Financial Developments

36. There was progress in the decontrol of the banking system, with further deregulation of interest rates on deposits. Scheduled commercial banks were given freedom to fix interest rates on term deposits of 30 days and over from October 22, 1997. The interest rate on NRE term deposits with maturity of 6 months and above was also deregulated from September 1997. This will help align the interest rate and maturity structure of non-resident (External) Rupee term deposits with that of domestic term deposits. Interest rate controls on FCNR (B) deposits were also liberalised in October 1997 by enabling banks to offer rates not exceeding LIBOR for relevant maturity and currency. As part of the monetary and credit policy for the first half of 1998-99, it has been decided to increase the interest rate ceiling on FCNR(B) deposits of one year and above by 50 basis points and to reduce that on such deposits below one year by 25 basis points.

37. Competition in the banking sector has intensified with the formation of ten new private sector banks. The ratio of net profits to total assets was the maximum (1.77%) for the new private sector banks in 1996-97, followed by foreign banks (1.41%), old private sector banks (0.92%) and public sector banks (0.56%). Capital adequacy ratio of the public sector banks improved from 8.7 per cent in 1995-96 to 10 per cent in 1996-97. By the end of March 1997 only two public sector banks failed to reach the prescribed Capital-to Risk-weighted Assets Ratio (CRAR).

38. The Reserve Bank of India (Amendment) Act, 1997, conferred wide ranging powers on the RBI for registration, regulation, supervision, issue of guidelines and winding-up of the non-banking financial companies (NBFCs). Under the amendment, compulsory registration, a minimum Net Owned Funds (NOF) of Rs. 25 lakh, maintenance of certain percentage of liquid assets and creation of reserve fund were prescribed for NBFCs. The process of registration of 37,478 NBFCs more than 9,000 of which have NOF of Rs.25 lakh and above is being attended to on top priority basis. The focus of supervision has now shifted to NBFCs accepting public deposits, as only such companies will be subjected to deposit regulations and prudential norms. Auditors have been entrusted with the task of ensuring compliance with regulations by the NBFCs not having public deposits. Any non-compliance has to be reported by auditors to the RBI without exception.

39. On January 2, 1998 the RBI issued detailed guidelines regarding norms of deposit acceptance, prudential norms, etc. for various categories of the NBFCs. These were later reconsidered and revised guidelines were issued on January 31, 1998. Deposit entitlement limits were raised in certain cases to minimise hardship without endangering the interests of depositors. According to these guidelines, an NBFC will have to obtain the minimum prescribed investment rating before accepting public deposits. The limit of acceptance of public deposit has been linked to the Net Own Funds of NBFCs and its rating.

40. During 1997-98, the financial assistance sanctioned by All India Financial Institutions grew by 48.8 per cent while disbursements increased by 28.5 per cent. This followed a sharp decline of 14.7 per cent in sanctions and a modest growth of 8.4 per cent in disbursements during 1996-97. This was one of the few quantitative indications of a potential recovery in industrial investment.

41. A number of measures were taken by RBI to enhance the depth and liquidity of the government treasury bill and government securities market. These included:

- Introduction of 14-day intermediate treasury bills and 14-day auction treasury bills.
- Registration of 9 companies as Satellite Dealers.
- Extension of repo and reverse repo transactions among institutions for all Central Government dated securities.
- Extension of reverse repo in treasury bills and Central Government securities to non-bank holders of SGL accounts and with RBI.
- Permission to FIIs in the category of 100 per cent debt-fund to invest in Government dated securities.

42. A number of measures were taken by SEBI to strengthen investor protection and develop capital markets, with particular emphasis on efficiency and transparency of both the primary and secondary segments. The primary market reforms included the following:—

- Dividend criterion for unlisted companies to make public issue modified as, dividend payment in immediately preceding 3 years.

- A listed company required to meet the entry norm only if the post-issue net worth becomes more than five times the pre-issue net worth.
- Companies have to complete full payment of their partly paid-up shares or forfeit them, before making a public or rights issue.
- Unlisted company allowed to freely price its securities provided it has shown net profit in the immediately preceding 3 years subject to its fulfilling the existing disclosure requirements.
- The promoters' contribution for public issues made uniform at 20% irrespective of the issue size.
- Written consent from shareholders in regard to lock-in made compulsory for securities to be referred for promoter's contribution.
- Appointment of Registrar to an issue for rights issues made mandatory.
- Disclosure of the share holding of the promoters whose names figure in the paragraph on "Promoters and their background" in the offer document.
- The SEBI (Registrars to an Issue and Share Transfer Agents) Rules and Regulations 1993 amended to ensure arm's length relationship between the Issuer and the Registrar to the issue.
- Corporates with infrastructure projects and Municipal Corporations to be exempted from the requirements of Rule 19(2b) of Securities (Contract) Regulation Rules. Public offer and listing of debt instruments and issue of fully or partly convertible debentures allowed even if equity is not listed. This is subject to conditions like investment grade rating.
- Merchant Bankers must henceforth be registered Companies.
- Multiple categories of merchant bankers reduced to one.
- Merchant Banker allowed to perform underwriting activity but required to seek separate registration to function as a Portfolio Manager under the SEBI (Portfolio Manager) Rules and Regulations, 1993.
- Merchant Bankers can no longer accept deposits, do leasing and bill discounting, or carry out fund based activities other than those related exclusively to the capital market.
- Existing NBFCs performing merchant banking activities to be given suitable time to restructure their activities.

43. Among the secondary market reforms undertaken were:

- Daily margin on carry forward trade reduced to 10% from 15%, 50% of which is to be collected up-front either in cash or in the form of bank guarantee.
- Overall carry forward limit enhanced to Rs. 20 crore per broker.
- The limit of Rs.10 crore for a financier to be eliminated. Shares received by Vyaj Badla financiers to continue to be deposited with the clearinghouse as earlier. Stock exchanges to arrange for proper insurance cover for aggregate value of shares lying in the clearinghouse.
- Institutional investors with portfolio worth more than Rs. 10 crore required to compulsorily trade in and settle only in dematerialised form eight scrips with effect from January 15, 1998. The list was expanded to thirty scrips recently, with another twenty slated for inclusion by August 1998.

44. The capital market continued to remain dormant in 1997-98. Resource mobilisation from the primary market through public issues steadily declined to Rs. 14276 crore in 1996-97 and further down to Rs. 4570 crore in 1997-98. The secondary market witnessed net FII sales for the first time in November 1997. Though net FII investment remained negative in December, 1997 and January, 1998, it was positive in both February and March, 1998. Resource mobilisation by mutual funds improved but their performance was affected by depressed market conditions. The introduction of a government Capital Indexed Bond provided a new financial instrument for investors to hedge their principal against inflation. However, the amount mobilised was rather modest at about Rs. 705 crore, which perhaps reflected low inflationary expectations.