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Banking and Finance

INTRODUCTION

The 1970s was a tumultuous decade for the world as well as for India. The Organisation of the Petroleum Exporting Countries (OPEC) had virtually quadrupled the price of crude oil during the decade and the Western economies had sunk into what Paul Samuelson labelled as stagflation — inflation and stagnant growth. For India the 1980s began with two major setbacks to the economy, namely, the second oil price shock of 1979 and the drought of 1979. Both shocks led to very high inflation, which touched 22.0 per cent at its highest. The five-year period preceding 1979, which had gone off smoothly with low and even negative inflation, comfortable foreign exchange reserves and steady economic growth, thus, came to an abrupt end. When the new Government took over in January 1980, it found itself with a host of problems, not the least of which was the low banking penetration and poor credit facilities. Also, the deficient financial resources of the Government prompted it to shift the burden of poverty-targeted direct interventions to the banking system. In that sense, banking took on the role of a social institution and lost a great deal of its commercial sharpness. It also became overextended, undermanned and undercapitalised. It turned, for all practical purposes, into an adjunct of the finance ministry, with the role of the Reserve Bank virtually relegated to the background.

By the beginning of the 1980s, it was clear that the banking system needed to consolidate and get back to sound banking practices. It was to this task that the Governor of the Reserve Bank, who took over in late 1982, devoted himself. The immediate agenda, as the 1980s set in, thus, was to consolidate and build on the gains of the 1970s. The key elements adopted by the banking sector during this phase were, *inter alia*, a significant slowdown in branch expansion while shifting the focus to covering spatial gaps in rural areas, drawing up of comprehensive action plans by individual banks (covering organisation and structure, training, housekeeping, customer service, credit management, recovery of dues, staff productivity and profitability), introducing modern technology in banking operations in a phased manner, relieving policy-related constraints on bank profitability by raising coupon rates on government bonds and return on cash balances held with the Reserve Bank, allowing greater flexibility in bank service charges, and strengthening the capital base of banks.[1] The media reaction to such policies reflected that the ambitious branch banking of the earlier years, without adequate preparatory work, had also meant heavy expenditure on new branches and the consequent losses in running these in many semi-urban and rural centres. It was thus realised that there was a need for consolidation. Attention also needed to be focused on the quality of lending and the safety of funds.[2]

The approach to banking consolidation was expressed by the Governor, Dr Manmohan Singh in his speech[3] at the founders' day of Bank of Maharashtra. He emphasised that the banking system had a major contribution to make to the Seventh Plan, which aimed to achieve a 5.0 per cent rate of gross domestic product (GDP) growth. The banks, he said, had a strategic role to play in increasing the national savings rate and in channelising the available savings to finance high-priority investments. Better utilisation of available capacities was required both in agriculture and industry through adequate supply of credit as working capital. The cause of social justice had to be promoted by increased emphasis on meeting the credit needs of hitherto neglected sectors and sections of the population, as also by providing finance for anti-poverty programmes, such as the integrated rural development programme (IRDP). He further pointed out that banking had a major impact on maintaining price stability and managing the balance of payments which, in turn, exerted a powerful

1. Malhotra, R.N. (1990). "The Evolving Financial System", *50 Years of Central Banking: Governors Speak*. Reserve Bank of India.
2. "Rigidity of Interest Rate Structure", Editorial, *The Hindu*. October 16, 1985.
3. Singh, Manmohan (1984). *Indian Banking System in the Seventh Five Year Plan*, Speech delivered at founders' day of the Bank of Maharashtra. Pune. September 16.

influence on the orderly implementation of development plans. To achieve all this, the banking system needed to promote greater efficiency and better customer service through new work technology, manpower planning and training arrangements. The international operations needed to be improved by streamlining the functioning of the overseas bank offices. At the same time, profitability of banking operations had to be taken care of. At the end, however, the task of getting all this done was the responsibility of the Reserve Bank. Further, the Reserve Bank, as banker to the Government and as the regulator of the banking system, was required to ensure that the expectations of the Government were met.

By 1985, there was a massive increase in the number of bank branches and a strong effort at mobilising savings and extending credit, as dictated by targets and sub-targets for the preferred sectors. That some of these endeavours were contrary to normal banking practices mattered little. These efforts did help in fact in creating the extensive financial infrastructure.

It must be noted, however, that while the Reserve Bank and the Government agreed on the ultimate objectives, some differences in perceptions and policies surfaced between the Reserve Bank and the Government.

APPROACH TO BRANCH LICENSING POLICY

The Indian banking system comprised commercial banks, co-operative banks and regional rural banks (RRBs). Commercial banks fell into three categories, *viz.*, public sector banks (PSBs) whose ownership was with the Government, private sector banks and foreign banks. In the case of PSBs and RRBs, whose share of business was more than 80.0 per cent in the 1980s, Government dominance and command was the unique feature, where the role of the Reserve Bank as regulator of the banking system was rather limited.

Indian banking, until nationalisation in 1969, was mostly urban. There were very few rural branches. The Government tried hard to persuade banks to open branches in the rural areas, but to little avail. So when the regime nationalised 14 banks, the aim of the branch licensing policy turned to spreading the branch network. The emphasis was on branch expansion in rural, semi-urban and urban centres. With time, however, it became apparent that there was a limit to which this policy could be pursued. The Reserve Bank, in consultation with the Government, therefore, reformulated the policy for the next triennium covering the fiscal years

1982–83 to 1984–85 to coterminate with the Sixth Five Year Plan. The basic message was to place requisite emphasis on relevant social factors.

While the policy of reducing interstate and inter-district disparities continued to be reiterated, the new policy[4] aimed at providing one bank office in the rural and semi-urban areas for a population of 17,000 on the basis of the 1981 census by March 1985. Provisions were also made for expansion in other areas keeping in view the growth in economic activities, the need for banking facilities, the potential for deposit mobilisation, the spatial gap in the availability of banking services in an area and other features. Sparsely populated areas, hilly regions and tribal areas were to be given special consideration.

SPREAD OF BANKING

The emphasis on branch expansion efforts yielded results. Consequently, between June 1981 and June 1989, the share of rural branches increased by about 8.0 per cent and that of metropolitan branches came down by about 2.0 per cent, indicating the special attention paid to create a network of branches in the rural and semi-urban centres (Table 6.1). The three-year branch expansion plan for the period April 1982 to March 1985 was implemented successfully. The main objectives of the branch licensing policy, namely, improving banking facilities in rural and semi-urban areas with greater emphasis on proper spatial distribution of bank offices and reduction in interregional disparities in banking development, were largely achieved. The coverage would have improved further if banks had also opened offices at about 5,000 rural and semi-urban centres for which they held licences. The expansion of branches in urban/metropolitan/port-towns, where the spread of banking services was already quite intensive, continued to be restricted and new branches in these areas were allowed to be set up on a selective basis, taking into account their necessity and financial viability. The expansion programme in these areas was implemented in two phases: phase 1 from April 1985 to March 1988 and phase 2 from April 1988 to March 1990.

4. A rural banking centre was to cover an average of about 200 sq km and a rural branch was to be normally available within 10 km. In urban and metropolitan centres, the policy was relatively restrictive but recognised the needs and potential of specific areas. Branch expansion programmes for rural areas of 18 states and 5 union territories (UTs) were finalised during the triennium period.

TABLE 6.1

Bank Branches

(Per cent of total)

Year (as at end-June)	*Rural*	*Semi-urban*	*Urban*	*Metro*
1981	49.4	23.6	14.4	12.6
1985	55.4	20.1	14.5	10.0
1989	57.2	19.4	13.0	10.4

Source: Reserve Bank of India, *Report on Currency and Finance*, various issues.

Interstate disparities in providing banking facilities were substantially reduced during the three-year period. Illustratively, in Assam, the population per bank office, which was as high as 35,000 in June 1982, came down to 25,000 by the end of February 1985. Similarly, in Bihar and Uttar Pradesh, the population coverage per bank office came down from 25,000 and 23,000 to 19,000 and 17,000, respectively during the same period. However, the trend of opening branches in the urban centres gradually declined, particularly after 1985.

Not every bank was able to deliver on the policy requirements. Three banks which had unsatisfactory financial position and unacceptable methods of operation were issued moratorium orders in 1985. Miraj State Bank Ltd with 26 branches was amalgamated with the Union Bank of India on July 30, 1985; Lakshmi Commercial Bank Ltd with 231 branches was merged with Canara Bank on August 24, 1985; and the Bank of Cochin Ltd with 108 branches was merged with the State Bank of India (SBI) on August 26, 1985. Consequent to these amalgamations, the total number of scheduled commercial banks (SCBs) reduced to 80, but increased subsequently to 81 with the inclusion of Oman International Bank S.A.O.G.,[5] which opened a branch in Bombay (now Mumbai) under the terms of the second schedule to the Reserve Bank of India (RBI) Act, 1934.

As noted earlier, relations between the Government and the Reserve Bank were not always mutually reinforcing. At times something as small as a request from the Government[6] to publicise the allotment of the identified centres for new bank offices led to a stiff response from the Reserve Bank.[7] Thus, in an internal note, the Bank told the Government that "it is not

5. S.A.O.G.: Societé Andrea Omani Generale.
6. D.O. letter no 1 (14)-87 dated October 26, 1987.
7. Reserve Bank of India, DBOD (BL section). Follow–up action based on the Finance Minister's meeting with the Governor on November 3, 1986.

the practice of the Bank to give any publicity on completion of allotment of identified centres to banks for opening branches. If the Government so desire they may consider issuing a press note to that effect." Further, "such publicity will not confer any benefits. On the contrary, the phased expansion programme will get upset by the owners of premises, who would seek to pressurise the banks to rush through the entire branch expansion plan in the very first year and also to change the need-based location to places where their premises are situated."

A review of branch expansion in 1989 revealed that allotment of centres to commercial banks, including RRBs, based on lists of centres received from the state governments, was almost complete. In all, 5,360 centres were allotted in rural and semi-urban areas up to June 30, 1989; 2,024 to RRBs and 3,336 to commercial banks. This left 775 deficit blocks that required additional offices. With the adoption of the service area approach (SAA), it became necessary to allow additional branches so that the number of villages allocated to a rural branch was within a manageable limit of 15 to 25. Considering both these aspects, 1,236 additional centres were allotted up to June 30, 1989. By any standards, it was a remarkable bureaucratic achievement, even if the banking benefits were not immediately visible.

INTERNATIONAL BANKING

From the time of bank nationalisation in 1969, foreign operations were not a high priority for the Government and policy in this respect was essentially need-based. On account of the relatively low level of openness, Indian banks did not have a very significant presence abroad. Thus, in 1980, there were only 12 Indian banks with 133 branches operating abroad. The decade of the 1980s saw no change in the restrictive policies in this regard. From 1985 to 1989, no new branches were opened and, on the contrary, as many as 27 branches were closed. The number of overseas branches of 9 Indian banks stood at 116 as on June 30, 1989.[8] It was the same case with the representative offices, although a few representative offices were opened by Bank of Baroda (BoB) and Indian Bank at Harare (Zimbabwe) and Jakarta (Indonesia) in 1985. The SBI merged the functions of its representative office and its branch at Frankfurt (West Germany). The number of representative offices of four Indian commercial banks stood at 12 in 10 countries at the end of June 1985, and this number came down to 10 as at the end of June 1989. There were three deposit-taking entities,

8. Nine banks had 123 branches abroad as on June 30, 1987.

three wholly-owned subsidiaries and six affiliates functioning abroad as at end-June 1989.

FOREIGN BRANCHES IN INDIA

The policy towards foreign banks and their branches was dictated by the strategy of reciprocity. Some minor policy changes were, however, made as follows:

(i) A start-up capital of ₹ 15 crore was prescribed for new entrants;

(ii) Lending to priority sectors was made obligatory and the banks were required to achieve a level of 10.0 per cent of total lending by end-March 1989, 12.0 per cent by March 1990, and 15.0 per cent by March 1992; and

(iii) Banks had to retain 20.0 per cent of the disclosed net profits in the Indian books.

In June 1985, 32 foreign banks had 134 branches and 13 representative offices in India. As on June 30, 1989; the number of branches and representative offices of foreign banks operating in India stood at 137 and 21 (of 21 banks), respectively.

FIRST INDO INTERNATIONAL BANK LTD[9]

The FIIB was floated by non-resident Indians (NRIs) and incorporated in Nassau, Bahamas, a tax haven where supervision by the central banking authority was practically non-existent. The FIIB approached the Reserve Bank for permission to open an office in India but the request was rejected at a meeting of the inter-departmental committee held on November 17, 1988. The FIIB approached the Reserve Bank again through the Indo-NRI Chamber of Commerce and Culture and also through the Ministry of Finance, Government of India (GoI),[10] emphasising that the proposed branch would help attract NRI investments to India. A note of commendation[11] was also forwarded, highlighting some points for reconsideration of the proposal. The points were:

(i) The FIIB was the largest NRI-owned bank in San Francisco.

(ii) The FIIB, which was promoted by the promoters of Foreign Intelligence Advisory Board (FIAB), was incorporated in Nassau, Bahamas, a leading off-shore financial centre.

9. FIIB, Bahamas.

10. Letter dated F. No. 16 (108)/89–B.O. 111 dated March 1, 1990.

11. From Shri Yashwant Sinha, Member Parliament.

(iii) The new capital adequacy rules in international banking might force closure of more branches of Indian banks abroad. This had happened — the number of branches of Indian banks had declined from 136 to 114 with the possibility of a further reduction in the process of rationalisation.

(iv) About 75.0 per cent of the business of people of Indian origin abroad was with foreign banks and 25.0 per cent of such business was with the overseas branches of Indian banks.

(v) The FIIB would open banks, buy banks and take over other banks in as many foreign centres as possible by involving local NRIs and their resources at each centre to serve the Indian community.

(vi) With the involvement of a large number of NRIs, the FIIB would be able to compete with foreign banks and take over a large share of Indian business from them.

The proposal[12] was turned down by the Reserve Bank, which felt that the proposal was not in conformity with the prevalent policy of not allowing banks incorporated in tax havens to enter the Indian financial system. Besides, the failure of the Bank of Credit and Commerce International (Overseas) [BCCI (O)] Ltd was still fresh in the memory. The Reserve Bank also took the view that the arguments of national pride and patriotic instincts put forward by the bank were not important and the proposal had emanated from the NRIs' desire to legalise their unauthorised/illegal incomes held outside India over the years. It had earlier rejected another proposal by an NRI-owned bank based in Britain, namely, Equatorial Bank, London, to open a branch in India. The other reasons were that the bank was incorporated in Nassau, Bahamas, a tax haven with little control by the host country and also that the bank existed merely on paper, having acquired the certificate of incorporation. It had not commenced banking operations even in the country of its incorporation and had not presented or maintained a balance sheet, said the Reserve Bank. Also, it had not constituted a Board, though, it proposed to do so after securing a licence to open a branch in Bombay.

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12. Shri Kalpanath Rai, Union Minister, Ministry of Power, had recommended the bank's request for consideration on 'sympathetic' grounds and, as a consequence, had invited a comment in the records that business decisions involving money and banking had to be taken on the basis of sound banking principles and not on sympathetic grounds. A note communicating the decision was approved by the Governor on March 25, 1992, and the Government was suitably informed.

The story of the BCCI (O) Ltd (incorporated in Grand Cayman), a wholly-owned subsidiary of the BCCI Holdings (Luxembourg), was different and controversial. The BCCI submitted an application to the Reserve Bank in April 1977 to open two branches in India. After initial hesitation, the Reserve Bank permitted the BCCI to open a representative office in June 1977. There were talks that the BCCI was linked to 'funny money', but nevertheless had some influential support from within the Indian financial system.

The BCCI again applied for a licence to open a branch office in Bombay towards the end of 1982. The request was not initially considered favourably by the Reserve Bank. The BCCI, however, finally got a licence, which was issued by the Reserve Bank in 1983. Nevertheless, the bank collapsed some years later, after being linked to suspicious transactions all over the world.

The policy of consolidation did not mean a mere slowdown in expansion of branches. It also led to amalgamations, liquidations and mergers. Banks found to be financially and operationally weak were sought to be strengthened and the number of banks was thus brought down by either mergers or amalgamations. During 1980–1985, 18 banks were dissolved after liquidation proceedings were completed and during 1985–1989, 4 banks were wound up. At the end of June 1989, 128 more banks were put under liquidation.[13]

13. Based on the recommendations of the Reserve Bank, the Government issued moratorium orders on April 27, 1985, in respect of Miraj State Bank and Lakshmi Commercial Bank. Miraj State Bank (with 26 branches) was amalgamated with the Union Bank of India effective July 30, 1985; Bank of Cochin (with 108 branches) was merged with the SBI on August 26 of the same year; and Lakshmi Commercial Bank (with 231 branches) was amalgamated with Canara Bank on August 24, 1985. Hindustan Commercial Bank Ltd was placed under moratorium from the close of business on May 24, 1986; the bank was subsequently amalgamated with Punjab National Bank (PNB). Further, a moratorium order was issued in respect of United Industrial Bank Ltd, Calcutta (now Kolkata) — a private sector bank — by invoking the provisions of section 45 of the Banking Regulation Act, 1949. The bank was thereafter merged with Allahabad Bank, with full protection to depositors. Moratorium orders were issued on August 22, 1989, in respect of four more private sector banks, *viz.*, Bank of Tamil Nadu Ltd, Bank of Thanjavur Ltd, Parur Central Bank Ltd, and Purbanchal Bank Ltd The Government sanctioned schemes of amalgamation in respect of five banks during the period 1985 to 1988. Traders Bank Ltd, New Delhi, a private sector bank, was amalgamated with BoB in May 1988. Of the four private sector scheduled commercial banks — Bank of Tamil Nadu Ltd, Bank of Thanjavur Ltd, Parur Central Bank Ltd, and Purbanchal Bank Ltd — placed under moratorium on August 19, 1989, the first three were amalgamated with Indian Overseas Bank (IOB), Indian Bank, and Bank of India (BoI), respectively, with effect from February 20, 1990. Purbanchal Bank Ltd was amalgamated with Central Bank of India on August 29, 1990.

BANKING LAWS

BANKING LAWS (AMENDMENT) BILL

All through the 1970s, various practical difficulties were encountered by the banks. It became clear by the mid-1970s that unless different parts of the banking laws were amended, forward movement on a number of intricate issues was not possible. Accordingly, a number of amendments were sought, and though proposed, they were not legislated. For example, the banking laws (amendment) bill, 1978, could not be considered as the Lok Sabha was suddenly dissolved in July 1979.

In 1981, the Reserve Bank established a special cell to process the recommendations of the banking laws committee which examined two reports, *viz.*, the documents of title to goods, 1978, and the indigenous negotiable instruments *(hundis)*, 1978. On the first report, the recommendations of the banking laws committee were considered by a study group comprising a representative each from the Reserve Bank and the Indian Banks' Association (IBA). The group examined the report on *hundis* but did not find it acceptable, mainly because of the policy of not encouraging the *hundi* system. The group instead recommended that modern banking practices be adopted.

In 1981, additional amendments to the Banking Regulation (BR) Act, 1949, and the RBI Act, 1934, were suggested by the Reserve Bank to the Government at the latter's instance. The bill was reintroduced in Parliament in May 1983. It contained important amendment provisions, such as, providing nomination facilities for bank accounts; prohibiting deposits by individuals and firms from more than the prescribed number of depositors, enabling banks to undertake innovative measures like leasing activities; restricting the tenure of directors of private sector banks to eight consecutive years and protecting directors nominated by PSBs on the boards of assisted units; empowering the Reserve Bank to vary statutory liquidity ratio (SLR) from 25.0 per cent to 40.0 per cent by issuing a notification; widening the scope of consideration by the Reserve Bank before issuing a licence to a bank to commence banking business; and placing the rules and regulations framed under the Act/Acts before each House of Parliament.

BANKING LAWS (AMENDMENT) ACT, 1983

The banking laws (amendment) bill, 1983, containing important provisions and proposing amendments to the laws affecting banking, mainly the RBI Act, 1934, and the BR Act, 1949, was passed by both Houses of Parliament in December 1983 and, after the President of India gave his assent, it was renamed as the Banking Laws (Amendment) Act, 1983. The Government issued a notification bringing into force the provisions of this Act. The amendments are reflected in Table 6.2.

TABLE 6.2

Amendments to Banking Laws

Name of Act	*Amendment/ Incorporation*	*Section*	
RBI Act	Amendment	42	Maintenance of cash reserve ratio (CRR) by scheduled banks.
RBI Act	Amendment	43	Weekly statement.
BR Act	Amendment	18	Maintenance of CRR by non-scheduled banks.
BR Act	Amendment	24	Maintenance of SLR by all banks.
BR Act	Incorporation	45Y to 45ZF	Nomination facilities to depositors, hirers of lockers and safe custody.
BR Act	Amendment	56(j) and (q)	Maintenance of CRR and SLR by co-operative banks.

Source: Reserve Bank of India, internal records.

Various provisions of the Banking Laws (Amendment) Act, 1983, came into force from February 15, 1984, except for sections 6, 7, 21, 26 and 37, and clauses (v) and (ix) of the section 42. The Government brought the provisions of these sections into force effective March 29, 1985, after finalising the necessary rules and regulations. The provisions of amendments in brief are captured in Table 6.3.

The Banking Laws (Amendment) Act, 1983, widened the activities that the banks could undertake, strengthened the powers of the Reserve Bank, streamlined returns, and prohibited unincorporated bodies from accepting deposits from the public, except to a specified extent. It led the Reserve Bank to issue a series of notifications.

The periodicity for the maintenance of average daily balances for CRR purposes was changed from one week to a fortnight. Changes were also made in the basis of calculating demand and time liabilities for the maintenance of SLR. The Reserve Bank was empowered to levy a penalty

TABLE 6.3
Details of Amendments

Section of the Amendment Act, 1983	*Amendment of the Existing Act/Section*	*Subject*
6	RBI Act section 42	Cash reserve of scheduled banks: change of periodicity of maintenance of CRR and submission of relative returns from weekly to fortnightly.
7	RBI Act section 43	Issue of press communique.
21	BR Act section 43	Cash reserve of non-scheduled banks.
26	BR Act section 24	Liquid assets of banks (scheduled as well as non-scheduled) providing for netting concept and conferment of power on the Reserve Bank to specify the increase in SLR up to 40.0 per cent, the mode of valuation of unencumbered approved securities and penalty provision.
37	BR Act—Incorporation of new sections 45Y to 45 ZF	To provide: (1) Period of preservation of bank records. (2) Nomination facilities to depositors, hirers of lockers and safe custody of articles
42 (v)	BR Act section 18 as applicable to co-operative banks	Cash reserve of non-scheduled co-operative banks.
42 (ix)	BR Act section 24 as applicable to co-operative banks	Liquid assets of all co-operative banks (scheduled and non-scheduled).

Source: Reserve Bank of India, internal records.

for non-compliance with SLR requirements. Section 37 of the Banking Laws (Amendment) Act, 1983, was also brought into operation; this related to the rules for preservation of banks' records and nomination facilities for bank customers. The nomination facility was a landmark provision, as it helped the general public in inheritance cases.

In a definitive step towards liberalisation, the BR Act was amended in 1984 to address the perceived decline in the role of banks due to financial disintermediation. Many banks, accordingly, set up subsidiaries to undertake merchant banking, securities market-related activities, equipment-leasing, hire-purchase, mutual funds, housing finance, and venture capital functions. Diversification of banking activities facilitated the banks to broaden their business portfolio and raise their profitability through the opportunity to gain non-interest income. This was a symbiotic process, as the industrial sector was also more comfortable with their banks handling these activities. As a result of the deregulation, distinct risks emerged that had to be countered. The Reserve Bank addressed these by encouraging banks to engage in the securities business through subsidiaries, thereby segregating traditional banking from non-traditional activities. The Reserve Bank also prohibited cross-holdings with industrial groups to minimise connected lending.

BANKING LAWS (AMENDMENT) ACT, 1985

The 1985 Act, amending mainly the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and 1980, and the RBI Act, 1934, was enacted in December 1985. Some provisions of the Act were brought into force from December 30, 1985, and the others from May 1, 1986.

The Amendment Act also provided for the termination of the services of the chairman of the National Bank for Agriculture and Rural Development

TABLE 6.4

Amendments to Banking Companies Act

Section and Act Amended	*Subject*
Section 17(4A) of RBI Act, 1934, with effect from May 1, 1986.	Borrowing powers of the state financial corporations (SFCs): limit was raised to twice the paid-up share capital of the SFCs instead of the earlier 90.0 per cent.
Section 17 (11A) (a) of RBI Act, 1934, with effect from May 1, 1986.	The amendment was consequent to deletion of chapter IV of the Deposit Insurance Corporation (DIC) (Amendment and Miscellaneous Provisions) Act, 1978. By this, section 17 (11A) (a) in the RBI Act, 1934, was restored.
Sections 3 and 9 of Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980, with effect from December 30, 1985.	The ceiling on the paid-up capital and reserves of nationalised banks was raised from ₹ 15 crore to ₹ 100 crore.
First Schedule of Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, with effect from December 30, 1985.	Changed the name of United Commercial Bank to UCO Bank.
SBI Act, 1955, SBI (Subsidiary Banks) Act, 1959, RRBs Act, 1976, Deposit Insurance and Credit Guarantee Corporation (DICGC) Act, 1961, Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980, with effect from May 1, 1986.	Provisions in these statutes required that the auditors' report and the report on the working and activities of the banks/corporations be laid for a total period of 30 days before each House of Parliament (while it was in session). The period of 30 days was deleted by the amendments. The above provision was incorporated in the RRBs Act, 1976.

Source: Reserve Bank of India, internal records.

(NABARD) by the Government by giving three months notice or three months' salary and allowances in lieu of such notice. Further, the Act provided for increasing the term of the chairman and managing director (CMD) of the Export-Import Bank of India (Exim Bank) from three to five years, on par with the chief executives of other banks and financial institutions (FIs). Some of the important amendments are given in Table 6.4.

SPECIAL LEGISLATION FOR RECOVERY OF BANK DUES

The Government accepted the recommendation of the Tiwari Committee to set up special tribunals that were devoted to adjudicating on issues related to recovery of bank dues. A committee of legal experts was constituted to prepare draft legislation for the purpose and it was decided to confer special powers on banks and FIs, similar to those vested in the Industrial Finance Corporation of India (IFCI) and SFCs under their respective statutes.

OTHER LEGISLATIVE MEASURES

The banking, public financial institutions and negotiable instruments laws (amendment) bill was passed by Parliament in December 1988. The provisions of the Act, except for three specific sections, were brought into force with effect from December 30, 1988. On the same day, the Government issued a notification that banks were required to close their accounts on the expiry of a period of 12 months ending March 31, instead of at the end of the calendar year, as was the practice earlier. Accordingly, banks closed their accounts on March 31, 1989, covering a 15-month period from January 1, 1988 to March 31, 1989. The other important provisions, which came into force on December 30, 1988, related to: (i) uniform tenure for directors of nationalised banks, associate banks and other FIs like the Industrial Development Bank of India (IDBI), NABARD, Exim Bank, DICGC and Industrial Reconstruction Bank of India (IRBI); (ii) increase in the limit of paid-up capital of nationalised banks from ₹ 100 crore to ₹ 500 crore; (iii) vesting authority in the Reserve Bank to direct special audits of banks; (iv) increase in the rate of interest specified in sections 80 and 117 (C) of the Negotiable Instruments Act (NIA), 1881, from 6.0 per cent to 18.0 per cent; and (v) removal of legal lacunae in the existing Nationalisation Act to provide for amalgamation of two nationalised banks and to enable transfer of part business in this regard.

Subsequently, the Government issued a notification that gave effect to the provisions of section 4 of the Amendment Act. This section provided for penalties in the case of cheques that were not honoured due to insufficient funds in the drawer's accounts. With effect from April 1, 1989, in the event of any cheque drawn by a person on any account maintained by him with a banker for payment to another person for discharge, in whole or in part, of any debt or liability was returned unpaid by the bank on account of insufficient funds in the account or because it exceeded the arrangements with the bank, such personnel were deemed to have committed an offence and were liable for imprisonment for a term extending up to one year or for a fine extending to twice the amount of the cheque, or both. The section also provided for safeguards to save harassment to unwary drawers of cheques. It was, *inter alia*, provided that the drawer could make payment within 15 days on receipt of the notice of return and, only if he failed to do so could prosecution be launched. It was also envisaged that the complaint could be made only by the payee or holder in due course.

The NIA, 1881, which governed laws related to cheques, was amended by the Banking, Public Financial Institutions and Negotiable Instruments Laws (Amendment) Act, 1988, to incorporate these provisions. The amendments resulted in inserting chapter XVII, with effect from April 1, 1989, comprising sections 138 to 142 relating to the penalties.

Before 1988, dishonour of a cheque entailed recourse to a civil suit and there were no effective legal provisions to restrain people from issuing cheques without having sufficient funds in their accounts. The purpose of introducing the penalties was to encourage the culture of using cheques and to enhance the credibility of the instrument.

DEPOSIT MOBILISATION

Throughout the 1970s, the Government and the banking system tried hard to get people to adopt banking habits. The drive was successful and was continued through the 1980s with fairly gratifying results (Table 6.5). The massive branch expansion during the 1970s and in the early part of the 1980s contributed considerably to improving deposit mobilisation by banks. The deposits of SCBs grew more than two-and-a-half times (264.6%) during the period 1981–1989. The growth in deposits was primarily due to strong growth in gross domestic product (GDP), special attention paid to improve customer service by banks, mechanisation of branches and improved banking habits due to greater awareness. Rationalisation of deposit rates in alignment with the rate of inflation, changes in the maturity pattern of deposits and the introduction of nomination facilities also helped to enhance deposit growth. The growth pattern during the period was, however, not uniform and there were downward fluctuations in the rate of growth in some years due to factors, such as drought conditions in the country, inflationary pressures, the competitive environment in deposit mobilisation, and the emergence of new institutions and instruments on account of the disintermediation process in banks.

TABLE 6.5

Aggregate Deposits of Scheduled Commercial Banks

(₹ crore)

Year	*Aggregate Deposits*	*Per cent Growth*
1981	40,549	21.5
1982	46,128	13.7
1983	54,039	17.2
1984	64,620	19.6
1985	77,075	19.3
1986	91,828	19.1
1987	1,07,899	17.5
1988	1,26,323	17.1
1989	1,47,854	17.0

Source: Reserve Bank of India, *Report on Trend and Progress of Banking in India*, various issues.

Following media reports in February 1982 that some banks were accepting funds from institutions like Life Insurance Corporation (LIC) and the Unit Trust of India (UTI) as deposits on a roll-over basis and paying interest at 11.5 per cent or higher, a series of measures related to commercial banking were announced. The Reserve Bank instructed the banks to treat deposits from these institutions as deposits from the public and, as such, apply the appropriate rates of interest. Banks that accepted such institutional deposits at rates in excess of the prescribed rates were asked to discontinue the practice and take steps to recover the excess interest, if paid, from the concerned institutions. Banks were also advised to stop rediscounting non-trade bills because technically these had all the characteristics of participation certificates; it was felt that resorting to such a practice for the purpose of resource mobilisation would defeat the Reserve Bank's credit restraint measures, as also its policy on recourse to participation certificates.

With a view to aligning short-term deposit rates with the rates on longer-term maturities, the Reserve Bank raised interest rates on term deposits for a period of less than three years. The new rates came into effect from March 1, 1982, and were applicable only on fresh deposits or on renewals of maturing deposits. SCBs that had aggregate demand and time liabilities of less than ₹ 25 crore were allowed to pay an additional interest rate of 0.25 per cent per annum at their discretion on all term deposits of less than three years. Similarly, RRBs were given the discretion to pay additional interest of 0.5 per cent per annum.

Up to March 1982, the rate of interest on bank deposits, along with the interest rate on investments in other specific categories of up to ₹ 3,000 was tax-free. In terms of the Finance Act, 1982, this exemption limit was raised to ₹ 4,000. The Act also provided for additional exemption of up to ₹ 2,000 on income from bank deposits with a maturity of one year or more along with the interest on government securities.

In July 1981, the Government promulgated an ordinance that no company (including a banking company), co-operative society, or firm shall repay to any person any deposit other than by an account payee cheque or account payee bank draft, when the amount of such deposit repayable with interest, if any, was ₹ 10,000 or more. If the repayment was by a banking company or a co-operative society, it was required to be made by crediting the amount to the account of the person to whom the deposit had to be repaid. The Reserve Bank directed all commercial banks to comply with the provisions of the ordinance. The Reserve Bank also reiterated its earlier stance that banks must satisfy themselves about the identity of their depositors through a proper introduction.

Deposit growth showed perceptible improvement during 1982–83 (July–June) as compared with the previous year, as the accretion to aggregate deposits of SCBs at ₹ 7,911 crore was significantly larger than that of ₹ 5,579 crore in 1981–82. The growth rate during the year worked out to 17.2 per cent compared with 13.7 per cent during the previous year. The improvement in absolute terms was noticed in three quarters of the year as compared with the corresponding quarters of the previous year. The growth in deposits in 1982–83 in the face of a deceleration in the rate of growth of national income could be attributed principally to an expansion in reserve money, revival of the category of term deposits of five years and above carrying a higher rate of interest in October 1982, and the response from non-residents to the offer of an interest rate at two percentage points premium over the rates permissible on domestic deposits of comparable maturities on non-resident deposits effective March 1, 1982.

Following the recommendations of the working group on bank deposits in October 1982, the category of term deposits of five years and above was revived with a directed interest rate of 11.0 per cent. The deposit category of five years and above was abolished in March 1981, and the maximum interest allowed on term deposits was 10.0 per cent for deposits of three years and above. The reversion to the long-term maturity category at a higher interest rate was intended to offer a better return on savings in the form of longer-term bank deposits and to assist banks in their deposit mobilisation efforts.

There was a sharp increase in deposits in 1983–84, which was attributable to a sizeable increase in national income, substantial growth of reserve money, large inflows of non-resident deposits and expansion in bank credit. The trend was maintained in 1984–85. The growth rate during the year 1983–84 worked out to 19.6 per cent, which was higher than the 17.2 per cent recorded during the previous year. A discernible feature of the deposit expansion in 1983–84 was that there was deposit accretion in all the four quarters, including the January–March quarter when deposits usually showed a sizeable decline after a large jump in the preceding quarter (October–December).

An analysis of the growth in aggregate deposits by type of deposit revealed that the rate of growth in demand deposits at 17.0 per cent was markedly higher than that of 12.7 per cent in 1982–83. With regard to time deposits, however, there was a marginal increase in the rate of growth at 18.4 per cent as compared with 18.2 per cent in 1982–83. The absolute increase in demand deposits was ₹ 1,737 crore in 1983–84 as against ₹ 1,146 crore in 1982–83, and in time deposits, it was ₹ 8,076 crore as against ₹ 6,765 crore the year before.

The increase in deposits during 1984–85, despite a lower growth in national income, a deceleration in price rise, competition from other savings instruments such as the national savings certificates (NSCs), national deposit schemes, and special schemes of the UTI, was a notable feature of banking during this period.

With effect from April 1985, the number of prescribed maturity slabs for fixed deposits was reduced from nine to five. Individual banks were allowed the freedom to fix interest rates, within the prescribed limit of 8.0 per cent, for maturities of less than one year and various maturities from 15 days and above, provided that uniform rates were adopted by all branches of the bank and applied to all its customers. The deposit rate for one year and over one year was raised from 8.0 per cent to 8.5 per cent.

The deposit rates for other maturities remained unchanged. The premium interest of 2.0 per cent on non-resident deposits of one year and above was kept unchanged. It was expected that these measures would enable banks to mobilise untapped sources of funds and thereby widen their deposit base.

THE 1985 EXPERIMENT

With the objective of providing credit to the productive sectors of the economy, bank lending rates as well as the allocation of bank credit were closely regulated by the Reserve Bank till the late 1980s.[14] Further, there was a multiplicity of deposit rates, which made little commercial or economic sense and commercial banks were demanding that they needed greater flexibility in setting the deposit rates. In April 1985, the Reserve Bank announced that within a ceiling of 8.0 per cent, banks could fix their own deposit rates for maturities between 15 days and less than one year. The move had unwelcome consequences as a rate war broke out among the banks. In the words of Shri S.S. Tarapore, Deputy Governor, "all banks, like sheep jumping off a cliff, offered 8 per cent for 15 days without giving attention to their profits. The RBI's expectation that banks would use their discretion with some finesse to maximise their profits was totally belied."[15] The short-lived freedom was withdrawn at the end of May 1985.

TABLE 6.6

Share of Demand and Time Deposits in Total Deposits

(Per cent)

	1981–82	*1982–83*	*1983–84*	*1984–85*	*1985–86*	*1986–87*	*1987–88*	*1988–89*
Demand	19.2	19.4	18.7	19.6	18.3	18.7	17.2	16.7
Time	80.8	80.6	81.3	80.4	81.7	81.3	82.8	83.3

Source: Reserve Bank of India, *Report on Trend and Progress of Banking in India*, various issues.

The break-up of the aggregate deposits (Table 6.6) for eight years revealed that the share of demand deposits, which had stabilised at a lower level of 18.0–19.0 per cent during 1981–82 to 1984–85, declined steadily,

14. Mohanty, Deepak (2010). *Perspectives on Lending Rates in India.* Speech delivered at the Bankers' Club. Kolkata. July.

15. Tarapore, S.S. (2011). "Episodes from Monetary and Other Financial Policies (1982–1997): An Anecdotal Presentation", in Sameer Kochhar (ed.), *Growth and Finance: Essays in Honour of C. Rangarajan.* New Delhi: Academic Foundation.

reaching 16.7 per cent during 1988–89. To provide a better rate of return on short-term surplus funds, effective March 28, 1989, the rate on the deposits of 46 days to 90 days maturity was raised from 4.0 per cent to 6.0 per cent; simultaneously, the category of fixed deposits of 15 days to 45 days, which had so far invited a rate of 3.0 per cent, was abolished. Thus, the period for fixed deposits became a minimum of 46 days as against 15 days hitherto.

WOOING NON-RESIDENT INDIANS

As was noted, when the 1980s began, India was short of foreign exchange and domestic savings. Indians settled abroad were remitting large sums of money to India and a significant part of it was routed through informal channels. It was decided to tap such resources and attract them into the banking system. The only instrument available to facilitate this was the interest rate and, thus, various schemes to attract NRI deposits were born. The Reserve Bank provided special incentives and banks were allowed to pay, effective March 1, 1982, additional interest on such deposits at 2.0 per cent premium over and above the rates applicable on domestic deposits of comparable maturities.

The deposits under non-resident external rupee account (NR(E)RA) and foreign currency non-resident account (FCNR(A)) schemes registered a sharp increase during the period 1981 to 1989 in response to the liberal incentives offered by both the Reserve Bank and the Government. The deposits under the NRE(R)A and FCNR(A) schemes increased by US$ 2,329.0 million and US$ 6,523.0 million, respectively, during the period 1981–1989. The net inflows of NRI deposits increased from US$ 226.0 million in 1981 to US$ 2,403.0 million in 1989, registering a staggering increase of 963.2 per cent. These flows helped, to a great extent, in minimising the adverse impact of the widening current account deficit (CAD) experienced by the economy during this period.

In this context, it was noted, "As the nation's economists look for India's balance of payments difficulties, there is only one point on which both Government and the opposition seem to agree — that a vital element in any equation will be the well-heeled, and still patriotic NRI."[16] Further, throughout the second half of the 1980s, remittances from NRIs —

16. Extracts from Tharoor, Shashi (2006). *India from the Midnight to the Millennium and Beyond*. New York: Arcade Publishing.

primarily the diligent Indian workers in the countries of the Arab/Persian Gulf — averaged ₹ 5,000 crore (US$ 1.5 billion) a year. As a source of foreign exchange, this amounted to 40.0 per cent of India's annual merchandise exports, or about 3.0 to 4.0 per cent of GDP. NRI depositors placed annually over ₹ 9,000 crore (nearly US$ 3.0 billion) in external accounts of Indian banks during the period 1976–1988. The incentives offered to NRIs included, *inter alia*, offers of government securities and facilities for direct investments in Indian industry. NRIs were granted an extraordinary range of special concessions by the Government, ranging from privileged rates of interest on their hard currency deposits in Indian banks to exclusive housing colonies and the opportunity to import Hollywood films onto Indian screens. The privileges also included coverage of forex risk, allowing opening of accounts in different currencies and priority for NRIs in the allotment of telephone connections and purchase of scooters and cars.

By the mid-1980s, there was a noticeable decline in interest rates abroad, particularly in the United States (US). The interest rates on the term deposits of one year and above under the FCNR (A) scheme were, therefore, reduced with effect from April 22, 1985, and again in February 1986 and May 1986. It was also specified that effective May 5, 1986, deposits under the FCNR (A) scheme were not to be accepted for maturity of above three years. The interest rates on NRE accounts were, however, kept unchanged at 2.0 per cent above the rates for domestic deposits. With effect from April 1987, the link between NRE deposit rates and domestic rates was severed and an independent structure of interest rates and maturities was specified.[17]

The FCNR deposit scheme, which was applicable to the pound sterling and the US dollar, was extended to deutsche mark (DM) and Japanese yen. Separate interest rates were prescribed for deposits in each of these currencies with effect from August 1, 1988.

The interest rates on deposits under FCNR (A) were revised on several occasions. With a view to providing a remunerative rate of return on short-term surplus funds, the term deposit rates for maturities of 91 days and above but less than six months were revised effective April 4, 1988, from 6.5 per cent to 8.0 per cent. As a result of this change, the deposit rate for 91 days and above but for less than one year stood at 8.0 per cent.

17. For details, refer to chapter 4: Monetary and Credit Policy.

CERTIFICATES OF DEPOSIT

To further widen the range of money market instruments and to give investors greater flexibility in the deployment of their short-term surplus funds, a new instrument, *viz.*, certificates of deposit (CDs) were introduced in 1989. CDs could be issued in multiples of ₹ 25 lakh, subject to a minimum size of an issue at ₹ 1 crore; the maturity could be between three months and one year; and these could be issued at a discount to face value and the discount rate could be freely determined. The CDs could be transferred 45 days after the date of issue. The total outstanding of all CDs issued by a bank at any point of time was not to exceed one per cent of its fortnightly average deposits. The CDs were subject to reserve requirements and banks were neither allowed to grant loans against CDs nor buy back their own CDs.

The Indian banking sector in the early 1980s faced competition from the stock and bond markets, non-banking financial companies (NBFCs) and mutual fund schemes. Many companies made successful foray into the equity market and floated bonds with remunerative yields, with and without tax incentives. Small savings instruments (such as the NSCs VI issue) also became popular as these offered tax benefits. This turned savers away from bank deposits that offered no such features and carried very low or negative real interest rates. The banking sector was largely constrained as the BR Act did not permit it to undertake non-banking activities. As a result, the share of bank deposits in the household sector's savings declined, while that of deposits with non-banking companies and in small savings instruments floated by the Government increased. The variety of investment opportunities available to individuals as well as corporate depositors was the main reason for beginning of the process of disintermediation in the banking industry.

DEPOSIT INSURANCE AND CREDIT GUARANTEE CORPORATION (DICGC)

As no comprehensive review of the deposit insurance and credit guarantee scheme was conducted since its inception 25 years ago, the Deposit Insurance and Credit Guarantee Corporation (DICGC) Board decided to appoint an expert committee to undertake an in-depth reexamination of the scheme. Accordingly, the expert committee was appointed on July 14, 1986, under the chairmanship of Shri M.N. Goiporia. The major terms of reference were:

(i) To examine the terms and conditions on which deposit insurance/credit guarantee cover was provided by the corporation under its various schemes and to make suggestions for rationalising the same.
(ii) To examine the existing procedures and to suggest simplifications, if necessary, to ensure prompt payment of insurance premium/guarantee fees by credit institutions and expeditious disposal of claims by the corporation.
(iii) To examine, in the light of growing claim liabilities, the adequacy of the corporation's funds and to make suggestions, if necessary, to rationalise the level and structures of guarantee cover so as to make the scheme viable.
(iv) To examine the operational problems, if any, experienced by the participating credit institutions and make suggestions for improvement.

The committee submitted its report in January 1987. The deposit insurance scheme had contributed to the growth of the banking system over the years. Availability of an insurance cover did provide an inducement to the public to retain their savings with the banking system. The committee felt that there was a need to continue with the incentives, given the highly competitive environment and availability of lucrative alternate avenues of investment, such as post office savings, NSCs and public sector bonds to the masses. The deposit insurance scheme was designed to provide protection primarily to relatively small depositors whose number was very large and to whom bank failure meant a severe blow. Coverage of 100.0 per cent of the deposits was seen to be impractical and costly. However, taking into account the inflation rate and the fact that the last revision was made in the year 1980, the committee felt that the insurance cover could be raised from ₹ 30,000 to ₹ 1 lakh.

DEPLOYMENT OF CREDIT

Throughout the decades of the 1950s and the 1960s, one constant refrain was that the banks were not lending to the poor. Consequently, after nationalisation in 1969, they were directed by the Government to start lending to the 'weaker sections of society'. While this in itself was not undesirable, it did mean that over a period of time the freedom available to banks in this realm would be lost. And this, in fact, was what happened. By the end of the 1970s, banks had virtually no freedom to deploy their resources as they desired. There was also the compulsion that the

Government's fiscal position was not strong and it had to draw heavily from banks for its socioeconomic programmes.

In addition, there was a multiplicity of interest rates, which were set by the Reserve Bank. The monetary and credit policies of the Reserve Bank were supportive to the Government's economic policies. The cost of funds and profitability of banks were not subjects of internal policy debate until the mid-1980s, when the issue of the viability of the banking system came into focus and the thinking began to change.

As the 1980s began, it became clear that although the economy had grown, it had not done so in a regionally balanced way. This led to a renewed emphasis on balanced regional growth, which for socioeconomic reasons was the top national priority. The Reserve Bank was assigned the task of reducing regional disparities in credit distribution, which, in turn, asked banks to increase their credit-deposit ratio in rural and semi-urban centres (Table 6.7).

TABLE 6.7

Credit-Deposit Ratio of Public and Private Sector Commercial Banks by Population Group

(Per cent)

	June 1982	*June 1985*	*December 1989*
Rural branches	58.7	65.6	63.8
Semi-urban branches	50.0	52.8	50.0
Urban/Metropolitan branches	75.1	74.6	69.8
Total	67.0	68.7	64.7

Source: Reserve Bank of India, *Report on Trend and Progress of Banking in India*, various issues.

Credit distribution was envisaged in a manner that enabled hitherto neglected regions like eastern and central to get an improved share, although the western and southern regions continued to enjoy sizeable credit disbursals (Table 6.8). Historically, these regions had a concentration of banking that reflected their advanced economic and social status.

The banking sector had to operate within the constraints of restrictions on the credit-deposit ratio imposed by the Reserve Bank in order to maintain orderly usage of banks' resources. This was supplemented by the instrument of moral suasion. The requirements of various schemes and detailed provisions complicated the banks' job. For instance, differential rates of interest (DRIs) were set by the central bank for various purposes in accordance with the needs of borrowers in an effort to align the Reserve

Bank's policies with the Government's development goals. Micro allocation of credit and credit subsidies to preferred sectors were undertaken to support the Government's growth initiatives. The result was that the banks had to operate within multiple restraints. Moreover, these quasi-fiscal policies gradually affected commercial banks' balance sheets by impinging upon their profitability. At the same time, the non-performing assets (NPAs) of banks increased sharply. The decline in profitability and increase in non-performing loans (NPLs) impacted the soundness of the banking sector as banks were unable to plough back their profits.[18]

TABLE 6.8

Credit-Deposit Ratio of Public and Private Sector Commercial Banks: Region-wise

(Per cent)

	Rural			*Semi-urban*			*Urban/Metropolitan*			*Total*		
Regions	*June 1982*	*June 1985*	*Dec. 1989*	*June 1982*	*June 1985*	*Dec. 1989*	*June 1982*	*June 1985*	*Dec. 1989*	*June 1982*	*June 1985*	*Dec. 1989*
Northern	50.1	48.9	45.6	52.1	52.3	45.7	84.7	69.6	59.3	73.3	63.7	55.0
North-East	45.8	62.5	66.7	37.6	39.7	41.3	55.5	51.7	49.8	43.9	48.9	50.9
East	49.6	57.6	56.9	33.5	35.1	33.7	64.0	55.7	58.2	55.5	52.0	52.9
Central	56.1	64.5	53.2	51.6	50.3	44.4	49.8	49.3	52.4	51.6	52.7	50.5
Western	52.5	57.1	66.0	47.8	52.2	49.9	75.5	87.7	75.6	68.5	79.9	71.3
South	80.7	94.9	103.4	60.4	64.5	64.9	89.4	93.1	95.4	79.1	84.4	87.0

Source: Reserve Bank of India, *Report on Trend and Progress of Banking in India*, various issues.

Some help was provided in the form of discretionary support by the Reserve Bank, as in most developing countries, through the use of instruments such as refinance on preferred activities, including credit to agriculture, co-operative banks and export credit. Such refinancing had two effects — direct credit effect and an announcement effect — and helped banks to cover their cost of lending to the preferred activities. However, like all subsidy-based quasi-fiscal regulations, such measures distorted the markets further as they enlarged the monetary base, altered the credit multiplier and complicated monetary management.

The gross bank credit expanded three times within a span of seven years *i.e.*, 1982–1989, indicating involvement of the banking system in

18. For details, refer to chapter 7: Developments in Banking Supervision.

the economic development of the country (Table 6.9). In response to the Government's economic policies and the Reserve Bank's directives/close monitoring and follow-up, the credit deployment pattern had become largely equitable among various sectors. The rate of increase in the case of priority sector was, however, significantly higher as compared with the other segments on account of the special thrust on priority sector advances in the successive Five Year Plans.

TABLE 6.9

Sector-wise Deployment of Credit

(₹ crore)

	June 1982	*June 1985*	*June 1989*
Gross Bank Credit	29,775	50,369	89,609
Food Credit	2,825	6,754	1,659
Non-food Credit	26,950	43,615	87,950
Total Priority Sector Advances	10,673	19,208	35,242
Agricultural Advances	4,594	7,978	14,133
Small Scale Industry (SSI)	3,909	6,956	13,677
Other Priority Sector Advances	2,170	4,274	7,432
Industry—Medium and Large	11,213	16,374	33,735
Wholesale Trade	2,122	2,771	4,919

Source: Reserve Bank of India, *Report on Trend and Progress of Banking in India*, various issues.

CREDIT AUTHORISATION SCHEME

In the early 1960s, when the Third Five Year Plan was being finalised, the Government became aware of the imbalances in bank credit. In 1965, the credit authorisation scheme (CAS) was introduced as a credit rationing tool. Basically, the scheme allowed the Reserve Bank and the Government to decide who would get how much credit. As such, the scheme was never very satisfactory. Attempts were made to fine-tune the CAS during 1982–1989 but without much success. Eventually, the scheme was abolished in 1989. The banks regained their freedom, which was intrinsic to their operations, after 25 years. The effects were quite encouraging in the ensuing years.

In the late 1980s, the industrial sector grew at a healthy annual rate of 5.5 per cent, with the manufacturing sector doing even better and growing at 8.9 per cent per annum. Market capitalisation galloped more than eight-fold over the decade. Consequently, some companies grew faster than the others and had better access to credit from the banking system because of their strong financial position. The Reserve Bank had to face an unusual situation during this period as banks took advantage of the process of liberalisation and accommodated industries generously by granting loans, occasionally ignoring the regulatory guidelines in force. One of the large corporate houses of the times turned out to be one of the major beneficiaries.

The Reserve Bank, during the course of inspection of BoI carried out in the first quarter of 1986, came across instances of large advances being granted against the security of shares of one of the large corporate and to certain companies reportedly connected with the corporate. At about that time, there were also press reports to the effect that substantial advances were granted by several banks to certain allied concerns of the said large corporate for the purpose of subscription to its 'F' series debentures. The Reserve Bank carried out a quick scrutiny of the corporate accounts at different banks and a preliminary report was submitted to the Government. This report was also placed on the table of the House by the Government in July 1986. In the context of the findings of the preliminary scrutiny and widespread discussions on the subject including in Houses of Parliament, the Reserve Bank considered it necessary in the public interest to enquire in detail into the circumstances leading to and connected with the advances made by some commercial banks to borrowers against the security of shares/debentures of the corporate. Accordingly, a committee was constituted by the Reserve Bank on July 14, 1986, under the chairmanship of Dr C. Rangarajan, Deputy Governor, to look into the issue. The committee came to the conclusion that banks had followed the letter of Reserve Bank guidelines but had violated the spirit. As a follow-up, necessary action was initiated by the Government.

In March 1987, the Reserve Bank asked the banks to review the position with respect to compliance with the requirements prescribed by the Tandon, Chore and Marathe Committees in respect of those borrowers whose aggregate working capital limits exceeded the cut-off points for the Reserve Bank's prior authorisation, *i.e.,* ₹ 7 crore for export-oriented units and ₹ 6 crore for borrowers other than those who could be classified as sick or weak industrial units. An exhaustive review in 1987 by the Reserve Bank showed that while the scheme had brought about a large measure of financial discipline, compliance by many parties was below expectations. It was decided that the entities which had broadly complied with the prescribed discipline should be treated differently from those who did not observe the same. Accordingly, in respect of borrowers who: (i) complied with the second method of lending, requiring a minimum current ratio of 1.33:1; (ii) regularly submitted the prescribed quarterly statements to their banks on their level of operations; and (iii) maintained levels of inventory/receivables within or at the prescribed norms/past levels, banks could release the entire amount of additional limits sanctioned by their boards of directors without the Reserve Bank's prior authorisation to such clients. Second, in the case of borrowers who complied with the disciplines at (i) and (ii) referred to above but were not fully compliant in respect of the inventory and receivables norms, the banks would have the discretion of relaxing the norms up to 20.0 per cent, if they considered it appropriate. Such cases were not required to be referred to the Reserve Bank for prior approval for sanctioning the enhanced credit limits. Third, where cases had still to be referred to the Reserve Bank, the existing limits for temporary accommodation by banks were raised substantially and discretionary powers were enhanced liberally to enable the banks to release funds without referring the cases to the Reserve Bank. This decision was expected to reduce the number of CAS cases to be referred to the Reserve Bank by about 35.0 per cent.

The Reserve Bank decided that it would give its decision on all proposals received for its prior authorisation within one month of the date of receipt of the proposals. Concurrently, banks were also advised to gear up their machinery to handle proposals for larger credit limits so that decisions were taken without undue delay, irrespective of whether or not the Reserve Bank's prior authorisation was to be sought. The liberalisation in the CAS was open-ended in that the CAS parties who started complying with the prescribed discipline subsequently were also exempted by the Reserve Bank from the condition of prior authorisation. Follow-up scrutiny by the Reserve Bank of the CAS cases decided by the banks continued as hitherto.

Revised instructions were issued to ensure closer co-ordination between banks and FIs in dealing with sick industrial units so that decisions on measures for their rehabilitation and implementation were expedited. Similarly, instructions were issued to the banks for promptly dealing with proposals of borrowers who were extended working capital credit by more than one bank under consortium arrangements. In both the cases, the role of the lead bank in a consortium was considerably strengthened.

In a review in 1988, it was found that the majority of the CAS parties complied with the prescribed level of the current ratio and that there had been substantial improvements in compliance with inventory norms as well as in the submission of quarterly information system (QIS) statements. Over a period, the inventory-sales ratio of the corporate sector had declined appreciably. Also the share of priority sectors in the outstanding bank credit, which was rising progressively, stood at well above the target of 40.0 per cent. It, thus, appeared that the objectives of CAS were being broadly achieved due mainly to the enforcement of basic financial discipline. In light of this review, it was decided to withdraw the system of prior authorisation by the Reserve Bank and an announcement to this effect was made on October 8, 1988, in the credit policy. CAS was replaced by the credit monitoring arrangement (CMA). However, as per the new approach, all proposals involving the sanction of aggregate working capital limits beyond ₹ 5 crore (instead of the prevailing limit of ₹ 2 crore) were to be subjected to post-sanction scrutiny by the Reserve Bank to ensure that the basic discipline was being observed. As far as term loans were concerned, all proposals which were required to be referred to the Reserve Bank for prior authorisation were henceforth to be subjected to post-sanction scrutiny.

The banks were advised that there was no change in the criteria for lending to borrowers and the assessment of the working capital requirements by banks needed to be in conformity with the following basic financial disciplines: (i) reasonableness of estimates/projections with regard to sales, chargeable current assets, current liabilities (other than bank borrowings) and net working capital; (ii) classification of current assets and current liabilities in conformity with the guidelines issued by the Reserve Bank; (iii) maintenance of the minimum current ratio of 1.33:1 (except in certain exempted categories); (iv) prompt submission of quarterly operations statements; (v) an undertaking by the borrower to submit annual accounts on time; and (vi) regular annual review of the limits by the bank, even where no enhancement in credit limits was involved. In case, as a result of the scrutiny instituted through the CMA, it was found that a particular bank was not enforcing the basic disciplines, the Reserve Bank could instruct such a bank to refer cases of larger accounts for prior authorisation.

The banks were apprised that term loans granted to industrial units needed to be in consonance with the priorities laid down by the Government and that term credit, either as loan or as guarantee/acceptances, was not to be provided for infrastructure activities financed from budgetary sources.

The banks made representations that the penalty for default in submitting statements under the QIS might be waived in the case of exporter-borrowers and sick/weak units. It was agreed that based on the merits of the each case, banks could exempt sick units which remained closed and borrowers affected by political disturbances, riots and natural calamities from paying penal interest. This was a great relief, both for borrowers and the banks. Freedom over micro-level control, which was exercised by the Reserve Bank, was henceforth gradually passed on to the banks after ensuring that both banks and borrowers adhered to the credit and financial discipline as per the Reserve Bank's regulatory requirements. This was a major shift and perhaps a pointer to the impending reforms.

The number of entities with credit limits stipulated under CAS/CMA increased to 931 by the end of March 1989 from 712 at the end of March 1988. The total limits in force relating to 931 parties amounted to ₹ 22,897 crore at the end of March 1989 as compared with ₹ 20,936 crore as at the end of March 1988. The share of public sector undertakings (PSUs) in the total limits at the end of March 1989 was ₹ 11,106 crore, *i.e.*, 48.5 per cent of the total. Of the total limits in force at the end of March 1989, 92.7 per cent was for working capital purposes (including packing credit, inland and foreign bills), 6.3 per cent for term finance and 1.0 per cent for sale of machinery on deferred payment basis.

Activity-wise, of the total working capital limit of ₹ 21,223 crore as end-March 1989, the share of the engineering industry was 16.9 per cent, followed by manufacture of chemical and chemical products (14.0%), cotton textiles (6.9%), and basic metal and metal products (5.7%). The aggregate working capital limits sanctioned to the industry as a whole amounted to ₹ 15,705 crore, *i.e.,* 74.0 per cent of the total. A working capital limit of ₹ 10,476 crore was in force for the public sector, of which trade accounted for 41.6 per cent (the share of food procurement being 21.4% and that of fertiliser distribution at 8.5% of the total), 11.2 per cent for fertiliser production, 11.7 per cent for the engineering industry, 6.0 per cent for the petroleum industry, 6.2 per cent for basic metal and metal products, and 3.2 per cent for generation and distribution of electricity.

TRANSFER OF BORROWAL ACCOUNTS

All parties, including those availing credit limits in excess of ₹ 5 crore, were allowed to transfer their accounts from one bank to another without requiring a no objection letter from the existing bank, provided the transferee bank agreed to take over the entire liabilities of the party. If any industrial group sought to transfer only a good account leaving an unsatisfactory account with the existing bank, the latter could refuse to allow such a transfer, unless arrangements were made by the concerned party to the bank's satisfaction.

CONSORTIUM ADVANCES

With a view to easing operational problems, the restriction on the number of banks (*i.e.*, 5) in respect of consortium advances with credit limits of up to ₹ 50 crore was removed. Banks were, however, advised to limit the number of banks in the formal consortia arrangements at around 10.

MECHANISATION OF BANKING

The Reserve Bank gave special emphasis in the 1980s to bring about mechanisation in banking, despite heavy opposition from trade unions and some political parties that feared massive unemployment from large-scale mechanisation. In 1983, the Reserve Bank constituted a committee under the chairmanship of the Deputy Governor, Dr C. Rangarajan[19] to identify areas/functions where mechanisation was essential, recommend appropriate hardware for various types of processing, recommend infrastructure needed to ensure smooth data flow, suggest a phased programme of implementation, suggest appropriate steps for the exchange of information through suitable computer media between different banks and the Reserve Bank, propose standardised procedures in different areas of work and examine the feasibility of common processing arrangements for all banks at selected focal points.

The committee submitted its report in 1984 in which it analysed the prevailing banking scenario. The committee observed that though the banking industry with 45,000 branches at that time was spread across 25,000 centres, 60.0–70.0 per cent of the business was concentrated in around 10,000 branches located in about 100 centres. It also observed that with the phenomenal increase in the activities of banks and the wide geographical coverage, a certain degree of mechanisation was essential to perform routine functions efficiently, especially in the areas of customer service, housekeeping, and data generation for control and monitoring. While making the recommendations, the committee took into account the extent and level of technology available in the country in the early 1980s and the agreement entered into by the IBA with the employees' union in 1983,

19. The Committee on Mechanisation in the Banking Industry (Rangarajan Committee), 1983.

which imposed limitations on the extent and degree of computerisation in terms of types of machines to be used, application areas, number of machines to be used and capacity of computers.

The major recommendations of the committee, *inter alia*, were that the mechanisation should encompass various levels — branch, regional/zonal office, and head office — with the emphasis varying from one level to another. At the branch level, mechanisation was to be implemented as either model I or model II of mechanisation. In model I, a stand-alone electronic ledger posting machine with an attached memory module was to be installed to perform dedicated functions at different counters; the machine was also expected to generate account statements and periodically work out products and interest accruing on accounts. In model II, a single microprocessor-based system was to be installed in a branch; vouchers were to be posted manually in primary ledgers and then information entered into the microprocessor system to generate supplementaries, day book, general ledger and other statistical returns. The approach was outlined as under:

(i) Data from branches were to be received by the regional/zonal offices and processed through microprocessor-based computer systems to generate appropriate outputs to facilitate their control functions. The data were then to be transmitted to the head office where they were to be stored in the mainframe system to generate macro-level information for the bank as a whole.

(ii) Input/output formats were to be standardised.

(iii) The mechanisation programme was to be implemented in two stages. During the three-year period from 1985 to 1987, regional/zonal offices and head offices were to be equipped with suitable systems. About 2,500 branches were to be equipped with 10,000 model I or model II machines. In stage II (1988–89), additional 6,000 branches were to be mechanised with 20,000 machines.

(iv) Telecommunication needed to be made more effective, and

(v) Clearing house operations needed to be computerised on a priority basis.

The IBA had entered into an agreement on mechanisation/computerisation with the All-India Bank Employees' Association (AIBEA) in September 1983 under which electronic ledger posting/accounting machines, microprocessors/minicomputers and mainframe computer systems were to be installed to support specified functional areas in branches, regional/zonal and head offices of the banks. The settlement specified that accounting machines, electric/electronic with memory, other than computers were to be utilised in the banks for all deposit accounts, general ledger accounts, cash credit, loan accounts, salary and payrolls.

There were other conditions in the agreement, which mainly included no staff retrenchment as a result of the introduction of machines/ computers, non-utilisation of accounting machines in rural branches and non-installation of electronic machines with memory. The capacities and configuration of machines were also expected to match the specifications. The number of machines to be installed by the banks, including 28 PSBs, was fixed at up to 3,500 for the period ending September 7, 1987, and up to 5,700 during the next two years, that were to be shared among the banks on a pro rata basis of the aggregate deposits as on December 31, 1985. It was also agreed that a special allowance of ₹ 350 per month would be paid to the machine operators.

Most of the banks did not have either a suitable organisational set up or technically qualified staff to effectively implement the computerisation plan. Therefore, the first task was to create a distinct and fully accountable organisational structure. For effective monitoring and to oversee the implementation of recommendations at the macro level, a high level standing monitoring committee was constituted by the Reserve Bank comprising representatives from the Government, the IBA, major banks and the Reserve Bank. The Reserve Bank conducted several meetings of liaison officers of banks to speed up and co-ordinate action at the operational level by banks. The steps taken included setting-up of a separate computer policy and planning department in each major bank, empanelling manufacturers of ledger posting machines (LPMs), standardising hardware and software, defining specifications for systems to be installed, determining the hardware configuration for the mainframe system to be installed at head offices and making arrangements to train about 300 systems analysts/programmers by 1985. As per the action programme announced by the Government in July 1985, LPMs were expected to be installed in about 1,000 branches and minicomputer systems in about 100 regional/zonal offices of PSBs by the end-March 1986.

In conformity with the policy to bilingualise enunciated by the Department of Official Languages, the hardware specifications were revised in the late 1987 to provide hardware capability for bilingual operations on advanced ledger posting machines (ALPMs). A separate group consisting of members from the Reserve Bank, Department of Electronics, a few commercial banks and experts from Computer Maintenance Corporation

Ltd (CMC) was set up in December 1986 to take a comprehensive look at all related issues. The group in its report submitted in 1987 outlined various applications at the head office level, and the required hardware and software specifications. The report covered the details pertaining to site preparation, selection and training of personnel and organisational set up as well as the need to develop standardised applications software. The group considered it desirable for banks to install such a set up in place of several minicomputers as the mainframe provided better security features, faster data transmission and message-switching facilities. While one bank installed an imported mainframe, another bank installed a mainframe from an empanelled vendor in June 1989. Efforts were on to pool in the resources of the banks and develop in house application software. A group was appointed to develop software specifications for two applications, *viz.*, location based service monitoring and co-ordination of government accounts among volunteering banks.

In addition to various systems installed for identified purposes within the guidelines of the Rangarajan Committee report (1984), banks also installed several other computers for activities, such as foreign exchange dealings, inter-branch reconciliation, word processing, training, generation of management information system (MIS) reports, software development and consolidation of annual accounts. The number of such systems, which included personal computers (PCs), minicomputers and other machines as on September 30, 1988, was about 600.

An agreement between the IBA and employees' unions was signed in March 1987 in terms of which banks were allowed to install 5,700 ALPMs by September 1989 in proportion to their share in aggregate deposits as on December 31, 1985. The share of PSBs worked out to 5,480 ALPMs. The banks were advised to initiate steps for site preparation and training of personnel and commence exercises for software development so as to ensure optimal utilisation of systems on delivery.

As at the end of June 1989, banks had installed 4,264 ALPMs at their branches, of which 3,997 ALPMs were operational and 2,962 ALPMs had a live run. The banks also installed 218 minicomputer systems at their regional/zonal offices at end-June 1989. As regards the mainframe systems at the head offices of banks, the benchmarking for the selection of three indigenously manufactured systems was completed and the results were communicated to the banks.

COMPUTERISATION IN THE RESERVE BANK

COMPUTERISATION OF CLEARING HOUSES

The work involved in cheque clearing operations was voluminous, repetitive and of a routine nature. To speed up the process, it was felt that clearing house operations needed to be computerised.[20] In the first phase, operations of the clearing houses managed by the Reserve Bank were computerised at the major centres, *viz.*, Ahmedabad, Bangalore (now Bengaluru), Bombay, Calcutta, Hyderabad, Kanpur, Madras (now Chennai), New Delhi and Nagpur. To facilitate cheque sorting and to cut delays, high-speed reader/sorter systems driven by IBM 4381 were installed at Bombay, New Delhi, Madras and Calcutta. The four systems processed about 10 lakh instruments per day, with the Bombay clearing house touching a peak of over 6 to 7 lakh on some days. Special clearing for high-value cheques of more than ₹ 1 lakh was introduced in Bombay, Calcutta and Madras; credit was made available to parties within a day and withdrawal allowed the next day. Inter-city cheque clearance was operationalised in four metros, *viz.*, Bombay, New Delhi, Calcutta and Madras; outstation cheques drawn on these centres could be cleared within a week, as against four weeks taken earlier.

As part of the efforts to mechanise cheque clearing, magnetic ink character recognition (MICR) technology was introduced. The MICR technology required standardisation of cheques in terms of paper quality and printing of particulars of cheques, such as, the serial number, city/bank/branch on which drawn, and account number, nature of transaction and amount at the bottom of the cheque in magnetic ink. Seven manufacturers of MICR grade paper and 51 security printers were empanelled and the size of the instruments was standardised. The first phase of mechanised cheque clearing using MICR technology, initiated by introducing a high-speed reader-sorter system for processing local as well as inter-city MICR cheques, commenced operations.

As part of the project to introduce national clearing of cheques and adoption of MICR technology for mechanised cheque processing, the majority of banks in Bombay, Madras and New Delhi began issuing

20. Computerisation in the Reserve Bank is dealt with in detail in chapter 21: Institutional Changes.

MICR cheques to their customers. Mechanised cheque processing at the centres of operation stabilised over time. Work was initiated to introduce mechanised cheque processing using MICR technology at Calcutta and for computerised clearing house settlement operations at Bhubaneswar, Jaipur, Nagpur, Patna and Trivandrum. Arrangements were made to computerise clearing house settlement operations at Guwahati. Mechanisation of clearing house settlement operations was also extended to select large clearing houses managed by the SBI.

Taking into account the progress achieved, the future requirements of banks to improve customer service and productivity and to consider allied issues, the Reserve Bank constituted a committee in September 1988 under the chairmanship of Dr C. Rangarajan, Deputy Governor, with members drawn from the major PSBs, FIs, training institutions, government departments and the Reserve Bank to prepare a perspective plan to computerise banks over the next five years, covering the period 1990 to 1994.

Further, an expert group was constituted by the IBA at the instance of the Reserve Bank to examine all aspects relating to the establishment of back-up cheque processing facilities to handle prolonged system breakdowns and other contingencies to ensure that clearing operations were not disrupted. Based on the recommendations of the group, the Bank finalised the uniform regulations and rules (URRs) for clearing houses, and these were adopted by all clearing houses in the country. Steps were also taken to frame regulations for clearing houses under section 58(2)(P) of the RBI Act, 1934. In centres where more than five banks were functioning and where there were no clearing houses to cater to their needs, banks were advised to take necessary steps to open clearing houses. During the year 1987–88, 30 new clearing houses were opened.

After the adoption of finalised URRs by all clearing houses, section 58(2)(P) of the RBI Act, 1934, which empowered the Reserve Bank to frame regulations for clearing houses only for scheduled banks, was amended by Parliament in December 1988 to provide for framing of regulations of clearing houses to govern all member banks, including non-scheduled, co-operative and post office savings banks. An expert group comprising senior officers drawn from the concerned departments of the Bank, the IBA and the SBI was constituted in May 1989 to review the existing URRs for clearing houses in order to place them on a statutory basis under the said Act. During 1988–89, 23 clearing houses were set up.

TELECOMMUNICATIONS NETWORK

Pursuant to the recommendations of the committee for a communication network for banks (1987), steps were taken to set up an exclusive data communication network for banks called BANKNET, which was a general-purpose network that provided basic connectivity from/to geographically dispersed locations across the country. Through its implementation, 37 banks in India (including the Reserve Bank) became members of the Society for Worldwide Interbank Financial Telecommunications (SWIFT), a co-operative society based in Belgium. Action was taken to install the SWIFT regional processor at Bombay, which was entrusted with acting as the international gateway.

Message formats conforming to SWIFT specifications were standardised by the Reserve Bank and the IBA. Through this network, any bank on the network could establish a connection with its own offices and with any other banks/offices/computers in the network. The connections in the network called ports were terminals of mini/micro systems and mainframe computers. The IBM computers installed at the National Clearing Cells (NCCs) of the Reserve Bank at the four metropolitan centres, *viz.*, Bombay, Madras, Delhi and Calcutta, formed the hub of the BANKNET network. Basic connectivity between the systems on the network was through the dedicated data transmission lines leased from the Department of Telecommunications (DOT). The activities to make BANKNET operational, *viz.*, commissioning the DOT circuits, importing essential communications equipment, defining application areas and preparing message formats and sites, were put in place in a phased manner.

STUDY GROUP ON FACTORING SERVICES

The Reserve Bank perceived extending factoring services as a measure to expedite collection of dues by suppliers and in this context constituted a study group in January 1988 under the chairmanship of Shri C.S. Kalyanasundaram, to examine the feasibility and mechanics of setting-up factoring organisations in India.

The terms of reference for the study group included considering the need and scope for one or more factoring organisations in the country, the nature of their constitution, whether they were to be in the public, private or joint sector, the changes required in the legal framework to promote factoring business, the feasibility of extending factoring services to exporters and other matters relating to factoring. The group submitted its report in January 1989 and its recommendations were accepted in principle by the Reserve Bank. The important findings of the study group were as follows:

(i) There was sufficient scope to introduce factoring services in India, which would be complementary to the services provided by banks.
(ii) Export of factoring services from India would provide an additional facility to exporters.
(iii) While quantification of the demand for factoring services was not possible, it was assessed that it would grow sufficiently so as to make factoring business a commercially viable proposition within a period of two/three years.
(iv) On the export front, there would be a fairly good availment of the services offered by export factors.
(v) To attain a balanced dispersal of risks, factors should offer their services to all industries and all sectors in the economy.
(vi) The pricing of various services by factors depended on the cost of funds. Factors should attempt a mix from among the various sources of funds to keep the cost of funds as low as possible, in any case not exceeding 13.5 per cent per annum so that a reasonable spread was available.
(vii) The Bank could consider allowing factoring organisations to raise funds from the Discount and Finance House of India Ltd (DFHI) as also other approved FIs, against their usance promissory notes covering receivables factored by them, along the lines of the revised procedure under the bill rediscounting scheme.
(viii) The price for financing services would be around 16.0 per cent per annum and the aggregate price for all other services might not exceed 2.5 per cent to 3.0 per cent of the debts serviced.
(ix) Only select promoter institutions/groups/individuals with a good track record in financial services and competent management were to be permitted to enter this new field.
(x) Initially the organisations could be promoted on a zonal basis.
(xi) There were distinct advantages in banks being associated with handling the factoring business. Subsidiaries or associates of banks were ideally suited to undertake this business.

(xii) Factoring activities could be taken up by the proposed Small Industries Development Bank of India (SIDBI), preferably in association with one or more commercial banks.

(xiii) The business community needed first to be educated through bank branches about the nature and scope of these services and the benefits accruing from them.

(xiv) Factors could not extend their services efficiently, effectively and economically without the support of computers, as also quick and dependable means of communication, and hence the adoption of the latest technology in this field needed to be encouraged. In this context, the promoters needed to initiate measures for organising a network of computers/dedicated lines linking branches/agents in different parts of the country for accounting, follow-up, remittances, and other activities involved in the factoring business.

(xv) The Central Government and the Reserve Bank needed to immediately initiate measures to set up specialised agencies for credit investigation and, until such agencies became fully operative, factors could rely on the information on clients/customers collected through banks or other sources.

(xvi) Since it was envisaged that suppliers would be able to obtain financial services from both banks and factoring organisations, it was necessary to provide for proper linkages between banks and factors.

(xvii) The factoring of small scale industry (SSI) units could prove to be mutually beneficial to both factors, and SSI units and factors needed to make every effort to orient their strategy to crystallise the potential demands from this sector.

(xviii) An efficient financial system could sustain itself on a viable basis only if a favourable environment was created and fostered; the Government needed to take expeditious steps to promote legislation, grant appropriate exemptions and amend existing laws in order to subserve the objectives of promoting factoring.

URBAN CO-OPERATIVE BANKS

The urban co-operative banks (UCBs) were essentially the common man's bank, operating in metropolitan, urban and semi-urban centres to cater to the needs of the weaker sections and small borrowers, such as SSI units, retail traders, professionals and the salaried class. The difference between

UCBs and commercial banks was in the scale of their operations. Their record of performance, however, depended on the quality and intentions of their boards. Though the share of UCBs in total deposits of urban and metropolitan areas was not significant, they were able to promote thrift and savings among small and medium-income groups in these centres. They provided loans to the small and medium categories of borrowers, and in this sense they had a definite role to play in meeting the financing needs of these categories.

TABLE 6.10

Performance of UCBs at End-June

(₹ crore)

	Number	Owned Funds	Deposits	Borrowings	Loans Issued
1982	1258	2,825	1,650	146	1,425
1983	1281	393	2,278	313	1,802
1984	1310	429	2,659	185	2,103
1985	1331	511	3,255	210	2,524
1986	1346*	612	3,939	214	3,046
1987	1354*	734	4,838	238	3,693
1988	1378*	886	5,789	317	4,636
1989	1378	1,082	7,232	376	5,820

Note: * Revised.

Source: Reserve Bank of India, *Report on Trend and Progress of Banking in India*, various issues.

Of the 1331 UCBs in the country in June 1985 (Table 6.10), 1015 constituting 76.3 per cent were located in Maharashtra, Karnataka and Tamil Nadu. These were also the states which had a concentration of commercial bank offices in urban and metropolitan areas. There were regional imbalances in the growth of UCBs in the country. Five states put together had 17 UCBs; these were: Assam (3), Haryana (6), Punjab (5), West Bengal (1) and Bihar (2). Of the 330 UCBs in Maharashtra (excluding salary earner-type banks), as many as 286 were either located in the Konkan region (including Bombay) or in western Maharashtra.[21]

21. Ojha, P.D. (1985). *Role of the Urban Banks in the Multi-Dimensional Economic Growth of the Country*, keynote address delivered at the Seminar of Chairmen of UCBs in Maharashtra State. Bombay: Maharashtra Urban Co-operative Bank Federation. August 24.

The UCBs came under the Reserve Bank supervision on March 1, 1966, but control over the organisation, management and staffing was exercised by the Registrar of Co-operative Societies, a functionary of the state governments. Over the years, the Reserve Bank evolved a mechanism, assisted by the standing advisory committee (SAC) constituted specifically for the purpose, to deal with the issue of dual control.

The agricultural credit board (ACB), set up under the aegis of the erstwhile Agricultural Credit Department (ACD) of the Reserve Bank, was entrusted with examining policy matters relating to rural credit. It was also a forum to discuss issues relating to non-agricultural credit such as those concerning primary (urban) co-operative banks. The board ceased to exist after the establishment of NABARD. The Reserve Bank, however, continued to shoulder the responsibility of discharging various functions towards primary (urban) co-operative banks. With the dissolution of the ACB, there was, however, no exclusive forum/body within the Reserve Bank to tender expert advice on matters relating to primary (urban) co-operative banks. The Reserve Bank, therefore, constituted an SAC in February 1983 to advise on policies relating to licensing of new primary (urban) co-operative banks, opening of branches, capital, membership, priority sector advances, refinance facilities, rehabilitation or merger/ liquidation of weak and non-viable primary co-operative banks, advice on the training needs of their staff, professionalisation of management and other important issues. The chairman of the advisory committee was a Deputy Governor of the Reserve Bank, and the chief general manager of the Urban Banks Department (UBD) acted as the member secretary of the committee. The SAC consisted of representatives from the Central Government, select state governments, national/state federation of primary (urban) co-operative banks, the IBA and NABARD. The diverse membership of the committee ensured that the Reserve Bank had the benefit of the expertise of various authorities on different aspects referred to the committee. The committee usually met once a year.

Recognising the importance of UCBs, the Reserve Bank extended certain concessions to them. They were permitted to pay 1.0 per cent higher rate of interest on their savings and term deposits, at their discretion, as compared with the rates payable by commercial banks. The prescribed rates for CRR and SLR for UCBs were lower than those for commercial banks. As an illustration, in August 1985, for UCBs these requirements were only

3.0 per cent and 25.0 per cent as against 9.0 per cent and 37.0 per cent, respectively in the case of commercial banks. Further, while commercial banks had to invest a major portion of their resources in government and trustee securities, UCBs could keep almost the entire statutory liquid assets with state/central co-operative banks, and such provisions enabled them to earn higher interest. The rationale behind such concessions was to induce UCBs to mobilise resources of the low and middle income groups, inculcate a sense of thrift among them and use these resources for the maximum economic benefit of the people in their area of operation.

Maharashtra continued to be at the forefront in the field of the co-operative movement, including the development of urban banks. The state took the lead in promoting urban banking and nearly 30.0 per cent of the UCBs in the country were located in Maharashtra by the latter half of the 1980s. Further, more than 40.0 per cent of the UCBs with a working capital of ₹ 5 crore and above, were located in Maharashtra. The UCBs in the state accounted for 45.0 per cent of the deposits of UCBs in the country. As many as 176 co-operative banks in the state had deposits of ₹ 1 crore and above.

The Reserve Bank as the central banking authority of the country assumed responsibility for ensuring harmonious and balanced growth of all banking constituents of the industry, while at the same time avoiding unhealthy and wasteful competition among them. It was recognised that sound banking development would also help reduce regional imbalances and promote growth. Towards this end, the Reserve Bank adopted a cautious and selective approach in forming new banks or opening branches to prevent overbanking of the areas and to facilitate an even geographical spread. However, in unbanked and underbanked areas, the Reserve Bank was willing to consider requests to set up new UCBs or branches of the existing banks, keeping in view, among others, if such banks/branches could function as viable business entities in the long run. Further, as there was a parallel rural banking infrastructure in the country, UCBs were not intended to function in rural areas, but were expected to cater to the needs of all residents in their area of operation regardless of caste, community, creed, or vocation. Since UCBs were required to have an open membership, the Reserve Bank did not accept demands to set up new banks on the grounds that the existing banks were catering to the needs of only particular groups and were unwilling to admit others into their fold. Further, the Reserve Bank did not want depositors' interests to be put at stake and wanted the management of UCBs to be cautious and avoid doing anything, advertently or inadvertently, that violated the Reserve Bank's guidelines or affected the health of the institutions.[22]

Inclusion in the second schedule to the RBI Act had been a persistent demand of UCBs. This was also one of the recommendations at the conference of the national federation of UCBs held at New Delhi in November 1986. The Governor appointed a committee under the chairmanship of an Executive Director of the Reserve Bank to look into these recommendations. The committee proposed that larger urban banks that had a working capital of above ₹ 10 crore could be considered for inclusion in the second schedule to the RBI Act and that the concessions given to state co-operative banks with regard to maintenance of cash reserve and liquid assets could be extended to such UCBs as well. The recommendations of the committee were discussed by the Reserve Bank management on June 24, 1987, and the proposal to accord scheduled status to bigger urban banks was accepted.

One factor that weighed in favour of according scheduled status to UCBs was that such banks, especially the larger ones, functioned like commercial banks and extended a variety of services to their members. Further, some scheduled banks were much smaller in terms of size and range of operations than the large urban banks. It was felt that urban banks had an important role to play in the Indian banking system, since they catered to the needs of people with small means and their exclusion from the second schedule came in the way of discharging their role efficiently and effectively. There was, therefore, little justification for keeping urban banks out of the second schedule to the RBI Act. However, as this meant a major policy change, it was decided to have a restricted criterion for scheduling urban banks and a cut-off point of ₹ 50 crore of deposits was laid down.

The proposal for inclusion of UCBs was submitted to the Government, which asked for certain clarifications. After detailed consultations between the UBD and the Department of Banking Operations and Development (DBOD), the following clarifications were submitted in September 1987:

(i) Preferential treatment to co-operative banks was envisaged in the provisions of the BR Act, 1949. In terms of section 42 of the RBI Act, and section 24 of the BR Act, commercial banks (excluding

22. Ojha (1985) *op. cit.*

RRBs) were at this point required to maintain 9.5 per cent and 37.5 per cent of their demand and time liabilities as CRR and SLR, respectively. However, scheduled co-operative banks were required to maintain a minimum statutory ratio of only 3.0 per cent (CRR) and 25.0 per cent (SLR), respectively. Such clauses were incorporated in the Acts by reason of the specific role that the co-operative movement was assigned to play in the development process of the economy. Such preference would not adversely affect commercial banks because the deposits of urban banks were at around ₹ 4,000 crore, which constituted only 4.0 per cent of the total deposits of commercial banks of over ₹ 1,00,000 crore. Further, while it was true that all sections of the BR Act were not applicable to co-operative banks, such banks had a distinct, useful role to play in the banking system and their inclusion in the second schedule would enable them to perform this role more effectively. This move was, however, not likely to adversely affect commercial banks because urban banks had a limited area of operation, generally confined to the limits of the city in which they were established. There were no such restrictions in the case of commercial banks, however.

(ii) In addition to direct access to the Reserve Bank refinance and improvement in image, which had been referred to by the Government, scheduling would enable urban banks to get direct finance from the Bank as also refinance assistance directly from the IDBI. Scheduling would also facilitate acceptance of their guarantees and letters of credit (LCs) by government departments and PSUs. It was stated that the UBD had frequently received representations from urban banks and their federations to the effect that their guarantees and LCs could be accepted by the government departments and the PSUs, but this request did not find favour with the Government because these banks were not included in the second schedule.

(iii) The functioning of central co-operative banks, which catered to the rural credit requirements of the society, was quite different and distinct from urban banks. The functioning of UCBs was akin to that of commercial banks. So far, central co-operative banks had not requested the Reserve Bank for inclusion in the second schedule. Perhaps these institutions did not face any handicap on this account. Conferring scheduled status on urban banks did not, therefore, amount to any discrimination against central co-operative banks.

(iv) The obligation for social banking cast on UCBs was much higher than that for commercial banks. Urban banks were required to channelise not less than 60.0 per cent of their total advances to the priority sector as against the level of 40.0 per cent prescribed for commercial banks, although the total deposits of UCBs constituted only about 4.0 per cent of the deposits of SCBs. Also, as per the criteria proposed by the Reserve Bank, only nine urban banks with deposits aggregating ₹ 1,108 crore were eligible for scheduling. With such a limited deposit base, urban banks in no way offered any competition to commercial banks.

(v) The Government examined the matter and in January 1988, it assured a decision to notify the primary co-operative banks[23] through a notification to this effect which was issued on April 5, 1988. Accordingly, the following 11 UCBs were included in the second schedule of the RBI Act with effect from September 1, 1988, after an inspection of these banks and satisfying other criteria:

(1) Abhyudaya Co-operative Bank Ltd, Bombay.
(2) Bombay Mercantile Co-operative Bank Ltd, Bombay.
(3) Development Co-operative Bank Ltd, Bombay.
(4) Janata Sahakari Bank Ltd, Pune.
(5) Kalupur Commercial Co-operative Bank Ltd, Ahmedabad.
(6) Rajkot Nagrik Sahakari Bank Ltd, Rajkot.
(7) Rupee Co-operative Bank Ltd, Pune.
(8) Sangli Urban Co-operative Bank Ltd, Sangli.
(9) Saraswat Co-operative Bank Ltd, Bombay.
(10) Shamrao Vithal Co-operative Bank Ltd, Bombay.
(11) Surat People's Co-operative Bank Ltd, Surat.

The UBD requested the Government in June 1988 to consider exempting scheduled UCBs from the provisions of section 18 of the BR Act, 1949 as they were required to hold cash reserves under section 42 of the RBI Act, 1934. The Government, in response, issued a notification on

23. As defined under clause (ccv) and section 5 read with section 56 of the BR Act, 1949, which were licensed and whose demand and time liabilities were not less than ₹ 50 crore as FIs for the purpose of sub-clause (iii) of clause (a) of sub-section (6) of section 42 of the RBI Act, 1934.

August 5, 1988, declaring that the provisions of section 18 of the BR Act, 1949 would not apply to UCBs included in the second schedule of the RBI Act, 1934.

SUPERVISORY ROLE

The bond between the Reserve Bank and the urban banks was not as close as was perceived. There were no statutory provisions for nominating a director from the Reserve Bank to the board of management of UCBs, unlike in the case of commercial banks. Continuous association with banks' executives, dialogues and consultations enabling the Reserve Bank and commercial banks to have the mutual benefit of exchange of information and feedback about operational problems related to policies and guidelines was not feasible with the urban bank set up in view of their large numbers and comparatively insignificant level of operations. The Reserve Bank was empowered, at best, to send an observer to attend the meetings of the board. Statutory inspections were conducted once in two years. There was no mechanism in place to get regular feedback about the policies and operating procedures being followed.

The Deputy Governor, Dr P.D. Ojha, cautioned that UCBs should not expect to depend continuously on concessions.[24] He emphasised that the banks functioned in a highly competitive environment and as such should develop their own strengths. He went on to say that it was essential for the urban banks to continue to be distinctive in the matter of quality of service rendered, as it was not only by performance that they would be recognised by the community. He exhorted them to continue their efforts to extend efficient customer service and ensure the most efficient management of available resources, besides earning and retaining confidence of the depositors. As in the case of other banks, deposits with UCBs were insured within limits by the DICGC, the subsidiary of the Reserve Bank. However, mere insurance of deposits did not satisfy the depositors who wanted to be assured that the institutions to which they entrusted their savings had the required financial strength and operational efficiency to ensure continued safety of their funds.

In September 1983, the Reserve Bank exhorted UCBs to lend not less than 60.0 per cent of their total loans to the priority sectors by June 1985, of which 25.0 per cent were to go to the weaker sections of society.

24. Ojha (1985) *op. cit.*

The underlying objective behind fixing priority sector lending targets was to ensure that loans went to the common man and got increasingly directed towards productive purposes. Granting of consumption loans was discouraged. Any weakness, for any reasons, in this respect was seen to adversely affect the image of banks and the same was conveyed to them.

A disturbing development in the case of UCBs was an increase in the number of weak banks. As at the end of June 1984, the number of such banks was as high as 310, of which 78 were located in Maharashtra. Their working was characterised by serious shortcomings including irregularities, gross mismanagement, deteriorating quality of their loan portfolios, heavy overdues and erosion of assets. Some banks did not comply with the statutory requirements of minimum share capital and were non-viable. The small and uneconomic size of the banks made their functioning inflexible, leading to failures. The existence of a large number of such units, which had attained the status of UCBs by virtue of crossing the owned funds limit of ₹ 1 lakh, proved to be a severe drag on the urban banking movement. This was a matter of concern for the Reserve Bank and the bank managements. Banks were advised to implement time-bound rehabilitation or reorganisation programmes to help themselves out of the mess.

The viability issue was engaging the attention of the Reserve Bank and the Bank conducted a comprehensive study to revise the norms of viability of UCBs. It emphasised that a sound UCB was not only meant to meet the administrative and operational costs, declare a reasonable dividend to shareholders and strengthen its reserves, but also had to ensure sustained growth in the years to come even after attaining the norms of viability. The Deputy Governor, Dr Ojha, highlighted in his address to the chairmen of UCBs that the boards of management should be well informed, fully conversant with all matters dealt with by UCBs, be progressive and forward-looking, objective in their outlook, dynamic and, above all, visibly honest in their dealings. They should know the broad national goals and priorities indicated in successive Five Year Plans. They should also be familiar with various provisions of the Acts, the rules, by-laws and instructions issued by the Registrar of Co-operative Societies and the Reserve Bank on various aspects of the working of UCBs. In short, they needed to be professional in their outlook and management.[25]

25. Ojha (1985) *op. cit.*

The regulation and supervision norms in respect of UCBs were broadly in conformity with those in vogue for commercial banks. The regional offices of UCBs were required to keep their central office informed of developments in the field of their operations through monthly demi-official letters that covered various aspects such as the progress in the inspection of banks, status of the proposals for setting-up new banks/branches, deployment of staff, position of urban banks in the region and conferences/meetings convened.

THE BANK, FIs AND NBFCs

Since the initiation of the Second Five Year Plan, the focus of Indian planning turned in favour of the development of highly capital-intensive, large scale basic and heavy industries. The strategy for industrialisation demanded more long-term credit from the banking sector and such needs were being met by commercial banks. The banks, however, had to provide finance to the priority sector of not less than 40.0 per cent of their net bank credit. This exerted tremendous pressure on them to strike a balance between the two areas of credit disbursal. It was in this context that the FIs stepped in to play a vital role in meeting the exclusive long-term credit requirements of the industrial sector, as per the Plan priorities.

It was, however, necessary to ensure that these institutions were subjected to prudential practices and standard procedures, and the Reserve Bank laid down broad guidelines keeping in view the day-to-day operations of the FIs. The MIS envisaged for the purpose had two facets: one, to aggregate information for facilitating monetary control and two, to examine the quality of assets from the supervisory standpoint. For this purpose, the Reserve Bank set out to collect all relevant information on the activities of non-banking financial institutions (NBFIs).

There was, however, only a limited attempt to evaluate developments in this field and practically no attempt to analyse the overall impact of the FI operations. This was clearly a deficiency from the viewpoint of macro monitoring of the financial system. Towards the late 1980s, a need was felt to devise adequate safeguards for effective monitoring and control of the FIs. With this in view, the Reserve Bank constituted an in house group on FIs headed by Shri S.S. Tarapore. The group submitted its report on June 2, 1990. In their report, the group recommended introducing an information system for the FIs, so as to obtain an insight into the financial health of these entities and to monitor their operations, particularly the total debt and investment instruments. From the viewpoint of effective supervision, introducing a system of annual financial review akin to that adopted for commercial banks was recommended; it also detailed a quarterly action plan to be put in place after the initial assessment of the health of these institutions by the Reserve Bank. Further, the group recommended that a system of formal dialogue be initiated for structured supervision of the FIs. The structure of the interest rates charged by the FIs was to be approved by the Reserve Bank in consultation with the Government. The group also suggested that a financial institutions cell (FIC) be set up in the Reserve Bank as an independent unit of the central office with an interdisciplinary officer orientation. Most of the recommendations were implemented during the early 1990s by the Reserve Bank.

INDUSTRIAL DEVELOPMENT BANK OF INDIA

The IDBI[26] was designed to cater to the long-term financial requirements of the corporate sector. It was instituted to provide two types of advances, *viz.*, direct assistance and indirect assistance, besides providing guarantees for loans and deferred payments. While direct finance comprised project finance of an industrial nature, indirect finance included refinance of industrial loans provided by other term-lending institutions, bill financing, loans to other financial institutions (OFIs), investments in shares and bonds of the OFIs and seed capital financing.

The aggregate financial assistance sanctioned and disbursed (excluding guarantees) by the IDBI increased by 26.6 per cent and 18.9 per cent, respectively, during 1983–84 over that of 1982–83. There was a rise of 13.1 per cent and 26.1 per cent in sanctions and disbursements of aggregate financial assistance, respectively, during the year 1984–85 over that in 1983–84. The aggregate sanctions and disbursements continued to rise through the 1980s and increased by 44.3 per cent and 28.4 per cent, respectively during 1988–89 over that in 1987–88.

Direct assistance disbursed by way of project loans, underwriting and direct subscriptions along with assistance for technical development recorded a rise of 43.7 per cent during 1985–86, 38.8 per cent during 1987–88 and 39.4 per cent during 1988–89, respectively, over those of the respective previous years. However, the rise in disbursements during 1983–84 stood at a dismal 2.8 per cent over the previous year, while total

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26. Set up in 1964.

sanctions recorded a significant rise of 44.9 per cent during the same period. Disbursement of indirect assistance by way of refinance of industrial loans, rediscounting of bills, subscription to shares and bonds, and seed capital also increased by 25.1 per cent during 1983–84, by 19.7 per cent during 1985–86 and by 22.3 per cent during 1988–89, over the respective previous years.

As a part of introducing innovative finance, the IDBI set up a textiles modernisation fund (TMF) during 1986–87. It initiated a new scheme of assistance for export-oriented units and floated a 9.0 per cent capital gains bond scheme with a maturity of three years. A new feature of the bonds was that investors had the option to receive the entire interest in advance on a discounted basis or half-yearly interest of 9.0 per cent per annum. Under the leadership of the IDBI, the FIs made the single-window concept more effective. The IDBI (amendment) Act, 1986 enlarged the scope of its activities, which included health care, storage, distribution of energy, consultancy, merchant banking and trusteeship activities.

In 1987–88, the IDBI set up a voluntary executive corps cell (VECC) to offer counselling to small scale units with investments above ₹ 5 lakh. To simplify the procedures, the IDBI along with the IFCI and Industrial Credit and Investment Corporation of India Ltd (ICICI) extended the single-window clearance concept to foreign currency loans. A scheme was devised to assist projects engaged in energy conservation during March 1988.

During 1988–89, the IDBI introduced the exchange risk administration scheme (ERAS) in collaboration with other FIs, *viz.,* the IFCI and ICICI, to offer protection against exchange risk to foreign currency borrowers. During the year, a decision was taken to extend financial assistance to tourism-related facilities, such as, amusement parks, cultural centres and restaurants. To meet the foreign currency requirements of industrial units, the IDBI entered into foreign currency lines of credit from commercial banks of foreign countries, *viz.,* West Germany, Japan, and the erstwhile USSR, among others. The Reserve Bank sanctioned credit limits to the IDBI ranging from ₹ 260 crore during 1982–83 to ₹ 375 crore during 1988–89 out of the NIC (LTO) fund for a period of 15 years at an interest rate of 8.0 per cent. The IDBI fully utilised the above credit. The Reserve Bank also sanctioned short-term credits from time to time against security of eligible usance bills rediscounted by it.

The total financial assets of all FIs stood at over ₹ 89,000 crore at the end of March 1989. The outstanding position revealed certain interesting facts. Illustratively, the total liability of the IDBI as at the end of March, 1989 amounted to ₹ 17,139 crore. Borrowings from the Reserve Bank were equivalent to 22.0 per cent of the total liabilities and 33.0 per cent of loans and advances. The capital and reserves together amounted to 8.3 per cent of the total liabilities of the IDBI. A number of FIs received assistance from the Reserve Bank either under the long-term operation (LTO) fund or through short-term credit; the total sum outstanding under the national industrial credit (NIC) (LTO) fund and national housing credit (NHC) (LTO) fund at the end of March 1990 amounted to ₹ 4,616 crore. Further, under the national rural credit (NRC) (LTO) fund and NRC [stabilisation (S)] fund, the outstanding as at the end of March 1990 amounted to ₹ 3,975 crore. Thus, credit outstanding under all the LTO funds together amounted to ₹ 8,591 crore or about 12.0 per cent of the reserve money. Further, a number of FIs were provided accommodation at the Bank Rate; these limits amounted to ₹ 530 crore at the end of March 1990, though there were no dues outstanding against these limits.

INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA LTD

Assistance from the ICICI[27] included rupee and foreign currency loans, underwriting, and direct subscriptions to shares, debentures and guarantees. Rupee loans continued to form the main component of assistance over a period of time; their share in total sanctions stood at 57.2 per cent during 1982–83, 45.9 per cent during 1983–84 and 41.6 per cent during 1988–89. As part of its merchant banking activities, the ICICI offered advisory services on foreign currency management, overseas company floatation and organisational restructuring. In collaboration with other institutions, it played an important role in setting-up the over-the-counter (OTC) market. The ICICI also introduced buyers' credit in December 1988 to enable companies to acquire equipment not covered under the suppliers' credit scheme. During 1988–89, the ICICI initiated negotiations with the World Bank for a programme to strengthen the capabilities of research institutions to provide technology services to industry. The Technology Development and Information Company of India Ltd (TDICI) established by the ICICI commenced operations to provide technological information and commercial R&D schemes. The ICICI extended assistance to various

27. Set up in 1955.

industrial sectors such as the chemical, fertiliser, cement, textiles and basic industries. It laid emphasis on providing assistance to industrially backward areas of the country. Assistance sanctioned by the ICICI during 1983–84 increased by 25.8 per cent and disbursements by 8.8 per cent over the previous year. The aggregate sanctions increased by 17.1 per cent, 14.1 per cent and 57.9 per cent during the years 1984–85, 1986–87 and 1988–89, respectively, over the corresponding previous years. Similarly, disbursement of assistance by the ICICI recorded a growth of 16.6 per cent, 44.2 per cent and 40.8 per cent during the years 1984–85, 1986–87 and 1988–89, respectively, over the respective earlier years.

The ICICI was sanctioned a credit limit of ₹ 10 crore during 1982–83 by the Reserve Bank and the corporation availed of the limit on several occasions for short periods. The amount was enhanced to ₹ 15 crore during 1984–85, which continued during 1985–86. However, during 1987–88, an *ad hoc* credit limit of ₹ 20 crore was sanctioned to the ICICI, which was fully utilised and a fresh limit of ₹ 25 crore was sanctioned for the financial year 1988–89. The facility was availed of on several occasions.

INDUSTRIAL FINANCE CORPORATION OF INDIA

The IFCI[28] was established by an Act of Parliament to provide medium and long-term loans to industrial concerns in the corporate and co-operative sectors. In the initial years, the assistance portfolio of the IFCI was concentrated in traditional industries like sugar and textiles, but over time it diversified its assistance portfolios to cover various promotional activities to help catalyse the growth of industrialisation in the country.

The assistance sanctioned by the IFCI during 1983–84 increased sharply by 43.3 per cent as against 5.6 per cent in 1982–83. Total disbursements showed an increase of 15.8 per cent during 1982–83, 14.8 per cent during 1983–84 and 21.6 per cent during 1984–85, over the respective previous years. The disbursement of assistance increased at a comparatively lower pace of 11.8 per cent and 48.0 per cent during the years 1985–86 and 1986–87, respectively. Further, aggregate assistance sanctioned by the IFCI during 1988–89 registered a growth of 85.9 per cent, while disbursements increased by 52.3 per cent over the previous year. During the 1980s, a volatile trend was discernible in the relative shares of rupee loans and foreign currency loans in total assistance sanctioned. The

28. Set up in 1948.

share of rupee loans in total sanctions declined gradually from 88.5 per cent in 1982–83 to 63.2 per cent during 1985–86 and increased to 72.6 per cent during 1988–1989. The share of foreign currency loans increased over the years, from 2.5 per cent during 1982–83 to 19.0 per cent during 1988–89. The remaining portion of sanctions comprised underwriting, direct subscriptions and guarantees. The IFCI sanctioned loans to textiles, basic chemicals, transport equipment, metals, fertilisers and electricity generation industries. An amendment to the IFCI Act in 1982 enabled it to extend project financing to other sectors, such as passenger and goods transport, road repairs, and industrial estate.

An important development that impacted IFCI's operations was the enactment of the Sick Industrial Companies (Special Provisions) Act (SICA), 1985. The Government established a quasi-judicial authority known as the Board for Industrial and Financial Reconstructions (BIFR) in January 1987, which became functional from May 15, 1987. The Appellate Authority for Industrial and Financial Reconstruction (AAIFR) was constituted in April 1987; this was an appellate authority to review the BIFR decisions and to formulate rehabilitation proposals for sick industries, since the number of sick units was on the rise during the 1980s.

A state-wise analysis of assistance disbursed revealed that the industrially backward states steadily improved their share in assistance received from the IFCI from 41.7 per cent in 1982–83 to 43.6 per cent in 1983–84 and further to 60.2 per cent, cumulatively up to the end of March 1985. Disbursements to backward areas during the year amounted to 57.5 per cent of the total disbursements. Of the total sanctions up to end-March 1989, over 50.0 per cent were meant for backward areas.

EXPORT-IMPORT BANK OF INDIA

Exim Bank[29] was established as a statutory corporation under the Export-Import Bank of India Act, 1981. Its objectives were to provide financial assistance to importers and exporters, to act as the principal FI in co-ordinating the work of other institutions financing international trade, and to undertake certain development and merchant banking activities.

Exim Bank was formed by transferring the export finance operations of the IDBI to the newly constituted bank. Established on January 1, 1982, the bank commenced operations from March 1, 1982. The export loans

29. Set up in 1982.

and guarantee portfolios of the IDBI were transferred to Exim Bank, which assumed a funded liability of ₹ 169 crore and non-funded liability in the form of export guarantees of ₹ 336 crore under the general fund and ₹ 3 crore under the development assistance fund, now termed the export development fund. The bank took over from the IDBI various programmes of funded assistance, *viz.*, direct financial assistance to exporters, overseas investment financing, pre-shipment credit, overseas buyers' credit, lines of credit and refinance of export credit.

Exim Bank operates various lending programmes to promote exports of engineering and capital goods and related services from India. Funded financial assistance on competitive credit terms is extended to enable Indian exporters to operate in the international markets. The bank, along with commercial banks in India, participates in the issuance of guarantees in foreign currencies on behalf of Indian exporters/contractors in favour of overseas importers.

During March–December 1982, Exim Bank's approvals in terms of funded assistance aggregated to ₹ 293 crore, of which sanctions and utilisation amounted to ₹ 236 crore and ₹ 179 crore, respectively. Approvals on account of non-funded facilities aggregated to ₹ 774 crore. Export guarantees of ₹ 102 crore were executed during March–December 1982. Outstanding sums at the end of December 1982 in terms of funded and non-funded assistance amounted to ₹ 220 crore and ₹ 399 crore, respectively. More than three-fourth of the funded approvals were to finance the export of transport equipment (43.0%), power generation and distribution equipment (33.0%), while the construction industry claimed the bulk of the non-funded approvals (78.0%).

Nearly two-third of the approvals for funded lending programmes was for exports to South-East Asia. Two regions, namely, South-East Asia and Africa, accounted for 93.0 per cent of funded approvals. Of the non-funded approvals, projects in West Asia received the largest share (66.0%) followed by those in Africa (22.0%) and South-East Asia (12.0%).

Exim Bank's resources as on December 31, 1982, amounted to ₹ 359 crore, comprising paid-up capital of ₹ 75 crore, long-term loans of ₹ 20 crore from the Government, ₹ 70 crore from the Reserve Bank, ₹ 172 crore due to the IDBI on transfer of export loans from the IDBI and the balance made up of reserves. The bank raised its first euro-dollar loan of US$ 25 million during the year.

NATIONAL HOUSING BANK

The Governor, Shri R.N. Malhotra in his address on November 28, 1990 expressed:[30]

> Housing activities were being financed by both institutional and non-institutional sources. Institutional sources included central and state governments, insurance companies, commercial banks, specialised housing finance institutions, such as, the Housing and Urban Development Corporation (HUDCO), Housing Development Finance Corporation Ltd (HDFC), Provident Fund, and the Unit Trust of India. However, investment in the housing sector declined from 34 per cent in the First Five Year Plan to less than 10 per cent in the Seventh Five Year Plan. The share of housing in Gross Domestic Product at 1980–81 prices slipped from 5.9 per cent in 1980–81 to 5.3 per cent in 1987–88. However, in absolute terms, the investment in housing had multiplied almost 28 times from Rs. 1,150 crore during the First Five Year Plan to Rs. 31,458 crore in the Seventh Five Year Plan. This investment in the housing sector was inadequate as the shortage of usable housing increased from 152 lakh units in 1961 to 233 lakh units in 1981 and was projected to widen further to 410 lakh units by 2001. Assuming a conservative cost of Rs. 50,000 per dwelling unit, the all-India shortage of 410 lakh units required an investment of over Rs. 2,05,000 crore. This figure indicated vast growth potential in this sector. The National Housing Policy formulated by the Central Government during 1988 set out the priorities and framed a strategy to eradicate the shortage of usable dwelling units by the turn of the century. The policy also advocated the creation of an institutional framework to mobilise savings for housing, meet the credit needs of the household sector and respond to the specific shelter needs, income patterns and living conditions of people in different parts of the country.

To achieve the above objective, the National Housing Bank[31] (NHB) was set up on July 9, 1988, with an initial share capital of ₹ 100 crore entirely subscribed to by the Reserve Bank. During 1988–89, the NHB

30. Malhotra, R.N. (1990). Inaugural Address at the inaugural ceremony of the Vysya Bank Housing Finance Ltd. Bangalore. November 28.

31. Set up in 1988.

floated bonds for ₹ 20 crore, carrying an interest rate of 11.5 per cent per annum. The NHB was sanctioned a long-term loan of ₹ 50 crore out of the NHC (LTO) fund constituted by the Reserve Bank.

To promote savings for acquisition of a house, a new scheme called home loan account scheme (HLAS) was introduced by the NHB in co-operation with scheduled banks. The scheme was announced by the Union Finance Minister while presenting the Union Budget for 1989–90. The minimum contribution to the savings scheme was fixed at ₹ 30 per month or ₹ 360 per annum. These savings earned the interest at the rate of 10.0 per cent per annum. Any individual not owning a house anywhere in India was eligible to join the scheme. After saving for a minimum period of five years, a member was eligible for a loan equal in amount to a multiple of the accumulated savings including interest. To make the scheme attractive, some fiscal concessions were extended. Savings in the HLAS of the NHB qualified for deduction from gross income under section 80C of the Income Tax Act, and repayment of the same housing loan up to a maximum of ₹ 10,000 per annum qualified for deduction under section 80C. Further, investments under the HLAS were exempted from wealth tax, subject to the overall ceiling of ₹ 5 lakh under section 5 of the Wealth Tax Act.

Another major initiative of the NHB was preparation of guidelines on formation of housing finance companies (HFCs) in the private and joint sectors. The guidelines stipulated that an HFC needed to have a minimum paid-up capital of ₹ 1 crore and that at least 20.0 per cent of the equity was required to be from a scheduled bank, a public FI, a state government or an HFC approved by the NHB. Further, at least two directors from banking/FIs were required to be on the board. Limitations were prescribed on the total borrowings of an HFC as a multiple of its net owned funds, on the maturity period of deposits, on the interest rate payable on deposits, on lending rates and margins, on front-end charges and administrative costs, and on the proportion of total lending that an HFC could undertake for purposes other than housing. The guidelines struck a balance between the regulatory and promotional roles of the NHB, as the objective was to create an enabling environment for the growth of housing finance institutions along sound lines.

The NHB had already commenced refinance schemes for SCBs, scheduled state co-operative banks, scheduled UCBs, HFCs and the apex co-operative housing finance societies. It had also formulated a scheme to extend financial support to the state-level land development banks (LDBs) in respect of housing loans granted by them, through subscription to special rural housing debentures to be floated by them. The terms and conditions of all the refinance schemes were more or less similar. The refinance was to be provided only in respect of direct lending to individuals/groups of borrowers (formal or informal, including co-operative societies).

The housing finance routed through RRBs by the sponsor banks was treated as direct lending of the latter. Refinance was provided up to 100.0 per cent of direct loans of up to ₹ 50,000 for construction of new housing units with built-up accommodation of 40 square metres. This facility was additional to, and separate from, housing loans granted under the annual credit allocation for housing made by the Reserve Bank and housing loans of up to ₹ 5,000 at a concessional interest rate of 4.0 per cent per annum extended to persons belonging to scheduled castes (SCs)/scheduled tribes (STs). Individual housing loans of up to ₹ 1 lakh granted in the urban areas were eligible for refinance, provided the built-up accommodation did not exceed 40 square metres. The refinance amount was, however, restricted to ₹ 50,000. In rural areas, the area limit of 40 square metres could be relaxed at the discretion of the lending agency, provided the cost of the housing unit did not exceed ₹ 65,000. The aggregate amount of refinance in no case exceeded the aggregate amount of outstanding loans to the eligible categories excluding overdues. Refinance was available to banks for 15 years, irrespective of the actual repayment period or moratorium allowed by them in individual cases. Banks were expected to stipulate a repayment schedule of 15 years, as provided under the Reserve Bank guidelines. In the case of HFCs and apex co-operative housing finance societies, the repayment period for refinance was fixed at 20 years.

The refinance schemes came into operation from January 1, 1989, and specified housing loans sanctioned after that became eligible for the scheme. As of end-June 1989, the NHB released refinance aggregating ₹ 96 lakh to two HFCs and an SCB.

During the year, United States Agency for International Development (USAID) provided a loan guarantee for US$ 50.0 million to the NHB under the USAID government housing guarantee programme, under which developing countries could borrow in the US capital market with the guarantee of the US government for periods up to 30 years.

Apart from organising financial resources for housing, the NHB initiated steps to augment real resources for housing. Towards this objective, it evolved guidelines to finance land development projects. The

NHB drew up a land development project keeping in view local conditions, technical feasibility and affordability for different income groups. This was intended to be an integrated project, including acquisition of land and on-site infrastructure. Funds were made available in the form of term loans at market rate of interest. To ensure timely execution, the NHB charged higher rate for time overruns. A period not exceeding two years was envisaged for developing land and making the site available for construction of a shelter.

The NHB also proposed to extend full support to industries that augmented supplies of building materials and/or led to construction at a lower cost. Some of the related activities that got the support of the NHB were production and use of: (i) locally produced, low-cost building materials and construction components; (ii) standardised building materials and components; (iii) building materials and components produced by use of agricultural and industrial wastes; (iv) building materials and components which replaced or reduced substantially the use of scarce resources like wood; and (v) low-energy consumption building materials and components.

NATIONAL BANK FOR AGRICULTURE AND RURAL DEVELOPMENT

With a view to providing all types of production and investment credit for agriculture and rural development and to act as an agency for promoting integrated rural development, the committee to review arrangements for institutional credit for agriculture and rural development (CRAFICARD), in its report submitted in March 1981 to the Bank, recommended the establishment of NABARD.[32] The bill for the establishment of NABARD[33] was passed by Parliament and received the assent of the President on December 30, 1981. NABARD came into existence on July 12, 1982. Established on the basis of the National Bank for Agriculture and Rural Development Act, 1981, NABARD was set up as the apex FI to provide and regulate rural credit and promote integrated rural development in the country. After its establishment, there was internal reorganisation of the departments within the Reserve Bank; the Agricultural Credit Department (ACD) ceased to function and a new Rural Planning and Credit Department (RPCD) was set up.

32. Set up in 1982.

33. A detailed account of NABARD is given in chapter 8: Rural Credit Policy.

The obligations cast on the Reserve Bank under section 54 of the RBI Act in the sphere of agricultural credit were modified. The amended section envisaged that the Reserve Bank would maintain expert staff to study various aspects of rural credit and development, tender expert guidance and assistance to NABARD, and conduct special studies in areas that it may consider necessary for the promotion of integrated rural development.

The board of directors of NABARD consisted of, besides the CMD, two directors from experts in rural economics and rural development, three directors from the Central Board of the Reserve Bank, three directors from among officials of the Government and two directors from among officials of the state governments. A Deputy Governor[34] from the Reserve Bank and chairman of the erstwhile Agricultural Refinance and Development Corporation (ARDC) was appointed as the chairman of NABARD.

The paid-up capital of NABARD was ₹ 100 crore and was held by the Reserve Bank and the Government in equal proportions. In terms of the provisions of the NABARD Act, the assets and liabilities of the erstwhile ARDC were taken over by NABARD. For its short-term operations, NABARD could draw funds mainly from the Reserve Bank. For its term loan operations, it could draw funds from the Government, float bonds in the open market and also draw, to the extent needed, from its NRC (LTO) fund and NRC (S) fund. The assets and liabilities of the two funds maintained by the Reserve Bank, *viz.*, the national agricultural credit (NAC) (LTO) fund and NAC (S) fund were transferred to the above funds of the NABARD. NABARD was also authorised to accept deposits with a maturity of not less than 12 months from the central and state governments, local authorities and scheduled banks, and to borrow, with the approval of the Central Government, foreign currency from any bank or FI in India or elsewhere. The short-term loans outstanding granted by the Reserve Bank to SCBs and RRBs under section 17 of the RBI Act [except those under section 17(4) (a)] were transferred to NABARD which, in turn, was required to repay these to the Reserve Bank.

NABARD was required to provide assistance by way of refinance credit, for the promotion of agriculture, SSI units in rural areas, cottage and village industries, handicrafts, other rural crafts and other allied economic activities in rural areas, with a view to promoting integrated rural development and securing rural prosperity. Short-term credit by

34. Shri M. Ramakrishnayya.

way of refinance (repayable within 18 months) was to be provided to SCBs, RRBs and OFIs (approved by the Reserve Bank) for agricultural operations or marketing of crops; marketing and distribution of inputs necessary for agriculture or rural development; bona fide commercial or trade transactions; production or marketing activities of artisans or SSI units in rural areas; industries in tiny and decentralised sectors, village and cottage industries or those engaged in handicrafts and other rural crafts; and other allied economic activities in rural areas. The short-term loans granted to SCBs and RRBs could be converted into medium-term loans for periods not exceeding seven years under conditions of drought, famine or other natural calamities. Medium-term loans *(i.e.,* 18 months to 7 years) were to be provided to SCBs and RRBs for agriculture and rural development and other purposes as determined by NABARD. Long-term loans (up to 25 years) and advances by way of refinance were to be provided to the LDBs, RRBs, SCBs, other scheduled banks, and OFIs for promoting agriculture and rural development, as well as for giving loans to artisans, SSIs, industries in tiny and decentralised sectors, and village and cottage industries. NABARD also extended short-term loans along with long-term loans, where such composite loans were considered necessary. It could also make loans and advances to the state governments for periods not exceeding 20 years to enable them to subscribe directly or indirectly to the share capital of co-operative credit societies.

NABARD was also required to maintain a R&D fund. Another provision in the NABARD Act stipulated that for the first 15 years, it would, after making provision for bad and doubtful debts, depreciation of assets and other provisions necessary or expedient, transfer the remaining surplus to the R&D fund. This, it was felt, would help promote research in agriculture and rural development, and aid NABARD in formulating and designing projects/programmes to suit the requirements of different areas.

INDUSTRIAL RECONSTRUCTION BANK OF INDIA

Industrial sickness had emerged as a major area of concern during the 1980s. The Industrial Reconstruction Corporation of India[35] (IRCI), a company registered under the Companies Act, was converted into the IRBI, a statutory corporation with the purpose of attempting to overcome the inherent difficulties faced by the IRCI in its efforts to rehabilitate and

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35. Established in 1984.

reconstruct sick industrial concerns. The IRBI was to function as the principal credit and reconstruction agency for industrial revival; it was also envisaged to co-ordinate similar work of other institutions, to assist and promote industrial development, and to facilitate rehabilitation of industrial concerns.

DISCOUNT AND FINANCE HOUSE OF INDIA LTD

The DFHI[36], set up jointly by the Reserve Bank, PSBs and the FIs to deal in short-term money market instruments with the primary objective of imparting improved liquidity, commenced operations from April 25, 1988. The DFHI was incorporated under the Companies Act, 1956, with an authorised and paid-up capital of ₹ 100 crore, of which ₹ 51 crore was contributed by the Reserve Bank, ₹ 33 crore by public sector banks and ₹ 16 crore by the FIs.

In the initial stages, the DFHI focused on two money market instruments, namely, 182-day Treasury Bills and rediscounting of short-term commercial bills. The DFHI's operations in 182-day Treasury Bills were aimed at imparting greater flexibility to banks in their management of short-term funds. As regards short-term commercial bills, the aim of the DFHI was to provide liquidity to commercial bills that had already been discounted or rediscounted by banks and the FIs by further rediscounting these bills. A line of credit of ₹ 200 crore at 12.0 per cent per annum was provided to the DFHI by the PSBs. In addition, to be able to perform its functions more effectively, the Reserve Bank provided the DFHI with back-refinance lines. By varying the quantum rate of interest on refinance to the DFHI, it was envisaged that the Reserve Bank would transmit signals to the short-term money market.

The DFHI was allowed to participate in the call and notice money market as both a lender and a borrower. This was a step towards providing some flexibility to the money market. The operations of DFHI in the call/notice money market were exempted from the provisions of the ceiling rate of interest set by the IBA. This resulted in freeing the call money markets in a limited way and also enabled the DFHI to contribute effectively to the overall stability of the money market.

36. Set up in 1988.

STOCK HOLDING CORPORATION OF INDIA LTD

The Stock Holding Corporation of India Ltd[37] (SHCIL), a depository institution jointly promoted and sponsored by seven all-India FIs (IDBI, IFCI, ICICI, UTI, LIC, General Insurance Corporation [GIC] and IRBI), commenced operations in August 1988. It was established to introduce a book entry system for transfer of scrips in lieu of the physical transfer of paper shares. The SHCIL began by offering custodial and post-trading services, and added depository and other services to its portfolio over time.

NON-BANKING FINANCIAL COMPANIES

Non-bank financial entities were a part of the financial architecture in India since time immemorial. With the significant expansion of banking in the 1970s, particularly after bank nationalisation, the importance of non-bank financial intermediaries was expected to wane. The NBFCs, however, mushroomed in the 1970s and 1980s, despite marked expansion and consolidation of the banking business in these two decades. The setting-up of targets for priority sector lending and higher allocation of bank credit to neglected sectors of economic activities pursued by weaker sections of the population did not seem to have any impact on the conditions of credit availability for the common man at large. Although commercial banks decisively enjoyed the confidence of the public, the NBFCs continued to record a manifold increase in their business after the nationalisation of banks. This could be attributed to a variety of factors. On the demand side, growth in farm and non-farm activities expanded rural incomes, and the sprouting of the small scale sector in urban and semi-urban areas escalated the credit requirements of small entrepreneurs, traders and transport operators. Though the banking business expanded, it however, could not keep pace with the credit requirements of several segments of society. On the supply side, a large size of funds that shied away from the banking system because of a reluctance to declare sources of funds appeared to have been channelled into NBFCs and such funds were aggressively deployed by these companies to earn reasonable returns. In fact, high rates of income tax in the 1970s fuelled the generation of such funds on a large scale, which was also vindicated by the impressive mobilisation of resources through voluntary disclosure schemes (VDS). Further, either the bank branches did not exist or the systems and procedures of banking institutions were

37. Established in 1988.

too complicated for the common customer. The procedural hassles, compounded by widespread illiteracy, often discouraged borrowers from approaching the banks. For the ordinary citizen, it was not easy to raise loans from the banks which required several documents, tangible collaterals and margins. This caused a large section of the rural poor, in particular, to keep away from the formal banking sector and seek alternative sources of funds. The NBFCs, thus, came up to complement commercial banks by filling the gaps in a range of services provided by the banks. Another positive feature of this development was that the growth of NBFCs offered competition to commercial banks, making them more efficient and responsive to customer needs. Also, substantial growth in the NBFCs supported the overall savings and investment in the economy, auguring well for economic growth. On the flip side, the NBFCs were said to have influenced liquidity, asset creation and interest rates in the economy, rendering monetary policy less effective.

A few NBFCs and non-banking non-financial companies also mobilised deposits from the public. The deposit-taking activities of the former were regulated by the Reserve Bank under the provisions of the non-banking financial companies' directions, 1977, and the deposit-taking activities of the latter category were regulated by the provisions of the Companies Act by the Government. Resources mobilised by these institutions were deployed in various economic activities undertaken directly by these companies.

The activities of the NBFCs such as those engaged in the business of hire-purchase, housing finance, investments, loans, mutual benefit financial and residuary financial companies, and convertible chit funds continued to be regulated by the Reserve Bank. However, chapter III B of the RBI Act, 1934 vested the Reserve Bank with powers to prohibit the issue of advertisements by a non-banking institution soliciting deposits from the public. The Bank scrutinised their books of accounts either through on-site inspection or through an offsite supervision mechanism. The Reserve Bank was empowered to prohibit the NBFCs from accepting deposits from the public and to prosecute defaulters for violating the directives in the said Act. The NBFCs and miscellaneous non-banking companies, including chit fund companies, could accept deposits for a minimum period of 6 months and a maximum of 36 months, except for the HFCs for which the maximum period for acceptance of deposits was laid down at 60 months during 1982–83. The HFCs could offer a maximum interest rate of 15.0 per cent per annum. Investment and loan companies could accept total deposits of up to 40.0 per cent of net owned funds (NOF); hire-purchase companies could accept 10 times the NOF; and for HFCs, no such ceiling was prescribed. NBFCs were required to maintain liquid assets in cash, bank deposits or unencumbered government or approved securities that were not less than 10.0 per cent of the outstanding deposits.

There was no uniform legislation to control massive growth of chit funds and money circulation schemes throughout the country. Barring a few, the states had not enacted legislation to control and monitor these activities. To plug this loophole and to bring about a uniform legislation applicable throughout the country, the Chit Funds Act, 1982 was enacted by Parliament. The Act received the assent of the President of India on August 19, 1983. The responsibilities of administration of the Act and framing of the rules under the Act were vested in the state governments. The Reserve Bank, therefore, issued a circular to the Chief Secretaries of all the state governments/UTs in December 1983 for adoption of the Act. The Reserve Bank continued to follow up with the state governments/UTs for speedy adoption of the legislation. Under the provisions of the Act, for commencing chit fund business, the minimum capital of the chit fund company was required to be not less than ₹ 1 lakh. Existing companies with a capital of less than ₹ 1 lakh were given three years to increase their paid-up capital. Before declaring dividends at the end of each year, a chit fund company had to transfer not less than 10.0 per cent of the net profits to a reserve fund. Also chit fund institutions were required to utilise the funds only to carry on the chit business, give loans to non-prized subscribers, invest in trustee securities or make deposits with approved banks. Besides the state governments, the Reserve Bank was also given the powers to inspect the operations of chit fund companies. The civil courts were barred from entertaining proceedings in respect of the chit business and deterrent penalties were provided for contravening the provisions of the Act.

The Prize Chit Money Circulation Scheme (Banning Act), 1978 prohibited the conduct of prize chits, lotteries and money circulation schemes. Prize chit companies included the Peerless General Finance and Investment Company Ltd, which filed 37 writ petitions challenging the applicability of the Act to their schemes. The Reserve Bank was impleaded as a respondent, while the Government and respective state governments were the main parties to the petition. On the grounds of violating the Prize Chit Money Circulation Scheme (Banning Act), 1978, the Government of West Bengal conducted raids on the office premises and partners of

Sanchaita Investments, Calcutta, which was accepting deposits from the public and reportedly offering very high interest rates. The partners of the firm filed a writ petition in the Calcutta High Court challenging the proceedings initiated after the raids.[38]

Some unincorporated bodies offered rates of interest more than they could earn, which resulted in default in repayment of principal and interest thereon. As per the Banking Laws (Amendment) Act, 1983, which prohibited unincorporated bodies from accepting deposits from the public except to a specified extent, an individual could not accept deposits from more than 25 depositors and a partnership firm from 25 depositors per partner with a maximum of 250 depositors. Thus, the ceiling imposed was on number of depositors rather than on the quantum of deposits. This amendment came into force in February 1984 by including a new chapter 111-C in the Act. In terms of this amendment, the Reserve Bank was not required to regulate the deposit-taking activities of unincorporated bodies. Unincorporated bodies that accepted deposits from the number of persons exceeding the prescribed limit were required to bring down the number of depositors within two years. Under the provisions of the Act, failure to adhere to these provisions attracted a penalty by way of imprisonment up to two years, or a fine up to twice the amount of deposits received or ₹ 2,000, whichever was more, or both. Officials of the Reserve Bank and the state governments were vested with powers to obtain search warrants under section 45 T of the Act; this enabled officers to enter and search premises suspected to be used for keeping documents relating to deposit acceptance in contravention of the provisions of section 45 S, and to launch prosecution.

The Department of Non-Banking Companies (DNBC) in the Bank was renamed as the Department of Financial Companies (DFC). In terms of the Banking Laws (Amendment) Act, 1983, it was possible for banks to undertake the business of equipment-leasing through subsidiaries set up for the purpose. Amendments were made to the directions to incorporate regulation of a new category of financial companies called equipment-leasing companies. These companies could accept deposits for periods ranging between 6 months and 36 months. The distinction between hire-purchase and leasing business was very narrow. Leasing companies were

38. The petitions were settled much later. Details of the procedures do not fall within the purview of Volume 4 of the RBI history.

permitted to raise deposits up to 10 times of their NOFs. However, for computation of the ceiling, all borrowings, *viz.*, borrowings from banks and funds raised in the form of bonds and debentures, were clubbed with deposits. Dr P.D. Ojha,[39] Deputy Governor stated:

> Equipment-leasing was a contractual agreement between two parties, *i.e.*, lesser and lessee for the hire of a specific asset selected from a manufacturer or a vendor of the asset by the lessee. The lessor, *i.e.,* the leasing company retained the ownership of the asset, while the lessee had its possession and used it against payment of specified rentals, over an agreed period. There were mainly two types of leases-financial lease and operating lease. A financial lease was akin to instalment credit, *i.e.*, a method of acquisition of an asset without making any payment for it.

The selection of equipment was the lessee's function. Under such an arrangement, the rentals covered the full cost of the equipment along with the interest component and profit. Most of the industrial and agricultural plants and equipment, mining and transportation and service facilities, printing presses, office machinery, computers, ships and aircraft could be available on lease.

Since 1983, leasing was slowly finding acceptance in the field of industrial and capital equipment, and during the late 1980s it developed as an important source of equipment finance. As per the prevalent practice in India, the lessor provided financial assistance for purchase of equipment selected by the lessee. The period of lease was normally lower than that of the depreciated life of the asset. The total rental payment during the obligatory period, which was not cancellable, was sufficient to amortise the full capital outlay. This approach was commonly called 'full pay out'. The lessee bore the risk of obsolescence and paid the maintenance fees, insurance premium and taxes. The main advantages of leasing to the lessee were the rentals which were reckoned as business expenditure for tax purposes; the lessor got a tax benefit in respect of depreciation provided. Further, there was no clause of a buy-back option in the lease agreement. One of the major benefits to a lessor was that the tax burden was borne by the lessee, and this enabled a leasing company to declare high levels of profit and distribute dividend from the very first year of its operations. In

39. Ojha, P.D. (1988). Address at the *Tenth Lease Financing Seminar*. Asian Leasing. March 10.

the absence of any prudential accounting procedure laid down for such companies by the Reserve Bank, some companies recognised larger portion of rentals as income than warranted, which tempted them to distribute larger dividends.[40]

Hire-purchase companies were regulated by the Reserve Bank under the provisions of the directions of 1977 as applicable to NBFCs. The number of such companies increased from 209 in 1983 to 412 in 1986, and the amount of deposits raised by these companies from the public increased from ₹ 158 crore to ₹ 278 crore during this period. A hire-purchase company was permitted to accept deposits payable between not less than 6 months and not exceeding 36 months from the date of deposit. A hire-purchase company was permitted to raise deposits from the public to the extent of 10 times of its NOFs calculated as the aggregate of the paid-up capital and free reserves as appearing in the latest audited balance sheet of a company, net of the accumulated balance of loss, deferred revenue expenditure and other intangible assets, if any, as disclosed in the balance sheet. These companies had to maintain an account in India with a scheduled bank or in unencumbered approved securities for a sum which was required to be not less than 10.0 per cent of its deposits outstanding at the close of business on any day. These companies were also required to comply with other provisions of the directions relating to submission of returns, balance sheet and issue of advertisements relating to soliciting deposits. The Reserve Bank was also empowered to prohibit acceptance of deposits by a company in case of non-compliance with the provisions of the directions. Management of these companies had the responsibility to utilise the mobilised funds in the most efficient manner and strictly for the purpose for which such deposits were mobilised.

On May 15, 1987, the Reserve Bank issued a fresh set of directions known as the residuary non-banking companies' directions, 1987. These directions were applicable to companies that were not in the business of hire-purchase, leasing or in other such prescribed activities under non-banking business. These companies were conducting deposit schemes that did not contain a prize element. The direction stipulated the minimum period of deposits at 12 months, the maximum period of deposits at 120 months and interest payable at 10.0 per cent compounded annually. They were also required to keep deposited or invested not less than 10.0 per cent

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40. Ojha (1988) *op. cit.*

of the deposits accepted in the form of fixed deposits with PSBs, not less than 70.0 per cent in approved securities and not more than 20.0 per cent or 10 times their NOFs, whichever was less, in other investments which in the opinion of the company were safe. Such investments were required to be made with the approval of the board of directors. The directions further provided that no such companies could forfeit any amount deposited by a depositor or interest, premium, bonus or other advantage accrued thereon. Every company was required to disclose as a liability in its books of account and balance sheet the total amount of deposits received, with interest and bonus accrued or payable to depositors. Companies in this category were required to keep the securities lodged with a designated PSB under its lien on behalf of the depositor, and these could be withdrawn only for repayment of deposits. These companies were also required to comply with other provisions relating to the submission of returns and advertisement rules, as applicable to other NBFCs.

The Reserve Bank's directions were amended, which provided for raising the minimum and maximum periods of deposits in respect of hire-purchase finance, equipment-leasing and HFCs. It imposed ceilings on the quantum of deposits and rate of interest to be paid for the first time.

From time to time, the Bank, with the assistance of the state governments, conducted raids on the office premises of unincorporated bodies. Prosecution proceedings were also initiated for violating the provisions of chapter III C of the RBI Act, 1934.

The Reserve Bank, through the guidelines and directions, was trying to provide protection to depositors. These guidelines related to the ceiling on quantum of deposits in relation to NOFs of a company, tenure of deposits, rate of interest, brokerage payable on deposits and the format for inviting deposits from the public. Companies inviting deposits from the public were required to comply with the advertisement rules known as non-banking (advertisement) rules, 1977, framed under section 58A read with section 642 of the Companies Act, 1956. These rules were administered by the Reserve Bank. In terms of these provisions, any company intending to invite deposits from the public was required to issue an advertisement in a leading English newspaper and a vernacular newspaper circulating in the state in which the registered office of the company was situated. These advertisement rules required disclosure of certain information in the prescribed format.

During the 1980s, certain companies issued advertisements soliciting deposits from the public, which deviated from the prescribed rules and

TABLE 6.11

Deposits with Non-Banking Corporate Sector

Deposits with Non-Banking Corporate Sector Category	*1983*		*1984*		*1985*	
	No. of Reporting Cos.	*Amount ₹ crore*	*No. of Reporting Cos.*	*Amount ₹ crore*	*No. of Reporting Cos.*	*Amount ₹ crore*
Financial Companies	2296	2,201	3599	4,995	4270	2,779
Non-Financial Companies	2557	6,746	2558	2,680	13113	7,963
MNBCs	503	229	641	1,066	689	382
Aggregate Deposits	5356	9,176	6798	8,741	18072	11,124
	1986		*1987*		*1988*	
	No. of Reporting Cos.	*Amount ₹ crore*	*No. of Reporting Cos.*	*Amount ₹ crore*	*No. of Reporting Cos.*	*Amount ₹ crore*
Financial Companies	4134	3,914	5957	5,206	6355	9,778
Non-Financial Companies	2510	11,784	2803	15,459	2498	18,016
MNBCs	864	442	1156	735	1235	855
Aggregate Deposits	7508	16,140	9916	21,400	10088	28,649
	1989					
	No. of Reporting Cos.	*Amount ₹ crore*				
Financial Companies	6327	5,852				
Non-Financial Companies	2691	18,289				
MNBCs	1148	776				
Aggregate Deposits	10166	24,917				

Source: Reserve Bank of India, *Handbook of Statistics on the Indian Economy, 2008–09.*

format. Some companies even offered promises of benefits that did not strictly conform to the advertisement rules and were not related to the types of business in which they were engaged. The Reserve Bank initiated appropriate action against all the erring companies as per the provisions of the advertisement rules. The Bank also issued a press note in 1987 asking non-banking companies to strictly abide by the rules so that the public could take well informed investment decisions.

The aggregate deposits of financial companies, non-financial companies and miscellaneous non-banking companies (MNBCs) (Table 6.11) showed an increase of 171.5 per cent during the period 1982–83 to

1988–89 and stood at ₹ 24,917 crore as on March 31, 1989. The deposits of financial companies, non-financial companies and miscellaneous non-banking companies recorded a rise of 444.0 per cent, 267.0 per cent and 373.0 per cent, respectively, during the period. The aggregate deposits of all three types of companies constituted 22.2 per cent of all SCBs' deposits during 1984–85, 21.1 per cent during 1985–86 and 20.8 per cent during 1986–87.

CONCLUDING OBSERVATIONS

BANKING

The broader objective set for the banking system during the 1980s was that as an institution, it should touch the lives of millions; should necessarily be inspired by a larger social purpose and subserve national priorities and objectives. This was achieved through various measures such as extending banking facilities to unbanked areas, covering in particular — the rural and semi-urban areas and mobilising financial savings; reorienting the flow of bank credit from a relatively few large and medium industry and trade accounts to a vast number of borrowers from agriculture, SSIs, small business and weaker sections of society; promoting a new class of entrepreneurs, so as to widen the industrial and economic base of society; and imbibing professionalism on the part of both bank management and the staff.

Thus, in the early 1980s, the banking system in India broadly reflected the priorities of the Government and functioned in line with the directions provided by the Government. The resource constraints of the Government, the poor economic conditions of a vast segment of the population engaged in agriculture residing in remote rural areas and the socio-political compulsions in a plural democratic system were the compelling factors influencing the performance and functioning of the banking system. The Reserve Bank being the regulator of the financial system, however, equally emphasised the need to carry out banking business on sound banking and commercial principles.

The rapid expansion in branch banking, entry into mass banking, a virtual expansion in banking transactions and lengthening the lines of command and control, however, brought in their wake considerable strains on the banking system. Fortunately, the importance of running banks along professional lines and to making banks a viable and reliable financial infrastructure to support the economy on an enduring basis was realised in the middle of the 1980s and all efforts were made to make amends and consolidate banking. Making the banking system viable and profitable became a subject of serious and conscious discussion at all forums and concrete steps were initiated towards this end from the mid-1980s. The Reserve Bank began the process of consolidation by bringing changes in banking policy and introducing appropriate measures in the areas of banking organisation and structure, training, housekeeping, customer service, credit management, recovery of bank dues, productivity and profitability, and technology and communication. Special emphasis was laid on viability and operational efficiency, strengthening the capital base of banks, and allowing them flexibility regarding determination of bank charges. The other changes brought about covered, *inter alia*, legislative measures, operational freedom, strengthening systems and procedures, diversification of business and building up of specialised institutions.

FINANCIAL INSTITUTIONS

FIs in India played a vital role in meeting the long-term credit requirements of the industrial sector. In order to ensure that these institutions were subjected to prudential practices and to apply standard procedures, the Reserve Bank laid down broad guidelines, keeping in view the nature of operations of the FIs. The MIS was devised to capture information for facilitating monetary control and to examine the quality of assets from the regulatory standpoint.

A number of FIs received assistance from the Reserve Bank either under the LTO fund or through short-term credit. The IDBI was designed to cater to the long-term financial requirements of the corporate sector. It provided two types of advances *viz.*, direct assistance and indirect assistance besides providing guarantees for loans. The IFCI was established by an Act of Parliament to provide medium and long-term loans to industrial concerns in the corporate and co-operative sectors. The objectives of Exim Bank were to provide financial assistance to importers and exporters, to act as the principal FI in co-ordinating the work of other institutions financing international trade, and to undertake certain development and merchant banking activities.

Towards the late 1980s, a need was felt to devise adequate safeguards for effective monitoring and control of the FIs. With this in view, an in house group on FIs headed by Shri S.S.Tarapore was constituted. Some of the major recommendations of the group related to monitoring the financial health of these institutions and the introduction of an annual financial review to ensure effective supervision. The group also suggested that an FIC be set up in the Reserve Bank. Most of the recommendations of the in house group were implemented by the Reserve Bank. As a result, the operations of IDBI, ICICI, Exim Bank, NHB, IRBI, DFHI and SHCIL were brought under effective monitoring and the control of the Reserve Bank.

The national housing policy formulated by the Central Government during 1988 set out the priorities and framed a strategy to eradicate the shortage of usable dwelling units by the turn of the 20th century. To achieve the above objective, the NHB was set up with the entire share capital subscribed by the Reserve Bank. To promote savings for acquisition of a house, a new scheme called HLAS was introduced by the NHB in co-operation with scheduled banks. Another major initiative of the NHB was the preparation of guidelines on formation of HFCs in the private and joint sectors. The objective of the guidelines was to create an enabling environment for the growth of housing finance institutions along sound lines. NHB also introduced refinance schemes for SCBs, scheduled state co-operative banks, scheduled UCBs and HFCs.

NON-BANKING FINANCIAL COMPANIES

The activities of NBFCs such as those engaged in the business of hire-purchase, housing finance, investments, loans, mutual benefit financial and residuary financial companies continued to be regulated by the Reserve Bank. Chapter III B of the RBI Act, 1934 vested the Reserve Bank with powers to prohibit the issue of advertisements by a non-banking institution soliciting deposits from the public. The Reserve Bank was empowered to prohibit NBFCs from accepting deposits from the public and to prosecute defaulters for violating the directives in the said Act. The period for which deposits could be accepted by NBFCs, the quantum of deposit and the interest to be paid on various maturities were prescribed by the Reserve Bank.

During the early 1980s, there was massive growth of chit fund companies and money circulation schemes throughout the country. Barring a few, the states had not enacted any legislation to control and monitor these activities. To plug this loophole and to bring about a uniform legislation applicable throughout the country, the Chit Funds Act, 1982 was enacted by Parliament. The Reserve Bank followed up with all state governments and UTs for adoption of the Act. The Reserve Bank was given powers to inspect the books and accounts of the chit fund companies. Hire-purchase companies were also regulated by the Reserve Bank under the provisions of the directions of 1977 as applicable to NBFCs. These companies were allowed to raise deposits from the public within permissible limits linked to their NOFs. These companies were required to comply with directions relating to submission of returns, balance sheet and issue of advertisements soliciting deposits. The Reserve Bank was empowered to prohibit acceptance of deposits by such companies in case of non-compliance with the provisions of directions. From time to time, the Reserve Bank, either singly or with the assistance of the state governments, conducted raids on the office premises of unincorporated bodies. Prosecution proceedings were also initiated against such unincorporated bodies for violating the provisions of chapter III C of the RBI Act, 1934.

The 1980s witnessed the mushrooming of NBFCs, posing a challenge to regulators. They carried out multifarious activities, some of which were apparently not permissible under the law resulting in regulatory arbitrage. Many unregistered companies also operated in many states and UTs. It was a difficult task, both for the Reserve Bank and the concerned state governments and UTs, to exercise proper regulation and control over irregular practices of such institutions and take action. However, stringent action by the regulators and other enforcement agencies within available powers brought back stability to the system and restricted the activities of such companies. This brought some transparency into the functioning of these companies, which was further strengthened by the prudential norms introduced by the Reserve Bank during the subsequent decade.