



## APPENDICES

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- D. The said Working Group examined the practices prevalent in other countries for tackling such situations and examined various options available to the Bank under the present statutory set up and made various recommendations:
- E. The said Working Group observed that the existing instruments being used by the Bank may become inadequate to tackle the situation arising out of the current level of forex inflows and suggested, *inter alia*, issuance of Market Stabilisation Bills and / or Bonds:
- F. The Government examined the recommendations of the said Working Group and decided that the Bank may use the existing instruments to the extent possible to tackle the current situation and any situation that may arise from time to time, and when needed, Treasury Bills and / or dated securities may be issued for the purpose of absorption of liquidity under a Market Stabilisation Scheme, in addition to the normal Market Borrowing Programme of the Government.
- G. It was considered necessary to enter into a Memorandum of Understanding between the Bank and the Government for issuing the said Treasury Bills and / or dated securities under the Market Stabilisation Scheme (MSS).

IN CONSIDERATION OF THE GOVERNMENT ISSUING THE SAID TREASURY BILLS AND / OR DATED SECURITIES FOR STABILISATION PURPOSES UNDER THE MARKET STABILISATION SCHEME (MSS) NOW IT IS HEREBY AGREED AND DECLARED AS FOLLOWS:

1. The Government may issue Treasury Bills and / or dated securities in addition to their normal market borrowing programme for absorbing liquidity from the system.
2. The Government, in consultation with the Bank, shall fix an annual aggregate ceiling for Treasury Bills (face value less discount) and / or dated securities (face value) under the MSS that may remain outstanding



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at any point of time. The said ceiling shall hold good till further revision during the course of the year, as mentioned below or any time thereafter. For the financial year 2004-05, the ceiling shall initially be Rs.60,000 crore. For the subsequent financial years, such limits shall be mutually agreed upon between the Government and the Bank.

3. The Government, in consultation with the Bank, shall also decide on a threshold limit within the ceiling. As soon as the Treasury Bills and/or dated securities issued under the MSS remaining outstanding touches the said threshold limit in any financial year, the Bank shall notify the Government and may seek revision of the ceiling. The Government may then revise the ceiling in consultation with the Bank and fix the revised ceiling and the revised threshold limit. This process shall be followed on reaching the revised threshold limit also. For the financial year 2004-05, the threshold limit shall be Rs.50,000 crore.
4. The actual outstandings under the MSS shall not exceed the ceiling or the revised ceiling at any point of time.
5. Within the above ceiling or the revised ceiling, as the case may be, the Bank shall decide the amount, tenure, modalities and timing of issue of such Treasury Bills and / or dated securities.
6. The Treasury Bills and / or dated securities issued under the MSS shall be indistinguishable from those under the normal market borrowing programme; however, they shall be accounted for separately by the Bank and the Government.
7. A Press release shall be issued by the Bank in respect of the Treasury Bills and /or dated securities issued under the MSS and for the purpose of accounting, the Bank shall advise the Government that they are being issued under the MSS.
8. The amounts so raised shall form part of the Consolidated Fund of India. The said amounts shall be credited to and held in a separate identifiable



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cash account titled the Market Stabilisation Scheme Account (MSS Account) to be maintained and operated by the Bank at Central Accounts Section (CAS), Nagpur.

9. The amounts so credited into the MSS Account shall be appropriated only for the purpose of redemption and / or buy back of the Treasury Bills and / or dated securities issued under the MSS. The Government is aware that the purpose of issuing these Treasury Bills and/or dated securities, namely, market stabilisation, would be defeated if the amounts in the said MSS Account are appropriated for any other purpose or expenditure and as such, undertakes not to appropriate or initiate any step to appropriate the amounts in the MSS Account except for the purpose of redemption and / or buy back of the Treasury Bills and / or dated securities issued under the MSS.
10. The payments on interest and discount shall not be made from the MSS Account. The receipts due to premium and/or accrued interest shall also not be credited to the MSS Account. Such receipts and payments towards interest, premium and discount shall be shown in the budget and other related documents as distinct components under separate sub-heads.
11. The Bank shall maintain the record of issue-wise details.
12. On maturity of the said Treasury Bills and / or dated securities for payment, the Bank shall initiate the redemption process and the Government shall take such steps as are required under the law to appropriate the amounts from the MSS Account for such redemption.
13. Subject to the above, the method of issue, accounting and redemption shall be the same as that which is followed at present in respect of Treasury Bills and dated securities. The transactions under the MSS shall, however, be accounted for under the corresponding sub-heads for Government debt and receipts and payments pertaining to interest, premium and discount in the main account of the Government.





APPENDICES

Appendix 3A.2



राकेश मोहन  
उप गवर्नर  
Rakesh Mohan  
Deputy Governor

SECRET

D.O.No. FMD. ऩ०न /02.02.012/2007-08

Dear Dr Subbarao,

**Market Stabilisation Scheme (MSS) –  
Revision of Annual Ceiling for 2007-08**

At present, the MSS ceiling for 2007-08 stands at Rs. 2,00,000 crore and the threshold level for revision of ceiling at Rs.1,85,000 crore vide MOF letter D.O.F.No. 4(1)W&M/2007 of October 4, 2007. In this connection, you would recall that while proposing the enhancement of the MSS ceiling vide my letter dated September 28, 2007, I had indicated that there was a high likelihood that this limit would have to be enhanced further during this fiscal year, given the pace of current market developments. The developments since then have corroborated our expectations.

2. The total outstanding amount of Treasury Bills and dated Government securities under the MSS as on October 26, 2007 is Rs. 1,77,155 crore. With the amount of new net issuance of Rs. 8,500 crore during the week beginning October 29, 2007, the total outstanding amount will reach Rs. 1,85,655 crore as on November 2, 2007. Capital inflows have gathered momentum in September, particularly after the 50 basis point cut in the U.S. Federal Funds Target Rate on September 18th. Consequently, we have already purchased \$ 24.41 bn (Rs.97,000 crore) since September 2007 so far taking the cumulative for fiscal 2007-08 to \$ 47.32 billion (Rs.1,90,000 crore). Notwithstanding the recent turbulence in the domestic market on account of participatory notes, the capital inflows remain strong. In the circumstances, our intervention operations as well as the sterilization requirements this fiscal are likely to be more than anticipated.

3. As mentioned in my earlier letter, the magnitude of enhancement of the MSS limit should not signal any view as to the anticipated volume of capital inflows or our strategy of exchange rate management but at the same time should communicate the ability of RBI to intervene in the market to ensure orderliness and curb volatility. Accordingly, we request that the MSS limit may be enhanced to Rs. 2,50,000 crore and the threshold to Rs. 2,35,000 crore, subject to review based on how the events unfold. I would reiterate that unless the situation changes significantly, there is a strong possibility that this limit will have to be enhanced further within this fiscal year.

4. In view of the current pace of MSS issuance, we would be grateful for urgent approval of this proposal.

With warm regards,

Yours sincerely  
  
(Rakesh Mohan)

Dr. D. Subbarao  
Finance Secretary  
Ministry of Finance  
Government of India  
New Delhi

APPENDICES

**Appendix 4A.1**

EC.CO.FID(I).No. /10.1.07.02.200(47)(25)/2002-2003.

December 16, 2002 **CONFIDENTIAL**

Dear Dr. Narayan,

Kindly recall the discussions the Governor had, in the context of a case relating to Basic Needs Trust, a UK based NGO's request for opening an office in India, emphasizing the need for the Reserve Bank and the Government to evolve a suitable mechanism to avoid delays in the disposal of applications. I wish to bring to your notice two more instances where lack of coordinated approach has led to delays and complaints from the applicants.

First, I am enclosing a letter from Mr. Frank Wisner regarding the case of AIG Indian Sectoral Equity Fund (AIG-I) set up jointly by AIG Inc, New York and Infrastructure Leasing and Financial Services, Mumbai (ILFS). Government (SIA/FIPB) approved the setting up of the AIG-I during August 1996-August 1998 at which point of time there were no guidelines for pricing of the disinvestments by such funds. On, ILFS approaching the Reserve Bank for approval for repatriating the proceeds of disinvestments in respect of one company, viz, RPG Mobile Ltd. a reference was made to the Government in June 2002 suggesting that the disinvestments may be approved on the basis of valuation by a Chartered Accountant as is being done under Regulation 10B of RBI notification No FEMA 20 dated 3 May 2000. It will be appreciated that RBI has no other means of ascertaining the fair value of the disinvestments. As this position was not entirely acceptable to Government protracted correspondence and a meeting held in September 2002, with the government ensued and the matter still remains unresolved with the Ministry of Finance. Copies of the relevant correspondence are enclosed for perusal.

Mr. Wisner has expressed his concern on the delay, which in his view has created a high level of embarrassment within the investing community and has severely undermined the prospects of participating in the future funds for India.

Second, I would like to bring to your notice, another matter, which has also led to delay in communicating approvals. As you may be aware, certain proposals for overseas investments are required to be cleared by a high powered Special Committee under my Chairmanship. MOC, MEA and MOF

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are represented in the Committee. The Committee in its last meeting held on 27<sup>th</sup> November 2002 authorized the Chairman to clear a particular proposal subject to the applicant company submitting a revised valuation as per certain norms that were discussed and approved. But the MOF representative has again raised certain objections after the Chairman approved the proposal under the authority delegated to him. A copy of the letter received from the representative of the MOF in this connection, and our reply thereto is enclosed for your information.

In the light of such a stand taken, two other proposals, which were also to be cleared by me, as authorized in the above meeting have been referred back to the MOF and other Special Committee members for approval by circulation. You will appreciate that this has not only rendered the delegation infructuous but has also resulted in significant delay in the decision making process. In the meantime, the companies who are unable to proceed further are pressing for our approvals.

Incidentally, CII in a recent letter to our Governor has highlighted the need for speedy decisions in the matter of approving overseas investment proposals.

In the light of the above it is necessary to review the current practices followed for aforesaid clearances. Our suggestions in this regard are :-

1. In cases where government clearances are required, government may directly receive the applications and accord requisite clearances. Alternatively, powers may be delegated to RBI for granting approvals. Such a single window approach will avoid delays that vitiate the investment climate in the country.
2. In the matter of the functioning of the Special Committee on Overseas investments, to avoid embarrassment of the kind stated above, either RBI may be vested with full powers to deal with all types of applications or alternatively, the Committee may be re-constituted without RBI representation, which is acceptable to us.

With best regards,

Yours sincerely,

  
( Vepa Kamesam )

Dr. S. Narayan  
Finance Secretary  
Government of India  
Ministry of Finance  
North Block  
New Delhi.

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Appendix 7A.1



उप गवर्नर  
DEPUTY GOVERNOR

**SECRET**

DO MPD No.3665/ 07.01.279/ 97-98

June 22, 1998

Dear Shri Ahluwalia,

**Market Borrowings – 1998-99**

This is in continuation of my letter D.O.IDMC.No.3360/10.03.01/97-98 dated April 3, 1998 which set forth the broad implications of the Interim Budget proposals on the economy for your consideration while finalising the Annual Budget for 1998-99. We are happy to see the effort in reducing the Net Market Borrowing Programme of the Central Government by Rs.6,773 crore from Rs.55,099 crore as indicated in the Interim Budget to Rs.48,326 crore in the Annual Budget.

2. Gross borrowing of the Central Government, however, is as high as Rs.79,376 crore, a figure much higher than Rs.63,000 crore indicated in the Governor's letter dated February 27, 1998. Any increase in Government Borrowing Programme beyond the projected level is likely to have implications in the form of upward pressure on inflation and hardening of interest rates.

3. In the light of the Budget proposals it is necessary to assess the impact of the market borrowing programme on the economy. The budget estimate of net market borrowing of Central Government for 1998-99 would work out to be 42.9 per cent higher than the budget estimates of 1997-98 and 19.6 per cent higher

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Continuation Sheet .....

than the actuals of 1997-98. The implied gross market borrowing for 1998-99 was higher by 49.9 per cent and 33.1 per cent respectively as compared to the budget estimate and actual for 1997-98. If the estimated borrowing by the State Governments of Rs.9,764 crore (gross) is also taken into account, the combined gross market borrowing of the central and state governments would work out to be as high as Rs.89,140 crore. So far, we have raised Rs.35,630 crore in respect of Central Government market borrowing which includes two private placements of Rs.10,000 crore and a devolvement to the RBI of Rs.13,999.50 crore. In addition, Rs.5,130 crore has been raised in respect of State Government market borrowing. It may be noted that tapping this order of market borrowing is already proving difficult and interest rates on Government paper are already showing signs of rising. You are also aware, the upward shift in these interest rates will put similar pressure on all other interest rates.

4. The implications of Government borrowing of the above order would need to be viewed from two angles viz., the macro economic angle and impact on the banking system. Some of my reflections on this score are set out below:

- (i) From the macroeconomic viewpoint, with the objective of maintaining overall price stability and continuing with credible monetary management, Reserve Bank's support to the market borrowing programme has to be limited and in this spirit, it was placed at Rs.7,000 crore in the Interim Budget. However, the final Budget proposals do not have any explicit reference to RBI support. It may, however, be noted that in our view, any support over the level of Rs.7,000 crore would contribute to more than warranted rise in monetary growth and generation of inflationary pressures in the economy.
- (ii) The level of market borrowing programme envisaged in the budget would imply investment by commercial banks of a high order. With the RBI support palced at Rs.7,000 crore, the effective SLR on an outstanding basis would work out to be about 34 per cent. If CRR requirements are also to be included, as much as 44 per cent of banks resources on an average basis and as much as 51 per cent of growth in

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deposits on an incremental basis in 1998-99 would be pre-empted from banks. Already Scheduled Commercial Banks have been maintaining excess SLR of around 7 – 8 per cent over and above the statutory requirement of 25 per cent. This would adversely affect flow of resources from the banking system to the commercial sector in a significant manner.

5. It may be noted in this context that during the current financial year, upto June 5, investment in Government Securities by Scheduled Commercial Banks at Rs.18,478 crore has been greater than the deposit accretion of Rs.16,279 crore.

6. It is important to recognise that the above calculations do not take into account, the Guarantee scheme offered by the Finance Minister to the tune of Rs.10,000 crore to major central Public Sector Undertakings in the context of outstanding dues to them from State Electricity Boards. If the concerned PSUs raise resources from the market directly on the basis of such guarantees, the additional burden on the banking system would further aggravate inflation and harden interest rates.

7. It may also be mentioned here that as per the Government notification towards the end of March 1998 for the issue of special bonds worth Rs.12,984 crore in favour of certain oil companies, one company has already asked for a term loan of Rs.1,000 crore. As such, loans against these special bonds will also exert pressure on the resources of commercial banks.

8. We are already experiencing pressures due to government market borrowing programme and private placement along with development on RBI has already reached a level of about Rs.14,000 crore putting undue upward thrust on reserve money and broad money. The inflationary potential is obvious.

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Continuation Sheet

9. Our capacity to off load the securities thus placed with us in the market is extremely limited given the likely interest rate movement unless we sell them at a discount - a very undesirable step.

10. Against the above backdrop and keeping in view the broad objectives of monetary policy viz. price stability with growth, there is a need to have a ceiling on the RBI support to Government. This, in my view, should, certainly be lower than and in no circumstances, exceed the present level which is as high as Rs.14,000 crore - twice the level given in the monetary projections.

11. I trust that you will bring this issue along with implications for exchange rate, as desired by Governor, to the notice of Finance Minister.

*with regards,*

Yours sincerely,

*Y.V.Reddy*  
(Y.V.Reddy)

Shri Montek Singh Ahluwalia,  
Finance Secretary,  
Ministry of Finance,  
Government of India,  
New Delhi 110 001

APPENDICES

Appendix 7A.2



राकेश मोहन  
उप गवर्नर  
Rakesh Mohan  
Deputy Governor

भारतीय रिज़र्व बैंक  
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rakeshmohan@rbi.org.in

CONFIDENTIAL

March 26, 2004

Dear *Shri Mohan*,

**Shortage of Securities in RBI's Investment Portfolio –  
Proposal for Ceiling on Investments of Surplus  
Balance of Government – Contingency Plan**

You are aware of the steep rise in the requirement of sterilization by Reserve Bank of forex inflows in the last two years. These inflows appear likely to continue and add to the already considerable liquidity in the system.

2. In the current week, we had to absorb considerable amounts under the Liquidity Adjustment Facility (average absorption of Rs.58,783 crore and peak absorption of Rs.62,995 crore on March 24, 2004). Surplus balance in the Government of India's cash account has also been very high in the last two weeks, going beyond Rs. 30,000 crore (peak level of Rs.35,732 crore on March 20, 2004). As a result, Reserve Bank came very close to running out of securities for delivery under LAF/investment of Government surplus. If Reserve Bank is forced to reject LAF repo bids on account of lack of securities, it will have serious repercussions not just for the interest rate environment in the system, but also on the forex markets. More significantly, this will undermine Reserve Bank's ability to effectively conduct its monetary policy. To avoid such a situation, we feel that Reserve Bank needs to have a reasonable cushion of securities for delivery under LAF.

3. Also, we need a cushion because Central Government accounts are closed with a one-day lag. Thus the investment requirement of a given day will be available only the next day, requiring backdated accounting.

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2.

4. We, therefore, propose placing a ceiling of Rs.20,000 crore on the amount of surplus balance of the Government of India that can be invested. In other words, any balance eligible for investment in excess of Rs.20,000 crore will not be invested by sale of securities from RBI's investment account, and therefore will not earn any interest. This will give Reserve Bank a cushion of approximately Rs.10,000 crore at current levels of LAF utilization, after taking out securities earmarked for PF/Pension investment portfolio and for State Governments' investments (like Consolidated Sinking Fund(CSF)/Guarantee Redemption Fund (GRF) etc.).

5. Currently, if Government runs surplus cash balances beyond a level of Rs.100 crore on any day, such surplus amount over and above the minimum daily cash balance is invested in Government securities at par from RBI's investment account. As per the Supplemental Agreement signed on March 26, 1997 between Government and RBI in this regard "(8) If the Government runs surplus cash balances beyond an agreed level, the Bank will make investments, as may be mutually agreed from time to time." Thus we feel there is scope to change the current arrangements, including placing a ceiling on the surplus amount to be invested.

6. This ceiling may be revised downwards depending on the availability of securities, consequent on the increasing size of our monetary operations in future. The pressure on the availability of securities for LAF may also ease after introduction of the MSS Scheme in April 2004. Therefore, the arrangement could be reviewed towards end-April, 2004.

With warm regards

Yours sincerely

A handwritten signature in black ink, appearing to read 'Rakesh Mohan', with a horizontal line extending to the right.

(Rakesh Mohan)

Shri D. Swarup  
Secretary (Expenditure & Budget)  
Ministry of Finance  
Government of India  
North Block  
New Delhi-110 001

APPENDICES

Appendix 7A.3



उप गवर्नर  
DEPUTY GOVERNOR

**SECRET**

D.O.IDMC.No. 3703/08.01.01-2001-02

February 13, 2002

Dear Shri Vasudev,

Please refer to my letter D.O.IDMC.No.3080/03.64.19/2001-02 dated December 28, 2001 enclosing the draft paragraphs for Finance Minister's Budget Speech. It was suggested that to enable both institutional and retail investors to plan their investments better, Finance Minister can make an announcement regarding issuance of calendar for dated Government Securities so as to add to the transparency and stability in the Government securities market. Keeping this in view we have attempted to prepare an indicative calendar of auctions for first six months of the ensuing financial year 2002-03 with reference to the core borrowing programme of the Government mainly comprising the items of committed expenditure, viz., salary, pension payments, transfer to States, redemptions of dated securities and coupon payments. A detailed note prepared in this regard is enclosed. You will observe that as against the total requirement of Rs. 75,000 crore in the first half of the year the calendar envisages auctions on 10 occasions aggregating to Rs. 65,000 crore, leaving a balance of Rs. 10,000 crore which, together with any other emergent requirement, could be mobilized through one or more additional auctions. It may also be observed that instead of giving the exact date of auctions, a range of dates have been indicated so as to retain some flexibility about the exact auction date.

2. We shall be glad if you will please go through the calendar and have your concurrence so that it can be released for the information of the market participants after the announcement by Finance Minister in this regard in the Budget. While issuing the calendar to the market, it will be made clear that it would be an indicative calendar and subject to variations depending on market conditions and other relevant factors.

3. I am also forwarding a copy of this letter to Dr. Rakesh Mohan, Adviser to Finance Minister.

With regards,

Yours sincerely

Y. V. Reddy

Encl : As above

Shri C.M.Vasudev  
Secretary  
Department of Economic Affairs  
Ministry of Finance  
Government of India  
New Delhi

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Appendix 7A.4



रक्षेरा मोहन  
उप गवर्नर  
Rakesh Mohan  
Deputy Governor

भारतीय रिज़र्व बैंक  
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DO.IDMD No 64/108.03.01/2004-2005

August 11, 2004

Dear Shri Gupta,

**Market borrowings Programme for  
State Governments – Recent experience**

As you are aware, a tap sale of State Development Loans was conducted recently on July 28 and 29, 2004 covering 18 states, largely comprising borrowings under Debt Swap Scheme. Despite keeping the sale open for two days, the issue had to be closed with a shortfall of Rs.2,545 crore for 12 out of 19 states. Shortfalls have been a regular feature in the case of the state borrowings recently. Four out of the five issues conducted since January 2004 have been closed with under-subscriptions; the only successful issue in April 2004 rested on subscriptions from EPFO which had sudden inflow by way of interest on SDS. The magnitude of the shortfall and the number of states involved this time is disquieting, particularly as liquidity continues to be comfortable in the system. Further, while on earlier occasions, at least the gross application amounts exceeded the notified amount due to oversubscription for some States, for the first time this year, the applications received substantially fell short of the notified amount on a gross basis with Rs.6,663 crore being received against a target of Rs.8,513 crore.

2. Though the recent hardening in interest rates and apprehensions of higher market risk could partly be responsible for under-subscription to the current issue, we have been sensing sure signs of growing market fatigue with state government paper, building up over some time on account of oversupply. This is evident from the fact that from a level of Rs.13,000 crore in 2000-2001, the gross borrowings during last fiscal reached Rs.50,521 crore. For the current year, the projected borrowings stands at Rs.55,123 crore if we include the additional market borrowings of Rs.8,000 crore contemplated on account of RIDF repayments to NABARD. Besides, the Government has also proposed for additional debt swap by allowing states to raise fresh loans to repay their high cost loans to other agencies besides NABARD and increased recourse to market borrowings for the states to reduce dependence on loans from the Central Government as indicated in the Budget Speech (2004-2005).

3. As you are aware, the market clearly perceives higher risk for state government paper due, *inter alia*, to the history of default on state guaranteed bonds

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Continuation of Shree, .....

and limited liquidity. Thus, at an aggregate level, the market participants, particularly banks, already holding Government securities much in excess of SLR requirements, would probably not be keen to build up further their portfolio in state government papers. Reducing the servicing burden on state governments through debt swap and RIDF loan prepayment is no doubt a desirable objective from the point of view of restructuring of the existing high cost debt. It is however imperative to decide whether such repayments should be financed only through increasingly difficult method of open market borrowing (OMB) or largely through small savings collections in conjunction with a marginal amount of OMB to the extent considered absolutely necessary.

4. In the circumstances, we think that the emerging market realities, particularly the limited appetite for state paper needs to be kept in view while approving additional market borrowings. Liquidity surplus in the system, as we have seen, is also no assurance of guaranteed subscriptions. Further, the basic needs of repayment of maturing amounts, plan allocations, MTFRP, etc., of the States need to be ensured. Placing repeated issues of state government paper with the attendant risk of under-subscriptions, we are afraid, would reinforce market fatigue and aggravate problems of credibility for the state government, the issuers, Reserve Bank of India, the merchant bankers and the Central Government which approves such borrowings. Even the better perceived states could be crowded out and face higher borrowing cost and subscription shortfalls.

5. May I therefore request you to consider the issues raised above and examine the possibility of moderating the estimated open market borrowing programme of the state governments for 2004-2005 and beyond. You may perhaps like to keep the Hon'ble Finance Minister apprised of this.

6. I am forwarding a copy of this letter to the Secretary (Financial Sector), Secretary (Expenditure), and the Chief Economic Adviser.

With kind regards

Yours sincerely



(Rakesh Mohan)

Shri D.C. Gupta  
Finance Secretary  
Ministry of Finance  
Government of India  
North Block  
New Delhi - 110001

APPENDICES

Appendix 7A.5



उप गवर्नर  
DEPUTY GOVERNOR

भारतीय रिज़र्व बैंक  
केन्द्रीय कार्यालय,  
शाहीद भगतसिंह मार्ग,  
मुंबई-400 001. भारत.  
**RESERVE BANK OF INDIA**  
CENTRAL OFFICE,  
SHAHEED BHAGAT SINGH ROAD,  
MUMBAI-400 001. INDIA.

DO. IDMC.No. 33<sup>0</sup> /08.06.09/2000-01

June 25, 2001

Dear Shri Ajit Kumar,

**State Government Agencies and bank financing**

As per extant guidelines, banks are not allowed to finance the expenditure by State Governments except through the approved market borrowing programme. The Central Government approves all borrowings by the States under Article 293 (3). The borrowings of States, however, comprise market loans under the approved borrowing programme, central loans under plan and non plan, and small savings, provident funds, special deposits and other items in the Public Account and the securities issued against small savings.

2. In the recent period, States have been indicating that they are not able to get sufficient allocation of funds under the market borrowing program or by way of Central loans for the implementation of their State plans. In such cases, it is reported that the Planning Commission and the MOF have been approving proposals for the States facilitating them to raise funds from the market through Special Purpose Vehicles. These SPVs consequently seem to issue bonds with guarantee by the concerned State Government and such borrowings are apparently defined as 'negotiated loans' by the Planning Commission. It has been reported that there have been instances where the State governments have been allowed to resort to such method for specific Plan projects even. The bonds issued by these entities with the guarantee of the State Government are mostly unrated and are privately placed. The case of West Bengal Government that had got approval from GOI for borrowing from WBIDC and had also sought direct debit permission from RBI was one such instance. You would agree that this not only dilutes the monetary policy management by RBI but also undermines the macro-economic stability and introduces non-transparent fiscal burden on State Governments well beyond the sustainable level.

3. An issue of concern that also has been voiced in the recent meeting of the Finance Secretaries of States was that, the lending institutions are sanctioning such accommodation with minimum credit appraisal as regards the commercial viability and bankability of the project, substituting it by the guarantee of the Government. In respect

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of a number of State Level SPVs, it is reported that in some cases, the bonds are neither serviced by the issuing entity nor honoured by the concerned State Government when the guarantee was invoked. If it is to be repaid out of budgetary funds, then the appraisal goes beyond the project and into the realm of assessing the viability of the State finances. There is a danger that these bonds and loans could turn non-performing if the fiscal burden of the guarantees increase to such an extent that there will be large scale default. States, in such cases, face serious reputational risk and the risk of their market borrowing programme not going through, despite the efforts of RBI. The moral risk extends on to the Reserve Bank as their debt manager.

4. As regards financing of projects by banks, our guidelines are explicit that "in respect of projects by PSUs term loans may be sanctioned only for corporate entities. Further, the term loans should not be in lieu of or to substitute budgetary resources envisaged in the project. The term loan could supplement budgetary resources if such supplementing was contemplated in the project design". The intention clearly is to enable bank financing of commercially viable projects undertaken by Public Enterprises as a supplement to Government financing of such commercially viable projects. The SPV route implies providing bank funds to help Government finance its expenditure.

5. While RBI would sensitise the banks that for guaranteed loans the prime factor should be the credit assessment of the viability of the project and they could also ask for rating by the rating agencies, the Government/Planning Commission on their part should also emphasize the intrinsic viability of the project before approving such negotiated loans' and trying to mobilise resources merely on the basis of Government guarantee.

6. I am constrained to bring this to your attention since it has a potential for serious reputational risk not only to Central and State governments but also to RBI.

With regards

Yours sincerely

(Y.V.Reddy)

Shri. Ajit Kumar  
Finance Secretary  
Ministry of Finance  
Government of India

## Appendix 8A.1 Vision Documents: Implementation

### *Vision Document: 2001–2004*

Under the approach to computerisation and networking, with the definitive role of technology in facilitating large-scale developments in payment and settlement systems, the main requirements of the Indian Financial Network (INFINET) becoming the secure, dedicated communication backbone for the banking and financial sector, namely a generic architecture model for connectivity, standardisation of hardware, operating systems, systems software, application software and messaging middleware, prescribing a common minimum requirement level for hardware and networking requirements for payment gateways, secured connectivity between the internet and INFINET, and a link between the Society for Worldwide Interbank Financial Telecommunication (SWIFT) and INFINET had all been achieved; facilities for e-mail and secured file transfer were available on INFINET; and applications for automated teller machine (ATM) transactions, intra-bank transactions like remittances and foreign exchange transactions used INFINET.

The setting up of the Credit Information Bureau of India Ltd. (CIBIL) facilitated the banking industry to carry out a credit check on credit card holders and, thus, reduced the incidence of frauds and default by individuals. As regards the design, development and implementation of critical payment system projects, the following were the major accomplishments:

- Extension of magnetic ink character recognition (MICR) based clearing to cover forty major commercial centres, thereby facilitating faster clearing of cheques at more centres.
- Operationalisation of real time gross settlement (RTGS) system (RTGS service available at more than 4,800 branches at 398 centres as at the end of April 2005).
- Risk mitigation in wholesale payment systems by way of creating enabling conditions for establishment of the Clearing Corporation of India Limited (CCIL) as a central counter party and settlement guarantee organisation for settlement of government securities trading amongst the negotiated dealing system (NDS) members and interbank foreign exchange transactions.
- Introduction of the NDS for government securities and migrating to delivery versus payment (DVP) III mode of settlement.
- Implementation of the structured financial messaging solution (SFMS) and the centralised funds management system (CFMS). Using CFMS,

## APPENDICES

banks maintaining accounts with the Reserve Bank at its various offices were in a position to know their balances at each location from their treasury branch.

- Increase in scope and coverage of electronic clearing service (ECS) in both its variants – credit clearing and debit clearing.
- Implementation of centralised ECS.
- Enhancement in scope and coverage of the electronic funds transfer (EFT) system had been achieved through the special EFT and the proposed national EFT; many banks had integrated EFT with their own product offerings.
- Removal of the per transaction limit for ECS and EFT transactions
- Participation of a few banks in electronic data inter-change (EDI) projects initiated by the Government of India.
- Launching of pilot project of multi-application smart cards as a prelude to setting standards in smart cards.
- Creating conditions for competition in financial switch service for interconnecting ATMs, leading to establishment of the national financial switch by the Institute for Development and Research in Banking Technology (IDRBT).
- Initiating steps for the cheque truncation pilot project in New Delhi.
- For the customer, there had been definitive benefits. Internet-based banking, which was one of the goals to be achieved, had been implemented in twenty-six banks. The need for core banking solutions at banks, which was at the base of many centralised initiatives such as internet and mobile banking, was also being implemented by banks and as many as thirty-nine banks had implemented core banking solutions while twenty-nine were at various stages of implementation.
- The delivery channels for customers had also improved with ATMs taking over a large number of cash-related functions. Recognising the potential of this delivery channel, the Reserve Bank not only set the direction for banks to share ATMs but also helped the settlement process in the form of an ATM switch, which had been set up and operated by the IDRBT, Hyderabad. Thus, card holders of any bank among the group can use their cards at the ATMs of any bank in the group.
- With regard to the upgrading of the processing environment, banks were undertaking business process re-engineering (BPR) as a part of implementing core banking, security standards had been prescribed, public key infrastructure (PKI) based digital signatures were used for security and legal protection.

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- On the legal front, the Negotiable Instruments Act, 1881, had already been amended to enable cheque truncation and to define e-cheque. A Payment and Settlement Systems Bill had been drafted. Consequent upon the Government of India gazette notification dated 18 February 2005 of the Reserve Bank of India (Board for Regulation and Supervision of Payment and Settlement Systems) Regulation, 2005, a Board for Payment and Settlement Systems had been constituted with effect from 7 March 2005.

### *Vision Document: 2005–08*

- The Payment and Settlement Systems Act, 2007 (the Act), had been enacted and the regulations under the Act, namely the Board for Regulation and Supervision of Payment and Settlement Systems Regulations, 2008, and the Payment and Settlement Systems Regulations, 2008, had come into effect from 12 August 2008.
- The National Payments Corporation of India Ltd. (NPCI), a company to operate retail payments, had been set up.
- The centralised funds management system (CFMS), which facilitates own account funds transfer across offices of the Bank, had been operationalised at all Reserve Bank centres. Use of the CFMS as a mode of funds transfer to achieve a national settlement system (NSS) was recommended by the committee set up to finalise the modalities for implementation of the NSS.
- Availability of the RTGS and national electronic funds transfer (NEFT) systems at more than 55,000 branches across the country had surpassed the target of 500 capital market intensive centres identified by the two stock exchanges (Bombay Stock Exchange and National Stock Exchange).
- NEFT settlement timings were rationalised.
- A separate new gateway for NEFT was also successfully operationalised. Back-up arrangements at the Reserve Bank data centre were activated. Extending NEFT beyond India was also achieved with the implementation of the Indo-Nepal Remittance Facility Scheme, a low-cost alternative for Nepali migrants in India to remit periodic sums back to Nepal.
- National ECS (NECS) was successfully launched in 2008. The NECS leverages on the core banking enabled network of bank branches with access from a centralised location (in Mumbai), thus providing pan-India

## APPENDICES

coverage. The launch of the NECS was yet another attempt to provide a national character to critical and popular payment systems.

- Local ECS availability was extended to seventy-six major locations in the country. The clearing cycle for local ECS was successfully brought down from T + 5 to T + 1. T + 1 clearing cycle is operational uniformly at all ECS centres in the country.
- The cheque truncation system (CTS) was successfully implemented in the National Capital Region of New Delhi. All member banks of the New Delhi Bankers' Clearing House were participating in the CTS. MICR clearing in New Delhi was discontinued.
- MICR-cheque processing centres (MICR-CPCs) were set up at thirty-one more centres during the period, taking the total number of MICR-CPC locations to sixty-six and the number of MICR-CPCs to seventy-one.
- At centres with low cheque volume but where there were five or more bank branches or at district headquarters where there were three or more bank branches, clearing houses (CHs) had been opened, with settlement arrived at by using the magnetic media based clearing system (MMBCS). Computerisation of CHs at over 90 per cent of the locations had been achieved.
- Improvements in outstation cheque collection – operationalisation of speed clearing to provide a facility for realisation of outstation cheques at the local centre of deposit was conceptualised and implemented in 2008.
- Minimum standards of operational efficiency at MICR-CPCs and other CHs operating with the MMBCS package were framed and put in place. All CHs were required to submit quarterly/half yearly self-assessment reports to the respective regional offices of the Bank.
- Benchmark indicators of efficiency for ECS (Credit and Debit) operations were formulated.
- Apart from the mechanism of Banking Ombudsmen to handle payment system related complaints, arrangements were put in place to look into queries and redress grievances of stakeholders by way of a NEFT help desk at NCC-Nariman Point, placing contact details of RTGS participants on the Bank's website, and so on.
- List of centres offering ECS, locations where speed clearing is operational, consolidated links to cheque collection policies (CCPs) of banks, comprehensive list of CHs, details of branches with Indian Financial System Code (IFSC) and MICR codes, particulars of branches offering

## APPENDICES

RTGS and NEFT products, frequently asked questions, or FAQs, on various payment system products, and, were placed on the Bank's website for wider dissemination and stakeholder awareness.

- The Department of Payment and Settlement Systems also participated effectively in various international and national events relating to payments systems. The Bank was actively represented in the SAARC Payments Council deliberations and a meeting of the council was also organised in the country.
- A world-class data centre with an on-city and off-city back-up had been set up. Back-up arrangements for RTGS, CFMS, NEFT and other critical payment systems had been put in place.

## Appendix 8A.2

### Core Principles for Systemically Important Payment Systems

A robust and efficient payment system is a key requirement in promoting financial stability since payment systems are a major channel through which shocks may be transmitted across domestic and international financial systems and markets. In recognition of this, the Committee on Payment and Settlement Systems of the Bank for International Settlements had in January 2001 published a paper, 'Core Principles for Systemically Important Payment Systems'. The core principles, ten in number, were a common set of universal international standards and best practices. These principles were aimed at reducing risks, achieving safety, measuring the efficiency of the financial systems and encouraging the development of appropriate strategies for the operation of safer and more efficient systemically important payment systems worldwide. They also incorporated the responsibilities of the central bank in applying these principles.

#### *Core Principles*

1. The system should have a well-founded legal basis under all relevant jurisdictions.
2. The system's rules and procedures should enable participants to have a clear understanding of the system's impact on each of the financial risks they incur through participation in it.
3. The system should have clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the system operator and the participants and which provide appropriate incentives to manage and contain those risks.
4. The system should provide prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day.
5. A system in which multilateral netting takes place should, at the minimum, be capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement exposure.
6. Assets used for settlement should preferably be a claim on the central bank; where other assets are used, they should carry little or no credit risk.

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7. The system should ensure a high degree of security and operational reliability and should have contingency arrangements for timely completion of daily processing.
8. The system should provide a means of making payments that is practical for its users and efficient for the economy.
9. The system should have objective and publicly disclosed criteria for participation, which permit fair and open access.
10. The system's governance arrangements should be effective, accountable and transparent.

### *Responsibilities of the Central Bank in Applying the Core Principles*

1. The central bank should define clearly its payment system objectives and should disclose publicly its role and major policies with respect to systemically important payment systems.
2. The central bank should oversee compliance with the core principles.
3. The central bank should oversee compliance with the core principles by systems it does not operate and it should have the ability to carry out this oversight.
4. The central bank, in promoting payment system safety and efficiency through the core principles, should cooperate with other central banks and with any other relevant domestic or foreign authorities.

## Appendix 8A.3



### Indian Banks' Association

**Chief Executive**

No.RB-1/atm/1657

February 25, 2008

Chief General Manager  
Department of Payment and Settlement Systems  
Reserve Bank of India  
14<sup>th</sup> Floor  
Shahid Bhagat Singh Road  
Mumbai 400 001

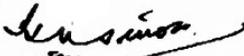
Dear Sir,

**Customer charges for use of ATMs for cash withdrawal and balance enquiry**

This has reference to your draft circular on the captioned subject put on website on February 18, 2008. We find that the draft circular is merely a reiteration of the contents of Draft Approach Paper released by the RBI on December 24, 2007. None of the suggestions made by us find reflection in the final draft.

You will kindly appreciate that when IBA gives a feedback on any issue, it is done after carrying out a detailed industry-wide consultations. The views expressed by us on ATMs were essentially based on a consensus arrived at after deliberating on divergent business interests of our member banks. We have therefore nothing more to add except saying that we are disappointed.

Yours faithfully,

  
H N Sinor

APPENDICES

Appendix 10A.1.1



उप गवर्नर  
DEPUTY GOVERNOR

भारतीय रिज़र्व बैंक  
केन्द्रीय कार्यालय  
शहीद भगतसिंह मार्ग  
मुंबई-400 001. भारत.  
RESERVE BANK OF INDIA  
CENTRAL OFFICE  
SHAHID BHAGAT SINGH ROAD  
MUMBAI-400 001. INDIA.

November 19, 2003

Dear Shri Sisodia,

**Voting Rights – Proposed amendments  
to the Banking Regulation Act**

This is to confirm the discussion you had with the Governor in regard to the above subject.

2. The RBI had earlier proposed an amendment for deleting sub section (2) of Section 12 of the above Act to enable the foreign banks to establish subsidiaries in India, and the government had processed it accordingly. However, the matter has been re-examined further in the light of some global developments.

Firstly, recent developments in regard to corporate governance and accounting practices in some industrialised countries causes some concern in regard to the type of FDI/FII flows to sensitive sectors like banking.

Secondly, recent OECD data shows that about 60 per cent of the cross border capital flows are accounted for by tax shelters and their banking transactions as well as identities are getting difficult to establish. Hence some safeguards are required as far as banking sector is concerned to avoid concentration of control over Indian banks by FII/FDI investments in an across the board fashion.

Thirdly, there may be merit at this stage of international financial systems and our own levels of corporate governance – structures, in avoiding the possibilities of close nexus between family based industrial houses and full control over banking companies.

3. In this regard, we had occasion to compile information on the limitations placed by other countries on the shareholding itself (which

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Continuation Sheet .....

automatically restricts voting rights) insofar as banks are concerned (see annexure I).

4. Under the circumstances described above, it is recommended that Government review the stand and consider replacement of the proposed amendments in the following manner:

- We may keep Section 12 of the B.R. Act as it is. But add a proviso that the limitations of 10 per cent on voting rights will not apply if the shareholder is a banking company regulated and licensed as a bank by a financial regulator in the home country. This facility will be available to banking companies registered in India also.
- The Statement of Objects and Reasons and Note on Clauses may be redrafted as appended. (Annex II, III & IV)

5. We understand that even constitutionally, giving of different voting rights could be justified on the basis of reasonable classification.

*Wam*  
With regards,

Yours sincerely

(K.J. Udeshi)

Encls: As above.

Shri N.S. Sisodia  
Secretary (Financial Sector)  
Government of India  
Ministry of Finance  
Department of Economic Affairs  
Parliament Street  
New Delhi – 110 001.

APPENDICES

Appendix 10A.1.2

FROM :

FAX NO. :

Oct. 17 2006 11:00AM P1



सत्यमेव जयते

**VINOD RAI**  
SPECIAL SECRETARY  
(FINANCIAL SECTOR)

भारत सरकार

वित्त मंत्रालय

आर्थिक कार्य विभाग

जीवन दीप भवन, तीसरी मंजिल

१०, पार्लियामेन्ट स्ट्रीट

नई दिल्ली ११०००९

GOVERNMENT OF INDIA

MINISTRY OF FINANCE

DEPARTMENT OF ECONOMIC AFFAIRS

JEEVAN DEEP BUILDING, 3RD FLOOR

10, PARLIAMENT STREET

NEW DELHI-110 001

TEL. : 23340222 FAX : 23340027

D.O. No.

October 17, 2006

*Dear Shri Leeladhar*

FM has recorded that in his discussion with the Governor on 29.9.2006 regarding applications for pending ATMs and branches by Indian banks (public and private) and foreign banks, the Governor was inclined to agree to the following procedure :-

- (i) All applications for ATMs would be cleared immediately including applications for ATMs for banks involved in the IPO scam.
- (ii) All applications for pending branches in unbanked areas will be cleared in the month of October. These will include banks involved in the IPO scam.
- (iii) All other applications will be considered on merits and orders issued before the end of December.

2. FM suggested to the Governor that step (i) may be done by 15<sup>th</sup> October and step (ii) may be completed substantially, by 31<sup>st</sup> October and the remaining in early November. Step (iii) of course, would have to be done before the end of December 2006.

3. FM has desired an update on the steps mentioned above. I shall be grateful for the same to be provided to me today.

*Regards*

Yours sincerely,

*V. Rai*  
(Vinod Rai)

Shri V. Leeladhar  
Deputy Governor  
Reserve Bank of India  
Central Office  
Mumbai.

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### Appendix 10A.2.1

#### DEPUTY GOVERNOR

D.O.No. DNBS (PD) /10.01/99-2000

September 15, 1999

Dear Shri Sharma,

#### **Need for extension of prudential requirements to all non-banks**

As you are aware, RBI regulates the activities of non-banking financial companies (NBFCs) under the provisions of Chapter IIIB of the Reserve Bank of India Act, 1934. In terms of the present regulatory provisions, all NBFCs (whether they are Government owned or in private sector), have to be registered with RBI. If they hold/accept public deposits, they are subject to comprehensive regulatory framework encompassing the quantum of public deposits, interest rate, period of deposit, maintenance of liquid assets, etc. Besides, the prudential norms, viz. income recognition, asset classification, provisioning, CRAR, credit concentration norm, etc are required to be complied with by these deposit taking companies. They are also required to submit periodical statutory returns to Reserve Bank. Similarly, while Development Financial Institutions such as IDBI, ICICI, IFCI, etc. come under the prudential supervisory jurisdiction of RBI, the housing finance companies are regulated and supervised by National Housing Bank. They are also subject to prudential norms almost on the lines prescribed for the banking system and NBFCs.

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2. There are a number of other deposit taking entities which are not governed under the extensive regulatory framework of RBI. While deposit acceptance activities of nidhis are only within the jurisdiction of RBI, their operational and other activities are within the purview of Department of Company Affairs (DCA). DCA has not prescribed comprehensive prudential norms to the Nidhi companies and they are also not reported to have put in place a mechanism to ensure compliance with various norms. Likewise, chit fund companies are functionally regulated under the provisions of Chit Funds Act, 1982 by the State Governments. RBI directions permit these companies to accept public deposits to the extent of 25 per cent of their NOF to meet their short-term funding requirements. Further, non-banking non- finance companies, like manufacturing, trading companies etc. although coming within the jurisdiction of DCA, are not subject to any prudential norms although they are accepting public deposits.
3. The position of State owned/sponsored financial institutions is no different. State Financial Corporations are governed under the provisions of State Financial Corporation Act. Since they are not companies as defined in Companies Act, they are not NBFCs. However, they are supervised by IDBI. State Industrial Development Corporations Ltd. (SIDCs) are established for promotion of industrial activity and engaged in extending loans to assisted companies and this activity comes within the purview of the function of financial business provided in RBI Act. They are presently required to comply with IDBI prudential norms in case they avail of refinance from them

## APPENDICES

as a condition for drawing refinance. Since they are NBFCs, they are subject to RBI regulations regarding mandatory registration, NBFC Directions on Acceptance of Public Deposits (if they accept/hold public deposits) and other prudential norms.

4. Some of the companies/corporations set up by Government of India/State Governments including the SIDCs, Power Finance Corporation Ltd., National Small Industries Corporation Ltd., etc. have approached us for exemption from one or the other provisions of the regulatory framework in so far as they relate to registration, maintenance of liquid assets, creation of reserve fund, etc. on the plea that they are governed by the norms prescribed by their own Department or Ministry or other nodal agency like IDBI in the case of SIDCs. These SIDCs have sought exemption from us on the ground that they perform social function and the objective of their setting up is entirely distinct from general NBFCs. However, some of them are also accepting public deposits but there may not be, perhaps any supervisory concern for RBI about repayment of deposits and protection of depositors' interest since they are functioning under respective State Governments and there is an implicit guarantee for the repayment of deposits. We have, in fact, proposed to Government that such Government companies could be exempted from the core provisions of RBI Act/Directions; they will, however, be required to get the mandatory registration from RBI.
5. As may be observed from the preceding paragraphs, NBFCs accepting public deposits, Housing Finance Companies and all India Development

## APPENDICES

Financial Institutions are subject to comprehensive prudential norms, viz. income recognition, asset classification, provisioning, capital adequacy, credit exposure norms, etc. in tune with the international accounting standards. The prudential norms have been made applicable to these institutions/ companies irrespective of their ownership, i.e. whether they are privately or publicly owned. SFCs are subject to the prudential norms prescribed by IDBI. In respect of SIDCs, although they are presently required to comply with IDBI prudential norms in case they avail of refinance from it, since they are NBFCs, they are subject to all directions and regulations of RBI as applicable to NBFCs but they have sought exemption from RBI.

6. It may be pertinent to observe in this regard that globally, any financial intermediary/ financial institution/entity accepting public deposits will be reckoned as a bank and subjected to comprehensive banking regulations. The prudential supervision, therefore, is on the basis of the activity, i.e. in this case deposit taking activity and not on the basis of constitution, ownership or nature of business undertaken by an institution or the purpose of utilisation of these funds. However, in India, for historical reasons, anybody can accept public deposits and, while some organisations come under the comprehensive and prudential supervision of RBI, some other organisations, although accepting public deposits, come within the regulatory jurisdiction of either State/Central Government or some other Regulator. Most of them are not subject to prudential norms viz. CRAR, income recognition, provisioning etc. There is, therefore, an absolute need for subjecting all the institutions,

## APPENDICES

whether in public or private sector, whether undertaking financial intermediation or otherwise, to prudential norms as applicable to banking system and NBFCs if they hold or accept public deposits. Although it would be desirable that all these organisations/institutions accepting public deposits are brought under one Regulator/Supervisor for the purpose of protection of depositors interest and uniformity of law applicable to each one of them, it may, perhaps, be very difficult for one single regulatory authority to supervise such a vast system and in any case RBI cannot accept responsibility in case of State level institutions which are governed under different Acts. It may, therefore, be both necessary and desirable that the concerned regulatory authorities like DCA, SEBI and State Governments are advised to bring those institutions/ organisations accepting public deposits under some prudential regulation by prescribing prudential norms, viz. income recognition, asset classification, provisioning, capital adequacy, credit exposure norms, etc. They should also put in place a comprehensive supervisory mechanism to ensure compliance and safeguard depositors' interest. Since the financial system is getting more matured, integrated and sophisticated, it is necessary to ensure that all players in the financial market, whether it is banks, NBFCs, non-NBFCs, corporations, etc. accepting public deposits are subject to same level of prudential regulation and supervision. The prudential guidelines should be well defined, consistent and appropriate whoever is regulating them.

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7. We, therefore suggest that the Government may consider setting up a high level Group to comprehensively review the existing regulatory arrangements and prudential norms for protection of retail depositors of non-banking non-financial companies, as also those national/state level organisations (presently not subjected to prudential norms by the respective regulators) etc. as discussed in this letter. The recommendations of the Group may ultimately go a long way in providing adequate protection to retail depositors of all the entities accepting public public deposits whether they are publicly-owned or privately-owned as also for further strengthening the financial system.

With kind regards,

Yours sincerely,



( S.P. Talwar )

Shri E.A.S.Sharma,  
Secretary,  
Ministry of Finance  
Department of Economic Affairs,  
(Banking Division),  
Government of India  
New Delhi 110 001.

Copy to Special Secretary (Banking Division), MoF, Gol, for information.

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Appendix 12A.1



सत्यमेव जयते

**VINEETA RAI**  
SECRETARY (BANKING & INSURANCE)

भारत सरकार  
वित्त एवं कम्पनी कार्य मंत्रालय  
आर्थिक कार्य विभाग  
"जीवन दीप"  
१०, पार्लियामेंट स्ट्रीट,  
नई दिल्ली-११००१  
GOVERNMENT OF INDIA  
MINISTRY OF FINANCE & COMPANY AFFAIRS  
DEPARTMENT OF ECONOMIC AFFAIRS  
"JEEVAN DEEP"  
10, PARLIAMENT STREET  
NEW DELHI-110 001  
TEL : 23742100  
FAX : 23742207

D.O. No.17(15)/2002-IFII

14<sup>th</sup> May, 2003

Dear *Dr. Rakesh Mahan*

**Priority Sector Lending Shortfall of Foreign Banks**

Please refer to your letter dated April 21, 2003 regarding the issue of revision in interest rates on deposits placed by foreign banks with SIDBI representing the shortfall in their lending to the priority sector.

You would appreciate that the priority sector lending through the banking system is aimed at channelising credit to sectors which are of prime importance to the economy as a whole, and therefore, deserve special attention. It is necessary that all banks operating in India lend directly and provide support to these vulnerable sectors. The system of placing deposits with SIDBI/NABARD towards shortfall in meeting the targets was introduced only as an alternative mechanism, should the banks fail to achieve the primary targets allotted to them. In other words, these deposits represent the failure of a foreign bank to meet the credit requirements of the national economy.

In this backdrop, linking the cost of these deposits with cost of funds of the foreign banks, and also allowing a mark up of 50 basis points, does not appear to be in tune with the philosophy and spirit of implementation of the priority sector lending. Moreover, placing these deposits with FIs does not entail any transaction cost for the foreign banks unlike the scenario of actual lending to the priority sector which has its associated risks.

As brought out in my letter dated April 1, 2003, Government is of the opinion that the fixation of interest rate on these deposits has to be done in such

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a manner that it acts as a disincentive for the foreign banks having a shortfall in priority lending. At the same time, it should provide an avenue for all India FIs like SIDBI to raise resources at a cost lower than the prevailing market rates so that they could serve the targeted segments through their wide range of activities on softer terms. Contrary to this, our interest rate of 6.75% p.a. currently payable by SIDBI for one year on such deposits offers an opportunity to the foreign banks not only to deploy their funds profitably but also to avoid the credit risk and save on cost of operations. It appears instead that such rates of interest will be an incentive giving an impression that we may be favouring foreign banks.

You are aware that the issue has been raised by the Parliamentary Standing Committee on Finance who felt that the rate on this kind of deposits should act as a penalty for the foreign banks for not fulfilling their priority sector obligations. Recently, this issue of downward revision in interest rate on such deposits also came up for discussion at the meeting of the Board of Directors of SIDBI where members, including those from commercial banks and Ministry of SSI, felt that RBI be requested for resetting the rate of interest on the deposits made by foreign banks at 2% below the Bank Rate.

In the light of the foregoing and the continued soft interest rate stance of RBI, you may like to suitably review the position and apprise us of your decision in the matter.

*With my regards*

Yours sincerely,

*Vineeta Rai*  
(VINEETA RAI)

Dr. Rakesh Mohan  
Deputy Governor  
Reserve Bank of India  
Central Office  
**Mumbai.**

APPENDICES

Appendix 15A.1

VINOD RAI  
SECRETARY

भारत सरकार  
वित्त मंत्रालय  
वित्तीय सेवाएँ विभाग  
जीवन दीप भारत तीवरी भवन  
१०, पार्लियामेंट स्ट्रीट  
नई दिल्ली ११०००१  
GOVERNMENT OF INDIA  
MINISTRY OF FINANCE  
DEPARTMENT OF FINANCIAL SERVICES  
JEEVAN DEEP BUILDING, 3RD FLOOR  
10, PARLIAMENT STREET,  
NEW DELHI-110 001  
TEL. : 23340222, FAX : 23340027  
23092839 (N.B.)

D.O.No. 11/5/2001-IR (Pt.I)

20.08.2007

*Dear Shri Leeladhar,*

Kindly refer to your letter dated 1.8.2007 seeking the indulgence and guidance of the Finance Secretary on the Memorandum to the Central Board relating to updation of pension of pre-1.11.1997 retirees.

We have reviewed the matter in its entirety. It has also since been discussed with FM. FM directed that the decision of the Government stands. The inability to accept the proposal and comments on the points made in the memorandum are annexed.

Government is unable to comprehend the intent and reasons for placing the matter before the Central Board for deliberations, especially, on account of the fact that the Central Board of the bank is not within its competence to carry out the amendments in the RBI Pension Regulations, 1990 without the previous sanction of the Government.

We would, therefore, request you to withdraw the Circular No. 2 dated 01.9.2003 relating to updation of pension of pre-1.1.1997 retirees, urgently.

*Regards*

Yours sincerely,

*V. Rai*

(VINOD RAI)

Shri V. Leeladhar,  
Deputy Governor,  
Reserve Bank of India,  
18<sup>th</sup> Floor, Shahid Bhagat Singh Road,  
Mumbai - 400 001