RBI Governor announces Mid-term Review of
Monetary and Credit Policy for the year 2001-2002

Highlights

- RBI cuts Bank Rate by 0.50 percentage point, from 7.0 per cent to 6.50 per cent to touch its lowest since May 1973.

- RBI reduces CRR by 2.0 percentage points from 7.50 per cent to 5.50 per cent, releasing on additional liquidity of Rs.6,000 crore to banks. RBI also removes most of the exemptions available on CRR.

- Interest rate paid on eligible CRR balances increased further to the level of Bank Rate i.e. 6.5 per cent (from 6.0 per cent since April 21, 2001 and 4.0 per cent earlier).

- Monetary Policy stance to continue as in the first half of the year.

- In view of global uncertainties, a projection in the range of 5.0 per cent to 6.0 per cent growth rate for 2001-02 considered reasonable for monetary management.

- Measures to strengthen financial system to continue.

- RBI provides operational flexibility to banks in "Loan System" for credit delivery.

- RBI initiates steps to closely monitor non-SLR investments by banks and FIs.

- RBI Current Account Facility being rationalised.

Mid-term Review of Monetary and Credit Policy for the year 2001-2002

Dr. Bimal Jalan, Governor, in a meeting with Chief Executives of major commercial banks presented the Mid-term Review of Monetary and Credit Policy for 2001-02. After reviewing the domestic and external developments, Governor stated that despite several uncertainties, the fundamentals of the economy, as reflected in moderate inflation, stable and low interest rates, high foreign exchange reserves, large foodgrains stock and competitive advantage of information technology related industries, are strong. He further stated that according to the present indicators, the liquidity in the system will remain adequate to meet all legimate requirements for credit. He said that unless circumstances change unexpectedly RBI will endeavor to maintain the current interest rate environment.

I. Mid-term Review of Macroeconomic and Monetary Developments

Domestic Developments

2. On the domestic front, quoting India Meteorological Department and the Ministry of Agriculture, Governor stated that the agricultural growth in 2001-02 is expected to be significantly higher than the previous year. On the other hand, the position regarding revival of industrial sector and export growth in the first half of the current year was not favourable. Considering the likely rate of growth in agriculture during the current year, the unfavourable behaviour of industrial and export sectors, taking in view of the global uncertainty, Governor mentioned that a firm projection of revised growth rate for the year as a whole is difficult. However, considering various factors, and assuming no further serious disruption in the world economic environment, at this stage, he felt that a projection in the range of 5.0 to 6.0 per cent growth rate in the current year may be reasonable for the purpose of credit and monetary management. Very few countries in the world would show a growth rate of this order in the current year, he added.

3. Governor stated that the inflation outlook for the year appears comfortable as agricultural growth prospects remain positive, and foodgrain stocks are very high. The annual inflation rate is 3.2 per cent as against 7.4 per cent a year ago.

4. Governor indicated that the growth rates in money supply and aggregate deposits of scheduled commercial banks in the current financial year were slightly higher than the growth rates observed a year ago. He added that the relative attractiveness of bank deposits has improved and if this deposit growth continued it may pose a challenge to the banking system in deploying resources, particularly in the context of sluggishness in credit and investment demand. Governor added that late in September and early October, there had been some pick up in non-food bank credit and other resource flows to the commercial sector from the banking system. Commenting on the sources contributing to the reserve money expansion he stated that while net RBI credit to the Central Government showed a modest increase, RBI's net foreign exchange assets increased significantly. He expected that the reserve money expansion may remain moderate during 2001-02.

5. While reviewing the borrowing programme of the Central Government, Governor mentioned that the Government market borrowing programme was conducted by elongating the maturity pattern and at a lower cost. The weighted average maturity of borrowing was 13.9 years against 10.6 years a year ago and the weighted yield at 9.96 per cent was lower by nearly 100 basis points. RBI continued to combine auction issues with acceptance of private placement of dated securities consistent with market conditions in its debt management policy.

6. The Centre's fiscal deficit upto August 2001 was higher and constituted about one half of the budget estimates for the current year. A steady increase in net foreign currency assets of the Reserve Bank combined with subdued real economic activity created a situation of excess liquidity during most part of the first half of the year. Commercial banks already hold government securities much in excess of the prescribed

Statutory Liquidity Ratio (SLR) to the extent of Rs.1,29,450 crore, consisting 36.3 per cent of NDTL.

7. He stated that the overall interest rate structure had come down substantially in the last two years and continued to show a softening trend. The prime lending rates (PLRs) of scheduled commercial banks softened. As banks are permitted to lend to exporters and their prime customers at sub-PLR rates, the cost of bank borrowings to such corporates has come down even further. Long-term domestic deposit rates of public sector banks declined from 10.50 per cent in March 2001 to 9.25 per cent in October 2001.

8. As announced in the annual policy Statement of April 2001, during the first half of the fiscal year, the Reserve Bank continued to provide appropriate liquidity through its Repo operations. The interest rate environment also remained fairly soft across maturities as well as various instruments and the yield on 10-year government securities declined by about 100 basis points, between April and mid-October 2001.

External Developments

9. Governor expressed concern over the global slowdown in the world economy and the impact of September 11 events. He stated that the outlook for growth in major industrialised countries as also emerging economies has been adverse. Quoting IMF, he stated that the downturn in the emerging markets of Asia may continue for a longer period. However, India and China are less affected. India is relatively insulated from global slowdown because of its lower share of trade in GDP and service oriented and cost efficient information technology sector.

10. Consequent upon September 11 events, forex markets became volatile with rupee depreciating by 1.3 per cent during the first ten days and affecting the government securities market. Stability was restored in financial markets in particular money and government securities markets, after a series of measures were announced by the Reserve Bank between September 15 and 25, 2001. Mentioning that there was no perceptible upturn in industrial output, he hoped that as global markets gain back momentum after some time, it would have a favourable impact on the investment climate in India also.

11. Reiterating the India's experience in managing the external sector during periods of external and domestic uncertainties, he highlighted the need for continuous vigilance and the importance of building adequate safety nets to withstand the effects of unexpected shocks and market uncertainties. In this context, Governor mentioned that India's exchange rate policy of focusing on managing volatility with no fixed rate target, while allowing the underlying demand and supply conditions to determine the exchange rate movements over a period in an orderly way, has stood the test of time. RBI will continue to follow the same approach of watchfulness, caution and flexibility in regard to the forex market; monitor closely, the developments in the financial markets at home and abroad and carefully coordinate its market operations with appropriate monetary, regulatory and other measures as considered necessary from time to time.

12. India’s foreign exchange reserves have increased sharply by over US $ 10 billion from US $ 35.0 billion as on October 13, 2000 to US $ 45.1 billion by October 12, 2001. 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. The policy for reserve management is thus judiciously built upon a host of identifiable factors and other contingencies. Governor expressed confidence about India’s comfortable foreign exchange reserves but cautioned that there can be no cause for complacency. He mentioned that the quantum of reserves in the long run is in line with the rate of growth in the economy, the share of external sector in the economy and the size of risk-adjusted capital flows. This provides greater security against unfavourable or unanticipated developments of the type witnessed recently as well as during earlier years.

13. On account of global slowdown, exports have not done well during the current year and imports increased by 2.5 per cent as against an increase of 13.8 per cent last year. Trade deficit in the first five months of the current financial year at US $ 4.6 billion was higher than that of US $ 3.7 billion in the same period last year. For the rest of the year, there is some uncertainty on the likely course of international oil prices. On present reckoning, it is expected that the current account deficit for the year 2001-02 will still be well below 2.0 per cent of GDP.

14. Governor recalled that as part of the efforts to provide support to exporters during the prevailing period of global uncertainty, the Reserve Bank advised reduction in ceiling interest rates on rupee export credit by 1.0 percentage point across the board for a period of six months. Taking into account forward premia, the effective interest cost on rupee export credit is only 3.0-4.0 per cent (assuming a forward premia of 5.0 per cent), which is internationally competitive. Similarly, exporters are free to avail of foreign currency loans in the currency of their choice at internationally competitive rates.

15. In the past, several measures have been introduced to ensure timely delivery of credit to exporters at reasonable cost and removal of procedural hassles. He mentioned the work of the survey on exporters’ satisfaction has been launched by the National Council of Applied Economic Research (NCAER), New Delhi.

16. In the recent period, procedures for financial transactions such as remittances, investments and maintenance of bank accounts, etc., for non-residents have been considerably simplified. Foreign direct investment (FDI) is permitted under the automatic route for most activities except in certain circumstances and for a very small negative list. Indian Companies are allowed to increase the FII investment limit upto the sectoral caps/statutory ceilings as applicable. A number of steps have been taken to improve liquidity in the ADR/GDR market and to give opportunity to Indian shareholders to divest their shareholding in the ADR/GDR market abroad. Indian companies wishing to make acquisitions of foreign companies or direct investment abroad in Joint Ventures/Wholly Owned Subsidiaries can now invest upto US $ 50 million on an annual

basis through automatic route with additional block allocation of foreign exchange subject to certain conditions.

17. Over a period, considerable flexibility has been given to the corporates to hedge their forex exposure in the market. Instruments available to the corporates for hedging their exchange risks include forward exchange cover, currency options, foreign currency-rupee swaps, hedging of the loan exposures etc. Banks are also allowed to hedge their asset-liability portfolio, after obtaining necessary policy approval in this regard from their top management.

18. It is observed that sometimes a noticeable portion of the corporate foreign currency commitments tend to remain unhedged by the coporates on the basis of their perceptions of the market and these could impact the overall financial status of the corporates under circumstances of severe uncertainties. Hence, he desired that banks who have large exposures to such corporates to put in place a system for monitoring such unhedged external exposures.

19. The Reserve Bank will continue with its efforts to simplify procedures, reduce documentation requirements and further liberalise opportunities for productive investment in India by NRIs and others and by Indian corporates/entities abroad. Governor welcomed further suggestions from experts, corporates and market participants in these areas through e-mail at helpnri@rbi.org.in

II. Stance of Monetary Policy for the Second Half of 2001-2002

20. Governor recalled that the annual policy Statement of April 2001 had indicated that 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, and 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.

21. During the first half of the year, Governor indicated that it was feasible to maintain adequate liquidity in the market, primarily through flexible operation of repos and reverse repos under LAF combined with open market operations, when necessary. Notwithstanding a high level of market borrowing by the Government, it was also feasible to maintain a stable interest rate environment, with further softening of interest rates.

22. At the short end of the market, the average call money rate came down sharply from 8.6 per cent in early-April to 7.0 per cent in mid-October 2001. During this period, the LAF repo rate also came down from 7.0 per cent to 6.5 per cent. The CRR was reduced by 50 basis points to 7.5 per cent, effective May 19, 2001. Responding to these operations, the interest rates in other money market instruments also showed a declining

trend. At the long end of the market, the secondary market yields on government paper in the range of 10-20 years have softened from 10.08-10.70 per cent in April to 9.12-9.92 per cent by mid-October 2001.

23. The decline in inflation rate since the mid-1990s, despite occasional supply and external shocks has had a positive impact on inflation expectations. Because of this, it has been possible to reduce nominal interest rates on a sustained basis despite a high level of fiscal deficit and other structural rigidities. While the risks of inflation are relatively low, as of now, in the context of ample liquidity already available in the system, RBI will continue to carefully manage the liquidity with a judicious mix of the range of instruments available with it.

24. Despite several uncertainties, Governor felt that the fundamentals of the economy as reflected in moderate inflation, stable and low interest rates, high foreign exchange reserves, large foodgrain stocks and competitive advantage of information technology related industries, are still strong. The prospects for agricultural growth during this year remain positive. Global and domestic inflationary outlook currently continues to be favourable. Governor, therefore, proposed to continue with the overall stance of monetary policy announced in the April Statement for the remaining half of the current year and ensure that all legitimate requirements for credit are met consistent with price stability. Unless circumstances change unexpectedly, RBI will also endeavour to maintain the current interest rate environment.

25. Governor emphasised that the Bank Rate will continue to remain the principal signaling instrument in so far as RBI is concerned, providing directional guidance to the extent feasible, to general level of interest rates. The LAF rates would operate around the Bank Rate, with a flexible corridor, as more active operating instruments for day-to-day liquidity management and steering short-term interest rates.

26. Governor, however, cautioned that while all efforts will be made to maintain the current stance of monetary policy, two caveats are necessary in order to ensure that banks and market participants do not take too complacent a view on the current monetary and interest rate environment. First, in their portfolio management, banks, primary dealers (PDs) and other market participants must explicitly take into account that the interest rate environment can change quite dramatically within a very short period of time. The substantial decline in interest rates in the last couple of years has resulted in large gains, realised and unrealised, to holders of medium and long-term securities. It is of utmost importance that these gains are not frittered away or used for illiquid market operations. Second, it needs to be recognised that in view of certain structural characteristics of our financial system, the scope for further softening in lending rates by banks and other financial intermediaries is limited. Among the factors, Governor mentioned :

- Holders of term deposits in banks generally belong to fixed income groups and expect a reasonable nominal interest rate, in excess of the long-term rate of inflation. This constrains the ability of banks to effect further reduction in their lending rates without affecting their deposit mobilisation and the growth of financial savings over the medium-term.

- The preference for fixed interest rates on term deposits effectively reduced the flexibility that banks have in lowering their lending rates in the short run.

- For public sector banks, the average cost of funds is over 7.0 per cent, combined with non-interest operating expenses of 2.5 to 3.0 per cent of total assets, puts pressure on the required spread over cost of funds. Relatively high overhang of Non-Performing Assets (NPAs) pushes up further the lending rates.

27. It is necessary to continue with the on-going efforts to reduce the impact of the above structural constraints on the flexibility of our interest rate structure. Recently, the Government has taken important steps to reduce the prevailing interest rates on contractual savings like Provident Funds and National Saving Schemes. A more sustainable and flexible interest rate regime for contractual savings has also been recommended by the Expert Committee set up by the Government (Chairman: Dr. Y.V. Reddy). It will also be highly desirable for banks to move over to a variable interest rate structure on longer-term deposits as early as possible. Since interest rates could vary in both directions, depending on the phase of the business cycle and inflationary outlook, a variable interest rate regime on long-term deposits does not necessarily imply lowering of the average interest rate earned by depositors over a period of time (compared with a fixed rate regime, which favours old deposits over new deposits when interest rates are coming down, and *vice versa* when rates are moving in the opposite direction). In addition, banks have to put in their best efforts to reduce their operating costs over time by improving productivity and increasing their volume of lending.

III. Financial Sector Reforms and Monetary Policy Measures

28. Governor briefly reviewed the progress made so far in respect of structural measures initiated by the Bank in the recent past to improve the functioning of the various segments of financial markets and announced modifications to some of them. He pointed out that as far as possible, changes proposed, had been decided after extensive consultations with experts and market participants and suggestions made by commentators in media as well as specialised journals.

Recent Financial Market Developments

29. Governor said that developments in equity market since March 2001, and involvement of a few banks in providing substantial support to a few stock-broking entities, contrary to RBI guidelines and normal prudential requirements, have raised concerns regarding the potential vulnerability in India's financial sector. As such, it was possible, through temporary and limited liquidity support measures, to avoid the "contagion" spreading from their activities in the equity market to the banking sector as a whole or to other important segments of the financial sector, particularly the money and

government securities markets. The scope for "regulatory forbearance" has to be minimized in the event of emerging weaknesses in a financial institution (irrespective of whether its ownership is co-operative, public or private).

30. The recent experience has also shown that irresponsible and unethical behaviour on the part of even a few co-operative banks in the country can have some contagion effect beyond the particular area or the State concerned and may cause severe harm to depositors, including smaller co-operative banks and impair confidence in the system. Measures for off-site monitoring and inspection, particularly in respect of weak banks and co-operative institutions, have already been introduced. RBI proposes to further strengthen its monitoring and supervisory machinery. In order to overcome supervisory problems arising from the present three-pronged and multi-level institutional system (consisting of the Centre, States and RBI), the Reserve Bank has suggested setting up of a new Apex Supervisory Body for the entire urban co-operative banking sector.

31. Governor said that the Reserve Bank welcomes the on-going constructive dialogue with UCBs and their representative associations. It will be prepared to further improve/modify specific measures subject only to one condition, i.e., providing an adequate, workable and transparent mechanism for protection of public deposits held in the co-operative sector.

32. Governor indicated that recent events have also brought to the fore the need for Boards of banks and financial institutions to exercise proper vigilance and supervision over the functioning of commercial banking and other financial institutions. The Reserve Bank proposes to set up a consultative group of directors of a select group of commercial banks and financial institutions to suggest, for consideration by Government/RBI, measures that should be taken to strengthen the internal supervisory role of Boards.

The following issues/measures were also discussed in the Statement:

Monetary Measures

(a) Bank Rate

- On the basis of a review of macroeconomic and monetary developments, the Bank Rate is being reduced by 0.50 percentage point from 7.0 per cent to 6.50 per cent with effect from the close of business today (October 22, 2001). At this level, it is the lowest Bank Rate since May 1973.

(b) Cash Reserve Ratio - Reduction and Rationalisation

33. All scheduled commercial banks [excluding Regional Rural Banks (RRBs)] are, at present, required to maintain with the Reserve Bank of India a cash reserve ratio (CRR) of 7.5 per cent of their net demand and time liabilities (NDTL). While the statutory minimum requirement of CRR maintenance at 3.0 per cent is obligatory on the banks, additional CRR has been imposed from time to time. At the same time, over a

period, various exemptions given to the banks on certain specific categories of liabilities for the CRR requirement. Exemptions and multiple prescriptions have increased the complexity of CRR as an instrument of liquidity management. With a view to rationalizing CRR prescription and moving towards the long-term goal of keeping CRR normally at the statutory level, important changes are proposed in respect of the coverage as well as the level of CRR :

- It is proposed to reduce the CRR by 200 basis points to 5.50 per cent from 7.50 per cent of NDTL. Effective from the fortnight beginning November 3, 2001, CRR will be reduced to 5.75 per cent; and effective fortnight beginning December 29, 2001, the CRR will be reduced further to 5.50 per cent of NDTL.
- At the same time, all the exemptions on the liabilities will be withdrawn except inter-bank liabilities, for the computation of NDTL (for requirement of maintenance of CRR) with effect from fortnight beginning November 3, 2001.

34. It is expected that these changes will facilitate the development of a short term yield curve, develop money market, reduce the regulatory arbitrage between banks and non-banks, enhance the availability of lendable resources with the banks and improve the efficiency of indirect instruments in the conduct of monetary policy.

- At the present level of NDTL, the combined impact of the above two measures will result in augmenting lendable resources of the banking system by about Rs.8,000 crore (about Rs.6,000 crore effective from November 3, 2001).
- RBI will continue to use the CRR instrument in both directions for liquidity management in addition to other instruments (such as, the LAF.)

c) Interest on Cash balances Maintained with RBI

- With effect from fortnight beginning November 3, 2001, the interest paid on eligible cash balances will be at the Bank Rate (i.e., 6.5 per cent).

Liquidity Adjustment Facility - Progress

35. The Liquidity Adjustment Facility (LAF), introduced in June 2000, has emerged as an effective and flexible instrument for influencing liquidity on a day-to-day basis. A package of measures was announced in the annual policy Statement in April 2001 encompassing changes in operating procedures of LAF, a strategy for smooth transition of call money market to pure inter-bank market and a programme for rationalisation of liquidity support available to the system. This has not caused any strain on the market. Volatility in call money rates has also come down significantly. It is encouraging to note that the volume of repo operations by non-bank participants has been increasing in recent period.

- In the context of improving the effectiveness of LAF, it is reiterated that in addition to overnight repos, RBI will also have the discretion to introduce longer-term repos upto 14-day period as and when required.

Commercial Paper – Dematerialised Holding

36. RBI issued fresh guidelines for issuance of Commercial Paper (CP) on October 10, 2000 relaxing the terms and conditions and streamlining the procedures. Further, to facilitate conversion of physicals into demat, FIMMDA, in consultation with market participants, depositories and RBI, prepared the related guidelines and made them public on October 3, 2001, which seem to be working reasonably well.

Development of Government Securities Market

- The notified amount of 91-day Treasury Bills (TBs) has been increased to Rs.250 crore. It has also been ensured that both the 91-day and 364-day TBs mature on the same day in order to facilitate the availability of adequate fungible stocks of TBs of varying maturities in the secondary market.

- A Negotiated Dealing System (NDS) is being introduced with a view to facilitating electronic bidding in auctions and secondary market transactions in government securities and dissemination of information on trades on a real-time basis.

- The Clearing Corporation of India Limited (CCIL) was registered on April 30, 2001 under the Companies Act, 1956 with the State Bank of India as the chief promoter. The operationalisation of CCIL is expected to commence with a test run in November 2001.

- With the approval of the Government, the new uniform price auction format will be introduced on an experimental basis.

- A scheme of retail participation for government securities on non-competitive basis has been finalised.

- The Reserve Bank has prepared a consultative paper drawing a road map for developing Separate Trading of Registered Interest and Principal of Securities (STRIPS).

Review of the Satellite Dealer System

37. The Satellite Dealer (SD) system was introduced in 1996 to serve as a second tier to PDs in the government securities market with the particular objective of promoting retail segment.

- The Reserve Bank has decided to undertake a review of SD system to examine the scope for establishing a better linkage between SDs and PDs and thereby improving the SD system as an effective distribution channel at a retail level for government securities.

Prudential Measures

(a) Credit Information Bureau

38. The annual policy Statement of April 2001 had mentioned about the setting up of the Credit Information Bureau (CIB) to collect, process and share credit information on the borrowers among banks and FIs.

- In order to operationalise the process of collection and dissemination of the data on credit information by the CIB, RBI will constitute a Group drawing representation from CIB, Indian Banks' Association (IBA), select banks and FIs. The Group will examine the possibility of the CIB performing the role of collecting and disseminating information on the list of suit-filed accounts and the list of defaulters, including willful defaulters, which is presently handled by RBI.

(b) Non-SLR Investments by Banks
and Financial Institutions

39. It has been observed that, of the investments by banks, a significant proportion of the banks' investments in non-SLR securities is through the private placement route. The non-transparent practices in this market could be a matter of concern.

- In order to contain the risks arising out of non-SLR investment portfolio of banks and FIs, in particular through the private placement route, it is proposed to issue further prudential guidelines to be observed by banks which will be finalised after further consultation with banks and FIs.

- Banks and FIs have already been advised that effective October 31, 2001, they will be permitted to make fresh investments and hold bonds and debentures, privately placed or otherwise, only in dematerialised form.

- To enable the transparency of the trades including nomenclature of the bonds, amount traded and the price at which traded, banks and FIs could evolve a reporting mechanism and the NSDL/CDSL can in turn disseminate such information to the market. These arrangements would apply uniformly to all bonds issued by corporates, banks, FIs and State and Central Government sponsored institutions directly or as Special Purpose Vehicles (SPVs).

- Overall, any proposals of direct or indirect financing of the Government budgets, directly or through SPVs should be eschewed and proposals should be for specific monitorable projects, particularly in capital-intensive and high-cost sectors, including infrastructure. Components of financing and returns need to be well defined and assessed.

(c) Transparency and Accounting Standards

40. As a further step in ensuring transparency and credibility of their financial positions, it has been decided that banks should furnish the following additional disclosures in the 'Notes on Accounts' in their balance sheets, from the year ending March 2002.

- Movement of provisions held towards NPAs and movement of provisions held towards depreciation on investments.
- It has been decided to set up a Working Group comprising representatives of Institute of Chartered Accountants of India (ICAI), banks and RBI to identify the compliance as also gaps in compliance with the accounting standards and recommend steps to eliminate/reduce the gaps.

Supervision and Monitoring

41. The Reserve Bank had introduced in 1999 off-site returns to monitor liquidity and interest rate risks on quarterly basis with the intention to finally move over to a fortnightly reporting system. The quarterly system has now stabilised.

- The Basel Committee on Banking Supervision (BCBS) released the second set of consultative documents on New Capital Accord. RBI has forwarded its comments to Basel Committee, which have also been put on RBI website in May 2001.

- A scheme of Prompt Corrective Action (PCA), based on pre-determined trigger points, is planned as part of continued efforts to enhance the existing supervisory framework.

- In order to involve banks in the smooth switch-over to Risk-based Supervision (RBS) process, the Reserve Bank has released a discussion paper seeking comments/suggestions of experts/public. It is planned to hold a pilot run of the RBS approach in due course.

Settlement of Non-Performing Assets

42. Under the one-time settlement of NPAs scheme, the public sector banks have recovered a total sum of Rs.2,192 crore in respect of 5.23 lakh accounts as on July 30, 2001.

- Given that the purpose of these guidelines was to provide an opportunity for "one-time settlement" within the specified time period, and sufficient time has already been provided, it is not proposed to extend this scheme. However, the broad framework provided for settlement in the 1995 guidelines will continue to be in place, and banks are free to design and implement their own policies for recovery and write-off incorporating compromise and negotiated settlements with the approval of their Boards, particularly for old and unresolved cases falling under the NPA category.

Urban Co-operative Banks

43. As a follow-up, of April 2001 policy announcement after discussing various issues involved, RBI has submitted a draft Bill on setting up of a separate Supervisory Authority to the Central Government.

- In order to strengthen the supervisory mechanism, RBI has since introduced off-site monitoring system for scheduled UCBs.

- In response to representations received from UCBs and their federations, it is now proposed to allow UCBs to grant loans to individuals against security of shares, subject to certain parameters.

- As per the annual policy Statement of April 2001, UCBs were required to achieve certain higher proportion of their SLR holding in the form of government and other approved securities as a percentage of their Net Demand and Time Liabilities (NDTL) by March 31, 2002. UCBs and their federations have represented that, in current market conditions, many smaller UCBs were facing genuine difficulties in adhering to the time schedule in achieving the prescribed levels of SLR holding. In response to these representations, it is proposed to modify the time-frame for achieving the prescribed levels of SLR holding.

- The Reserve Bank has already issued guidelines relating to capital adequacy norms to be followed by UCBs. It is clarified that, under the existing guidelines, the scheduled UCBs are required to achieve the capital adequacy norms gradually by March 2004 and the non-scheduled UCBs by March 2005.

Credit Delivery Mechanism

(a) "Loan System" for Delivery of Bank Credit

44. The "Loan System" was introduced to minimise the risks of cash and liquidity management on the part of the banking system, caused by volatile movements in cash credit component of working capital.

- In the current environment of short-term investment opportunities available to both corporates and banks, banks will henceforth have the freedom to change the composition of working capital by increasing the cash credit component beyond 20 per cent, for working capital limits of Rs.10 crore and above, if they so desire.

(b) Consortium Arrangement for Food Credit

45. A Committee consisting of representatives of banks, RBI, Government of India and Food Corporation of India was constituted by the Reserve Bank for undertaking a review of the consortium arrangement for food credit.

- The Report of the Committee is under consideration in consultation with the concerned agencies and the Government.

(c) Kisan Credit Cards

46. Kisan Credit Cards (KCCs) Scheme for eligible agricultural farmers has proved to be successful.

- To accelerate the scheme of KCCs to cover all eligible agricultural farmers within the next 3 years, the Reserve Bank has advised all banks about their targets to be achieved for 2001-02.

Universal Banking

- The Reserve Bank intends to process applications promptly in the light of considerations outlined in RBI's circular to FIs on approach to Universal Banking in April 2001. In processing a specific proposal, the overwhelming consideration of the Reserve Bank will be to meet the strategic objectives of the concerned financial institution for meeting the varied needs of different categories of customers, while at the same time ensuring healthy competition in the financial system through transparent and equitable regulatory framework applicable to all the participants in banking business.

Non-Banking Financial Companies

47. The Reserve Bank had received applications for Certificate of Registration (CoR) from 36,505 Non-Banking Financial Companies (NBFCs), of which, 13,815 applications were approved and 18,355 were rejected as at the end of August 2001. RBI places substantial importance to further development of the NBFC sector along prudent lines.

- RBI has, therefore, been discussing with the informal Advisory Group of NBFCs, and also with various NBFC associations, the need to promote the formation of a Self Regulatory Organisation (SRO), particularly for the benefit of smaller NBFCs.

Technology Upgradation

48. To facilitate banks to effectively participate in the payment and settlement systems and to provide a road map of the various payment system projects, a draft Payment System Vision Document was prepared; based on the feedback received from

banks and comments of the members of apex bodies such as the National Payments Council, the Vision Document is being finalised.

- The Indian Financial Network (INFINET) is already available for use by all banks and common inter-bank applications are being implemented on this network. One of the systems provided by the Reserve Bank for quick, safe and secure movement of funds in an electronic mode is the Electronic Funds Transfer (EFT).

Rationalisation of Current Account Facility
by the Reserve Bank

- The operationalisation of the CCIL and the proposed implementation of NDS would also obviate the need for having current account with RBI by some of the non-bank entities. This issue was examined by a Group.

Legal Reforms

49. Major legal reforms has been initiated in the banking sector covering areas such as security laws, Negotiable Instruments Act, fraud on banks, regulatory framework of banking, etc., were indicated. Further progress in regard to various initiatives for legal reforms is given below:

- The Working Group constituted by the Government for suggesting changes in the provisions of Negotiable Instruments Act, 1881, has, *inter alia*, recommended the introduction of truncation of cheques and electronic cheques and suggested appropriate legal amendments. The Working Group on Asset Securitisation has drafted a Bill on Asset Securitisation which is under consideration of the Government. The draft legislation prepared by another Working Group constituted by the Government to examine the vesting of powers with banks and FIs for taking possession and sale of securities without intervention of the courts has been put on the RBI Website in August 2001 seeking comments from the public.

- Proposals regarding amendments to the Reserve Bank of India Act, 1934, Banking Regulation Act, 1949, Government Securities Bill in replacement of the Public Debt Act, 1944, are currently under consideration of the Government.

- For drafting a legislation on Payment Systems in India, an international consultant and an eminent Indian draftsman have been appointed by RBI in consultation with the National Payments Council.

- An Expert Committee on Bank Frauds (Chairman: Dr.N.L. Mitra) submitted its Report to RBI in September 2001 which has been put on the RBI website. The Committee examined and suggested both the preventive and curative aspects of bank frauds. The important recommendations of the Committee include: a need for including financial fraud as a criminal offence and amendments to the Indian

Penal Code by including a new chapter on financial fraud; amendments to the Indian Evidence Act to shift the burden of proof on the accused person and special provision in the Code of Criminal Procedure for transferring the properties involved in the financial fraud and confiscating unlawful gains; and preventive measures including the development of Best Code Procedures by banks and FIs. The Report is being examined by the Reserve Bank.

International Financial Standards and Codes

- All the Advisory Groups constituted by the Standing Committee on International Financial Standards and Codes have submitted their Reports to the Chairman of the Standing Committee and these reports are placed on RBI Website www.rbi.org.in for wider dissemination.

Alpana Killawala
General Manager

Press Release No. 2001-2002/498