IV CREDIT DELIVERY AND FINANCIAL INCLUSION

Ensuring adequate flow of credit to agriculture, micro, small and medium enterprises and the export sector has been a policy thrust for achieving the objective of sustainable and inclusive economic growth. Accordingly, strengthening credit delivery mechanisms for these sectors is a priority concern of the Reserve Bank. In the wake of the global crisis, a number of measures were taken to facilitate credit delivery and thereby contain the adverse impact on small and medium enterprises as well as exports. At the aggregate level, financial inclusion provides an avenue for bringing the savings of the poor into the safer formal financial intermediation system, besides offering credit and products that could enhance their income and also help in meeting non-economic needs. During 2009-10, which was the Platinum Jubilee year of the Reserve Bank, outreach programmes were organised to raise the level of penetration of the financial system in remote unbanked areas. By promoting growth with equity, financial inclusion initiatives have consistently striven to enhance the contribution of the financial system to meet the diverse needs of the large segment of the population at the lower strata of the society so as to bring them from the margin to the mainstream.

IV.1 The primary objective of credit delivery is enabling access to financial products and services from mainstream financial institutions for productive and needy sectors of the economy. This requires creating a conducive environment for banks to provide adequate and timely finance at reasonable rates. Such an environment could be created either through incentives for banks or through specific regulations that are designed by intention to attain the objective of economic development. India faces the daunting challenge of stepping up the growth potential by bringing the financially excluded within the ambit of the formal financial system, providing financial literacy and strengthening credit delivery mechanisms which, in turn, could improve the distribution of the benefits of high growth. Various initiatives taken in this area include encouraging diverse forms of provision of lending such as self-help groups (SHGs), micro finance institutions (MFIs) and enhancing the scope of the business correspondent (BC) model; improving credit delivery procedures in respect of micro and small enterprises (MSEs); and encouraging adoption of information and communication technology (ICT) solutions to bolster both credit delivery and financial inclusion.

IV.2 Since financial inclusion entails bringing new customers with no credit history into the fold of mainstream banking, banks would have to cultivate innovative risk management approaches. The proposed unique identity numbers (*Aadhaar* numbers) are expected to help in bringing the financially excluded within the formal banking sector fold by enhancing information about the customers.

PRIORITY SECTOR LENDING

IV.3 Although different categories of banks had achieved the overall target for priority sector lending as on the last reporting Friday of March 2010, three out of 27 public sector banks, two out of 22 private sector banks and four out of 28 foreign banks had not achieved the priority sector lending targets of 40 per cent and 32 per cent, respectively (Table IV.1).

IV.4 The domestic SCBs, which fail to achieve the priority sector/agriculture lending targets/sub-targets, are mandated to deposit into the RIDF such

Table IV.1: Priority Sector Advances

(Amount in Rupees crore)

As on the Last Reporting Friday	Public Sector Banks	Private Sector Banks	Foreign Banks
1	2	3	4
March 2009	7,20,083	1,90,207	55,483
	(42.5)	(46.8)	(34.2)
March 2010	8,64,564	2,15,552	60,290
	(41.7)	(46.0)	(35.1)

Note: 1. Figures in brackets are percentages to ANBC or credit equivalent of OBE, whichever are higher, in the respective groups.

2. The target for aggregate advances to the priority sector is 40 per cent of the ANBC or credit equivalent of OBE, whichever is higher, for domestic banks and 32 per cent for foreign banks.

amounts as may be assigned by the Reserve Bank. The Fund has so far completed fifteen years of operation. The Union Budget for 2010-11 had announced that RIDF XVI (corpus of ₹16,000 crore), MSME (Refinance) Fund (corpus of ₹4,000 crore) and Rural Housing Fund (corpus of ₹2,000 crore) would be set with NABARD, SIDBI and NHB, respectively, during the year.

Flow of Credit to Agriculture Sector

IV.5 The Government had set the agriculture credit flow target for 2009-10 at ₹3,25,000 crore. Banks, including co-operative banks and RRBs, met 112.9 per cent of the target by March 2010. The disbursement by public sector banks to agriculture under the Special Agricultural Credit Plan (SACP) was ₹90,023 crore between April-September 2009, against the target of ₹2,01,710 crore for the year, while disbursement by private sector banks was ₹30,092 crore, against the target of ₹62,352 crore. The recovery rate of direct agriculture advances improved marginally during the year ended June 2009 (Table IV.2).

IV.6 During 2009-10 public sector banks issued 53,13,085 Kisan Credit Cards (KCCs) for an amount of ₹39,940 crore. Since inception of the scheme, public sector banks had issued 42.4 million KCCs for an amount of ₹2,33,190 crore, by March 2010.

Table IV.2: Recovery of Direct Agriculture Advances

(Amount in Rupees crore)

Year ended June	Demand	Recovery	Overdues	Per cent of Recovery to Demand
1	2	3	4	5
2008	95,100	71,739	23,361	75.4
2009	1,19,084	90,660	28,424	76.1

IV.7 During 2009-10, the government provided: (i) Interest subvention of 2 per cent per annum to public sector banks in respect of short-term production related credit up to ₹3 lakh provided to farmers. This subvention was made available condition/precedent that short-term credit at ground level was extended at 7 per cent per annum; and (ii) Additional interest subvention of 1 per cent per annum to public sector banks in respect of those farmers who repaid their short-term production credit within one year of disbursement of such loans, so that the effective rate of interest for such farmers was 6 per cent per annum. In the Union Budget for 2010-11, the additional subvention for farmers who repaid loans promptly was enhanced to 2 per cent per annum, thereby, reducing the effective rate of interest payable to 5 per cent per annum. Apart from the interest subvention scheme of the Union Government, several state governments have also extended additional interest subvention on agricultural loans in their respective states.

IV.8 Since inception of the scheme, the government has released ₹40,000 crore to the Reserve Bank for reimbursement under the Agricultural Debt Waiver and Debt Relief Scheme, 2008. Of this, ₹28,000 crore was passed on to NABARD for reimbursement to RRBs and co-operative banks and the remaining amount was utilised for reimbursing SCBs, local area banks and urban co-operative banks (UCBs).

IV.9 The Raghuram Rajan Committee on Financial Sector Reforms had, *inter alia*, recommended introduction of "priority sector lending certificates (PSLCs)" to be purchased by the commercial banks which failed to achieve the priority sector lending target/sub-targets. A Working

Group was set up (Chairman: Shri V.K. Sharma) to examine the issues involved in the introduction of PSLCs and make suitable recommendations. The terms of reference of the Group include, among others, to make suitable recommendations on introduction of PSLCs and their trading in the open market and to examine pros and cons of inclusion of bank lending to MFIs under priority sector lending. The Working Group is expected to submit its Report shortly.

Flow of Credit to Micro, Small and Medium Enterprises (MSMEs)

IV.10 A High Level Task Force (Chairman: Shri T.K.A. Nair) was constituted to consider various issues raised by micro, small and medium enterprises (MSMEs). The Task Force recommended several measures having a bearing on the functioning of MSMEs, *viz.*, credit, marketing, labour, exit policy, infrastructure/ technology/skill development and taxation. All SCBs were advised: (i) to achieve a 20 per cent year-on-year growth in credit to MSEs to ensure enhanced credit flow; (ii) to achieve a 10 per cent annual growth in the number of micro enterprise accounts; (iii) the allocation of 60 per cent of the advances to the micro enterprises is to be achieved in stages, *viz.*, 50 per cent in 2010-11, 55 per cent in 2011-12 and 60 per cent in 2012-13; and (iv) to open more MSE-focussed branch offices at different MSE clusters which could also act as counselling centres for MSEs. Each lead bank of a district could adopt at least one MSE cluster.

IV.11 Considering the criticality of MSEs for employment generation necessary for inclusive and equitable growth and larger economic empowerment, the Working Group to review the credit guarantee scheme of the Credit Guarantee Fund Trust for Micro and Small Enterprises (Chairman: Shri V. K. Sharma) recommended the mandatory doubling of the limit for collateral-free loans to MSEs to ₹10 lakh. This was advised to banks, while also urging them to encourage their branch-level functionaries to avail of credit guarantee scheme cover, including making performance in this regard a criterion in the evaluation of their field staff.

IV.12 The Working Group on Rehabilitation of Sick SMEs (Chairman: Dr. K.C. Chakrabarty) made several recommendations pertaining to the rehabilitation of sick SMEs, credit flow to the SME sector and other developmental issues. While the recommendations relating to the Government of India, state governments and SIDBI have been forwarded to them for necessary action, guidelines have been issued to banks advising them to formulate a Board-approved dedicated loan policy on MSEs, and an appropriate rehabilitation/ restructuring and non-discretionary “one-time settlement scheme” (OTS) for the distressed units taking into account the recommendations of the Committee.

IV.13 All SCBs were advised to furnish an Action Taken Report regarding the implementation of the OTS policy, restructuring/ rehabilitation policy and loan policy as advised to them in May 2009. They were also advised to give wide publicity to the OTS scheme for recovery of loans in the MSE sector on their websites. Till June 2010, 39 SCBs (including public and private sector banks) had displayed the publicity material relating to OTS policy on their respective websites. Reflecting the revival in demand conditions, in 2009-10, the total credit to MSEs from the SCBs increased at more than double the rate of the previous year (Table IV.3).

Table IV.3: Credit to MSE Sector by SCBs

As on the last Friday of March	Outstanding Credit to the MSE Sector		MSE/ SSI Credit as per cent of ANBC
	Number of Accounts (in million)	Amount (₹crore)	
1	2	3	4
2009	4.85	2,56,128 (19.9)	11.3
2010*	8.73	3,64,001 (42.1)	13.4

* : Data are provisional.

Note: Figures in parentheses indicate per cent growth in credit over previous year.

IV.14 Advances to minority communities were ₹1,06,812 crore as on September 30, 2009, forming 11.4 per cent of the priority sector advances as against ₹96,802 crore (10.6 per cent of the priority sector advances) as on March 31, 2009.

FINANCIAL INCLUSION

IV.15 Financial inclusion is the process of ensuring access to appropriate financial products and services needed by vulnerable groups such as weaker sections and low income groups at an affordable cost in a fair and transparent manner from mainstream institutional players.

IV.16 The High Level Committee to review the Lead Bank Scheme (Chairperson: Smt. Usha Thorat) submitted its report in August 2009. The Committee, *inter-alia*, had envisaged a greater role for the state governments to support the initiatives of banks for greater financial inclusion and flow of credit to the priority sectors. In this regard, it recommended that, among others, the state governments support the financial literacy and credit counselling initiatives, adopt IT solutions for disbursal of payments under the NREGA and social security payments such as National Old Age Pension Scheme, bring in participation of private sector banks in various government sponsored schemes and strengthen various fora under the scheme at the state/district levels. Comprehensive guidelines on the implementation of the recommendations were issued to State Level Bankers Committee (SLBC) convenor banks and lead banks. The lead banks were advised to constitute a sub-committee of District Consultative Committees to draw a roadmap by March 2010 to provide banking services through a banking outlet in every village having a population of over 2,000. The banking services could be provided through any of the various forms of ICT-based models (such as BCs) and not necessarily through a brick and mortar branch.

IV.17 The Annual Policy Statement for 2010-11 noted the need for better understanding of the functioning of grassroot level rural co-operatives as they have potential to play an important role in financial inclusion. These include primary agricultural credit societies (PACS), large *adivasi* multi-purpose co-operative societies (LAMPS), farmers' service societies (FSS), as also thrift and credit co-operatives set up under the parallel Self-Reliant Co-operative Societies Acts in some states. For the purpose, it has been decided that a detailed study of the working of select (about 200) well-functioning rural co-operatives across the country would be carried out by the Reserve Bank in association with NABARD and state governments. It is intended to gain insights into the operations of these bodies with reference to their membership profile, management structure, range of services offered, savings mobilised from members/non-members, percentage of non-borrower members, credit extended to tenant farmers, oral lessees and agricultural labourers, women, in order to gauge their strength and potential as effective vehicles of financial inclusion. The work of identification of rural co-operatives for the study is in progress.

IV.18 The BC model was comprehensively reviewed by a Working Group and based on the recommendations of the Group, in November 2009 banks were permitted to engage the following additional entities as BCs (a) individual *kirana*/ medical/fair price shop owners, (b) individual Public Call Office operators, (c) agents of small saving schemes of Government of India/insurance companies, (d) individuals who owned petrol pumps, (e) retired teachers, (f) authorised functionaries of well-run SHGs linked to banks. Further, with a view to ensuring viability of the BC model, banks (not BCs) were permitted to collect reasonable service charges from the customer, in a transparent manner. In April 2010, the BC ambit was further widened by permitting banks to engage any individual as BC, subject to their comfort level and their carrying out due diligence, as also instituting additional safeguards considered appropriate to minimise agency risks.

IV.19 All domestic SCBs were advised in January 2010 to draw up specific Board-approved Financial Inclusion Plans (FIP) by March 2010 incorporating certain basic minimum qualitative features and quantitative indicators with a view to rolling them out over the next three years. Banks were advised that financial inclusion should be an integral part of their business plans and performance under financial inclusion should be incorporated in the performance evaluation parameters of field staff. The FIPs are expected to, *inter alia*, cover the status of implementation of core banking solutions (CBS) at the rural branches, position of CBS implementation in the RRBs sponsored by the commercial banks, technology solutions for reaching out to the hitherto unbanked and under-banked areas and strategy for employing BCs. The plan should furnish the position regarding the types of products and services offered, extent of coverage of villages through the brick and mortar branch model as well as through the BC model/ others. It should outline the strategies of the bank to cover the urban centres as also to adapt to the solutions being proposed by the Unique Identification Authority of India. The names of the villages covered by the banks are to be put on the respective bank's website. The FIP is to indicate the monitoring mechanism for reviewing the progress in implementation of the plans. The Reserve Bank has been holding meetings with the banks to review the FIPs prepared by them. Banks have been asked to submit revised FIPs based on the discussions held in these meetings. The progress in implementation of FIPs by the banks would be monitored on a quarterly basis by the Reserve Bank.

IV.20 Based on the recommendations of the "Committee on Financial Inclusion" set up by the Government of India (Chairman: Dr. C. Rangarajan), two funds, namely the "Financial Inclusion Fund" for meeting the cost of developmental and promotional interventions for ensuring financial inclusion, and the "Financial Inclusion Technology Fund", to meet the cost of technology adoption were set up with NABARD, with an overall corpus of ₹500 crore each. In the Union Budget for 2010-11, the corpus of these funds was enhanced by ₹100 crore each.

IV.21 Since inception in November 2005, 50.6 million 'no frills accounts' have been opened by banks by March 2010, with outstanding balance of ₹5,386 crore. In 2009-10, banks were advised to provide small overdrafts in such accounts. By March 2010, banks had provided 0.18 million overdrafts amounting to ₹28 crore. General-purpose credit cards (GCCs) offered by banks at their rural and semi-urban braches are in the nature of revolving credit, entitling the holder to withdraw up to the limit sanctioned (₹25,000). By March 2010, banks had provided credit aggregating ₹635 crore in 3.5 million GCC accounts.

IV.22 To improve banking penetration in the north-east, the Reserve Bank asked the state governments and banks to identify centres where there was a need for setting up either full-fledged branches or those offering foreign exchange facilities, handling government business or for meeting currency requirements. It also offered to fund the capital and running costs for five years, provided the state government concerned was willing to make available the premises and put in place appropriate security arrangements. In Meghalaya, eight centres have been allotted to three public sector banks, following a bidding process. The Reserve Bank is in the process of extending the special dispensation scheme to other states in the north-east region which have finalised the list of identified centres, *viz*., Tripura (5), Arunanchal Pradesh (12), Manipur (11) and Nagaland (6).

IV.23 The Reserve Bank had introduced a scheme in 2008 to quicken the pace of adoption of electronic benefit transfer (EBT) mechanism by banks and roll out the EBT system in the states that were ready to adopt the scheme. As per the scheme, the Reserve Bank partially reimbursed the banks the cost of opening accounts with bio-metric access (through which payment of social security benefits, payments under NREGA and other government benefit programmes would be routed) at the rate of ₹50 per account. The incentive package was dependent on the state governments agreeing to pay to the transacting banks a mutually agreed transaction fee. The scheme closed on June 30, 2010.

IV.24 Each SLBC convenor bank has been asked to set up a credit counselling centre in one district as a pilot, and extend it to all other districts in due course. A model scheme on financial literacy and credit counselling centres (FLCCs) was formulated and communicated to all SCBs and RRBs with the advice to set up the centres as distinct entities, maintaining an arm's length from the bank, so that the FLCCs' services were available to even other banks' customers in the district. Up to March 2010, banks had reported setting up 135 credit counselling centres in various states of the country.

Outreach Activities

IV.25 The outreach activities were the flagship event of the Platinum Jubilee year celebrations of the Reserve Bank. The outreach events across the country were chosen to further financial inclusion, with particular focus on financial education and literacy. An important aspect of the outreach activities was making the Banking Ombudsman an integral part of the activities so that there could be spot redressal of some of the grievances. During the outreach visits, information was disseminated through lectures, demonstrations, interactions, skits, posters, short films, pamphlets, comic books, displays and computers. Quiz programmes and essay competitions, exchange of notes and coins were organised. The target groups included students, SHG members, villagers, farmers, NGOs, bankers, government employees, senior citizens, housewives, *panchayat* members, rag pickers, daily wage earners and defence personnel. The top management of the Reserve Bank participated in 40 outreach programmes organised in remote unbanked villages across the country during 2009-10 (also see Box X.1).

IV.26 Out of the 167 villages identified for transformation into 'model villages', 160 are unbanked. A total of 130 BCs/business facilitators (BFs) were appointed covering 111 villages, while ICT-based financial inclusion was initiated in 88 villages by issue of 26,850 smart cards covering 59.6 per cent households in the villages. Of the 88 villages, 33 have achieved 100 per cent BC-ICT based financial inclusion.

IV.27 The outreach programmes provided an opportunity to the Reserve Bank to understand how grassroot organisations such as SHGs, MFIs, NGOs, rural co-operatives and RRBs work to bring about development in the remote unbanked villages. This platform also gave an opportunity to disseminate information about the functions of the Reserve Bank to the rural masses across the country. The involvement of all cadres of staff of the Reserve Bank in organising these activities and interacting with common public in large numbers has increased the sense of responsibility of the staff to deliver better and efficient services to the general public, while banks used this platform to identify new business opportunities in rural areas and also for the development of customised products.

IV.28 It has been decided by the Top Management to continue the outreach activities. In particular, Regional Directors would undertake atleast three outreach visits in the year 2010-11 and the Top Management would participate in at least one of them. Selection of villages was left to the discretion of the Regional Directors, subject to the fulfillment of guidelines and parameters prescribed for outreach activities. Accordingly, the Regional Directors have selected villages for future outreach activities for achieving 100 per cent sustainable BC-ICT based financial inclusion.

EXPORT CREDIT

IV.29 In the wake of the global crisis and the problems being faced by exporters, the Reserve Bank had reduced the interest rate ceiling to 250 basis points below BPLR on pre-shipment rupee export credit up to 270 days and post-shipment rupee export credit up to 180 days. This was available up to June 30, 2010. On top of this, the Government of India extended interest rate subvention of 2 per cent (from December 1, 2008 to March 31, 2010) on pre- and post-shipment rupee export credit, for certain employment-oriented export sectors such as handicrafts, carpets, handlooms and small and medium enterprises. Hence, banks were not to charge interest rates exceeding BPLR minus 4.5 per cent on pre-shipment credit up to 270 days and post-shipment credit up to 180 days on the outstanding amount to the above-mentioned sectors. The total subvention was, however, subject to the condition that the interest rate, after subvention, was not below 7.0 per cent, *i.e.*, the rate applicable to the agriculture sector under priority sector lending. The Union Budget for 2010-11 extended the 2 per cent interest rate subvention to the select sectors up to March 31, 2011. In April 2010, the Reserve Bank deregulated the interest rate on rupee export credit with effect from July 1, 2010 and stipulated that the interest rate on rupee export credit could be priced at or above the base rate.

IV.30 The Reserve Bank has clarified that, in the case of interest rate subvention given by government to rupee export credit, banks will have to reduce the interest rate chargeable to exporters by the amount of subvention available. If, as a consequence, the interest rate charged to exporters goes below the base rate, such lending would not be construed as violative of the base rate guidelines. On August 9, 2010, the interest rate subvention scheme was further extended to leather and leather manufacturers, jute manufacturing including floor covering, engineering goods and textiles for the period from April 1, 2010 to March 31, 2011.

IV.31 With significant improvement in the international capital market in the recent period, the Reserve Bank reduced the interest rate ceiling on foreign currency export credit from LIBOR plus 350 basis points to LIBOR plus 200 basis points on February 19, 2010. Correspondingly, the interest rate on the overseas lines of credit borrowing by banks for the purpose of granting foreign currency credit to exporters was reduced from 6-month LIBOR plus 150 basis points to 6-month LIBOR plus 100 basis points.

IV.32 On balance, ensuring credit at affordable price and furthering financial inclusion are cherished objectives. The Reserve Bank recognises that financial regulation and financial inclusion cannot be at cross-purposes. For sustenance of the efforts directed at financial inclusion, the delivery models need to be viable. The introduction of the base rate and the concomitant removal of interest rate ceiling on small loans and freeing of rupee export credit interest rate is expected to enhance the allocative efficiency of the financial intermediation process by banks, while also promoting financial inclusion. The interest rate deregulation would enable greater flow of credit to agriculture and small businesses. As a regulator, the Reserve Bank emphasises transparency, customer education/awareness and effective grievance redressal systems.