Report of the Internal Group on External Liabilities of Scheduled Commercial Banks

April 2004

RESERVE BANK OF INDIA

Mumbai

The Governor
Reserve Bank of India,
Central Office,
Mumbai-400 001

Dear Sir,

Sub: Report of the Internal Group on External Liabilities of Scheduled Commercial Banks in India

We are pleased to submit the Report of the "Internal Group on External Liabilities of Scheduled Commercial Banks".

Yours faithfully,

sd/-
(D.Anjaneyulu)
Principal Monetary Policy Adviser
Member

sd/-
(Narendra Jadhav)
Principal Adviser. DEAP
Member

sd/-
(T.C.Nair)
CGM-in-Charge, DEIO
Member

sd/-
(Grace Koshie)
CGM-in-Charge, FED
Member

sd/-
(C.R.Muralidharan)
CGM-in-Charge, DBOD
Member

sd/-
(Deepak Mohanty)
Adviser, MPD
Member

sd/-
(M.D.Patra)
Adviser, DEAP
Member

sd/-
(O.P.Mall)
Director, MPD
Group-Secretary

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Executive Summary

External liabilities of banks need to be seen in the overall context of external debt. Though the non-debt creating remittances have been consistently accounting for a dominant component of NRI inflows, the non-resident and other foreign currency deposits have substantially increased their share in total external debt during the last ten years. International liabilities of banks are now nearly double of their international assets which is another issue of serious concern.

Following are the major recommendations of the Group:

- Reserve and liquidity requirements on NRI deposits may be left unaltered for the present.
- NRE savings deposit interest rate may be delinked from domestic savings deposit rate and may have the ceiling of one-month LIBOR/SWAP rates on US dollar deposits.
- The interest rate on NRE term deposits may be changed to LIBOR of the corresponding maturity.
- The non-banking financial companies and non-financial corporates should be phased out from accepting NRI deposits and the acceptance of NRI deposits should be restricted to only Authorized Dealers.
- The Resident Foreign Currency (RFC) scheme may be made non-interest bearing. The EEFC and RFC(D) accounts should continue to remain non-interest bearing.
- NRO deposits may have the nature of current/savings accounts only. The existing NRO term/recurring deposits may be allowed to be maintained till maturity.
- For better availability of export credit in foreign currency, the present ceiling on interest on such credit may be deregulated. If complete deregulation is not considered feasible, the interest rate ceiling may be raised by 50 basis points to LIBOR plus 125 basis points to ensure greater availability of export credit in foreign currency.
- The interest income from NRI deposits may be made taxable on the lines of domestic deposits consistent with the current account convertibility.

Section I: Introduction

1.1 With a view to comprehensively reviewing the status position and examining the various policy issues relating to the External Liabilities of banks, Governor had constituted an internal group with Principal Monetary Policy Adviser, Principal Adviser, Department of Economic Analysis and Policy (DEAP), CGM-in-Charge, Department of Banking Operations and Development (DBOD), CGM-in-Charge, Department of External Investment and Operations (DEIO), CGM-in-Charge, Foreign Exchange Department (FED), Adviser (MPD) and Adviser (DEAP) as members.

The terms of reference of the internal group are as follows:

(i) to study the recent trends in external deposits and other external liabilities of banks and the concentration of such liabilities across banks;

(ii) to evaluate risks associated with the existing exposure of the banks to these liabilities and to consider the impact of various existing external deposit schemes on the health of the banking sector in relation with associated costs and benefits;

(iii) to review the effect of reserve requirements in past and present on such deposits and to suggest appropriate policy on the same for future;

(iv) to study the impact of tax regime on such deposits and to assess whether existing tax incentives are appropriate;

(v) to consider interest rate policies in respect of such deposits, specially in respect of interest rate prescriptions by the Reserve Bank; and

(vi) to study any other related policy issues and make policy recommendation on the above.

1.2 The Group co-opted Dr.O.P.Mall, Director, MPD as Group-Secretary. The secretarial assistance to the Group was provided by MPD.

1.3 The Group held four meetings to deliberate on the issues referred to it. The Group members had the benefit of interaction with the Governor, Deputy Governor (Dr.Rakesh Mohan) and Executive Director (Smt.Shyamala Gopinath) in its third meeting held on April 12, 2004.

1.4 The rest of the report of the Group is organized as follows. Section II analyses the behaviour of external liabilities of banks in the context of the evolving external debt scenario. Section III discusses the trends in external liabilities of banks including the non-resident deposits which are the largest component of these liabilities. The concentration of non-resident deposits across banks is also discussed in this section. Section IV discusses the utilization pattern of external funds by banks. The major issues in banking sector's external liabilities are discussed in Section V. The concluding Section VI presents the recommendations of the Group.

Section II: External Debt and External Liabilities of Banks

2.1 Developing countries typically accumulate external debt/liabilities for financing their current account deficits with a view to achieving higher levels of investment as a means of accelerating the process of long-term economic growth. The current account deficits are financed by recourse to foreign savings either by way of non-debt creating foreign investments or by way of debt flows in the form of bonds, loans and deposits, etc. The recipient countries are thus able to make larger domestic investments without cutting their current consumption while the foreign lenders also reap the benefit of having appropriate returns on their capital. Over a period of time, the increased investment is expected to put the

economy on a higher growth path. This enables the economy to increase the potential to generate current account surpluses to service the accumulated debt/liabilities over the years. This process not only facilitates the growth of the economy but also achieves consumption smoothing for both borrowers and lenders.

2.2 In the Indian context, the structure of foreign savings was circumscribed by the pursuit of self-reliant growth in the early years of the planning period with particular emphasis on domestic resources. However, the current account deficits of an average of two per cent per annum in the 1980s, necessitated the absorption of a higher level of foreign savings. The two oil shocks in 1970s shifted substantial resources towards oil exporting countries and international banks acquired a central position in international finance reflecting the preferences of oil-exporting countries. The oil shocks also provided investment opportunities in the oil-rich countries and the resulting employment opportunities attracted a large number of Indians. These Non-Resident Indians (NRIs) repatriated a part of their savings in the form of current transfers. The potential of surplus savings of NRIs prompted the authorities to devise specific deposit schemes to tap these savings. Consequently, the recourse to such relatively high-cost as well as short maturity sources of external finance increased significantly to supplement external assistance as a source of external finance.

2.3 The composition of external sources of finance has shifted significantly over the past five decades. The concessional external assistance flows in the form of official aid/multilateral and bilateral credits in the early period was gradually supplemented, albeit on a moderate scale, in the 1970s by commercial borrowings and non-resident deposits as additional sources of external finance. Moreover, the emphasis on external assistance flows in the early period was with the hope that the concessionality in these flows would restrict the debt-servicing in the early stages of growth and would not adversely affect the net transfers.

2.4 Prior to 1991, foreign direct investment was restricted and foreign portfolio investment was channeled most exclusively into a small number of public sector bond issues. Foreign equity holdings in Indian companies by way of portfolio investment were not permitted. The external payments crisis of 1990-91 brought about a paradigm shift in external sector policies, which ware conspicuous by a restrictive policy on foreign investment till then. Structural reforms which were aimed at imparting a competitive edge to the Indian economy appreciated the fact that foreign investment has an important role to play as a source of both finance and technology. Consequently, the share of non-debt creating foreign investment inflows comprising almost half of foreign savings expanded subsequently and debt-creating flows have correspondingly lost their share.

2.5 Comparable external debt statistics for India are available only from March 1990. While the external debt has increased from US$ 75.9 billion as at end-March 1990 to US$

112.1 billion as at end-December 2003, the external debt-GDP ratio, which is a meaningful measure of an economy's debt-servicing capability, has been declining after 1991. The debt-GDP ratio almost trebled from 14 per cent in 1980-81 to 41 per cent in 1991-92 and the debt-service ratio rose from 10 per cent in 1980-81 to a peak of 35.3 per cent in 1990-91. However, by 2002-03, the debt-GDP ratio moderated to 20.3 per cent whereas the debt-service ratio declined to 14.7 per cent following a conscious effort to encourage non-debt creating flows.

2.6 The perceptible improvement in overall debt scenario has been brought out by policy reforms incorporating, *inter alia*, the management of current account within sustainable limits with the current account showing a surplus since 2001-02. The major ingredients of the external debt strategy in recent years, *inter alia*, constitute: a distinct shift in the policy preference in favour of equity as against debt in the matter of capital inflows; monitoring of short-term flows; a market-determined exchange rate which has helped in avoiding the excessive risk-taking that occurred in some of the East Asian countries which followed a policy of either a fixed or a predictable exchange rate regime; a transparent policy on external commercial borrowings (ECBs) with the stated objectives of prudent debt management aimed at lengthening of maturity while keeping a ceiling on approvals, restrictions on end-use in the form of investments in stock markets/real estate; use of forex reserves to pre-pay some of the external debt and the policy efforts aimed at achieving a commensurate growth in current receipts, especially in exports, to service the existing debt.

2.7 While a large part of India's external debt is on account of bilateral and multilateral loans (nearly 43.3 per cent in December 2003), there has been a significant rise in the proportion of (ECBs) (inclusive of export credit) over the 1990s (from 12.2 per cent at end-March 1991 to about 23.9 per cent in 2001 before declining to 18.3 per cent in December 2003) (Table 1). The proportion of Non-Resident and other foreign currency deposits which was at 13.8 per cent in March 2000, rose to 17.4 per cent by March 2002 and further to 25.8 per cent by December 2003.

2.8 NRI deposits pose potential problems for policymakers in times of crises, when they display a high degree of volatility irrespective of maturity constraints. For instance, in the case of FCNR(A) deposits, in contrast to an average annual inflow of US$ 1.3 billion (excluding accrued interest) during the three-year period 1987-88 to 1989-90, the inflow declined to a trickle (a mere US$ 168 million) in 1990-91 and turned into a net outflow of US$ 1.6 billion (excluding accrued interest) in 1991-92. The FCNR(A) outflow during 1991-92 was almost one-sixth of its outstanding balances as at end-March 1991, with the bulk of it moving out in the first quarter (April-June 1991). This illustration highlights the need for adoption of appropriate policies for (a) mobilisation of NRI deposits at internationally

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comparable interest rates, (b) foreign exchange guarantee by the central bank/government and, above all, (c) pursuance of sound macroeconomic policies to stabilise the capital flows.

2.9 An important feature of NRI deposits is that these deposits, like the domestic term deposits, can be withdrawn by the holders at any time, subject to usual penalty at the discretion of banks in terms of interest rate being lowered by one per cent (in addition, FCNR(B) deposits should have run for a minimum period of six months to be eligible for interest) except for savings deposits where no such penalty is applicable. As NRI deposits can be withdrawn at any time, they are different from short-term debt as roll-over problems could occur in the case of short-term debt only on the amortisation date. This option with depositors distinguishes it from other components of external debt which do not enjoy such facility. While bonds issued in the international capital markets come with both call and put options, the present policy restricts the Indian bond issuers in international markets from allowing these options. The fact that almost entire non-resident deposits are repatriable also has implications for foreign exchange markets.

2.10 From the country's balance of payments point of view, NRI funds can come into India through two channels, namely, remittances recorded in the current account of the balance of payments and deposits which are recorded in the capital account. An increase in remittances (both official and private), helps reduce the current account gap. Such remittances are primarily on a non-repatriable basis and are not a part of the external debt. India is one of the few countries where invisible receipts form a substantial portion of the current account. Net invisible receipts have remained positive for the last 30 years (barring a marginal outflow in the year 1990-91 which witnessed the BOP crisis). Remittances account for a dominant share of inflows from NRIs and have been steadily increasing over the years. Table 6 presents the net invisible flows as percentage of GDP and the net annual inflows on account of private transfers (remittances) as well as NRI deposits. Since 1996-97, net invisible receipts have been amounting to more than two per cent of GDP every year. Within invisibles, the private transfers account for a substantial portion and net private transfers from NRIs amounted to about US $ 14.8 billion during 2002-03 compared to less than US $ 3.0 billion as NRI deposits. As remittances are non-debt flows, it is desirable that such inflows are preferred over NRI deposits which can be withdrawn at any time. In the recent past, it has been the Government policy to reduce the external debt by resorting to pre-payment. It would, therefore, be consistent with the overall debt management policy to make efforts to limit exposure to non-resident deposits.

2.11 In the light of above discussions, the major issue that arises in this context has been that the large increase in non-resident deposits has implications for external debt of the country. Since NRI deposits have to be seen in the overall context of external debt of the

country, any sharp change in their levels or shift in their composition needs to be monitored carefully.

2.12 Non-resident deposit schemes were introduced at various stages in the past to attract foreign exchange funds by offering tax benefits, higher interest rates, exchange cover, etc. These deposits earlier offered much higher return in presence of these incentives than otherwise. Gradually, the interest rates on these deposits were aligned to domestic rates and international rates as relevant. While this issue needs further articulation in terms of structuring and rationalisation in the policy area, the Group feels that the policy preference relating to external liabilities management should continue to be in favour of equity as against debt, ensuring at the same time that an increasing proportion of non-resident flows into the country is in the form of remittances.

Section III: Trends in External Liabilities of Banks

3.1 Banks in their role as financial intermediaries are part of the process of raising external resources. The external liabilities of banks can be classified into the following major categories:

- i) Non-resident deposits
- ii) Own bonds (e.g., RIB/IMD)
- iii) Loans
- iv) Other liabilities
- v) Off balance sheet exposure

These are detailed in Annex I.

III.1 External Liabilities *versus* External Assets

3.2 An overview of movements in the International Assets and International Liabilities of banks since March 2001 is presented in Table 2. These are based on the International Banking Statistics (IBS) compiled by the Reserve Bank under the Bank for International Settlements (BIS) reporting system and published in article form in the RBI Bulletin on a quarterly basis. The commercial banks and cooperative banks authorised to deal in foreign exchange and accept non-resident deposits (Rupee and foreign currencies) are covered under the IBS system. It needs to be mentioned that the international liabilities of banks covered in IBS, as defined by the BIS, and external debt accounted for by the banking sector in India are not strictly comparable as certain items of liabilities like ADRs, GDRs, equities, etc., of banks towards non-residents are not part of external debt but are international liabilities of banks under the BIS reporting system.

3.3 The key point to note from Table 2 is that the international assets of banks are nearly half of their international liabilities which is a major systemic issue. The international liabilities of banks are predominantly to non-banks though this share has come down from 83.2 per cent in March 2001 to 76.4 per cent in September 2003. Foreign currency liabilities constituted 58.3 per cent of total international liabilities in September 2003 to non-residents. Over 96 per cent of international assets of banks are in foreign currency. The international assets in rupees (comprising of the Rupee loans to non-residents out of the non-resident deposits) are less than 4 per cent. A major shift has occurred in case of international assets of banks in the recent past and over 55 per cent of these assets are with non-banks in September 2003 whereas in March 2001 only 26 per cent of assets were with non-banks. The issue of composition of assets is further examined in Section IV.

III.2 External Liabilities on Banks' Balance Sheet

3.4 Table 3 presents the trend in major external liabilities of scheduled commercial banks in Rupee terms since March 1997. It may be seen that the NRE deposits have increased more than five-fold since 1997 whereas FCNR(B) deposits have less than doubled during this period. The EEFC balances have declined after reaching the peak level in 2000 whereas the Lines of credit from abroad for Pre-shipment Credit in Foreign Currency (PCFC) and Export Bill Rediscounting (EBR) have increased substantially since 2002. The balances under two schemes, *viz.,* the resident foreign currency (RFC) deposits which is meant for returning Indians, and the resident foreign currency (domestic) [RFC(D)] deposits which is meant for residents, have been showing marginal increase in the recent past (Table 3).

3.5 Tables 4 and 5 present the movements in the quantum and share of various components of external liabilities on banks' balance sheet to the total external liabilities from March 2001 to September 2003. It may be seen that the share of banks' deposits/borrowings in foreign currency in external liabilities has increased from 30.6 per cent to 35.5 per cent over this period due to a rise in the share of foreign currency borrowings from less than one per cent in March 2001 to over 10 per cent in September 2003. The share of ADRs/GDRs, increased from 0.6 per cent in March 2001 to 2.4 per cent in September 2003. On the other hand, the share of non-resident deposits has declined from 62.4 per cent in March 2001 to 57.6 per cent in September 2003. Composition wise, while the share of FCNR(B) deposits in the external liabilities has declined from about 25 per cent in March 2001 to about 20 per cent in September 2003, the share of NRE deposits increased from less than 20 per cent in March 2001 to more than 30 per cent over the same period.

III.3 Off-Balance Sheet External Liabilities of Banks

3.6 An analysis of the guarantees given by authorised dealers (ADs) to non-residents on behalf of residents shows that such guarantees amounted to nearly US $ 2.9 billion in November 2003 and are largely issued to foreign branches. Guarantees for ECBs were for nearly US $ 0.36 billion in June 2003. Guarantees issued by FIs amounted to another US $ 1.2 billion in June 2003. The present RBI guidelines advise banks that before giving financial guarantees on behalf of customers, they should ensure that the customer would be in a position to reimburse the bank contingent on the bank making any payment under the guarantee. Also, in case of performance guarantees, banks are to ensure that the customer has the necessary experience, capacity and means to perform the obligation. Keeping in view these extant safeguards along side the restrictions relating to the quantum of exposures, the Group feels that the off-balance sheet exposures are not likely to pose any systemic concern as such.

III.4 Trends in Non-Resident Deposits

3.7 As discussed earlier, the non-resident deposits constitute a dominant share in the external liabilities of SCBs. Table 7 presents the annual outstanding non-resident deposits (in US dollar terms) under various categories since 1991. The NRO deposits as of now constitute about three per cent of non-resident deposits and are not included in Table 7. Also, with the discontinuation of fresh deposits under NRNR scheme as at end-March 2002, the share of NRNR deposits which stood at around 25 per cent as at that time has gone down substantially to around 5 per cent of total NRI deposits by March 2004.

3.8 The total non-resident deposits have been increasing over the years and have nearly doubled during the past eight years. The increase has been more rapid during the last three years especially in the case of NRE deposits which has increased by around 187 per cent in Rupee terms (195.7 per cent in US dollar terms). A part of this increase can be attributed to the transfer of the maturity proceeds of NRNR deposits. The FCNR(B) deposits registered an increase of 23.3 per cent in US dollar terms during the last three years .

3.9 A noticeable feature in non-resident deposits in the recent past has been that there appears to be a reduction in arbitrage possibilities following the lowering of the interest rate ceiling by RBI in July 2003 (which was subsequently lowered thrice). This has reflected in a slowdown of the growth in NRE deposits in the recent months particularly after September 2003. From Table 8, it may be seen that during 2003-04, the fortnightly average NRE deposits inflow was much lower at Rs.478 crore during September 06–March 19 as against the corresponding figure of Rs.1,309 crore during March 22-September 05, 2003. In contrast, the fortnightly average FCNR(B) deposits inflow increased by Rs.302 crore in the second period as against the decline of Rs.292 crore during the first period.

III.5 Concentration of External Liabilities Across Banks

3.10 Table 9 presents the concentration of non-resident deposits for the last three years based on the information received in Form A (Section 42) return for the three categories of deposits, viz., FCNR(B), NRE and Total (=FCNR(B)+NRE+NRNR) deposits from scheduled commercial banks. More than half of the non-resident deposits with SCBs (53.9 per cent in March 2004) are concentrated with six banks. Also the concentration of deposits is more for the foreign currency deposits when compared to Rupee deposits. Nearly 61.4 per cent of FCNR(B) deposits in March 2004 were concentrated with top six banks as compared with their share of 50.2 per cent of NRE deposits.

3.11 Another interesting aspect has been the increase in concentration of FCNR(B) deposits across banks in contrast to the decline in concentration of NRE deposits. The share of top three banks in total NRE deposits declined from 39.3 per cent in March 2002 to 36.7 per cent in March 2004 whereas their share in total FCNR(B) deposits increased from 43.3 per cent to 45.6 per cent over the same period. This implies that the smaller banks are receiving increasingly higher share of the faster growing NRE deposits. On the other hand, FCNR(B) deposits are getting more concentrated with banks which have been holding large share of such portfolio in the past.

3.12 The fact that banks' international liabilities are nearly double of their international assets is an issue of systemic concern as it may to translate itself into a liquidity risk in case of crisis of confidence. The concerns as detailed above need to be addressed and good risk management practices put in place to bring down the mismatches to reasonable levels. High forex reserves are a comforting factor but there are several complexities involved. The use of forex reserves by central banks for bailing out domestic institutions raises the moral hazard issue which has been discussed in detail in Section V.

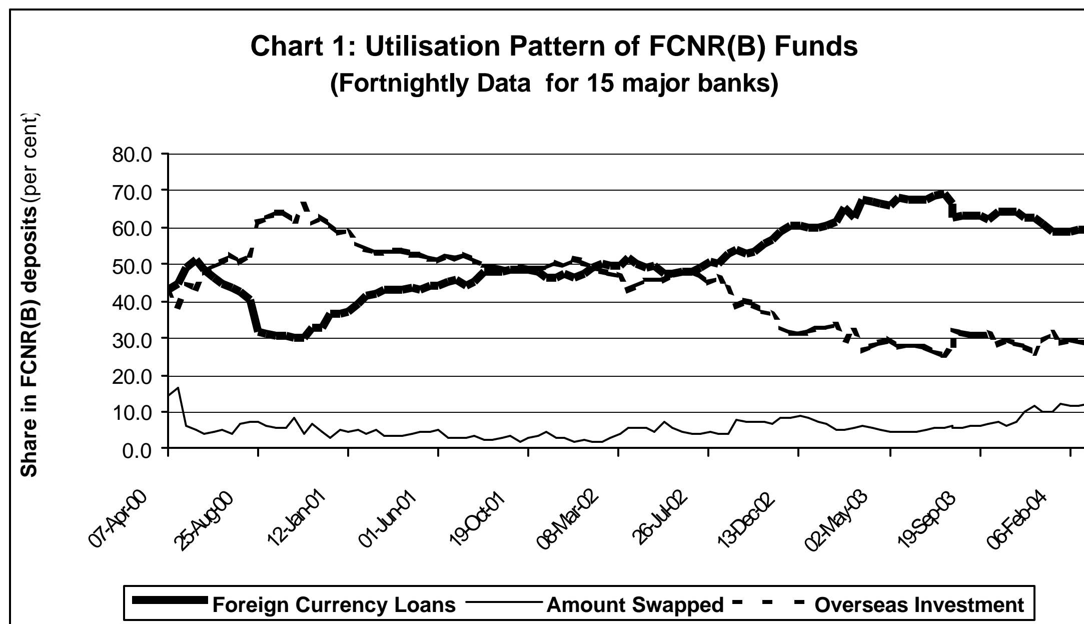
Section IV: Banks' Assets against External Liabilities

4.1 Banks with a high concentration of external funds (especially FCNR(B) deposits), are in a better position to provide foreign currency loans to exporters/importers. Banks are presently allowed to extend PCFC and EBR facilities to exporters from the foreign currency balances available in EEFC, RFC & FCNR(B) accounts, under ESCROW accounts and also by availing lines of credit from abroad as well as from other banks in India.

4.2 Table 10 presents the international assets of banks classified according to liability type. A majority of these assets are in the form of loans and deposits. The share of Nostro balances (including balances in term deposits with non-resident banks and FCNR funds held

abroad) in total international assets of banks has come down from 61.6 per cent in March 2001 to 34.4 per cent in September 2003. On the other hand, the share of foreign currency loans to residents (including loans out of FCNR(B) deposits, PCFCs, foreign currency lending and foreign currency deposits with banks in India, etc.) has increased from 16.2 per cent in March 2001 to 36.4 per cent in September 2003.

4.3 Table 11 presents the quarterly pattern of utilisation of FCNR(B) deposits by 15 major banks since March 2000. It may be seen that the share of foreign currency loans in FCNR(B) deposits increased from 44.8 per cent in June 2000 to 67.4 per cent three years later. Thereafter, it declined to 60.3 per cent by March 2004 (Chart 1).



4.4 FCNR(B) funds provide an important source for foreign currency loans including export credit. Table 12 presents the quarterly data on export credit outstandings in respect of pre-shipment credit in foreign currency (PCFC) and export bill rediscounting (EBR). It may be seen that, since December 1998, line of credit has been an important source of fund for banks for extending export credit in foreign currency and has accounted for 27.1 per cent to 39.5 per cent in the total export credit in foreign currency. The share of finance of PCFC and EBR through funds from major foreign currency deposits of banks (FCNR(B), EEFC, RFC, etc.) was below 4 per cent of these deposits during March 1998 through September 2002. Subsequently, it increased to 26.0 per cent by March 2004. However, it is interesting to see that the period of rapid increase in foreign currency export credit (September 2002 onwards) has not coincided with a major increase in FCNR(B) deposits. In fact, during September 2002 to September 2003, export credit in foreign currency other than those from lines of credit increased by Rs.8,138 crore, though FCNR(B) deposits declined by Rs.3,914 crore during the

same period. This was the period of gradual appreciation of the rupee when the FCNR(B) deposit flows were lower but NRE deposits increased rapidly. The seven-fold increase from Rs.1,923 crore in September 2002 to Rs 14,947 crore in March 2004 in foreign currency credit (excluding line of credit) was, therefore, financed by banks despite the FCNR(B) deposits remaining unchanged in rupee terms (Rs.50,689 crore in September 2002; Rs.50,616 crore in March 2004).

4.5 Though the present interest rate ceiling of LIBOR + 75 basis points on export credit in foreign currency is intended to help small exporters, banks are finding it difficult to lend on these rates as these small advances have high transaction costs. Many banks are reported to have levied additional service charges to cover their transaction costs on these advances.

4.6 The Group examined the interest rate ceiling on export credit in foreign currency. It was recognised that the basic issue in export credit in foreign currency is that of pricing rather than availability of foreign currency. It was felt that since banks are permitted to access overseas lines of credit without limit for the purpose of on-lending to exporters, any removal of the interest rate cap will lead to a quantum jump in PCFC as well as in overseas borrowings by banks as this will give them an attractive spread.

4.7 On balance, the Group recommends that the present ceiling on interest on export credit in foreign currency may be deregulated for better availability of export credit in foreign currency though it may lead to higher overseas borrowings by banks. If complete deregulation is not considered feasible, the interest rate ceiling may be raised by 50 basis points to '125 basis points above LIBOR' which will ensure greater availability of PCFC in the short-run by enabling banks to access larger overseas lines of credit at slightly higher rates than before.

Section V: External Liabilities of SCBs: Major Issues

5.1 In view of the increase in external liabilities of the banks, it may be that some banks are taking higher risk. This needs to be looked into from the angle of risk on the balance sheet, the growth component and the systemic issues. Especially in case of NRI deposit schemes, the issue needs to be reviewed in the light of the need to rationalize to ensure policy consistency and stability across the deposit schemes and maintaining relationship with the NRIs. In this connection, the Group deliberated on a number of issues involved which are discussed below:

V.1 Reserve Requirements on Non-Resident Deposits

5.2 While NRI deposits have been an important source of external finance, the accretion to these deposits form a liability of the banking system and also impact on the monetary aggregates. Capital inflows translate into overall balance of payments surpluses, which have been absorbed by the Reserve Bank as part of its exchange rate management strategy. This policy in turn has implications for monetary management. As NRI deposits differ in this respect from other components of capital flows, they have been regulated in the recent past as part of overall monetary management in the form of reserve requirements and interest rate stipulations taking into account the trends in external financing requirement and external capital flows.

5.3 In India, the cash reserve ratio (CRR) stipulation on NRE deposits was the same as on domestic deposits in the 1970s. In the 1980s, the CRR was significantly lowered to make these deposits more attractive in the wake of increasing current account deficit. After the external payments crisis of 1990-91, the composition of foreign currency deposits was preferred towards the non-repatriable NRNR deposits from macro-economic management point of view. The FCNR(B) and NRNR schemes were introduced in the early 1990s and were initially exempt from CRR requirements. However, as the NRI inflows steadily rose over the years, reserve requirements were imposed beginning 1994-95 so as to render these deposits relatively unattractive from the point of view of containing monetary impact. In 1995-96, in the wake of then prevailing high volatility in the foreign exchange market, CRR was initially reduced and finally withdrawn so as to facilitate greater flow of such deposits. Subsequently, with a view to bringing all liabilities to public under one umbrella of reserve requirements, incremental CRR was imposed on all deposits with effect from April 1997. While incremental CRR on Rupee deposits was withdrawn with effect from November 1997, that on FCNR(B) deposits was withdrawn from November 1999. Exemptions and multiple prescriptions made over time in response to specific requirements were also withdrawn with effect from November 2001 combined with a reduction in the overall CRR. Though the above movements in CRR were decided by the prevailing economic conditions, the use of SLR for such purpose has been rather limited.

5.4 Different reserve and liquid asset requirements for these categories of deposits alter the relative cost of these deposits which is likely to influence the composition of liquidity between resident/non-resident deposits and domestic currency/foreign currency deposits and also have an impact on the nature of foreign currency intermediation. In the Indian case, the reserve requirements as applicable for resident and non-resident deposits and also for domestic and foreign currency deposits are presently the same. Annex IV gives a brief review of the country practices in case of reserve requirements on external deposits.

5.5 The Group discussed the issue of reserve requirements on external deposits in detail and noted that the reserve requirements on different categories of deposits have already been rationalised. In accordance with the medium-term objective of reducing CRR to the statutory minimum level of 3.0 per cent in the spirit of recommendations of Narasimham Committee II on banking sector reforms, CRR has been brought down considerably over the years. However, the Group recognized that reserve/liquidity requirements are effective instruments of moderating the flows of NRI deposits and the option to influence the cost/return in respect of such deposits through reserve requirements may be left open. However, in the present context, no differential CRR needs to be introduced at this stage for different categories of deposits.

V.2 Tax Regimes Governing Non-Resident Deposits

5.6 At present, the income from interest on funds held in NRE/FCNR(B) accounts is exempt from income tax. However, similar concession is not available in respect of balances held in NRO Accounts where deposits are subject to wealth-tax and interest income is subject to Indian income tax at source. In case of NRNR deposits, interest income from deposits will be free from Indian income-tax and deposit is also exempt from Gift-tax for one-time gifting in case of NRIs.

5.7 The Group deliberated at length on the existing tax regime governing NRI deposits including the appropriateness of the existing tax incentives. The Group feels that tax concessions on NRI deposits were given in the period of difficult balance of payment (BoP) conditions and low forex reserves to attract such deposits. Over the years, forex reserves situation has improved. The quantum of NRI deposits has increased substantially and their share in the country's external debt is continuously increasing. The interest income on resident deposits as also on external commercial borrowings is taxable. Keeping these factors in view as also the need for maintaining uniformity of treatment, the Group recommends that interest income on non-resident deposits may be made taxable on par with domestic deposits and external commercial borrowings (ECBs) consistent with the current account convertibility.

V.3 Interest Rate Arbitrage

5.8 The interest rate arbitrage could occur to restore interest parity and on exchange rate expectations. Under this dispensation, an investor in a country where interest rate is low would convert his funds into the currency of a country having high interest to benefit therefrom. The investor's gain through the interest rate differential may be offset by a possible loss stemming from exchange rate changes. In the recent past, in the Indian case, while the former argument seems to have worked, the latter explanation did not hold. Though the domestic interest rate was relatively high, currency was appreciating against the US dollar

though depreciating against other major currencies. However, the positive interest rate differential coupled with appreciating currency prompted large NRI inflows into Rupee accounts till the cap on interest rate was placed after which such inflows slowed down due to the reduced arbitrage opportunity.

5.9 As regards the FCNR(B) deposits, the scope for arbitrage due to interest rate differential seems to have disappeared, following the fixation of ceiling of interest rate offered on the former at 25 basis points lower than the corresponding international interest rates. However, though the interest rate on NRE term deposits has been capped, the interest rate applicable on NRE saving deposits continues to be the same as the interest rate on domestic saving deposits. This, in a way, gave rise to the anomaly of the short-term rate being higher than the long-term fixed deposit rates in the present context.

5.10 The quarterly data on NRE savings deposits obtained from four banks which have a significant share of NRE deposits along with their corresponding total NRE deposits based on the information supplied in the Form A (Section 42) return by them are presented in Table 13.

5.11 An analysis of NRE deposits for the selected banks showed that the share of new NRE savings deposits in the total new NRE deposits increased considerably once the ceiling on NRE term deposits was introduced in July 2003. After the ceiling was further lowered in October 2003, the incremental share of NRE savings deposits in total NRE deposits increased from 6.6 per cent in April-June 2003 to 39.5 per cent in July-September 2003 and further to 97.5 per cent in October-December 2003. This implies that while the NRE deposit inflows have come down in view of the reduced arbitrage opportunity in case NRE term deposits (as discussed in Section III.4), fresh NRE deposit inflows are largely reflected in NRE saving deposits due to the higher interest rate on NRE saving deposits.

5.12 The Group deliberated in detail on the issue of the present equivalence between the interest rate offered on domestic and non-resident savings deposits. It was felt that the saving accounts are not intended to be maintained for large deposits and, in the present context, NRE saving deposits are providing avenues for interest rate arbitrage. The NRE savings deposits are repatriable and can be drawn down sharply without penalty. The Group, therefore, recommends that NRE savings deposit interest rate and the domestic savings deposit rate could be delinked to reduce the scope of arbitrage as also to avert the scope for using the NRE saving accounts for unintended purposes. This option seems to be better than that of putting a cap on the quantum of NRE saving deposits which may be operationally difficult to implement. The Group recommends that interest rate on NRE saving deposits may be reset on a quarterly basis and may have an interest rate ceiling of one month US dollar LIBOR.

5.13 The Group feels that interest rates on non-resident deposits should be close to international rates available on similar tenor. In this context, the Group recommends that the interest rate on NRE term deposits may be changed to LIBOR of the corresponding maturity instead of the present rate of LIBOR plus 25 basis points.

V.4 The Issue of Repatriablity

5.14 The NRO deposits are the only category of non-resident deposits where the principal amount is non-repatriable. However, current income and interest up to US $ 1 million per calendar year is repatriable out of NRO balances/sales proceeds of assets. The large window for making remittances makes it virtually repatriable. In case of NRO accounts, banks are free to determine the interest rates except for the NRO saving deposits where interest rates are the same as domestic saving deposits. It was felt that in the present context of substantial inflows, there is little utility of non-repatriable deposit scheme. Also the interest rates on NRO deposits are deregulated (except for the savings deposits) and arbitrage opportunity exists. Therefore, interest rates on all non-resident deposit schemes need to be closer to the corresponding international interest rates.

5.15 In the light of the above, the Group had detailed discussions on the feasibility of discontinuation of NRO deposit scheme on the lines of NRNR deposits where fresh deposits were not accepted after March 2002. NRO deposits presently account for nearly three per cent (nearly Rs.3,600 crore in September 2003) of the total non-resident deposits. Interest income from NRO accounts is taxable and these accounts are intended to be mainly used for transactional purposes. Funds which do not qualify under the present regulations for remittances outside India are required to be credited under NRO accounts. It was recognized that the NRO scheme also serves the requirements of foreign nationals resident in India. Also, the average balances under NRO savings deposits are relatively small as these are generally maintained by small depositors for their operations in India.

5.16 Taking the above factors into account, the Group recommends that the NRO deposits should be in the nature of current or savings accounts only. The existing NRO term / recurring deposits may be allowed to be maintained till maturity after which the balances may be allowed to be repatriated or may be credited to NRO/NRE saving/current deposits if the account holder so desires. This would, in a sense, tantamount to further current account liberalization.

V.5 Authorisation to accept Non-Resident Deposits

5.17 As discussed earlier in Section III, the spread of non-resident deposits is highly skewed and six banks accounted for more than half of non-resident deposits. At present, authorised dealers (ADs) and banks specifically authorised by RBI can maintain accounts in the name of NRIs. In addition, Financial Institutions, Non-Banking Financial Companies (NBFCs), Residuary Non-Banking Companies (RNBCs) and certain co-operative/ commercial banks (referred to as authorised banks) have been specifically permitted to maintain NRI rupee accounts even though they may not be ADs. RBI has recently clarified (March 18, 2004) that no entity other than a licensed banking company can solicit foreign currency deposits from residents. A company registered under the Companies Act, 1956 or a body corporate or created under an Act of Parliament or State Legislature can accept deposits from NRIs on repatriation basis subject to certain terms and conditions. Also an Indian company or proprietorship concern or a firm in India can accept deposits from NRIs on a non-repatriation basis under certain conditions.

5.18 Since Rupee accounts do not involve foreign exchange risk for banks, any restriction on acceptance of Rupee deposits from non-residents needs to be looked into from the point of view of non-resident customer relationship, the prevention of possible money laundering and the implementation of the *Know Your Customer* (KYC) policy in case of non-banks. In the present context, NRE deposits are additional source of funds for the institutions mobilizing these deposits. It is, however, important to mention that non-bank entities like NBFCs/RNBCs/MNBCs/non-financial corporates which accept NRI deposits, do not have DICGC cover. From the point of view of maintaining relationship with NRIs and for restricting any unscrupulous transactions involving money-laundering, it may be useful to phase out non-banks from accepting non-resident deposits and restrict the acceptance of NRI deposits to authorised dealers (ADs) as they are part of the network that extend credit in foreign currency. To smoothen such transition, any institution which is prohibited from accepting NRI deposits as convergence faces transitional problem, may approach RBI for special dispensation with a structured transition plan.

V.6 Liquidity Risk

5.19 Banks in India are considered as implicitly guaranteed by the Government even though the DICGC cover is available for deposits up to a limit. In some cases, issues relating to international liquidity in balance sheet of banks can pose systemic problems affecting the general confidence of the public in the banking system. In the case of the Indian banking system, it was seen earlier (Section II and Table 2) that the foreign currency liabilities of banks were over 20 per cent more than their foreign currency assets and their international liabilities were nearly double of their international assets.

5.20 In the process of liberalizing capital controls, higher forex reserves are required to ensure adequate liquidity, as shortage of reserves would be costly as has been seen in the context of the Asian financial crises. However, the policies towards the management of liquidity risks have to be framed keeping in view the health of the financial system, the risk management practices, the level of unhedged foreign currency borrowings and the moral hazard of encouraging domestic borrowers to expect the Government/central bank to bail them out in the event of crisis. Any hedging within the domestic banking system may not provide adequate comfort as exposure is not reduced at the overall level.

5.21 Though central banks in many countries (e.g. Norway, Sweden and Korea) have used their forex reserves to give liquidity support to the banking sector to meet the inter-bank liabilities denominated in foreign currency, it needs to be recognized that the use of forex reserves to meet a banking crisis can send a wrong signal and, in some cases, may lead to a currency crisis. The reliance of the banking system for such purposes, therefore, needs to be reduced by promoting self-reliance within the system. This needs to be approached by relating exposure limits to certain assets and also through ensuring proper risk assessment systems in banks.

V.7 Exchange Risk

5.22 In terms of implications for the health of the banking system, foreign currency deposits are different from the Rupee deposits. The foreign currency deposits bear exchange rate risk which the rupee deposits do not. Exchange risk in mobilising NRI deposits of banks is a potential gain or loss for banks that occurs as a result of an exchange rate change. Banks face such a risk in mobilising NRI deposits in foreign currency.

5.23 In the case of NRE and NRO deposits, banks do not face any exchange risk as they are repayable in domestic currency. In the case of FCNR(B) deposits, the bank bears the exchange rate risk which is partly covered through hedging and appropriate risk management

systems. Further, to cover themselves from the exchange risk, banks resort to maintaining assets like foreign currency loans, overseas investments, etc. where they get returns linked to international interest rates. Banks face credit risk in case of loans given against such deposits and, therefore, need to monitor their borrowers' foreign exchange risk. The other external liabilities in foreign currency like EEFC, RFC, etc., can also be used for giving export credit, advances against such deposits, etc.

5.24 It emerged from Section IV that FCNR(B) deposits have not been used extensively for pre-shipment credit in foreign currency (PCFC). The latter is financed more by way of lines of credit and other sources. Though over one-half of FCNR(B) funds are used for giving foreign currency loans (FCL), the share of FCNR(B) loans to exporters is very low as non-export FCL are more profitable to banks in the absence of interest rate cap on them. However, these deposits are still useful sources of foreign exchange for banks and are relevant from the point of view of maintaining relationship with NRIs. The Group, therefore recommends, that the scheme may be continued in its present form.

V.8 The Issue of Dollarisation

5.25 Dollarisation occurs when residents of a country extensively use foreign currency alongside or instead of the domestic currency. In case of unofficial dollarisation, residents hold much of their financial wealth in foreign assets to protect against losing wealth through inflation in the domestic currency even though foreign currency may not be a legal tender as against the full dollarisation when foreign currency has exclusive or predominant status as full legal tender. The demand for foreign assets will be high in the case of crisis of confidence in the banking system in any emerging economy. Dollarised systems are prone to higher risk as they are exposed to both solvency and liquidity risks and, therefore, the entities with large foreign currency liabilities must balance their foreign exchange positions by either extending foreign currency lending to local currency earners or holding foreign currency assets abroad.

5.26 The recent liberalization in the foreign exchange regulations has, among other facilities, allowed the residents to open Resident Foreign Currency (Domestic) (RFC(D)) accounts. The original RFC account facility which is available for returning Indians is presently interest bearing whereas the EEFC and RFC(D) accounts are non-interest bearing. Moreover, transactions using foreign currency are only allowed in select current and capital account items and RFC accounts are allowed for specific small proceeds which would not support dollarisation of Indian economy. Again under the recently released Liberalised Remittance Scheme (LRS), residents are allowed to make remittance upto US $ 25,000 per calendar year for any current/capital account transaction. LRS allows remittances of Indian residents to foreign countries and, therefore, discourages dollarisation in India. The scheme permits

remittances for investments by resident Indians from their own sources for the sole purpose of utilisation abroad.

5.27 At present, the foreign currency deposit schemes (EEFC/RFC/ RFC(D)) available to residents do not constitute a significant proportion of the deposit accounts and the ratio of foreign deposits held by residents to total deposits is lower than one per cent which is not large enough to render the system vulnerable to the effects of dollarisation. The Group feels that all these accounts are essentially for transaction purposes and, therefore, they need not be interest-bearing. The Group recommends that the original RFC accounts may be allowed only in the form of current account. However, the existing term deposits may be allowed to continue till maturity. Also, regular review of the external liabilities at the aggregate level is necessary to ensure that the country is not exposed to the risk of dollarisation.

Section VI: Conclusions and Recommendations

6.1 The Group examined the issues relating to the external liabilities of banks in the light of the changing pattern of India's external debt and the capital flows, the utilisation pattern of external sources of finance, the relationship with NRIs, the systemic issues relating to health of the domestic banking sector, the cost of such funds, the opportunity for arbitrage and the risk of dollarisation.

6.2 The Group based its decisions on the following principles:

- External liabilities of banks need to be seen in the overall context of external debt. As non-debt creating remittances have been consistently accounting for a dominant component of NRI inflows, the deposit component which has implications for external debt needs to be evaluated cautiously;
- In the matter of capital inflows, there should be a continued policy preference in favour of equity as against debt;
- Non-resident deposit schemes provide linkage between the domestic and international markets. The relationship has to be seen both from macro and individual considerations;
- Interest rate on external deposit schemes should be comparable to international interest rates as these are essentially debt flows;
- The acceptance of NRI deposit schemes may be restricted to increase the effectiveness of policy changes relating to these deposits from the point of view of asset-liability structure of entities accepting such deposits;
- Non-resident accounts meant for transaction purposes may be allowed only in non-interest bearing form;

- Foreign currency accounts available to residents for transaction purposes should be non-interest bearing; and
- Tax treatment and differential reserve requirements are important instruments for moderating NRI deposit flows as witnessed in the past.

6.3 On the basis of the above principles and the analysis contained in previous sections, the conclusions and recommendations of the Group are as follows:

- Non-resident deposit schemes were introduced at various stages in the past to attract foreign exchange funds by offering tax benefits, higher interest rates, exchange cover, etc. The share of NRI deposits and other foreign currency deposits in total external debt has increased from 12.2 per cent in March 1991 to 25.8 per cent in December 2003. NRI deposits can be withdrawn at any time whereas the rollover problem could occur in the case of other debt components only on the date of amortisation. In the recent past, there have been attempts to reduce India's external debt by prepayment but NRI deposits have been a major source of increase in external debt during this period. The Group is of the view that in the fast-changing international scenario, there are dangers of excessive short-term debt and its share in overall external debt should be low.

  (paras 2.7 - 2.11)
- The off-balance sheet exposures of banks in terms of foreign currency are restricted with safeguards on the quantum of such exposures and they are not likely to raise any systemic problem.

  (para 3.6)
- Past experience shows that export credit in foreign currency is being financed by lines of credit and other sources in addition to the use of FCNR(B) deposits. The Group feels that the basic issue in export credit in foreign currency is that of pricing rather than availability of foreign currency. For better availability of export credit in foreign currency, the Group recommends that present ceiling on interest on such credit may be deregulated. If complete deregulation is not considered feasible, the interest rate ceiling may be raised by 50 basis points to '125 basis points above LIBOR' which will ensure greater availability of PCFC in the short-run by enabling banks to access larger overseas lines of credit at slightly higher rates than before.

  (para 4.5 – 4.7)
- The reserve requirements (CRR) and liquidity requirements (SLR) on various categories of deposits (resident / non-resident; domestic / foreign currency) are effective instruments of moderating the flows on NRI deposits and the option to influence the cost / return in respect of such deposits through reserve requirements may be left open. However, in the present context, these may be left unaltered.

  (para 5.5)

- Non-resident deposit schemes were given tax benefits in the past to attract foreign exchange funds in the times of pressing BoP requirements. However, over the years, NRI deposit inflows have become much larger and there is no need to give such benefits on these deposits in light of the comfortable forex reserves. The Group recommends that interest income from NRI deposits may be made taxable on the lines of domestic deposits consistent with the current account convertibility.

(para 5.7)

- The linking of NRE saving deposits rate to the domestic interest rate, which is higher than the international interest rate, is providing arbitrage opportunities. Saving accounts are not intended to be maintained for large deposits but are presently providing clear avenues for arbitrage. The Group feels that the NRE savings deposit interest rate needs to be delinked from domestic savings deposit rate especially because NRE savings deposits are repatriable, and can be drawn down sharply without penalty as also to avert the scope for using the NRE savings accounts for arbitrage. This would be a much better option than putting a cap on the quantum of NRE savings deposits which may be operationally difficult to implement. The interest rates on NRE saving deposits may not exceed the one-month LIBOR/SWAP rates on US dollar deposits.

(para 5.12)

- The Group feels that interest rates on non-resident deposits should be close to international rates available on similar tenor. In this context, the interest rate on NRE term deposits may be changed to LIBOR of the corresponding maturity instead of the present rate of LIBOR plus 25 basis points.

(para 5.13)

- The Group is of the view that all non-resident deposits should be repatriable when the forex reserves position is comfortable. The Group recommends that NRO deposits may have the nature of current/ savings accounts only. The existing term/recurring deposits under NRO scheme may be allowed to be maintained till maturity after which the balances may be allowed to be repatriated or may be credited to NRO/NRE savings/current deposits if the account holder so desires.

(para 5.15 – 5.16)

- The Group is of the view that in order to increase the effectiveness of the policies relating to NRI deposits, to ensure good service to NRIs and also to prevent money-laundering, the non-banking financial companies and non-financial corporates should be phased out from accepting NRI deposits. The Group recommends that the acceptance of NRI deposits should be restricted to only Authorised Dealers who have better *Know Your Customer* policy when compared to non-banks and others.

(para 5.18)

- The international liabilities of banks are nearly double of their international assets. Any liquidity support by Government/ central bank to the banking sector to meet their asset-liabilities mismatch involves the moral hazard of encouraging domestic borrowers to expect the Government / central bank to bail them out in the event of crisis. The Group feels that in order to keep the systemic risks at bay, the external liabilities and assets of banks need to be regulated to ensure that the mismatch is not high and appropriate risk assessment systems are in place. Banks need to maintain good risk management systems to effectively use the larger availability of foreign currency in the system for expanding their business.

  (paras 5.19 – 5.21)

- The Group is of the view that the country is not exposed to any risk of dollarisation for the present. However, continuous monitoring of the external liabilities becomes imperative so as to ensure that the country is not exposed to the risk of dollarisation. All foreign currency accounts that are allowed to residents for transaction purpose should be non-interest bearing so that the risk of dollarisation is under check. The Resident Foreign Currency (RFC) scheme may be made non-interest bearing. The EEFC and RFC(D) accounts should continue to remain non-interest bearing.

  (para 5.27)

Table 1: Share of Various Components in India's External Debt (1991-2003)

(Amount in US $ million)

As in	Multilateral + Bilateral Loans		Commercial Borrowings		NR + FC(B&O) Deposits		Others		Total External Debt	
	Amount	% Share	Amount	% Share	Amount	% Share	Amount	% Share	Amount	% Share
Mar-91	35068	*41.8*	10209	*12.2*	10209	*12.2*	28261	*33.7*	83801	*100.0*
Mar-95	48812	*49.3*	12991	*13.1*	12383	*12.5*	24760	*25.0*	99008	*100.0*
Mar-98	46522	*49.7*	16986	*18.2*	11913	*12.7*	18042	*19.3*	93531	*100.0*
Mar-00	49613	*50.5*	19943	*20.3*	13559	*13.8*	15077	*15.3*	98263	*100.0*
Mar-01	47079	*46.6*	24215	*23.9*	16568	*16.4*	13200	*13.1*	101132	*100.0*
Mar-02	47221	*47.8*	23248	*23.5*	17154	*17.4*	11067	*11.2*	98761	*100.0*
Mar-03	46809	*44.7*	22370	*22.3*	23160	*22.1*	11361	*10.9*	104700	*100.0*
Dec-03	48500	*43.3*	20545	*18.3*	28960	*25.8*	14100	*12.6*	112105	*100.0*

Table 2: International Assets and International Liabilities of Banks –Sectoral Break-up **(Amount in Rs.crore)**

Sector	31-Mar-01		31-Mar-02		31-Mar-03		30-Jun-03		30-Sep-03	
Assets										
With Banks	61,633	(74.0)	66,981	(66.1)	48,409	(46.3)	48,518	(45.4)	48,136	(44.6)
With Non-banks	21,600	(26.0)	34,394	(33.9)	56,165	(53.7)	58,330	(54.6)	59,672	(55.4)
Total	**83,233**	**(100.0)**	**101,375**	**(100.0)**	**104,574**	**(100.0)**	**106,848**	**(100.0)**	**107,808**	**(100.0)**
In Foreign Currency	81,137	(97.5)	97,357	(96.0)	100,705	(96.3)	103,281	(96.7)	104,139	(96.6)
In Rupee	2,096	(2.5)	4,018	(4.0)	3,869	(3.7)	3,567	(3.3)	3,669	(3.4)
Liabilities										
With Banks	25,620	(16.8)	32,460	(18.9)	47,435	(23.7)	46,508	(22.6)	50,912	(23.6)
With Non-banks	126,760	(83.2)	138,876	(81.1)	153,058	(76.3)	159,284	(77.4)	164,689	(76.4)
Total	**152,380**	**(100.0)**	**171,336**	**(100.0)**	**200,493**	**(100.0)**	**205,792**	**(100.0)**	**215,601**	**(100.0)**
In Foreign Currency	N.A.		99,207	(57.9)	119,186	(59.4)	120,216	(58.4)	125,776	(58.3)
In Rupee	N.A.		72,130	(42.1)	81,308	(40.6)	85,575	(41.6)	89,826	(41.7)
Ratio of Liabilities to Assets (per cent)										
Banks	41.6		48.5		98.0		95.9		105.8	
Non-banks	586.9		403.8		272.5		273.1		276.0	
Total	**183.1**		**169.0**		**191.7**		**192.6**		**200.0**	

Note: (i) Foreign Currency Assets include loans to residents/non-residents, Outstanding Export Bills, FC lending to banks in India, FC deposits with banks in India, Overseas FC Assets, Remittable profits of foreign branches of Indian banks, etc.

(ii) Rupees Assets with Non-residents includes Rupee loans to non-residents out of non-resident deposits.

(iii) Foreign Currency Liabilities are both to residents and non-residents.

(iv) Rupee Liabilities are liabilities to non-residents denominated in Indian Rupees.

(v) All Figures are inclusive of accrued interest

(v) Figures in parentheses are the percentage share in total assets / liabilities.

(vii) Data pertain to the reporting branches of banks under International Banking Statistics for the BIS System (Quarterly Article in RBI Bulletin).

Table 3: Selected External Liabilities of Scheduled Commercial Banks

(Rs. crore)

Category of Deposits	28-Mar-97	27-Mar-98	26-Mar-99	24-Mar-00	23-Mar-01	22-Mar-02	21-Mar-03	19-Mar-04
1. NRE	17,886	22,267	25,629	29,465	33,357	42,724	73,181	95,588
2. NRNR	20,116	24,735	28,058	29,447	31,966	36,300	17,362	8,760
3. FCNR(B)	26,906	33,445	33,222	35,632	42,357	48,537	49,901	50,616
A Total Non-resident Deposits (1 to 3)	**64,908**	**80,447**	**86,909**	**94,544**	**107,680**	**127,561**	**140,444**	**154,964**
4. EEFC	1,427	3,875	6,926	7,667	4,488	4,779	5,397	4,808
5. RFC	242	389	540	690	1,025	1,283	1,374	1,374
6. ESCROW	94	72	99	140	92	122	173	105
7. Line of Credit from abroad for PCFC	4	64	197	219	153	165	3,394	5,847
8. IBFCD	1,119	214	710	1,433	616	453	343	601
B Total Other Accounts (4 to 8)	**2,886**	**4,614**	**8,472**	**10,150**	**6,374**	**6,802**	**10,681**	**12,735**
C Resurgent India Bonds			17,945	17,945	17,945	17,945	17,945	
D India Millennium Deposits					25,662	25,662	25,662	25,662
E Total External Liabilities (A+B)	**67,794**	**85,061**	**95,380**	**104,694**	**114,054**	**134,363**	**151,125**	**167,699**
F Total External Liabilities (A+B+C+D)	**67,794**	**85,061**	**113,325**	**122,639**	**157,661**	**177,970**	**194,732**	**193,361**

Table 4: International Liabilities of Banks Classified According to Type

(Rs. Crore)

Liability Type	Amount outstanding as on				
	31-Mar-01	**31-Mar-02**	**31-Mar-03**	**30-Jun-03**	**30-Sep-03**
1. Deposits and Loans	**104,148**	**120,604**	**145,930**	**150,038**	**158,460**
(a) Foreign Currency Non-resident Bank [FCNR(B)] scheme	37,991	39,636	43,989	43,361	43,456
(b) Resident Foreign Currency (RFC) A/Cs	882	1,127	1,232	1,289	1,320
(c) Exchange Earners Foreign Currency (EEFC) A/cs	3,544	4,865	4,881	4,532	4,425
(d) Other foreign currency deposits (including Inter-bank Foreign Currency deposits)	593	1,484	1,809	1,725	1,956
(e) Foreign Currency Borrowing (Inter-bank borrowing in India and from abroad, external commercial borrowings of banks)	1,222	5,514	18,411	18,561	23,025
(f) VOSTRO balances and balances in exchange houses and in term deposits	2,454	3,382	2,541	2,196	2,249
(g) Non-resident External Rupee(NRE) Accounts in term deposits	29,413	33,233	53,124	60,491	65,887
(h) Non-resident Non-Repatriable (NRNR) Rupee Deposits	25,867	27,181	15,207	12,992	11,001
(i) Non-resident Special Rupee (NRSR) Deposits	336	1,009	353	315	265
(j) Non-Resident Ordinary (NRO) Rupee Accounts	1,423	2,136	3,504	3,581	3,555
(k) QA 22 Accounts	267	550			
(l) Embassy Rupee accounts	46	131	123	118	107
(m) Foreign Institutional Investors' (FII) Accounts	38	248	602	704	1065
(n) ESCROW A/cs	72	111	154	172	148
2. Own Bonds(Including IMDs/ RIBs)	**43,652**	**43,582**	**44,087**	**43,978**	**43,817**
3. Other Liabilities	**4,580**	**7,150**	**10,475**	**11,775**	**13,324**
(a) ADRs/GDRs	850	1,862	3,833	4,226	5,255
(b) Equities of banks held by non-residents	382	547	556	617	766
(c) Capital / remittable profits of foreign banks in India and other unclassified international liabilities	3,348	4,741	6,086	6,932	7,303
Total International Liabilities	**152,380**	**171,336**	**200,493**	**205,792**	**215,601**

Note : In view of the incomplete data coverage from all the branches, the data reported under the IBS are not strictly comparable with those capturing data from all the branches.

Table 5: International Liabilities of Banks Classified According to Type

Liability Type	**Share** (in per cent)				
	31-Mar-01	**31-Mar-02**	**31-Mar-03**	**30-Jun-03**	**30-Sep-03**
1. Deposits and Loans	68.3	70.4	72.8	72.9	73.5
(a) Foreign Currency Non-resident Bank [FCNR(B)] scheme	24.9	23.1	21.9	21.1	20.2
(b) Resident Foreign Currency (RFC) A/cs	0.6	0.7	0.6	0.6	0.6
(c) Exchange Earners Foreign Currency (EEFC) A/cs	2.3	2.8	2.4	2.2	2.1
(d) Other foreign currency deposits (including Inter-bank Foreign Currency deposits)	0.4	0.9	0.9	0.8	0.9
(e) Foreign Currency Borrowing (Inter-bank borrowing in India and from abroad, external commercial borrowings of banks)	0.8	3.2	9.2	9.0	10.7
(f) VOSTRO balances and balances in exchange houses and in term deposits	1.6	2.0	1.3	1.1	1.0
(g) Non-resident External Rupee(NRE) Accounts in term deposits	19.3	19.4	26.5	29.4	30.6
(h) Non-resident Non-Repatriable (NRNR) Rupee Deposits	17.0	15.9	7.6	6.3	5.1
(i) Non-resident Special Rupee (NRSR) Deposits	0.2	0.6	0.2	0.2	0.1
(j) Non-Resident Ordinary (NRO) Rupee Accounts	0.9	1.2	1.7	1.7	1.6
(k) QA 22 Accounts	0.2	0.3	0.0	0.0	0.0
(l) Embassy Rupee accounts	0.0	0.1	0.1	0.1	0.0
(m) Foreign Institutional Investors' (FII) Accounts	0.0	0.1	0.3	0.3	0.5
(n) ESCROW A/cs	0.0	0.1	0.1	0.1	0.1
2. Own Bonds(Including IMDs/ RIBs)	28.6	25.4	22.0	21.4	20.3
3. Other Liabilities	3.0	4.2	5.2	5.7	6.2
(a) ADRs/GDRs	0.6	1.1	1.9	2.1	2.4
(b) Equities of banks held by non-residents	0.3	0.3	0.3	0.3	0.4
(c) Capital / remittable profits of foreign banks in India and other unclassified international liabilities	2.2	2.8	3.0	3.4	3.4
Total International Liabilities	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Table 6: Selected Items from India's Balance of Payments

(Amount in US $ million)

Year	Net Invisibles / GDP (per cent)	Private Transfers (Net)	NRI Deposits (Net)
1980–81	2.8	2693	226
1981–82	2.2	2314	231
1982–83	1.8	2510	398
1983–84	1.6	2558	688
1984–85	1.7	2496	740
1985–86	1.3	2207	1444
1986–87	1.1	2327	1290
1987–88	0.8	2698	1419
1988–89	0.5	2652	2510
1989–90	0.2	2281	2403
1990–91	-0.1	2068	1536
1991–92	0.7	3783	290
1992–93	0.6	3852	2001
1993–94	1.1	5265	1205
1994–95	1.8	8093	172
1995–96	1.6	8506	1103
1996–97	2.7	12367	3350
1997–98	2.4	11830	1125
1998-99	2.2	10280	960
1999-00	2.9	12256	1540
2000-01	2.6	12798	2317
2001-02	3.1	12125	2754
2002-03	3.7	14807	2976

Table 7: Non-Resident Deposits – Outstanding

(in US $ million)

End-March	NRE	FCNR(A)	FCNR(B)	NR(NR)RD	FC(B&O)D	FC(O)N	TOTAL	IMD	RIB	TOTAL @
1991	3618	10103	-	-	265	-	13968	-	-	13968
1992	3025	9792	-	-	732	-	13549	-	-	13549
1993	2740	10617	-	621	1037	-	15015	-	-	15015
1994	3523	9300	1108	1754	533	12	16230	-	-	16230
1995	4556	7051	3063	2486	-	10	17166	-	-	17166
1996	3916	4255	5720	3542	-	13	17446	-	-	17466
1997	4983	2306	7496	5604	-	4	20393	-	-	20393
1998	5637	1	8467	6262	-	2	20369	-	550	20919
1999	6045	-	7835	6618	-	-	20498	423	550	21471
2000	6758	-	8172	6754	-	-	21684	423	550	22657
2001	7147	-	9076	6849	-	-	23072	423	550	24045
2002	8449	-	9673	7052	-	-	25174	423	550	26147
2003	14923	-	10199	3407	-	-	28529	423	550	29502
2004	21136	-	11192	1937	-	-	34265	423	-	34688

@ Including the amount raised through RIB and IMD schemes

Table 8: FCNR(B) and NRE deposits – Scheduled Commercial Banks
(Rs. Crore)

Fortnight ended	**FCNR(B) Deposits**		**NRE Deposits**	
	Outstanding	Variation	Outstanding	Variation
21.03.2003	49901		73181	
04.04.2003	49686	-215	75319	2138
18.04.2003	50831	1145	76221	902
02.05.2003	49362	-1469	77350	1129
16.05.2003	48761	-601	78553	1203
30.05.2003	48330	-431	80315	1762
13.06.2003	48101	-229	83062	2747
27.06.2003	48115	14	84636	1574
11.07.2003	46968	-1147	85895	1259
25.07.2003	46787	-181	87432	1537
08.08.2003	47111	324	87914	482
22.08.2003	46551	-560	88446	532
05.09.2003	46392	-159	88891	444
12 Fortnights	**Average**	**-292**	**Average**	**1309**
19.09.2003	46775	383	89857	966
03.10.2003	47432	657	90517	660
17.10.2003	48790	1358	91265	748
31.10.2003	48721	-69	92071	806
14.11.2003	49061	340	92475	404
28.11.2003	49675	614	92965	490
12.12.2003	49645	-31	93282	317
26.12.2003	50153	508	93777	496
09.01.2004	50488	335	94013	236
23.01.2004	50488	0	94559	546
06.02.2004	50392	-96	95083	524
20.02.2004	50748	356	95498	415
05.03.2004	50635	-113	95714	216
19.03.2004	50616	-19	95588	-126
14 Fortnights	**Average**	**302**	**Average**	**478**

Table 9: Concentration of Non-Resident Deposits across Major Banks

Concentration	Non-Resident Deposits			FCNR(B) Deposits			NRE Deposits		
	Mar-04	Mar-03	Mar-02	Mar-04	Mar-03	Mar-02	Mar-04	Mar-03	Mar-02
Share of First 3 banks (C3)	39.8	40.2	40.4	45.6	42.7	43.3	36.7	38.6	39.3
Share of First 6 banks (C6)	53.9	54.5	55.5	61.4	60.0	59.6	50.2	51.4	55.3
Share of First 10 banks (C10)	67.8	68.4	67.6	72.3	72.0	70.6	65.9	67.2	67.1
Share of First 20 banks (C20)	86.2	86.3	85.2	88.3	88.8	86.7	85.4	85.5	85.2
Share of First 40 banks (C40)	96.6	96.4	95.5	96.3	96.3	94.9	96.8	96.5	95.9
All Scheduled Commercial Banks (Excluding RRBs) - 96	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: Banks are ordered on the basis of their outstanding non-resident deposits in March ’04.

Table 10: International Assets of Banks Classified According to Type

Asset Type	Share in Total International Assets (per cent)				
	Mar-01	**Mar-02**	**Mar-03**	**Jun-03**	**Sep-03**
1 Loans and Deposits	**96.6**	**94.5**	**93.4**	**94.1**	**93.6**
(a) Loans to Non-residents (includes Rupee loans and Foreign Currency Loans out of non-resident deposits)	5.3	5.1	4.4	4.3	4.1
(b) FC Loans to Residents (incl. loans out of FCNR(B) deposits, PCFCs, FC lending to & FC Deposits with banks in India, etc.)	16.2	19.3	35.2	35.7	36.4
(c) Outstanding Export Bills drawn on non-residents by residents	13.4	15.0	18.4	18.4	18.4
(d) NOSTRO balances (incl.balances in Term Deposits with non-resident banks and FCNR funds held abroad)	61.6	54.9	35.1	35.4	34.4
(e) Foreign Currency /TTs, etc., in hand	0.2	0.2	0.2	0.3	0.4
2 Holdings of Debt Securities	**0.7**	**0.9**	**1.0**	**0.9**	**0.9**
(a) Investment in Foreign Govt. Securities (incl. Tbills)	0.3	0.4	0.4	0.4	0.4
(b) Investment in Other Debt Securities	0.4	0.6	0.6	0.6	0.5
3 Other Assets	**2.7**	**4.6**	**5.6**	**5.0**	**5.5**
(a) Investments in Equities Abroad	0.4	0.5	0.4	0.4	0.4
(b) Capital supplied to and receivable profits from foreign branches/ subsidaries of Indian banks and other unclassified international assets	2.2	4.1	5.2	4.6	5.1
Total International Assets	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Amount (Rs.crore)	83233	101375	104574	106848	107809

Table 11: Utilisation of FCNR(B) Deposits for 15 Major Banks

Reporting Friday	FCNR(B) Deposits (US $ million)	Share in FCNR(B) Deposits (per cent)		
		Foreign Currency Loans	Amount Swapped	Overseas Investment and others
24-Mar-00	6347	40.4	28.2	31.4
30-Jun-00	6445	44.8	4.9	50.3
22-Sep-00	6561	30.5	5.6	64.0
29-Dec-00	6266	36.3	5.2	58.5
23-Mar-01	7228	42.8	3.5	53.7
29-Jun-01	7305	45.8	2.8	51.4
21-Sep-01	7560	48.4	3.7	47.9
28-Dec-01	7737	46.6	2.1	51.3
22-Mar-02	7754	51.7	5.6	42.7
28-Jun-02	8034	48.0	4.1	47.9
20-Sep-02	8214	52.6	7.3	40.1
27-Dec-02	8288	59.9	8.5	31.6
21-Mar-03	7624	67.3	6.2	26.6
27-Jun-03	7542	67.4	5.0	27.6
19-Sep-03	8094	63.2	6.1	30.7
26-Dec-03	8802	60.8	9.9	29.3
19-Mar-04	9015	60.3	7.5	32.2

Table 12: Export Credit in Foreign Currency (Rs.crore)

Quarter	**Pre-shipment Credit in Foreign Currency** (PCFC)	**Export Bill Rediscounting** (EBR)	**Export Credit in Foreign Currency** (PCFC + EBR)	**Line of Credit** (LOC) for foreign currency export credit	**Foreign Currency Export Credit other than Line of credit** (PCFC + EBR - LOC)	**FCNR(B) Deposits**
	(1)	(2)	(3)	(4)	(5)	(6)
Jun.97	775	650	1425	26	1399	28565
Sep.97	1692	1374	3066	116	2950	29987
Dec.97	**1135**	**1130**	**2265**	**6**	**2259**	**30603**
Mar.98	570	796	1366	64	1302	33445
Jun.98	458	662	1120	64	1056	34498
Sep.98	268	310	578	31	547	32753
Dec.98	**225**	**255**	**480**	**207**	**273**	**30710**
Mar.99	131	233	364	197	167	33222
Jun.99	119	136	255	83	172	33327
Sep.99	112	230	342	97	245	34554
Dec.99	**141**	**284**	**425**	**23**	**402**	**34967**
Mar.00	151	241	392	219	173	35632
Jun.00	163	369	532	71	461	37223
Sep.00	233	285	518	70	448	39460
Dec.00	**161**	**251**	**412**	**55**	**357**	**41046**
Mar.01	172	184	356	153	203	42357
Jun.01	155	235	390	112	278	43214
Sep.01	281	332	613	126	487	45226
Dec.01	**413**	**481**	**894**	**141**	**753**	**46674**
Mar.02	642	701	1343	165	1178	48537
Jun.02	992	1062	2054	557	1497	50176
Sep.02	1521	1505	3026	1103	1923	50689
Dec.02	**3045**	**2323**	**5368**	**2118**	**3250**	**50636**
Mar.03	6089	3147	9236	3394	5842	49901
Jun.03	7770	3988	11758	3872	7886	48115
Sep.03	8965	5084	14049	3988	10061	46775
Dec.03	**11837**	**6057**	**17894**	**4999**	**12895**	**50153**
Mar.04	14085	6709	20794	5847	14947	50616

Contd.

Table 12: Export Credit in Foreign Currency

(Amount in Rs.crore)

Quarter	Major Foreign Currency A/cs of Banks [FCNR(B) + RFC + EEFC + Escrow]	Share of Line of credit in export credit in foreign currency	Share of foreign currency export credit from other than Line of Credit in major foreign currency a/cs of Banks	**Increase during the quarter**	
				FCNR(B) Deposits	Foreign Currency Export Credit from other than Line of Credit
	(7)	(8)	(9)	(10)	(11)
Jun.97	34076	1.8	4.1		
Sep.97	33233	3.8	8.9	1422	1641
Dec.97	**34137**	**0.3**	**6.6**	**616**	**-801**
Mar.98	37781	4.7	3.4	2842	-899
Jun.98	39682	5.7	2.7	1053	-246
Sep.98	39230	5.4	1.4	-1745	-542
Dec.98	**37418**	**43.1**	**0.7**	**-2043**	**-98**
Mar.99	40787	54.1	0.4	2512	-116
Jun.99	40589	32.5	0.4	105	-109
Sep.99	42518	28.4	0.6	1227	87
Dec.99	**43462**	**5.4**	**0.9**	**413**	**83**
Mar.00	44129	55.9	0.4	665	-33
Jun.00	45391	13.3	1.0	1591	140
Sep.00	45492	13.5	1.0	2237	-14
Dec.00	**46611**	**13.3**	**0.8**	**1586**	**-106**
Mar.01	47962	43.0	0.4	1311	-56
Jun.01	48507	28.7	0.6	857	34
Sep.01	50781	20.6	1.0	2012	223
Dec.01	**52575**	**15.8**	**1.4**	**1448**	**281**
Mar.02	54721	12.3	2.2	1863	449
Jun.02	57222	27.1	2.6	1639	711
Sep.02	57631	36.5	3.3	513	972
Dec.02	**57942**	**39.5**	**5.6**	**-53**	**2342**
Mar.03	56845	36.7	10.3	-735	3868
Jun.03	54205	32.9	14.5	-1786	2522
Sep.03	52671	28.4	19.1	-1340	2291
Dec.03	**56415**	**27.9**	**22.9**	**3378**	**3845**
Mar.04	57504	28.1	26.0	463	2900

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Table 13: Balances in NRE Accounts for Select Banks

(Amount in Rs.crore)

Quarter	NRE Savings	NRE Total	Ratio of Saving to Total (per cent)
	Outstanding Balances		
March 2003	3421	10690	**32.0**
June 2003	3594	13292	**27.0**
September 2003	3854	13899	**27.6**
December 2003	4416	14496	**30.5**
	Variation during the Quarter		
Apr-Jun-03	173	2602	**6.6**
Jul-Sep-03	240	608	**39.5**
Oct-Dec-03	582	597	**97.5**

Annex I

Major Items of External Liabilities of Scheduled Commercial Banks

Following are the major items of external liabilities of scheduled commercial banks in India:

(i) Non Resident Deposits: NRI deposits form an important source of external funds. There are basically two definitions of the term Non Resident Indian (NRI) - one given by the income tax act (used for the purpose of taxation) and the other given by the Foreign Exchange Management Act (FEMA). The definition under the Income Tax Act mainly depends upon the duration of stay in India whereas, under FEMA, a non-resident Indian is a person of Indian nationality or origin, who resides abroad for employment, or for carrying on some business, or for any other purpose in circumstances indicating an indefinite stay abroad. Government officials and officials of public sector undertakings, deputed abroad on assignments or posted abroad (including diplomatic missions) are considered NRIs.

Overseas companies, trusts, partnership firms, societies and other corporate bodies, owned directly or indirectly at least to the extent of 60% by NRIs are termed as Overseas Corporate Bodies (OCBs). These overseas firms need to submit a certificate from an overseas auditor or chartered accountant regarding the ownership. In addition to NRIs, OCBs were also allowed to invest in NRI deposit schemes earlier. However, after a review of the investment activities of OCBs, they were derecognised as a distinct eligible class of investors in India with effect from September 16, 2003. They will now be treated on par with any other foreign investors. Consistent with the objectives of Offshore Banking Units (OBUs) located in Special Economic Zones (SEZs), their exposure to the Domestic Tariff Area (DTA) has been restricted to a limit of 25 per cent of their previous working day's total liabilities only, under the scheme of External Commercial Borrowings (ECBs), subject to FEMA regulations. Further, a bank cannot borrow from its OBU. These guidelines were put into effect on October 10, 2003.

Various deposit schemes have been designed from time to time to suit the requirements of NRIs which can be put into two broad categories: (i) deposits denominated in Indian Rupees and (ii) foreign currency denominated deposits. While the former category does not provide any exchange guarantee, the depositors in the latter category enjoy such a guarantee. The increase in such deposits mainly shows an increase in the non-residents' propensity to save in the home country due to several reasons like safety, ease of liquidity, interest rate differential, repatriability, etc. Annexure II presents the non-resident deposit schemes available at present.

ii) Loans: Banks can avail of loans / overdrafts from their head offices, overseas branches and correspondents solely for replenishing their rupee resources subject to certain conditions. ADs can also borrow under lines of credit from a bank outside India for the purpose of

granting pre-shipment or post-shipment credit in foreign currency to their exporter constituents. Banks are also permitted to use foreign currency funds generated through buy / sell swaps in the domestic forex markets for granting pre-shipment credit in foreign currency (PCFC) and export bill rediscounting (EBR) schemes to exporters. Banks and financial institutions which had participated in the textile or steel sector restructuring package as approved by the Government are also permitted to obtain external commercial borrowings to the extent of their investment in the package and assessment by RBI based on prudential norms. Foreign Banks are allowed to raise subordinated debt in foreign currency in the form of external commercial borrowings from head office. All categories of overseas foreign currency borrowings including existing ECBs and overdrafts on Nostro accounts not adjusted within five days should be up to 25 per cent of their unimpaired Tier-I capital or US $ 10 million or its equivalent, whichever is higher and borrowings above this limit need RBI's prior approval. However, overseas borrowings by ADs for financing export credit and subordinated debt placed by head offices of foreign banks with their branches in India are outside this limit.

(iii) Own Bonds: In the late 1990s, the foreign exchange reserves had gone down considerably owing to the rising oil prices and slowing foreign capital inflows. Oil prices had hit 10-year highs and were expected to stay that way. This caused a jump by 91.65 per cent in the Indian import bill. In such a scenario, it was necessary to boost foreign exchange reserves and support the Rupee which had been slipping steadily. With these twin objectives in mind, the Government (through the State Bank of India) launched two schemes, namely, the “Resurgent India Bonds” (August 1998) and the “India Millennium Deposits” (October 1999).

iv) Other External Liabilities: In addition to the above non-resident deposits, following are the other major components of external liabilities of banks;

a) EEFC: Exchange Earner's Foreign Currency Account;

b) RFC: Resident Foreign Currency Account;

c) ESCROW Accounts by Indian Exporters;

d) Lines of Foreign Credit for Pre-Shipment Credit in Foreign Currency (PCFC) and External Bill Rediscounting (EBR); and

e) IBFCD: Inter-Bank Foreign Currency Deposits.

Of these liabilities, the RFC accounts need special mention in the context of the risk of dollarisation of the economy. The RFC accounts are of two types – the original RFC scheme and the RFC (Domestic) [RFC(D)] scheme. The original RFC accounts are for the Indians who are returning to the country after long stay abroad who maintain such accounts out of the proceeds of conversion of assets abroad, gift or inheritance, receipt of pension from abroad, etc. The RFC(D) scheme introduced in November 2002. Resident citizens who normally stay in the country and

acquire foreign exchange, while on visit to any place outside India or by gift or honorarium or has unspent amount of forex acquired by him for travel abroad can open RFC(D) accounts. The RFC(D) accounts are non-interest bearing current accounts from which debits can be made for authorised current/capital account transactions.

v) Off-balance sheet exposure of banks in foreign currency: In addition to the above external liabilities, there are various off balance sheet exposure of banks in terms of foreign currencies. Under the extant FEMA regulations, guarantees issued by Authorised Dealers (ADs) may be grouped under the following categories as under:

a) Guarantees given by ADs without RBI approval: An authorised dealer may give a guarantee in favour of non-resident in respect of any obligation of a resident to the non-resident (i) as an exporter, on account of exports from India, (ii) as an importer, in respect of imports on deferred payment terms in accordance with the approval granted by the Reserve Bank for import of such terms. Effective September 27, 2002, ADs have been delegated powers to approve short term credit up to US $ 20 million per import transaction. RBI has been giving approval for issuance of guarantees in respect of short-term credit up to US $ 20 million when approached by AD. ADs can give guarantee in respect of debt incurred by a non-resident to an Indian resident in respect of trade transaction covered by counter guarantee from an international bank or to cover guarantee issued by branch / correspondent outside India on behalf of Indian exporter. ADs also extend guarantee in respect of missing or defective documents, or authenticity of signatures on behalf of its customers, branch or correspondent outside India or in favour of travellers cheque issuing organisation outside India stocked for sale by AD or his constituents.

b) Cases where ADs can give guarantee with specific approval of RBI: At present, ADs are allowed to issue guarantees, with prior approval of RBI, on behalf of their customers for the certain broad categories of transactions. Permissions are given on the basis of the underlying transactions for travel agents/tour operators/domestic airlines/shipping companies, and execution of projects/contracts abroad. In addition, ADs approach RBI to give guarantees in favour of overseas branches / correspondents where the latter extend facilities abroad to the NRI depositors / third parties and such guarantees are backed by security of NRI deposits.

c) Guarantees for Short-term Credit: Prior to September 27, 2002, all short-term credit proposals were approved by Central Office of Exchange Control Department (ECD). Effective September 27, 2002, ADs were permitted to approve suppliers' credit (above six months to less than 3 years) and buyers' credit (less than three years) up to USD 20 million per import transaction. Short-term credits for imports above US $ 20 million, were being approved by RBI and where such cases involve bank guarantee specific approval

for guarantee was also given by RBI. For loans up to US $ 20 million involving bank guarantees banks approach RBI for approval.

d) Guarantees for External Commercial Borrowings: Under Auto route wherever guarantees were involved approval was being given by the Regional offices of RBI till October 13, 2003 when a circular was issued to withhold such approvals. Under RBI route, approvals have been kept in abeyance since the High-level Committee on Capital Markets (HLCM) meeting held in July 2003. Till then, wherever guarantees were involved they were being approved as part of ECB approval. Since the issue of the new guidelines in November 2003 specifically prohibiting guarantees the question of approving such guarantees has not arisen.

Annex II

Present Non-Resident Deposit Schemes

Following are the Non-resident deposit schemes presently available in India:

a) **NRE Rupee account:** The Non-Resident (External) Rupee Account NR(E)RA scheme also known as the NRE scheme was introduced in 1970. Any NRI can open an NRE account with funds remitted to India through a bank abroad. This is a repatriable account and transfer from another NRE account or FCNR(B) account is also permitted. A NRE rupee account may be opened as current, savings or term deposit. Local payments can be freely made from NRE accounts. Since this account is maintained in Rupees, the depositor is exposed to the exchange risk. NRIs / PIOs have the option to credit the current income to their Non-Resident (External) Rupee accounts, provided the authorised dealer is satisfied that the credit represents current income of the non-resident account holders and income-tax thereon has been deducted / provided for.

b) **FCNR(B) account:** The Foreign Currency Non-Resident (FCNR(B)) scheme was introduced in 1994 to replace the prevailing FCNR(A) scheme which was introduced in 1975, where the foreign exchange risk was borne by RBI and subsequently by the Govt. of India. The FCNR(A) scheme was withdrawn from August 1994 in view of its implications for the central bank's balance sheet and quasi-fiscal costs to the Government. FCNR(B) accounts can be opened as term deposits in any of the designated currencies, which are, US Dollar, Pound Sterling, Japanese Yen and Euro. There is no exchange risk to the depositor since the account is opened in foreign currencies. The interest received is fully exempt from tax. This is also a repatriable account and can be used to make local payments as well as remittances abroad. Interest rates for different maturities and different currencies are fixed by the bank based on the prevailing rate in the international market. Loans and overdrafts to NRIs in India and abroad can be granted against security of NRE/ FCNR(B) deposits without any limits. Repayment of such loans or overdrafts can be made from the proceeds of forex remittances or NRE/ FCNR(B) deposits.

c) **The Non-Resident Ordinary (NRO) Rupee account:** At a point of time when a resident becomes an NRI, his existing rupee account(s) is designated as Non-resident Rupee (NRO) account(s). Such accounts are maintained in the nature of current, saving, recurring or term deposits. NRIs can also open NRO accounts for collecting their funds from local bonafide transactions or NRNR account proceeds on redemption if the NRNR account holder so desires. Interest earned on NRO account is not exempt from tax. These accounts can be opened in the name of non-resident individuals / entities who have left India for a foreign country (other than Nepal and Bhutan) for taking up employment or business or vocation for an extended period of time or permanently. Funds in this account are not repatriable and

cannot be remitted abroad or transferred to NRE accounts without prior permission of the RBI. However, NRIs/PIO/Foreign Nationals (including retired employees or non-resident widows of Indian citizens) can remit, through the AD, up to US dollar one million per calendar year, out of the balances held by them in NRO account / sale proceeds of assets, for all bonafide purposes.

d) **Non-Resident Non Repatriable (NRNR) Rupee Deposit account:** This scheme was introduced in June 1992. These accounts can be opened in Rupees out of funds remitted from abroad or transferred from non-resident external accounts. Principal amount of this deposit cannot be repatriated. However, interest is repatriable as a result of current account convertibility. Rupee loans can be granted to deposit holders (for purposes other than investments). This scheme has been discontinued w.e.f April 01, 2002 and the maturity proceeds can be transferred to NRE/ NRO accounts.

Annex III

Interest rate on Non-Resident Deposits – A Brief History

While prior to August 1985, interest rate on both NR(E)RA and FCNR(A), the schemes in vogue at that time, was two percentage points higher than that prescribed for domestic term deposits. Interest rates on FCNR(B) in the subsequent period were revised taking into account trends in international interest rates. The differential in the case of (maximum rate on) the FCNR(A) deposits *vis-à-vis* the US deposit rates which was over 3 percentage points in 1985 and 1986, was reduced to a little over one percentage point in 1989; the differential, however, widened again in the early 1990s reflecting efforts to attract these deposits in view of the external payments crisis. The differential of two percentage points in the case of NR(E)RA however continued and widened to three percentage points, effective April 1987, as the maximum domestic term deposit rate was reduced to 10 per cent while the maximum rate on NR(E)RA remained unchanged at 13 per cent. By 1991, the interest differential *vis-à-vis* domestic deposits, however, narrowed down to one percentage point reflecting tight monetary policy to counter the external payments crisis even though the maximum interest rate on NR(E)RA deposits was increased to 14 per cent.

Prior to 1991, a liberal policy was followed with regard to NRI deposits particularly those denominated in foreign currency. A favourable interest rate differential over the prevailing international interest rates was maintained for various currencies to attract non-resident deposits and a foreign exchange guarantee was extended by the RBI to various banks. As a result of this policy by end-March 1991, the foreign currency denominated deposits were over 70 per cent of total NRI deposits. These deposits were easily repatriable and hence were vulnerable to adverse external sector developments.

A series of developments led to the external payments crisis in 1990-91, when large volumes of NRI deposits were liquidated. To overcome this situation, a number of policy measures were announced. Firstly, the exchange guarantee scheme was withdrawn by phasing out the FCNR(A) scheme, which was finally wound up in August 1994. The FCNR(B) scheme was introduced as an alternative to the FCNR(A) scheme. Interest rates on FCNR(B) deposit schemes were aligned with the prevailing international rates of relevant currencies to prevent arbitrage. Also, interest rates on Rupee denominated NRI deposits were aligned with domestic interest rates. The rupee denominated Non-Resident Non-Repatriable (NRNR) Scheme was introduced which allowed repatriability of interest income only. In the case of NRNR scheme, banks were allowed the flexibility to fix the interest rates from the inception of the scheme (June 1992) i.e., even before the freedom was granted to domestic deposits. On account of exemption

from CRR and SLR, these deposits attracted higher interest rates and reflected the policy efforts to change the composition of the NRI deposits towards NRNR. As mentioned earlier, this scheme has been discontinued in 2002.

In the case of FCNR(B) deposits, banks were initially permitted effective from April 16, 1997, to determine interest rates subject to ceilings prescribed by the Reserve Bank. Subsequently banks were provided more freedom by linking these rates to LIBOR. Effective from October 21, 1997, banks were allowed to offer rates at not more than LIBOR of the relevant currency and maturity. To discourage short term speculative flows, the guidelines were modified effective April 29, 1998, wherein banks were allowed to offer these deposits at 50 basis points above LIBOR for maturity of one year and above and 25 basis points below LIBOR for maturity below 1 year. Also, the minimum maturity of foreign currency deposits was raised, from six months to one year effective from October 1999. The ceiling on interest rates on FCNR(B) deposits were revised to LIBOR/ SWAP rates for the corresponding maturities minus 25 basis points in April 2002.

As part of the financial sector reforms operational freedom was provided to banks in early 1990s to determine interest rates on various deposit schemes. As a first step towards more flexibility, the detailed maturity-wise prescriptions were rationalised in the case of NR(E)R deposits, on the lines of flexibility provided in the case of domestic deposits, by allowing banks to determine their own term structure, subject to a single prescription of ‘not more than 13 per cent’ (effective October 1992) and ‘not more than 12 per cent’ (effective April 18, 1993). However, the differential vis-à-vis domestic deposits remained broadly unchanged at one percentage point. In order to moderate the impact of capital inflows on money supply, the maximum interest rate was reduced to 10 per cent effective from May 1994. As a further disincentive, it was reduced to 8 per cent with effect from October 1994, i.e., two percentage points below the domestic rate. In 1995, the non-resident deposit flows became vital following the drying up of capital flows and the ceiling rate was increased to 12 per cent in October 1995. A disparity existed between these interest rates and the rates of domestic term deposits, hence as a remedial measure, interest rates on term deposits with maturity of two years and above were freed with effect from April 4, 1996 and that of term deposits of one year and above were freed with effect from April 16, 1997. The banks were given full freedom of interest rate determination across all maturities effective from September 13, 1997.

In April 2003, the maturity period for NRE term deposits was made one to three years on the lines of FCNR(B) deposits. However, banks were allowed to accept NRE deposits above three years in case they had ALM mismatch. In response to changing conditions in the financial markets, interest rates on NRE term deposits were linked to international rates and a ceiling of

250 basis points above the corresponding US dollar LIBOR/Swap rates was placed on the interest rates on fresh non-resident external (NRE) deposits effective July 17, 2003 which was reduced to 100 basis points above the LIBOR/Swap rates on September 15, 2003 and further to 25 basis points above the LIBOR/Swap rates on October 18, 2003.

Annex IV

Reserve Requirements of External Deposits – Country Practices

Reserve requirement on external deposits with the domestic banking system has direct impact on capital movements by influencing the cost of such funds/return on such deposits. Differential reserve requirements can influence the quantum and nature of external flows (short-term/long-term). A number of policy measures on monetary policy operating procedures are used in emerging market economies in this regard. Nonetheless, differential ratios are applied to serve particular objectives. For instance, in many countries, reserve requirements were imposed only on local currency deposits but foreign currency deposits were free from reserve requirements (e.g. the Philippines, Singapore, Columbia, Croatia, Slovenia, Saudi Arabia, Macedonia, Kenya and Syria). In many other countries, foreign currency deposits attract lower reserve requirements than domestic currency deposits (e.g. China, Egypt and Poland). On the contrary, higher reserve requirements were sometimes imposed on foreign currency deposits compared with domestic currency deposits in Peru and Thailand on prudential and liquidity grounds. The reserve requirements in Korea for foreign currency deposits of residents are much higher than the foreign currency deposits of non-residents. In Israel, the reserve requirements on foreign currency deposits are uniform for resident/non-resident accounts while interest is paid only on the reserve balances pertaining to the non-resident foreign currency accounts.