Financial Sector Reform: Review and Prospects*

I am thankful to Professor Nirvikar Singh for giving me this opportunity to be with a group of very eminent economists, with deep understanding of various aspects of India's economy. I have set, for myself, a humble task of presenting before you, a consolidated account of financial reform measures undertaken so far, and indicate where we were before reform and where we are now. Comments and outlook in regard to some of the measures would also be in order, keeping in view internationally acceptable standards or practices. The main focus would naturally be on the RBI's role in banking sector and financial markets. I will conclude by highlighting what emerge as the most critical issues that need to be currently addressed.

Main Features

The financial system in India built a vast net work of financial institutions and markets over time, and the sector is dominated by banking sector which accounts for about two-thirds of the assets of the organised financial sector. The first phase of current reform of financial sector was initiated in 1992, based on the recommendations of Committee on Financial System (CFS or Narasimham Committee). Briefly stated, the main features of the financial sector reforms undertaken so far are: First, financial sector reforms (FSR) were undertaken as part of overall economic reform. Second, while the reform process itself commenced in India well after many developing countries undertook reform, FSR were undertaken early in the reform cycle. Third, these were orderly as designed by a high-level committee taking into account the prevailing circumstances. Fourth, while on the regulatory aspects and relevant financial ratios, there was discernible progress, on structural aspects, especially public ownership and incentive structures including autonomy of public sector banks, reform process fell short of expectations of CFS. Fifth, the reforms have brought about some efficiency, as for example evidenced by recent reduction in interest spreads or increasing trend in household savings, especially financial savings. Sixth, the financial system and in particular the banking system displays continued stability relative to other countries. While during the initial stages of the FSR, India was often criticised as being far too gradual, the financial crisis in the past two years which have afflicted a number of developing countries, not to talk about some developed countries, have shown the merits of India's gradual reforms.

Finally, the progress that has been made in a substantial yet non-disruptive manner, has given confidence to launch what has been described as second generation or second phase of reforms - especially in the banking sector.

---

* Keynote address by Dr. Y. V. Reddy, Deputy Governor, Reserve Bank of India, at the Conference on "Growth, Governance and Empowerment: The Future of India's Economy" at University of California, Santa Cruz on November 20, 1998.

I am grateful to Mrs. Shyamala Gopinath and Dr. A.Prasad for their valuable assistance.
I am thankful to Mr. Malegam for his kind advice on accounting standards.
I am also thankful to Messrs D. Mohanty, M.S. Mohanty, and Dr. D. Ajit for background notes.

In this background, a second Committee under Mr. Narasimham, who chaired the CFS, was constituted to advice Government on banking sector reforms (CBSR) . The Report of the Committee (April 1998) provides a framework for the current phase of reforms. The RBI has already acted on many of the recommendations as per announcements made in Governor Jalan's October 1998 Monetary and Credit Policy Review statement.

RBI'S Approach

RBI's approach to reform in financial sector has been ably articulated by Dr. C. Rangarajan in his speeches as Governor, RBI. The approach that governs both the first and second phase is similar and, could be summarised as *pancha-sutra* or five principles.

First, cautious and proper sequencing of various measures – giving adequate time to the various agents to undertake the necessary norms; e.g., the gradual introduction of prudential norms.

Second, mutually reinforcing measures, that as a package would be enabling reform but non-disruptive of the confidence in the system, e.g., combining reduction in refinance with reduction in the cash reserve ratio (CRR) which obviously improved bank profitability.

Third, complementarity between reforms in banking sector and changes in fiscal, external and monetary policies, especially in terms of co-ordination with Government; e.g., recapitalisation of Government owned banks coupled with prudential regulation; abolition of *ad hoc* treasury bills and its replacement with a system of ways and means advances, coupled with reforms in debt markets.

Fourth, developing financial infrastructure in terms of supervisory body, audit standards, technology and legal framework; e.g., establishment of Board for Financial Supervision, setting up of the Institute for Development and Research in Banking Technology, legal amendment to the RBI Act on Non-Banking Financial Companies (NBFCs).

Fifth, taking initiatives to nurture, develop and integrate money, debt and forex markets, in a way that all major banks have an opportunity to develop skills, participate and benefit; e.g., gradual reduction in the minimum period for maturity of term deposits and permitting banks to determine the penalty structure in respect of premature withdrawal, syndication in respect of loans, flexibility to invest in money and debt market instruments, greater freedom to banks to borrow from and invest abroad.

Reform Measures and Outlook

Reform measures have been grouped, for convenience, and presented in Annexure I. The pre-reform position, reform measures undertaken on an year wise basis, current status and comments on outlook are indicated. I will mention here only some significant aspects to link up with critical issues that we intend identifying.

Preemptions

Major problem faced by the banking system was on account of constraints, mainly in terms of massive preemption of banks' resources to finance Government's budgetary needs and administered interest rates. Removal of these constraints meant a planned reduction in statutory preemption and a gradual deregulation of interest rate prescriptions. Since FSR, total effective preemption has been brought down from 54 per cent to less than 35 per cent. The effective CRR which was as high as 16.5 per cent has

been brought down to 9.75 per cent. CRR in excess of 3 per cent is currently remunerated at 4 per cent per annum. Given that the CRR is a tax on the banking system it is better to gradually reduce the CRR rather than maintain a much higher CRR with a relatively higher remuneration on these balances. The medium-term objective of reducing CRR has to take account of money supply considerations and also the objectives of exchange rate stabilisation. Furthermore, reduction of the CRR would depend on manoeuarability on money supply impact presently constrained by degree of monetisation of fiscal deficit and uncertainties in forex markets.

Statutory Liquidity Ratio (SLR) has been gradually brought down from an average effective rate of 37.4 in 1992 to the statutory minimum of 25 per cent though at present, many banks hold SLR well in excess of statutory prescription. Further reduction in SLR, though desirable, would have to await reductions in fiscal deficit apart from needed improvements in prudential standards including internal risk management systems. Ofcourse, enabling legislative changes would also be needed.

Interest Rates

Structure of administered interest rates has been almost totally dismantled. Prescriptions of rates on all term deposits, including conditions of premature withdrawal, and offering uniform rate irrespective of size of deposits have been dispensed with. Currently, there is a prescribed rate of 4.5 per cent for savings bank accounts which are used by individuals virtually as current accounts and as the cost of servicing these accounts is high the remuneration on these accounts has necessarily got to be low. There is yet to emerge a consensus on further deregulation of interest rate on savings deposits. There is understandably a differentiated interest rate ceiling prescribed for foreign currency denominated deposits from non-resident Indians, and such ceiling will have to continue as part of managing external debt flows, especially short-term flows till fuller liberalisation of capital account. Lending rates for different categories, which were earlier prescribed, have been gradually abolished but transparency is insisted upon. Each Bank is required to announce Prime Lending Rates (PLR) and the maximum spread that it charges. However, there are three exceptions. Currently interest rate on smaller advances (i.e., up to Rs.200,000) should not exceed PLR. The element of concessionality of very small loans below Rs.200,000 has to be seen in the context of very small loans. As the figure up to Rs.200,000 has not been adjusted since 1990, the real effective protection for small loans has been gradually reduced by the inflation drift. Lending rate for exports are still prescribed. The prescription of interest rates for exports linked to the period of availment is to some extent used as an instrument to influence leads and lags in repatriation of export proceeds. Finally, ceilings are prescribed in respect of certain advances in foreign currency, which could be reviewed.

Prudential Norms

Prudential norms are being introduced gradually to meet the international standards. Consequent upon CBSR recommendations, action has already been initiated to increase the capital adequacy ratio; assign risk weights to Government approved securities, to take care of the market risks; and also assign risk weights to open position in forex and gold. In most of these, a time table has been indicated for the first phase only, so that banks are on notice for the first phase while the RBI has retained the

freedom to decide on the timing of the second phase. Given the normal growth of 17 to 18 per cent in credit, and the required level of capital adequacy after implementing CBSR recommendations, a substantial infusion of capital into the banking system will be warranted. This is likely to have significant implications for public sector. Government has to weigh the desirability of further budgetary support *vis-à-vis* substantial reduction in share of Government ownership of banks. Incidentally, as long as capital markets are sluggish, and their view on banks, bearish, a high proportion of divestment may be needed to raise the resources needed, since share premia may be low.

Similarly, internationally accepted norms of income recognition have been introduced except that income on asset is not recognised if it is not received within two quarters after it is past due, i.e., due date plus thirty days. The international norm is 90 days. Tighter standards, though desirable, have to be introduced gradually so that both banks and borrowers have notice to adjust their operations, and there is no serious disruption in the normal banking activity or erosion in public confidence in the banking system due to balance sheet impact. Also, a sharp tightening of the norms would pose an unbearable burden on banks and would serve no substantive purpose unless corresponding changes are made in credit appraisal systems and debt recovery mechanisms.

Asset classification, which was introduced as per internationally acceptable practices early in the reform process is sought to be further strengthened gradually, as per CBSR. A significant decision taken relates to treatment of assets guaranteed by the State Government as non-performing under certain circumstances. This is a somewhat exceptional provision to take care of the temporary delays observed in respect of a few State Governments in honouring their guarantee obligations when invoked.

Competition and Transparency

Competition is sought to be fostered by permitting new private sector banks, and more liberal entry of branches of foreign banks. The share of public sector banks in the banking business is going down, particularly in metropolitan areas. Competition is sought to be fostered in rural and semi-urban areas also by encouraging Local Area Banks. Some diversification of ownership in select public sector banks has helped the process of autonomy and thus some response to competitive pressures. The RBI’s efforts to enhance competition do, however, take into account the response of public sector banks and their principal, the Government. There are some banking institutions such as cooperatives, regional rural banks and local area banks, which are yet to be brought fully into the discipline of reform process.

The transparency and disclosure standards have been enhanced to meet international standards, though there are a few areas where we are lagging. These relate to maturity pattern of assets and liabilities, movements in provision account and NPAs and progress needs to be made in all these areas. To provide an authentic comparative information on the performance of banks, the RBI’s annual publication `Trend and Progress of Banking in India’ presents, since the last two years, detailed information on individual banks enabling public assessment of the working of banks.

Supervision

An independent Board for Financial Supervision under aegis of the RBI has been established, and consistent with international practice, focus is also on offsite inspections and on control systems internal to the banks. Status of implementation of Core Principles of Banking Supervision (Annex II) shows that of 46 principles, 33 have been implemented, 11 are partially implemented, while only two are yet to be implemented. These two relate to the critical aspect of adequacy of reserves against country risk and transfer risk; and consolidated reporting. While the former is not a major issue at this juncture in view of limited cross border exposure, the latter is of significance warranting early action. Even in respect of the Core Principles, which have been implemented, the RBI is making constant efforts to improve the quality of supervision and the skills of supervisors.

Credit Controls

Selective credit controls have been dispensed with. Micro-regulation of credit-delivery has been given up, and there is a greater freedom to both banks and borrowers in matters relating to credit. However, there are apprehensions on two counts, viz., the discipline of priority sector lending and flow of credit to the needy and deserving, on a timely basis. The advances eligible for priority sector lending have been enlarged, interest rates deregulated and alternate avenues of investment permitted, thus making the priority lending far more flexible than before. No doubt, banks are averse to sub-ceilings in priority sector, and have some problems with procedural requirements. The major area of serious concern relates to Government sponsored programmes involving subsidies, where there are serious problems of both co-ordination and recovery. CBSR has made some recommendations and these are still under consideration.

There was a general consensus that the real issue in credit-delivery is more availability of credit than cost. Consequent upon the deregulation of interest rates, there was an expectation that credit flow to the needy will be enhanced, but there is some disappointment about the credit-delivery – especially to small industry. Procedural simplifications have been advised by the RBI for rural credit, credit to small industry and more recently the RBI is working on procedural streamlining for export credit.

Incentives and Legal Reforms

The most critical issue in financial sector reform relates to consequences of the extent of public ownership and special laws governing publicly owned banks. CBSR has devoted a significant part of its report to reform of public sector banks, on which Government, as the principal, needs to act. At present, public ownership has adverse effects on level playing field among banks, capacity and willingness to compete in the market place, incentives to perform, and binding work practices/methods that inhibit efficiency. The issue of efficiency in public sector banks has several dimensions, and legal is one of them. Again, issues of optimal efficiency, autonomy and ownership are intertwined and need to be resolved. Reduction of public ownership below the majority level prescribed would need an amendment to the three different laws that govern public sector banks. Sale of shares already held by Government also needs amendments to law.

Debt Recovery

Progress in establishing and operationalising debt-recovery systems has been painfully slow, partly due to judicial review. CBSR suggested several legislative measures that would facilitate debt-recovery, securitisation, electronic systems etc. A serious consequence of tightening prudential norms and pressurising banks to reduce NPA without strengthening the debt-recovery system is the choking of credit. While large corporates may be partly spared by recourse to alternate sources such as debentures or commercial paper, the rest, especially medium and smaller corporates could face credit choke and hence the pace of introduction of measures needs to be carefully modulated.

Accounting Standards

There is apprehension in some quarters that the Indian Accounting standards followed by the Indian banks are not in line with International Accounting Standards. Annexure III gives a comparative position of some of the significant standards relevant to banking sector and comparative Indian standards/regulations. It will be seen that on accounting and valuation, Indian standards and *defacto* practices are comparable with international standards. The major area of divergence in accounting is in respect of group accounting and consolidation. In India, currently consolidation is not required and investments in associated companies are not accounted for under equity method. In regard to disclosure, Indian banks do not, at present, disclose maturity pattern of assets/liabilities, concentrations of assets liabilities and off balance sheet items, net foreign currency exposure, movement in provisions account, and gross non-performing assets and related party transactions in the financial statements. However, as regards disclosure of related party transactions, banks are prohibited from granting advances to firms in which a Director is interested. RBI has formally stated that instructions on further disclosures will be announced in due course. Meanwhile, many banks are also taking steps to build appropriate information systems, which some disclosures entail.

Financial Markets

Since April 1997, the RBI has been taking special efforts to develop the various segments of the financial markets, in particular, money market, Government securities market and foreign exchange market (Annexure IV to VI). Significant steps have been taken to introduce new instruments, strengthen the institutional infrastructure, widen the participant base, introduce efficient settlement mechanism, rationalise tax measures, and improve transparency in operations.

Money Market

In order to facilitate the conduct of monetary policy, it is essential to improve the efficiency of transmission mechanism through the money market. Among the measures taken by the RBI in the recent past are: cautious entry to additional participants in the inter-bank call money market; actions to develop the term money market, the major among them being the exemption of inter-bank liabilities from CRR and SLR stipulations; and refinements in instruments such as Commercial Paper, Certificate of Deposit, inter-bank participation certificate and rediscounting of commercial bills. The RBI has also been conducting repos of 3/4/14 days both on auction and fixed interest rate basis, depending on prevailing situation in the market. The medium-term objective is to

make the call/term money market purely inter-bank market for banks while non-bank participants who are not subject to reserve requirements can have free access to other money market instruments and operate through repos in a variety of instruments. The completion of documentation and operational details will pave the way for the introduction of interest rate swaps and other derivative instruments. With proper asset-liability management systems in place, the term money market can also be expected to develop. An electronic dealing system is envisaged to be operationalised by March 1999. The RBI recognises that a Liquidity Adjustment Facility (LAF) needs to be introduced, but this will depend on the replacement of General Refinance Scheme though not necessarily on a review of export refinance.

Government Securities Market

With the switchover to borrowings by Government at market related interest rates, and more recently, abolition of system of automatic monetisation, it was possible to progress towards a genuine market for Government securities. Reforms instituted by the RBI in this market include selling of Government securities through auctions; introduction of new instruments such as zero coupon bonds, floating rate bonds and capital indexed bonds; introduction of Treasury Bills of varying maturities; establishment of specialised institution, viz., Securities Trading Corporation; institution of system of Primary Dealers and Satellite Dealers; institution of the system of Delivery versus payment; prescription of standard valuation norms; and transparency in operations through market process and dissemination of information.

Future developments in the Government Securities market hinges on three main issues, viz., legal reforms, technological upgradation and achievement of standardised practices. The legislative measures relate to Public Debt Act, to be consistent with modern technology and market practices; Amendment to Securities Contract Regulations Act to allow derivatives and give formal jurisdiction to RBI to regulate the Government debt market; and abolition of Stamp duty to avoid transaction costs in debt markets. These are essential for enabling the development of the market. Development of technology is an integral part of reforming the debt market and the RBI has embarked upon the technological upgradation of debt market. Introduction of the Electronic Dealing System, a Real Time Gross settlement System, integrating the payments and settlement systems for Government securities are all part of the short-term agenda. Finally, standardisation of practices with regard to manner of quotes, conclusion of deals and code of best practices are being evolved for repo transactions.

Foreign Exchange Market

Measures initiated to integrate the Indian forex market with global financial system include permitting banks to fix their own position limits as per international terms and aggregate Gap Limits; to borrow from and invest abroad up to 15 per cent of their Tier I capital; and to arrange to hedge risks for corporate clients through derivative instruments. Other measures such as permitting forward cover for some participants, and the development of the rupee-forex swap markets also have provided additional instruments to hedge risks and help reduce exchange rate volatility. There has been a temporary slow down in further progress due to uncertainties in the market. These

matters will have to be reviewed from time to time and the process of reform restored with appropriate change.

The road map for longer-term developments in the forex markets has been drawn by the Committee on Capital Account Convertibility but a view will have to be taken on each one of them depending on domestic and international developments, especially the pace of liberalisation of the capital account. In any case, the process of liberalisation of capital account itself will, to a large extent depend, *inter alia,* on progress of financial sector reforms.

Critical Issues

In identifying critical issues, it is necessary to recognise the strengths of the Indian banking sector. These include, long history of regulation, early start of financial reforms, stability imparted by reserve requirements, limited exposure to risky assets such as real estate or stocks or foreign currency, strict control over off-balance sheet transactions, and relatively well diversified credit exposures, rather than undue concentrations. However, greater efficiency can be brought about, only and only if co-ordinated efforts are made by RBI, Government of India and banks themselves.

Reserve Bank of India

First, the medium-term objective of reducing preemptions will be pursued, subject to reduction in fiscal deficit by Government, monetary developments *vis-à-vis* growth in real output, and uncertainties in forex markets. Reduction in CRR will help improve profitability of banks. No doubt, reduction in refinance window will give greater flexibility in this regard.

Second, on interest rate regime, reform objectives continue to be further deregulation and enabling environment for reduction in interest spreads. These would again depend on the progress in reduction of fiscal deficit; reduction in non-performing assets which in turn needs changes in debt recovery system as also improvement in credit appraisal systems by banks themselves; and rationalisation of interest rates in small savings, bonds, etc., which are alternatives for savers. Furthermore, inflationary expectations do play a critical role in determining interest rates, and these in turn, are dependent on credibility of price stability.

Third, RBI will pursue with implementation of the first phase of reform announced in October, 1998 and mount the second phase of reform on prudential requirements soon. These requirements would, however, warrant significant additions to the capital of the banking system as a whole. Further progress will depend on resolution of issues in Government relating to budgetary support, permitting access to capital markets, the strategy for weak banks, mergers, possible changes in the percentage of public ownership, etc.

Fourth, RBI will continue to foster competition between banks and in due course between banks and other financial intermediaries. The issue of competition with other financial intermediaries has to recognise the level playing field argument warranting special treatment to banks as long as they have large preemptions, especially CRR - again linked to fiscal deficit. As regards competition among banks, the issues relating to diversified ownership, incentive structure and reorganisation of public sector banks have to be addressed by Government to enable RBI to pursue measures to enhance competition

without serious systemic implications. RBI will intensify consultations with Centre and States, on issues relating to co-operatives and Regional Rural Banks.

Fifth, RBI would also pursue vigorously, improvements in transparency, disclosure standards as also accounting standards to attain the best international practices. Similarly, compliance with Core Principles is being expedited. To focus on criticality of payment and settlement systems, the October 1998 statement on Monetary Policy has laid out a concrete programme of implementing the banking sector reforms.

Sixth, credit-delivery systems will be improved to ensure smooth credit flow but this is facilitated only when legal systems and judicial processes are reviewed to replace cumbersome, and time consuming procedures. In addition to laws relating to debt recovery, changes in bankruptcy law, tenancy laws, urban land ceilings etc. would be needed to ensure that the collateral offered is in reality a realisable collateral.

Seventh, improvements in financial markets are being so attempted by the RBI as to address both technological and procedural/documentation issues. Development of money and debt markets would also require, among other things, reduction in preemptions, amendments to Securities Contract Act, replacement of Public Debt Act and resolution of Stamp Duty issue.

Government of India

It is very clear that further progress in financial sector would, to a significant extent, depend on the resolution of fiscal, legal, and structural issues.

First, sustainable level of fiscal deficit is of paramount importance. Furthermore, cost of raising resources, viz., interest payment for small savings and tax treatment on income from Government securities need to be reviewed. A view has to be taken on budgetary support for recapitalisation of banks and contingent liabilities in case Asset Reconstruction Company route is favoured. An appropriate approach is also needed on how the Government sponsored subsidised special programmes of employment generation would operate in the new milieu.

Second, legislative changes that are essential for successful reform are many and CBSR had attempted to address these issues. In particular, legislative changes affecting debt recovery and growth of financial markets, as already listed, are very critical. Legislative changes may also be needed for greater flexibility in change of public ownership.

Third, structural issues affecting public sector banks have been dwelt at length by CBSR, and suffice to say that the reordering of relationship between Government as principal/owner and banks as agents, through legislative changes or otherwise, would influence the further direction of reform, introduction of competitive pressures and incentive-structures for efficiency-enhancement. Key to financial sector reform is banking reform; key to banking reform is public sector banking reform; and key to public sector banking sector reform is Government's initiative.

Banks

It is clear that actions of RBI and initiatives of Government provide enabling environment, incentive framework and to some extent punitive measures. The outcome will depend on the response of banks, i.e., boards of banks, management, officers and

staff. There are, in particular, four broad areas of internal systems which may need thorough overhauling and which need to be facilitated by Government and the RBI.

First, the internal control systems in the banks, especially Public Sector Banks.

Second, the placement, work practices etc., which inhibit incentives for efficiency and improved customer service.

Third, flexibility in obtaining and enhancing highly skilled or talented people.

Fourth, introduction and effective use of technology in banks, especially public sector banks.

Conclusion

I trust I have brought to your notice the efforts made by the RBI, the challenges before us, and the need for co-ordinated actions between the RBI, Government of India and banks themselves. You would appreciate that, by and large, we try to be aware of what is desirable and we are implementing whatever is feasible.

Thank you.

Annexure I
Banking Sector Reform

Elements of Reforms	Pre-reform status	Reform measures	Current status	Comments/Outlook
1. Removal of external constraints (a) Reduction of pre-emptions (i) Cash Reserve Ratio (CRR)	• CRR 15 percent on Net Demand and Time Liabilities (NDTL) • Incremental CRR of 10 percent on NDTL over the level of NDTL as on May 3, 1991	• 1992-93 – Incremental CRR of 10 percent on NDTL withdrawn. • 1993-November 1997 – Average CRR reduced in phases from 15 per cent to 9.5 per cent. However, CRR was increased temporarily in 1994 for monetary policy reasons. Inter-bank liabilities exempted from CRR in 1997. During the period average CRR of 15 per cent was imposed gradually on non-resident deposits and subsequently removed. In April 1997 10 per cent incremental CRR was imposed on increase in Foreign Currency Non Residents (Banks) Liabilities. • December 1997- January 1998 – CRR increased in phases by 1 per cent temporarily for stabilising forex markets and then reduced to 10 per cent. • 1998 – CRR hiked to 11 per cent for stabilising forex markets.	• CRR at 11 per cent on NDTL (excluding zero CRR liabilities). • 10 per cent incremental CRR on FCNR(B) deposits over the level as on April 11, 1997. • Remaining balances under 10 per cent incremental CRR between May 3, 1991 and April 17, 1992. • In view of exemption of CRR for certain categories of foreign currency liabilities and net inter bank liabilities, effective CRR is 9.75 per cent • Interest on cash balances maintained with RBI is paid to SCBs at 4 per cent per annum on eligible cash balances over the minimum 3 per cent of CRR.	• Minimum CRR as per law is 3 per cent. • The reduction in CRR has to take into account the reduction in fiscal deficit, reduction in overall liquidity position and developments in financial markets in particular the possible spill over effects on the foreign exchange markets.

Elements of Reforms	Pre-reform status	Reform measures	Current status	Comments/Outlook
(ii) Statutory Liquidity Ratio (SLR)	• SLR 38.5 per cent on domestic liabilities and 30 per cent on non-resident liabilities - effective SLR 37.4 per cent.	• 1992-94 – SLR reduced in phased manner through a steeper reduction on SLR on incremental deposits and by bringing forward the base date every time. SLR on increase in NDTL over the level as on September 30, 1994 was reduced to 25 per cent. The base level SLR was reduced to 33.75 percent. • 1997 – In April 1997 inter- bank liabilities was exempted from SLR and in October 1997 SLR reduced to 25 per cent on entire NDTL which is the minimum stipulated under Sec. 24 of Banking Regulation Act. Banks are maintaining on average above 30 per cent.	• SLR is 25 percent on NDTL which is the minimum prescribed under the Banking Regulation Act.	• Further reduction can be contemplated with reduction in fiscal deficit.

Elements of Reforms	Pre-reform status	Reform measures	Current status	Comments/Outlook

(b) Interest rate deregulation
(i) Deposit Rates
	• Administered interest rates structure on all deposits including term deposits of various maturities.
	• Regulations on pre-mature withdrawal of deposits and loans against fixed deposits
	• Interest rate on term deposits uniform for term deposits of same maturity irrespective of size.
	• Foreign Currency (Non-Resident) Deposits Scheme – Interest rates prescribed by RBI and exchange risk also borne by RBI.
		• 1992 – Deposits rates were subject to only one ceiling rate as against prescribed rates earlier.
		• 1993 – New Foreign Currency (Non-Resident) Deposits (Banks) Scheme introduced. Exchange risk has to be borne by the banks. Interest rates prescribed by RBI. The earlier scheme was phased out and closed by August 1994.
		• 1995-96 – Banks given freedom to fix their own interest rates on domestic & NRE deposits with maturity of over two years which was later reduced to one year.
		• 1997 – Interest rates on bank deposits of less than one year linked to Bank Rate.
		• 1997 – Banks given full freedom to determine interest rates on term deposits of 30 days and above.
		• 1997 – Interest rates on foreign currency deposits to be determined by banks subject to ceiling rate prescribed by RBI followed by freedom to offer interest rates linked to LIBOR.
		• 1998 – Minimum lock in period of term deposits reduced from 30 days to 15 days.
		  • Banks advised to determine their own penal rates of interest on premature withdrawal of domestic term deposits and NRE deposits.
		  • Banks given freedom to offer differential rate of interest based on size of deposits of Rs.1.5 mn and over.
		  • Banks allowed to charge interest rate on loans against fixed deposits not exceeding its Prime Lending Rate (PLR).
			• The only administered interest rate on rupee rate deposits is on savings bank deposits
			• On current account balances no interest is payable.
			• Differentiated ceiling rate of interest on foreign currency deposits continues.
				• The deregulation of interest rates on savings deposits will be examined at the appropriate time.
				• The ceiling rate on foreign currency deposits will continue for sometime as a measure of prudent debt management.

Elements of Reforms	Pre-reform status	Reform measures	Current status	Comments/Outlook
(ii) Lending rates	• Lending rates structure consisted of six categories based on size of advances. Under one category the RBI had prescribed a minimum lending rate.	• 1992-1994 – Rationalisation of lending rate structure from the earlier six categories to three categories. • 1994 – Banks given freedom to fix their own Prime Lending Rate (PLR) for advances over Rs.2,00,000/- (about US $ 4500/-) • 1998 – Ceiling rate on loans below Rs.25,000/- fixed at PLR of banks. Lending categories reduced to two. • Both PLR and LTPLR to be announced by banks • Spreads over PLR to be announced.	• Interest rates on advances above Rs.2,00,000 to be linked to PLR of each bank. • Advances "upto" Rs.2,00,000 not to exceed PLR. • Export credit rates regulated by RBI. Currently at concessional rate. • Certain advances denominated in foreign currrency subject to a ceiling. • Loan against FD not exceeding PLR.	• Ceilings certain on advances in foreign currency could be reviewed

2. **Prudential Norms** (a) Capital Adequacy	• No capital adequacy requirements.	• 1992 – Capital to risk asset ratio of 8 per cent prescribed as per Basle Committee norms to be achieved in a phased manner as follows : Foreign banks by 31 March 1993 Indian banks with international operations by 31 March 1994 Other banks 4% by March 1993 8% by March 1996	• All banks comply with the capital adequacy ratio of 8 per cent except for 4 banks in private sector and one bank in public sector. • Capital adequacy ratio increased to 9 percent to be achieved by March 2000. • Capital adequacy on market risk for Govt./approved securities has been announced which will be implemented in two phases. 2.5% risk weight by the year ending March 31, 2000. Balance of 2.5% will be announced later. • Capital adequacy on forex and gold positions introduced • Investments in Government guaranteed securities of Government undertakings which do not form part of market borrowing will be subject to additional risk weight of 20% from 2000-2001. • Risk weight on outstanding stock of the above securities as on 31 March 2000 will be implemented in two phases at the rate of 10 per cent each in 2001-2002 and 2002-2003. • Risk weights of 20 percent will be assigned for advances guaranteed by State Government where the State Governments have remained in default as on March 31 2000 in cases where the guarantee has been invoked. The risk weight will be increased to 100 per cent if they continue to be in default after March 31, 2001 in respect of such invoked guarantees.	• The Narasimham Committee has suggested increase in capital adequacy ratio to 10 per cent. 9 per cent to be achieved by March 2000 and 10 per cent by 2002. • Decision about further enhancement will be announced later.

Elements of Reforms	Pre-reform status	Reform measures	Current status	Comments/Outlook
(b) Income recognition	• Income recognition based on health code system under which advances were categorised into eight categories. Of which four categories were deemed as non-performing assets viz. • (i) debts recalled • (ii) suit filed accounts • (iii) decreed debts • (iv) debts classified as bad and doubtful. Banks could not recognise income on these categories. • No clear definition of problem credits • Subjectivity in classification of problem credits.	• Banks cannot recognise interest income on all non-performing assets. • Non performing assets defined as on asset on which interest is past due for a period of four quarters ending March 1993, three quarters ending March 31, 1994 and two quarters ending March 31, 1995 and onwards. Past due is defined as 30 days beyond due date. • Interest on advances guaranteed by Government which is past due for two quarters should not be recognised as income. However the advances will be treated as standard assets.	• Banks cannot recognise income on assets where income is not received within two quarters after it is past due. • Banks not allowed to recognise collateral or government guarantees for recognising interest income.	• The Narasimham Committee II has recommended that RBI should implement the international norm of 90 days in a phased manner by 2002.

Elements of Reforms	Pre-reform status	Reform measures	Current status	Comments/Outlook
(c) Asset Classification	Assets were classified into eight health code categories as under : 1. Satisfactory 2. Irregular 3. Sick – viable under nursing 4. Sick – Non-viable/sticky 5. Advances recalled 6. Suit filed accounts 7.Decreed debts 8. Debts classified by the banks as bad/doubtful The classification was left to the discretion of each bank and was not objective.	• 1992 – All advances have to be classified by banks into four broad groups a) Standard b) Sub-standard c) Doubtful d) Loss • As asset is classified as sub-standard when the bank stops recognising income on accrual basis i.e. when it gets classified as non-performing asset (NPA). • An asset is classified as doubtful when it remains in substandard category for 24 months. • A loss asset is an asset which is considered as irrecoverable and not written off.. • In view of the large number of borrowal accounts classification of advances below Rs.25,000/- was allowed to be done in a phased manner but income recognition norms were applicable. This relaxation was allowed upto March 31, 1998. • Advances guaranteed by Government are not classified as non-performing asset even if income is not being recognised on accrual basis.	• The classification standards as defined in column 3 continue. RBI has announced in October 1998 that an asset will be treated as doubtful if it has remained in sub-standard category for 18 months instead of 24 months by March 31, 2001. • Advances guaranteed by State Government will be classified as NPA if guarantee is invoked and the concerned Government remains in default for more than two quarters with effect from April 1, 2000.	• The Narasimham Committee II has recommended that an asset be classified as doubtful if it is in the sub-standard category for 18 months in the first instance and eventually for 12 months • The Narasimham Committee II has recommended that for the purpose of evaluating the quality of asset portfolio Government guaranteed advances which have turned sticky should be treated as NPAs. If however for reason of the sovereign guarantee argument such advances are excluded from computation, such NPAs should be separately shown as an aspect of fuller disclosure and greater transparency of operations. • Further tightening of norms has not been announced.

Elements of Reforms	Pre-reform status	Reform measures	Current status	Comments/Outlook

(d) Provisioning standards	• The provisions to be made by banks was left to the discretion of the bank. RBI Inspecting officers would however determine whether provisions were adequate to assess the real value of capital and reserves.	• 1992 - 10 per cent general provision on outstanding sub-standard advances
		  • 100 per cent provision on unsecured portion of doubtful debts.
		  • 20 per cent to 50 per cent provision on secured portion of doubtful assets over a three year period.
		  • 100 per cent on loss assets
		• On non-performing advances below Rs.25,000/- banks had to make a provision on aggregate outstanding advances without netting for collateral @ 2.5 per cent in 1992-93 which was increased to 15% in 1997-98. This applied only to banks which had not classified the accounts. Banks had to complete classification of all such advances by 1997-98 after which the normal provisioning norms came into force.
		• 1993 - Banks were allowed to make provisions on substandard and doubtful assets in March 1993 spread over two years. In subsequent years no such relaxation has been given.
			• The provisioning norms as indicated in column 3 continue.
			• RBI has announced that banks shall make a general provision of a minimum of 0.25 per cent for the year ending March 31, 2000.
			• Additional provisions arising from the revised definition of doubtful asset being phased in as on March 31, 2001 to be made over two years as on 31 March 2001 and 31 March 2002.
			• Provisions on advances guaranteed by State Government which have been invoked and remain in default for more than two quarters will be made over a period of four years from the year ending 31 March 2000 to 31 March 2003 with minimum of 25 per cent each year.
				• Narasimham Committee II has recommended that in case of all future loans, asset classification and provisioning norms should apply even to Government guaranteed advances in the same manner as for any other advance. For existing Government advances, RBI, Government and banks may work out a mechanism for a phased rectification of the irregularities in these accounts.
				• The Narasimham Committee II has recommended that a general provision on standard assets of say 1 percent may be introduced in a phased manner.

Elements of Reforms	Pre-reform status	Reform measures	Current status	Comments/Outlook
(e) Classification and Valuation of Investment Portfolio.	• Investments in Government and other approved securities could be carried at book value without recognising any diminution in the value of the portfolio. • In the case of other investments banks had to make adequate provisions for diminution in value.	• 1992 - Banks were required to bifurcate investments in Government and approved securities into permanent category and current category. Banks had to classify minimum 30 per cent of the portfolio as current investments to facilitate valuing all the investments on fully 'marked to market' basis. • 1992 – Guidelines were laid down for transfer of approved securities from 'current' to 'permanent' and 'vice versa' . These guidelines ensure that latent losses are provided for at the time of such transfer. • 1993 - The entire investment portfolio of banks other than investments classified as 'permanent' has to be classified into six categories for the purpose of valuation. The valuation will be done for each category of investments. While net depreciation has to be provided by debit to the Profit and Loss account, net gains have to be ignored. Permanent investments can be carried at book value. Premium will have to be amortised over the life of the investment but discount cannot be recognised as income. • 1993-1998 The said minimum ratio of 30 per cent has been increased in a phased manner to 60 per cent as on 31 March 1998. It has further been decided to increase the ratio to 70 percent for the year ending March 31, 1999. New private sector banks are required to mark to market their entire investments in approved securities from 31 March 1997.	• Banks have to mark to market 70 per cent of the investments in Government and approved securities by 31 March 1999. • RBI has announced that in the next three years the entire portfolio will be marked to market.	• The Indian standards are quite stringent and no further changes are required.

Elements of Reforms	Pre-reform status	Reform measures	Current status	Comments/Outlook
3. Competition	• Entry of foreign banks restrictive • No new private sector commercial bank licensed since 1972	• 1991-1998 - A number of foreign banks were allowed entry into the Indian banking sector. The number of foreign banks operating in India increased from 21 in 1990 to 43 in 1998. Existing foreign banks were allowed 36 additional branches. • 1993 –In order to introduce greater competition in the banking sector, the Reserve Bank issued guidelines in January 1993 for the establishment of new banks in the private sector. The minimum paid up capital for these banks is Rs. 1000mn The banks will have to be publicly listed. They are also required to start operations in a fully computerised environment with state of the art technology. Foreign banks/foreign financial institutions are allowed to have 20 per cent stake within the overall non-resident limit of 40 per cent as technical collaborator/partner in private banks. • 1994 – 1996 Nine new banks have been set up in the private sector and one co-operative bank was allowed to convert to a private commercial bank. • 1996 – The Union Budget 1996-97 proposed setting up of new private local area banks with jurisdiction over two or three contiguous districts. RBI issued guidelines in 1996 for setting up of new private local area banks. The minimum paid up capital for these banks will be Rs. 50mn.	• India has made commitments in the World Trade Organisation (WTO) under the General Agreement on Trade in Services in 1995 to grant eight licences per year to new and existing foreign banks. The number was increased to 12 in 1997. In actual practice India has allowed foreign banks to open 15 branches in a year. In addition, off-site ATMs which require a branch licence are outside this limit of 12. • Public sector still dominates and effective competition to them is in metropolitan areas.	The Narasimham Committee has suggested that : • Foreign banks may be allowed to set up subsidiaries/joint ventures in India which will be subject to the same regulations on directed credit as Indian banks. • The licensing policy for setting up new private banks may be reviewed and no category should be excluded on a priori grounds. These should be well defined. • Revamping of Regional Rural banks and establishment of Local Area Banks could facilitate competition in the rural and semi-urban areas also. • Co-operatives are involved in banking operations and these are subject to dual control. • The licensing policy for new private banks is under review by a internal Working Group.

Elements of Reforms	Pre-reform status	Reform measures	Current status	Comments/Outlook
4. Transparency and Disclosure	The income in the profit and loss account was shown net of all provisions and therefore provisions were not disclosed. Loss on sale or revaluation of investments and other assets could be deducted from income. Only aggregate amounts under a few categories were disclosed in the Profit and Loss Account. There were no schedules or detailed break-up. The Balance Sheet disclosure was also very limited. Accounting policies were not disclosed.	• The whole format of Profit and Loss Account and Balance Sheet was revised in 1992 with a view to ensure greater transparency and disclosure. The revised format provides for detailed disclosure of all income items and expenditure items with schedules. The Balance Sheet also is presented in more detailed format with several schedules. Disclosure of accounting policies has been made mandatory. • In 1996 banks were advised to include their assessment of capital adequacy ratio in the balance sheet. • In 1997 banks were advised to disclose percentage of shareholding of Government, percentage of net NPAs to net advances. Details of provision made category-wise i.e. towards NPAs, depreciation etc. Amount of subordinated debt raised as Tier II capital Gross value of investments less cumulative depreciation. • In January 1998 banks were advised to disclose. Capital adequacy ratio – Tier I capital Capital adequacy ratio – Tier II capital Interest income as a percentage of average working funds Operating profit as a percentage of average working funds Return on assets Business (deposits and advances) per employee Profit per employee	• The transparency and disclosure standards have been enhanced substantially. • Instructions on further disclosures will be issued in due course.	• The Narasimham Committee II has recommended that there is need for disclosure in a phased manner of the maturity pattern of assets and liabilities, movement in provisions account and NPAs. • The annual statutory report on Trend and Progress of Banking by RBI gives a consolidated account of status of non-performing assets of individual banks also.

5. Supervisory System	Dependence on on-site inspection of banks. Focus on deposit mobilisation priority sector credit and credit portfolio. Investment and risk management not given much importance. Long inspection cycles Emphasis was on solvency and not on other aspects like capital adequacy, liquidity management etc.	• 1994 – In order to exercise integrated supervision over credit institutions in the financial system and to ensure implementation of regulations in the areas of credit management asset classification income recognition and treasury operations a Board for Financial Supervision was set up within the RBI in 1994. The supervisory strategy as finalised by BFS in 1994 has four components. i) restructuring system of inspection ii) setting up of offsite surveillance iii) enhancing the role of external auditors and iv) strengthening corporate governance internal controls and audit functions. • 1995 – An offsite surveillance function has been set up with the primary objective of monitoring the financial condition of banks in between on-site examinations identifying banks which show financial deterioration and trigger an onsite examination. • The new approach to annual financial inspection based on CAMELS (Capital Adequacy Asset Quality, Management Earnings, Liquidity and Systems) framework commenced from July 1997. • Two supervisory rating models based on CAMELS and CACS (Capital adequacy, Asset Quality, Compliance and Systems) factors for rating of Indian commercial banks and foreign banks operating in India respectively have been worked out and would help RBI identify banks where condition warrants special supervisory attention. • The role of the external auditors has been enhanced and enlarged. Besides audit of annual accounts auditors are now required to verify and certify other aspects as also financial ratios to be disclosed in the balance sheets. The system of concurrent audit has been introduced. Each bank has to designate 'Compliance Officer' to act as nodal officer.	The RBI supervisory strategy consists of both onsite inspections and off-site surveillance. A detailed off-site surveillance system based on prudential supervisory framework on a quarterly basis covering all important areas has been made operational. In regard to on-site inspections the process is now on the evaluation of the total operations and performance of the bank under the CAMEL system. Apart from evaluating asset quality and compliance with prudential norms focus is now on the effective functioning of Board management, efficacy of internal audit and control systems and risk management. The entire cycle of inspection and follow up action is now completed within a maximum period of twelve months.	The Narasimham Committee has recommended that an integrated system of regulation and supervision be put in place to regulate and supervise the activities of banks, financial institutions and non-bank finance companies (NBFCs) the agency to be called Board for Financial Regulation and Supervision (BFRS). The BFRS should be given statutory powers and be reconstituted in such a way as to be composed of professionals. At present, the professional inputs are largely available in an advisory board which acts as a distinct entity supporting the BFS. The Committee, taking note of the formation of BFS has recommended that the process of separating it from the Reserve Bank qua central Bank should begin and the Board should be invested with requisite autonomy and armed with necessary powers so as to allow it to develop experience and professional expertise and to function effectively. However, with a view to retain an organic linkage with RBI, the Governor, RBI should be head of the BFRS. Supervisory skills of RBI may need enhancement, especially to capture technological changes and new financial instruments.

Elements of Reforms	Pre-reform status	Reform measures	Current status	Comments/Outlook
6. Risk Management	Focus was entirely on credit risk and to a large extent on the management of foreign exchange risk and operating risk. a) Credit Risk: Emphasis on toning up of the appraisal standard, strengthening post sanction supervision and intensive follow-up of large value accounts. Introduction of health code norms for classification of advances, single and group exposure limits set up by RBI; and banks required to set up industry exposure norms. b) Foreign Exchange Risk Internal control guidelines issued in a comprehensive manner in 1981. Main emphasis on setting up open position limits and aggregate gap limits. c) Operating Risk Focus on fraud reporting and preventive measures; emphasis on house keeping i.e. balancing of books and reconciliation of interbank and inter branch accounts.	a) Credit Risk : Introduction of income recognition and asset classification norms; Introduction of capital for credit risk as per Basle Committee's recommendation Drawing up loan policy and recovery policy by banks Extending the exposure norms to cover all forms of exposure in addition to credit exposure b) Forex Risk A Committee looked into the entire gamut of foreign exchange markets in India Consequent to the recommendation of this Committee, the method of computation of open position was refined and setting up of open position limits was made banks specific and liberalised Introduction of market risk capital for open position limits in foreign exchange and gold. More flexible setting up of aggregate gap limits; Introduction of simple value at risk calculation in respect of forward gaps d) Operating Risk: Intensive monitoring of inter branch, inter bank and nostro accounts, reconciliation by RBI Introduction of concurrent audit by banks Setting up of Audit Committee of Board Setting up of compliance officers Implementation of recommendations of Jilani Committee for strengthening of internal inspection and audit system in banks e) Treasury Operations Introduction of standards for conduct of investment operations including audit and accounting norms.	Having introduced credit risk, management attention is now focussed on market risk management particularly in the context of deregulation and liberalisation of interest rates. Comprehensive asset liability management systems are being introduced from 1 April 1999 to take care of interest rate, liquidity and currency risks.	Asset Liability Management guidelines are to be finalised. A view has to be taken on the introduction of capital for market risk.

Elements of Reforms	Pre-reform status	Reform measures	Current status	Comments/Outlook
7. Credit Controls/ Credit Delivery System	• Credit delivery mainly in the form of cash credit for working capital finance. • A system of credit authorisation scheme existed under which loans availed by a borrower above a cut off point had to be referred to RBI. • Detailed regulations on how banks should calculate permissible bank finance as also norms for receivables and inventory holdings of various industries were prescribed by RBI. • It was mandatory for banks to form a consortium above Rs.50 million. • Regulations on levy of commitment charge and levy of additional interest on certain portion of book debt finance. • Regulations on functioning of consortium arrangement. • Limits on grant of term loans for projects by banks.	1993 – Banks were given freedom to decide on their own the levels of holdings of inventory and receivables of various industries while assessing credit requirements of borrowers. 1993 – The threshold limit of obligatory consortium lending raised from Rs.50 million to Rs.500 million. 1995-1996 – Loan system for Delivery of Bank Credit for working capital purpose was introduced to bring about greater discipline in credit utilisation and to gain better control over borrowers in respect of borrowers with assessed maximum permissible bank finance of Rs.200 million and above. The cash credit component was initially restricted to 70% and then gradually reduced to 60%, 40 per cent and 25 per cent in 1996. The system was also extended to borrowers with assessed MPBF of Rs.100 million to Rs.200 million and cash credit component fixed at 40 per cent. 1996 – The levy of commitment charge was left to the discretion of banks. Mandatory levy of additional interest on certain portion of book debt finance was also withdrawn. 1996 – Participating banks in a consortium were permitted to frame ground rules of the consortium arrangements.	There is no mandatory consortium requirement and borrowers can either have single or multiple banking arrangements or syndicate/consortium method. The regulations on credit will form part of the loan policy which has to be formulated by each bank with Board" approval. There is considerable flexibility with regard to credit delivery systems for borrowers. Procedural simplifications in regard to agriculture and small industry has been brought about recently and such simplification for export sector is expected soon.	With pressure on banks to reduce NPA's and in the absence of effective debt recovery systems the credit flow especially to medium and small sector is reported to be choked.

Elements of Reforms	Pre-reform status	Reform measures	Current status	Comments/Outlook
	• Selective credit controls on sensitive commodities.	1997 – In order to provide greater freedom in assessing working capital requirements all instructions relating to Maximum Permissible Bank Finance (MPBF) were withdrawn and banks were advised to evolve their own methods for assessment. Banks were required to lay down loan policy for each industry for this purpose. 1997 – Mandatory requirement on formation of consortium for borrowal accounts with limit of Rs.500 million and above from more than one bank withdrawn. 1997 – Limits on grant of term loans for projects by banks was withdrawn. Banks are free to sanction term loans for projects within the ceiling of exposure norms. 1997 – Loan component for all borrowers with credit limit of Rs.100 million and above made uniform at 80 per cent. 1997 – Credit Monitoring Arrangement which replaced Credit Authorisation Scheme was withdrawn. 1996 - Selective credit controls on all sensitive commodities was abolished except for sugar.		

Elements of Reforms	Pre-reform status	Reform measures	Current status	Comments/Outlook
8. Priority Sector Lending or Directed Credit	• Definition comprised agriculture, small scale industries (including setting up of industrial estates), small road and water transport operators, small business, retail trade, professional and self-employed persons, State-sponsored organisations for SCs/STs, educational loans granted to individuals by banks under their schemes, credit scheme for weaker sections and refinance by sponsor banks to RRBs. • Target for Indian banks: 40 per cent of net bank credit of which direct agriculture 18 per cent, advances to weaker sections 10 per cent of bank credit • Target for foreign banks includes export sector: 10 per cent by March 1989 12 per cent by March 1990 15 per cent by March 1992	1992 – Export credit target of 10 per cent introduced. 1993 – Foreign banks target revised to 32 per cent and which includes export credit with sub targets of 10 per cent for export and 10 per cent for SSI. 1993 – Target of 18 per cent for agriculture for Indian banks to include indirect advances to the extent of 4.5 per cent of Net Bank Credit. 1996 – Export sub target raised from 10 to 12 per cent 1993 – 1998 – Definition of priority sector enlarged to include i) loans to traditional plantation crops viz. Tea, Coffee, rubber, cardamom, etc. irrespective of size of holdings ii) loans for housing upto Rs.500000. iii) loans to transport operators upto 10 vehicles, iv) advances to dealers of drip/sprinkler irrigation system and agricultural machinery v) investments made by banks in special bonds of SIDBI, NABARD, NHB, NSIC, HUDCO, SFCs, SIDCs and REC and contributions to Rural Infrastructure Development Fund (RIDF). vi) banks' investments in bonds issued by Rural	It is clear from the reforms introduced in the area that the scope of priority sector credit has been increased and provides opportunities to banks to make loans on commercially viable terms. There is no element of interest subsidy. Further, the markets have an option to invest short fall in priority sector lending in NABARD/SIDBI, thus exercising freedom not to lend to commercially unviable activities. Since banks have freedom to invest in bonds, debentures, shares etc., the resource base for calculating priority sector lending is restricted to advances, excluding expanding investments.	• While priority sector lending as currently operated is not considered a serious constraint on operations, there are a variety of government sponsored programmes which are to be funded by banks. The Narasimham Committee has recommended that given the special needs of this sector, the current practice may continue. However, for ensuring greater involvement and accountability and also appraisal of schemes on commercial considerations without any extraneous influences, the branch managers of banks should be fully responsible for the identification of beneficiaries under the Government sponsored credit linked schemes. This is yet to be acted upon. • The Narasimham Committee has also noted the changes in the scope of beneficiaries under the priority sector since the earlier CFS Report was submitted and proposes that given the importance and needs of employment oriented sectors like food processing and related service activities in agriculture, fisheries, poultry and dairying these sectors should also be covered under the scope of priority sector lending. • Banks are also averse to sub ceilings in priority sector and procedure of computation.

		Electrification Corporation (REC) for financing its Systems Improvement Scheme under Special Project Agriculture (SI-SPA). vii) advances to NBFCs for onlending to truck operators satisfying priority sector norms viii) advances upto Rs.10mn to Software Industry .		

Elements of Reforms	Pre-reform status	Reform measures	Current status	Comments/Outlook
9. Ownership	• Nationalised banks are fully owned by Government, State Bank of India by RBI and the associates of SBI by SBI. In the case of nationalised banks there was no provision for private participation. As there was no capital adequacy requirement there was no need to consider accessing the market. In certain cases Government provided the necessary capital.	• 1993 – SBI Act amended to enhance the scope of the provision for private shareholding. RBI share not to fall below 55%. • 1994 – Banking Companies (Acquisition and Transfer of Undertakings) amended effective July 15, 1994 permitting nationalised banks to raise capital upto 49% from the public. • 1995 – Banking Companies (Acquisition & Transfer of Undertaking Act) amended to enable banks to reduce the paid-up capital subject to the condition that the paid up capital cannot be reduced at any time below 25 per cent as on the date of amendment. This amendment enabled banks to set off losses against capital. • 1993 – SBI first public sector bank to raise capital from the market (Rs.22120 million as capital). In 1996 SBI raised capital in the form of GDRs. • 1994–1998 - Oriental Bank of Commerce, Dena Bank, Bank of India, Corporation Bank, Bank of Baroda, State of Travancore, State Bank of Bikaner & Jaipur accessed capital markets to raise capital. Total capital including premium raised by all public sector banks amounted to Rs.60150 million. (Premium Rs.52540 million). The Government/RBI/SBI shareholding after public issue now ranges from 59.73 to 77% in these banks. • Refund of Capital • 1995-1998 - Till date four banks viz. Punjab National Bank, Bank of India, Bank of Baroda and Corporation Bank have returned to Government of India paid up capital aggregating Rs.6421 million. The reduction of capital results in an improvement in earnings per share and helps the banks in better pricing of the share at the time of public issue.	Currently out of 105 commercial banks (excluding Regional Rural banks), 27 are publicly owned. As per existing law governing Public Sector Banks, majority of public ownership should always be maintained. In the case of SBI the RBI shareholding cannot be less than 55% and for subsidiaries of SBI, SBI shareholding cannot go below 55%. In nationalised banks, the minimum Government shareholding has to be 51 per cent. Eight public sector banks have so far raised capital from the public. Public sector banks would require additional capital to meet their normal asset expansion as also the enhanced capital requirements and more stringent provisioning standards. The minimum public share of 55/51 per cent may become a constraining factor for some banks unless the Act is amended.	Related issue is "autonomy" and inhibiting factors such as jurisdiction of vigilance, investigative agencies as long as there is majority of public ownership. Further, the public sector banks are governed by three different statues. Narasimham Committee recommended dilution of public ownership to 33 per cent. According to them the reduction of the minimum holding of Government below 51 per cent would in itself be a major and clear signal about the restoration to banks and financial institutions of autonomy in their functioning.

Elements of Reforms	Pre-reform status	Reform measures	Current status	Comments/Outlook
10. Legal and Institutional Reforms:	As per law banks can realise the securities pledged to them by filing a suit against the borrower and retain the pledged goods as collateral till the debts are satisfied or sell the goods by giving reasonable notice to the borrower without the intervention of the Court. The realisation of debts by filing a suit takes very long As regards selling the pledged goods by giving notice, very often banks do not have the goods in their possession as these are mostly inventories and are only hypothecated to the bank. In case of immovable properties, the law of mortgage is unsatisfactory as often the right of sale without the intervention of the Court is not available to banks/financial institutions. • Once a sick industrial company defined as a company registered for not less than five years whose net worth has been fully eroded stands referred to Board for Industrial and Financial Reconstruction, no proceedings for the winding up of such company or for execution of the properties of such company or for appointment of a receiver in respect thereof and no suit filed for recovery of money or for the enforcement of securities shall lie or be proceeded with further, except with the consent of the Board. • Banks and financial institutions therefore faced considerable difficulties in recovery of dues	• In order to effect speedy recovery of loans Government passed the Recovery of Debts due to banks and Financial Institutions Act 1993 for the creation of Special Tribunals for banks and financial institutions. Monetary claims above Rs. 1 mn and above are adjudicated by the Debt Recovery Tribunals. The Tribunals are expected to dispose of such claims of banks and financial institutions within 6 months of such applications. The tribunals follow a summary procedure that is expected to expedite disposal of suits filed by banks.	• Government has set up so far 9 Recovery Tribunals covering 22 states and 4 Union Territories. The constitutional validity of the Act has been challenged and is under adjudication of the Supreme Court. However, the Supreme Court stayed the operation of the Delhi High Court which quashed the notification constituting the Tribunals and allowed the DRTs to function.	• The functioning of the Tribunals has not been effective as there are several problems faced by them. A Working Group appointed by RBI has made several recommendations to improve the functioning of DRTs including amendments to certain provisions. • Amendments are being introduced to the SICA 1985 in the Parliament to provide that the stay of legal proceedings/suits for recovery of moneys or enforcements etc against the sick industrial companies should operate only on the specific orders of the Board for Industrial and Financial Reconstruction (BIFR) rather than automatically to limit the possibilities of misuse of the provisions of the Act. • The Narasimham Committee II has suggested need for several legislative amendments to existing laws which affect operations of banks including recovery through sale without judicial intervention, changes in Transfer of Property Act to facilitate securitisation, reduction in stamp duties, clarity in law on matters arising from computerisation and electronic funds transfer, structure of the banking system etc • According to the Committee the evolution of legal reforms has

	from the borrowers and enforcement of security charged to them due to the delays in the legal process. A significant portion of the funds is thus blocked in unproductive assets, the values of which keep deteriorating with the passage of time. • The Sick Industrial Companies Act further enables borrowers to avoid meeting their obligations as once the networth is eroded automatically the Act applies and they come within the ambit of BIFR. Thus all proceedings against the company are stayed and banks are unable to effect recoveries.			not kept pace with the changing commercial practice and with the financial sector reforms. As a result the economy has not been able to reap the full benefits of the reform process. • In view of the wide-ranging changes needed in the legal framework, the Committee has recommended setting up a Expert Committee to formulate specific legislative proposals to give effect to the suggestions made by them. • The Finance Minister has announced setting up of an Expert Committee.

Annexure II
STATUS OF IMPLEMENTATION OF CORE PRINCIPLES OF BANKING SUPERVISION

Core Principle	**Implemented**	**Partially Implemented**	**Not Implemented**
Principle 1, Part 1 An effective system of banking supervision will have clear cut responsibilities and objectives for each agency involved in the supervision of banks.	✓		
Principle 1, Part 2 Each such agency should possess operational independence and adequate resources.	✓		
Principle 1, Part 3 A suitable legal framework for banking supervision is also necessary including provisions relating to authorisation of banking establishments and their ongoing supervision	✓		
Principle 1, Part 4**.** A suitable legal framework for banking supervision is also necessary including powers to address compliance with laws as well as safety and soundness concerns	✓		
Principle 1, Part 5**.** A suitable legal framework for banking supervision is also necessary including legal protection for supervisors.		✓ A working group setup by the RBI has examined this and concluded that while statutory protection is available for acts done in good faith, the liability of supervisors in case of negligence is yet to be tested in law. This will now be referred to the Expert Group set up by GOI to reexamine Banking related legislation.	
Principle 1, Part 6 Arrangements for sharing information between supervisors and protection for confidentiality of such information, should be in place.		✓ Interagency cooperation amongst supervisors has been examined by an inhouse group and the BFS has decided to refer their suggestions to GOI to set up a Technical Group on which major supervisors will be represented. It has also been suggested that a specific provision be incorporated in the Act authorising the Bank to share information with other supervisors. This will be looked into by the Expert Group setup by GOI.	

Core Principle	**Implemented**	**Partially Implemented**	**Not Implemented**
Principle 2, Part 1 The permissible activities of institutions that are Licensed and subject to supervision as banks must be clearly defined	✓		
Principle 2, Part 2 the use of word 'bank' in names should be controlled as far as possible.	✓		
Principle 3, Part 1 The Licensing authority must have the right to set criteria and reject applications of establishments that do not meet the standards set.	✓		
Principle 3, Part 2 The Licensing process at minimum should consist of an assessment of the bank's ownership structure, directors and senior management; its operating plan and internal controls and its projected financial conditions, including its capital base.		✓ A Group was set up earlier this year to critically evaluate fulfillment of the objectives envisaged for the new banks set up in the private sector, examine the need for setting up new banks and suggest criteria for issuing Licenses in future. The issues raised here are also being looked into by this Group,	
Principle 3, Part 3 Where the proposed owner or parent organisation is a foreign bank, the prior consent of its home country supervisor should be obtained.	✓		
Principle 4 Banking Supervision must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.		✓This matter has been examined and it has been decided to refer this to the Expert Group which will be examining the Banking related Legislation.	
Principle 5, Part 1 Banking Supervision must have the authority to establish criteria for reviewing major acquisitions or investments by a bank	✓		
Principle 5, Part 2 Banking Supervision must have the authority to establish criteria for ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.	✓		

Core Principle	**Implemented**	**Partially Implemented**	**Not Implemented**
Principle 6, Part 1 Banking Supervisors must set minimum capital requirements for banks that reflect the risks that the banks undertake and must define the components of Capital bearing in mind its ability to absorb losses.	✓		
Principle 6, Part 2 For internationally active banks these requirements should not be less than those established in the Basle Capital Accord.	✓		
Principle 7, Part 1 As essential part of any supervisory system is the evaluation of a bank's policies and procedures related to the granting of loans and making of investments	✓		
Principle 7, Part 2 As essential part of any supervisory system is the evaluation of a bank's policies and procedures related to ongoing management of the loan and investment portfolios.	✓		
Principle 8, Part 1 Banking supervisors must be satisfied that banks establish and adhere to adequate policies practices and procedures for evaluating the quality of Assets	✓		
Principle 8, Part 2 Banking supervisors must be satisfied that banks establish and adhere to adequate policies practices and procedures for evaluating adequacy of Loan Loss Provisions and Loan Loss Reserves .	✓		
Principle 9, Part 1 Banking Supervisors must be satisfied that banks have Management Information Systems that enable management to identify concentrations within the portfolio	✓		
Principle 9, Part 2 supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.	✓		
Principle 10, Part 1): In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on arms-length basis,	✓		

Core Principle	**Implemented**	**Partially Implemented**	**Not Implemented**
Principle 10, Part 2): In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on arms-length basis that such extensions of credit are effectively monitored	✓		
Principle 10, Part 3, In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that other appropriate steps are taken to control or mitigate the risks.	✓		
Principle 11, Part 1 Banking Supervisors must be satisfied that banks have adequate policies and procedures for identifying monitoring and controlling country risk and transfer risk in their international lending and investment activities		✓This issue was examined by the Risk Management Group which has made several recommendations. BFS has desired that the practice followed by different banks be studies and the recommendations resubmitted.	
Principle 11, Part 2 Banking Supervisors must be satisfied that banks have adequate policies and procedures for maintaining adequate reserves against such risks.			✓Although the Risk Management Group has made several recommendations regarding country risk, this particular aspect requires more detailed study.
Principle 12, Part 1: Banking Supervisors must be satisfied that banks have in place systems that accurately control market risks;		✓Banks will now be required to provide Market Risk capital based on BIS standard methodology as a minimum requirement.	
Principle 12, Part 2 Supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures if warranted.	✓		
Principle 13 Banking Supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate Board and Senior Management oversight) to identify measures monitor and control all other material risks and where appropriate to hold capital against these risks.		✓ An in-house group has gone into the matter and made several recommendations regarding Risk Management structures and measures to be taken by banks. These will be communicated to banks for implementation.	

Core Principle	**Implemented**	**Partially Implemented**	**Not Implemented**
Principle 14, Part 1 Banking Supervisors must determine that banks have in place internal Controls that are adequate for the nature and scale of their business.	✓		
Principle 14, Part 2 Banking Supervisors must determine that banks have in place internal Controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility, separation of the functions that involve committing the bank, paying away its funds, and proper accounts for its assets and liabilities reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.	✓		
Principle 15, Banking Supervisors must determine that banks have adequate policies, practices and procedures in place including strict 'Know Your Customer' Rules that promote high ethical and professional standards in the financial sector and prevent the bank being used intentionally and unintentionally by criminal elements.	✓		
Principle 16 An effective Banking Supervisory System should consist of some form of both on-site and off-site supervision.	✓		
Principle 17 Banking Supervisors must have regular contact with bank Management and thorough understanding of the institution's operations.	✓		
Principle 18, Part 1 Banking Supervisors must have means of collecting reviewing and analysing Prudential Reports and Statistical Returns from banks on a solo basis.	✓		
Principle 18, Part 2 Banking Supervisors must have means of collecting reviewing and analysing Prudential Reports and Statistical Returns from banks on a consolidated basis.			✓ Consolidated Reporting by banks will be implemented after introduction of consolidated accounting which is being looked into by an inhouse group.

Core Principle	Implemented	Partially Implemented	Not Implemented
Principle 19 Banking Supervisors must have a means of independent validation of supervisory information either through On-site Examination or use of External Auditors.	✓		
Principle 20 An essential element of bank Supervision is the capability of the supervisors to supervise the banking group on a consolidated basis.		✓Introduction of consolidated supervision is on the agenda of the Bank for implementation. An inhouse group is examining related issues.	
Principle 21, Part 1 Bank Supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the Supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business	✓		
Principle 21, Part 2 Bank Supervisors must be satisfied that the bank publishes on a regular basis Financial Statements that fairly reflect its condition.	✓		
Principle 22 Banking Supervisors must have at their disposal adequate Supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements such as minimum capital adequacy ratios when there are regulatory violations or where depositors are threatened in any other way. In extreme circumstances this should include the ability to revoke the banking licence or recommend its revocation	✓		
Principle 23 Banking Supervisors must practice global consolidated supervision over their internationally active banks, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organisations worldwide, primarily at their foreign branches, joint ventures and subsidiaries.		✓ The BFS has approved the proposals made by an inhouse group in this regard and these will be now implemented.	

Core Principle	Implemented	Partially Implemented	Not Implemented
Principle 24 A key component of Consolidated Supervision is establishing contact and information exchange with the various other Supervisors involved (primarily host-country Supervisory Authorities).		✓The BFS has approved the proposals made by an in house group in this regard and these will be now implemented.	
Principle 25, Part 1 Banking Supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions .	✓		
Principle 25, Part 2 Banking Supervisors must have powers to share information needed by the home country Supervisors of those banks for the purpose of carrying out consolidated Supervision**.**		✓ It has been suggested that a specific provision be incorporated in the Act authorising the Bank to share information with other supervisors. This will be looked into by the Expert Group set up by GOI.	
46	**33**	**11**	**2**

Annexure III

Accounting Standards as relevant to banks
A comparative analysis

Issue	International Accounting Standard	Indian Standard/Regulation as applicable to banks	Comments
1.*Asset recognition and measurement:* I) Investments			
a) Definition of current and permanent	a) A Current investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year. ➢ A long term investment is an investment other than a current investment.	a) As per international standard.	In UK the investments are classified as current/non-current but in US there are three categories: (I) held to maturity for debt securities only (ii) available for sale and (iii) trading.

b)Valuation	b) Investments classified as current assets should be carried in the balance sheet at market value or the lower of cost or market value. The comparison of cost and market value can be performed either on an aggregate portfolio basis, in total or by category of investments, or on an individual investment basis. ➢ For current assets held at market value gains and losses can be included in income or can be credited to revaluation surplus. ➢ Investments classified as long term assets should be carried in the balance sheet at either: (a) cost (b) revalued amounts (c) in the case of marketable equity securities the lower of cost and market value determined on portfolio basis.	b) For the purpose of valuation all investments other than permanent investments in Government and approved securities held as permitted by RBI has to be treated as current investments and marked to market. Banks have been advised by RBI to bifurcate all investments in approved and Government securities into current and permanent. The minimum ratio of current investments prescribed by RBI has been increased gradually from 30 percent to 70 percent for the year ending March 31 1999. RBI has already announced that in the next three years all the investments have to be treated as current. The valuation of current investments is done category wise. Any net gains under each category is ignored but losses have to be debited to Profit and Loss account under Provisions and Contingencies. If on valuation, there is an excess in the provision for depreciation account created by earlier debit to profit and loss account, it can be written back to profit and loss	Current investments are valued at the lower of cost and net realisable value or at current cost. In US held to maturity securities should be held at amortised cost. Trading and available for sale securities should be measured at fair value. Gains and losses should be taken to income for trading securities but to shareholders' equity for available for sale securities. The Indian accounting standards laid down by RBI in consultation with the Institute of Chartered Accountants of India is more conservative as

Issue	International Accounting Standard	Indian Standard/Regulation as applicable to banks	Comments
	If revalued amounts are used, a policy for the frequency of revaluation should be adopted and investments should be valued in entire categories. The resulting changes in carrying value can either be recognised through the income statement or adjusted on owners' equity as a revaluation surplus provided that the valuation is above cost. Any revaluation below cost is recognised as an expense in the income statement. The enterprise should recognise any decline in value below cost other than on a temporary basis on an item- by-item basis.	account under the head 'provisions and contingencies' . However, such excess has to be transferred to Capital Reserve which is allowed to be treated as part of Tier II capital and cannot be used for distribution of dividend. In case of unquoted investments the value is to be determined on the basis of 'Yield to Maturity'. However the values have to be further discounted where interest or redemption are in arrears. Permanent investments can be held at book value. However, any premium paid has to be amortised over the life of the investment. Any discount has to be ignored. For the purpose of valuation, as stated above, banks are not allowed to treat more than 30 percent of their portfolio has permanent investment and progressively over the next three years the intention is that the full portfolio should be marked to market.	banks cannot classify investments as permanent once the 100 percent mark to market is achieved. Further banks cannot recognise unrealised net gains as income.
c) Fixed to current transfers	c) In cases where current investments are carried at lower of cost and market, transfer has to be made at the lower of cost and carrying amount. Any revaluation reserve remaining after the transfer has to be reversed. Where current investments are carried at market, transfer carrying amount. Transfer any remaining revaluation reserve to income if the policy on current assets is to take gains and losses to income.	c) Banks have to recognise the depreciation in the value of the investment when it is transferred to current category at the time of such transfer.	
d) Current to fixed transfers	d) Transfer at lower of cost and market or at market if that was the basis used.	d) the transfer will be at value net of depreciation. However, with banks moving to 100 percent mark to market such transfers will be few.	

Issue	International Accounting Standard	Indian Standard/Regulation as applicable to banks	Comments
ii) Lease accounting	➢ a finance lease is defined as a lease that transfers substantially all the risks and rewards.UK and US have laid down the presumptions and conditions in this regard. ➢ The lease depreciation period is usually useful life unless there is no certainty about eventual purchase when the shorter of useful life and lease term should be used. ➢ The lessor's income is allocated on the basis of either net investment or net cash investment used consistently according to the character of the lease. ➢ In the case of sale and lease back transactions of finance leases apparent profit if recognised should be taken over the lease term. ➢ finance leases are capitalised and depreciation provided thereon. The lease obligation is shown in creditors.	➢ Financial leases like operating leases are capitalised in the books of the lessor and not in the books of the lessee. Indian Accounting Standard on lease accounting ensures that the lease rentals are allocated between finance charge and repayment of the lease obligation. A matching annual charge is made to profit and loss account representing recovery of the net investment/fair value of the leased asset over the primary period of the lease.	
iii) Impairment of assets	➢ There is no specific international accounting standard on this and each country adopts its own practice. However an international accounting standard on this issue is expected shortly. ➢ As far as banks are concerned, each regulator has laid down norms for recognition of income and for provisions for loan losses or they rely on the assessment of the external auditor such as in UK Germany etc.	➢ In India banks follow the detailed norms laid down by RBI for income recognition, asset classification and provisioning.	

Issue	International Accounting Standard	Indian Standard/Regulation as applicable to banks	Comments
2. Liability recognition and measurement **i) Contingencies and events occurring after the balance sheet date**	➢ The amount of a contingent loss should be recognised as an expense and a liability if (a) it is probable that future events will confirm that an asset has been impaired or a liability incurred at the balance sheet date; (b) a reasonable estimate of the amount of the resulting loss can be made. The existence of a contingent loss should be disclosed in a note to the accounts if it is probable that the gain will be realised ➢ Events which occur after the balance sheet date but before the date on which financial statements are authorised for issue may indicate a need to make adjustments to assets and liabilities or may require disclosure. The essential test is whether the event provides additional evidence about conditions existing at the balance sheet date or provides if normatiion relating to the applicability of the going concern assumption. For e.g. a borrower becoming bankrupt after the balance sheet date.	➢ The Indian accounting standards are on par with the International Accounting Standard In regard to off balance sheet items the external auditors and RBI inspectors do verify whether contingent losses have been provided for.	The International Organisation of Securities Companies has called for a review of the measurement requirements of this standard as guidance is required to define more clearly the nature of contingencies. If this can be achieved the revised standard will provide a basis for distinguishing on-balance sheet.and off-balance sheet items. There is also a particular concern about the use of provisions in financial statements which will also be addressed when this standard will be reviewed
ii) Income taxes	➢ The international standard requires that a deferred tax liability should be recognised for all taxable temporary differences (apart from some specific exceptions). A deferred tax asset may be recognised (for the carry-forward of unused tax losses and unused tax credits) to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised. Measurement of deferred tax liabilities and assets should be at the tax rates which are expected to apply when the liability is settled or the asset is realised	➢ No provision is made for deferred tax liability or deferred tax credit. The provision for taxation is based on the estimated tax liability currently payable. This is one area where Indian GAAP differs from US/UK GAAP. As far as banks are concerned they have more of deferred tax credit as provisions made by them towards non-performing assets are not tax deductible and provisions are made gross of tax.	

Issue	International Accounting Standard	Indian Standard/Regulation as applicable to banks	Comments
iii) Employee benefits **(iv) Financial instruments: Disclosure and Presentation**	➢ The contributions are reflected in the profit and loss account ➢ The standard was made effective from January 1 1996 in view of the increasing use of derivatives interest rate swaps etc. ➢ In order to provide an understanding of risk for each class of financial asset, liability and equity instrument disclosure is required of terms conditions and accounting policies, interest rate risk, credit risk fair value and hedges.	➢ Indian Accounting Standard is in line with the International Standard. ➢ In India except for few products allowed for managing for foreign currency liabilities which are governed by conservative limits on positions etc we are yet to introduce complex derivatives products. The standard will be applied when we introduce these products in the banking sector.	
3. Revenue Recognition	➢ Revenue is recognised when it is probable that future economic benefits will flow to the enterprise and these benefits can be measures reliably. ➢ The standard applies this principle to the sale of goods, the rendering of services and the rise by others of enterprise assets yielding interest, royalties and dividends. ➢ Revenue should be recognised on the following basis. ➢ Interest should be recognised on a time proportion basis that takes into account the effective yield on the asset ➢ Dividends should be recognised when the shareholder's right to receive dividend is established.	➢ The Indian standards are on par with IAS. Banks are allowed to recognise interest and other income on accrual basis. However, if interest is past due for two quarters, it cannot be recognised on accrual basis.	
4. Effects of changes in foreign exchange rates	➢ The financial statements are affected by foreign exchange rates in two ways. The enterprise may undertake transactions in foreign currency, alternatively it may operate part of its business in a foreign country which has a different currency.	➢ The recognition of effects of changes in foreign exchange rates in respect of foreign currency transactions are as per international standard. ➢ In regard to translation of financial statements of overseas branches of Indian banks, the RBI instructions are that any translation gains should not be recognised as income but transferred to a separate account in the balance sheet.	

Issue	International Accounting Standard	Indian Standard/Regulation as applicable to banks	Comments
.	➢ Foreign currency transactions should be recorded in the reporting currency of the enterprise by applying the exchange rate relevant at the date of the transaction exchange differences arising from settlement or reporting of monetary items should be recognised as income or expenses in the period in which they arise. ➢ The method of accounting for transaction depends on whether the foreign operations are integral to the operations of the reporting enterprise or whether it is an operation which enjoys a significant degree of autonomy from the reporting enterprise.		
5.*Group accounting*	➢ a parent which issues consolidated financial statements should consolidate all subsidiaries foreign and domestic with few exceptions. For example where a subsidiary operates under severe long term restrictions which significantly impair its ability to transfer funds to the parent. ➢ The international accounting standards deal with many of the problem areas of group accounting such as foreign exchange rates; the nature of a business combination; consolidated financial statements and investments in subsidiaries; investments in associates and interests in joint ventures. ➢ Investments in associated companies are accounted under the equity method.	➢ Consolidation is not required. ➢ Investments in associated companies are not accounted for under equity method. Investments are carried at cost. ➢ In the case of banks as consolidated supervision is one of the core principles for effective banking supervision, it is proposed to call for a off-site reporting on consolidated basis.	

Issue	International Accounting Standard	Indian Standard/Regulation as applicable to banks	Comments
6. Disclosure and presentation – International Accounting Standard 30 which specifically deals with disclosure in the financial statements of banks and other similar financial institutions			
Income statement	1. Accounting policies disclosure	1. Accounting policies are disclosed	
	2. Income statement: A bank should present an income statement which groups income and expenses by nature and discloses the amounts of the principal types of income and expenses	2. income statement complies with international standard	
	3. Income and expenses should not be offset except for those relating to hedges and to assets and liabilities where there is a legal right to set off and the offsetting represents the expectation as to the realisation or settlement of the asset or liability.	3. IAS compliant	
Balance sheet	4. a bank should present a balance sheet that groups assets and liabilities by nature and lists them in an order that reflects their relative liquidity.	4. Assets listing reflects liquidity but not the liabilities.	
Investments	5. a bank should disclose the market value of dealing securities and marketable investment securities if these values are different from the carrying amounts in the financial statements	5. Market value of current investments is disclosed. Market value of permanent investments is not disclosed.	
	6. the amount at which any asset or liability is stated in the balance sheet should not be offset by the deduction of another liability or asset unless a legal right of set-off exists and the offsetting represents expectation as to the realisation or settlement of the asset or liability.	6. IAS compliant	

Issue	International Accounting Standard	Indian Standard/Regulation as applicable to banks	Comments
Contingencies and commitments	7. a bank should disclose specified contingencies and commitments and events occurring after the balance sheet date as already stated above.	7. IAS compliant – as per assessment of external auditors	
Maturity pattern of assets and liabilities	8. a bank should disclose an analysis of assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity	8. Banks are yet to build up information on maturity pattern. RBI has advised banks to put in place suitable systems to capture this information.	
Concentrations of assets, liabilities and off-balance sheet items	9. a bank should disclose any significant concentrations of its assets liabilities and off balance sheet items. Such disclosures should be made in terms of geographical areas, customer or industry groups or other concentrations of risk. A bank should also disclose the amount of significant net foreign currency exposures.	9. The banks disclose exposures to public sector priority sector Government and banks. Secured and unsecured exposures are also disclosed.	
Losses on loans and advances	10. a bank should disclose the following in regard to losses on loans and advances: • the accounting policy which describes the basis on which uncollectable loans and advances are recognised as an expense and written off. • details of the movements in provisions for losses on loans and advances during the period. • the aggregate amount of the provision for losses on loans and advances at the balance sheet date and • the aggregate amount included in the balance sheet for loans and advances on which interest is not being accrued and the basis used to determine the carrying amount of such loans and advances.	10 The following disclosure is mandatory. ➢ accounting policies ➢ provisions made during the year ➢ net non-performing assets to net advances Indian regulations not IAS compliant.	
Related party transactions	11. .related party transactions should be disclosed	11. Not disclosed. However, as per Banking Law, banks are prohibited from giving loans to companies/firms in which directors are interested	

Annexure IV
Money Market

Elements of Reform	Pre-Reform Status	Reform Status	Current Status	Comments/outlook
1. Call/Notice/Term Money Market	• Only banks were allowed to participate in market as borrowers and lenders. • Financial institutions allowed as lenders. • CRR/SLR required to be maintained on interbank liabilities. • Telephone oriented market.	• Primary Dealers allowed as lenders and borrowers. • Private Mutual Funds allowed as lenders. • Routing of transactions allowed to entities through DFHI as lenders with minimum size of operations at Rs.20 crore, which was reduced gradually to Rs.3 crore. • IDBI/ICICI/IRBI/SIDBI/ EXIM Bank and NABARD permitted to borrow from term money market for periods 3-6 months within stipulated ceilings. • Interbank liabilities exempted for purpose of CRR and SLR subject to statutory ceiling on NDTL. • Telephone oriented market	• Banks and PDs are permitted to lend and borrow. FIs/insurance companies/mutual funds/corporate entities through PDs are permitted to lend. CRR/SLR exempted for interbank liabilities. Reference rate emerging through Reuters/NSE.	• Proposal to make the call/term money market purely an interbank market with only banks/PDs operating as lenders and borrowers. • Others to operate through repo. • Proposal to operationalise Electronic Dealing System. • ALM guidelines to limit exposure of banks in call money market.
2. Commercial Paper	• Issued by corporates • Discounted instrument • Prior permission of RBI required. • Issue of CP linked to Maximum Permissible Bank Borrowing (ceiling on aggregate amount of CP linked to fund based working capital) • Facility of stand-by available • Requirement of minimum	• PDs are also allowed to issue CP • Discounted instrument • Prior permission of RBI dispensed with • Ceiling increased to 100 per cent of working capital • Facility of stand-by abolished. • Requirement of minimum current ratio dispensed with. • Minimum size of CP to	• Corporates and PDs are permitted to issue CP as a discounted instrument for a minimum maturity of 15 days and maximum maturity of 1 year. • The minimum size of CP is Rs.25 lakh. • The issue requires to be rated. • Banks, FIs, NRIs on a non-repatriable basis and individuals can invest in	• Rationalisation of stamp duty structure • Electronic Dealing System. • Variation to instrument such as coupon bearing CP and floating rate CP.

	current ratio (1.33 :1) • Minimum size of CP issue at Rs.1 crore in denomination of Rs.25 lakh. • Maturity range of 3-6 months. • Rating required	investor reduced to Rs.25 lakh with denomination of Rs.5 lakh. • Minimum maturity gradually reduced to 15 days and maximum maturity elongated to 1 year. • Rating required.	CP.	
3. Certificate of Deposits	• Issued only by commercial banks (excluding RRBs) as a discounted instrument. • Minimum size of CD : Rs.1 crore, and issued in multiples of Rs.25 lakh. • Minimum maturity of CD should not be less than 3 months and maximum maturity not more than 1 year. • Bankwise limit on issue of CD at 1 per cent of fortnightly average outstanding aggregate deposits in the previous year. • Initial lock-in period of 45 days.	• Financial institutions can also issue CD for maturity 1-3 years. • Minimum size of CD gradually reduced to Rs.5 lakh. • Bankwise limits gradually raised up to 10 per cent and later withdrawn. • Initial lock-in period reduced gradually to 15 days.	• Banks and FIs can issue CDs for maturity of 3 months to 1 year and 1 to 3 years, respectively. • CD is issued as a discounted instrument. • The minimum size of CD is Rs.5 lakh and the minimum lock-in period is 15 days.	Rationalise the maturity structure of CDs. Rationalise stamp duty structure. Variation to instrument such as interest bearing CD and floating rate CD.
4. Money Market Mutual Funds	• Did not exist.	• Can be set up by Scheduled Commercial Banks/PFIs directly or through the existing mutual funds as MMDA or MMMF • NRIs can invest on non-repatriation basis. • Initial Minimum lock-in-period – 46 days. Subsequently reduced to 15 days • Units could be issued to	• In principle approval has been given for 10 banks and institutions to set up MMMFs/ MMDAs. • IDBI, UTI and Kothari Pioneer Mutual Funds have floated MMMF schemes. • MMMFs permitted to invest in corporate debentures/bonds with	• Consider reduction in minimum holding period of 15 days. • Consider cheque issuance facilities.

		Corporates and others on par with other mutual funds (April 1996) • Investment in money market instruments such as CP/T-Bills/CD/Dated Securities with maturity less than one year. • Launched 100 per cent Gilt fund with liquidity support from RBI.	maturities less than one year, within limits.	
5. Commercial Bills Rediscounting	• Maturity of commercial bills not to exceed 30 days. • All participants in the call money market are participants in this market. • No ceiling on interest rates. • No minimum period of rediscounting.	• Minimum period of 15 days prescribed for rediscounting (April 1995).	• All participants in the call money market can rediscount commercial bills for a minimum period of 15 days.	

Annexure V
Government Securities Market

Elements of Reform	**Pre-Reform Measures**	**Reform Measures**	**Current Status**	Comments/Outlook
1. Policy	• Absence of internal debt management policy • Automatic monetisation of budget deficit through a system of ad-hoc T-Bills at interest rate of 4.6 per cent. • System of Tap T-Bills at 4.6 per cent.	• Active debt management policy . • Abolition of system of Ad-hoc T-Bills (since April 1, 1997) and introduction of system of ways and means advances (WMA) within agreed limits at Bank rate. Maximum period of overdraft at Bank rate plus 2 percentage points. • Tap T-Bills replaced by 14-Day Intermediate T-Bills (since April 1, 1997).	• Limit of WMA for the first half of 1998-99 fixed at Rs.11,000 crore and for the second half at Rs.7,000 crore. • Monitoring Group of Cash and Debt Market constituted with RBI and debt officials.	• Limits of WMA to be reviewed further. • No overdraft will be permitted beyond 10 days after March 31, 1999.
2. Dated Government Securities	• Dated Securities sold at low preannounced coupon rate. • Long-Dated Securities of 20-30 years were being issued. • Instrument used was plain vanilla fixed coupon security	• Securities sold through auction process (June 1992). • Discriminatory type of auction (June 1992). • Maturity of security usually not more than 10 years. • Variety of instruments used such as zero-coupon bonds, floating rate bonds, partly paid stock, capital indexed bonds, etc. • Notified amount preannounced in respect of each auction (Oct 1998). • A portion of the notified amount underwritten by Primary Dealers (PDs) (since June 1997). This replaced the system of commission introduced in	• Securities generally sold through discriminatory auction process. • Securities also sold at market related preannounced coupon rate and also on tap, depending on prevailing conditions.	• Can consider new instruments. • Aim to move to totally market clearing yields at auctions.

		July 1996.		
3. Treasury Bills	• 14-day Tap T-Bills at a coupon of 4.6 per cent • 182-Day T-Bills	• Tap T-Bills replaced by 14-Day Intermediate T-Bills (April 1, 1997). • A variety of T-Bills exist – 14-Day, 91-Day and 364-Day. 182-day T-bills withdrawn. • T-Bills sold through auction basis (since April 1992). • Notified amounts pre-announced • Non-competitive bids (allowed in respect of 14-Day and 91-Day T-Bills) kept outside notified amounts. • T-Bills auction underwritten by PDs.	• T-Bills sold through auctions. • 14-Day and 91-Day T-Bills auctions held every Friday and 364-Day auctions every alternate Wednesdays. • Discriminatory auctions used in respect of 14-day and 364-day T-Bills and uniform type auction in respect of 91-Day T-Bills. • Notified amount varied depending on prevailing market conditions.	• Announced intention to introduce 28-day T-Bills and reintroduce 182-day T-Bills. • Could sell through uniform or discriminatory auctions depending on experience gained.
4. Institutional Development	• No specialised institution	• Securities Trading Corporation of India Ltd. Promoted by RBI (July 1994) to develop trading in Government Securities. • A system of Primary Dealers (March 1995) and Satellite Dealers (December 1996) have been established to activate primary and secondary markets and retail Government Securities.	• RBI has diluted most of its holdings in STCI and is a minority shareholder. • STCI has acquired PD status.	
5. Primary Dealers	• Did not exist.	• Initially six PDs licensed (March 1996). • PDs given bidding commitments. • PDs have access to call money market both as borrowers and lenders (March 1996) and can raise	• Recently, seven new PDs have been given in-principle approval (October 1998). • Individual PDs cannot underwrite more than 30 % of the notified amount. • PDs have formed an SRO	• Consider increasing the number of PDs. • Increase the proportion of underwriting to 100 % of notified amount. • Consider introducing when-issued market.

		funds through issue of CP, by way of loans from banks and from the intercorporate market (September 1996) . • PDs underwrite 50 % of notified amounts in auction (August 1998).	called Primary Dealers Association.	
6. Satellite Dealers	• Did not exist.	• Nine SDs registered initially (Nov 1997). • Two in-principle approval given to banks (Nov 1997). • SDs do not have access to call/notice money market.	• Four out of nine SDs have graduated as PDs. • SDs permitted to issue CP (June 1998).	• Consider increasing the number of SDs.
7. Settlement System	• Through Subsidised General Ledger Accounts maintained in the Public Debt Office of RBI. • Banks, FIs, PFs holding SGL accounts. • Manual Accounting and no Delivery Versus Payment.	• Through SGL accounts maintained in PDO of RBI • Computerised environment with DVP system for settlement. • Participants given two SGL accounts, one for own transactions and the other for constituents. • PFs asked to close SGL accounts with RBI and encouraged to open constituent accounts with banks, etc.	• DVP system in operation. • Banks/FIs/PDs/NSE/NSDL /SHCIL have SGL and current account with RBI.	• To move to real time gross settlement system. • To integrate SGL and current account.
8. Secondary Market Trading	• Transactions conducted over telephone. • Transactions routed through brokers. • Tax deducted at source (TDS) in respect of income from secondary market transactions.	• Transactions continue to be conducted over telephone. • Transactions are usually directly between counterparties. • If routed through brokers they must be through a recognised stock exchange. • Individual broker limits fixed for banks. Any increase in broker limits needs ratification by bank Boards. • TDS abolished.	• PDs, foreign banks and new private sector banks are usually active in the secondary markets. • PDs are expected to give active two way quotes.	• Electronic Dealing System being put in place. • Ease in individual broker limits may be considered.

9. Inter-Bank Repos	• Freely done	• Heavily restricted • Banks and PDs can borrow and lend through repos (June 1994). • Mutual funds/other select holders can lend through repos (April 1997). • Minimum period of repo reduced to 1 day (October 1998).	• Banks and PDs can lend and borrow through repos. • Non-bank participants who are lenders in call money market can lend through repos. • Minimum period of repos is one day	• It is proposed to make the interbank call money market purely interbank. The sequencing will require all non-bank participants to allow access to the repo market in Government and Non-Government debt in dematerialised form • Encourage dematerialisation of non-Government debt. • Introduce different form of repos. • Introduce code of conduct for market practices and standardised contracts for repos.
10. RBI Repos		• RBI conducts 3 /4/14 day repos. • Repos conducted both on auction basis and fixed rate volume tender (Nov 1997).	• Currently RBI conducts 3 /4 day repos on fixed rate volume tender basis.	• 1 day repo being contemplated and will be conducted as and when necessary.
11. Foreign Investment		• NRI/ Overseas Corporate Bodies/ Foreign Institutional Investors can operate Dated Securities in primary and secondary markets. • Since May 1998, FIIs permitted investment in T-Bills also in both primary and secondary markets.		

Non-Government Debt Market

Elements of Reform	Pre-Reform Status	Reform Measures	Current Status	Comments/ Outlook
1. PSU Bonds	• Tax-free and taxable bonds permitted to be issued. • Maximum interest rate on taxable bonds at 14%. • Maximum interest rate on tax-free bonds fixed at 10% • Ceiling of banks investments in PSU bonds and corporate debentures at 1.5 per cent of incremental deposits.	• Tax-free and taxable bonds continue to be permitted. • Interest rate on taxable bonds freed • Ceiling on tax-free bonds raised to 10.5 per cent. • Repos permitted in PSU bonds in demat form and through recognised stock exchanges • Ceiling of banks investments in PSU bonds removed. • PFs initially allowed to invest 15% of their incremental deposits in bonds of PSUs and public financial institutions	• Taxable and tax-free bonds can be issued. There is ceiling of 10.5% on tax-free bonds and no ceiling on taxable bonds. Banks can invest freely in PSU bonds. There are a variety of bonds in the market. • Repos are permitted if PSU bonds are in demat form and done through NSE. But, yet to take off as Stamp Duty clearances awaited. • Limit of PFs investment in PSU bonds increased to 30 per cent.	• Proposal to rationalise stamp duty structure to promote secondary market trading.
2. Corporate Debt	• Interest rate ceiling of 14% on taxable debentures • Conversion in respect of convertible debentures compulsory • Ceiling of banks investments in PSU bonds and corporate debentures at 1.5 per cent of incremental deposits. • Traditional debt instruments	• Interest rate ceiling removed. • Conversion made optional at the choice of investor. • Ceiling on banks investments in PSU bonds removed. • Innovative instruments such as deferred interest secured payment notes, Non-convertible debentures with detachable equity warrants, Zero interest fully and convertible instruments, optionally fully convertible debentures, debentures with call and put options, step-up interest rates, deep discount bonds, etc.	• A variety of corporate debt instruments are available. Banks can invest freely in such instruments. • Announced the intention to introduce interest rate swaps	• Innovation will continue. • Derivatives will be introduced.
Institutional Development	• Securities and Exchange Board of India set up as a regulatory body	• SEBI accorded statutory status. Office of Controller of Capital Issues abolished. • National Stock Exchange set up (screen-based dealing).	• SEBI is the regulator. There are depositories like NSDL and custodians like SHCIL.There is an electronic stock exchange in the form of NSE and a stock exchange for small value instruments like	

		• OTCEI set up (for small value securities). • Stock Holding Corporation of India set up (custodial services). • National securities Depository Ltd. (Depository). • Credit Rating Agencies set up.	OTCEI.	

Annexure VI
Foreign Exchange Market

Elements of Reforms	Pre-Reform Status	Reform Measures	Current Status	Comments/ Outlook
1. Exchange Rate Regime	• Exchange rate officially determined by RBI in terms of a weighted basket of currencies of India's major trading partners. The regime was characterised by daily price setting by RBI. • Given the RBI's obligation to buy and sell unlimited amounts of the intervention currency i.e., pound sterling, arising from the banks' merchant purchases, its quotes for buying/selling effectively became the fulcrum around which the market moved. • Debt Service Payments were routed through foreign exchange reserves.	• A significant two stage downward adjustment in the exchange rate of the rupee took place on July 1 and 3, 1991. • Simultaneously EXIM Scrip scheme was introduced. LERMS was in place during 1992-93, under which 40 per cent of the proceeds of the exchange earners had to be surrendered at the official rate and 60 per cent at the market rate. With effect from March 1, 1993, the exchange rate of the rupee was unified and the era of fully floating market-determined exchange rate began. • RBI discontinued quoting of buying and selling rate from October 4, 1995. The RBI now quotes its buying rate to any authorised dealer on receiving a specific request. • With effect from July 3, 1995 Debt Service Payments routed through the market.	• Exchange rate of the rupee is market determined, based on the demand and supply of foreign exchange.	-
2. Overnight Positions/ Aggregate Gap Limits (AGL) of Authorised Dealers (ADs).	Uniform limit of Rs 15 crore on the overnight positions of ADs. AGL not to exceed US $ 100 million or six times the net owned funds of a bank.	• Consequent upon the recommendations of the Expert Group on Foreign Exchange Market (Chairman: Shri O.P. Sodhani), the uniform limit of Rs 15 crore on the overnight positions of the ADs was removed with effect from January 4 1996. Banks allowed to operate on the limits fixed by their management's and vetted by RBI. • Aggregate Gap Limit (AGL) was left to be fixed by the individual banks since April 1996 depending upon their foreign exchange operations, risk taking capacity, balance sheet size and other relevant parameters subject to the approval from the Reserve Bank.	• Since August 20, 1998, ADs advised to report (at close of business everyday) their open position as at 10.a.m. as also their peak intra-day position	-

Elements of Reforms	Pre-Reform Status	Reform Measures	Current Status	Comments/ Outlook
3. Cross Currency Options and derivative Products	• No cross currency options/derivative products were available. • Banks not permitted free trading opportunities in the overseas markets.	• Since April 1996, ADs were allowed to initiate cross currency position overseas, to cancel and rebook cross currency options and offer derivative products to enable their customers to hedge their external liabilities. • Since August 1996, ADs allowed to offer (a) Interest rate swaps (b) Currency swaps, (c)Coupon swaps, (d) Purchase of interest rate caps/collars and (e) Forward rate agreements to their corporate clients for their asset-liability management either by booking the transactions overseas or on a back-to-back basis, without prior approval of the government or the Reserve Bank. Payment of upfront premia as well as other charges incidental to the hedge transactions could also be effected by ADs without prior approval of the Reserve bank. • Since September 1996, ADs accorded freedom to offer to their customers cost reduction strategies and risk-reduction option strategies like Range Forwards, Ratio Range Forwards etc. subject to the condition that there is no net inflow of premium to the customers by shorting volatilities. Corporates were allowed to freely book and cancel options.	-	-
4. Foreign Currency Loans.	• Banks not allowed to offer foreign currency loans from the pool of non-resident deposits.	Banks permitted in October 1996 to provide foreign currency denominated loans to their customers out of the pool of FCNR(B) deposits.	-	-

Elements of Reforms	Pre-Reform Status	Reform Measures	Current Status	Comments/ Outlook
5. Overseas borrowings/ investments by banks.	Banks not permitted	• ADs were permitted in April 1997 to borrow from their overseas offices/ correspondents as well as to invest funds in overseas money market instruments up to US $ 10 million. In October 1997, this limit was raised to 15 per cent of the Tier I capital of the banks. • Limit modified to include overnight investments out of nostro account balances of the banks.	• ADs advised informally not to arbitrage between the money and foreign exchange markets which could bring in additional volatility in the market.	• As the forex market deepens further and the markets become integrated, this limit would be raised. • The Report on Capital Account Convertibilty recommends that the only restriction should be Section 25 of BR Act, 1949 and open position/gap limits.
6. Forward Market	• To access the forward market corporates were required to produced ocuments evidencing exposure. • Unlimited cancellation and rebooking of forward contracts not allowed. • The participants in the forward market were limited.	• ADs permitted to book forward cover for exporters and importers on the basis of a declaration of exposures supported by past performance and business projection provided the total forward contracts outstanding at any point of time did not exceed the average export/import turnover of the last two years. • Corporates were given complete freedom in 1992 to actively hedge their exposures by freely booking and cancelling forward contracts. • Since December 1, 1997 rebooking of forward contracts on non-trade transactions for the same underlying exposure was banned and only rollover was allowed. • Since August 20, 1998, it was decided to withdraw the facility of rebooking cancelled contracts for trade related transactions covering imports. However, contracts can be rolled over before maturity. • Participants in the forward market have been increased considerably. In August 1997, FIIs were allowed to cover their debt exposures in the forward market. • In October 1997, the facility of forward cover was extended to NRI depositors in respect of	• Booking of forward contract based on presumptive exposure temporarily withdrawn since December 2, 1997 in view of the volatility in the forex market and presently forward cover is allowed based only on documents evidencing exposures. • Facility for rebooking of cancelled contracts is presently available only for exports. Rebooking of cancelled contracts is not allowed in case of non-trade transactions and imports.	• The need for documents to enter into a forward contract would be withdrawn.

		deposits held in Non Resident (External) Rupee accounts [NRE(R)A] and Foreign Currency Non-Resident (Banks) [FCNR(B)] schemes • With effect from June 12, 1998, forward cover facility for equity investment by FIIs was made available for "incremental investments" (over and above the level of investment in equity prevailing at the end of business on June 11, 1998). • Since August 20, 1998, ADs were allowed to offer forward cover facility to FIIs to the extent of 15 per cent of the value of their investments as on June 11, 1998. This facility was in addition to the facility already available for incremental investments. • Forward contracts have also been allowed for remittance of dividend in respect of direct foreign investment.		

Elements of Reforms	Pre-Reform Status	Reform Measures	Current Status	Comments/ Outlook
7. Rupee based derivatives	• No rupee based derivatives were available.	• In April 1997, RBI permitted ADs to offer dollar-rupee swaps to corporates corporates and run a swap-book within their open position/gap limits without prior approval of the Reserve Bank of India.	• Once this was permitted the market has seen forward deals upto 5 years whereas earlier a price beyond 6 month was not available.	Rupee based derivatives would be developed further with the deepening of the forex market and the emergence of a stable rupee yield curve.
8. Exchange Earners' Foreign Currency (EEFC) Account	• Exporters and exchange earners were not allowed to retain any portion of their proceeds.	• Exporters and exchange earners are allowed to retain 50 per cent of their foreign exchange earnings in the Exchange Earners' Foreign Currency (EEFC) accounts. • 100 per cent EOUs are allowed to retain 70 per cent of their earnings in such accounts. • Since August 20, 1998, it was decided to permit exporters to use the balances in EEFC accounts for all business related payments in India and abroad at their discretion including payments of airfare and hotel expenditure.	-	The ultimate objective is to allow exporters and exchange earners to retain 100 per cent of their proceeds.