Credit Information Review

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APRIL 2001

Monetary and Credit Policy for 2001-2002*

- The macro-economic, monetary and price situations and external sector developments remained by and large favourable in 2000-01 despite the lower performance of industry and some adverse developments in certain segments of financial market.
- RBI to provide adequate liquidity to meet credit growth and support revival of investment demand.
- RBI expects the present stable interest rate environment to continue and announces a preference for further softening during the year.
- Measures to reduce interest rates on export credit by 1 to 1.5 percentage points and rationalise export credit refinance.
- Steps to move forward to the next stage of Liquidity Adjustment Facility: wide-ranging package of measures including Back-stop Facility to banks and PDs.
- CRR made more flexible, interest on CRR balance increased.
- PLR norms liberalised.
- Banks allowed to offer higher interest on deposits held by Senior Citizens.
- Prudential measures to strengthen Urban Co-operative Banks.
- RBI favours separate apex supervisory body for co-operative banks.
- RBI to streamline its role by divesting ownership in financial institutions.
- Steps being taken to set a stage for separation of debt management function from RBI.
- Revised guidelines on exposure of banks to stock markets to be effective May 2001 after further consultations.

Dr. Bimal Jalan, Governor, Reserve Bank of India, in a meeting with the Chief Executives of banks presented the annual Monetary and Credit Policy for 2001-02 on April 19, 2001. The statement covered a review of macro-economic and monetary developments, stance of monetary policy and wide-ranging package of measures to strengthen the financial system and for development of markets and institutional infrastructure. In his statement, the Governor also dealt with some analytical and practical issues concerning monetary policy and exchange rate and reserves management.

At the outset, the Governor pointed out that this year's policy is being presented at a time when serious lacunae have emerged in the functioning of certain segments of the financial system. The Governor mentioned that necessary remedial measures urgently need to be taken to remove the weaknesses that have been noticed so that India's financial sector continues to remain strong and safe.

Stance of Monetary Policy for 2001-02

Under normal circumstances and barring emergence of any adverse and unexpected developments in domestic or external sectors, the overall stance of monetary policy for 2001-02 will be :

- Provision of adequate liquidity to meet credit growth and support revival of investment demand while continuing a vigil on movements in the price level.
- Within the overall framework of imparting greater flexibility to the interest rate regime in the medium-term, to continue the present stable interest rate environment with a preference for softening to the extent the evolving situation warrants.

Financial Sector Reforms and Monetary Policy Measures

Governor announced certain structural measures to strengthen the financial system and to improve the functioning of the various segments of financial markets.

Review of Liquidity Adjustment Facility - Stage II

It has been decided to move forward to implement the second stage of LAF.

- It is proposed to split the standing liquidity facilities available from RBI into two parts, viz., (i) normal facility and (ii) Back-stop facility.
- The normal facility will be provided at the Bank Rate.
- The back-stop facility will be provided at a variable rate linked to reverse repo rate/repo rate/NSE-MIBOR:
- Of the total limits of liquidity support available to PDs and banks, the normal facility would initially constitute about two-thirds and the back-stop facility about one-third.

Export Credit Refinance

With effect from the fortnight beginning May 5, 2001, scheduled commercial banks would be provided export credit refinance to the extent of 15.0 per cent of the outstanding export credit eligible for refinance. Banks will have the comfort that refinance on the basis of current formula will set the minimum limit up to March 31, 2002. This change in formula will benefit a larger number of banks and besides an increase in the aggregate refinance. When the volume of export credit increases, banks' refinance eligibility will also correspondingly increase.

Rationalisation of Interest Rates on Export Credit

Interest rate on export credit extended by banks is rationalised and will be indicated as a ceiling rate linked to PLR, so that the interest rate charged by the banks can actually be lower than the prescribed rate. Based on the current PLR up to 180 days of major public sector banks, there is likely to be a reduction in interest rate by 1.0 - 1.5 percentage points. Banks can also offer lower than PLR minus 1.5 per cent rate for export finance.

Measures Associated with Money Markets

- Permission to corporates to route their call transactions through PDs would be available upto June 30, 2001.
- Access to other non-bank institutions (including financial institutions, mutual funds and insurance companies) to operate in call/notice money market would be gradually reduced in four stages:
  – In stage I, non-banks would be allowed to lend up to 85 per cent of their average daily lending in call market during 2000-01.
  – In stage II, with effect from the date of operationalisation of Clearing Corporation, non-banks would be allowed to lend up to 70.0 per cent;
  – In stage III, with effect from three months after stage II, access of non-banks to call/notice money market would be equivalent to 40.0 per cent; and

– In stage IV, with effect from three months after stage III, access of non-banks to call/notice money market would be equivalent to 10.0 per cent.

- From a date to be notified by RBI, after the on-set of stage IV, non-banks will not be permitted to lend in call/ notice money market. The above measures would allow sufficient time for market participants to adjust their portfolios without any disruption in the market.
- It has been decided to reduce the minimum maturity period for term deposits to 7 days from the present 15 days in respect of wholesale deposits of Rs.15 lakh and above.
- From the fortnight beginning August 11, 2001, the maintenance of daily minimum CRR requirement of 65.0 per cent is reduced to 50.0 per cent for the first seven days of the reporting fortnight; the minimum requirement of 65.0 per cent will be applicable to all the next seven days including the reporting Friday without any exception.
- While the medium term objective will be to reduce CRR to the statutory minimum, as an intermediate measure, interest rate on eligible balances will be aligned with the Bank Rate in two stages. From the fortnight beginning April 21, 2001, the interest will be increased to 6.0 per cent.
- The inter-bank term liabilities of maturity of 15 days and above are exempted from the prescription of minimum CRR requirement of 3.0 per cent.
- The present 14 day Treasury Bill and 182 day Treasury Bill auctions are to be discontinued and the notified amount in the 91 day Treasury Bill auctions increased to Rs.250 crore. 91 day and 364 day bills will become fungible floating stocks to activate secondary market.
- In order that the market participants prepare themselves for the proposed Negotiated Dealing System (NDS), with effect from June 2, 2001, all transactions settled through the Delivery versus Payment (DVP) system of RBI will be on T plus 1 basis.

Interest Rate Policy

(a) Review of Norms Relating to Prime Lending Rate

- It has been decided to relax the requirement of PLR being the floor rate for loans above Rs.2 lakh. PLR will serve as a bench mark and banks will be able to offer loans at below-PLR rates to exporters or other creditworthy borrowers including public enterprises on the lines of a transparent and objective policy approved by their Boards.

(b) Deposit Schemes for Senior Citizens

- Banks are permitted to formulate fixed deposit schemes specifically meant for senior citizens offering higher and fixed rates of interest as compared to normal deposits of any size.

(c) Term Deposits - Flexibility to Banks

- Banks will be given freedom to exercise their discretion to disallow premature withdrawal of large deposits held by entities other than individuals and Hindu Undivided Families.
- Renewal of overdue deposits at the rate of interest prevailing on the date of maturity will be allowed only for an overdue period of 14 days.

(d) Interest Rate on FCNR(B) Deposits

- The ceiling of LIBOR/Swap rate plus 50 basis points, revised downward to LIBOR/Swap rates.

Development of Government Securities Market

Following the announcement made in the Union Budget for 2001-02, a Clearing Corporation and an electronic Negotiated Dealing System (NDS) are expected to be made operational and the Public Debt Act is proposed to be replaced by the Government Securities Act.

- To promote retailing, individuals and Provident Funds will be allowed on non-competitive basis through primary dealers and satellite dealers.
- Uniform price auction format for auctions of dated securities, on a selective and experimental basis.

Progress towards Separation of Debt Management

Governor mentioned that though the separation of debt management from monetary management function was recommended by a Working Group in 1997, its implementation depended upon three pre-conditions viz. development of financial markets, reasonable control over fiscal deficit and necessary legislative changes. Substantial progress has already been made on all the fronts such as,

- The amendment to the Securities Contracts (Regulation) Act, demarcating the regulatory roles of the RBI and SEBI,
- The Finance Minister's expression to accord greater operational flexibility to the RBI for conduct of monetary policy,
- Proposals from RBI for amendments to the RBI Act, the proposed Fiscal Responsibility Bill to bring in reasonable control over the fiscal deficit,
- The setting up of the Clearing Corporation and the operation of the full-fledged Liquidity Adjustment Facility, Governor mentioned that once legislative actions are accomplished, it is proposed to take up with the Government, the feasibility and further steps for separation of debt management function of RBI.

Prudential Measures

(a) 90 days Norm for Recognition of Loan Impairment

It has been decided to adopt the 90 days norm for recognition of loan impairment, from the year ending March 31, 2004, but provisions will be required to be made from March 31, 2002.

(b) Prudential Norms for Financial Institutions

The asset of a financial institution would be treated as non-performing if interest and/or principal remain overdue for 180 days instead of the present 365 days, with effect from the year ending March 31, 2002.

(c) Norms for Statutory Central Auditors (SCAs) for Private Banks

With effect from the year 2001-02, the audit firms recommended by Indian private sector banks for appointment as their SCAs will have to satisfy the prescribed standards such as minimum standing, minimum number of full time partners and chartered accountants associated with the firm, etc.

(d) Revised Guidelines for Recovery of NPAs

The revised guidelines for one time settlement operative till March 31, 2001 were extended upto June 30, 2001; for processing these applications/cases, banks have been given time upto September 30, 2001.

(e) Method of Computation of Credit Exposure

- Exposure ceilings to be computed uniformly in relation to total capital as defined under international capital adequate standards effective from March 31, 2002.
- Non-fund based exposures should be reckoned at 100 per cent and in addition, banks should include forward contracts in foreign exchange and other derivative products, effective from April 1, 2003.

- The exposure ceiling for single borrower adjusted from the existing 20 per cent to 15 per cent effective from end-March 2002. Similarly, the group exposure limits adjusted to 40 per cent of capital funds.

(f) Debt Recovery Tribunals

Government has decided to set up 7 more Debt Recovery Tribunals (DRTs) during 2001-02 in addition to the existing 22 DRTs and 5 Appellate Tribunals to facilitate banks to quickly recover their dues from borrowers. Besides, the Government has proposed to bring in legislation for facilitating foreclosure and enforcement of securities in case of default so as to enable banks and financial institutions to realise their dues.

(g) Widening the Coverage of Defaulters' List

Pending appropriate amendments in banking laws, RBI has advised banks to incorporate a condition in the loan agreement for obtaining consent of the borrowers to disclose their names in the event of their becoming defaulters. Banks, which have not yet put in place the system of obtaining consent of the borrowers, are advised to complete the process by September 30, 2001.

(h) Exposure of Banks to Stock Market

The report of the RBI-SEBI Technical Committee, which was submitted to RBI on April 12, 2001 has been released and is available on the RBI website.

The Technical Committee's recommendations are expected to minimise the possibility of unwarranted and unethical "nexus" emerging between some inter-connected stock broking entities and promoters/managers of some private sector or co-operative banks. In the light of the recommendations of the Technical Committee, RBI proposes to revise the guidelines issued earlier in November 2000 on banks' investments in shares as also advances against shares and other connected exposures and issue the final guidelines in early May 2001 after taking into account further comments/suggestions.

(i) Reliance on Call Money Market

A recent assessment has indicated that some of the banks have taken concrete steps in building core deposit base, arranging committed lines of credit, etc., in order to reduce their dependence on call money borrowings. If, however, any bank continues to rely excessively on call money market for carrying out their banking operations, after discussion with such bank, RBI will lay down specific ceilings to reduce its long-term dependence on call money.

(j) Commercial Paper

(i) Preference for Dematerialised holding

It has been decided that with effect from June 30, 2001, banks, FIs, PDs and SDs will be permitted to make fresh investments and hold CP only in dematerialised form and outstanding investments in scrip form should also be converted into demat by October, 2001. As a corollary, it is also considered expedient to extend the demat form of holding to other investments like bonds, debentures and equities. Accordingly, with effect from October 31, 2001 banks, FIs, PDs and SDs will be permitted to make fresh investments and hold bonds and debentures, privately placed or otherwise, only in dematerialised form and outstanding investments also should be converted into demat by June, 2002.

(ii) Documentation and Procedure

As part of the new guidelines on issue of CP released in October 2000, Fixed Income Money Market and Derivatives Association (FIMMDA) was entrusted with the task of prescribing standard procedures and documentations. FIMMDA would circulate a draft of these guidelines among its members and other market participants.

(k) Credit Information Bureau

While Credit Information Bureau (CIB) can be functional within the existing framework, to strengthen the legal mechanism for making the functioning of CIB effective, a draft legislation covering responsibilities of the Bureau, rights and obligations of the member credit institutions, safeguarding of the privacy rights, has been forwarded to the Government of India.

Urban Co-operative Banks (UCBs)

(i) Prudential Measures

In order to strengthen prudential measures for urban cooperative banks, in the interest of their members and depositors, the following measures are proposed:

- With immediate effect, Urban Co-operative Banks (UCBs) are being advised not to entertain any fresh proposals for lending directly or indirectly against security of shares either to individuals or any other entity. They are also advised to unwind existing lending to stock-brokers or direct investment in shares, at the earliest.
- Their borrowings in the call/notice money market on a daily basis should not exceed 2.0 per cent of their aggregate deposits as at end March of the previous financial year.
- As a safety precaution, UCBs are advised not to increase their term deposits with other UCBs.
- The proportion of SLR required to be held in the form of government and other approved securities as percentage of NDTL being increased for all categories of UCBs. With effect from April 1, 2003, the scheduled UCBs will need to maintain their entire SLR assets of 25.0 per cent of NDTL only in government and other approved securities.
- All scheduled and large UCBs to maintain investments in government securities only in SGL Accounts with RBI or in constituent SGL Accounts of public sector banks and PDs.

All these measures are either 'prospective' in nature or sufficient time has been allowed to implement them in the interest of their members.

(ii) A New Supervisory Structure for UCBs?

In the light of the recent experience, one of the options that deserves to be seriously considered is the setting up of a new apex supervisory body which can take over the entire inspection/supervisory functions in relation to scheduled and non-scheduled UCBs. This apex body could be under the control of a separate high-level supervisory board consisting of representatives of the Central Government, State Governments, RBI as well as experts and it may be given the responsibility of inspection/and supervision of UCBs and ensuring their conformity with prudential, capital adequacy and risk-management norms laid down by RBI.

Credit Delivery Mechanism

Relief Measures for Gujarat

As relief towards Gujarat, a large number of measures have been taken. These inter alia include:

- Interest rate on loans at PLR of the SBI.
- Relief/concessions for affected exporters by extending the period of packing credit, conversion of dues into short-term loans repayable in suitable instalments and relaxation in NPA classification norms.

- In respect of agricultural loans, banks are not to recover principal or interest for a period of two years with a provision for reschedulement upto 7 years.

Technology Upgradation

(a) Payments System Vision Document

The Reserve Bank is examining comments/feedback received and the final version of the Vision Document would be published shortly.

(b) 'Imaging' as Pre-cursor for Cheque Truncation

A Working Group constituted by the Ministry of Finance, Government of India is examining the legal requirements for cheque truncation under the Negotiable Instruments Act.

(c) Internet Banking

Based on the levels of technology usage in different banks, staggered approach is being prepared covering the introduction of settlement of internet based transactions in a highly secured environment with appropriate risk control measures and risk management techniques.

Legal Reforms

RBI has forwarded its recommendations to Government of India for comprehensive amendments to the Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949, which are under consideration by the Government. Government of India has constituted a Working Group for suggesting changes in the provisions of Negotiable Instruments Act, 1881, to bring it in conformity with the Information Technology Act, 2000. A Bill on asset securitisation for enactment has been drafted and submitted to the Government.

Edited and published by **Alpana Killawala** for the **Reserve Bank of India,** Press Relations Division, Central Office, Shahid Bhagat Singh Marg, Mumbai 400 001 and printed by her at Mona Printers, India Printing House, 42 G. D. Ambekar Marg, Wadala, Mumbai 400 031. **Annual Subscription : Rs. 12. Readers desirous of subscribing may remit the subscription, by way of cheque/DD payable at Mumbai to the Director, DRRP (Sales Section), DEAP, Reserve Bank of India, Amar Building, Sir P. M. Road, P.B. No. 1036, Mumbai - 400 001. Also available on internet at www.cir.rbi.org.in**