RBI Governor announces Monetary and Credit Policy for the year 2001-2002

<u>Highlights</u>

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

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

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

Domestic Developments

3. Governor mentioned that even though the immediate loss of production may not be sizeable, the Gujarat earthquake has caused considerable damage and the cost of restoration of infrastructure is expected to cause a fiscal strain on the state reflecting loss of revenue and financing of relief and rehabilitation. The Reserve Bank has already taken several initiatives to deal with the situation.

4. Governor said that GDP growth in 2000-01 is likely to be about 6.0 per cent as compared with 6.4 per cent and 6.6 per cent in the previous two years. A welcome feature of macroeconomic development last year was good performance of the services sector, particularly of information technology related services. The annual rate of inflation was 4.9 per cent in 2000-01 as against 6.8 per cent a year ago. Inflation as reflected in consumer price index (CPI) was much lower at 3.0 per cent upto end-February 2001.

5. Referring to monetary developments, Governor noted that in 2000-01, the annual growth in money supply (M_3) on a point-to-point basis, was higher at 16.2 per cent as against 14.6 per cent a year ago and captured large inflows amounting to about Rs.26,000 crore of India Millennium Deposits. Aggregate deposits of the scheduled commercial banks increased by 17.8 per cent as against 17.2 per cent in the previous year. For the year as a whole, non-food credit registered a lower growth of 14.3 per cent as against an increase of 16.5 per cent in the previous year.

6. The increase in reserve money during 2000-01 at 8.3 per cent (about Rs.23,200 crore) was comparable to that of 8.1 per cent (about Rs.21,000 crore) in the previous year. The expansion in reserve money largely emanated from increase in net foreign exchange assets.

7. Governor expressed concern over the large buffer stocks of foodgrains and pointed out in this context the opportunity costs arising from fiscal and monetary perspectives. He welcomed the reforms in the management of the food economy announced in the Union Budget 2001-02.

8. Governor felt that the containment of fiscal deficit in 2000-01 facilitated the task of monetary and debt management as the market borrowing programme of the central government (Rs.1,15,183 crore gross and Rs.73,787 crore net) could be put through without undue pressure on interest rates.

9. Governor welcomed the efforts towards fiscal consolidation including the promise of Fiscal Responsibility Legislation and felt that coupled with lowering of interest rates on contractual savings, these would facilitate a move towards a favourable interest rate regime. This should also help in releasing government resources for much needed investment in physical and social infrastructure, which in turn could stimulate private investment.

10. While highlighting the continuation of easy liquidity conditions and softer interest rate environment, Governor emphasised that in case the present economic circumstances change, it may again become necessary to take appropriate monetary measures which may not be in consonance with the present easy conditions. He urged the banks and financial institutions to make adequate allowance for unforeseen

contingencies in their business plans, and fully take into account the implications of changes in the monetary and external environment on their operations.

11. Dealing with certain practical aspects of monetary management, Governor pointed out the difficulty in the correct assessment of the potential inflationary pressures based on the latest available data for the current period. It, therefore, becomes extremely important to appreciate the underlying inflation both from demand and supply side factors before building up an appropriate policy stance. The Reserve Bank will continue refinement in the methodology for assessment of the inflationary outlook and a set of monetary indicators which could best guide the formulation of monetary policy in a changing environment.

External Developments

12. Governor mentioned that India's foreign currency assets increased by about US $ 7.0 billion in the second half of 2000-01 and exchange rate movements were generally orderly and range-bound, largely due to restoration of confidence in India's external prospects.

13. Governor drew the attention to the varied behaviour of the forex market, sharply different during the two halves of the year, even though there was no significant change in the 'real' economy or important economic variables, such as, the growth rate, trade deficit or oil prices.

An analysis of forex markets in two halves of the year 2000-2001 leads to following broad observations :

- The day-to-day movements, in the short-run, in foreign exchange markets have little to do with the so-called 'fundamentals' or country's capacity to meet its payments obligations, including debt service. Any adverse news, and 'expectations' generated by it tend to play a paramount role. Adverse expectations are also generally self-fulfilling because of their adverse effect on "leads and lags" in export/import receipts and payments, remittances and inter-bank positions.

- In view of inter-bank activity, which sets the pace in forex markets, transaction volumes in "gross" terms are several times higher, and more variable, than "net" flows. Exchange rates are more sensitive to "gross" flows, and variability in "gross" flows in turn is sensitive to exchange rate expectations.

- Any initial adverse movement, following bad news or unfavourable development may get exacerbated because of greater inter-bank activity. Given the "bandwagon" effect of any adverse movement and the herd behaviour of market participants, the situation can lead to further buying or hedging activity among non-bank participants. The "Daily Earnings At Risk" (DEAR) strategies of risk management tends to reinforce herd behaviour. There is a natural tendency to do what everyone else is doing in the event of any adverse development rather than taking a contra position, particularly in thin and underdeveloped markets dominated by a few leading operators.

- Developing countries generally have smaller and localised forex markets where nominal domestic currency values are expected to show a depreciating trend, particularly if relative inflation rates are higher than those of major industrial countries. In this situation, there is a greater tendency among market participants to hold long positions in foreign currencies and to hold back sales when expectations are adverse and currencies are depreciating, than the other way round when currencies are appreciating and expectations are favourable. Thus, market behaviour is not symmetrical in both directions.

- The tendency of importers/exporters and other end-users to look at exchange rate movements as a source of return without adopting appropriate risk management strategies, at times, creates severe uneven supply-demand conditions, often based on “news and views”. A self-sustaining triangle of supply demand mismatch, increased inter-bank activity to take advantage of it and accentuated volatility triggered by negative sentiments, not in tune with fundamentals can be set in motion, requiring quick intervention/response by authorities.

14. Governor reiterated that eventhough in theory, there is a strong case for either freely floating exchange rates (without intervention) or a currency board type arrangement of fixed rates, in practice, however, most countries have some variety of “managed” floats and central banks intervene in the market periodically.

15. Governor stressed the importance of building up foreign exchange reserves to take care of unforeseen contingencies, volatile capital flows and other developments which can affect expectations adversely. He maintained that these economic costs are likely to be substantially higher than the net financial cost, if any, of holding reserves. Governor reiterated that the overall approach to the management of India’s foreign exchange reserves in recent years has reflected the changing composition of balance of payments, and has endeavoured to reflect the “liquidity risks” associated with different types of flows and other requirements. India’s foreign exchange reserves are at present comfortable, however, there can be no cause for complacency.

16. He mentioned that the suggestions received from exporters and export trade organisations were examined by RBI and the Bankers' Group and guidelines were issued to banks to further simplify procedures for export credit. Governor has proposed to conduct a survey with the help of an independent outside agency in order to have a feedback on simplification of procedures by RBI for export credit delivery as also the level of exporters’ satisfaction with bank services.

17. Governor stated that for mitigating the problems of exporters due to the severe earthquake, guidelines have been issued to banks for providing relief/concessions. These include extending the period of packing credit, conversion of dues into short-term loans repayable in suitable instalments and relaxation in NPA classification norms.

18. Governor also dealt with various steps taken recently to promote Foreign Investment, such as foreign investment proposals in the IT sector, automatic approval for general permission to Indian companies to receive funds and issue shares to their foreign collaborators, improvement in the ADR/GDR market and opportunity to Indian shareholders to divest their shareholding, etc. Governor added that the Reserve Bank will continue with its efforts to simplify procedure, reduce documentation requirements and further liberalise opportunities for productive investment in India by NRIs and others and by Indian corporates abroad.

II. Stance of Monetary Policy for 2001-02

19. Governor stated that during March 2001, considerable turbulence and uncertainty in the equity markets led to problems in certain stock exchanges as well as liquidity/insolvency problems in some co-operative banks, which in turn affected certain commercial banks also. An important priority of the Reserve Bank during this difficult period was to try and minimise the "contagion" spreading from equity markets to money and government securities markets or to the banking system as a whole. Governor further stated that in the interest of financial stability, it is important to take measures to strengthen the regulatory framework for the co-operative sector.

20. Governor mentioned that the impact of slow down in the world economy on India may not be substantial. A favourable factor this year is that the international inflationary environment is reasonably benign. Governor expressed confidence that though merchandise exports growth may slightly moderate, software exports with more diversified destinations and private remittances may still be maintained. The size of current account deficit is expected to continue to be well within 2.0 per cent of GDP.

21. Governor, citing the lower fiscal deficit and contained borrowing programme, mentioned that RBI expects to conduct debt management without serious pressure on overall liquidity and interest rates.

22. Governor mentioned that RBI will ensure that all legitimate requirements for credit are met consistent with price stability. Towards this objective, the Reserve Bank will continue its policy of active demand management of liquidity through OMO, including two-way sale/purchase of Treasury Bills, and further reduction in CRR as and when required. It should also be possible to maintain the current interest rate environment, and explore the possibility of some further softening in medium and long-term rates. He cautioned however, that banks and financial institutions should be prepared for a reversal or tightening, in case of unfavourable and unexpected developments.

23. Governor indicated that for purposes of monetary policy formulation, for the year as a whole, growth rate of real GDP may be placed at 6.0 to 6.5 per cent, the rate of inflation to be within 5.0 per cent and the projected expansion in broad money (M_3) at about 14.5 per cent. Non-food bank credit (adjusted for investments) is projected to increase by 16.0 to 17.0 per cent which is expected to adequately meet the credit needs.

24. Regarding further flexibility of interest rates, he stressed that the financial system should improve its operational efficiency and aim at further reductions in cost of intermediation. It is necessary for banks to undertake further improvements in operational efficiency and active liability management for interest rate flexibility in line with changes in the inflationary outlook.

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

- Provision of adequate liquidity to meet credit growth and support revival of investment demand while continuing a vigil on movements in the price level.

- Within the overall framework of imparting greater flexibility to the interest rate regime in the medium-term, to continue the present stable interest rate environment with a preference for softening to the extent the evolving situation warrants.

III. Financial Sector Reforms and Monetary Policy Measures

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

Review of Liquidity Adjustment Facility - Stage II

27. On the basis of experience gained in operating LAF and after wide ranging consultations and the general appreciation among the market participants that the first stage of LAF worked smoothly, it has been decided to move forward to implement the second stage of LAF.

a) Changes in Standing Liquidity Facilities,
Introduction of Back-stop Facility and
New Formula for Export Refinance

- It is proposed to split the standing liquidity facilities available from RBI into two parts, viz., (i) normal facility and (ii) Back-stop facility.
- The normal facility will be provided at the Bank Rate.
- The Back-stop facility will be provided at a variable rate linked to reverse repo rate/repo rate/NSE –MIBOR:

  (i) at 1.0 percentage point over the reverse repo cut-off rate;

  (ii) where no reverse repo bid was accepted, at 2.0 to 3.0 percentage points over the repo cut-off rate;

  (iii) in case no bids were accepted at either repo or reverse repo auctions at 2.0 to 3.0 percentage points over NSE-MIBOR.

- Of the total limits of liquidity support available to PDs and banks, the normal facility would initially constitute about two-thirds and the back-stop facility about one-third.

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

(b) Changes in LAF Operating Procedures

29. The following measures relate to LAF operating procedures:

- Minimum bid size reduced from Rs.10 crore to Rs.5 crore.
- Timing is advanced by 30 minutes for receipt of bids and announcement of results.
- Dissemination of information on the scheduled commercial banks' aggregate cash balances with RBI
- An additional option to switchover to fixed rate repos which is expected to be sparingly used.
- RBI will also have the discretion to introduce longer-term repos upto 14 days.
- Introduction of multiple price auction on an experimental basis.

(c) Rationalisation of Interest Rates on Export Credit

30. Interest rate on export credit extended by banks rationalised and will be indicated as a ceiling rate linked to PLR, so that the interest rate charged by the banks can actually be lower than the prescribed rate. This is expected to introduce healthy competition and provide exporters a greater choice to avail of banking services in terms of interest rate, quality of service and transaction costs. Based on the current PLR up to 180 days of major public sector banks, there is likely to be a reduction in interest rate by 1.0 – 1.5 percentage points. Banks can also offer lower than PLR minus 1.5 per cent rate for export finance.

(d) Complementary Measures Associated with Money and Government Securities Markets

31. The following complementary and associated measures in respect of money and government securities markets are announced:

(i) Moving towards Pure Inter-bank Call Money Market

- Permission to corporates to route their call transactions through PDs would be available upto June 30, 2001.
- Access to other non-bank institutions (including financial institutions, mutual funds and insurance companies) to operate in call/notice money market would be gradually reduced in four stages:

  - In stage I, non-banks would be allowed to lend up to 85 per cent of their average daily lending in call market during 2000-01. Similarly,

  - In stage II, with effect from the date of operationalisation of Clearing Corporation, non-banks would be allowed to lend up to 70.0 per cent;

  - In stage III, with effect from three months after stage II, access of non-banks to call/notice money market would be equivalent to 40.0 per cent; and

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

- From a date to be notified by RBI, after the on-set of stage IV, non-banks will not be permitted to lend in call/notice money market. The above measures would allow sufficient time for market participants to adjust their portfolios without any disruption in the market.

(ii) Shortening of Minimum Maturity Period of Term Deposits

- It has been decided to reduce the minimum maturity period for term deposits to 7 days from the present 15 days in respect of wholesale deposits of Rs.15 lakh and above.

(iii) Relaxation in Daily Minimum Cash Reserve Ratio Maintenance Requirement

- From the fortnight beginning August 11, 2001, the maintenance of daily minimum CRR requirement of 65.0 per cent is reduced to 50.0 per cent for the first seven days of the reporting fortnight; the minimum requirement of 65.0 per cent will be applicable to all the next seven days including the reporting Friday without any exception.

(iv) Interest on Cash balances Maintained with Reserve Bank of India under Cash Reserve Ratio

- While the medium term objective will be to reduce CRR to the statutory minimum, as an intermediate measure, interest rate on eligible balances will be aligned with the Bank Rate in two stages. From the fortnight beginning April 21, 2001, the interest will be increased to 6.0 per cent.

(v) Exemption of Inter-bank Term Liability from Minimum Cash Reserve Requirement

- The inter-bank term liabilities of maturity of 15 days and above are exempted from the prescription of minimum CRR requirement of 3.0 per cent.

(vi) Treasury Bill Market

- The present 14 day Treasury Bill and 182 day Treasury Bill auctions are to be discontinued and the notified amount in the 91 day Treasury Bill auctions increased to Rs.250 crore. 91 day and 364 day bills will become fungible floating stocks to activate secondary market.

(vii) T plus 1 Settlement for SGL Settled Transactions

- In order that the market participants prepare themselves for the proposed Negotiated Dealing System (NDS), with effect from June 2, 2001, all transactions settled through the Delivery versus Payment (DVP) system of RBI will be on T plus 1 basis.

<u>Interest Rate Policy</u>

(a) Review of Norms Relating to Prime Lending Rate

- Keeping in view the international practice and to provide further operational flexibility to commercial banks in deciding their lending rates, it has been decided to relax the requirement of PLR being the floor rate for loans above Rs.2 lakh. PLR will serve as a bench mark and banks will be able to offer loans at below-PLR rates to exporters or other creditworthy borrowers including public enterprises on the lines of a transparent and objective policy approved by their Boards.

(b) Deposit Schemes for Senior Citizens

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

(c) Term Deposits – Flexibility to Banks

- Banks will be given freedom to exercise their discretion to disallow premature withdrawal of large deposits held by entities other than individuals and Hindu Undivided Families.

- Renewal of overdue deposits at the rate of interest prevailing on the date of maturity will be allowed only for an overdue period of 14 days.

(d) Interest Rate on FCNR(B) Deposits

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

<u>Development of Government Securities Market</u>

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

- To promote retailing, individuals and Provident Funds will be allowed on non-competitive basis through PDs and SDs.

- Uniform price auction format for auctions of dated securities, on a selective and experimental basis.

<u>Progress towards Separation of Debt Management</u>

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

- the amendment to the Securities Contracts (Regulation) Act, demarcating the regulatory roles of the RBI and SEBI,

- the Finance Minister's expression to accord greater operational flexibility to the RBI for conduct of monetary policy,

- proposals from RBI for amendments to the RBI Act, the proposed Fiscal Responsibility Bill to bring in reasonable control over the fiscal deficit,

- the setting up of the Clearing Corporation and the operation of the full-fledged Liquidity Adjustment Facility,

Governor mentioned that once legislative actions are accomplished, it is proposed to take up with the Government, the feasibility and further steps for separation of debt management function of RBI.

Prudential Measures

(a) Adoption of 90 days Norm for Recognition of Loan Impairment

With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt the 90 days norm for recognition of loan impairment, from the year ending March 31, 2004, but provisions will be required to be made from March 31, 2002.

(b) Prudential Norms for Financial Institutions

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

(c) Norms for Statutory Central Auditors (SCAs) in respect of Private Sector Banks

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

(d) Revised Guidelines for Recovery of NPAs

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

(e) Method of Computation of Credit Exposure

- Exposure ceilings to be computed uniformly in relation to total capital as defined under international capital adequate standards effective from March 31, 2002.
- Non-fund based exposures should be reckoned at 100 per cent and in addition, banks should include forward contracts in foreign exchange and other derivative products, effective from April 1, 2003.
- The exposure ceiling for single borrower adjusted from the existing 20 per cent to 15 per cent effective from end-March 2002. Similarly, the group exposure limits adjusted to 40 per cent of capital funds.

(f) Debt Recovery Tribunals

37. Government has decided to set up 7 more Debt Recovery Tribunals (DRTs) during 2001-02 in addition to the existing 22 DRTs and 5 Appellate Tribunals to facilitate banks to quickly recover their dues from borrowers. Besides, the

Government has proposed to bring in legislation for facilitating foreclosure and enforcement of securities in case of default so as to enable banks and financial institutions to realise their dues.

(g) Defaulters' List – Widening the Coverage

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

(h) Revised Guidelines on Exposure of banks to Stock Market

39. The report of the RBI-SEBI Technical Committee, which was submitted to RBI on April 12, 2001 has been released and is available on RBI website. The Committee has taken into account the recent experiences of the banks and the exposures taken by them by way of advances against shares and financial guarantees. The Committee has found that the overall exposure of banks in capital markets (both in terms of funded and non-funded credit facilities) continues to be modest, but some relatively small banks (in terms of their share in total advances) do not seem to have observed appropriate risk management guidelines, particularly in respect of advances against shares and non-funded guarantees to a few stock broking entities (including their associated and inter-connected companies). This concentration of exposure on a few entities by these few banks was unjustified on prudential grounds and substantially increased the risks attached to such advances/guarantees, besides raising serious ethical concerns.

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

(i) Reliance on Call Money Market

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

(j) Commercial Paper

(i) Preference for Dematerialised holding

42. It has been decided that with effect from June 30, 2001, banks, FIs, PDs and SDs will be permitted to make fresh investments and hold CP only in dematerialised form and outstanding investments in scrip form should also be converted into demat

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

(ii) Documentation and Procedure

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

(k) New Basel Capital Accord

44. In RBI, an internal Working Group is currently examining the implications of the new Accord released by the Basel Committee on Banking Supervision.

(l) Consolidated Accounting and Supervision

45. A multi-disciplinary Working Group has been set up to look into the introduction of consolidated accounting and quantitative techniques for consolidated supervision, in line with international best practices. The Group is expected to submit its report before July 2001.

(m) Move towards Risk-based Supervision (RBS)

46. Following the recommendations of an international consultant appointed to advise a proper structuring of the RBS approach, a dedicated Group has been set up within RBI for project implementation.

(n) Credit Information Bureau

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

(o) Prompt Corrective Action

48. A framework for Prompt Corrective Action (PCA) was prepared with various trigger points for prompt responses by the supervisors and based on the suggestions received, the scheme has been modified. The scheme will be finalised in consultation with banks and the Government.

(p) Macro-Prudential Indicators

49. An Inter-Departmental Group was constituted and a pilot review of MPIs for the half-year ended March 2000 was finalised and a review for September 2000 has since been prepared.

<u>Urban Co-operative Banks (UCBs)</u>

(i) Prudential Measures

50. In order to strengthen prudential measures for urban co-operative banks, in the interest of their members and depositors, the following measures are proposed:

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

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

(ii) A New Supervisory Structure for UCBs?

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

Ownership Functions of the Reserve Bank of India

53. RBI has accepted the recommendations of Narasimham Committee II for transfer of ownership of its shares in SBI, NHB and NABARD to the Central Government, and is in touch with the Government in this regard. RBI also plans to initiate the process in respect of IDFC at an appropriate time in future. In respect of DICGC, RBI had submitted proposals to the Government for framing a new Act to make it consistent with financial sector liberalisation. In respect of DFHI and STCI, it has been decided to completely divest shareholdings in the current year.

Credit Delivery Mechanism

Relief Measures for Gujarat

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

- Interest rate on loans at PLR of the SBI.
- Relief/concessions for affected exporters by extending the period of packing credit, conversion of dues into short-term loans repayable in suitable instalments and relaxation in NPA classification norms.
- In respect of agricultural loans, banks are not to recover principal or interest for a period of two years with a provision for reschedulement upto 7 years.
- Provision of additional limits/rescheduling of existing limits for affected Small Scale Industries (SSI), business, trade and industry.
- RBI has sanctioned a long-term loan of Rs.1,000 crore at 6.0 per cent rate of interest per annum to enable National Housing Bank provide refinance assistance for reconstruction.

Non-Banking Financial Companies

55. NBFCs are advised to repay public deposits as per the terms of their acceptance and continue to adhere to the provisions of RBI Act and other directives issued from time to time. NBFCs should submit the returns as prescribed by RBI at periodical intervals even if the application for granting CoR has been rejected.

56. The Government has proposed a separate legislation to provide for enhanced protection to the depositors covered by NBFCs. The Bill is under consideration of the Government.

Technology Upgradation

(a) Payments System Vision Document

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

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

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

(c) Internet Banking

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

Legal Reforms

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

International Financial Standards and Codes

61. Reports of the seven Advisory Groups have been put on the RBI website for debate and discussion. Three more reports are expected by May 2001. The Standing Committee also plans to help the Groups in organising Seminars/Workshops to enhance awareness and concretise views on the recommendations and seek comments/feedback from both private and public sector organisations, international institutions and experts.

Regulations Review Authority

62. Though the RRA has ceased its operations, in view of the favourable response to the Scheme, RBI has decided to make the review exercise an integral part of its internal system and accordingly, has put in place an alternate mechanism under the charge of an Executive Director for dealing with such applications from April 1, 2001.

Mid-term Review

63. A review of credit and monetary developments in the first half of the current year will be undertaken in October 2001.

Alpana Killawala
General Manager

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