

Banking policy and trends

3.39 Union Budget for 2006-07 announced interest rate relief at two percentage points on the principal amount up to Rs. 1 lakh on crop loans availed of by the farmers for *Kharif* and *Rabi* seasons 2005-06. Conforming to the announcement, banks were advised on March 9, 2006 to credit the amount of relief to the borrower's account before March 31, 2006 and seek reimbursement thereafter. Out of a grant of Rs. 1,700 crore, funds aggregating Rs.840 crore were placed with the National Bank for Agriculture and Rural Development (NABARD) and NABARD settled claims aggregating to Rs. 500.65 crore to cooperative banks and regional rural banks (RRBs) upto December 31, 2006 and balance of Rs. 339.35 crore was remitted to Government of India (GOI). In compliance with the 2006-07 budget announcement, PSBs and RRBs, were advised by the RBI on June 5, 2006 that, with effect from *Kharif* 2006-07, Government would provide them interest rate financial assistance of 2 per cent per annum in respect of short-term production credit up to Rs. 3 lakh provided to farmers. This amount of financial assistance is calculated on the amount of crop loan disbursed from the date of disbursement/drawal up to the date of payment or up to the due date, i.e. March 31, 2007, for the *Kharif* and June 30, 2007 for the *Rabi*, respectively, whichever is earlier. This financial assistance is available on the condition that they make available short-term credit at ground level at 7 per cent per annum. This subvention was available only to short-term production credit disbursed by RRBs out of their own funds and excludes such credit as supported by refinance from NABARD. Subsequently, GOI extended the interest subvention at rate of 2 per cent on the own involvement of banks in crop loan lendings at 7 per cent to cooperative banks also.

3.40 Banks were advised to formulate a transparent policy, with the approval of their Boards, for providing 'One Time Settlement' facility to those farmers whose accounts have been rescheduled/restructured due to natural calamities as also for those who have defaulted on account of circumstances beyond their control.

3.41 Banks were further advised in July 2006 to ensure that loan accounts of farmers, which are overdue as on July 1, 2006 be

rescheduled on the lines of the package of Relief Measures to the Vidarbha Region in Maharashtra announced by the Prime Minister and the interest thereon (as on July 1, 2006) be waived. Fresh finance was to be ensured to such farmers. The total amount of credit of Rs. 1,275 crore envisaged to be released by banks was allocated by Bank of Maharashtra (as the Maharashtra State Level Bankers' Committees (SLBC) convenor), among the banks functioning in the relevant districts of the Vidarbha region.

3.42 In order to mitigate distress of farmers in the 31 debt-stressed districts of Andhra Pradesh, Maharashtra, Karnataka and Kerala, GOI has announced a rehabilitation package in respect of agriculture credit. The components of the package are (a) the entire interest on overdue agricultural loans as on July 31, 2006 will be waived and all farmers will have no past interest burden as on that date, so that they will be immediately eligible for fresh loan from the banking system, (b) the overdue loans of the farmers as on July 31, 2006 will be rescheduled over a period of 3-5 years with one-year moratorium, and (c) an additional credit flow will be ensured in these 31 districts through the banking sector. The burden of waiver of overdue interest on agricultural loans will be shared equally by the Central and State Governments.

3.43 The Annual Policy Statement of RBI for 2006-07 envisaged that banks' total exposure to venture capital funds (VCFs) will be treated as part of capital market exposure and assigned a higher risk weight of 150 per cent. In August 2006, banks were advised that all exposures to VCFs (both registered and un-registered) would be deemed at par with equity, and hence would be reckoned for compliance with the capital market exposure ceilings (ceiling for direct investment in equity and equity-linked instruments as well as ceiling for overall capital market exposure), and the limits prescribed for such exposure would also apply to investments in VCFs.

3.44 During the year, it was also announced that for opening small accounts banks need to seek only a photograph of the account holder and self-certification of address. Outstanding balances in these accounts at any time will be limited to Rs. 50,000 and the total transactions limited to Rs.200,000 in one year.

3.45 To protect customers' rights, enhancing the quality of customer service and strengthening grievance redressal mechanism in banks, RBI initiated several measures on an ongoing basis. To facilitate customer service in banks under a single window, RBI set-up a separate Customer Service Department (CSD) in July 2006. Its main functions, among other things, include: (i) disseminating instructions/information relating to customer service and grievance redressal by banks; (ii) administering the Banking Ombudsman (BO) scheme; (iii) acting as a nodal department for the Banking Codes and Standards Board of India (BCSBI); ensuring redressal of complaints received directly by the RBI on customer service in banks; and (iv) liaising between banks, Indian Banks Association (IBA), BO offices and the regulatory departments within RBI on matters relating to customer service and grievance redressal.

3.46 After taking into account the state of preparedness of the banking sector, RBI allowed banks some more time to put in place appropriate systems so as to ensure full compliance with BASEL II. Indian banks having presence outside India and foreign banks operating within India are to migrate to

the standardised approach for credit risk and the basic indicator approach for operational risk under BASEL II with effect from March 31, 2008. All other scheduled commercial banks are encouraged to migrate to these approaches under BASEL II in alignment with them, but in any case not later than March 31, 2009.

Financial performance

3.47 High sustained growth was observed in credit extended by SCBs in 2005-06; the growth in non-food credit extended by SCBs during 2005-06 was 31.8 per cent which was higher than the growth of 27.5 per cent in 2004-05. The aggregate deposits, on the other hand, grew by 18.1 per cent in 2005-06 compared to 12.8 per cent in 2004-05. This led the banks to fund loans and advances by increased resort to borrowings and offloading of Government and other approved securities. SCBs also accessed the capital market for this purpose as well as to strengthen their capital base: Rs.11,067 crore was raised from the equity market during 2005-06; in addition, Rs.30,151 crore was raised through 97 issues by private placement as compared to Rs.15,219 crore raised through 87 such issues in 2004-05.

Table 3.4 : Working results of scheduled commercial banks

Items	Public sector banks		Foreign banks		Old pvt. sector banks		New pvt. sector banks		SCBs	
	2004-05	2005-06	2004-05	2005-06	2004-05	2005-06	2004-05	2005-06	2004-05	2005-06
	Rs. Crore									
A. Income	144567	160946	13036	17435	10525	11729	22107	32099	190236	222209
I) Interest Income	120365	137614	9170	12236	9275	10359	16990	24301	155801	184510
II) Other income	24202	23332	3866	5199	1250	1370	5117	7797	34435	37698
B. Expenditure	129125	144407	11054	14367	10089	10852	19010	27990	169278	197616
I) Interest expended	68764	80272	4042	5150	5673	6236	10600	15261	89079	106919
II) Intermediation cost	37041	41532	4417	5625	2611	3123	6064	8450	50133	58729
III) Provisions and contingencies	23319	22603	2595	3592	1806	1493	2345	4279	30065	31968
C. Operating profit	38761	39142	4577	6661	2242	2369	5443	8388	51023	56560
D. Net profit (A-B)	15442	16539	1982	3069	436	876	3098	4109	20958	24593
E. Net interest income (Spread)	51601	57342	5129	7086	3602	4123	6390	9041	66722	77591
F. Total assets	1692681	1926334	153636	201586	133470	149749	294421	421659	2355509	2787892
	As Per cent of total assets									
A. Income	8.5	8.4	8.5	8.6	7.9	7.8	7.5	7.6	8.1	8.0
I) Interest Income	7.1	7.1	6.0	6.1	6.9	6.9	5.8	5.8	6.6	6.6
II) Other income	1.4	1.2	2.5	2.6	0.9	0.9	1.7	1.8	1.5	1.4
B. Expenditure	7.6	7.5	7.2	7.1	7.6	7.2	6.5	6.6	7.2	7.1
I) Interest expended	4.1	4.2	2.6	2.6	4.3	4.2	3.6	3.6	3.8	3.8
II) Intermediation cost	2.2	2.2	2.9	2.8	2.0	2.1	2.1	2.0	2.1	2.1
III) Provisions and contingencies	1.4	1.2	1.7	1.8	1.4	1.0	0.8	1.0	1.3	1.1
C. Operating profit	2.3	2.0	3.0	3.3	1.7	1.6	1.8	2.0	2.2	2.0
D. Net profit (A-B)	0.9	0.9	1.3	1.5	0.3	0.6	1.1	1.0	0.9	0.9
E. Net interest income (Spread)	3.0	3.0	3.3	3.5	2.7	2.8	2.2	2.1	2.8	2.8
F. Total assets	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Memo item										
1. Operating expenses as per cent of net income	48.9	51.5	49.1	45.8	53.8	56.9	52.7	50.2	49.6	50.9

3.48 During 2005-06, the total income of SCBs increased by 16.8 per cent compared to 3.5 per cent in 2004-05. However, as a proportion of assets, income at 8.0 per cent in 2005-06 was marginally lower than 8.1 per cent in 2004-05. Interest income, which is the major source of income of SCBs, grew sharply by 18.4 per cent in 2005-06 as against 7.9 per cent in the previous year, largely owing to increased volumes of credit and hardening of interest rates. 'Other income' grew by 9.5 per cent as compared to a decline of 12.9 per cent in 2004-05.

3.49 Expenditure of SCBs registered substantial growth of 16.7 per cent in 2005-06 compared to 4.8 per cent in 2004-05. Due to higher borrowing cost, interest expended by SCBs increased sharply by 20.0 per cent compared to 1.7 per cent in the previous year. Non-interest income increased by 17.1 per cent compared to 14.7 per cent in the previous year. Accordingly, banks' burden (excess of non-interest expenditure over non-interest income) increased marginally to 0.7 per cent of assets in 2005-06 from 0.6 per cent in 2004-05; the efficiency ratio —defined as operating expenses as a percentage of net interest income plus non-interest income — deteriorated from 49.6 per cent to 50.9 per cent between 2004-05 and 2005-06.

3.50 With the favourable impact of increased interest income, overall operating profit of SCBs registered a growth of 10.9 per cent in 2005-06 as against a decline of 3.0 per cent in 2004-05. Operating profits of all bank groups (consisting of State bank group, nationalised banks, other public sector banks, foreign banks etc.) increased in 2005-06 except for the nationalised banks whose operating profit marginally declined to Rs.23,011 crore in 2005-06 from Rs. 23,121 crore in 2004-05. Operating profits for SCBs, as a proportion of total assets, declined to 2.0 per cent during 2005-06 from 2.2 per cent in 2004-05. (Table 3.4)

Interest spread

3.51 Net interest income or spread — defined as the difference between interest income and interest expenses — of SCBs as a proportion of total assets remained unchanged at 2.8 per cent in 2005-06, substantially higher than the standard international norm. The spread of foreign banks increased to 3.5 per cent in 2005-06 from 3.3 per cent in 2004-05, and that of PSBs and old private banks was 3.0 per cent and 2.8 per cent, respectively, in 2005-06 as compared to 3.0 per cent and 2.7 per cent, respectively, in 2004-05. (Table 3.4)