Chapter IV

Financial Institutions

In the pre-reform era, financial institutions (FIs) were largely engaged in providing medium- and long-term loans predominantly in the form of project finance. They had access to low cost funds like concessional long term operation (LTO) funds, government guaranteed funds from bilateral/ multilateral agencies and issues of statutory liquidity ratio (SLR) bonds. Over the years, the FIs played a pivotal promotional role by providing risk capital, underwriting new issues, arranging for foreign currency loans, identifying investment projects and preparing and evaluating project reports. They also provide technical advice, market information about both domestic and export markets, and management services.

4.2 The functional barriers amongst different types of financial intermediaries are, however, getting blurred with increasing competition and deregulation. FIs are facing new challenges both on the asset and liability sides. Concessional sources of funds, having dried up, FIs are raising resources including short-term funds at market-related rates. On the asset side, the distinction between banks and FIs are getting blurred as both are offering long- and short-term financing. In view of such changes, asset-liability management, prudential norms, accounting standards and disclosure norms are becoming increasingly important for FIs.

4.3 FIs and banks together face competition from market-based modes of financing. Dominance of one system over the other varies from one country to another; but available evidence does not support the superiority of any system in optimal allocation of resources. In fact, existence of both financial intermediary-based and market-based modes of financing are considered essential for efficient allocation of resources (Box IV.1).

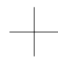
4.4 The wide variety of FIs existing in India could be broadly classified into all-India financial institutions (AIFIs), State level institutions and other institutions. The FIs within these groups can be further categorised according to their main activities/functions: (a) all India development banks[1] comprising IFCI Ltd., Industrial Development Bank of India (IDBI), Small Industries Development Bank of India (SIDBI), and Industrial Investment Bank of India Ltd. (IIBI); (b) specialised financial institutions comprising Export Import Bank of India (EXIM Bank), IFCI Venture Capital Funds (IVCF, formerly RCTC) Ltd., ICICI Venture Ltd. (formerly TDICI), Tourism Finance Corporation of India (TFCI) Ltd., and Infrastructure Development Finance Company (IDFC) Ltd.; (c) investment institutions such as Life Insurance Corporation (LIC), Unit Trust of India (UTI) and General Insurance Corporation (GIC)[2] and four erstwhile subsidaries; and (d) refinance institutions such as National Housing Bank (NHB) and National Bank for Agriculture and Rural Development (NABARD). State Financial Corporations (SFCs) and State Industrial Development Corporations (SIDCs) are the State level FIs. Export Credit Guarantee Corporation of India (ECGC) Ltd. and Deposit Insurance and Credit Guarantee Corporation[3] (DICGC) are some of the other FIs. Among the AIFIs, only nine AIFIs[4] fall within the regulatory and supervisory domain of the RBI (Chart IV.1).

[1] This included ICICI Ltd. which was merged with ICICI Bank Ltd. on March 30, 2002.

[2] Pursuant to the enactment of the General Insurance Business (Nationalisation) Amendment Act, 2002, GIC has been delinked from its four subsidiaries. GIC would undertake only reinsurance business and cease to carry on its general insurance business. The four "acquiring insurance companies" (*i.e.*, its former subsidiaries) would carry on general insurance business.

[3] The Central Government Budget 2002-03 proposed to convert DICGC to Bank Deposits Insurance Corporation (BDIC) to make it an effective instrument for dealing with depositors' risks and for dealing with distressed banks.

[4] IDBI, IFCI Ltd., IIBI Ltd., TFCI Ltd., IDFC Ltd., EXIM Bank, NABARD, NHB, and SIDBI. For regulatory and supervisory purposes, the last three FIs are referred to as 'Refinancing Institutions', while the other six as 'Term Lending Institutions'.



Box IV.1: Financial Intermediary-based *versus* Market-based Financing

The literature on the comparative role of financial intermediary-based as opposed to market-based debt in financing the corporate sector tries to theorise different conditions under which one form of finance would be advantageous over the other. Several benefits are cited in favour of a financial intermediary-based system. It has been argued that there are higher costs associated with market-based finance which places small firms in a relatively less privileged position to access such markets. The possibility of long-term relationship or commitment between borrower and the lender can also engender a preference for financial intermediary-based finance. This is because financial intermediaries are often better placed in providing long-term finance to firms due to *inter alia* specialisation in transfer of funds, expertise in credit appraisal and monitoring, enforcement of specific contractual covenants and debt renegotiation under distress. The theory on "life cycle" of financing behaviour of a firm indicates that relatively new firms would be more dependent on institutional finance and with maturity firms would increase their dependence more on market-based debt instruments. The proponents of intermediation based on "control" argue that intermediaries are better placed to exercise such controls. As for market-based finance, it is felt that markets provide liquidity and permit risk sharing. They also enable continuous valuation/revaluation of portfolios.

Different countries have followed different models. Most of the finance for corporates in industrialised countries is generated internally. As a source of external finance, institutional financing is more dominant in countries like Germany, France, Italy and Japan, while market-based financing is more prevalent in the United States. Notwithstanding these broad patterns, the relative importance of various sources of finance has undergone significant cyclical fluctuations and changes over time. In countries like Germany and Japan, for instance, where institutions have historically played a dominant role, capital markets are becoming increasingly important. This is partly due to the growing role of institutions in the capital market. On the other hand, in the United States, there are growing pressures on institutions to play a greater role in corporate finance.

It has been argued that the differences in institutional structures, tax regimes, stages of development of capital market were important reasons for the sharp differences in financing pattern of firms, between industrialised and industrialising countries.

India has, historically, followed a financial-intermediary-based system, where banks and FIs played a dominant role. The corporate financing patterns in India indicate that, on average, internal sources constitute about one-third of total sources of funds, while external sources account for the rest. Taking together all sources of finance from the capital market, *i.e.*, equity capital and debentures, their share was particularly important during the period 1991-92 to 1994-95, but declined thereafter. The share of borrowings in total sources has moved inversely with equity financing in the post-reform period. Of the various components of borrowings, bank borrowings generally constitute the most important source, followed by borrowings from FIs and through debentures.

With the initiation of financial sector reforms, the avenues for raising long-term finance for the Indian corporates are undergoing some shift. While corporates now have increased access to international capital markets, the channelisation of funds from the traditional source of long-term finance to the corporate sector, i.e., development financial institutions (DFIs) have been slowing down. After the East Asian crisis, a view has emerged according to which a multi-agency approach for meeting the demand for long-term funds would be both effective and efficient. A multi-agency approach is better since it diversifies the risks in the system and increases efficency through enhanced competition. Under such an approach, the equity market, the debt market, banks and financial institutions should together meet the long-term financing needs of the corporates.

Reference:

Allen, F. and D. Gale (1999), *Comparing Financial Systems*, MIT Press, Cambridge.

Davis, E. P. (2001), "Multiple Avenues of Intermediation, Corporate Finance and Financial Stability", *IMF Working Papers*, International Monetary Fund, Washington D. C., 115.

Levine, R. (2000), "Bank-Based or Market-Based Financial System: Which is Better?" University of Minnesota, *mimeo*.

Rajan, R. G. and L. Zingales (1995), "What Do We Know About Capital Structure? Some Evidence from International Data", *Journal of Finance*, 50.

Singh, A. (1995), "Corporate Financial Patterns in Industrializing Economies", *Technical Paper*, International Finance Corporation, Washington, D.C., 2.

4.5 Due to merger of ICICI Ltd. with ICICI Bank Ltd. with effect from March 30, 2002 the balance sheet data for ICICI Ltd. as on March 31, 2002 do not exist. The flow data on sanctions and disbursements, resources raised from the capital market and money market operations during 2001-02 (up to March 29,2002), however, are available for ICICI Ltd.

4.6 During 2001-02, for the first time in the last four years, both financial assistance sanctioned and disbursed by AIFIs (including ICICI Ltd.) declined by 36.9 per cent and 20.6 per cent, respectively, to Rs.72,878 crore and Rs.56,985 crore which can be attributed to the economic slowdown, in general, and deceleration in the growth of the industrial sector, in particular. Concomitantly, the share of fresh deployments of funds in the total uses of funds by AIFIs (excluding ICICI Ltd.) also declined. The institutions seemed to have taken advantage of

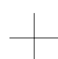
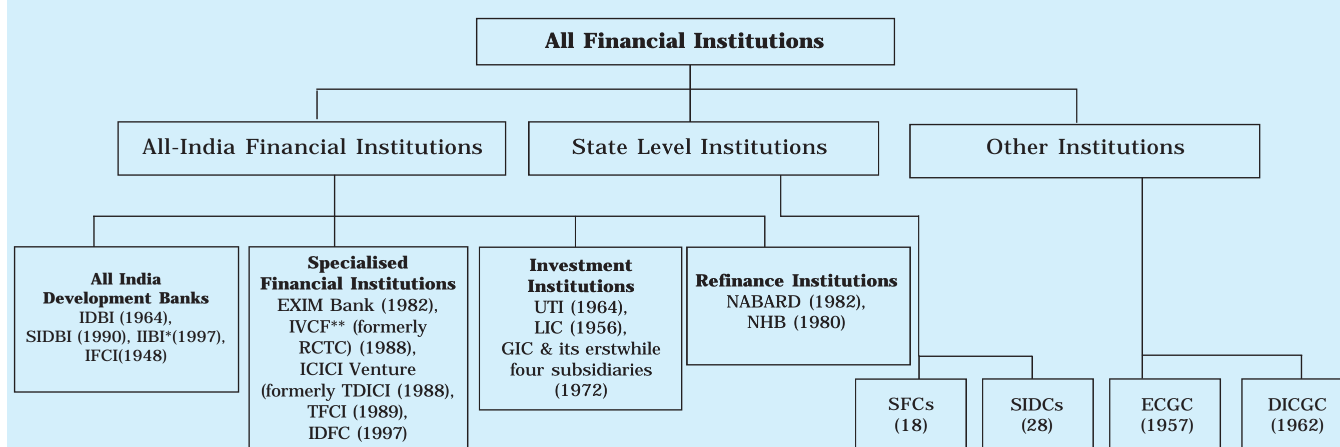


Chart IV.1: Organisational Structure of Financial Institutions



* The erstwhile Industrial Reconstruction Bank of India (IRBI), established in 1985 under the IRBI Act, 1984, was renamed as Industrial Investment Bank of India Ltd. (IIBI) with effect from March 27, 1997.

** IVCF-IFCI Venture Capital Funds Ltd.

Notes : 1. Figures in brackets under respective institution indicate the year of establishment or incorporation.
2. Figures in the brackets under State Financial Corporations (SFCs)/ State Industrial Development Corporations (SIDCs) indicate the number of institutions in that category.

the softer interest rate environment and increased the share of external sources in the total sources of funds. Simultaneously, the share of repayment of past borrowings in total uses of funds also increased.

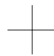
4.7 The industrial slowdown and exposure to certain industries have adversely impacted the assets and margins of some FIs, such as IFCI, IDBI and IIBI. The share of net NPAs in net loans as at end-March 2002 was highest in the case of IIBI at 24.1 per cent followed by IFCI (22.5 per cent), TFCI (20.2 per cent) and IDBI (13.4 per cent). Return on assets in the case of IFCI (-4.0 per cent) was lowest among the FIs while for IDBI, it was 0.6 per cent. The CRAR of IFCI at end-March 2002 at 3.1 per cent was the lowest amongst the FIs. Owing to liquidity constraints, IFCI could not meet certain liabilities on time in respect of bonds issued by it which fell due during the year. The overdue amount was Rs. 902 crore as on March 31, 2002. The Central Government has provided support through subscription to the 20-year convertible bonds issued by IFCI for Rs. 400 crore, which qualify as tier I capital. In addition, major shareholders of IFCI, *viz.*, IDBI, SBI and LIC were to extend assistance of Rs. 200 crore each to shore up the capital adequacy ratio of IFCI. In view of the deterioration in the quality of assets and the profitability of the FIs some restructuring seems imperative.

4.8 Resource mobilisation by mutual funds continued to decline during 2001-02. Net resource mobilisation by all mutual funds declined by 27.9 per cent to Rs.8,024 crore from Rs.11,135 crore in the previous year mainly due to a large outflow in the case of UTI and lower resource mobilisation by other public sector mutual funds. Net resource mobilisation by private sector mutual funds, however, increased by 50.4 per cent, but it remained below its record level during 1999-2000. The composition of the portfolio of mutual funds changed in favour of debt instruments.

1. Regulation and Supervision of Financial Institutions

Policy Developments

4.9 Several policy initiatives were undertaken by the RBI during 2001-02 in respect of the nine FIs falling within the regulatory and supervisory domain of the RBI (details in the Annex on chronology of various policy measures). Some of the major policy developments are presented here.



Prudential Norms

Assets Classification of the Projects under Implementation -Time Overrun

4.10 Under the original policy (effective March 1994), a time overrun of upto 50 per cent of the originally envisaged time-schedule was permitted for projects under implementation before downgrading the asset to sub-standard category. Subsequently in June 1996, a one-time refixing of time period for projects with the approval of the Board of the FI was allowed even if the time overrun had exceeded 50 per cent and the asset could be treated as standard till the time refixed by the Board of the FI. Upon review, it was observed that time overruns adversely affect the viability of projects as well as impair the quality of loans and advances extended by FIs. To ensure that loan assets relating to projects under implementation are appropriately classified and asset quality correctly reflected, a definite time frame for completion of projects was evolved. For the purpose, such projects were grouped into three categories for determining the reference date to be used for asset classification. Accordingly, the RBI issued new guidelines, effective March 31, 2002 (Box IV.2).

Overdue Period for the Principal Amount Reduced for NPAs of FIs

4.11 With effect from the year ending March 31, 2002 FIs are classifying an asset as non-performing, if interest and/or instalment of principal remain overdue for more than 180 days instead of the overdue period of 365 days for principal earlier.

Risk-Weight on Staff Loans and Advances

4.12 A risk-weight of 20 per cent has been assigned on all loans and advances granted to FIs own employees which are fully covered by superannuation benefits and mortgages of flats/ houses. All other loans and advances granted to their own employees are subject to 100 per cent risk-weight.

Treatment of Preference Shares for Capital Adequacy of FIs - Grant Equivalent

4.13 Under the extant instructions (effective April 1999), the amount of “grant equivalent” in

Box IV.2: Guidelines for time Overrun in Projects under Implementation and Classification of Assets

To ensure that loan assets with respect to projects under implementation are classified appropriately and asset quality correctly evaluated, projects under implementation have been classified under the following three categories:

Category I: *Projects where financial closure had been achieved and formally documented.*

In such cases, usually involving infrastructure or large value manufacturing projects financed post 1997, the two year time period is to be counted from the date of completion of project, as envisaged at the time of original financial closure. The asset is to be treated as standard for a period not exceeding two years beyond the date of completion, envisaged at the time of initial financial closure of project. In case of projects where the financial closure has not been formally documented, the norms enumerated for category III would apply.

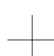
Category II: *Projects with original project cost of Rs. 100 crore or more.*

Such projects (sanctioned prior to 1997) where the date of financial closure had not been formally documented, an independent Group was constituted with experts from outside as well as lending institutions to decide on a project-by-project basis, the deemed date of completion of the project. The asset in this category, is to be treated as standard only for a period not exceeding two years beyond the deemed date of completion of project.

Category III: *Projects with original project cost of less than Rs. 100 crore.*

For projects (sanctioned prior to 1997), where financial closure has not been formally documented, the date of commencement of commercial production is to be deemed as the date exactly two years after the date of completion of project, as originally envisaged at the time of sanction. The asset is to be continued to be treated as standard only for a period not exceeding two years beyond the originally envisaged date of completion of project.

In all the three categories, in case of time overruns beyond the aforesaid periods of two years, the asset is to be classified as sub-standard regardless of the record of recovery and provided for accordingly. For projects to be financed by FIs in future, the date of completion should be clearly indicated at the time of financial closure. If the date of commencement of commercial production extends beyond six months after the originally envisaged date of project completion, the account should be treated as sub-standard. To ensure uniformity in interpretation, the term ‘financial closure’ for projects was standardised. For greenfield projects, financial closure is a legally binding commitment of equity holders and debt financiers to provide/mobilise funding for at least 90 per cent of total cost, thereby securing the construction of the facility.



respect of preference shares of 20-year original maturity issued by the FIs, is permitted to be reckoned as an element of tier I capital of the FI. The instructions for computation of the amount of "grant equivalent" were modified with effect from November 29, 2001 to obviate certain anomalies observed. Accordingly, for such preference shares, the amount of "grant equivalent" reckoned towards tier I capital of FIs is to be computed after making certain adjustments on account of present value (PV) of dividend outflows, dividend tax and tax on income from investment[5]. If the balance amount after creating the corpus is not deployed in separate identifiable investments/securities but instead utilised as working funds, then cash inflow on account of income thereon is computed as notionally equivalent to the return on average working funds in the preceding financial year.

Conversion of Debt into Equity or other Instruments

4.14 As part of restructuring of borrowal accounts, the debt outstanding is, at times, converted into certain financial instruments which would normally comprise the principal and interest components. If interest dues are converted into equity or other instruments, the income recognised in consequence shall be fully provided for. This would be in addition to the provision made towards depreciation in value of equity/other instruments, as per investment valuation norms. If interest is, however, converted into equity which is quoted, interest income can be recognised at market value of equity on the date of conversion. Such equity would be then classified as "available for sale" and valued at lower of cost or market value.

4.15 The debentures issued for conversion of principal and /or interest in respect of NPAs should be treated as NPA, *ab initio*, in the same asset classification applicable to the loan prior to conversion, with usual normative provisions. This is also applicable to zero coupon bonds or other instruments seeking to defer the liability of the issuer. On such debentures, income should be recognised only on realisation basis. The income in respect of unrealised interest converted into debentures or any fixed maturity instrument is to be recognised only on redemption of such instrument. The equity shares or other instruments arising from conversion of principal amount of loan are also subject to the usual prudential valuation norms, as applicable to such instruments.

Corporate Debt Restructuring

4.16 A three-tier corporate debt restructuring (CDR) system was introduced on August 25, 2001. This is applicable only to multiple banking/syndicates/consortium accounts, in the standard and sub-standard categories, with outstanding exposure of Rs.20 crore and above with banks and FIs. FIs should disclose accounts restructured under this system, under the standard and sub-standard categories as also in aggregate, separately, in the annual reports under "notes to accounts".

Classification and Valuation of Investments

Treatment of Preference Shares

4.17 Preference shares, excepting convertible preference shares, with definite maturity period can be included in the held to maturity (HTM) category irrespective of maturity period, subject to the following:

- Preference shares acquired as a part of project financing, and meeting the extant criteria for treating bonds and debentures as 'in the nature of advance' should be treated as in the nature of advance. Such shares are not counted

[5] Amount received against the preference shares ....(A)

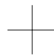
less

(a) the amount of corpus created as per the existing norms; (b) the PV of the dividend outflows on the preference shares issued; (c) the PV of the dividend tax payable; (d) the PV of the tax payable on the income from investment of the amount left after creating the corpus;

add

(e) the PV of the cash inflows / income from the investment of the amount left after creating the corpus

Amount of "grant equivalent" that would be counted towards tier I capital........ } = [A – (a + b + c + d) + e]



towards the ceiling of 25 per cent on investments in HTM category and valued by notionally extending asset-classification norms on outstanding loans of issuing company and provision for depreciation is also accordingly made. If loans are in standard category, provision as applicable to standard loan assets is required for depreciation in the value of shares. If loans are in doubtful category, the preference shares held are treated as an unsecured facility and fully provided for.

- All other preference shares in HTM category are to be reckoned within the ceiling of 25 per cent for investments in HTM category. Such shares should be valued at acquisition cost unless acquired at a premium, in which case, the valuation ought to be at amortised cost. Any diminution, other than temporary, in value should be determined and provided for each investment individually and not be set off against appreciation in other preference shares.

Valuation of non-HTM Preference Shares

4.18 In view of the modification in the tax treatment of dividend on shares by the Central Government Budget 2002-03, the norms for valuation of preference shares were also modified and a revised formula for valuation of preference shares in AFS and HFT categories was prescribed as follows:

(1) a) Yield to maturity (YTM) of the preference share is to be determined as per its cash flow profile;

b) Obtain YTM on government security of equivalent residual maturity; add applicable credit spread/risk premium as per the rating of the preference shares; [in case of unrated preference shares, the aforesaid credit/risk premium should be determined as per the extant norms detailed below at item (2)]

c) Value the preference shares as per the following formula :

$$\frac{\text{YTM of the Preference share}}{\text{rate arrived at step (b)}} \times 100.$$

(2) For unrated preference shares, the credit spread/risk premium added to YTM of specified government security is determined in the following manner:

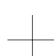
a) In case the company issuing unrated preference shares has other rated instruments which are outstanding, then a rating one full-notch below that rating should be arrived at (for instance, for a ‘AAA’ rating, only ‘AA’ rating is reckoned). If more than one rated instrument issued by the company is outstanding, then rating of that instrument which has been assigned the rating most recently is reckoned. The risk spread corresponding to such rating, as announced by Fixed Income Money Market and Derivatives Association (FIMMDA), would be the spread to be added to the YTM of the government security;

b) In case, no other instrument of the company issuing the preference shares has been rated and is outstanding, then a credit spread not less than the spread applicable to bond of minimum investment grade, i.e., a ‘BBB’ rated bond, would be added to the YTM of the government security.

Ceiling on YTM Valuation of Preference Shares

4.19 The restriction of not valuing preference shares above their redemption value stands withdrawn. Unquoted preference shares are to be valued on YTM basis, even if it results in higher than redemption value. For equity shares, if the market quotation is more than 30 days old it is reckoned as an unquoted investment and valued at break-up value. The market price for valuation of quoted equity shares is the price derived for reasonable volume of transactions between two independent parties, in an arms-length relationship, and not just a solitary trade for small volume transactions.

4.20 The thinly traded equity is identified as having monthly trading of less than Rs. 5 lakh or total trading volume less than 50,000 shares. If stock exchange identifies such securities, the latest quotation should be used for valuation. If stock exchange does not provide identification information, FIs may determine whether the share is a thinly traded one, and use the latest quotation for valuation.



The Age of "Latest" Balance Sheet

4.21 In view of genuine operational problems faced by the FIs in valuation of unquoted equity shares of companies which close their annual accounts on dates other than March 31, the latest balance sheet for determining the break up value should not be older than 21 months as on valuation date, failing which, the equity shares would be valued at Re. 1/- per company.

Tenor of Bonds/Debentures Deemed to be in the Nature of Advance

4.22 Reckoning the predominantly long-term nature of loan assets of FIs, the exemption available at present, from the 25 per cent ceiling for HTM category of investments, in respect of debentures/bonds acquired by FIs as part of working capital finance with a maturity of less than one year, was removed. Debentures/bonds with tenor of three years and more, acquired through private placement, with the FI holding at least 10 per cent stake in the issue, would only be deemed to be in the nature of advance and included in HTM category, but excluded for the purpose of 25 per cent ceiling on HTM category. All debentures/ bonds of less than three-year tenor are to be placed in the available for sale (AFS) or held for trading (HFT) category and if kept in HTM category, these are to be reckoned within the 25 per cent ceiling.

Wilful Defaulters

4.23 The RBI, in consultation with the Central Government, constituted a Working Group on Wilful Defaulters (WGWD), (Chairman : Shri S. S. Kohli). The Group submitted its report in November 2001. As per the new definition, a wilful default would be deemed to have occurred if any of the following events is noted: (a) the unit has defaulted in meeting its payment/ repayment obligations to the lender even when it has the capacity to honour the said obligations; (b) the unit has defaulted in meeting its payment/repayment obligations to the lender and has not utilised the finance from the lender for the specific purposes for which finance was availed of but has diverted the funds for other purposes; and (c) the unit has defaulted in meeting its payment/repayment obligations to the lender and has siphoned off the funds and these have not been utilised for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets.

4.24 No additional facilities should be granted by any bank or FI to the listed wilful defaulters. In addition, the entrepreneurs or promoters of companies where banks or FIs have identified siphoning/diversion of funds, misrepresentation, falsification of accounts and fraudulent transactions should be debarred from institutional finance from scheduled commercial banks, DFIs, Government owned NBFCs, investment institutions, etc. for floating new ventures for a period of five years.

Additional Disclosures

4.25 To enhance transparency in the annual reports of FIs and in consonance with international best practices, additional disclosures of certain parameters were considered desirable and were made effective from the financial year 2001-02. These disclosures relate to publication of movement in provisions held towards NPAs and depreciation in investment portfolio and are to be made in the annual reports as part of "notes to accounts". This would enable authentication of such information by the auditors. The disclosures are to be made even if the information is contained elsewhere in the annual report. The prescribed disclosures constitute the minimum, and it is considered desirable for FIs to make further disclosures.

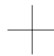
Supervision of Financial Institutions

On-site Inspection

4.26 The RBI commenced on-site inspection, once in two years, of select all-India FIs, since 1995 under Section 45 N of the RBI Act, 1934. The process was strengthened with the introduction of annual inspections effective March 31, 2001 and all supervised FIs were inspected under inspection cycle 2001-02 accordingly. Inspection cycle 2002-03 has been initiated and inspection of all 9 FIs falling under RBI supervision has been scheduled with reference to balance sheet date of the FIs.

Prudential Off-site Surveillance System

4.27 A prudential supervisory reporting system (PSRS) for an on-going off-site surveillance as a



part of the integrated supervisory strategy was introduced in July 1999. Effective quarter ended September 2001, the formats of returns were revised to reflect latest regulatory prescriptions and FIs have to submit all seven returns on a 'quarterly' basis. The prudential returns submitted by FIs are scrutinised and an analytical review is submitted to the Board for Financial Supervision (BFS). The Report for the quarter ended June 2002 has been submitted to BFS.

Other Policy Developments

Dematerialisation of Bonds/Debentures, CPs and CDs

4.28 In public interest, FIs were advised to issue certificates of deposits (CDs) and make fresh investments in Commercial Papers (CPs) only in dematerialised form effective June 30, 2001. All outstandings had to be converted into dematerialised form by October 31, 2001. Moreover, FIs were required to make fresh investments and hold bonds, debentures, privately placed or otherwise, only in dematerialised form with effect from October 31, 2001. Outstanding investments in scrip form had also to be converted into dematerialised form by June 30, 2002. As regards holding of equity instruments in demat form, the date would be notified in consultation with SEBI.

Minimum Size and Pricing of CDs

4.29 To expand the investor base for CDs, both the minimum and multiple requirements were reduced to Rs.1 lakh from the existing levels of Rs.10 lakh and Rs. 5 lakh, respectively. The amount relates to face value (i.e., maturity value) of CDs issued. In order to provide more flexibility for pricing of CDs and to give additional choice to both investors and issuers, banks and FIs may issue CDs on floating rate basis provided the methodology of computing the floating rate is objective, transparent and market-based.

Ready Forward Contracts

4.30 With the operationalisation of Clearing Corporation of India Ltd. (CCIL), modified instructions were issued to FIs which, *inter alia*, state that ready forward contracts would be settled through the participant's Subsidiary General Ledger (SGL) accounts with the RBI or through the accounts of CCIL with the RBI.

Exposure Norms for Refinancing Institutions (RFIs)

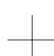
4.31 It was clarified that the credit exposure norms applicable to term lending institutions are also applicable to the refinancing institutions (*viz*. NABARD, NHB and SIDBI). Since refinancing is the core function of these institutions, their refinance portfolio, however, is not subject to such exposure norms. From a prudential perspective, however, RFIs should evolve credit exposure limits, even for the refinancing portfolio, with the approval of their Boards. These norms could, among others, be related to the capital funds or regulatory capital of the institution. Relaxation or deviation from such norms should only be permitted with prior approval of the Board.

Asset Liability Management (ALM) System - Treatment of Securities in the Trading Book

4.32 As some FIs are still in a nascent stage of developing risk management systems, and with a view to keeping the ALM system simple at the initial stages, it was decided that the 'trading book' may continue to be covered under the ALM system, till the ALM system stabilises and FIs are able to migrate to more sophisticated techniques for management of interest rate risk, separately for the banking and trading book. In the interregnum, the securities in the trading book may be slotted as per the residual maturity or re-pricing maturity for floating rate securities, as against the defeasance period prescribed earlier. Accordingly, the ALM guidelines in respect of the related items were amended.

Guidelines for Entry of all-India Financial Institutions into Insurance Business

4.33 On account of the interest evinced by some all-India FIs for entering into insurance business, guidelines regarding entry of FIs into insurance sector were issued in November 2001 (Box IV.3). The FIs are required to ensure that risks involved in insurance business do not get transmitted to the FI and that any risk that may arise from insurance business does not contaminate its principal business.



Box IV.3: Guidelines for Entry of All-India Financial Institutions into Insurance Business

A. Insurance business without risk participation

An FI having a net owned fund of Rs. 2 crore is permitted to undertake insurance business as an agent of insurance companies on fee basis, without any risk participation.

B. Insurance business with risk participation

An FI which satisfies the eligibility criteria given below is permitted to set up a joint venture company for undertaking insurance business with risk participation, subject to safeguards. The maximum equity contribution that the FI can hold in the joint venture company will normally be 50 per cent of the paid-up capital of the insurance company. On a selective basis, a higher equity contribution by a promoter FI may be permitted initially, pending divestment of equity within the prescribed period. The eligibility criteria for joint venture participant are: owned fund of at least Rs.500 crore, minimum CRAR of 15 per cent, NPAs not more than 5 per cent of outstanding loans and advances, and net profits for the last three consecutive years. Further, performance of subsidiaries, if any, should be satisfactory. There should be demonstrated compliance with the regulatory requirement of the RBI for raising of resources.

In case where a foreign partner contributes 26 per cent of equity with approval of Insurance Regulatory and Development Authority / Foreign Investment Promotion Board, more than one FI may be allowed to participate in the equity of the insurance joint venture.

No FI would be allowed to conduct business with risk participation departmentally. A subsidiary or a company in the same group of the FI or of another FI engaged in non-banking or banking business, will not normally be allowed to join the insurance company on risk participation basis.

FIs, not eligible as joint venture participants, can make investments up to 10 per cent of the owned fund of the FI or Rs.50 crore, whichever is lower, in the insurance company. Such participation is subject to certain eligibility conditions and will be treated as an investment and is without any contingent liability for the FI.

All FIs entering into insurance business as agents or investors or on risk participation basis have to obtain prior approval of the RBI.

2. Financial Position[6]

Financial Assets of All-India FIs

4.34 The aggregate financial assets of banks and FIs as at end-March 2002 at Rs. 17,58,032 crore recorded a growth of 9.2 per cent over the corresponding level of the previous year, lowest in the last ten years [Appendix Table IV.1 (A)]. There was a sharp decline in the growth of financial assets of FIs by 12.5 per cent as at end-March 2002 consequent to the merger of ICICI Ltd. with ICICI Bank. Accordingly, the share of FIs in the aggregate financial assets of banks and FIs as at end-March 2002 declined as compared to the previous year.

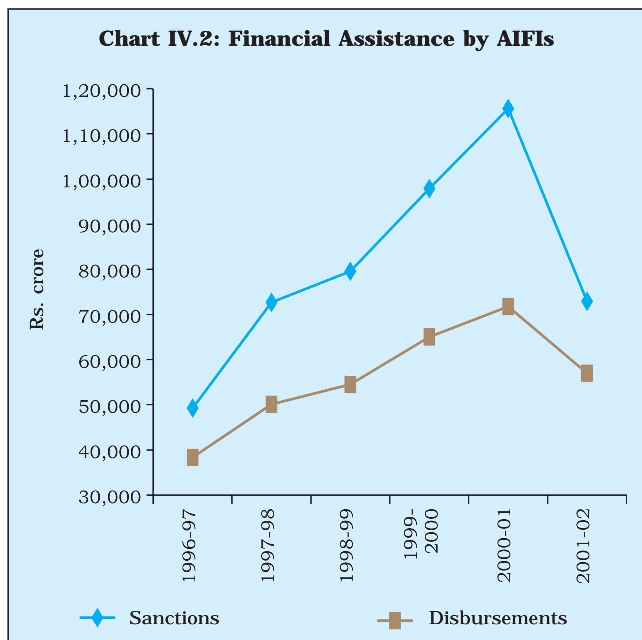
4.35 Among the AIFIs, NABARD recorded the maximum rise of 15.5 per cent in its financial assets, followed by IDFC (13.9 per cent) and EXIM Bank (11.1 per cent). There was decline in the financial assets of IDBI (6.6 per cent), IFCI (3.7 per cent) and NHB (1.4 per cent) [Appendix Table IV.1(B)].

Financial Assistance Provided by AIFIs[7]

4.36 Financial assistance sanctioned and disbursed by AIFIs during 2001-02 at Rs.72,878 crore and Rs.56,985 crore, respectively, declined by 36.9 per cent and 20.6 per cent over the previous year. During 2000-01 sanctions and disbursements had increased by 18.1 per cent and 10.3 per cent, respectively (Appendix Table IV.2 and Chart IV.2). The upward trend in financial assistance sanctioned and disbursed since 1996-97 was, thus reversed during 2001-02, mainly attributable to excess capacity in the industrial sector and lower effective demand. Financial assistance sanctioned by all-India development banks (AIDBs), which accounted for bulk of sanctions (86.1 per cent of total sanctions by AIFIs) declined by 35.0 per cent, while their disbursements declined by 24.2 per cent. During 2001-02, specialised financial institutions (*viz.*, IFCI Venture Capital Funds, ICICI Venture and TFCI) witnessed sharp increase in both sanctions and disbursements by 157.3 per cent and 242.8

[6] Due to merger of ICICI Ltd. with ICICI Bank Ltd. with effect from March 30, 2002 the balance sheet data for ICICI Ltd. as on March 31, 2002 do not exist. Flow data on sanctions and disbursements, resources raised from the capital market and money market operations during 2001-02 are, however, available for ICICI Ltd. (upto March 29, 2002).

[7] Data include those for ICICI Ltd. for 2000-01 and 2001-02 (upto March 29, 2002).



per cent, respectively, to Rs.872 crore and Rs.869 crore. The sanctions and disbursements by investment institutions declined to Rs.9,238 crore (by 50.6 per cent) and Rs. 11,649 crore (8.9 per cent), respectively.

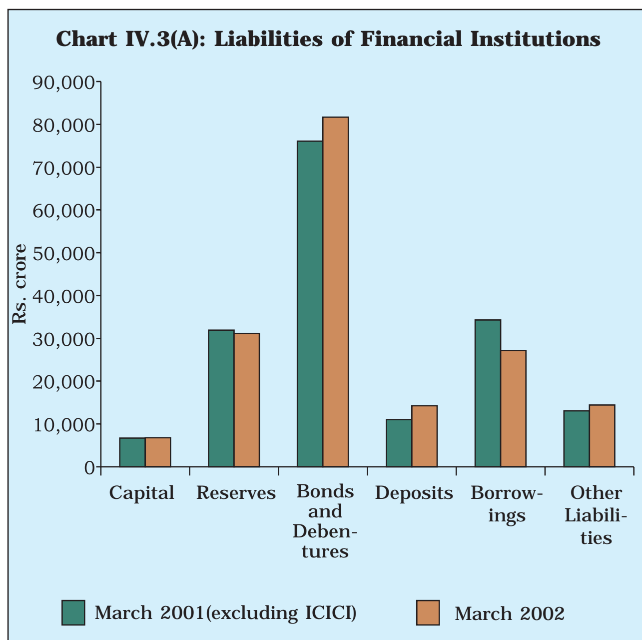
Assets and Liabilities Structure of FIs[8]

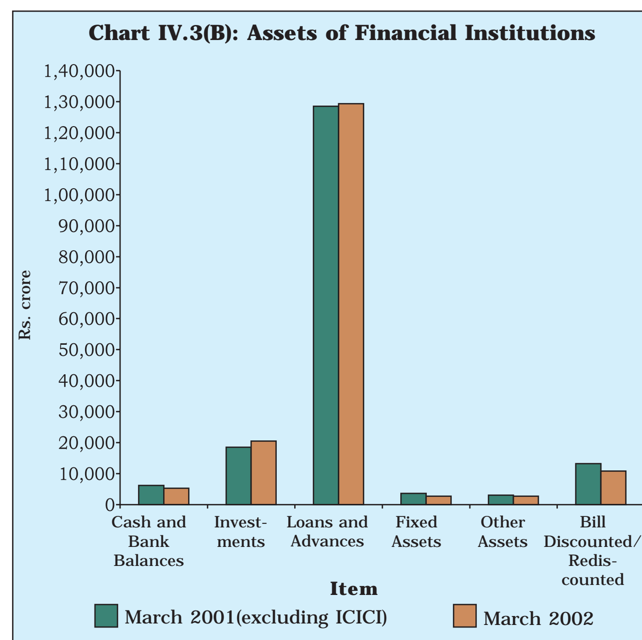
4.37 Total assets/liabilities of AIFIs as at end-March 2002 increased by 1.4 per cent over the previous year's level (excluding ICICI) (Appendix Table IV.3). As in the previous year, the composition of liabilities continued to move in favour of bonds and debentures and deposits. The combined share of bonds and debentures and deposits as at end-March 2002 stood at 54.7 per cent as compared to 50.3 per cent in the previous year. During the same period, the share of capital and reserves declined from 22.4 per cent to 21.6 per cent [Chart IV.3(A)].

4.38 Loans and advances (the major component on the asset side) recorded only 0.6 per cent growth over the previous year though its share in the total assets declined from 75.5 per cent as at end-March 2001 to 75.0 per cent at end-March 2002. The share of investments increased during the same period while that of cash and bank balances, bills discounted/ rediscounted and fixed assets declined [Chart IV.3 (B)].

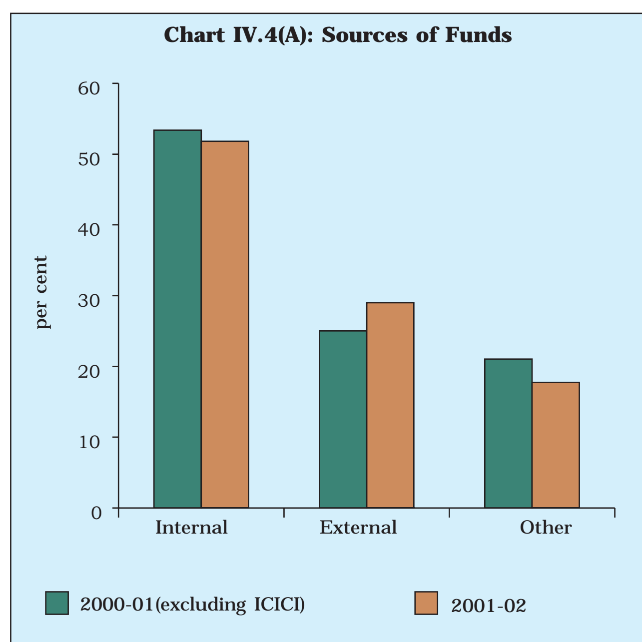
Sources and Uses of Funds

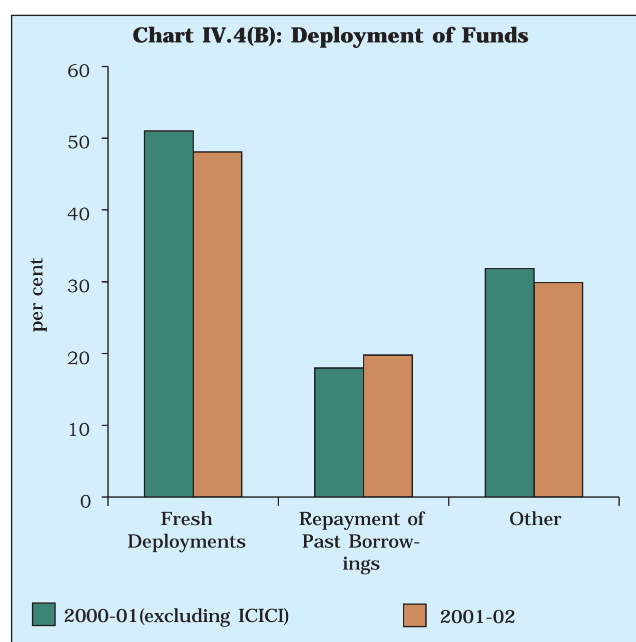
4.39 The dependence of FIs on external sources of funds increased during the year which may be attributed to the softer interest rate environment. The share of internal sources in the total sources of funds for FIs during 2001-02 was lower at 52.5 per cent as compared to 53.4 per cent in the previous year (excluding ICICI) (Appendix Table IV.4). The share of





[8] For the sake of comparability, the data for ICICI Ltd. have been excluded from 2000-01.





external sources during 2001-02 was 29.1 per cent as compared to 25.6 per cent in the previous year [Chart IV.4 (A)].

4.40 Reflecting the industrial slowdown, the share of fresh deployments in the total uses of funds declined to 49.5 per cent, while that of repayment of borrowings increased to 21.3 per cent during 2001-02 [Chart IV.4(B)].

Financial Performance of AIFIs[9]

4.41 The combined net profit of 9 AIFIs continued to decline during 2001-02. While income declined by 3.2 per cent, expenditure increased by 4.8 per cent, mainly due to a sharp increase of 97.3 per cent in provisions. Consequently, net profit showed a sharp decline of 46.5 per cent during 2001-02. The spread (net interest income) as ratio of total assets worsened from 1.55 per cent in 2000-01 to 1.27 per cent in 2001-02 (Table IV.1).

4.42 In order to meet the new disclosure requirements, FIs had been providing certain operating ratios from the year 2000-01 (Appendix Table IV.5). These include, among others, return on average assets, CRAR and net NPAs to net loans. IFCI continued to record negative return on average assets and net loss per employee. CRAR has been high in the case of all AIFIs, excepting IFCI. The ratio of net NPAs to net loans and advances is the highest in case of IIBI (24.1 per cent), followed by IFCI (22.5 per cent) TFCI (20.2 per cent) and IDBI (13.4 per cent).

Prime Lending Rates (PLRs)

4.43 There has been a softening of interest rates during 2001-02 (Table IV. 2). The long term PLR in respect of IDBI exhibited a decline from 14.0 per cent in March 2001 to 11.5 per cent in March 2002. Similarly, the medium and short term PLR also decreased from 13.0 per cent and 12.5 per cent, respectively, to 12.5 per cent and 12.0 per cent. In the case of IFCI, interest rates softened at the long end of the maturity spectrum but remained constant at the short end.

Resources Raised by Major Financial Institutions

4.44 During 2001-02, the total resources mobilised by the three major FIs [*viz.*, IDBI, ICICI (upto March 29, 2002) and IFCI] from the capital market aggregated Rs.18,735 crore registering an increase of 11.9 per cent over Rs.16,737 crore raised during 2000-01 (Table IV.3). The private placement market remained the dominant source of resources, as 73.5 per cent of the funds

[9] For the sake of comparability, the data for ICICI Ltd. have been excluded from 2000-01.

Table IV.1: Financial Performance of Financial Institutions*

(Amount in Rs. crore)

Item	2000–01		2001-02	Variation of			
		(Excluding ICICI)		Column (4) over (2)		Column (4) over (3)	
				Absolute	Percentage	Absolute	Percentage
1	2	3	4	5	6	7	8
A. Income (i+ii)	**27,064.52 (100.00)**	**17,766.47 (100.00)**	**17,195.79 (100.00)**	**-9,868.73**	**-36.46**	**-570.68**	**-3.21**
i) Interest Income	24,721.22 (91.34)	15,885.05 (89.41)	15,516.49 (90.23)	-9,204.73	-37.23	-368.56	-2.32
ii) Other Income	2,343.30 (8.66)	1,881.42 (10.59)	1,679.30 (9.77)	-664.00	-28.34	-202.12	-10.74
B. Expenditure (i+ii+iii)	**23,745.46 (100.00)**	**14,984.68 (100.00)**	**15,708.43 (100.00)**	**-8,037.03**	**-33.85**	**723.75**	**4.83**
i) Interest Expended	19,571.50 (82.42)	13,194.72 (88.05)	13,287.37 (84.59)	-6,284.13	-32.11	92.65	0.70
ii) Provisions	1,576.15 (6.64)	657.25 (4.39)	1,296.97 (8.26)	-279.18	-17.71	639.72	97.33
iii) Other Expenses	2,597.81 (10.94)	1,132.71 (7.56)	1,124.09 (7.16)	-1,473.72	-56.73	-8.62	-0.76
of which : Wage Bill	476.34 (2.01)	377.30 (2.52)	404.82 (2.58)	-71.52	-15.01	27.52	7.29
C. Profit							
i) Operating Profit	**4,895.21**	**3,439.04**	**2,784.33**	**-2,110.88**	**-43.12**	**-654.71**	**-19.04**
ii) Net Profit	**3,319.06**	**2,781.79**	**1,487.36**	**-1,831.70**	**-55.19**	**-1,294.43**	**-46.53**
D. Total Assets	**2,46,525.84**	**1,73,112.11**	**1,75,520.47**	**-71,005.37**	**-28.80**	**2,408.36**	**1.39**
E. Financial Ratios (per cent) @							
i) Operating Profit	1.99	1.99	1.59				
ii) Net Profit	1.35	1.61	0.85				
iii) Income	10.98	10.26	9.80				
iv) Interest Income	10.03	9.18	8.84				
v) Other Income	0.95	1.09	0.96				
vi) Expenditure	9.63	8.66	8.95				
vii) Interest Expended	7.94	7.62	7.57				
viii) Other Operating Expenses	1.05	0.65	0.64				
ix) Wage Bill	0.19	0.22	0.23				
x) Provisions and Contingencies	0.64	0.38	0.74				
xi) Spread (Net Interest Income)	2.09	1.55	1.27				

@ Ratios to Total Assets.

* IDBI,TFCI,EXIM BANK,NABARD,SIDBI,IDFC,IFCI, IIBI and NHB which are regulated and supervised by the RBI.

Note: Figures in brackets are percentage shares to the respective total.

aggregating Rs.13,772 crore were raised through this route. The relative reliance on the private placement market, however, declined as these institutions raised substantial amount from the public issue market as well. The debt issues by IDBI and ICICI constituted 69.8 per cent of the total resources mobilised in the public issue market. Institution-wise, ICICI during 2001-02 (prior to its merger), raised the maximum amount of Rs.13,411 crore from the capital market, while IDBI and IFCI raised Rs. 4,359 crore and Rs.965 crore, respectively.

FIs' Money Market Operations

4.45 With a view to moving towards pure inter-bank call/notice money market, non-bank entities are permitted to lend, on average in a reporting fortnight, upto 85 per cent of their average lending during 2000-01 effective May 5, 2001. Accordingly, with regard to FIs, the effective limit for thirteen FIs (*viz.*, UTI, LIC, IDBI, NABARD, erstwhile ICICI, GIC, EXIM Bank, NHB, SIDBI, IIBI, ECGC, IFCI and TFCI) who had been permitted to lend in call/notice money market, stood reduced to Rs. 3,429 crore. As a

Table IV.2: Lending Rate Structure of Major FIs

(Per cent per annum)

Effective from	IDBI	ICICI #	IFCI
March 2001			
LTPLR	14.0	12.5	13.0
MTPLR	13.0	12.5	-
STPLR	12.5	12.5	12.5
July 2001			
LTPLR	13.1	12.5	13.0
MTPLR	12.5	12.5	-
STPLR	12.0	12.5	12.5
March 2002			
LTPLR	11.5	12.5	12.5
MTPLR	12.5	12.5	-
STPLR	12.0	12.5	12.5

LTPR - Long Term PLR MTPLR - Medium Term PLR
STPLR - Short Term PLR

Merged with ICICI Bank Ltd. with effect from March 30, 2002.

Note: All interest rates stated above are exclusive of interest tax unless stated otherwise.

Source: Respective FIs

result, the average daily lending by FIs declined from Rs.4,034 crore during 2000-01 to Rs. 2,620 crore during the year 2001-02. The share in aggregate lending thus, dropped from 31.5 per cent to 15.6 per cent over this period. During the year, one major insurance company had requested for enhanced access to call/notice money market in view of unexpected large inflows and the RBI accorded permission for a limited period. During the year 2002-03 (upto October 20, 2002), the average lending of the FIs in the call/notice money market increased to Rs.2,795 crore, in contrast to the decline witnessed in 2001-02. This amounts to 20.1 per cent of total lending in call/notice money market.

4.46 During the course of 2001-02, while the average lending in the call market increased, largely reflecting improved liquidity in the system, the net supply of funds by non-banks (i.e., FIs and mutual funds) in the repo market more than doubled from Rs. 16,980 crore in May 2001 to Rs. 36,178 crore in March 2002. It, however, declined to Rs.32,152 crore in April 2002 and further to Rs.28,462 crore in August 2002.

4.47 Select all-India FIs are permitted by the RBI to raise resources by way of term money, issue of CDs and CPs, acceptance of term deposits and ICDs (wherever applicable). The select FIs, *viz.,* IDBI, IFCI, EXIM Bank, SIDBI, IIBI, TFCI, NABARD, IDFC and NHB have been given umbrella limits to raise resources equivalent to 100 per cent of their net owned funds (NOF) as per their latest audited balance sheet. The average aggregate amount of resources raised by the FIs by way of these instruments declined to Rs.10,112 crore (33.0 per cent of limits) during 2001-02. It declined further to Rs.6,904 crore during the period April to September 20, 2002 (Table IV.4). Significantly, only three institutions *viz.,* erstwhile ICICI (upto March 29, 2002), IDBI and IFCI accounted for as much as about 97 per cent of total resources mobilised. After the exit of ICICI, however, only IDBI and IFCI continue to account for the major part of resources mobilised. NABARD, NHB and IDFC had not mobilised any resources under their umbrella limits during the period under review. Inter-corporate deposits (ICDs) continued to remain the most preferred instrument followed by term money, term deposits, CDs and CPs during 2001-02 and 2002-03 (April-September 20, 2002).

Table IV.3: Resources Raised by Major FIs

(Rs. crore)

	ICICI			IDBI			IFCI			Total		
	1999-00	2000-01	2001-02	1999-00	2000-01	2001-02	1999-00	2000-01	2001-02	1999-00	2000-01	2001-02
1	2	3	4	5	6	7	8	9	10	11	12	13
Public Issue	2,575.2	2,050.0	4,058.0	2,073.6	1,111.0	905.0	352.0	0	0	5,000.8	3,161.0	4,963.0
	(33.0)	(18.6)	(30.0)	(34.0)	(26.0)	(21.0)	(13.0)	(0.0)	(0.0)	(30.0)	(18.9)	(26.5)
Private Placement	5,196.6	8,944.1	9,352.8	4,094.3	3,099.9	3,453.6	2,357.2	1,531.8	965.4	11,648.1	13,575.8	13,771.8
	(67.0)	(81.4)	(70.0)	(66.0)	(74.0)	(79.0)	(87.0)	(100.0)	(100.0)	(70.0)	(81.1)	(73.5)
Total	**7,771.8**	**10,994.1**	**13,410.8**	**6,167.9**	**4,210.9**	**4,358.6**	**2,709.2**	**1,531.8**	**965.4**	**16,648.9**	**16,736.8**	**18,734.8**
	(100.0)	**(100.0)**	**(100.0)**	**(100.0)**	**(100.0)**	**(100.0)**	**(100.0)**	**(100.0)**	**(100.0)**	**(100.0)**	**(100.0)**	**(100.0)**

Note: Figures in parenthesis indicate percentage share in total resource mobilisation.

Table IV.4: Money Market Operations of Select all-India Financial Institutions

(Rs. crore)

Instrument	2000-01	2001-02	2002-03 (April-September 20, 2002)
1	2	3	4
Average Lendings			
1 Call / Notice Money	4,034	2,620	2,795 *
Average Borrowings			
2 Term Money	999	1,206	464
3 Term Deposit	701	1,166	1,215
4 Inter Corporate Deposits	5,940	6,526	4,116
5 Certificates of Deposit	2,686	981	543
6 Commercial Paper	72	234	566
Total (2 to 6)	10,398	10,112	6,904

* Upto October 20, 2002

Asset Classification and Capital Adequacy of Select FIs.

4.48 As mentioned earlier, the prudential regulatory norms of RBI relating to asset classification and capital adequacy are attracted only by the nine all-India FIs which fall within the regulatory domain of RBI. In respect of these FIs, the ratio of net NPA to total loans as on March 2002 was 24.1 per cent for IIBI followed by IFCI (22.5 per cent), TFCI (20.2 per cent) and IDBI (13.4 per cent). As compared to the previous year, IDBI, EXIM Bank and TFCI have recorded some improvement in their NPA position while IFCI, IIBI and SIDBI have recorded deterioration with respect to the share of delinquent loans in net loans (Table IV.5).

4.49 The CRAR for SIDBI, EXIM Bank, NABARD and IDFC ruled higher than 30 per cent. IFCI remained the only institution which recorded CRAR below 10 per cent (Table IV.6).

RBI Assistance to Financial Institutions

4.50 As part of the initiative to divest itself of development financing functions, the RBI transferred the assets on account of loans and advances worth Rs. 3,792 crore (face value) to the developmental financial institutions (*viz.* IDBI, SIDBI, EXIM Bank and IIBI) out of National Industrial Credit (Long Term Operations) Fund to the Government, replacing them with long-term Government of India securities (10.25 per cent Government Stock 2021 of Rs. 3,213 crore face value) through private placement. The transaction was effected by matching the discounted present values (discounted at yields prevailing on March 28, 2002) so that it was cash neutral. These FIs issued 20 years convertible bonds in favour of the Central Government which qualify as tier I capital. The outstanding long-term borrowing by NHB from the National Housing Credit (LTO) Fund as at end-March 2002 stood at Rs.175 crore.

4.51 Under Section 17(4A)/(4BB) of the RBI Act, 1934, the RBI sanctioned *ad hoc* borrowing

Table IV.5: Asset Classification of Select FIs
(As at end-March)

(Rs.crore)

Institution	Standard		Sub-standard		Doubtful		Loss		Total Net Loans Outstanding #		Net NPA/Net Loans (per cent)	
	2001	2002	2001	2002	2001	2002	2001	2002	2001	2002	2001	2002
1	2	3	4	5	6	7	8	9	10	11	12	13
IDBI	48,107	40,947	3,014	2,490	5,356	3,865	—	—	56,478	47,302	14.8	13.4
ICICI	54,525	@	885	@	2,097	@	—	—	57,506	@	5.2	@
IFCI	14,818	13,373	934	877	2,963	2,996	—	—	18,715	17,246	20.8	22.5
SIDBI	13,934	12,344	61	270	113	112	—	—	14,108	12,727	1.2	3.0
NABARD	35,771	40,960	0	0	0	0	—	—	35,771	40,960	0.0	0.0
NHB	4,046	4,630	0	0	0	0	—	—	4,046	4,630	0.0	0.0
IIBI	2,108	1,700	201	115	424	424	—	—	2,733	2,239	22.9	24.1
EXIM Bank	4,562	5,624	236	247	171	201	—	—	4,969	6,072	8.2	7.4
IDFC	1,199	2,007	0	0	0	0	—	—	1,199	2,007	0.0	0.0
TFCI	604	619	81	47	75	110	—	—	759	776	20.5	20.2

Data for 2001-02 are provisional. # Net of provisioning and write-offs. @ merged with ICICI Bank Ltd.
Note: NPA in any year is the aggregate of the amounts under sub-standard, doubtful and loss category in that year.
Source: Respective Financial Institutions.

Table IV.6: Capital Adequacy Ratio@ of Select FIs

(Per cent)

Institution	As at end-March			
	1999	2000	2001	2002
1	2	3	4	5
1. IDBI	12.7	14.5	15.8	17.9
2. ICICI	12.5	17.2	14.6	#
3. IFCI	8.4	8.8	6.2	3.1
4. SIDBI	26.9	27.8	28.1	45.0
5. IIBI	11.7	9.7	13.9	13.6
6. EXIM Bank	23.6	24.4	23.8	33.1
7. NABARD	53.3	44.4	38.5	36.9
8. IDFC	235.5	119.7	85.5	56.9
9. NHB*	17.3	16.5	16.8	22.1
10. TFCI	15.4	16.2	18.6	18.5

@ As per cent of risk weighted assets.

Merged with ICICI Bank Ltd.

* Relate to general fund.

Note : The figures furnished in this table may not tally with the data given in Appendix Table IV.5 due to different sources of data.

Source : respective Financial Institutions.

limits amounting to Rs.166 crore to 13 State Financial Corporations (SFCs) during 2001-02 at bank rate, against *ad hoc* bonds guaranteed by respective State Government/Union Territories. The outstanding borrowing by SFCs as at end-June 2002, amounted to Rs.31 crore (Table IV.7).

Table IV.7: RBI Assistance to FIs

(Rs.crore)

Type of Assistance	Amount outstanding as on June 30, 2001	Amount outstanding as on June 30, 2002
1	2	3
A. Long Term Credit [NIC(LTO)Fund]		
1. IDBI	1,440.0	—
2. SIDBI	2,004.8	—
3. Exim Bank	617.0	—
4. IIBI	160.0	—
Total of A	**4,221.8**	**—**
B. Long Term Credit [NHC(LTO)Fund]		
1. NHB	875.0	175.0
Total of B	**875.0**	**175.0**
C. Medium/short term credit		
1. IDBI	—	—
2. SFCs	—	30.8
Total of C	**—**	**30.8**
D. Grand Total (A+B+C)	**5,096.8**	**205.8**

— NIL

3. Other Developments

Universal Banking

4.52 In response to the interest evinced by FIs to convert themselves to universal banks, RBI advised FIs to work out the transition paths for their evolution towards universal banks. Accordingly, some FIs took initiatives in this direction. For instance, ICICI Ltd. had approached the RBI with its proposal for conversion to a bank by means of reverse merger with its subsidiary ICICI Bank Ltd. The RBI gave clearance after the merger case was cleared by the High Court of Mumbai and the clearance was subject to certain terms and conditions relating to, *inter alia*, reserve requirements, prudential norms, etc.

4.53 Similarly, in order to pave the way for conversion into a universal bank, IDBI had approached the Government of India to corporatise IDBI by repealing the IDBI Act. Accordingly, the Central Government announced the proposal for corporatising IDBI by introducing the necessary legislative changes. Furthermore, in order to strengthen its capital, the International Bank for Reconstruction and Development (IBRD) loan outstanding in respect of IDBI was transferred to the Central Government and replaced with a long-term bond, which qualified as tier I capital.

Mutual Funds

Policy Developments relating to Mutual Funds

4.54 The SEBI tightened the disclosure norms for the mutual funds to help investors take more informed decisions. SEBI laid down detailed investment and disclosure norms for employees of asset management companies (AMCs) and Trustee companies in order to avoid any actual or potential conflict of interest. To promote venture capital activity, SEBI allowed the mutual funds to invest in the listed or unlisted securities or units of venture capital funds within the overall ceiling for such investment. Detailed guidelines on disclosure and reporting requirements were issued to mutual funds for investment in foreign securities. With a view to improve the professional standards, SEBI decided to make it mandatory for all mutual funds to appoint agents/distributors who have obtained Association of Mutual Funds of India (AMFI) certification.

Resource Mobilisation by Mutual Funds

4.55 During 2001-02 resource mobilisation (net) by all mutual funds together declined by 27.9 per cent to Rs.8,024 crore from Rs.11,135 crore in the previous year. While resource mobilisation by the public sector mutual funds (other than UTI) declined to Rs.1,330 crore from Rs.1,521 crore, that by the private sector mutual funds at Rs.13,977 crore increased by 50.4 per cent from Rs.9,292 crore during the same period (Table IV.8 & Appendix Table IV.6). The composition of portfolio of mutual funds moved away from equity funds in favour of debt funds. Resource mobilisation by UTI declined sharply registering an outflow of Rs.7,284 crore during 2001-02 as compared with an inflow of Rs.322 crore during the previous year.

Restructuring of UTI

4.56 The Cabinet Committee on Economic Affairs (CCEA) granted its approval to a UTI reform package in its meeting on August 31, 2002. The major highlights of the reform package are :

- The Government would honour the redemption guarantee, as approved by Cabinet Committee of Economic Reforms on December 27, 2001, for US-64 unit holders. The liability in this account was estimated to be about Rs.6,000 crore, which could vary depending on market conditions. In respect of the assured return schemes, wherever interest can be reset, it will be reset at a lower level. The shortfall in these schemes was estimated to be about Rs. 8,561 crore. The Government would also consider certain tax concessions on US-64 with a view to providing an incentive to unit holders to remain invested with the scheme.
- UTI would be divided into two parts:

Table IV.8: Resource Mobilisation by Mutual Funds

(Rs. crore)

Mutual Funds	1998-99	1999-2000P	2000-01P	2001-02P
1	2	3	4	5
I. Bank - sponsored (1 to 6)	**-88.3**	**335.9**	**247.8**	**717.6**
1. SBI Mutual Fund	-71.8	659.0	251.5	457.0
2. Canbank Mutual Fund	-16.5	-361.0	-5.4	143.2
3. Indian Bank Mutual Fund	..	..	..	..
4. BOI Mutual Fund	..	..	..	..
5. PNB Mutual Fund	..	39.6	2.1	56.7
6. BOB Mutual Fund	..	-1.7	-0.4	60.7
II. FIs - sponsored (1 to 3)	**546.8**	**295.5**	**1,272.8**	**612.8**
1. GIC Mutual Fund	-12.1	-268.2	-43.5	58.2
2. LIC Mutual Fund	348.4	284.5	566.0	732.5
3. IDBI Mutual Fund	210.5	279.2	750.3	-177.9
III. Unit Trust of India	**170.0**	**4,548.0**	**322.0**	**-7,284.0**
	(1,300.0)	(5,762.0)	(1,201.0)	(-6,119.0)
IV. Private Sector Mutual Funds	**2,066.9**	**16,937.4**	**9,292.1**	**13,977.1**
TOTAL (I+II+III+IV)	**2,695.4**	**22,116.8**	**11,134.7**	**8,023.5**

P Provisional

.. Nil or negligible.

Notes: 1. For UTI, the figures are gross value (with premium) of net sales and for other mutual funds, net sales under all schemes.

2. Figures in brackets in case of UTI pertain to net sales at face value.

3. Data exclude amounts mobilised by off-shore funds and through roll-over schemes.

Source : UTI and respective mutual funds.

(a) UTI-I and (b) UTI-II

(a) old protected UTI-I comprising of US-64 for which assured repurchase prices have been announced and assured returns schemes, and

(b) New UTI (UTI-II) comprising of all net asset value based schemes.

- Government will meet its obligations annually to cover any deficit in UTI-I .
- UTI-I will be managed by a Government appointed administrator and a team of advisers nominated by Government.
- UTI-II will for the time being be managed by professional Chairman and Board of Trustees and will be disinvested.
- UTI Act would be repealed through issue of an Ordinance and both UTI-I and UTI-II will be structured as per the SEBI Regulations.
- The operational aspect including, but not limited to distribution of assets and liabilities between UTI-I and UTI-II etc., would be worked out by Government.

4.57 On September 3, 2002, the Government announced the following decisions:

a) In view of the commitment of the Government of India to meet all shortfalls in UTI-I, UTI-I will not indulge in asset bleeding to meet redemption pressure and all sale and purchase of stocks will take place in UTI-II based upon the market perception of its fund managers or the management.

b) Fresh units of US-64 in its present form will not be issued by UTI-I.

4.58 Certain initiatives undertaken by the UTI in the recent past in the areas of investor service and efficient fund management are the following:

- making US-64 NAV-based effective January 1,2002;
- disclosure of portfolio for all schemes including US-64 on a monthly basis;
- daily announcement of NAVs;
- introduction of special repurchase facility with monthly increasing price support for investments upto 3,000 units per investor from August 1, 2001 and upto 5,000 units per investor from January 1, 2002;
- price support of Rs. 10 per unit from May 31, 2003 for holdings in excess of 5,000 units per investor;
- issue of detailed investment manual and comprehensive delegation of powers;
- setting up of Risk Management department;
- setting up of Asset Reconstruction Fund for focussed effort for recovery of NPAs;
- performance-linked incentivisation for officers;
- commissioning of Central Processing Centre and Central Data Centre and centralisation of all back office functions; and
- implementation of integrated front office automation system.