All India financial institutions (AIFIs)

3.47 The AIFIs, which constitute an important source of funds for the commercial sector, have been fast losing ground. The situation has come about as a result of the distinction between development and commercial banking getting blurred, high cost of funds and asset-liability mismatches. With reforms in the financial sector, the facility of low cost funds under long-term operations funds, funds from bilateral and multilateral agencies and bond issues under statutory liquidity ratio is no more available. Now the financial institutions are raising funds at market related rates of interest. The Narasimham Committee-II had recommended that with the convergence of activities between banks and development financial institutions (DFIs), the DFIs should, over a period of time, convert themselves into banks paving the way for only two forms of intermediaries, viz., banking companies and non-banking financial institutions. RBI had advised financial institutions to chart a path for their evolution into universal banks. The merger of ICICI with the ICICI Bank was approved by the RBI in April, 2002. The merger was approved subject to ICICI fulfilling conditions relating to reserve requirements and prudential norms after the merger.

3.48 The ICICI accounted for over 49 percent of sanctions and 45 percent of disbursements of AIFIs in 2001-02. With its merger with ICICI Bank, the role of AIFIs has subsided further.

3.49 A number of policy initiatives were taken during the year to strengthen the regulatory and supervisory mechanism for financial institutions.In June, 2002, RBI introduced the supervisory rating system based on "CAMELS" model for financial institutions on lines similar to commercial banks. RBI had evolved a time frame for completion of projects to ensure that loan assets relating to projects under implementation were appropriately classified and asset quality correctly reflected. The new guidelines issued by RBI effective from March 31, 2002 stipulate that in case of time overruns longer than two years, the asset is to be classified as sub-standard regardless of the record of recovery, and provided for accordingly. For projects to be financed by FIs in future, the date of completion should be indicated at the time of financial closure. If the date of commencement of commercial production extends beyond six months after the originally envisaged date of project completion, the account should be treated sub-standard.

3.50 Other policy initiatives relate to audit, connected lending, loans against guarantees extended by banks, and prudential norms. Financial institutions have been advised to rotate the partners of the audit firms, if the same firm has continued for more than four years. The RBI in consultation with the Government of India has issued detailed guidelines in regard to 'connected lending' in December 2002. Pursuant to the directions of the Audit Sub-Committee of the Board of Financial Supervision (BFS), a Committee on Computer Audit was constituted. This Committee has classified the possible areas of audit interest in the Information System (IS) environment into 15 broad categories and has prepared standardised checklists under each category to facilitate the conduct of computer audit in banks and financial institutions and to ensure that the requisite controls are applied by their computerised branches.

3.51 Banks have been permitted to extend guarantees in respect of Infrastructure projects, in favour of other lending institutions, provided the bank issuing the guarantee takes a funded share in the infrastructure project at least to the extent of five percent of the project cost and undertakes normal credit appraisal, monitoring and follow up of the project. The loan extended by a FI against such guarantee of a bank would attract a risk weight of 20 percent in computation of CRAR. The risk

weight of 20 percent would apply to only to that part of the loan which is covered by bank's guarantee and the remaining amount of loan, if any, would attract 100 percent risk weight. For the purpose of exposure norms, however, the entire loan transaction should be reckoned as an exposure on the borrowing entity and not on the bank guaranteeing the loan, so as to correctly reflect the degree of credit concentration.

3.52 Prudential norms have been liberalised in August 2002. Housing loans extended by financial institutions against the mortgage of residential housing property would attract a risk weight of 50 percent (as against 100 percent hitherto). Investment by financial institutions in mortgage backed securities (MBS) would attract a risk weight of 50 percent in addition to 2.5 percent weightage for market risk, subject to certain terms and conditions issued by the RBI. In September, 2002 RBI had issued guidelines in respect of consolidated supervision of financial institutions. These institutions were advised that the provisions held by them in respect of accounts related to projects with project cost of Rs. 100 crore or more should not be reversed even in cases where, as per the deemed date of completion of such project, certain amounts might become eligible for upgradation to the standard category.

3.53 Sanctions and disbursements by the AIFIs (net of mergers) were down by 51.4 percent and 47.4 percent, respectively in the first nine months of the current financial year compared with the corresponding period of the previous year (Table 3.8). The declining trend in sanctions and disbursements is mainly on account of reduction in the number of project proposals seeking financial assistance, financial restructuring of asset portfolios by FIs, weak financial position of IDBI and IFCI and spread of universal banking.

3.54 Government proposes to address the problems of IDBI and IFCI. A Bill to repeal the IDBI Act 1964 has been introduced in Parliament in December, 2002. The Bill seeks to corporatise IDBI and to give it appropriate flexibility and leeway to structure itself into a viable and effective organisation.

Table 3.8 : Assistance by AIFIs

Rs. crore

Items	April-March		April-December	
	2000-01	**2001-02**	**2001-02**	**2002-03**
A. Sanctions				
(a) DFIs*	97,686	63,375	21,434	9,101
(b) Investment Institutions	18,684	9,238	5,740	4,116
AIFIs (a+b)	116,370	72,613	27,174	13,217
B. Disbursements				
(a) DFIs*	59,694	45,036	14,742	5,718
(b) Investment Institutions	12,793	11,649	6,999	5,714
AIFIs (a+b)	72,487	56,685	21,741	11,432

*** Includes special financial institutions.**

Notes : Data is provisional and not adjusted for inter institutional flows.

Source : IDBI