserves of the scheme had turned negative as on June 30, 1998, due to a steep depreciation in its investments. In this backdrop, UTI constituted a Committee under the Chairmanship of Shri Deepak Parekh in October 1998, to undertake a comprehensive review of the functioning of the UTI and to recommend measures for sustaining investor confidence and strengthening the US-64 scheme.

The terms of reference of the Committee were:

1. To review the objectives, features and structure of the US-64 scheme in the context of its role in the mobilisation of domestic savings and investment in the capital market.
2. To review the policies of the US-64 scheme relating to pricing and income distribution, having regard to the profile of existing investors of the scheme.
3. To review the policies and procedures about the portfolio composition of the scheme, as well as the asset management process.
4. The committee submitted its report to UTI in February 1999. The recommendations made by the Committee include those needing immediate implementation as well as those that need to be put in place over the restructuring period.

Some of the recommendations are qualitative and the major recommendations of the committee are summarised below:

1. As a one-time measure, contributors to the initial capital of the US–64 scheme, which includes IDBI, LIC, SBI and its subsidiaries, other institutions and scheduled banks, infuse at least Rs. 500 crore at the ruling sale price immediately into the corpus of the scheme. This will be in keeping with both domestic and international practice where the sponsoring institutions stand by their fiduciary obligations.

2. The Committee observed that PSU stocks having book value of approximately Rs.4800 crore are those that have actually depreciated in value. They recommended that the PSU portfolio should be transferred at book value to a Special Unit Scheme (SUS 99) created for this purpose. The Government of India (GoI) would subscribe to SUS 99 by issue of dated GOI securities. SUS 99 would discharge the transfer consideration to US-64 by transferring these dated GOI securities to US-64. As an alternative to GOI directly subscribing to the units of SUS 99, GOI could guarantee the bonds to be issued by SUS 99 to discharge the transfer consideration to US-64. Thus Government will be able to provide support without any immediate impact on its budget.

3. US-64 make a strategic sale of its significant equity holdings by negotiation to the highest bidder to ensure fetching the best value for the unit holder. It is important that to achieve this objective, UTI be accorded full autonomy to negotiate and effect sale of shares.

4. In the interest of the early revival of the mutual fund industry, the benefit of tax rebate under Section 88 may be extended to retail investment in mutual funds without any sub-limit, as at present. The investment ceiling under Section 88 be increased from Rs. 60,000 to Rs. 70,000, and this increase of Rs. 10,000 should be available only for investments made under section 88(2)(xiiib), provided that such investments are locked in for a minimum period of three years. As a special dispensation, investments in US-64 should qualify for tax rebate under the suggested provision even if its equity investments constitute less than fifty percent of its long term investments for the next three years while the scheme is being re-structured.

5. As a special dispensation, dividends from US-64 be rendered tax free in the hands of the investors even if the equity investments constitute less than fifty per cent of total long term investments in the next three years while the scheme is being re-structured.

6. The commercial banks have had two years of strong deposit growth. However, inspite of the RBI initiative in encouraging banks to invest upto five per cent of their incremental deposits in equity shares, not much progress has been achieved by the banks. In order to help revive the capital market, the Committee recommended that commercial banks be encouraged to contribute Rs.1,000 crores to Rs.1,500 crores towards the corpus of a new equity related scheme to be promoted by the UTI.

Over and above the financial support that the UTI needs, there are several qualitative changes that need to be made in the functioning of the UTI.

1. The UTI Act will need to be amended to increase the size of the Board of Trustees, so as to induct five additional independent Trustees.

2. The UTI Act may be amended to facilitate the setting up of an Asset Management Company. Pending the

amendment, the present Asset Management Committee should be reconstituted and its role and responsibilities clearly defined.

3. UTI may appoint separate and independent teams of fund managers for each scheme. Inter-scheme transfers, if any, should be effected on the basis of independent decisions and requirements of the fund managers of the concerned schemes, and at market determined prices. These fund managers should have the final authority and responsibility in the decision-making process.

4. US-64 would have to become a NAV driven scheme. The Committee considered that a period of about three years should suffice to bring the NAV of the units in line with their re-purchase price.

5. Dividend distribution policy of UTI is to be thoroughly revamped to ensure that the scheme is responsive to changing market conditions.

6. The Committee noted with concern that, despite the adverse past experience, the UTI continues to promote 'assured return' schemes, and that too for the benefit of institutional investors. The Committee was also of the view that the concept of assured returns, in an era of volatile interest rates, should be done away with in respect of all mutual fund schemes in the country.

7. The Committee observed that there would have to be a major asset re-allocation of the portfolio composition of US-64 to provide for more weightage to debt consistent with the objectives of the Scheme. This needs to happen without US-64 having to resort to selling large parts of its equity portfolio in the market, as this would severely hurt the market sentiment and add to the present difficulties.

8. The operations of the US-64 be brought within the purview of the SEBI at the earliest. Necessary amendments to the UTI Act should be made.

9. UTI should commission a detailed review of the asset management processes including the back office processes, inter-scheme transfers, and of the investor servicing processes by an independent professional firm.

To sum up, the Committee observed that with over two crore unit holders, public confidence in the US-64 is a virtual proxy of public confidence in the Indian financial system. The Committee was of the opinion that the recommendation in their report when viewed in the perspective, would justify the envisaged financial support from the Government.

New Mutual Fund Schemes

4.50 During the year 1998-99, three new private sector mutual funds were registered with SEBI, taking the total number of mutual funds (excluding UTI) registered with SEBI to 40 as on March 31, 1999.

4.51 Three new off-shore funds were launched in the previous year, viz., India Debt Fund-a 100 per cent debt fund, the India PSU Fund-an equity fund investing exclusively in PSUs and the India IT Fund-an equity fund investing predominantly in information technology sector. During 1998-99, UTI mobilised over Rs.87 crore via off-shore funds.

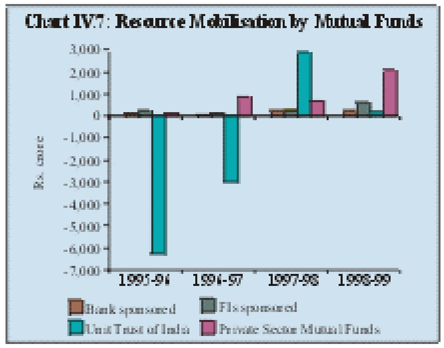

Chart IV.7: Resource Mobilisation by Mutual Funds

Table IV.8: Resources Mobilised by Mutual Funds: 1993-94 to 1998-99
(April-March)

(Rs. crore)

Mutual Fund	1993-94	1994-95	1995-96	1996-97	1997-98 P	1998-99 P
I. Bank-sponsored (1 to 6)	**148.11**	**765.49**	**113.30**	**5.90**	**242.96**	**253.18**
1. SBI MF	105.00	218.26	76.00	2.61	190.11	248.04
2. Canbank MF	43.11	205.55	2.71	1.69	52.85	5.14
3. Indian Bank MF	..	94.40	..	..	..	..
4. BOI MF	..	53.49	..	..	..	..
5. PNB MF	..	155.95	10.32	..	..	..
6. BOB MF	-	37.84	24.27	1.60	..	..
II. FIs-sponsored (7 to 9)	**238.61**	**576.29**	**234.81**	**136.85**	**205.55**	**576.42**
7. GIC MF	227.23	319.68	64.88	-32.40	-19.20	17.63
8. LIC MF	11.38	68.97	116.51	169.25	99.75	377.54
9. IDBI MF	-	187.64	53.42	-	125.00	181.25
III. Unit Trust of India	**9,297.00**	**8,611.00**	**-6,314.00**	**-3,043.00 a**	**2,875.00**	**170.00**
	(7,453.00)	**(6,800.00)**	**(-2,877.00)**	**(-855.00) a**	**(2,592.00)**	**(1,300.00)**
IV. Private Sector MFs	**1,559.52**	**1,321.79**	**133.03**	**863.58**	**678.29**	**2,090.37**
Total (I+II+III+IV)	**11,243.24**	**11,274.57**	**-5,832.86**	**-2,036.67**	**4,001.80**	**3,089.97**

Notes: 1. P - Provisional
- Not applicable
.. No amounts collected or reported
a Excludes re-investment sales.
2. For UTI, the figures are gross value (with premium) of net sales under all domestic schemes and for other mutual funds, figures represent net sales under all on-going schemes.
3. Figures in brackets in case of UTI pertain to net sales at face value.
4. Data exclude amounts mobilised by off-shore funds and through roll-over schemes.

Source: UTI and respective Mutual Funds.

Asset Management Committees by Unit Trust of India

4.52 UTI had reconstituted the three Asset Management Committees (AMCs) separately for US-64, Equity Schemes and Debt Schemes. Each AMC presently has seven members comprising outside professionals and senior officials of UTI. The scope of activity of AMCs has been enlarged and is aimed at ensuring adherence to/compliance with the stated objectives of each scheme, UTI General Regulations, SEBI (Mutual Fund) Guidelines and the prudential investment norms laid down by the UTI Board of Trustees from time to time.