Banking policy and trends

3.18 During the year 2003-04, banking sector reforms were carried forward with the introduction of risk-based supervision, issue of guidelines and directions under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, liberalisation of foreign direct investment in banking companies, and enhanced transparency in the pricing of loan products. During April-June 2003, RBI had introduced risk- based supervision (RBS) for a select few banks on a pilot basis parallel to regular on-site inspection. Based on the feedback, RBI proposes to extend RBS to all banks in a phased manner. It has been decided to extend the RBS with some modifications to 15 more banks during the year 2004-05. RBS aims at allocating supervisory resources in accordance with the risk profiles.

3.19 The RBI had issued final guidelines under the SARFAESI Act in April 2003. These guidelines covered aspects relating to registration and operations of asset reconstruction/securitisation companies. In addition to these guidelines, RBI had issued guidance notes of a recommendatory nature covering acquisition of assets and issue of security receipts. In order to facilitate sale of NPAs to securitisation companies (SCs)/ asset reconstruction companies (RCs), RBI had issued guidelines to banks/FIs, inter-alia, covering accounting treatment of sale of NPAs to SCs/RCs and investment in bonds/ debentures/security receipts and provisioning/ valuation norms, capital adequacy norms and exposure norms relating thereto. With a view to enabling banks to meet the shortfall, if any, resulting from sale of assets at a discount, banks were advised to build up provisions significantly above the minimum regulatory requirements for their NPAs, particularly for those assets which they propose to sell to securitisation/reconstruction companies.

3.20 An important policy announcement made in the year relates to the liberalisation of foreign direct investment in banking companies. In the Union Budget for 2003-04, Finance Minister announced the decision to raise the limit of foreign direct investment in banking companies from the present level of 49 per cent to 74 per cent. The Government had since issued a Press Note allowing the aggregate foreign investment in a private bank from all sources upto a maximum of 74 per cent of the paid up capital of the bank. At all times, at least 26 per cent of the paid up capital will have to be held by residents, except in regard to a wholly owned subsidiary of a foreign bank. A foreign bank may operate in India through only one of the three channels, viz., (i) branches, (ii) a wholly owned subsidiary and (iii) a subsidiary with aggregate foreign investment up to a maximum of 74 per cent in a private bank. These measures are expected to facilitate setting up of subsidiaries by foreign banks.

3.21 The focus of policy continued to remain on a soft interest rate regime. Policy initiatives were taken to inject transparency into the pricing of loan products. In its annual policy statement (April 2003), RBI had advised banks to announce BPLR taking into account cost of funds, operating expenses and requirement of provisioning. The RBI suggested discontinuation of tenor-linked PLR as all lending rates can be determined with reference to the BPLR. For smooth implementation of the new system, the Indian Banks Association (IBA) issued a circular to the member banks outlining broad parameters to be followed by banks for the computation of BPLR. Almost all commercial banks have adopted the new system of BPLR and the rates are lower in the range of 25-100 basis points from their earlier PLRs

3.22 Technical upgradation remained a priority area of banking sector reforms. RBI commenced implementation of the Real Time Gross Settlement (RTGS) system in a phased manner. A demonstrable version of the system was implemented in June 2003. Hands-on practice was given to officials of 104 banks. The system was made operational in March 2004. Inter-bank as well as customer related transactions are being put through the system.

Currency management

3.23 During the year 2003-04, the RBI stepped up its efforts towards improvement of customer services in matters relating to issue of coins, acceptance of coins from public and exchange of soiled and mutilated notes. Adequate availability of coins in circulation has reduced the new demand for coins. An independent survey commissioned by the RBI during the year through the Administrative Staff College of India (ASCI) Hyderabad, in the states of Maharashtra, Madhya Pradesh, Gujarat and Karnataka, revealed a satisfaction level of 97 per cent in the matter of availability of coins. In order to tackle the reverse flow of coins, RBI offices and banks were advised to accept coins in exchange of notes or for deposit. The RBI reiterated its direction to all scheduled commercial banks to issue coins, accept coins and soiled notes in transactions or for exchange without any restriction. In order to facilitate the tendering of coins by members of the public over the counters and taking over of coins by cashiers, banks were advised to provide polythene sachets of predetermined capacity (100 coins) to members of the public. Banks were also advised to display notices, both inside and outside their branch premises, indicating the exchange facilities made available by them to members of the public.

3.24 The RBI's Department of Currency Management continued its efforts to improve the quality of notes in circulation. The process of mechanisation initiated in 1999 was carried forward by the Department by installation and commissioning of additional Currency Verification and Processing Systems with higher capacity of processing 50,000 to 60,000 bank notes per hour taking the total number of such systems to 48. Discontinuance of the age old practices of stapling of notes contributed to the circulation of more clean notes. With a view to ensuring that the benefits of clean note policy reaches the common people, banks were instructed to advise their branches to sort the notes and issue only clean notes to the public and remit the non-issuable notes to the currency chests/RBI issue offices. Banks were also instructed to provide table top note sorters to their currency chest branches and also large branches where large volumes of cash were handled daily.

3.25 The RBI has introduced a single window customer service at its issue offices under which coins of all denominations are either issued or accepted at one counter or notes of all denominations are either issued or accepted at one counter or notes of all denominations are either issued or accepted for exchange at one counter. Similarly, mutilated notes packed in a closed cover are now being accepted in a Drop Box even beyond normal banking hours without any limit.

Financial performance

3.26 There was considerable improvement in the performance of SCBs in 2002-03. The ratio of net profits to total assets increased from 0.75 per cent in 2001-02 to 1.0 per cent in 2002-03, the highest in the last six years. Operating profits of SCBs increased from Rs.29,837 crore in 2001-02 to Rs.40,682 crore in 2002-03, registering an increase of over 36 per cent as compared with an average growth of 24 per cent in the previous six years. The ratio of operating profits to total assets increased from 1.9 per cent in 2001-02 to 2.4 per cent in 2002-03.

3.27 During 2002-03, total income of the SCBs increased by 14.1 per cent as compared with an increase of 11.4 per cent in expenditure. Within expenditure, while interest expenditure increased by 7.0 per cent, expenditure towards provisions and contingencies increased by as much as 29.3 per cent. The impending introduction of the 90-day norm for asset classification on portfolio basis from March 2005 prompted SCBs to make higher provisions. An analysis of income of SCBs reveals a marked change in its composition. The share of interest income has been declining on account of slower growth of credit and softening of interest rates. Growth of interest income in 2002-03 at 10.8 per cent was considerably lower than the growth of 31.5 per cent in other income. The Government securities market remained buoyant as a result of excess liquidity, declining yields and soft interest rates.

Active trading in Government securities resulted in an increase in trading profits. Though the growth of other income decelerated from 41.7 per cent in 2001-02 to 31.5 per cent in 2002-03, the share of other income in total income increased from 15.9 per cent to 18.4 per cent in the same period. The changing composition of income of SCBs reflects the changing composition of assets of the banking system. Between 1997-98 and 2002-03, while investments of SCBs recorded a compound annual growth rate of 20.6 per cent, advances recorded a lower growth of 18.0 per cent.

3.28 There were wide variations in the performance of SCBs across bank groups. Increase in income was the lowest for old private sector banks (3.0 per cent) and the highest for new private sector banks (108.6 per cent). Foreign banks witnessed a decline in their income as well as expenditure. While their income declined by 7.1 per cent, expenditure declined by 10.9 per cent. The higher decline in expenditure was mainly on account of containment of interest expenditure. Public sector banks (PSBs) experienced a higher growth of 9.6 per cent in their income and a lower growth of 6.6 per cent in their expenditure. In the case of PSBs, there was a substantial increase in other income by 28.6 per cent. Increase in interest expenditure of these banks was contained at just 1.0 per cent.

3.29 The ratio of net profits to total assets was the highest for foreign banks (1.6 per cent) followed by old private sector banks (1.2 per cent), PSBs (1.0 per cent) and new private sector banks (0.9 per cent). The ratio of operating profits to total assets followed more or less a similar pattern with foreign banks performing the best (3.2 per cent) followed by old private sector banks (2.7 per cent) and PSBs and new private banks (2.3 per cent each).

3.30 There was an increase in the provisions and contingencies for all bank groups, reflecting efforts to improve their credit portfolios. An exception to this was the foreign banks, which recorded a decline of 5.8 per cent in their provisions reflecting an improvement in their asset portfolio. Increase in provisions was the highest in the case of new private sector banks (99.7 per cent) followed by PSBs (30.3 per cent) and old private sector banks (4.1 per cent). (Table 3.4)

Table 3.4 : Working results of scheduled commercial banks for 2001-02 and 2002-03

Items	SBI Group Banks		Nationalised Banks		Public Sector Banks		Foreign Banks		Old Pvt Sector Banks		New Pvt. Sector Banks		All SCBs	
	2001-02	2002-03	2001-02	2002-03	2001-02	2002-03	2001-02	2002-03	2001-02	2002-03	2001-02	2002-03	2001-02	2002-03
Rs. crore														
A. Income	44763	48867	72490	79598	117252	128465	12964	12043	10946	11279	9871	20587	151032	172374
I) Interest Income	38746	40869	61965	66325	100711	107194	9700	8972	8725	8918	7823	15635	126958	140718
II) Other income	6017	7998	10525	13273	16541	21271	3264	3071	2221	2361	2048	4952	24074	31656
B. Expenditure	41313	44356	67635	71814	108948	116170	11472	10219	9942	10047	9096	18861	139454	155297
I) Interest expended	26556	27207	42598	42646	69154	69853	6054	5065	6497	6327	5813	12361	87516	93607
II) Intermediation cost	9487	10431	16935	18466	26422	28897	3397	3250	1933	2147	1927	3791	33679	38085
III) Provisions and contigenies	5270	6718	8102	10702	13372	17420	2021	1904	1512	1573	1356	2708	18261	23605
C. Operating profit (A-Bi-Bii)	8720	11229	12957	18486	21677	29715	3513	3728	2516	2805	2131	4434	29837	40682
D. Net profit (A-B)	3450	4511	4855	7784	8305	12295	1492	1824	1004	1232	775	1726	11576	17077
E. Total assets	449289	493954	706109	791281	1155398	1285235	113321	116401	93229	105110	174477	192170	1536424	1698916
As per cent of total assets														
A. Income	10.0	9.9	10.3	10.1	10.1	10.0	11.4	10.3	11.7	10.7	5.7	10.7	9.8	10.1
I) Interest Income	8.6	8.3	8.8	8.4	8.7	8.3	8.6	7.7	9.4	8.5	4.5	8.1	8.3	8.3
II) Other income	1.3	1.6	1.5	1.7	1.4	1.7	2.9	2.6	2.4	2.2	1.2	2.6	1.6	1.9
B. Expenditure	9.2	9.0	9.6	9.1	9.4	9.0	10.1	8.8	10.7	9.6	5.2	9.8	9.1	9.1
I) Interest expended	5.9	5.5	6.0	5.4	6.0	5.4	5.3	4.4	7.0	6.0	3.3	6.4	5.7	5.5
II) Intermediation cost	2.1	2.1	2.4	2.3	2.3	2.2	3.0	2.8	2.1	2.0	1.1	2.0	2.2	2.2
III) Provisions and contigenies	1.2	1.4	1.2	1.4	1.2	1.4	1.8	1.6	1.6	1.5	0.8	1.4	1.2	1.4
C. Operating profit	1.9	2.3	1.8	2.3	1.9	2.3	3.1	3.2	2.7	2.7	1.2	2.3	1.9	2.4
D. Net profit	0.8	0.9	0.7	1.0	0.7	1.0	1.3	1.6	1.1	1.2	0.4	0.9	0.8	1.0

3.31 During the first quarter of 2003-04, the financial performance of SCBs improved further. Due to further containment of interest expenditure, net profits to total assets of SCBs for the quarter ended June 2003 was 0.32 per cent as compared with 0.24 per cent in the previous corresponding quarter.

Interest spread

3.32 A notable development in 2002-03 was the increase in the net interest income or spread of SCBs by 19.5 per cent (Table 3.5). With the exception of foreign banks, all bank groups recorded a double-digit increase in spread mainly on account of containment of interest expenditure due to falling interest rates, particularly on deposits. The ratio of spread to total assets had increased for all bank groups in 2002-03. The ratio was the highest for foreign banks (3.4 per cent), followed by public sector banks (2.9 per cent), old private sector banks (2.5 per cent) and new private sector banks (1.7 per cent). Expanding spread is also indicative of the fact that lending rates have remained sticky and have not fallen as much as the deposit rates.

Table 3.5 : Net interest income (Spread) of SCBs

Banks/years	2000-01	2001-02	2002-03
Rs. crore			
1. Public sector	29,436	31,557	37,340
1.1 Nationalised banks	18,188	19,367	23,678
1.2 State banks group	11,249	12,190	13,662
2. Old private sector banks	2,123	2,229	2,591
3. New private sector banks	1,685	2,009	3,273
4. Foreign banks	3,707	3,646	3,907
SCBs	36,950	39,441	47,111
As per cent of total assets			
1. Public sector	2.86	2.73	2.91
1.1 Nationalised banks	2.90	2.74	2.99
1.2 State banks group	2.79	2.71	2.77
2. Old private sector banks	2.51	2.39	2.46
3. New private sector banks	2.14	1.15	1.70
4. Foreign banks	3.63	3.22	3.36
SCBs	2.85	2.57	2.77

Non-performing assets of the banking sector

3.33 In order to improve the performance of SCBs, recovery management is being given top priority in recent years. Measures taken to contain NPAs include reschedulement/ restructuring at the bank level, corporate debt restructuring, recovery through Lok Adalats, Civil Courts and Debt Recovery Tribunals and compromise settlements. The recovery management got a fillip with the enactment of SARFAESI. There was a sharp decline in the gross NPAs from Rs.70,861 crore in 2001-02 to Rs.68,715 crore in 2002-03. Net NPAs declined from Rs.35,554 crore to Rs.32,764 crore in the same period. While the incremental gross NPAs of PSBs declined by Rs.2,387 crore, those of private (old and new) and foreign banks increased by Rs.138 crore and Rs.103 crore, respectively. The ratios of gross and net NPAs to advances and total assets have been declining across all bank groups (Table 3.6). The ratio of gross NPAs to

Table 3.6 : Non-performing assets of scheduled commercial banks

Items	Gross NPAs (Rs. crore)				Percentage to gross advances				Percentage to total assets			
	1999-2000	2000-01	2001-02	2002-03	1999-2000	2000-01	2001-02	2002-03	1999-2000	2000-01	2001-02	2002-03
Bank Group												
1. Public Sector	53033	54672	56473	54086	14.0	12.4	11.1	9.4	6.0	5.3	4.9	4.2
2. Private Sector	4761	5963	11662	11800	8.2	8.4	9.6	8.1	3.6	3.7	4.4	4.0
3. Foreign	2614	3106	2726	2829	7.0	6.8	5.4	5.2	3.2	3.0	2.4	2.4
4. SCBs (1+2+3)	60408	63741	70861	68715	12.7	11.4	10.4	8.8	5.5	4.9	4.6	4.0
	Net NPAs (Rs. crore)				Percentage to net advances				Percentage to total assets			
1. Public Sector	26187	27977	27958	24963	7.4	6.7	5.8	4.5	2.9	2.7	2.4	1.9
2. Private Sector	3031	3700	6676	6883	5.4	5.4	5.7	5.0	2.3	2.3	2.5	2.3
3. Foreign	855	785	920	918	2.4	1.8	1.9	1.8	1.0	0.8	0.8	0.8
4. SCBs (1+2+3)	30073	32462	35554	32764	6.8	6.2	5.5	4.4	2.7	2.5	2.3	1.9

gross advances for all SCBs declined from 12.7 per cent in 1999-00 to 8.8 per cent in 2002-03.

3.34 An analysis of NPAs by sector reveals that, in 2002-03, advances to non-priority sectors accounted for bulk of the outstanding NPAs in the case of public sector banks (50.7 per cent) and private banks (78.6 per cent).

Capital adequacy ratio

3.35 At end-March, 2003, capital to risk weighted assets ratio (CRAR) for PSBs stood at 12.6 per cent, higher than the level of 11.8 per cent as at the end of March, 2002. All the PSBs had CRAR above the stipulated minimum of 9 per cent in 2002-03. Of the 27 PSBs, as many as 26 banks had CRAR exceeding 10 per cent. In the case of 30 private sector banks operating in India, only two bank, viz., Centurion Bank with a CRAR of just 2.0 per cent and Global Trust Bank with zero CRAR were below the minimum requirement of 9 per cent.