IV CREDIT DELIVERY

Ensuring adequate flow of credit to all productive sectors of the economy without diluting the emphasis on asset quality is one of the objectives of the Reserve Bank. This became all the more important in the wake of the dampening effects of the synchronised global recession on the domestic growth momentum in the second half of 2008-09 and the associated deceleration in credit demand. While announcing a number of measures for sectors which were affected by the global crisis, the Reserve Bank continued with its focus on financial inclusion and financial literacy/credit counselling. Strengthening credit delivery mechanisms to the targetted sections of the population under different schemes has been an important aspect of the Reserve Bank's policy focus in recent years.

IV.1 In the face of a severe global credit squeeze, credit markets in India continued to function normally. While in the global credit markets, it was a problem on the supply side because of the pressure of forced deleveraging by banks and financial institutions, it is the economic slowdown and the associated contraction in aggregate demand, which largely affected the credit markets in India in the second half of 2008-09. Thus, while in the advanced countries, significant unconventional measures were introduced to unfreeze the credit markets, in the case of India, reviving aggregate demand through policy stimulus assumed greater significance. Expansion in credit at reasonable cost without diluting the credit standards was seen by the Reserve Bank as essential to promote consumption and investment demand in a slowing economy.

IV.2 The Indian financial markets came under pressure for a short time following the adverse international developments in September 2008, which affected the credit markets to some extent. In view of the changed environment characterised by capital outflows and increase in risk aversion, there was a substantial shrinkage of non-bank sources of funding in India, such as from domestic capital markets, funding from NBFCs and mutual funds and external funding in the form of commercial borrowings and ADRs/GDRs. Accordingly, there was a sudden rush for bank credit from various sectors of the economy which created the perception of an emerging credit crunch in India as well. This was compounded by the large demand for credit from petroleum and fertiliser companies, as there had been an incomplete pass-through of the high international crude prices in the first half of 2008-09 to domestic petroleum prices. Reflecting these developments, non-food bank credit (y-o-y) accelerated to around 30.0 per cent by October 2008. In response, a number of steps were taken by the Reserve Bank to make available adequate rupee and foreign exchange liquidity while emphasising the need to ensure adequate flow of credit to the productive sectors of the economy. The subsequent period also exhibited a turn in the credit cycle, reflecting rising risk aversion in the Indian financial system, besides moderation in demand for credit on account of the economic downturn.

IV.3 Even though bank credit had registered an annual average growth of around 29.6 per cent per annum during 2004-08, there was no dilution in lending standards to sustain the high credit growth. Bank's loans to individuals for housing were backed by prudent loan-to-value ratios. In view of the rapid credit growth to certain sectors, however, the Reserve Bank had pre-emptively tightened prudential norms (in the form of provisioning requirements and risk weights) for those sectors in order to safeguard financial stability. Even for standard assets, provisioning norms were raised across the board, except for the agriculture and the SME sectors. These tightened provisioning norms and risk weights have now been rolled back in the wake of the slowdown in order to ensure easier flow of credit to the productive sectors of the economy. This approach of the Reserve Bank facilitated creation of adequate buffers within the banking system to deal with asset quality concerns associated with credit cycles and the same approach is now being seen internationally as a relevant practice in the context of the global financial crisis.

IV.4 The growth in overall credit in 2008-09, thus, was lower than that of the previous year, mainly on account of the slowdown in the growth momentum of the economy during the second half of the year. The Reserve Bank has maintained a policy framework that aims at keeping credit delivery on track so as to arrest the moderation in the growth of the economy. Taking the signals from the Reserve Bank's significant policy rate cuts, most big banks have reduced their benchmark prime lending rates, though with a lag, both in terms of timing and magnitude. The gradual softening of lending rates of banks has affected the pace and effectiveness of monetary policy transmission. The other policy measures taken during the year relating to the credit markets include expansion and liberalisation of refinance facilities for exports and certain unconventional measures such as an exclusive refinance window and a special purpose vehicle (SPV) for supporting NBFCs. Refinance facilities were announced for apex financial institutions in order to augment their ability to refinance credit to small industries, housing and exports.

IV.5 It has been the endeavour of the Reserve Bank to improve credit delivery mechanisms for the small borrowers, particularly for the agriculture and the small enterprises sectors by creating a conducive environment for banks to provide adequate and timely finance at reasonable rates without procedural hassles. In the wake of the crisis in 2008-09, the Reserve Bank took various measures for enhancing the flow of credit to those sectors of the economy, which were more severely hit due to the world-wide recession, and also to the employment-intensive sectors. The Reserve Bank has also been emphasising the role of the financial system for ensuring greater financial inclusion, supporting employment generation in rural and unorganised sectors, promoting financial literacy and credit counselling. Wide-ranging initiatives have been taken in this regard. These include strengthening of the financial institutions, including rural co-operatives and regional rural banks (RRBs), which cater predominantly to the rural areas and the common persons; liberalisation of branch licensing policies for RRBs for enhancing their banking outreach; encouraging multiple channels of lending such as self-help groups (SHGs), micro finance institutions (MFIs) and adoption of business facilitator (BF)/business correspondent (BC) model; improving credit delivery through simplification of the procedures and processes for lending to agriculture and micro, small and medium enterprises (MSME) sectors, while encouraging adoption of information and communication technology (ICT) solutions for achieving greater banking outreach and reducing transaction costs.

PRIORITY SECTOR LENDING

IV.6 India's mandated priority sector lending has helped in imparting resilience to the agricultural sector. Even in the wake of the global financial crisis, this lending norm has kept the flow of institutional credit to agriculture intact. The farm loan waiver package implemented by the Government also helped the agriculture sector.

IV.7 The domestic SCBs, both in the public and the private sectors, which fail to achieve the priority sector and/or agriculture lending targets, are required to deposit into the Rural Infrastructure Development Fund (RIDF) such amounts as may be assigned by the Reserve Bank. The Fund has so far completed fourteen years of operation. The Union Budget for 2008-09 had announced the setting up of RIDF XIV with NABARD and the creation of certain other funds (Box IV.1).

Box IV.1
Augmentation of the Resource Base of SIDBI, NHB and NABARD

The Union Budget for 2008-09 had indicated that the RIDF XIV would have a corpus of Rs.14,000 crore during 2008-09 and a separate window under the RIDF XIV for rural roads under *Bharat Nirman* with a corpus of Rs.4,000 crore and would be operated by NABARD. In the Budget speech, it was also announced that in order to increase the resource base of NABARD, SIDBI and NHB and to take forward the financial inclusion process, the following funds would be created with contributions from SCBs to the extent that they fell short of their obligations to lend to the priority sector:

(i) A fund of Rs.5,000 crore with NABARD to enhance its refinance operations to short-term cooperative credit institutions.

(ii) Two funds of Rs.2,000 crore each with SIDBI – one for risk capital financing and the other for enhancing refinance capability of the MSME sector.

(iii) A fund of Rs.1,200 crore with NHB to enhance its refinance operations in the rural housing sector.

Each of these funds were to be governed by the general guidelines that are applicable to the RIDF, with some modifications.

Pursuant to the above announcements, RIDF XIV with a corpus of Rs.10,000 crore, a separate window under RIDF XIV for rural roads component of *Bharat Nirman* with a corpus of Rs.4,000 crore and Short-Term Co-operative Rural Credit (STCRC) (Refinance) Fund with a corpus of Rs.5,000 crore were set up with NABARD; Micro Small and Medium Enterprises (Refinance) Fund with a corpus of Rs.1,600 crore and MSME (Risk Capital) Fund with a corpus of Rs.1,000 crore were set up with SIDBI. The Rural Housing Fund with a corpus of Rs.1,000 crore was set up with NHB. The funding for these came from contributions by SCBs which failed to achieve their obligations to lend to the priority sector as on the last reporting Friday of March 2008. The balance portion of Rs.4,000 crore of the corpus of RIDF XIV and Rs.1,000 crore of the corpus of MSME (Risk Capital) Fund would be assigned to SCBs on the basis of the shortfall in achievement of priority sector lending targets/sub-targets as on the last reporting Friday of March 2009.

With a view to dealing with the growing ramifications of the global crisis for the Indian economy, the Reserve Bank took a number of policy measures. One of the primary aims of these measures was to augment domestic and foreign exchange liquidity and to enable banks to continue to lend for productive purpose while maintaining credit quality so as to sustain the growth momentum. As part of the broad objective, one measure taken by the Reserve Bank in November 2008 was assigning amounts, in advance, to SCBs for contribution to SIDBI and NHB to the extent of Rs.2,000 crore and Rs.1,000 crore, respectively, against banks' estimated shortfall in achievement of weaker section lending target of 10.0 per cent as on the last reporting Friday of March 2009.

Accordingly, the corpus of MSME (Refinance) Fund (maintained with SIDBI) and the Rural Housing Fund (maintained with NHB) were enhanced by Rs.2,000 crore and Rs.1,000 crore, respectively. It was also decided that the enhanced portion of the corpus of the above two Funds would be contributed by the domestic SCBs, both in the public and the private sectors, which had a shortfall in achievement of the sub-target of 10 per cent for lending to the weaker sections, on a pro-rata basis. The assignments were made in advance against banks' estimated shortfall in achievement of the sub-target for lending to weaker sections as on the last reporting Friday of March 2009 and would be adjusted against future contributions, if any, which may be needed to be made by banks during 2009-10 on the basis of the actual shortfall in achievement of priority sector lending target/sub-targets as on the last reporting Friday of March 2009. The domestic SCBs were advised on November 20, 2008 their respective shares for depositing in the above Funds.

IV.8 Various banks had represented for either phasing out the contribution to these Funds over a longer period or exempting them from placements of deposits in these Funds. The main contention of banks was that their allotment amount for the year 2008-09 was very high compared to previous years and placing a large amount of deposit in these Funds at a very low rate of interest could affect their profitability. Taking into account the large increase in allocations for some banks and the resultant strain on the banks' resources/profitability, the rate of interest in respect of deposits placed by banks in the above Funds was kept at the Bank Rate (6.0 per cent at present) uniformly for all banks, irrespective of the percentage of shortfall in achievement of priority sector lending targets/sub-targets.

IV.9 The Union Finance Minister had announced in the Interim Budget for 2009-10 (February 2009) that RIDF XV, with a corpus of Rs.14,000 crore, and a separate window under RIDF XV for rural roads under the *Bharat Nirman* programme, with a corpus of Rs.4,000 crore, would be set up with

NABARD. Further, in the Union Budget for 2009-10 (July 2009) it was announced that a separate fund with corpus of Rs.4,000 crore, out of RIDF would be set up with SIDBI to incentivise banks and State Finance Corporations to lend to micro and small enterprises (MSEs) by refinancing 50 per cent of incremental lending to MSEs during the current financial year. Further, the Union Budget for 2009-10 also announced a contribution of Rs.2,000 crore to the Rural Housing Fund.

IV.10 The total allocation under the RIDF (I to XV), since its inception, including separate windows for rural roads component under the *Bharat Nirman* programme, is Rs.1,16,000 crore. Of this, sanctions aggregating Rs.90,268 crore have been accorded to State Governments/Union Territories and Rs.58,041 crore was disbursed as at end-June 2009. A total amount of Rs.12,385 crore has been disbursed to National Rural Roads Development Agency (NRRDA) against the total sanction of Rs.16,000 crore as on June 30, 2009. During the first quarter of 2009-10, 11 State Governments were sanctioned loans aggregating Rs.2,197 crore (15.7 per cent of the corpus of RIDF XV) and total disbursements amounted to Rs.1,970 crore (an increase of 13.5 per cent over the comparable period of the previous year).

IV.11 Consequent to the announcement of certain measures by the Reserve Bank on December 6, 2008 to revive the growth momentum as also the urgent need for providing support to the housing sector, banks were advised that loans granted to housing finance companies (HFCs) for on-lending to individuals for purchase/construction of a dwelling unit per family, could be classified as housing loans under priority sector, provided the loans granted by the HFCs did not exceed Rs.20 lakh per dwelling unit. The maximum amount of loans granted by banks to HFCs that would be eligible for classification as housing loans under priority sector in the books of banks, however, could not exceed 5.0 per cent of the individual bank's total priority sector lending on an ongoing basis. The above special dispensation is applicable for loans granted by banks to HFCs up to March 31, 2010.

IV.12 The particulars of lending to priority sector by public sector banks, private sector banks and foreign banks are given in Table 4.1. Although as groups, different categories of banks had achieved the overall target for priority sector lending as on the last reporting Friday of March 2009, three out of 27 public sector banks and five out of 22 private sector banks; and four out of 27 foreign banks had not achieved the overall priority sector lending targets of 40.0 per cent and 32.0 per cent, respectively.

Flow of Credit to the Agriculture Sector

IV.13 Agriculture and allied sectors directly condition the output, wages, employment and consumption patterns of a vast section of our population, thereby unleashing growth impulses in the economy, while also promoting economic development. Though there has been a deceleration in the share of agriculture in the GDP

Table 4.1: Priority Sector Advances

(Amount in Rupees crore)

As on the Last Reporting Friday of March	Public Sector Banks	Private Sector Banks	Foreign Banks
1	2	3	4
2004	2,44,456	48,920	17,960
	(43.6)	(47.3)	(34.1)
2005	3,07,046	69,886	23,843
	(42.8)	(43.6)	(35.3)
2006	4,09,748	1,06,586	30,439
	(40.3)	(42.8)	(34.4)
2007	5,21,376	1,44,549	37,831
	(39.7)	(42.9)	(33.4)
2008	6,10,450	1,64,068	50,254
	(44.7)	(47.8)	(39.5)
2009*	7,20,083	1,90,207	55,483
	(42.5)	(46.8)	(34.3)

* : Data are provisional.

Notes : 1. Figures in brackets are percentages to the net bank credit up to 2007, thereafter they are percentages to adjusted net bank credit (ANBC) or credit equivalent of off-balance sheet exposure (OBE), whichever is higher, in the respective groups.

2. The target for aggregate advances to the priority sector was 40.0 per cent of the net bank credit for domestic banks and 32.0 per cent of net bank credit for the foreign banks. The targets have been linked to ANBC or credit equivalent of OBE, whichever is higher, with effect from April 30, 2007.

from 36.4 per cent in the 1980s to around 17.0 per cent now, the number of people dependent on agriculture for their food and livelihood remains largely unchanged. A number of steps have, therefore, been taken by the Reserve Bank and the Government of India for facilitating increased flow of credit to the agriculture sector.

IV.14 The public sector banks have been formulating special agricultural credit plans (SACPs) since 1994-95 with a view to achieving a distinct and marked improvement in the flow of credit to agriculture. Under SACP, the banks are required to fix targets for achievement during the financial year. The targets fixed by the banks for a particular year are generally 20 to 25 per cent higher than the disbursements made in the previous year. The SACP mechanism was made applicable to private sector banks from the year 2005-06. Disbursements under the SACP by banks during the last three years are depicted in Table 4.2.

Table 4.2: Disbursements under Special Agricultural Credit Plans

(Amount in Rupees crore)

Year	Target	Disbursements	Achievement of Target (per cent)	Year-on-year Growth in Disbursements (per cent)
1	2	3	4	5
Public Sector Banks				
2006-07	1,18,160	1,22,443	103.6	29.9
2007-08	1,52,133	1,33,226	87.6	8.8
2008-09*	1,59,470	1,44,302	90.5	8.3
Private Sector Banks				
2006-07	40,656	44,093	108.5	41.3
2007-08	41,427	47,862	115.5	8.5
2008-09*	57,353	59,805	104.3	25.0

* : Provisional.

IV.15 The target set for flow of credit to the agriculture sector by the Union Budget of the respective years, has been consistently exceeded since 2004-05. As regards the target of Rs.2,80,000 crore set for 2008-09, the disbursement by all banks (including co-operative banks and RRBs) during the year was Rs.2,87,149 crore or 102.6 per cent of the target (Table 4.3).

IV.16 The *Kisan* Credit Cards (KCCs) scheme was introduced in the year 1998-99 to enable the farmers to purchase agricultural inputs and draw cash for their production needs. Since the inception of the scheme, the number of KCCs issued by public sector banks stood at 37.1 million with sanctioned limits aggregating to Rs.1,93,250 crore as on March 31, 2009. During 2008-09, public sector banks issued 5.9 million KCCs with sanctioned limits aggregating to Rs.39,009 crore.

IV.17 Though neither the public sector banks nor the private sector banks, as individual groups, have achieved the agriculture lending target of 18.0 per cent, the outstanding advances to agriculture of both these bank groups have been gradually increasing every year towards the stipulated target (Table 4.4).

Table 4.3: Targets and Actual Disbursement to Agriculture by Banks

(Amount in Rupees crore)

Agency	2004-05		2005-06		2006-07		2007-08		2008-09	
	Target	Disbursement	Target	Disbursement	Target	Disbursement	Target	Disbursement	Target	Disbursement
1	2	3	4	5	6	7	8	9	10	11
Commercial Banks	57,000	81,481	87,200	1,25,477	1,19,000	1,66,486	1,50,000	1,81,088	1,95,000	2,23,663
Co-operative Banks	39,000	31,231	38,600	39,786	41,000	42,480	52,000	48,258	55,000	36,762
RRBs	8,500	12,404	15,200	15,223	15,000	20,435	23,000	25,312	30,000	26,724
Other Agencies*	-	193	-	-	-	-	-	-	-	-
Total	**1,04,500**	**1,25,309**	**1,41,000**	**1,80,486**	**1,75,000**	**2,29,401**	**2,25,000**	**2,54,658**	**2,80,000**	**2,87,149**

***** : Co-operative societies, State Financial Corporations, Agricultural Development Finance Corporation.

Source : NABARD.

Table 4.4: Outstanding Agricultural Advances

(Amount in Rupees crore)

As on the Last Reporting Friday of March	Public Sector Banks		Private Sector Banks	
	Amount Out-standing	Per cent of Net Bank Credit	Amount Out-standing	Per cent of Net Bank Credit
1	2	3	4	5
2003	70,501	14.5	9,924	10.9
2004	84,435	15.1	14,730	12.7
2005	1,09,917	15.3	21,636	12.3
2006	1,55,220	15.3	36,712	13.6
2007	2,02,614	15.4	52,034	12.7
2008	2,49,397	17.5	58,567	15.4
2009*	2,98,211	17.2	76,062	15.9

* : Data are provisional.

Note : The target for advances to agriculture was 18.0 per cent of net bank credit for the domestic banks. The target has been linked to ANBC or credit equivalent of OBE, whichever is higher, with effect from April 30, 2007.

The recovery of direct agricultural advances of public sector banks has shown an undulating trend in recent years (Table 4.5).

IV.18 The SCBs (including RRBs) were advised in August 2008 to accept affidavits submitted by landless labourers, share croppers and oral lessees giving occupational status (*i.e.*, details of land tilled/ crops grown) for loans up to Rs.50,000, where there were difficulties in getting certification from local administration/*panchayati raj* institutions regarding the cultivation of crops, *etc.* They were also advised to encourage the Joint Liability Group (JLG)/SHG mode of lending for such persons. Banks, however, should go through their procedures of identification as per Know Your Customer (KYC) norms, appraisal and usual pre-sanction checks before extending finance.

Table 4.5: Public Sector Banks – Recovery of Direct Agricultural Advances

(Amount in Rupees crore)

End-June	Demand	Recovery	Overdues	Percentage of Recovery to Demand
1	2	3	4	5
2004	33,544	25,002	8,542	74.5
2005	45,454	35,733	9,721	78.6
2006	46,567	37,298	9,269	80.1
2007	73,802	58,840	14,958	79.7
2008	95,100	71,739	23,361	75.4

IV.19 Following the announcement in the Annual Policy Statement for 2008-09, the domestic SCBs, including RRBs, were advised to select, on a pilot basis, one rain-fed district for introduction of a new product for financing crop production whereby: (i) 80.0 per cent of the crop loan requirement of individual borrowers could be met through a short-term production loan in conformity with the present norms/practices; and (ii) the remaining 20.0 per cent representing the 'core component' (expenses for land preparation, pre-sowing operations, *etc.*, besides self-labour/consumption) could be sanctioned as a 'clean credit limit' to ensure round the year liquidity. The banks were also advised to allow drawings from this 'clean credit limit' on the pattern of operations in cash credit/overdraft accounts as long as the farmers continued to service the interest. Asset classification norms, as applicable to non-agricultural cash credit/overdraft accounts, would apply to this clean credit limit. Further, any reschedulement of the loans in terms of extant guidelines on relief measures to be provided in the event of natural calamities would warrant clubbing of balances outstanding in the clean credit account with the outstanding in the loan account for reschedulement and a fresh 'clean credit limit' would be made available to the farmer. Under normal circumstances, the extant guidelines of borrower-wise asset classification would prevail in the case of this new product also, unless specifically dispensed with, as in the case of natural calamities. Rate of interest and periodicity of interest application in respect of the 'clean credit limit' would be applicable as to other agricultural advances. Banks were asked to try the new system in select branches.

Guidelines for Interest Subvention Relief to Farmers

IV.20 With effect from *kharif* 2006-07, the Government has been providing an interest rate subvention of 2.0 per cent in respect of short-term production credit up to Rs.3 lakh provided to farmers by the public sector banks and RRBs. The Government increased the subvention for the financial year 2008-09 to 3.0 per cent in December 2008.

The Government has so far provided Rs.1,742 crore for reimbursing claims of public sector banks, co-operative banks and RRBs. It was announced in the Union Budget for 2009-10 that the interest subvention scheme for short-term crop loans to farmers for loans up to Rs.3 lakh would be continued. It was also announced that for the year 2009-10, the Government would pay an additional subvention of 1.0 per cent as an incentive to those farmers who repaid their short-term crop loans on schedule. Thus, the interest rate for these farmers would be 6.0 per cent per annum.

Agricultural Debt Waiver and Debt Relief Scheme, 2008

IV.21 A scheme of agricultural debt waiver and debt relief for farmers with the total estimated value of overdue loans being waived at Rs.50,000 crore and a one-time settlement (OTS) relief on the overdue loans at Rs.10,000 crore was announced in the Union Budget for 2008-09, for implementation by all SCBs, local area banks, RRBs and co-operative credit institutions. The Government of India had advised the schedule of reimbursement under the Agricultural Debt Waiver and Debt Relief Scheme, 2008 for compensation to the lending institutions in a phased manner (Table 4.6).

IV.22 Pending release of the first reimbursement installment of Rs.25,000 crore by the Government of India, the Reserve Bank provided temporary liquidity support (at the prevailing fixed repo rate under LAF and valid till December 16, 2008) aggregating Rs.17,500 crore to RRBs and co-operatives through NABARD and Rs.7,500 crore to commercial banks with a view to ensuring adequate financing of agricultural operations. The limits in this regard were related to the quantum of debt waived by banks under the Scheme and the liquidity support was provided by the Reserve Bank under Sections 17(3-B) and 17(4E) of the RBI Act, 1934 to scheduled banks and NABARD, respectively.

Table 4.6: Proposed Reimbursement

(Amount in Rupees crore)

Lending Institutions	First Installment September 2008	Second Installment July 2009	Third Installment July 2010	Fourth Installment July 2011
RRBs and Co-operatives	17,500	10,500	2,800	Balance amount, if any.
SCBs, UCBs and Local Area Banks	7,500	4,500	9,200	Balance amount, if any.
Total	**25,000**	**15,000**	**12,000**	**Balance amount, if any.**

IV.23 Subsequently, the Government released Rs.25,000 crore in December 2008 as the first installment under the scheme for reimbursing the claims of lending institutions. Out of this fund, Rs.17,500 crore was passed on to NABARD for reimbursing RRBs and co-operatives, and Rs.7,500 crore was kept with the Reserve Bank for reimbursing fully the claims of local area banks and proportionately of domestic SCBs and urban co-operative banks (UCBs). Out of the Rs.7,500 crore, the claims of domestic SCBs and UCBs were reimbursed to the extent of Rs.7,494 crore. The Government subsequently released Rs.5,000 crore as the first tranche of the second installment, of which, Rs.3,500 crore was passed on to NABARD for reimbursing the RRBs and co-operatives. An amount of about Rs.101 crore was also paid proportionately to those UCBs which were awaiting their first installment for want of funds earlier. Thereafter, an amount of Rs.1,389 crore was disbursed to SCBs and UCBs in a proportionate manner (7.5 per cent) as the first tranche of the second installment.

Guidelines for Relief Measures by Banks to Poultry Industry

IV.24 In addition to the relief measures for the poultry industry announced by the Reserve Bank in February 2008, the Government of India decided to grant interest subvention of 4.0 per cent per annum on the outstanding non-overdue loan amount as on January 1, 2008 to the poultry units of West Bengal for the period from January 1, 2008 to March 31, 2009. Accordingly, the following guidelines on the scope of the subvention and its calculation as well as disbursement to the banks were issued in February 2009: (i) The interest subvention would be calculated at four percentage points on the term loans and working capital loans outstanding as on January 1, 2008. This would not include any part of the principal amount that had become overdue before the notification of the first occurrence of bird flu in the State; (ii) All categories of borrowers such as individuals, partnerships, private limited companies, public limited companies, SHGs and co-operatives would be eligible for relief by way of interest subvention; and (iii) The interest subvention would cover term loans and working capital loans sanctioned for all activities relating to chicken, turkey, Japanese quail, guinea fowls, ducks, ostrich and emu.

Table 4.7: Outstanding Credit to Micro and Small Enterprises

(Amount in Rupees crore)

As on the Last Reporting Friday of March	Public Sector Banks	Private Sector Banks	Foreign Banks	All SCBs	Percentage of MSE Credit to Net Bank Credit for SCBs*
1	2	3	4	5	6
2007	1,02,550	13,136	11,637	1,27,323	7.2
2008	1,51,137	46,912	15,489	2,13,538	11.6
2009(P)	1,90,968	47,916	18,188	2,57,072	11.4

* : As percentage of ANBC or credit equivalent of OBE, whichever is higher, from 2008 onwards.

P : Provisional

Note: With effect from April 30, 2007, small scale industries have been redefined as MSEs.

Flow of Credit to the Micro and Small Enterprises Sector

IV.25 Promotion and growth of the small enterprises sector has been an integral feature of the industrial policy in India. Small enterprises constitute a crucial section of the industrial sector as they play a vital role in value addition, employment generation, equitable distribution of national income, regional dispersal of industries, mobilisation of capital and entrepreneurial skills and contribution to export earnings. Bank credit to small scale industrial (now micro and small enterprises) sector constitutes a major segment of total credit to the non-farm sector. Data relating to advances of scheduled commercial banks to the small enterprises during the recent years are presented in Table 4.7.

IV.26 The total credit provided by public sector banks to small enterprises sector as on the last reporting Friday of March 2009 amounted to 26.5 per cent of the total priority sector advances of these banks. The total credit provided by private sector banks to small enterprises sector as on the last reporting Friday of March 2009 formed about 11.8 per cent of ANBC and 25.2 per cent of the total priority sector advances of these banks.

IV.27 Public sector banks have been advised to operationalise at least one specialised SME branch in every district and centre having a cluster of SME units. At end-March 2009, 869 specialised SME bank branches were operationalised by banks. The data on sick SME units and the amount outstanding against them in the books of SCBs for three years up to end-March 2008 is given in Table 4.8.

Table 4.8: Credit to Sick Micro and Small Enterprises

(Amount in Rupees crore)

End-March	Total Sick Units		Potentially Viable		Non-viable		Viability yet to be Decided		Units put under Nursing	
	No. of Units	Amount Out-standing	No. of Units	Amount Out-standing	No. of Units	Amount Out-standing	No. of Units	Amount Out-standing	No. of Units	Amount Out-standing
1	2	3	4	5	6	7	8	9	10	11
2006	1,26,824	4,981	4,594	498	1,17,148	4,141	5,082	342	915	234
2007	1,14,132	5,267	4,287	428	1,09.011	4,757	834	82	588	269
2008	85,186	13,849	4,210	247	75,829	13,462	5,147	140	1,262	127

IV.28 The Government of India (Ministry of Labour and Employment) has identified four clusters in the minority concentrated districts of the country under the Prime Minister's New 15-Point Programme for the Welfare of Minorities. The Ministry of MSME, Government of India has approved a list of clusters under the "Scheme of Fund for Regeneration of Traditional Industries" (SFURTI) and "Micro and Small Enterprises Cluster Development Programme" (MSE-CDP) located in 121 minority concentrated districts. Public sector banks have been advised to take appropriate measures to improve the flow of credit to the identified clusters benefitting the micro, small and medium entrepreneurs from the minority communities residing in those districts.

IV.29 In the context of the global developments and the knock-on effects in the domestic credit markets, the Reserve Bank took several measures to enhance credit delivery to the employment-intensive MSE sector. SCBs were advised to organise special meetings of State Level Bankers' Committee (SLBC) to address the problems of the MSE sector, and steps were taken for timely restructuring and additional facilities, *etc*. Banks were also advised to extend collateral-free loans up to Rs.5 lakh for all new loans to the MSE sector (both manufacturing and service enterprises).

IV.30 Since the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGFTMSE) was not picking up, it was announced in the Annual Policy Statement for 2009-10 that the Standing Advisory Committee on MSEs would be asked to review the credit guarantee scheme so as to make it more effective. Accordingly, a Working Group (Chairman: Shri V.K. Sharma) was constituted, to review the working of the scheme in order to enhance the usage and facilitate increased flow of collateral-free loans to MSEs. The other terms of reference of the Group include to make suggestions for simplifying the existing procedures and requirements for obtaining cover and invoking claims under the CGFTMSE and to examine the feasibility of a whole turnover guarantee for the MSE portfolio.

Working Group on Rehabilitation/Nursing of Potentially Viable Sick SME Units

IV.31 The rehabilitation/nursing of potentially viable sick units often gets delayed due to the inability of the promoters to bring in additional contribution of capital. A Working Group (Chairman: Dr. K.C. Chakrabarty) was constituted to look into the issue and suggest remedial measures so that potentially viable sick units could be rehabilitated at the earliest. Based on the recommendations made by the Group and public feedback, detailed guidelines were issued to banks in May 2009 and banks were advised to undertake a review and put in place the following policies for the MSE sector, duly approved by the Board of Directors: (i) loan policy governing extension of credit facilities; (ii) restructuring/rehabilitation policy for revival of potentially viable sick units/enterprises; and (iii) non-discretionary one-time settlement scheme for recovery of non-performing loans.

IV.32 The recommendations of the Working Group on setting up of various Funds, *viz.*, Rehabilitation Fund, Fund for Technology Upgradation, Marketing Development Fund, were forwarded to the Government in April 2009 for consideration and necessary action. The regional offices of the Reserve Bank were also advised in April 2009 to monitor the actions initiated by the State Governments/SLBC convenor banks in the SLBC meetings and keep the Reserve Bank apprised.

Lead Bank Scheme

IV.33 Subsequent to the announcement in the Mid-term Review of the Annual Policy Statement for 2007-08, a High Level Committee (Chairperson: Smt. Usha Thorat) with members drawn from various financial institutions, banks, chief secretaries of select States, was constituted to review the Lead Bank Scheme and improve its effectiveness, with a focus on financial inclusion and recent developments in the banking sector. The Committee conducted ten meetings and a questionnaire covering various aspects of the Lead Bank Scheme was forwarded to all State Governments and major banks. The Committee submitted its draft report in May 2009, which was placed on the Reserve Bank's website for comments from stakeholders and public (Box IV.2).

Special Task Force for the North-East Region

IV.34 A Special Task Force (Chairperson: Smt. Usha Thorat) was constituted to give a fresh impetus for creation of banking facilities in North-Eastern India. A scheme of providing financial support to banks by the Reserve Bank for setting-up banking facilities (currency chests, extension of foreign exchange and Government business facilities) at centres in the North-Eastern region, which are not found to be commercially viable by banks, was formulated, requiring the State Governments to make available necessary premises and other infrastructural support. The Reserve Bank as its contribution would bear the

Box IV.2
Draft Report of the High Level Committee to Review the Lead Bank Scheme

The High Level Committee on the Lead Bank Scheme submitted its draft Report in May 2009, which highlights the following:

Financial Inclusion

The Committee recommended that a roadmap be drawn to provide banking services at least once a week at every *Gram Panchayat* through a banking outlet. In the first instance, efforts could be made to cover every village with population exceeding 2,000.

Role of State Government

The Committee suggested that State Governments should ensure road and digital connectivity to all centres where penetration by the formal banking system was required. The State Governments should be able to leverage on the benefits of undertaking Government business by banks to incentivise in Government sponsored schemes. Hence, private sector banks may actively involve themselves with the District Consultative Committees (DCCs) and action plans.

Banks - Strengthening State Level Banker Committee (SLBC) and DCC Machinery

The Committee suggested that a one-time comprehensive State Level/District Level Development Plan should be formulated for all the districts that should indicate the roles and responsibilities of banks, State Governments and other stakeholders to ensure banking development for inclusive growth. The primary objective of these plans, according to the Committee, would be to identify the 'enablers' and 'impeders' for banking development and evolve a strategy for banking development for inclusive growth. Lead banks should organise awareness and feedback public meetings in their districts every quarter. Wide publicity should be given to these meetings so that the people's/media representatives, local leaders as also NGOs working in the districts could attend those meetings.

Financial Literacy and Credit Counseling

The Committee observed that there was a need to create and improve awareness of the common persons about banking facilities and schemes available for their benefit. Each lead bank should open a financial literacy and credit counseling centre in each district by following the recent guidelines issued by the Reserve Bank.

Credit Plus Activities

Credit plus initiatives include capacity/skill building of prospective small entrepreneurs/borrowers to manage businesses, enhancing farmers' capability for absorbing new technology and practices, *etc*. It is proposed to establish rural development and self-employment training institutes in each district by 2012 and the lead banks should take expeditious steps in this regard.

Revised Service Area Monitoring and Information System (SAMIS)

The Committee recommended that the revised SAMIS reporting system, known as priority sector monitoring and information systems, could be implemented on a pilot basis in one/two States and thereafter in other States. The IBA could devise software for consolidation and generation of bank-wise, block-wise, district-wise, sector-wise, activity-wise reports by the SLBC convenor banks on an urgent basis.

Initiatives for Urban Areas

The Committee suggested that in urban areas, KYC norms for opening bank account for small value accounts could be simplified. To start with, banks with the largest presence in cities with more than one million population could take the leadership in convening a meeting of bankers and allocating responsibility for various wards to different banks.

one-time capital cost and recurring expenses for a limited period of five years as per the lowest bid offered by a bank. The Government of Meghalaya agreed to the proposal of providing premises and security. Bids were received from public sector banks for setting-up branches at centres identified by the State Government and the banks, which have submitted the lowest bids, have been awarded centres. Action has been initiated in respect of other States in the region.

Government Sponsored Schemes

IV.35 During the year 2008-09, 4,09,069 self-employed persons received bank credit amounting to Rs.333 crore under the *Swarnajayanti Gram Swarozgar Yojana*, with Government subsidy totalling to Rs.119 crore as at end-September 2008, of which 47.2 per cent of the beneficiaries were women, 22.8 per cent were scheduled castes and scheduled tribes (SC/STs) and 0.7 per cent were physically handicapped.

IV.36 Under the *Swarna Jayanti Shahari Rojgar Yojana*, disbursements amounting to Rs.75 crore were made in 20,002 cases (out of the 46,073 applications received) during 2008-09 as at end-September 2008. Of this amount, Rs.20 crore was disbursed to 6,040 SC/STs, Rs.17 crore was disbursed to 4,863 women and Rs.1 crore was disbursed to 184 disabled persons.

IV.37 The Self Employment Scheme for Rehabilitation of Manual Scavengers (SRMS) contains provisions for capital subsidy, concessional loans and capacity building for rehabilitation of manual scavengers in alternative occupations. The scheme provides loans for projects costing up to Rs.5 lakh. The loan amount could be the remaining portion of the project cost, after deducting the admissible capital subsidy. No margin money/promoter's contribution is required to be provided under the scheme. Both, term loan (up to a maximum cost of Rs.5 lakh) and micro finance (up to a maximum of Rs.25,000) could be admissible under the scheme. Micro financing would be done through SHGs and reputed non government organisations (NGOs). The rate of interest chargeable from the beneficiaries is: (i) 5.0 per cent per annum for projects up to Rs.25,000 (4.0 per cent for women beneficiaries); and (ii) 6.0 per cent per annum for projects above Rs.25,000. The period of repayment of loan is three years for projects up to Rs.25,000 and five years for others. The moratorium period for start of repayment of loan is six months. Credit-linked capital subsidy is provided upfront to the beneficiaries in a scaled manner. Under the new SRMS, disbursements aggregating to Rs.4.5 crore were made to 1,409 beneficiaries for the half-year ended September 2008.

IV.38 The outstanding advances of public sector banks under the differential rate of interest (DRI) scheme, as on the last reporting Friday of March 2009, amounted to Rs.753 crore under 3.11 lakh borrowal accounts, forming 0.04 per cent of the outstanding advances of previous year as against the target of 1.0 per cent.

IV.39 Government of India has introduced a new credit-linked subsidy programme called Prime Minister's Employment Generation Programme (PMEGP) by merging the two schemes that were in operation till March 31, 2008, namely the Prime Minister's *Rozgar Yojana* and the Rural Employment Generation Programme for generation of employment opportunities through establishment of micro enterprises in the rural as well as the urban areas. PMEGP is administered by the Ministry of MSMEs. The scheme is to be implemented by the *Khadi* and Village Industries Commission (KVIC), a statutory organisation under the administrative control of the Ministry of MSMEs, as the single nodal agency at the national level. At the State level, the scheme would be implemented through State KVIC Directorates, State *Khadi* and Village Industries Boards (KVIBs) and District Industries Centres (DICs) and banks. The Government subsidy under the scheme would be routed by KVIC through the identified banks for eventual distribution to the beneficiaries/entrepreneurs in their bank accounts. The implementing agencies, namely KVIC, KVIBs and DICs would associate reputed NGOs/autonomous institutions/SHGs/National Small Industries Corporation/*Udyami Mitras* (empanelled under Rajiv Gandhi *Udyami Mitra Yojana*), *panchayati raj* institutions and other relevant bodies in the implementation of the scheme, especially in the area of identification of beneficiaries as well as area-specific viable projects and providing training in entrepreneurship development.

IV.40 The Reserve Bank has advised SCBs to ensure that the benefits flowing from various Government sponsored special programmes are secured by the minority communities in fair and adequate measure. Banks have been asked to create a separate cell to ensure smooth flow of credit to minority communities and also cover the role of the lead bank in the 121 minority concentration districts identified for the purpose of earmarking of targets and location of development projects under the Prime Minister's New 15 Point programme for the welfare of minorities. The data on credit facilities to the minority communities under priority sector advances by all SCBs for the three years up to March 2008 is furnished in Table 4.9.

Table 4.9: Bank Credit to Minority Communities by SCBs under Priority Sector Advances

(Amount in Rupees crore)

End-March	Priority Sector Advances (PS)	Share of Minority Communities in Priority Sector Advances (in all districts)		Amount of Credit to Minority Communities in Identified Districts*
		Amount	Per cent Share to PS	
1	2	3	4	5
2006	5,16,945	45,491	8.80	6,261
2007	6,64,948	53,541	8.05	7,751
2008	7,72,185	72,481	9.39	24,006

* : The number of minority identified districts was enhanced by the Government of India from 44 to 101 with effect from April 27, 2007 and further to 121 with effect from July 16, 2007.

Source : All domestic SCBs (public sector banks and private sector banks).

MICRO FINANCE

IV.41 Recognising the potential of micro finance to positively influence the economic conditions of the poorer sections of the society, the Reserve Bank has been providing a facilitating environment for development of the micro finance sector in the country. The SHG-bank linkage programme, being implemented by commercial banks, RRBs and co-operative banks, is the major channel for providing micro finance in the country, with more than 7.01 crore poor households covered. At end-March 2008, a total of 3.6 million SHGs with a total outstanding bank loan of Rs.17,000 crore were credit linked with the banks (Table 4.10). As on March 31, 2008, a total of 5.0 million SHGs were having savings bank accounts with the banking system of which the commercial banks had the maximum share (56.0 per cent) followed by the RRBs (28.0 per cent) and co-operative banks (16.0 per cent).

IV.42 Recognising the need for boosting the micro finance intervention in the country, the Union Budget for 2000-01 had announced the creation of a Micro Finance Development Fund (MFDF). The fund with a corpus of Rs.100 crore was established with NABARD to which the Reserve Bank and NABARD contributed Rs.40 crore each and the

Table 4.10: Bank Loans Outstanding against SHGs as on March 31, 2008

Agency	No. of SHGs	Share in per cent	Amount (Rs. crore)	Share in per cent	Per SHG Out-standing Loan (Rupees)
1	2	3	4	5	6
Commercial Banks (Public Sector)	22,98,200	63.4	10,930	64.3	47,560
Commercial Banks (Private sector)	80,647	2.2	545	3.2	67,596
Sub Total (Commercial Banks)	**23,78,847**	**65.6**	**11,475**	**67.5**	**48,240**
Regional Rural Banks	8,75,716	24.2	4,421	26.0	50,485
Co-operative Banks	3,71,378	10.2	1,103	6.5	29,711
Total	**36,25,941**	**100.0**	**17,000**	**100.0**	**46,884**

Source : Status of Microfinance in India 2007-08, NABARD.

balance Rs.20 crore was allocated to 11 public sector banks with CRAR of 11.5 per cent and above as on March 31, 2000. Subsequently, in line with the announcement in the Union Budget of 2005-06, the MFDF was redesignated as Micro Finance Development and Equity Fund (MFDEF) with an enhanced corpus of Rs.200 crore. The objective of the redesignated Fund was to facilitate and support the growth of the micro finance sector through diverse modalities for enlarging the flow of financial services to the poor, particularly for women and vulnerable sections of the society, consistent with sustainability. The Fund is being managed by a Board comprising representatives of the Reserve Bank, NABARD, commercial banks and professionals possessing domain knowledge. The Government also decided that the additional amount of Rs.100 crore would be contributed by the Reserve Bank, NABARD and other banks on the same pattern as the earlier MFDF. NABARD contributed Rs.40 crore to the MFDEF. The Reserve Bank has made its contribution of Rs.20 crore to the Fund and has advised NABARD that the balance would be released as the fund gets further utilised. Those public sector banks which had not contributed to the Fund earlier were advised to contribute a total of Rs.20 crore to the MFDEF based on their net working funds.

FINANCIAL INCLUSION

IV.43 Banks and financial institutions play a vital role as financial intermediaries by accepting deposits from the public and providing credit facilities to the needy sectors of the economy for their development. As participants in the payments and settlement system, they also help in the management of assets and income streams. The Reserve Bank, therefore, has all along emphasised access to banking services for all sections of the society and all regions, which is reflected in the branch authorisation policy and the guidelines on priority sector lending. Despite the substantial increase in the number of bank branches, a significant portion of the households still remain outside the coverage of the formal banking sector. The Reserve Bank has taken a number of measures since 2005 to promote financial inclusion (Box IV.3).

IV.44 RRBs and UCBs play an important role in the process of financial inclusion as also in extending credit to MSEs. Therefore, with a view to ensuring that a larger section of the population is covered by the commitment of banks to provide easy, speedy and transparent access to banking services, the Banking Codes and Standards Board of India (BCSBI) decided to enrol scheduled UCBs and RRBs as its members. Presently, 79 SCBs/UCBs/RRBs are members of the BCSBI, while membership of seven RRBs is under process.

IV.45 In pursuance of the commitments made in the Code of Bank's Commitment to Micro and Small Enterprises a simple, standardised and easy to understand loan application form for MSEs was circulated by the IBA for expeditious adoption by banks. During 2008-09, 268 branches of member banks located in different cities were visited to review the extent of their adherence to the two Codes. The sample was such that it included 70 per cent of the branches which had a poor track record of adherence to the Code. The findings of the branch visits revealed some perceptible improvement in overall adherence to the provisions of the Code over that observed during the previous survey conducted in 2007. Furthermore, to ascertain the factual position regarding opening of 'no frills' accounts at branches, the BCSBI randomly selected 44 branches of 26 public, private and foreign banks located in Mumbai and carried out *incognito* visits. The findings revealed that the general awareness about the 'no frills' accounts and relaxed KYC requirements in respect of the same was insufficient among the staff of the banks visited and the staff were not proactive in opening such accounts.

IV.46 As part of the initiative to identify at least one suitable district in each State/Union Territory for achieving 100 per cent financial inclusion, which started in April 2006, 431 districts had been identified as on March 31, 2009. The target has

Box IV.3
Financial Inclusion: Policy Prescriptions

Financial inclusion broadly refers to delivery of financial services, at an affordable cost, to the vast sections of disadvantaged/low-income groups who often tend to be excluded from the formal financial system. Notwithstanding the widespread expansion of the banking sector during the last four decades, a sizeable proportion of households, especially in the rural areas, remains outside the coverage of the formal banking system. The Reserve Bank has taken a number of initiatives for bringing the financially excluded population within the ambit of the formal financial system. The major initiatives include:

(i) In November 2005, banks were advised to make available a basic banking 'no frills' account with low or nil minimum balances as well as charges so as to expand the outreach of banking services to vast sections of the population. As on March 31, 2009, public sector banks had opened 2,98,59,178 'no frills' accounts, while private sector banks and foreign banks had opened 31,24,101 accounts and 41,482 accounts, respectively.

(ii) In order to ensure that persons belonging to low income group, both in urban and rural areas, do not encounter difficulties in opening bank accounts, the KYC norms for opening accounts were simplified for those accounts with balances not exceeding Rs.50,000 and credits thereto not exceeding Rs.1,00,000 in a year. The simplified procedure allowed introduction by a customer on whom the full KYC drill had been already applied.

(iii) Banks have been asked to consider introduction of a general-purpose credit card (GCC) facility up to Rs.25,000 at their rural and semi-urban branches. The credit facility is in the nature of a revolving credit entitling the holder to withdraw up to the limit sanctioned. The Reserve Bank further advised banks in May 2008 to classify 100 per cent of the credit outstanding under GCCs as indirect finance to the agriculture sector under the priority sector with immediate effect.

(iv) At the state level, the SLBC is required to identify one or more districts for 100 per cent financial inclusion. Responsibility is given to the banks in the area for ensuring that all those who desire to have a bank account are provided with one by allocating the villages among the different banks.

(v) In certain less developed states, such as those in the North Eastern region, Bihar, Chhattisgarh, Jharkand, Himachal Pradesh, Lakshadweep and Uttarakhand, Working Groups appointed by the Reserve Bank have made specific recommendations for financial inclusion, strengthening financial institutions and improving currency and payments systems. The recommendations of these Working Groups are under implementation.

(vi) In January 2006, the Reserve Bank permitted banks to utilise the services of NGOs, MFIs (other than NBFCs) and other civil society organisations as intermediaries in providing financial and banking services through the use of business facilitator (BF) and business correspondent (BC) models. The BC model allows banks to do 'cash in - cash out' transactions at a location much closer to the rural population.

(vii) The Reserve Bank has been encouraging the use of ICT solutions by banks for enhancing their outreach with the help of their BCs. Banks have been urged to scale up IT initiatives for financial inclusion speedily while ensuring that solutions are highly secure, amenable to audit and follow widely-accepted open standards to ensure eventual inter-operability among the different systems.

reportedly been achieved in 204 districts in 18 States and six Union Territories. All districts of Haryana, Himachal Pradesh, Karnataka, Kerala, Uttarakhand, Goa, Chandigarh, Puducherry, Daman and Diu, Dadra and Nagar Haveli and Lakshadweep have reported achieving 100 per cent financial inclusion.

IV.47 The Reserve Bank undertook an evaluation study through external agencies on the progress made in achieving 100 per cent financial inclusion in 26 districts that had reported achievement of the target with a view to draw lessons for further action in this regard. The studies were carried out in the States of Andhra Pradesh, Gujarat, Himachal Pradesh, Karnataka, Orissa, Punjab, Rajasthan and West Bengal. The findings revealed that although the SLBCs had declared several districts as fully financially included, the actual financial inclusion was not to the full extent in all the districts. Further, most of the accounts that had been opened as a part of the financial inclusion drive remained inoperative due to various reasons. The awareness with regard to 'no frills' accounts continued to be dismal and virtually non-existent in many districts. In order to sustain the momentum for financial inclusion, banks were advised in January 2009, among others, to ensure that steps were taken to provide banking services nearer to the location of the ‘no frills’ account holders through a variety of channels, to consider providing GCCs/small overdrafts along with ‘no frills’ accounts to encourage the account holders to actively operate the accounts, to conduct awareness drives so that the ‘no frills’ account holders were made aware of the facilities offered, to review the extent of coverage in districts declared as 100 per cent financially included and to efficiently leverage the technology-enabled financial inclusion initiatives being implemented in various States.

IV.48 In April 2008, banks were permitted to engage retired bank employees, ex-servicemen and retired government employees as BCs, in addition to the entities already permitted, subject to appropriate due diligence. The distance between the place of business of a BC and the base branch was not to, ordinarily, exceed 15 kms in rural, semi-urban and urban areas and 5 kms in metropolitan centres. In case a need was felt to relax the distance criterion, however, the matter could be referred to the District Consultative Committee (DCC) of the district concerned for approval. Where such relaxations covered adjoining districts, the matter could be cleared by the SLBC, which would also be the concerned forum for metropolitan areas. The distance criterion for rural, semi-urban and urban areas was relaxed to 30 kms with effect from April 24, 2009.

IV.49 SCBs, including RRBs and local area banks, were advised in August 2008 that they could engage companies registered under Section 25 of the Companies Act, 1956 as BCs, provided that these companies were stand-alone entities or not more than 10 per cent of their equity was held by NBFCs, banks, telecom companies and other corporate entities or their holding companies. Further, while engaging Section 25 companies as BCs, banks would have to strictly adhere to the distance criterion, between the place of business of the BC and the branch.

IV.50 In case, the duly appointed BCs of banks desired to appoint sub-agents at the grassroot level to render the services of a BC, banks were advised to ensure that: (i) the sub-agents of BCs fulfilled all relevant criteria stipulated for BCs in terms of extant guidelines; (ii) the BC appointed by them carried out proper due diligence in respect of the sub-agent in order to address reputational and other risks involved; and (iii) the distance criterion, as applicable, from the base branch should invariably be fulfilled in the case of all sub-agents. Banks were also advised that where individuals under the permitted categories were appointed as BCs, they could not in turn appoint sub-agents. Consequent to the announcement in the Annual Policy Statement for 2009-10, a Working Group was constituted to examine the experience to date of the BC model and suggest measures, to enlarge the category of persons that could act as BCs, keeping in view the regulatory and supervisory framework and consumer protection issues. The Working Group has since submitted its Report.

IV.51 The Reserve Bank had constituted a High Level Committee to go into the issues connected with the modalities of electronic benefit transfer (EBT) and suggest a common strategy for adoption by the State Governments. Subsequently, the Reserve Bank formulated a scheme to quicken the pace of adoption of the smart card/biometric based EBT mechanism by the banks and roll out the EBT system in the States that are ready to adopt the scheme. As per the scheme, the Reserve Bank would partially reimburse the banks the cost of opening accounts with biometric access at the rate of Rs.50 per account through which payment of social security benefits, National Rural Employment Guarantee Act payments and payments under other Government benefit programmes would be routed.

IV.52 The Working Groups set up to suggest measures for improving the outreach of banks and their services and promoting financial inclusion in certain less developed States/Union Territories, have made specific recommendations for achieving the above objectives and strengthening of financial institutions, improving currency and payments systems and revitalisation of the RRBs and UCBs in the respective regions. The status in respect of compliance with the recommendations of these Groups is outlined in Box IV.4.

IV.53 Despite the host of measures taken by the Reserve Bank since 2005, moneylenders remain a dominant source of credit, especially in the rural areas and hinterland. With a view to addressing the needs of the people who rely on informal sources of credit, the Reserve Bank had constituted a Group to review the legislation on money lending (Box IV.5).

Box IV.4
Implementation of Recommendations of the Working Groups on Improvement of Banking Services in Different States/Union Territories

The Reserve Bank in the recent period constituted Working Groups in certain States with a view to improving the outreach of banks and their services, promoting financial inclusion and supporting the development plans of the State Governments. The reports submitted by these Groups have been found very useful from several points of view. First, they have examined the adequacy of banking services in the context of the respective State's development plan and tried to plug the gaps. Second, they have thrown up a host of constructive suggestions towards enhancing the outreach of banks and promoting financial inclusion, keeping in view the regional requirements, resources and opportunities. Third, the studies undertaken have also made useful suggestions for revitalisation of RRBs and UCBs in the respective regions. Lastly and most importantly, the studies undertaken jointly by the Reserve Bank, the concerned State Governments, NABARD, banks and financial institutions have imparted a renewed impetus for concerted action to bring about improvements in the economies of the respective States. In this regard, Working Groups were constituted for Bihar, Uttaranchal, Chhattisgarh, Lakshadweep, Himachal Pradesh and Jharkhand between July 2006 and October 2007.

These Working Groups made wide-ranging recommendations, which included not only measures for enhancing greater outreach/penetration of the banking system through consistent use of IT and available business processing technologies but also developmental measures to be taken by respective State Governments to improve infrastructure and attract investment.

The compliance marked to State Governments/banks/other agencies are monitored through the respective regional offices of the Reserve Bank. For this purpose it was decided to constitute a special sub-committee of the SLBC, which was entrusted with the implementation of the recommendations made by the Working Group within a prescribed timeframe. The sub-committee would be chaired by the SLBC convenor bank and have representatives from respective State Governments, Reserve Bank, other banks and NABARD. The State Governments were requested to nominate a senior official from the Finance and Planning Department on this sub-committee to oversee the implementation of the recommendations of the Working Groups. Further, State Governments were also requested to form Empowered Committees under the chairmanship of the Chief Secretary to expedite action on the unfulfilled recommendations. Thus, there exists a proper mechanism to strategise and implement the recommendations of the Working Groups. A lot of qualitative and sustainable action has been initiated by the regional offices that are monitored by the central office of the Reserve Bank. Action has been initiated by all the regional offices on major recommendations/suggestions to improve the financial network as also the banking facilities and services in unbanked areas. The regional offices have reported compliance related to following recommendations:

1. Opening of new branches.
2. All branches to be made RTGS and NEFT enabled to reap the benefits of electronic payment and settlement system.
3. Agencies to take initiatives to promote more SHGs by making use of the services of NGOs
4. Setting up of rural development and self-employment training institutes for promoting self employment opportunities.
5. Banks to aggressively use the BF model for increasing banking outreach.
6. Use of post offices for augmenting credit flow in rural areas.
7. Village *panchayats* can also act as BFs/BCs for banks.
8. Banks and other agencies to carry out awareness campaign for opening of 'no frills' accounts.
9. Inclusion of under developed districts for 100 per cent financial inclusion.
10. Opening of credit counselling centres in the districts of the States by major banks.

Most of the recommendations, particularly those marked to State Governments, are long-term in nature such as development of infrastructure, horticulture, fisheries, tourism, in the States. Thus, the implementation of such recommendations is an ongoing process.

Box IV.5
Technical Group for Review of Legislation on Money Lending

A Technical Group (Chairman: Shri S.C. Gupta) was set up to review both the efficacy of the existing legislative framework governing money lending and its enforcement machinery in different States and to make recommendations to the State Governments for improving the legal and enforcement framework in the interest of the rural households. The Group had submitted its Report in July 2007.

The Group prepared a model legislation for consideration and adoption by the State Governments that do not presently have a comprehensive legislation in place for governing money lending. The model legislation provides for a hassle-free procedure for compulsory registration and periodic renewal by money lenders, a simplified dispute resolution mechanism to ensure better enforcement, periodic fixing of the maximum interest rate in line with market rates and adoption of the rule of *damdupat,* restricting the maximum amount of interest chargeable by the money lender. The Group also explored establishment of a link between the formal and informal credit providers whereby a money lender, who is an 'accredited loan provider', could serve as an additional credit delivery channel for the formal sector, provided there were safeguard measures.

The Report was translated into different vernacular languages for all regions with copies handed over to the Chief Secretaries of the State Governments by the Regional Directors of the Reserve Bank. As per the responses received, although some of the State Governments have evinced interest in the model legislation, relevant action in regard to adoption of its recommendations into their respective extant legislations has not yet been taken. The Government of Uttar Pradesh has incorporated some suggestions of the model legislation in the UP Regulation of Money Lending (Amendment) Act, 2008. Reportedly, a few State Governments such as Bihar, Delhi, Kerala, Orissa and West Bengal are processing the matter. In Maharashtra, the State Government is reported to be enacting a new legislation in which the provision of *damdupat* has been incorporated. The Maharashtra Money Lending (Regulation) Act, 2008 has been submitted to the Central Government for clearance as some provisions of the proposed Act fall within the ambit of certain Central Government Acts. The regional offices of Reserve Bank are following up the matter.

FINANCIAL LITERACY AND CREDIT COUNSELLING

IV.54 The Reserve Bank has been taking a number of initiatives to promote financial literacy, as lack of awareness is a major factor for financial exclusion. 'Project Financial Literacy' has been undertaken to educate the common person on financial matters. The common person for this purpose is defined as one who is not financially literate. To ease access to information, the 'For the Common Person' link on the Reserve Bank's website has been made multi-lingual, with information accessible in Hindi, English and eleven regional languages.

IV.55 The financial education site launched by the Reserve Bank in November 2007 and aimed at teaching basics of banking, finance and central banking to children in different age groups, would eventually have information useful to other target groups.

IV.56 The other initiatives of the Reserve Bank to promote financial awareness include conducting essay/quiz/inter-school debate competitions for school children on topics related to banking and financial inclusion; distributing material such as comic books, pamphlets and posters on financial literacy free-of-cost; participating in fairs/exhibitions to disseminate information on the Reserve Bank's role as a central bank; educating the general public about the Reserve Bank's clean note policy, security features of currency notes, detection of forged notes, foreign exchange facilities to residents, guidance to the public on investment in NBFCs and on the Banking Ombudsman Scheme, among others. The Reserve Bank holds meetings with banks, MFIs, rural insurance agencies, officials of Department of Posts and other field-level functionaries to familiarise them with the Reserve Bank's instructions on financial inclusion and provide operational guidance. Workshops/seminars are conducted for the controlling heads of major banks to encourage them about working towards greater financial inclusion, such as, opening of 'no frills' accounts, IT-enabled financial inclusion, formation of SHGs. The Reserve Bank urges the branch managers of banks operating in districts, block development officers, lead district managers, lead district officers and members of local media to have a door-to-door campaign to bring all the households in their areas into the banking fold. There is interaction with the representatives of local print and electronic media to disseminate information on financial literacy initiatives of the Reserve Bank and matters pertaining to currency management taken up by the regional offices. Select villages are visited to discuss issues relating to, *inter alia*, financial planning, accessing banking services, availing loans under the DRI scheme and other Government sponsored schemes, availing the services of rural self-employment training institutes, simplification of lending procedures for crop loans, advantages of KCCs. An awareness campaign has been launched for the army personnel to apprise them of the various banking products and interactive sessions are held with officers and *jawans* to address their banking related queries. Roadshows are organised at prominent public places such as railway stations, bus stands and beaches, to promote financial inclusion.

IV.57 The Reserve Bank has undertaken a project of setting up a permanent exhibition centre on financial education in Mumbai. A pilot project on developing and including chapters on financial education as part of the curriculum in schools has been undertaken in collaboration with the Karnataka Government.

IV.58 The Annual Policy Statement for 2007-08 had advised SLBC convenor banks to set up a financial literacy *cum* counselling centre in any one district on a pilot basis and extend it to all other districts in due course, based on the experience gained. Several banks have since taken initiatives in opening credit counselling centres in the country. So far, banks have reported setting up 148 credit counselling centres in various States of the country. The feedback received in this regard indicated that most of these centres were in effect set up as extensions of the bank branches and engaged in promotion of bank-specific products. Accordingly, 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 FLCC's services were available to even other banks' customers in the district (Box IV.6).

EXPORT CREDIT

IV.59 The export sector not only confronted with the challenge of decelerating global demand but also tighter access conditions in the market for trade credit. In response, a number of measures were taken to address the concerns relating to trade credit and give a boost to the export sector.

IV.60 The challenges relating to trade credit have to be seen in the context of the fact that the inventories were building up due to the slowdown in export demand. Further, the realisation of export proceeds was not taking place on the due date. Therefore, a need was felt to extend the period of entitlement of pre-shipment and post-shipment export credit. Accordingly, the period for prescribed interest rate ceiling of 250 basis points below BPLR for pre-shipment and post-shipment rupee export credit was extended by 90 days each to 270 days (with effect from November 15, 2008) and 180 days (with effect from November 28, 2008), respectively. The prescribed rate was also made applicable to overdue bills up to 180 days with effect from December 8, 2008. Further, the validity of the interest rate ceiling of 250 basis points below BPLR for pre-shipment rupee export credit up to 270 days and post-shipment rupee export credit up to 180 days was extended up to October 31, 2009 (Appendix Table 57).

IV.61 Banks are permitted to deploy amounts raised through FCNR (B) deposits and foreign currency lines of credit for extending foreign currency loans to exporters. Though banks are permitted to access overseas lines of credit for on-lending to exporters, the ability of banks to borrow is constrained by the interest rate ceiling specified by the Reserve Bank on such borrowings. As the availability of US dollar funds in the inter-bank money market dried up with considerable widening

Box IV.6
Financial Literacy and Credit Counselling Centres – Model Scheme

Consequent to the announcement in the Mid-term Review of the Annual Policy for 2007-08, a concept paper on Financial Literacy and Credit Counselling Centres (FLCCs) was placed on the Reserve Bank's website. Based on the feedback received from the public as also from banks that had started operating the counselling centres, a model scheme for setting up FLCCs was formulated in February 2009.

Model Scheme for FLCCs

The broad objective of the FLCCs would be to provide free financial literacy/education and credit counselling. The specific objectives of the FLCCs would be: (i) to provide financial counselling services through face-to-face interaction and other available media as per the convenience of the interested persons, including education on responsible borrowing, proactive and early savings and debt counselling to individuals who are indebted to formal/informal financial sectors; (ii) to educate the people in the rural and the urban areas with regard to various financial products and services available from the formal financial sector; (iii) to make the people aware of the advantages of being connected with the formal financial sector; (iv) to formulate debt restructuring plans for borrowers in distress and recommend the same to formal financial institutions, including co-operatives, for consideration; (v) to take up any activity that promotes financial literacy, awareness regarding banking services, financial planning and amelioration of debt-related distress of an individual.

To start with, banks could set up trusts/societies for running the FLCCs, singly or jointly with other banks. Respected local citizens could be inducted on the Board of such a trust/society while serving bankers could be excluded. Initially, the FLCCs may be fully funded by the bank/s.

The counselling centres should maintain 'arm's length' relationship with the parent bank and, preferably, not be located in the bank's premises. The centres should not promote the products of their parent banks. The independence of the counselling centres has to be ensured so that non-partisan and objective guidance is provided to the customers.

In order to have maximum coverage, FLCCs should be set up in blocks, districts, towns and cities. SLBCs could coordinate with banks, both in the public and the private sectors, and arrive at a plan for setting up FLCCs at different levels in a phased manner.

Debt counselling/credit counselling can be both preventive and curative. In case of preventive counselling, the centres could provide awareness regarding the cost of credit, availability of backward and forward linkages where warranted, *etc.* The clients could be encouraged to avail of credit on the basis of their repaying capacity. Preventive counselling could be through the media, workshops and seminars.

FLCCs may consider introducing a generic financial education module in vernacular language, broadly including the need for savings, budgeting, advantages of banking with formal financial institutions, concept of risk and rewards and time value of money, various products offered by banks, insurance companies, *etc.* The module may also cover aspects relating to deposits and various other financial products, the method of calculation of interest on savings accounts, fixed deposits, *etc.*, and method of compounding.

In the case of curative counselling, the clients could approach the counselling centres to work out individual debt management plans for resolving their unmanageable debt portfolio. Preventive counselling may be made mandatory for individual borrowers based on their income level or size of loan. Such mandatory credit counselling could be made a part of fair lending practice of banks.

Banks may encourage their own customers in distress or customers of any bank to approach the FLCCs set up by them. Information about such FLCCs could be provided through the various fora available under the Lead Bank Scheme. Banks may evolve trigger points to refer cases, where there are early warning signals, to the counselling centres before taking measures for recovery. Timely intervention would help to arrest any further financial deterioration of the borrower. The counsellors should be mandated to refer cases to banks and work out debt management plans for distressed borrowers with a view to facilitating restructuring/rescheduling of their debts. The choice of finally accepting or rejecting a debt restructuring proposal suggested by the FLCCs may be left to the bank/s concerned. However, in case of non-acceptance or rejection of restructuring proposals forwarded by FLCCs, the banks may give the reasons in writing to the concerned FLCC in the interest of transparency.

As FLCCs are expected to play a crucial role in assisting and guiding the distressed individual/borrower, it is necessary that only well-qualified and trained counsellors are selected to man the centre on a full time basis. Individuals such as retired bank officers and ex-servicemen, may be allowed to be appointed, among others, as credit counsellors. Credit counsellors should have sound knowledge of banking, law, finance, requisite communication and team building skills, among others. Training is also required to be provided to the counsellors on an ongoing basis to constantly upgrade their skills.

The functioning of the FLCCs in each State may be monitored by a committee headed by the Regional Director of the Reserve Bank and the feedback be provided to the banks on a regular basis. The committee may comprise SLBC convenor bank, other banks, NABARD, IBA, consumer organisations and NGOs working in the area.

of spreads in the international market, in the aftermath of global financial crisis, Indian banks were finding it difficult to access foreign exchange lines of credit within the interest rate ceiling and extend export credit within the prescribed ceiling rate. In order to facilitate banks financing of export credit in foreign currency to exporters, in consultation with the Government of India, the ceiling rate on export credit in foreign currency was raised to LIBOR *plus* 350 basis points from LIBOR plus 100 basis points on February 5, 2009 and the ceiling interest rate on the lines of credit with overseas banks for the banks providing export credit was raised from 6- month LIBOR *plus* 75 basis points to 6-month LIBOR *plus* 150 basis points.

IV.62 The rupee export credit interest rate scheme is formulated by the Government of India for which operational details are issued by the Reserve Bank. The scheme of rupee export credit interest subvention of 2.0/4.0 per cent for certain specified sectors effective from April 1, 2007 was brought to a close on September 30, 2008. This scheme was formulated to alleviate the exporters' concerns in the context of appreciation of the rupee. In the wake of the global financial crisis, a fresh scheme of rupee export credit interest subvention of 2.0 per cent was, however, introduced for seven employment-oriented export sectors for the period from December 1, 2008 to September 30, 2009 on pre- and post-shipment rupee export credit. This scheme has since been extended up to March 31, 2010.

IV.63 The Reserve Bank provides export credit refinance (ECR) facility to scheduled banks under Section 17(3A) of the Reserve Bank of India Act, 1934. All scheduled banks (excluding RRBs), which are authorised dealers in foreign exchange and have extended rupee export credit (for both pre-shipment and post-shipment), are eligible for refinance. The quantum of the refinance facility and the rate of interest applicable are prescribed by the Reserve Bank from time to time based on the monetary policy stance. In 2001, the quantum of ECR limit was fixed at 15.0 per cent of the outstanding rupee export credit eligible for refinance as at the end of the second preceding fortnight. With a view to strengthening the credit delivery mechanism and improving credit delivery for sustaining the growth momentum, this limit was enhanced to 50.0 per cent with effect from November 15, 2008. The rate of interest charged on ECR facility is fixed at the repo rate under the LAF of the Reserve Bank. The reliance on ECR facility by banks was generally low, barring a few occasions. However, the recourse to ECR facility in terms of daily average utilisation by banks during July-September 2008 was higher in the range of 26.0-56.0 per cent of the limit, coincident with the tightening of overall liquidity conditions. Nevertheless, aggregate utilisation of the ECR facility remained much below the ECR limits in the recent period and it was as low as 5.4 per cent in June 2009 (Appendix Table 22).

EXTENSION OF COLLATERAL FACILITY – SAVINGS BONDS

IV.64 In terms of relevant Government of India Notifications, 7.0% Savings Bonds 2002, 6.5% Savings Bonds 2003 (Non-taxable) and 8.0% Savings (Taxable) Bonds 2003, were not eligible as collateral for loans from banks, financial institutions and NBFCs, *etc*. On a review, it was decided by the Government of India to allow for pledge or hypothecation or lien of the bonds issued under the above schemes as collateral for obtaining loans from scheduled banks. Accordingly, the holders of the said bonds would be entitled to create pledge or hypothecation or lien in favour of scheduled banks in accordance with Section 28 of the Government Securities Act, 2006 and Regulations 21 and 22 of the Government Securities Regulations, 2007. However, the collateral facility is available only for the loans extended to the holders of the bonds and, as such, the facility is not available in respect of the loans extended to third parties.

NON-BANKING FINANCIAL COMPANIES

IV.65 The Government had announced the setting up of an SPV for addressing the temporary liquidity constraints of NBFCs-ND-SI. The SPV issues Government guaranteed securities to the Reserve Bank and uses the funds to acquire only investment grade CPs and non-convertible debentures of the NBFCs to tide over temporary liquidity mismatch. The total liquidity support from the Reserve Bank to NBFCs would be limited to Rs.20,000 crore with an option to raise it by a further Rs.5,000 crore. This facility is available for any paper issued by NBFCs up to September 30, 2009. The SPV would cease to make fresh purchases after December 31, 2009 and would recover all dues by March 31, 2010. NBFCs utilised the special liquidity facility from the Reserve Bank through the SPV (*viz.*, IDBI SASF) in the range of 0.8-3.0 per cent up to July 6, 2009 and the total outstanding amount of Rs.290 crore was repaid on July 7, 2009.

SCHEDULED COMMERCIAL BANKS

IV.66 The Reserve Bank has allowed banks to avail liquidity support under the LAF for the purpose of meeting the funding requirements of mutual funds (MFs), NBFCs and housing finance companies (HFCs) through relaxation in the maintenance of SLR up to 1.5 per cent of their NDTL. This facility, with a limit of Rs.60,000 crore, is available up to March 31, 2010. Banks have utilised only a small portion of their limit so far. During November 2008-July 2009, utilisation was in the range of 0.2-8.4 per cent.

IV.67 In order to provide flexibility to Indian banks in managing their short-term funding requirements at their overseas offices, the Reserve Bank with effect from November 7, 2008 provided foreign exchange liquidity to Indian public and private sector banks having foreign branches or subsidiaries, through foreign exchange swaps of tenures up to three months. Banks are allowed to borrow under the LAF for the corresponding tenure at the prevailing repo rate for funding the swaps, and the Reserve Bank is also prepared to consider any specific relaxation of SLR requirements, if need be, for this purpose. This facility is available up to March 31, 2010. Under the foreign exchange swap facility, banks have availed funds in the range of Rs.470-1,030 crore till August 14, 2009.

IV.68 In the context of the intense credit freeze that affected the global economy, the significance of the Reserve Bank's continuous emphasis on ensuring adequate flow of credit to all productive sectors of the economy and the specific measures for promoting credit delivery alongside financial inclusion of the masses became evident. Despite some moderation in credit growth, credit continued to flow to all the productive sectors of the economy. In this regard, the Reserve Bank policies have been supplemented by the Government of India initiatives, such as the Agriculture Debt Waiver and Debt Relief Scheme, 2008. Recent years have seen a steady improvement in credit flow to the agriculture and the MSE sectors. Though 'no frills' accounts have been opened at a rapid pace since their introduction in November 2005 as part of the policy on financial inclusion, the Reserve Bank has issued fresh instructions to ensure that these accounts remain operative and serve the purpose of financial inclusion. The new model scheme on FLCCs should increase awareness about the array of products that are available to an individual to connect with the formal banking system. The model legislation on money lending suggested by the concerned Technical Group is expected to be incorporated into various States' laws on money lending and help address the needs of people who remain outside the formal credit channel. Even though the Reserve Bank would continue to take initiatives to further strengthen the credit delivery mechanisms, the emphasis on credit quality would, however, not be diluted.