Banking Policy and Trends

16. Based on the recommendations of the Narasimham Committee (II) on banking sector reforms, the Reserve Bank announced a number of decisions as part of its Mid-term Review of the monetary and credit policy released on October 30,1998. These related to phased introduction of risk weight for Government/ approved securities, risk weight for Government guaranteed advances, general provision for standard assets, higher Capital to Risk-weighted Asset Ratio (CRAR, 9%))for banks, etc. Though most of these decisions have prospective effect, they assume significance in view of the growing exposure of Indian banks to market risks, which impact significantly on the financial performance of banks (Box 3.2)

Financial Performance

17. The profits of commercial banks reflected better financial health in 1997—98 (Tables 3.5 and 3.6). New private sector banks registered the maximum increase in operating profits (52.7 per cent). Other bank groups registered lower increase in their operating profits, which ranged from 6.2 per cent to 28.9 per cent. Net profits of SBI and associates registered substantial improvement due to decline in provisioning requirements in respect of "mark-to-market" proportion of investment in Government securities. This was true of nationalised banks as well, which reflected the relatively higher level of public sector banks' investment in Government securities.

Net Interest Income (Spread)

18. The percentage of spread to total assets declined in 1997-98 for all groups of scheduled commercial banks. The maximum decline was in the case of new private sector banks (2.88 per cent to 2.18 per cent), followed by old private sector banks (2.93 per cent to 2.56 per cent), SBI and associates (3.48 per cent to 3.14 per

TABLE 3.5

Working Results of Scheduled Commercial Banks for 1996-97 and 1997-98

SCBs	SBI Group		Nationalised banks		Public Banks		Pvt. Sector Sector Banks		Pvt. Sector Banks (Old)[1]		Foreign Banks (New)[2]		All Banks[3]	
	1996-97	1997-98	1996-97	1997-98	1996-97	1997-98	1996-97	1997-98	1996-97	1997-98	1996-97	1997-98	1996-97	1997-98
A. Rupees Crore														
A. Income	23277	24871	37983	42831	61260	67702	5389	6438	1968	3012	7608	8697	76225	85849
i) Interest	19923	21209	33977	37858	53900	59067	4733	5497	1639	2386	6212	6783	66484	73733
ii) Other income	3354	3662	4006	4973	7360	8635	656	941	329	626	1396	1914	9741	12116
B. Expenditure	21570	22412	36538	40263	58108	62675	4983	5996	1688	2612	6942	8067	71721	79350
i) Interest	12819	13904	23519	26260	36338	40165	3431	4084	1173	1821	3896	4222	44838	50292
ii) Provisions and contingencies	2751	2273	2984	2964	5735	5236	434	640	201	335	1365	1914	7735	8125
iii) Other operating expenses	6000	6235	10035	11039	16035	17274	1118	1272	314	456	1681	1931	19148	20933
C. Operating Profit	4458	4732	4429	5532	8887	10263	840	1082	481	735	2031	2544	12239	14624
D. Net Profit	1707	2459	1445	2568	3152	5027	406	442	280	400	666	630	4504	6499
E. Total Assets	204356	232747	351940	416439	556296	649186	44457	55205	16160	25856	56063	65288	672976	795535
B. Per Cent of Total Assets														
A. Income	11.4	10.7	10.8	10.3	11.0	10.4	12.1	11.7	12.2	11.6	13.6	13.3	11.3	10.8
i) Interest	9.7	9.1	9.7	9.1	9.7	9.1	10.6	10.0	10.1	9.2	11.1	10.4	9.9	9.3
ii) other income	1.6	1.6	1.1	1.2	1.3	1.3	1.5	1.7	2.0	2.4	2.5	2.9	1.4	1.5
B. Expenditure	10.6	9.6	10.4	9.7	10.4	9.7	11.2	10.9	10.4	10.1	12.4	12.4	10.7	10.0
i) Interest	6.3	6.0	6.7	6.3	6.5	6.2	7.7	7.4	7.3	7.0	6.9	6.5	6.7	6.3
ii) Provisions and contingencies	1.3	1.0	0.8	0.7	1.0	0.8	1.0	1.2	1.2	1.3	2.4	2.9	1.1	1.0
iii) Other operating expenses	2.9	2.7	2.9	2.7	2.9	2.7	2.5	2.3	1.9	1.8	3.0	3.0	2.8	2.6
C. Operating Profit	2.2	2.0	1.3	1.3	1.6	1.6	1.9	2.0	3.0	2.8	3.6	3.9	1.8	1.8
D. Net Profit	0.8	1.1	0.4	0.6	0.6	0.8	0.9	0.8	1.7	1.5	1.2	1.0	0.7	0.8

1 **The data relate to 25 Indian private sector banks.**
2 **The data relate to 9 new Indian private sector banks.**
3 **The data relate to 42 foreign banks only.**

TABLE 3.6

Increase in Profits of Schelued Commercial Banks in 1997-98 over 1996-97

(Rs. crore)

Sub-Group	Operat-ing Profit	Provisions and Contingencies	Net Profit
1. Public Sector (i+ii)	1376(15.5)	-499(-8.7)	1875(59.5)
(i) SBI & Associates	275(6.2)	-478(-17.4)	753(44.0)
(ii) Nationalised Banks	1102(24.9)	-20(-0.7)	1122(77.7)
2. Private (Old)	242(28.9)	206(47.5)	37(9.0)
3. Private (New)	253(52.7)	134(66.7)	119(42.6)
4. Foreign	512(25.2)	548(40.2)	-36(-5.5)
Total	**2384(19.5)**	**390(5.0)**	**1995(44.3)**

Note : Figures in brackets show percentage change over the previous year.

cent), foreign banks (4.13 per cent to 3.92 per cent) and nationalised banks (2.97 per cent to 2.78 per cent). Increasing recourse to non-traditional banking activities has contributed to the decline in spread.

Non-Performing Assets (NPAs)

19. NPAs constitute a source of deadweight loss to the commercial banks and thwart downward movement in lending rates. In gross terms, the ratio of NPAs to total advances in respect of public sector banks came down from 17.8 per cent in 1996-97 to 16.0 per cent in 1997-98. Nevertheless, the absolute magnitude of gross NPAs increased by 4.8 per cent over 1996-97 and remained at a very high level of Rs. 45653 crore. The ratio of net NPAs (gross NPAs minus items like interest due but not received, part payment received and kept in suspense account and total provisions held) to net advances also declined from 9.2 per cent in 1996-97 to 8.2 per cent in 1997-98. The year 1997-98 also witnessed a decline in the share of priority sector in the aggregate gross NPAs of the public sector banks (Table 3.7). In order to reduce NPAs, the Union Budget for 1998-99 proposed strengthening of Debt Recovery Tribunals (DRTs) to cover all States. Accordingly, action for setting up five more DRTs and four Debt Recovery Appellate Tribunals (DRATs) has been initiated by the Government/RBI. The Union Budget also proposed creation of Assets Reconstruction Companies (ARCs) to tackle the problem of NPAs. A Task Force comprising representatives of Banking Division, RBI and Nationalised Banks has been constituted to prepare an action plan for setting up of ARCs. The Task Force has submitted its report.

TABLE 3.7

Distribution of Gross NPAs of Public Sector Banks (%) in 1997-98

Bank Group	Priority Sector	Non-Priority Sector	Public Sector
1. SBI& Associates	48.1 (50.4)	47.6 (43.8)	4.3 (5.7)
2. Nationalised Banks	45.5 (46.3)	52.2 (51.5)	2.3 (2.2)
3. Public Sector Banks (1+2)	46.4 (47.7)	50.6 (49.0)	3.0 (3.3)

Note: Figures in brackets are for 1996-97. Figures may not add up to 100 due to rounding.

Prudential Regulations

20. On the basis of recommendations of the Committee on Banking Sector Reforms (Narasimham Committee-II), the Reserve Bank tightened regulations in the following areas.

- Risk weight of 2.5 per cent to cover market risk in respect of Government securities and other approved securities by March 31, 2000.
- Risk weight of 20 per cent for State Government guaranteed advances which have been invoked and have remained in default as on 31.03.2000.
- Application of provisioning norms in respect of advances granted *w.e.f.* April 1, 2000 against State Government guarantee, where the guarantee is invoked and has remained in default for more than 2 quarters. And provisioning to be made in respect of advances guaranteed by State Governments which stood invoked as on March 31, 2000 during the financial years ending March 31, 2000 to March 31, 2003 (minimum 25 per cent each year).
- 100 per cent risk weight to foreign exchange/ gold open position limit with effect from March 31, 1999.
- Reduction in the time frame for treating assets in sub-standard category as doubtful assets from 24 months to 18 months by March 31, 2001.
- General provision of 0.25 per cent for standard assets from the year ending March 31, 2000.

Capital Adequacy

21. In pursuance of the Narsimham Committee (II) recommendation, the Union Budget, 1998-99 proposed to raise the minimum Capital to Risk-weighted Asset Ratio (CRAR) from the

existing level of 8 per cent to 10 per cent in phases. Accordingly, the Reserve Bank has decided to raise the CRAR to 9 per cent by March 31, 2000. Out of the 27 public sector banks, 26 banks attained the stipulated 8 per cent CRAR by March 31,1998. By this date 19 PSBs attained CRAR exceeding 10 per cent. This favourable development was facilitated by large-scale recapitalisation of banks. During 1997-98 the Government contributed a sum of Rs.2700 crore towards recapitalisation of three banks, viz. Canara Bank, (Rs.600 crore), Indian Bank (Rs.1750 crore) and UCO Bank (Rs.350 crore). The contribution by Government to nationalised banks till 1997-98 amounted to Rs.20,046 crore. Canara Bank was allowed to reduce paid up capital as on 31.3.1998 by Rs. 507 crore against their loss under the CANSTAR Scheme. Aggregate capital allowed to be written off by nationalised bank till 1997-98 is Rs.3979 crore. The Punjab National Bank returned to the Government of India capital worth Rs. 138 crore during 1997-98, thereby raising the total amount of capital returned to Rs. 643 crore till date. Some banks also raised resources from the market to enhance their capital base.

Bank Supervision

22. Supervision of banks consists of both on-site and off-site supervision. The new approach to on-site system has been in force from July, 1997. This is the modified version of CAMEL model, namely, CAMELS, which evaluates banks' Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Systems and Control. This system covers the mandated aspects of solvency, liquidity and financial/operational health of banks. The objective of off-site supervision system is to maintain continuous surveillance on the performance of banks as part of the ongoing supervisory strategy formulated by the Board for Financial Supervision (BFS) and to track industry and peer group trends in respect of Capital Adequacy, Asset Quality, Operating Results, Large Exposures, Connected Lending, Changes in ownership based on quarterly returns, and Advance warning signals thrown by the scrutiny of these returns. Besides sensitising the bank managements to the supervisory concerns, it would trigger supervisory actions in the form of monitoring visits, other examinations, etc. in order that timely corrective measures are initiated. This function consists of a computerised data base system based on prudential supervisiory reporting framework comprising quarterly returns of financial data from banks and financial institutions.

Credit Delivery System

23. RBI's credit policy for the first half has underlined the need to accelerate credit flow to productive sectors, particularly to agriculture and small scale industries. Though there has been significant increase in the total volume of credit flowing to these sectors, sanctioning credit to these sectors is perceived to be too complex and time-consuming. Banks have therefore been advised by the RBI to implement the recommendations made by the one-man Committee under the Chairmanship of Shri R.V. Gupta in regard to several procedural modifications on agricultural credit (Box 3.3). Banks have been advised to delegate sufficient powers to their branch managers. To facilitate quicker submission of application for and delivery of loan, the Indian Banks Association has been requested to frame simpler application forms for agricultural loans. Banks have also been advised

BOX 3.3

Major Recommendations of the High Level Committee on Agricultural Credit through Commercial Banks

- Simplification of procedures regardding loan application forms, agreements/documents etc.
- Rationalisation of internal returns of banks.
- Banks may ensure that pre-sanction appraisal of the borrower focusses on income stream of the borrower, his capability for taking up the activities proposed, integrity etc. and technical viability of the proposal.
- Delegation of powers to branch managers to ensure quick disposal; at least 90% of loan applications should be disposed at the branch level.
- Introduction of Composite Cash Credit limits to all agricultural borrowing families.
- Introduction of new loan product with savings component.
- Cash disbursement of loan.
- Dispensation of No Due Certificates as a compulsory requirement. Obtaining No Due Certificate is now left to the discretion of lending banker.
- Discretion to banks on the matters relating to margin/security requirements for agricultural loans above Rs.10,000/-.
- The target of agricultural lending should be based on the flow of credit through preparation of Special Agricultural Credit Plans (SACP), the objective of which should be to accelerate the flow as well as to substantially improve the quality of lending.
- Addressing a host of HRD related issues with regard to bank officials posted at rural branches.

by the Reserve Bank to formulate a suitable scheme of hassle-free settlement of chronic overdues in respect of agricultural advances and issue necessary instructions to branches.

24. As regards Small Scale Industries (SSI), which account for 40 per cent of gross turnover of the manufacturing sector, 45 per cent of manufacturing exports, and 35 per cent of total exports, there is a long-felt need to enhance SSI's access to institutional finance. The one-man Committee under the Chairmanship of Shri S.L. Kapur made many recommendations covering several facets of the financing of the SSI sector. RBI examined these recommendations and decided to accept a number of them for immediate implementation. These, inter alia, relate to delegation of more powers to branch managers, simplification of application forms, opening of more specialised SSI branches, higher limits for composite loans, stronger loan recovery mechanism, etc. The remaining recommendations are under examination in consultation with NABARD, SIDBI and Government of India. To expedite payment of dues of SSI sector, banks have been advised by the Reserve Bank to take appropriate action for clearing of overdues by medium/large corporate borrowers.

Sectoral Deployment of Bank Credit

25. During 1997-98, out of the total increase in non-food gross bank credit amounting to Rs. 36404 crore, 41.0 per cent (Rs. 14926 crore) flowed to medium and large industries, 9.4 per cent (Rs. 3427 crore) to agriculture and 20.8 per cent (Rs. 7564 crore) to small scale industries (Table 3.8).

26. The sectoral breakdown of bank credit available for the period April-October in the current financial year shows increase in non-food gross bank credit to industry (medium and large) by 2.0 per cent (Rs.2293 crore) as against the decline by 1.1 per cent (Rs.1142 crore) during the corresponding period of 1997-98. Credit to agriculture increased by 5.0 per cent (Rs.1750 crore) as against 4.7 per cent (Rs.1476 crore) during April-October, 1997. Credit to small scale industries increased during this period by 1.4 per cent (Rs.592 crore) as against 1.1 per cent (Rs.395 crore) in 1997-98.

Export Credit

27. The outstanding export credit of scheduled commercial banks as on March 27,1998 stood at Rs.34,430 crore forming 10.6 per cent of total outstanding net bank credit (NBC) as against Rs.30,112 crore forming 10.8 per cent of NBC as on March 28,1997. As on December 4, 1998 aggregate export credit of banks was Rs. 34,873 crore (10.3 per cent of net bank credit). Effective from the fortnight beginning January 17,1998, banks were provided export credit refinance upto 50 per cent of the increase in outstanding export

TABLE 3.8
Sectoral Deployment of Gross Bank Credit
Variations during[1]

On the last reporting Friday	1996-97	1997-98	April-October 1997-98	April-October 1998-99	1996-97	1997-98	April-October 1997-98	April-October 1998-99
	(Rs.crore)				(Per cent)			
I. Gross bank credit	27131	41292	3346	12638	11.7	15.9	1.3	4.2
1. Public food procurement	-2194	4888	2616	4243	-22.4	64.3	34.4	34.0
2. Gross non-food credit	29325	36404	730	8395	13.2	14.5	0.3	2.9
(a) Priority sector (i+ii+iii)[2]	11551	14627	3355	3924	15.8	17.2	4.0	3.9
(i) Agriculture	4398	3427	1476	1750	16.3	10.9	4.7	5.0
(ii) Small scale industry	4060	7564	395	592	12.7	21.0	1.1	1.4
(iii) Other priority sectors	3093	3636	1484	1582	21.5	20.8	8.5	7.5
(b) Medium and large industries	9551	14926	-1142	2293	10.3	14.5	-1.1	2.0
(c) Wholesale trade (excluding food procurement)	360	877	-952	-61	3.0	7.1	-7.7	-0.5
(d) Other sectors	7863	5974	-531	2239	18.0	11.6	-1.0	3.9
II. Export credit[3]	418	3939	-1166	-1056	1.4	13.1	-3.9	-3.1

1 All figures are provisional.
2 As on last Friday of the period.
3 Also included in non-food credit.

Note : Data relate to 50 scheduled commercial banks which account for 90-95 per cent of the bank credit of all scheduled commercial banks. Gross bank credit data include bills rediscounted with RBI,IDBI, Exim Bank and other approved financial institutions.

credit eligible for refinance over the level of such credit as on February 16,1996. After reviewing the monetary and foreign exchange situation, the export credit refinance limits were restored to 100 per cent of the incremental export credit eligible for refinance with effect from May 9, 1998. In order to ensure internationally competitive interest cost for exporters, RBI advised banks on June 11, 1998 to limit the spread to 1.5 percentage points over LIBOR on foreign currency loans(as against LIBOR +2.0/ 2.5 points earlier). The Government announced a reduction by 2 percentage points in interest rates in August, 1998 (to be effective till 31-3-99) for both pre-shipment and post-shipment export credit. Reserve Bank therefore made a corresponding two-percentage-point reduction in the refinance rate available to banks from 9 per cent to 7 per cent, which is effective during August 6, 1998 to March 31, 1999. This has led to higher daily average utilisation of export credit refinance. During the fortnight ended December 4,1998 daily average utilisation of export credit refinance by banks was at Rs.5304 crore (94.7 per cent of limits) as compared with only Rs. 36 crore during the corresponding fortnight last year. This was an important source of reserve money growth during the year.

Priority Sector Credit

28. As per provisional data, the flow of gross non-food credit from scheduled commercial banks (SCBs) to the priority sector during April-October, 1998 increased by Rs. 3924 crore (3.9 per cent) over end-March 1998 as against Rs. 3355 crore (4.0 per cent) in the corresponding period of 1997-98. The corresponding figures in respect of agriculture and small-scale industry have been given in paragraph 26. However, separate figures for banks in public sector and private sector are not available for April-October, 1998. Analysis of priority sector advances for different categories of banks for 1997-98 shows that the public sector banks extended credit amounting to Rs. 12188 crore to the priority sector, which represented an increase of 15.4 per cent over end-March, 1997. The private sector commercial banks are also covered by the priority sector credit targets. During 1997-98, credit extended by the private sector banks to the priority sector increased 31.5 per cent (Rs.2782 crore) over end-March 1997. In the case of foreign banks, priority sector advances amounted to Rs.801 crore in 1997-98, which constituted an increase of 13.0 per cent over end-Marh 1997. As regards outstanding advances to priority sector, the amount in respect of public sector banks stood at Rs.91319 crore as on March 27 ,1998 whereas it stood at Rs.11,614 crore and 6938 crore in respect of private sector banks and foreign banks respectively as on the same date. As for the share of outstanding priority sector advances in outstanding NBC as on March 27,1998, it worked out to 41.8 per cent, 40.9 per cent and 34.3 per cent for public sector, private sector and foreign banks respectively.

Rural Credit

29. Keeping in view the significance of timely availability of institutional credit to the rural sector, the NABARD has been playing a leading role in strengthening the rural credit delivery system in the country. To enable NABARD to provide short term credit facilities to Cooperative banks and Regional Rural Banks (RRBs), RBI renewed the General Line of Credit (GLC I and II) by Rs. 5700 crore in 1998-99. This consisted of Rs. 4850 crore under GLC I for seasonal operations and Rs. 850 crore under GLC II for various other approved short term purposes. During the current financial year, share capital of NABARD has been raised by Rs. 500 crore to Rs. 2000 crore with contributions from RBI (Rs. 400 crore) and Government of India (Rs. 100 crore). In pursuance of the policy to channelise shortfall in priority sector lending by banks into rural infrastructure, the Union Budget, 1998-99 proposed the establishment of the Rural Infrastructure Development Fund (RIDF-IV) with a corpus of Rs.3000 crore. RIDF IV has been set up in NABARD, which has initiated action for sanctioning viable projects posed by States. Analysis of the trends in sanctions and disbursements under RIDF shows that the utilisation of funds (disbursements) was 83 per cent of sanctions under RIDF-1, 42 per cent under RIDF-II and 14 per cent under RIDF-III, as at the end of October 1998. Underutilisation of RIDF funds has been largely due to difficulties /delays in project identification by State Governments and lack of budgetary support for projects involving only part funding from RIDF. To enhance the flow of funds to micro enterprises NABARD has initiated action to increase the coverage of Self Help Groups (SHGs). Commercial banks have been asked to enhance credit support to SHGs. To enable Regional Rural Banks (RRBs) to play a more effective role in rural credit, the Government has been infusing capital through budgetary allocations. The Union Budget 1998-99 provided for Rs. 265 crore for carrying forward the process of rehabilitation and recapitalisation of RRBs.