Financial Intermediation

5

CHAPTER

Efficient intermediation by financial markets leads to higher economic growth by increasing savings and their optimal allocation for productive uses. A shift of our growth trajectory to the pre-crisis level of over 8 per cent and above critically depends on efficient financial intermediation between savers and borrowers. Historically, banks have played this role. However, with the start of the reform process beginning 1990s, the importance and nature of financial intermediation has undergone a transformation with other intermediaries including non-banking financial companies (NBFCs), insurance and pension funds, and mutual funds(MF) emerging as the new mechanisms for channelling savings to investments. These developments have also been accompanied by the emergence of equity and debt markets, financial products like forwards, futures and other derivatives instruments which have the capacity of reallocating risks and putting capital to more efficient use. However, keeping in view India's growing integration with global financial markets, external-sector vulnerabilities have an increasingly large impact on India through the trade and capital account channels. It is therefore important that the development of an efficient and healthy financial market should also be accompanied by an effective regulatory mechanism that keeps track of external vulnerabilities. This chapter summarises the recent developments in the financial sector in India and the challenges and opportunities it faces in the context of developments in the global financial market.

Bank Credit

5.2 Banks as financial intermediaries collect deposits from savers and on-lend these to investors and others. The deposits of banks form the basis of their lending operations. Aggregate deposits of the banking sector increased from an average of ₹ 48,019.8 billion in 2010-11 to ₹ 64,362.3 billion during Q3 of 2012-13. Year-on-year growth of aggregate deposits, however, moderated from an average of 17.9 per cent in Q1 of 2011-12 to 12.87 in Q3 of 2012-13. This decline in the rate of growth of aggregate deposits also moderated the rate of growth of credit, from an average of 21.73 per cent in Q1 of 2011-12 to 16.49 per cent in Q3 of 2012-13. While the growth of food credit which is primarily advanced for food procurement, and constitutes around 2 per cent of total credit, fluctuated, growth in non-food credit had a near secular decline (Table 5.1).

5.3 Banks use their deposits for advancing credit or for making investment in government and other securities. The ratio of their investment in approved securities to aggregate deposits has remained range bound at around 30 per cent, significantly higher than the minimum required under the statutory liquidity ratio (SLR). The higher allocation to government securities may be either because of a higher risk perception or non-availability of quality lending opportunities to the private sector or both. The ratio of credit to deposits, however, increased

Table 5.1 : Growth Rate of Deposits, Credit, and Investments (y-o-y per cent)

	2010-11	2011-12	2011-12				2012-13		
			Q1	Q2	Q3	Q4	Q1	Q2	Q3
Aggregate deposits	15.69	16.51	17.92	17.59	16.25	14.51	14.62	13.91	12.87
Bank credit	21.27	18.71	21.73	19.63	17.61	16.37	18.07	16.79	16.49
Food credit	15.85	33.02	24.72	42.52	35.64	29.80	56.99	35.28	33.76
Non-food credit	21.36	18.48	21.69	19.29	17.32	16.14	17.45	16.46	16.17
Investments in approved securities	9.42	14.26	10.26	15.45	15.46	15.74	16.09	14.45	15.18

from 74.3 per cent in Q1 of 2011-12 to 76.7 per cent in Q3 of 2012-13, allowing the banks to maintain a higher credit growth than would otherwise have been feasible given the growth in deposits (Figure 5.1).

Interest Rates

5.4 Monetary policy started becoming a little more accommodative in 2012-13. A moderation in inflation created space for the Reserve Bank of India (RBI) to reduce policy rates and take other measures for improving liquidity in the system. The policy rates were cut during 2012-13, including a reduction of 75 basis points (bps) in the repo rate in two steps (50 bps in April 2012 and 25 bps in January 2013), a reduction of 100 bps in the SLR in August 2012, and a 75 bps cut in the cash reserve ratio (CRR) in three steps (25 bps effective 22 September 2012, 25 bps effective 3 November 2012 and 25 bps effective 9 February 2013). Taking a cue from these cuts, several banks reduced their deposit and lending rates during the year. Though the impact of these policy measures is still unfolding, the transmission of the policy rate to deposit and lending rates of banks is relatively less pronounced compared to money market rates, reflecting the presence of structural rigidities in the credit market.

Domestic Deposit Rates

5.5 The modal term deposit rates for banks across all maturities declined by 15 bps to 7.27 per cent during 2012-13 (as on 15 December 2012). The decline was noted across all bank groups and mostly for maturities up to one year (Table 5.2). The rates of interest on savings deposits, which were deregulated by the RBI effective October 2011, however were generally stable. Eighteen scheduled commercial banks (SCBs) with a market share of 5.5 per cent in aggregate deposits, increased their savings deposit rates in the range of 100-300 bps for savings deposit balances up to ₹ 1 lakh and 100-680 bps for balances above ₹ 1 lakh. So far, none of the public-sector banks has increased its savings deposit rates, since the deregulation of these rates by the RBI.

Figure 5.1: Aggregate Deposits and Credit and investment/Deposit ratio

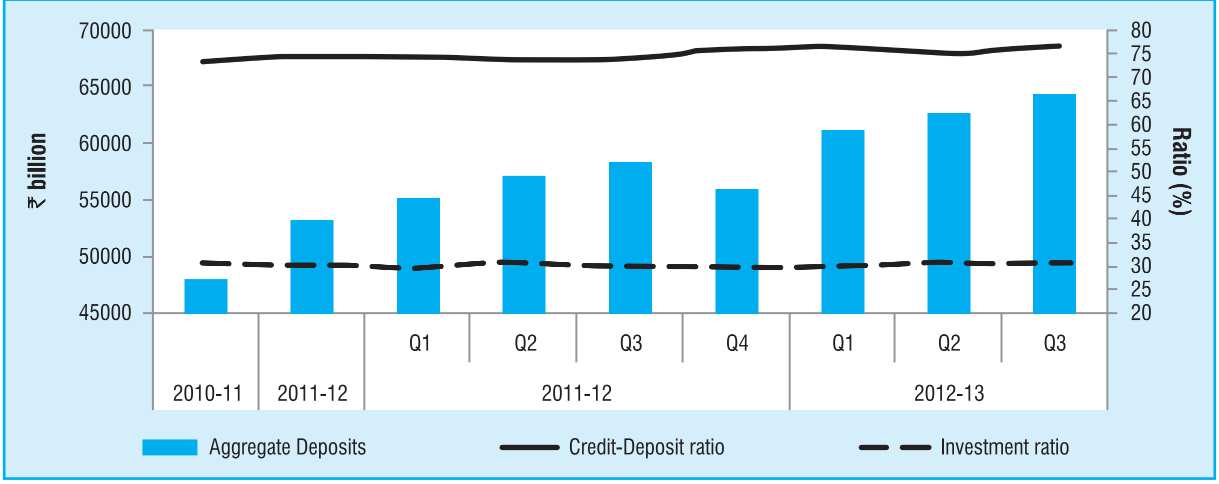


Table 5.2 : Deposit and Lending Rates of SCBs

(per cent)

Item	Dec.- 11	Mar.- 12	Jun. -12	Sept.-12	Dec.-12#
(A) Domestic deposit rates					
(i) Public-sector banks					
Up to 1 year	1.00-9.55	1.00-9.75	4.00-9.25	4.00-9.25	4.00-9.00
1 - 3 years	8.55-9.75	9.00-9.75	8.75-9.50	8.50-9.30	8.50-9.25
Above 3 years	8.00-9.50	8.50-9.50	8.00-9.50	8.50-9.30	8.50-9.10
(ii) Private-sector banks					
Up to 1 year	3.00-9.25	3.00-9.50	3.00-9.25	3.00-9.25	3.00-9.00
1 - 3 years	8.00-10.50	8.00-10.50	8.00-10.00	8.00-9.75	8.00-9.75
Above 3 years	8.00-10.10	8.00-10.10	8.00-10.00	8.00-9.50	8.00-9.50
(iii) Foreign banks					
Up to 1 year	3.50-10.00	3.50-11.80	3.50-9.25	2.43-9.25	2.21-9.00
1 - 3 years	3.50-9.75	3.50-9.75	3.50-9.75	3.50-9.75	3.50-9.75
Above 3 years	4.25-9.50	4.25-9.50	3.75-9.50	3.75-9.50	4.35-9.50
SCBs					
Modal deposit rate (all tenors)	7.46	7.42	7.40	7.29	7.27
(B) Base Rate					
Public-sector banks	10.00-10.75	10.00-10.75	10.00-10.50	9.75-10.50	9.75-10.50
Private-sector banks	10.00-11.25	10.00-11.25	9.75-11.25	9.75-11.25	9.75-11.25
Foreign banks	6.25-10.75	7.38-11.85	7.38-11.85	7.25-11.75	7.20-11.75
SCBs					
Modal base rate	10.75	10.75	10.50	10.50	10.50
(C) Median lending rate*					
Public-sector banks	10.25-15.25	10.60-15.35	10.50-15.50	10.50-15.38	-
Private-sector banks	10.00-15.50	10.50-15.50	10.63-15.38	10.20-15.63	-
Foreign banks	9.50-14.38	10.00-14.50	10.00-14.50	9.95-14.50	-

Source **: RBI.**

***: Median range of interest rate on advances at which at least 60 per cent business has been contracted.**
Notes: **#: As on 15 December 2012.**

Interest Rates on NRI Deposits

5.6 The modal interest rate on non-resident (external) rupee (NRE) deposits of banks declined by 37 bps during 2012-13 (up to December 15) to 8.71 per cent, reflecting subdued demand for export credit in the economy. Interest rates on foreign currency non-resident (bank) account (FCNR [B]) deposits continue to be regulated by the RBI. With a view to augmenting foreign currency inflows into the economy, effective 5 May, 2012 the interest rate ceiling on FCNR (B) deposits was raised to LIBOR/Swap rates plus 200 bps for 1-3 year maturity and LIBOR/Swap rates plus 300 bps for 3-5 year. The interest rate ceiling on overseas line of credit arranged by banks for exporters has also remained regulated by the RBI. At present, the prescribed ceiling in this regard is at six-month LIBOR/EURO LIBOR/EURIBOR plus 250 bps, subject to review as and when warranted.

Lending Rates

5.7 Following the reduction in the repo rate in April 2012 and the calibrated liquidity easing measures announced by the RBI during 2012-13, the modal base rate of banks declined by 25 bps to 10.50 per cent during the current fiscal (Table 5.2). The median lending rates on bank advances (at which 60 per cent or more business was contracted), other than export credit, ranged between 9.50 and 15.75 per cent in November 2012, showing a moderation of 25-50 bps compared to the rates which prevailed in March 2012. The median lending rates on pre-shipment rupee export credit up to 180 days ranged between10.55-13.00 per cent in November 2012 compared to 10.75-12.88 per cent in March 2012.

Table 5.3 : Sectoral Deployment of Credit

	2010-11	2011-12	2011-12				2012-13		
			Q1	Q2	Q3	Q4	Q1	Q2	Q3
Credit disbursed (₹ billion)									
Total credit	**33359**	**39506**	**37525**	**38299**	**39957**	**42244**	**44190**	**44610**	**46386**
Food credit	546	726	625	678	769	832	949	950	1018
Agriculture & allied activities	4159	4561	4524	4388	4459	4874	5217	5266	5479
Industry	14461	17656	16541	17121	17964	18999	19772	19890	20752
Services	7859	9298	8903	8943	9395	9950	10405	10383	10617
Personal loans	6333	7255	6932	7129	7369	7588	7847	8121	8520
Shares of the broad sectors in credit disbursed (per cent)									
Food credit	1.64	1.84	1.66	1.77	1.93	1.97	2.15	2.13	2.20
Agriculture & allied activities	12.47	11.55	12.06	11.46	11.16	11.54	11.81	11.80	11.81
Industry	43.35	44.69	44.08	44.70	44.96	44.98	44.74	44.59	44.74
Services	23.56	23.53	23.73	23.35	23.51	23.55	23.55	23.28	22.89
Personal loans	18.99	18.36	18.47	18.61	18.44	17.96	17.76	18.20	18.37
Average annual rate of growth (per cent)									
Total credit	**20.84**	**18.43**	**21.19**	**19.43**	**17.15**	**16.38**	**17.76**	**16.48**	**16.09**
Food credit	16.03	32.91	19.63	39.00	39.48	33.46	51.95	40.01	32.38
Agriculture & allied activities	19.82	9.67	12.54	10.27	6.63	9.39	15.32	20.02	22.86
Industry	26.48	22.10	24.82	22.57	21.21	20.24	19.54	16.17	15.52
Services	19.55	18.30	22.23	19.93	16.76	15.02	16.87	16.10	13.01
Personal loans	11.96	14.54	17.78	15.45	13.27	12.13	13.19	13.92	15.61

Source : RBI.

Table 5.4 : Particulars of Priority Sector Advances

(₹ crore)

	Public Sector Banks			Private Sector Banks			Foreign Banks		
	Mar-10	Mar-11	Mar-12	Mar-10	Mar-11	Mar-12	Mar-10	Mar-11	Mar-12
Total Priority sector Advances	863777	1021496	1129993	*214669*	*249099*	*286420*	59959	66737	80559
Advances to Agriculture#	372463	414973	475148	*90737*	*92146*	*100900*	121	56	111
Advances to Micro and Small enterprises	276318	369930	396343	*64824*	*88115*	*110513*	21147	20981	21760
Advances to weaker sections	211376	240321	293960	*25532*	*28575*	*38929*	0 .00	0.00	0.00
Advances to Exports	NA	NA	NA	NA	NA	NA	35167	43322	51742
Priority Sector Advances as percentage of total advances									
Total Priority sector Advances	41.50	40.90	37.40	45.80	46.60	39.40	36.00	39.70	40.90
Advances to Agriculture#	17.90	16.60	15.70	19.30	17.20	13.80	0.00	0.00	0.00
Advances to Micro and Small enterprises	13.20	14.80	13.10	13.80	16.50	15.20	12.70	12.40	11.00
Advances to weaker sections	10.10	9.60	9.70	5.40	5.30	5.30	0.00	0.00	0.00
Advances to Exports							21.10	25.70	26.20

Source: RBI.

Note: # Indirect agriculture is reckoned only up to 4.5 per cent of the ANBC or credit equivalent of off-balance sheet exposures, whichever is higher; NA-Not Applicable

Foreign Currency Export Credit

5.8 The interest rate on export credit in foreign currency was deregulated effective 5 May 2012 to increase foreign currency loans to exporters. The modal lending rate (at which 60 per cent or more business was contracted) for the reporting banks on pre-shipment credit in foreign currency declined by 20 bps to 4.03 per cent between November 2012 and June 2012 in line with decline in LIBOR rate during the period. On the assets side, trade credit for importers has also remained regulated and at present, all-in-cost ceilings on trade credit for imports for maturity period up to five years is at six-months LIBOR (for the respective currency of credit) plus 350 bps effective 11 September, 2012.

Sectoral Deployment of Credit

5.9 Details of sectoral deployment of credit are maintained by the RBI on a regular basis for 47 scheduled banks accounting for nearly 95 per cent of total credit flow. Industry has remained the dominant sector accounting for around 45 per cent of total credit disbursed by the banks. While food credit, primarily advanced for food procurement, has fluctuated, credit to the agriculture and allied sector has grown after Q3 of 2011-12. While the growth of credit for the industry and services sectors has declined, growth in personal loans appears to have bottomed out and some recovery is visible in Q3 of 2012-13 (Table 5.3). Inflation affected the consumption of non-food items. Sectoral shares in the credit flow have generally remained stable.

Priority-sector Lending

5.10 In view of the need to ensure adequate institutional credit flow to the vulnerable sectors, the RBI has mandated that banks should lend a minimum of 40 per cent of their advances to the priority sectors. Priority sector broadly includes advances to agriculture, small scale industries, weaker section, exports, education, SHGs, etc. Details of priority sector are provided in Appendix 4.6 . Revised guidelines issued by the RBI on priority sector lending (PSL) on 20 July 2012, mandates commercial banks and foreign banks with 20 or more branches to allocate 40 per cent of their adjusted net bank credit (ANBC) or credit equivalent amount of off-balance sheet exposures (OBE), whichever is higher, to the priority sector. Within this, sub-targets of 18 per cent and 10 per cent of ANBC or credit equivalent amount of OBE have been mandated for lending to agriculture and the weaker sections respectively. For foreign banks with less than 20 branches, the target PSL is 32 per cent of ANBC or credit equivalent amount of OBE, whichever is higher. Foreign banks have been given a period of 5 years beginning April 2013 to achieve their PSL target. Their action plan, however, is required to be approved by the RBI.

5.11 The total outstanding priority-sector advances of public-sector banks (PSB) increased from ₹ 10,21,496 crore as on the last reporting Friday of March 2011 to ₹ 11,29,993 crore as on the last reporting Friday of March 2012, showing a growth of 10.6 per cent. The achievement of PSBs as a group was 37.4 per cent as on the last reporting Friday of March 2012. The outstanding priority-sector advances of private-sector banks grew by 14.9 per cent in 2011-12 and these were 39.4 per cent of their total advances as on the last reporting Friday of March 2012.The outstanding priority-sector advances of foreign banks had reached the targeted level of 40 per cent as on March 2012, though these advances have largely been in export sector (Table 5.4).

Rural Infrastructure Development Fund

5.12 The Rural Infrastructure Development Fund (RIDF) was instituted in the National Bank for Agriculture and Rural Development (NABARD) through an announcement in Union Budget 1995-6 with the objective of giving low cost fund support to states and state-owned corporations for quick completion of ongoing projects relating to medium and minor irrigation, soil conservation, watershed management, and other forms of rural infrastructure. Allocation to the RIDF is made from the shortfall in meeting PSL targets by the banks. From the inception of the RIDF in 1995-6 to March 2012, 462,229 projects have been sanctioned with a sanctioned amount of ₹ 143,230 crore. Of the cumulative RIDF loans sanctioned to state governments, 42 per cent have gone to the agriculture and allied sector, including irrigation and power; 15 per cent to health, education, and rural drinking water supply; while the share of rural roads and bridges has been 31 per cent and 12 per cent, respectively. The annual allocation of funds under the RIDF has gradually increased from ₹ 2,000 crore in 1995-6 (RIDF I) to ₹ 20,000 crore in 2012-13 (RIDF XVIII).

Table 5.5 : Sanctions and Disbursements under the RIDF and Bharat Nirman (Rural Roads Components)

(₹ crore)

Region	2012-13 (up to November 2012)			Cumulative up to November 2012		
	Target	Achievement	Achievement (%)	Sanction	Disbursement*	Disbursement as % of sanction
South	3775	1420	37.6	37899	26529	70.0
West	2170	1134	52.3	22149	15693	70.9
North	4850	1810	37.3	44668	30092	67.4
Central	1480	356	24.1	13080	8078	61.8
East	3800	863	22.7	26600	15625	58.7
NER & Sikkim	725	145	20.0	6758	4034	59.7
Sub total	**16800**	**5728**	34.1	**151154**	**100051**	66.2
Warehousing	-	101	-	2512	1208	48.1
Bharat Nirman	-	-	-	18500	18500	100.0
Grand total	**16800**	**5829**	34.7	**172166**	**119759**	70.0

Source : NABARD.
Note: NER is north-eastern region.

5.13 As against the total allocation of ₹ 1,72,500 crore, encompassing RIDF I to XVIII, sanctions aggregating ₹ 1,51,154 crore have been accorded to various state governments and an amount of ₹ 1,00,051 crore disbursed up to the end of November 2012. Nearly 55 per cent of allocation has been made to southern and northern regions. The National Rural Roads Development Agency (NRRDA) has disbursed the entire amount of ₹ 18,500 crore sanctioned for it (under RIDF XII-XV) by March 2010. During 2012-13 (up to end November 2012), ₹ 5,829 crore was disbursed to the states under the RIDF (Table 5.5).

Financial Inclusion

Micro-Finance: Self Help Group-Bank Linkage Programme

5.14 Though there are different models for pursuing micro-finance, the Self-Help Group (SHG)-Bank Linkage Programme has emerged as the major micro-finance programme in the country. It is being implemented by commercial banks, regional rural banks (RRBs), and cooperative banks. Under the SHG-Bank Linkage Programme, as on 31 March 2012, 79.60 lakh SHG-held savings bank accounts with total savings of ₹ 6,551 crore were in operation. By November 2012 another 2.14 lakh SHGs had come under the ambit of the programme, taking the cumulative number of savings-linked groups to 81.74. As on 31 March 2012, 43.54 lakh SHGs had outstanding bank loans of ₹ 36,340 crore (Table 5.6). During 2012-13 (up to November 2012), 3.67 lakh SHGs were financed with an amount ₹ 6,664.15 crore.

Extension of Swabhimaan scheme

5.15 Under the Swabhimaan financial inclusion campaign, over 74,000 habitations with population in excess of 2,000 had been provided banking facilities by March 2012, using various models and technologies including branchless banking through business correspondents (BCs). The Finance Minister in his Budget Speech of 2012-13 had announced that Swabhimaan would be extended to habitations with population more than 1,000 in the north-eastern and hilly states and population more than 1,600 in the plains areas as per Census 2001. Accordingly, about 45,000 such habitations had been identified for coverage under the extended Swabhimaan campaign. As per the progress received through the convenors of State Level Bankers' Committee (SLBC), out of the identified habitations, 10,450 have been provided banking facilities by end of December, 2012. This will extend the reach of banks to all habitations above a threshold population.

Setting up of Ultra Small Branches

5.16 Considering the need for close supervision and mentoring of the business correspondent agents (BCAs) by the respective banks and in order to ensure that a range of banking services are available to the residents of such villages, ultra small branches

Table 5.6 : Progress of Micro-finance Programme

Year	SHGs Financed by Banks during the year*			Bank Loan Outstanding		
	No. (lakh)	Amount (₹ crore)	Growth (%)	No. (lakh)	Amount (₹ crore)	Growth (%)
2007-08	12.28	8849.26	-	36.26	16999.90	-
2008-09	16.09	12256.51	38.50	42.24	22679.85	33.41
2009-10	15.87	14453.30	17.90	48.52	28038.28	23.62
2010-11	11.96	14547.73	0.65	47.87	31221.17	11.35
2011-12	11.48	16534.77	13.66	43.54	36340.00	16.40

Source: NABARD.
Note: *Includes new as well as repeat loans to SHGs.

(USBs) are being set up in all villages covered through BCAs under financial inclusion. These USBs will comprise a small area of 100-200 sq. feet where the officer designated by the bank will be available with a laptop on pre-determined days. While cash services will be offered by the BCAs, the bank officer will offer other services, undertake field verification, and follow up banking transactions. The periodicity and duration of visits can be progressively enhanced depending upon business potential in the area. A total of over 40,000 USBs have so far been set up in the country.

Roll out of Direct Benefit Transfer

5.17 The Government of India has decided to introduce a Direct Benefit Transfer (DBT) scheme with effect from 1 January 2013. To begin with, benefits under 26 schemes will directly be transferred into the bank accounts of beneficiaries in 43 identified districts across respective states and union territories (UT). Banks will ensure that all beneficiaries in these districts have a bank account. All PSBs and RRBs have made provision so that the the data collected by the Departments/Ministries/Implementing agency concerned can be used for seeding the bank account details in the core banking system (CBS) of banks with Aadhaar. All PSBs have also joined the Aadhaar Payment Bridge of the National Payment Corporation of India for smooth transfer of benefits.

Agricultural Credit

5.18 As against the target of ₹ 4, 75,000 crore fixed for 2011-12, ₹ 5, 11,029.09 crore was disbursed to the agricultural sector, thereby exceeding the target by 8 per cent. While commercial banks and RRBs together extended credit to 99.65 lakh new farmers during 2011-12, cooperative banks extended

Table 5.7 : Agency-wise Credit Disbursed to the Agriculture Sector between 2006-07 and 2012-13

(₹ crore)

Sl No.	Agency	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12^	2012-13 *
1	Cooperative banks $	42480	48258	46192	63497	78121	87963	64664
	Share (%)	18.52	18.95	15.30	16.51	16.68	17.21	26.99
2	RRBs	20435	25312	26765	35218	44293	54450	32127
	Share (%)	8.91	9.94	8.87	9.16	9.46	10.65	13.41
3	Commercial banks	166485	181088	228951	285799	345877	368616	142838
	Share (%)	72.57	71.11	75.83	74.33	73.86	72.13	59.61
	Total (1+2+3)	**229400**	**254658**	**301908**	**384514**	**468291**	**511029**	**239629**

Source: Commercial Bank data – Indian Banks Association (IBA)/RBI, Cooperative Banks and RRBs data –NABARD.
Notes: $ Including others, ^ Provisional, * Up to September 2012.

Table 5.8 : Agency-wise KCCs Issued and Amount Sanctioned

(As on 31 August 2012)

Agency	Cards Issued (lakh)				Amount Sanctioned (₹ crore)			
	2009-10	2010-11	2011-12	2012-13*	2009-10	2010-11	2011-12	2012-13**
Cooperative banks	17.43	28.12	29.59	9.75	7606	10719	10642	4111
RRBs	19.50	17.74	19.96	6.2	10132	11468	11516	4127
Commercial banks	53.13	55.83	68.03	NA	39940	50438	69518	NA
Total	**90.06**	**101.69**	**117.58**	**15.95**	**57678**	**72625**	**91676**	**8238**

Source: NABARD and RBI.

Notes: NA-Not Available

* Up to 31 August 2012

** Amount outstanding against cards issued during the year 2012-13 up to 31 August 2012

credit to 21.52 lakh new farmers during the same period, thus taking the total number of new farmers brought under the banking system to 121.17 lakh. The total number of agricultural loan accounts financed as on March 2012 was 6.47 crore. The credit flow to agriculture during 2012-13 by commercial banks, cooperative banks, and RRBs together was ₹ 2,39,629 crore till September 2012, accounting for 42 per cent of the annual target of ₹ 5,75,000 crore set for 2012-13 (Table 5.7).

Kisan Credit Card Scheme

5.19 The Kisan Credit Card (KCC) has been an important initiative for universal access of farmers to institutional credit . The number of operative KCCs issued by cooperative banks and RRBs in the country as on 31 August 2012 was 406 lakh against which the outstanding loan amount was ₹ 1,12,333.90 crore. During 2012-13 (April 2012 to August 2012), 16 lakh (approximately) KCCs were issued by cooperative banks and RRBs against which the outstanding loan amount was ₹ 8,238 crore. As reported by the RBI, Commercial banks, had issued a total of 547.49 lakh cards (cumulative since inception) as on 31 March 2012, with a sanctioned amount of ₹ 3,53,144.82 crore (Table 5.8).

Box 5.1 : Interest Subvention Scheme 2012-13

The Interest Subvention Scheme 2012-13 for short-term crop loans up to ₹ 3 lakh is being made available during 2012-13 with the following stipulations:

(i) Interest subvention of 2 per cent per annum to PSBs, cooperative banks, and RRBs on their own funds used for short-term crop loans up to ₹ 3,00,000 per farmer provided the lending institutions make available short-term credit at the ground level at 7 per cent per annum. Interest subvention is calculated on the crop loan amount from the date of its disbursement/drawal up to the date of actual repayment, subject to a maximum period of one year.

(ii) An additional interest subvention of 3 per cent is available to the prompt-paying farmers from the date of disbursement of the crop loan up to the actual date of repayment or up to the due date fixed by bank for repayment of crop loan, whichever is earlier, subject to a maximum period of one year from the date of disbursement.

(iii) Further, in order to discourage distress sales, post-harvest benefit of interest subvention was made available in the year 2011-12 to small and marginal farmers holding KCCs for a further period of up to six months on the same rates as available to crop loans against negotiable warehouse receipts for keeping their produce in warehouses. This has been continued in 2012-13 as well.

(iv) In order to provide relief to farmers, it was also decided that in cases where crop loans were restructured due to drought during 2012-13, the interest subvention of 2 per cent per annum which is already available for short-term crop loans to PSBs, RRBs, and rural cooperative credit institutions will continue to be available for the current financial year on the full restructured loan amount. However, the restructured loans will attract normal rate of interest from the next financial year onwards.

Interest Subvention Scheme

5.20 The Interest Subvention Scheme is being implemented by the Government of India since 2006-7 to make short-term crop loans up to ₹ 3 lakh for a period of one year available to farmers at the interest rate of 7 per cent per annum. The Government of India has since 2009-10 been providing additional interest subvention to farmers who repay their loans in time. The additional subvention which was 1per cent in 2009-10 was gradually increased to 2 per cent in 2010-11 and 3 per cent in 2011-12 and 2012-13 (see Box 5.1).

Financial Performance of Banks

5.21 Performance of Indian banks during the year 2011-12 was conditioned to a large extent by fragile recovery of the global financial markets as well as a challenging operational environment on the domestic front, with persistent high inflation and muted growth performance. In addition, stressed financial conditions of some State Electricity Boards and airline companies added to the deterioration in asset quality of banks. The consolidated balance sheet of SCBs grew at a slower pace during 2011-12 as compared to the previous year due to slower growth of credit as well as deposits. In addition, net profit of banks slowed down. Though Indian banks remained well-capitalized, concerns regarding growing non-performing assets (NPAs) persisted.

5.22 The operating performance of the SCBs as shown in Table 5.9 can be summed up as follows:

- PSBs had a dominant share and accounted for 72 per cent of the total income of the SCBs and 72.8 per cent of aggregate assets.
- In 2011-12, there was a sharp increase in the expenditure on provisioning and contingencies; the rate of growth, however, varied across the bank categories. While contingency and provisioning expenses recorded a growth of 16.1 per cent for all commercial banks, the rate of growth was 21.3 per cent for PSBs and only 3 per cent for the new private-sector banks. As percentage of PSB assets, the provisioning expenditure increased from 1.04 per cent in 2010-11 to 1.11 per cent in 2011-12.
- PSBs were able to increase their interest spread from 2.55 per cent in 2010-11 to 2.59 per cent in 2011-12. The interest spread declined for old private-sector banks and foreign banks. An increase in interest spread for all SCBs during 2011-12 with a relatively moderate growth in credit disbursement is significant.
- Net profit as percentage of assets remained sticky at 0.98 per cent in 2010-11 and 2011-12. However, in case of the PSBs, this declined from 0.85 per cent in 2010-11 to 0.82 per cent in 2011-12. Foreign banks and old and new private-sector banks, however, were able to increase the ratio of net profit to assets.

Capital Adequacy Ratio

5.23 Following the uncertainties prevailing in the domestic market and relatively subdued performance of the equity market during the first half of 2011-12, banks abstained from raising resources through public issues during 2011-12. During 2011-12, banks' resource mobilization through private placements also slowed down as compared to the previous year. However, this reduction was seen in the case of PSBs, while private-sector banks continued to raise resources through private placements.

5.24 The capital to risk-weighted assets ratio (CRAR) remained well above the RBI's stipulated 9 per cent for the system as a whole as well as for all bank groups during 2011-12, indicating that Indian banks remained well-capitalized. Also, the CRAR at system level improved marginally compared to the previous year. The CRAR (under Basel II) at system-wide level stood at 14.24 per cent as at end-March 2012, as compared to 14.19 per cent as at end-March 2011.

5.25 As capital is a key measure of banks' capacity for generating loan assets and is essential for balance sheet expansion, the Government of India has regularly invested additional capital in the PSBs to support their growth and keep them financially sound so as to ensure that the growing credit needs of the economy are adequately met. A sum of ₹ 12,000 crore was infused in seven PSBs during 2011-12 to enable them to maintain a minimum Tier-I CRAR of 8 per cent and also to increase shareholding of the Government of India in these PSBs.

5.26 In 2012-13 also, the Government has infused capital in PSBs to augment their Tier-I capital so that they maintain their Tier-I CRAR at a comfortable level and remain compliant with the stricter capital adequacy norms under BASEL-III. This will also support internationally active PSBs in their national and international banking operations undertaken through their subsidiaries and associates. For this

Table 5.9 : Operating Parameters of Commercial Banks

(₹ crore)

Items	Income	Interest Income	Expen-diture	Interest Expended	Provisions and contin-gencies	Net Profit	Total Assets
				2010-11			
PSBs	414099	366135	369199	231153	55080	44901	5294006
Foreign banks	39505	28493	31786	10623	8595	7719	491175
Old private-sector banks	26328	23299	23226	14768	2858	3101	309011
New private-sector banks	91259	73414	76649	42381	12261	14610	1089206
All SCBs	571191	491341	500860	298925	78795	70331	7183398
				2011-12			
PSBs	535098	484740	485584	328539	66831	49514	6037982
Foreign banks	47223	36340	37797	15195	9056	9426	583600
Old private-sector banks	35975	32592	32051	22506	3005	3924	375015
New private-sector banks	122503	101387	103709	64279	12626	18794	1302786
All SCBs	740799	655059	659141	430519	91517	81658	8299383
				As percentage to Assets			
				2010-11			
PSBs	7.82	6.92	6.97	4.37	1.04	0.85	2.55
Foreign banks	8.04	5.80	6.47	2.16	1.75	1.57	3.64
Old private-sector banks	8.52	7.54	7.52	4.78	0.92	1.00	2.76
New private-sector banks	8.38	6.74	7.04	3.89	1.13	1.34	2.85
All SCBs	7.95	6.84	6.97	4.16	1.10	0.98	2.68
				2011-12			
PSBs	8.86	8.03	8.04	5.44	1.11	0.82	2.59
Foreign banks	8.09	6.23	6.48	2.60	1.55	1.62	3.62
Old private-sector banks	9.59	8.69	8.55	6.00	0.80	1.05	2.69
New private-sector banks	9.40	7.78	7.96	4.93	0.97	1.44	2.85
All SCBs	**8.93**	**7.89**	**7.94**	**5.19**	**1.10**	**0.98**	**2.71**

purpose an amount of ₹ 12, 517 crore has been allocated in the Revised Estimates (RE) 2012-13 under Plan.

5.27 The High Level Committee to assess the capitalization of PSBs in the next 10 years, headed by the Finance Secretary has inter alia recommended various options for funding of PSBs. Given the budgetary constraints, it may not be feasible for the government to infuse huge sums into the PSBs. The High level Committee has, therefore, recommended the formation of a non-operating financial holding company (HoldCo) under a special act of Parliament with the following key objectives:

- to act as an investment company for the Government of India;
- to hold a major portion of the Government of India's holdings in all PSBs;
- to raise long-term debt from domestic and international markets to infuse equity into PSBs; and
- to service the debt from within its sources.

Recapitalisation of RRBs to improve their CRAR

5.28 RRBs have played a pivotal role in credit delivery in rural areas, particularly to the agriculture sector. To enhance their outreach and provide banking services more effectively to rural masses, RRBs need to undertake a continuous process of technology and capital upgradation. With a view to bringing the CRAR of RRBs up to at least 9 per cent, Dr K.C. Chakrabarty Committee inter alia recommended recapitalization support to the extent of ₹ 2,200 crore to 40 RRBs in 21 States. Pursuant to the recommendation of the Committee, recapitalization amount is to be shared by the stakeholders in proportion to their shareholding in RRBs, i.e. 50 per cent central government, 15 per cent concerned state government, and 35 per cent the concerned sponsor banks. The central government share works out to ₹ 1,100 crore. The, recapitalisation process, which started in 2010-11, was to be completed by 2011-12. Although the central government released an amount of ₹ 468.9 crore during 2010 and 2011-12 to 21 RRBs, the process of recapitalisation could not be completed in 2011-12 as all the state governments did not release their share towards recapitalisation. The recapitalisation scheme has therefore been extended up to March 2014. A provision of ₹ 200 crore was made for the purpose in the Budget for 2012-13 and the entire provision has been released. Thus, till 31 December 2012, a total sum of ₹ 668.9 crore had been released by the government to 27 RRBs.

Amalgamation of RRBs

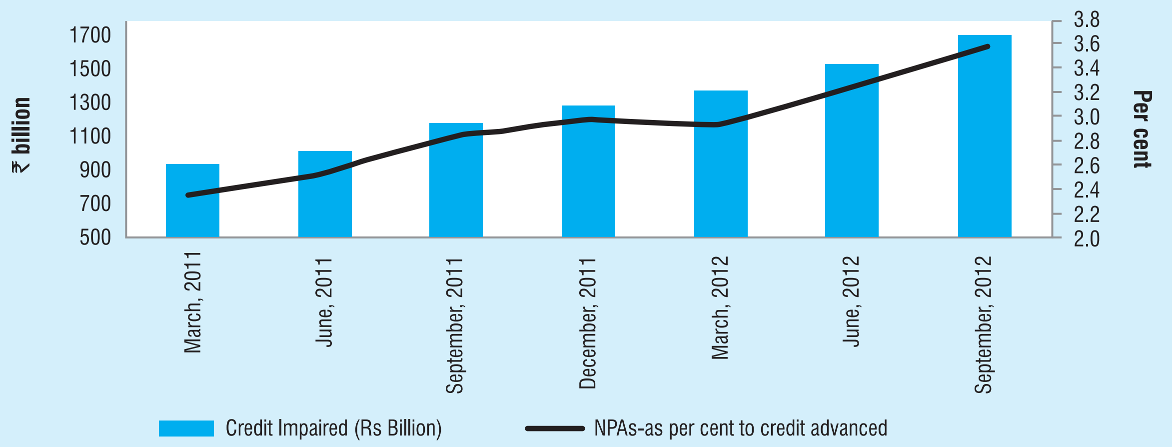
5.29 With a view to minimising overhead expenses and optimizing the use of technology in RRBs, the government, in consultation with NABARD, the concerned state government, and sponsor banks, has initiated amalgamation of geographically contiguous RRBs in a state. This will enhance the capital base and area of operation of the amalgamated RRBs and increase their exposure. Thus the amalgamated entities will have sustainable financial health and will be able to serve their area better with absorption of technology and improved management. Till 1 January 2013, 22 RRBs had already been amalgamated into 9 RRBs.

Improving recovery in PSBs

5.30 Because of the slowdown and high levels of leverage, some industry and infrastructure sectors are experiencing a rise in NPAs. Overall NPAs of the banking sector increased from 2.36 per cent of total credit advanced in March 2011 to 3.57 per cent of total credit advanced in September 2012 (Figure 5.2). While there has been an across-the-board increase in NPAs, the increase has been particularly sharp for the industry and infrastructure sectors, with NPAs as a percentage of credit advanced increasing from 1.91 per cent in March 2011 to 3.44 per cent as in September 2012. Sectors particularly under stress include textiles, chemicals, iron and steel, food processing, construction, and telecommunications.

5.31 As per RBI data, gross NPAs (GNPA) of PSBs have shown a rising trend during the last three years from ₹ 59,972 crore (March, 2010) to ₹ 71,080 crore (March, 2011), ₹ 1,12,489 crore (March, 2012), and ₹ 1,44,437 crore (September, 2012). As a percentage of credit advanced, NPAs were at a level of 4.01 per cent in September 2012 compared to 2.09 per cent in 2008-9. Although GNPAs have

Figure 5.2: Non-Performing Assets of the Banking Sector



increased at system level, the GNPA ratios of PSBs are still at manageable levels. However, given their rapid growth, albeit partly for technical reasons, they need to be closely monitored.

5.32 The main reasons for increase in NPAs of banks are (a) switchover to system-based identification of NPAs by PSBs; (b) current macroeconomic situation in the country; (c) increased interest rates in the recent past; (d) lower economic growth; and (e) aggressive lending by banks in the past, especially during good times. Some recent initiatives taken by the government to address the rising NPAs include (a) appointment of nodal officers in banks for recovery at their head offices/ zonal offices/ for each Debts Recovery Tribunal (DRT); (b) thrust on recovery of loss assets by banks; (c) close watch on NPAs by picking up early warning signals and ensuring timely corrective steps by banks; (d) directing the state-level Bankers' Committee to be proactive in resolving issues with the state governments; and (e) designating asset reconstruction companies (ARCs) resolution agents of banks. Pursuant to the second review of the Monetary Policy, the RBI has also announced the following remedial measures:

- the provision for restructured standard accounts is to be raised from the existing 2 per cent to 2.75 per cent;
- the sanction of fresh loans/ad-hoc loans from 1st Jan 2013 will be made on the basis of sharing of information among banks;
- banks will conduct sector- /activity-wise analysis of NPAs; banks will put in place a robust mechanism for early detection of sign of distress, amendments in recovery laws, and strengthening of credit appraisal and post credit monitoring.

5.33 Steps taken by the government and the RBI have resulted in improvement in recovery of NPAs by the PSBs which has increased from ₹ 9,726 crore as on March 2010 to ₹ 13,940 crore as on March 2011 and ₹ 17,043 crore as in March 2012.

Non-Banking Financial Institutions (NBFIs)

Financial Institutions (FIs)

5.34 As at end-March 2012, there were four institutions, viz. EXIM Bank, NABARD, National Housing Bank (NHB), and the Small Industries Development Bank of India (SIDBI) regulated by the RBI as all-India financial institutions (FIs). The outstanding resources mobilized at any point of time by an FI, including funds mobilized under the 'umbrella limit' comprising term deposits, term money borrowings, certificates of deposit (CD), commercial paper (CP), and inter-corporate loans, as prescribed by the Reserve Bank, should not exceed 10 times its net-owned funds (NOF) as per its latest audited balance sheet. However, in view of the difficulties expressed by the NHB and EXIM Bank, their aggregate borrowing limit has been reviewed. Accordingly, EXIM Bank's aggregate borrowing limit has been enhanced to 12 times its NOF for a period up to 31 August 2013 and for the NHB to 11 times of NOF for a period up to 30 September 2012. The 'umbrella limit' for aggregate borrowings through these specified instruments should not at any time exceed 100 per cent of NOF of the FI concerned as per its latest audited balance sheet. However, in view of the difficulties expressed by the NHB, SIDBI, EXIM Bank and NABARD, their borrowing under 'umbrella limit' was enhanced from 100 per cent of NOF to 150 per cent of NOF for a period of one year (for NHB, SIDBI, and EXIM Bank up to 30 June 2012 and for NABARD up to 31 December 2012), subject to review.

5.35 Resources raised by FIs during 2011-12 were considerably higher than those raised during the previous year. While the long-term resources and short-term resources raised witnessed a sharp rise during 2011-12 as compared to a year earlier, foreign currency resources raised declined during the same period of time. The NHB mobilised the largest amount of resources, followed by NABARD and SIDBI (Table 5.10).

5.36 Total sources/deployment of funds of FIs increased 42.8 per cent to ₹ 4, 25,182 crore during 2011-12. A major part of the funds was raised internally, followed by external sources. A large part of the funds raised was used for fresh deployments, followed by repayment of past borrowings. Other deployments including interest payments formed a comparatively small part of the funds of FIs (Table 5.11).

5.37 The NBFCs as a whole account for 12.7 per cent of the assets of the total financial system. With the growing importance assigned to financial inclusion, NBFCs are being regarded as important financial intermediaries particularly for the small-scale and retail sectors. There are two broad

Table 5.10 : Resources Mobilized by Financial Institutions

(Amount in ₹ crore)

		EXIM Bank	NABARD	NHB	SIDBI	Total
Long Term	2010-11	11,132	9,741	7,538	11744	**40155**
	2011-12	10,100	17,914	9814	14648	**52476**
Short Term	2010-11	1,538	18,532	3380	5958	**294708**
	2011-12	4205	9,035	5215	4250	**22705**
Foreign Currency	2010-11	11,456	-	-	1700	**13156**
	2011-12	9,122	-	93	1980	**11195**
Total	2010-11	24,126	28,273	10918	19402	**82719**
	2011-12	23427	26,949	15122	20878	**86376**
Total Outstanding	2011	47,192	33,891	22765	46331	**150179**
(end March)	2012	54,655	42,299	26980	53785	**177719**

Source: Respective FIs.

Notes: - Nil/Negligible;

Long-term rupee resources comprise borrowings by way of bonds/debentures; and short-term resources comprise CP, term deposits, Inter Corporate Deposits, CDs and borrowing from term money. Foreign currency resources largely comprise bonds and borrowings in the international market.

categories of NBFCs based on whether they accept public deposits, viz. deposit-taking NBFCs (NBFCs-D) and non-deposit-taking NBFCs (NBFCs-ND). The total number of NBFCs registered with the RBI witnessed a continuous decline mainly due to cancellation of certificates of registration and their exit from deposit-taking activities. The number of non-deposit-taking systemically important NBFCs (NBFCs-ND-SI) with asset size ₹ 100 crore and above), however, increased (Table 5.12). The ratio of deposits of reporting NBFCs [including residuary non-banking companies (RNBCs)] to the aggregate deposits of SCBs dropped to 0.15 per cent as on 31 March 2012 from 0.21 per cent in the previous year mainly due to the decline in deposits of RNBCs.

Table 5.11 : Pattern of Sources and Deployment of Funds of Financial Institutions

(₹ crore)

Item	2011		2012		Increase in per cent
	Value	Per cent Share	Value	Per cent Share	
A -Sources of funds	297784	100.0	425182	100.0	42.78
Internal	163197	**54.8**	262263	**61.7**	60.7
External	119072	**40.0**	149529	**35.2**	25.57
Others@	15515	**5.2**	13390	**3.2**	-13.69
B- Deployment of funds	297784	100.0	425182	100.0	42.78
Fresh deployment	174674	**58.7**	273914	**64.4**	56.81
Repayment of past borrowings	83971	**28.2**	129044	**30.4**	53.67
Other deployment	39139	**13.1**	22222	**5.2**	-43.22
Of which: interest payments	14227	**4.8**	14504	**3.4**	1.94

Source: RBI-Respective FIs (EXIM Bank, NABARD, NHB and SIDBI).
@ Includes cash and balances with the RBI and others banks.
Percentage variation could be slightly different due to rounding off.

Table 5.12 : Number of NBFCs Registered with the RBI

End June	Number of Registered NBFCs	Number of NBFCs-D	Number of NBFCs-ND-SI
2006	13014	428	149
2007	12968	401	173
2008	12809	364	189
2009	12740	336	234
2010	12630	308	260
2011	12409	297	330
2012	12385	271	370

Source: RBI.

NBFCs-D

5.38 The total assets of NBFCs-D (including RNBCs) increased to ₹ 1,24,419 crore as on 31 March 2012 from ₹ 1,16,897 crore in the preceding year. Public deposits held by NBFCs-D and RNBCs together declined by 15.5 per cent to ₹ 10,106 crore as on 31 March 2012 from ₹ 11,964 crore in the previous year. NOFs witnessed 25.4 per cent growth for the year ended March 2012 and stood at ₹ 22,544 crore. The consolidated balance sheet of NBFCs-D (excluding RNBCs) recorded 10.8 per cent growth for the year ended March 2012 (as against 11.9 per cent growth in the previous year). Borrowings, which is the major source of funds for NBFCs-D, increased by 15.9 per cent during the year. On the assets side, loans and advances witnessed a growth of 12.1 per cent while investments declined by 24.8 per cent for the year ended March 2012.

5.39 During 2011-12, there was significant increase in the GNPAs to total advances of NBFCs-D. Category-wise, GNPA and net NPA ratios of asset finance companies and loan companies deteriorated during 2011-12 as compared to the previous year. CRAR norms were made applicable to NBFCs-D in 1998, whereby every NBFC-D is required to maintain a minimum capital, consisting of Tier-I and Tier-II capital, of not less than 15 per cent (12 per cent up to 31 March 2011) of its aggregate risk-weighted assets. As on 31 March 2012, 187 out of 198 reporting NBFCs-D had CRAR of more than 15 per cent as against 199 out of 204 NBFCs-D in the previous year.

NBFCs-ND-SI

5.40 The balance sheet size of the NBFCs-ND-SI sector increased by 21 per cent to ₹ 9,21,321 crore as on 31 March 2012 (against ₹ 7,61,282 crore in the previous year). Significant increase in balance sheet size of the NBFCs-ND-SI sector is mainly attributed to sharp increase in owned funds, debentures, bank borrowings. Owned funds (which accounted for 26.1per cent of total liabilities) increased by 21.5 per cent during 2011-12. Total borrowings (secured and unsecured) of the sector increased sharply by 29.3 per cent to ₹ 6,39,830 crore and formed 69.4 per cent of total liabilities as on 31 March 2012. During the period ended June 2012, total borrowings further increased by 4.0 per cent to ₹ 6,65,728 crore. The pattern of deployment of funds by the NBFCs-ND-SI sector for the year ending March 2012 remained broadly in line with the pattern witnessed in the previous year. Secured loans continued to constitute the largest share (48.7 per cent of total assets), followed by unsecured loans with a share of 15.3 per cent, hire purchase assets (6.8 per cent), investments (17.3 per cent), cash and bank balances (3.9 per cent), and other assets (7.9 per cent) during the year ended March 2012.

5.41 The financial performance of the NBFCs-ND-SI sector deteriorated marginally as reflected in the decline in net profit during 2011-12. Return on assets (net profit as a percentage of total assets) of the sector stood at 1.5 per cent as on 31 March 2012 (2.1 per cent in the previous year). Both gross and net NPA ratios of the NBFCs-ND-SI sector increased for the year ended March 2012 indicating overall deterioration in asset quality of the sector. The GNPA ratio of the sector stood at 1.48 per cent for the year ended March 2012 (1.28 per cent in the previous year), while net NPAs remained at 0.88 per cent (0.51 per cent in the previous year) during the same period.

5.42 CRAR norms were made applicable to NBFCs-ND-SI w.e.f. April 2007. In terms of the extant instructions, every NBFC-ND-SI is required to maintain a minimum capital, consisting of Tier-I and Tier-II capital, of not less than 15 per cent of its aggregate risk-weighted assets. As on March 2012, barring a few, most of reporting companies maintained the stipulated minimum norm of 15 per cent CRAR.

Major Policy Developments

5.43 The regulatory and supervisory framework of NBFCs continued to focus on prudential regulations with specific attention to the NBFCs-ND-SI. Some of the important developments have been the following:

(i) **NBFC-Micro Finance Institutions (NBFC-MFIs): Provisioning Norms—Extension of Time and Modifications:** Taking into account the difficulties faced by the MFI sector and the representation received by banks from them, it was decided to defer the implementation of asset classification and provisioning norms for NBFC-MFIs to 1 April 2013.

(ii) **Lending against Security of Single Product--Gold Jewellery:** Since NBFCs that are predominantly engaged in lending against the collateral of gold jewellery have inherent concentration risk and are exposed to adverse movement of gold prices, as a prudential measure it was decided that all such NBFCs shall:

- hereafter maintain a loan-to-value (LTV) ratio not exceeding 60 per cent for loans granted against the collateral of gold jewellery and
- disclose in their balance sheet the percentage of such loans to their total assets;
- maintain a minimum Tier I capital of 12 per cent by 1 April 2014;
- not grant any advance against bullion / primary gold and gold coins.

(iii) **Core Investment Companies (Reserve Bank) Directions 2011 Clarification on CICs Issuing Guarantees:** Systemically important core investment companies (CIC) with total assets not less than ₹ 100 crore, either individually or in aggregate along with other CICs in the group, and that raise or hold public funds, shall apply to the RBI for grant of certificate of registration (CoR).

(iv) **Infrastructure Debt Funds (IDFs):** The RBI on 21 November 2012 issued detailed guidelines with regard to the regulation of IDF-NBFCs. In terms of the guidelines, for the purpose of computing capital adequacy, IDF-NBFCs are permitted to assign a risk weight of 50 per cent on bonds covering Public Private Partnership(PPP) and post commercial operations date (COD) projects in existence over a year of commercial operation. In order to bring uniformity in regulations in this regard, this reduction in risk weight is extended to all infrastructure finance companies (IFCs) for assets covering PPP and post COD projects that have completed at least one year of satisfactory commercial operations.

(v) **The Non-Banking Financial Company-Factors (Reserve Bank) Directions 2012:** Factoring business refers to the acquisition of receivables by way of assignment of such receivables or financing, there against either by way of loans or advances or by creation of security interest over such receivables but does not include normal lending by a bank against the security of receivables etc. A new category of NBFCs, viz. non-banking financial company-factors, has been introduced and separate directions have been issued in this regard by the RBI. These directions include a mention that every company intending to undertake factoring business shall make an application for grant of CoR as NBFC-factor to the RBI. Existing NBFCs that satisfy all the conditions enumerated in these directions can also apply for change in their classification. An NBFC-factor, will need to commence business within six months from the date of grant of CoR. NOF for every company seeking registration as NBFC-factor has been fixed at a minimum of ₹ 5 crore.

(vi) **Revisions to the Guidelines on Securitization Transactions:** Securitisation is a process by which assets are sold to a bankruptcy remote special purpose vehicle (SPV) in return for an immediate cash payment. The cash flow from the underlying pool of assets is used to service the securities issued by the SPV. While there is sale of single asset or pool of assets to a 'bankruptcy remote' SPV in return for an immediate cash at the first stage of Securitisation, the second stage involves repackaging and selling the security interests representing claims on incoming cash flows from the asset or pool of assets to third party investors by issuance of tradable debt securities. In order to prevent unhealthy practices surrounding securitization, viz. origination of loans for the sole purpose of securitization and in order to align the interest of the originator with that of the investors and with a view to redistributing credit risk to a wide spectrum of investors, it was felt necessary that originators should retain a portion of each securitization originated and ensure more effective screening of loans. In addition, a minimum period of retention of loans prior to securitization was also considered desirable, to make the investors more comfortable regarding due diligence exercised by the originator.

Capital Market

Primary Market

5.44 During financial year 2012-13 (up to 31 December, 2012) resource mobilization through primary market (equity issue) witnessed an upward movement (Table 5.13). The cumulative amount mobilised as on 31 December 2012 through equity public issues stood at ₹ 13,050 crore. During 2012-13, 20 new companies [initial public offers (IPOs)] with resource mobilisation amounting to ₹ 6,043 crore were listed at the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) with mean IPO size of ₹ 302 crore. However, in the public issue of corporate debt category, ₹ 4,974 crore was mobilised through debt issue in 2012-13 compared to ₹ 35,611 crore in 2011-12.

Mutual Funds

5.45 After two years of redemption pressures, mutual funds (MF) mobilized ₹ 1,20,269 crore from the market in 2012-13 (Table 5.14). The market value of their assets under management stood at ₹ 7,59,995 crore as on 31 December 2012 compared to ₹ 5, 87,217 crore as on 31 March 2012, indicating an increase of 29.4 per cent.

Secondary Market

5.46 Indian benchmark indices, i.e. the BSE and NSE closed at 19426.7 and 5905.1 (as on 31 December 2012), gaining 25.70 per cent and 27.70 per cent respectively over the closing value of 15454.9 (Sensex) and 4624.3 (Nifty) on 30 December 2011 (Table 5.15). On 9 February 2013, the Honourable FM inaugurated the trading in equity and equity derivative segment by MCX-SX and the Exchange officially commenced trading in these segments on 11 February 2013.

5.47 Further, during the current financial year (up to 31 December 2012), the rise in the indices stood

Table 5.13 : Resource Mobilization through the Primary Market

(₹ crore)

	Mode	2009-10	2010-11	2011-12	2012-13#
1.	Debt	2500	9451	35611	4974
2.	Equity	46736	48654	12857	13050
	Of which IPOs	24696	35559	5904	6043
	Number of IPOs	39	53	34	20
	Mean IPO size	633	671	174	302
3.	Private placement	212635	218785	261282	263644
4.	Euro issues (ADR/GDR)	NA	NA	NA	NA
	Total (1+2+3+4)	**261871**	**276890**	**309750**	**281667**

Source: Securities and Exchange Board of India (SEBI) and RBI (for Euro issues).
Notes: NA indicates Not Available;
as on 31 December 2012 (Provisional); the Equity issues are considered only equity public issues; ADR is American Depository Receipts and GDR is Global Depository Receipts.

Table 5.14 : Trends in Resource Mobilization (net) by Mutual Funds

(₹ crore)

	Sector	2009-10	2010-11	2011-12	2012-13#
1.	UTI	15653	-16636	-3184	10617
2.	Public	12499	-13555	-3394	8746
3.	Private	54928	-19215	-22024	100906
	Total (1+2+3)	**83080**	**-49406**	**-28602**	**120269**

Source : SEBI. *Note* : # As on December 31, 2012.

at 11.62 per cent for the Sensex and 11.51 per cent in case of Nifty. Among the major Asian and markets, Indian markets have been the best performing in terms of returns. Annual movement of BSE and NSE index is provided in figure 5.3.

5.48 Reinvigorated foreign institutional investor (FII) inflows into the country during the year 2012 helped the Indian markets become one of the best performing in the world in 2012, recovering sharply from their dismal performance in 2011. The calendar year-wise trend in FII flows is provided in Figure 5.4.

5.49 FIIs make investments in markets on the basis of their perceptions of expected returns from such markets. Their perceptions among other things are influenced by the prevailing macroeconomic environment, the growth potential of the economy, and corporate performance in competing countries. At the end of December 2012, 1,759 FIIs were registered with SEBI, with the number of registered sub-accounts increasing to 6,359. The total net FII flows to India in 2012 stood at US $ 31.01 billion. These flows were largely driven by equity inflows

Table 5.15 : Performance of Major Markets in the World (level and percentage change)

Index	Last trading day of 2010 (31 Dec. 2010)	Last trading day of 2011 (30 Dec. 2011)	Last trading day of 2012 (31 Dec. 2012)	% change in 2012 over 2011
BSE SENSEX	20509.09	15454.92	19426.71	25.7
NSE NIFTY	6134.5	4624.3	5905.1	27.7
S&P 500	1257.64	1257.6	1426.19	13.4
DAX	6914.19	5898.35	7612.39	29.1
FTSE 100	5899.94	5572.28	5897.81	5.8
NIKKEI 225	10228.92	8455.35	10395.18	22.9
HANG SENG	23035.45	18434.39	22656.92	22.9
BRAZIL BOVESPA	69304.81	56754.08	60952.08	7.4
KOSPI	2051	1825.74	1997.05	9.4
DJIA	11577.51	12217.56	13104.14	7.3
Straits Times	3190.04	2646.35	3167.08	19.7
SHANGHAI SE COMPOSITE	2808.077	2199.417	2269.128	3.2
CAC 40	3804.78	3159.81	3641.07	15.2

Source : Bloomberg.

Figure 5.3: Annual movements in Sensex and Nifty since 2005

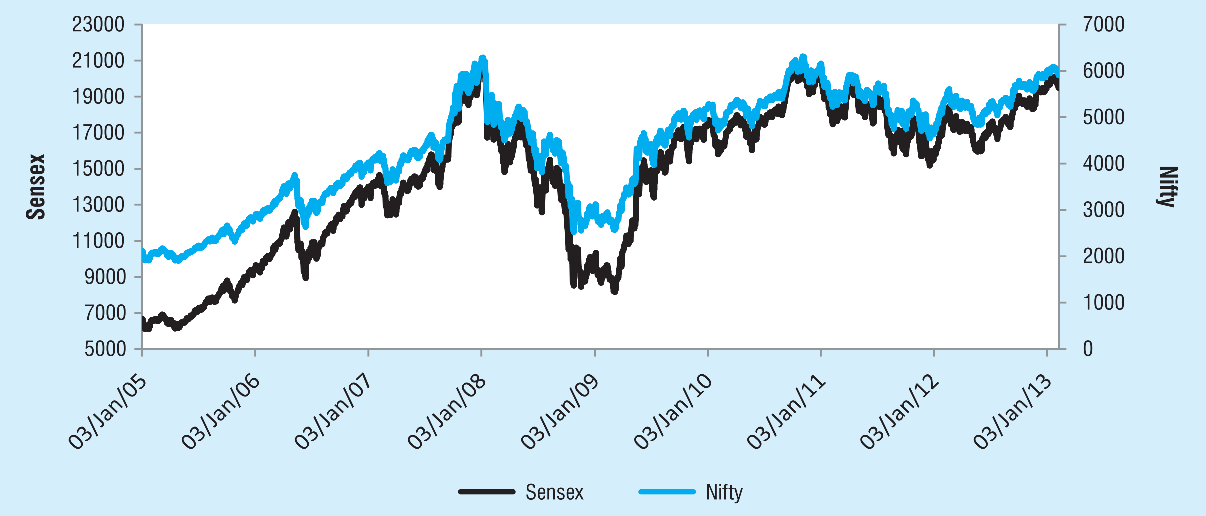
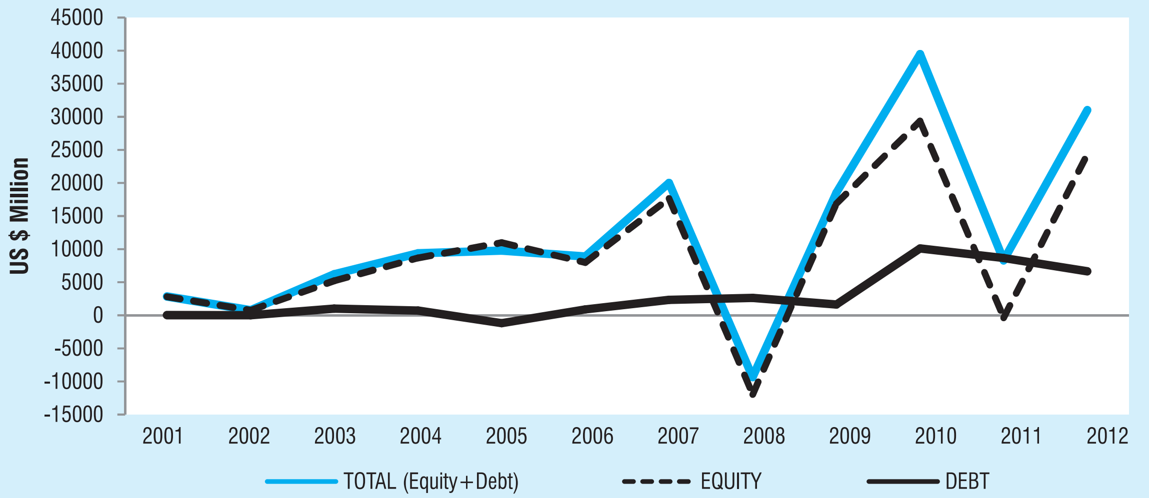


Figure 5.4: Net FII Investment



(80 per cent of total flows) which remained buoyant, indicating FII confidence in the performance of the Indian economy in general and Indian markets in particular. The economic and political developments in the Euro zone area and United States had their impact on markets around the world including India. The resolution of the 'fiscal cliff' in the US had a positive impact on the market worldwide including in India. Further, the reform measures recently initiated by the government have been well received by the markets.

5.50 Market turnover has also increased during the current year. In the cash segment of the equity market, the total turnover of the BSE and NSE stood at ₹ 4,10,230 crore and ₹ 19,73,624 crore during 2012-13 (April-December) as compared to ₹ 6,67,498 crore and ₹ 28,10,893 crore respectively in 2011-12 (Table 5.16).

5.51 In the equity derivatives segment, the NSE witnessed a total turnover of ₹ 2,28,79,486 crore during 2012-13 (April-December) as compared to ₹ 3,13,49,732 crore during 2011-12. The total turnover in the equity derivatives segment of the BSE stood at ₹ 57,41,593 crore in 2011-12 (April-December).

5.52 In the currency derivatives segment, the NSE witnessed a turnover of ₹ 37,25,842 crore in 2012-13 (April-December). The turnover in the currency derivatives segment of the Multi-Commodity Exchange (MCX-SX) stood at ₹ 23,63,819 crore in 2012-13 (April-December) . Further, the United Stock Exchange (USE) witnessed a turnover of ₹ 32,109 crore during the same period (Table 5.17).

Table 5.16 : Market Turnover

(₹ crore)

Market	2009-10	2010-11	2011-12	2012-13#
BSE				
Cash	1378809	1105027	667498	410230
Equity derivatives	234	154	808476	5741593
NSE				
Cash	4138024	3577410	2810893	1973624
Equity derivatives	17663665	29248221	31349732	22879486

***Source*: BSE and NSE.**

***Note*: # as on 31 December 2012.**

Table 5.17 : Trends in Currency Derivatives

Year	NSE		MCX- SX		USE	
	2011-12	2012-13#	2011-12	2012-13#	2011-12	2012-13#
No. of contracts (lakh)	9733	6772	7703	4272	3153	57
Trading value (₹ crore)	4674990	3725842	3732446	2363819	1488978	32109
Average daily trading value (₹ crore)	18775	20140	14990	12777	5980	174

Source: NSE, MCX-SX and USE.
Note: # as on 31 December 2012.

Volatility in the equity and currency derivatives market

5.53 Together with an increase in the turnover in the securities markets, there was also a decline in volatility of both the Nifty and Sensex. Volatility which had increased in 2010-12 (two years), moderated considerably (Table 5.18).

Major Policy Initiatives

5.54 In the overall context of the evolving macroeconomic situation in the country and global financial developments, the government in close collaboration with the RBI and SEBI has recently taken a number of initiatives to meet the growing capital needs of the Indian economy. Some of the initiatives are as follows:

Primary Market

5.55 **SEBI (Alternative Investment Funds) Regulations 2012:** With a view to extending the reach of regulation to unregulated funds, ensuring systemic stability, increasing market efficiency, encouraging new capital formation, and providing investor protection, SEBI has notified new regulations covering alternate investment funds (AIFs) under three broad categories:

Table 5.18 : Volatility of weekly returns on Indian Equity Markets

Index	2009-10	2010-11	2011-12	2012-13#
Nifty	3.8	2.5	2.9	1.8
Nifty Junior	4.5	2.7	2.9	2.0
Sensex	3.6	2.5	2.9	1.8
BSE 500	3.9	2.4	2.8	1.8

Source : BSE and NSE.
Note : # As on 31 December 2012.

- **Category 1 :** AIFs with positive spillover effects on the economy, for which certain incentives or concessions might be considered by SEBI or the Government of India or other regulators in India; and which shall include venture capital funds, small and medium enterprises (SME) funds, social venture funds, and infrastructure funds.
- **Category 2 :** AIFs for which no specific incentives or concessions are given by the government or any other regulator; which shall not undertake leverage other than to meet day-to-day operational requirements as permitted in these regulations
- **Category 3 :** AIFs with funds (including hedge funds) that are considered to have negative externalities.

5.56 The recent initiatives taken to develop the Indian corporate bond markets are summarized in Box 5.2.

5.57 **Financial Literacy:** With the objective of promoting financial education in a synergistic manner, under the aegis of the Financial Stability and Development Council (FSDC) Sub-Committee a draft National Strategy on Financial Education has been formulated and public consultation on the same has been undertaken. The document is in the stage of finalization.

5.58 **Two-way fungibility in Indian Depository Receipts (IDRs):** Pursuant to the budget announcement of 2012-13, the Ministry of Corporate Affairs (MCA) [1 October 2012], the RBI, and SEBI (28 August 2012) have carried out amendments to the existing legal framework to facilitate two-way fungibility in Indian depository receipts.

Box 5.2 : Recent Initiatives for further Development of Corporate Bond Markets

- To permit banks to take limited membership in SEBI-approved stock exchanges for the purpose of undertaking proprietary transactions in the corporate bond markets.
- To enhance liquidity in the corporate bond markets the Insurance Regulatory and Development Authority (IRDA) has permitted insurance companies to participate in the repo market. The IRDA has also permitted insurance companies to become users of credit default swap (CDS).
- In consultation with the Technical Advisory Committee on Money, Foreign Exchange, and Government Securities Markets, it has been decided to reduce the minimum haircut requirement in corporate debt repo from the existing 10 per cent/12per cent/15per cent to 7.5 per cent/8.5per cent/10 per cent for AAA/AA+/AA-rated corporate bonds.
- MFs have been permitted to participate in CDS in corporate debt securities, as users. MFs can participate as users in CDS for eligible securities as reference obligations, constituting from within the portfolio of only fixed maturity plans (FMP) schemes having tenor exceeding one year.
- Revised guidelines on CDS for corporate bonds by the RBI provide that in addition to listed corporate bonds, CDS shall also be permitted on unlisted but rated corporate bonds even for issues other than infrastructure companies.
- Users shall be allowed to unwind their CDS-bought position with the original protection seller at a mutually agreeable or Fixed Income Money Market and Derivatives Association of India(IMMDA) price. If no agreement is reached, then unwinding has to be done with the original protection seller at FIMMDA price.
- CDS shall be permitted on securities with original maturity up to one year like CPs, certificates of deposit, and non-convertible debentures with original maturity less than one year as reference/deliverable obligations.

Secondary Market

Rajiv Gandhi Equity Savings Scheme

5.59 On 23rd November 2012, the government notified a new tax saving scheme called the Rajiv Gandhi Equity Savings Scheme (RGESS), exclusively for first-time retail investors in the securities market. This scheme provides 50 per cent deduction of the amount invested from taxable income for that year to new investors who invest up to ₹ 50,000 and whose annual income is below ₹ 10 lakh. The operational guidelines were issued by SEBI on 6 December 2012 (Box 5.3).

Electronic Voting Facility made mandatory for top listed companies

5.60 As mandated in the Union Budget 2012-13 for top listed companies to offer electronic voting facility to their shareholders, SEBI has come out with the necessary amendments in this regard on 13 July 2012, to be incorporated in the equity listing agreement by stock exchanges. To make a beginning, based on market capitalization, electronic voting is now mandatory for the top 500 listed companies at the BSE and NSE, in respect of those businesses to be transacted through postal ballot.

SME Exchange / Platform

5.61 Separate trading platforms for SMEs were launched and became functional at the BSE and NSE in March 2012 and September 2012 respectively. As on 14 January 2013, the number of equities listed on the BSE and NSE SME platforms is 12 and 2 respectively.

Reduced Securities Transaction Tax for cash delivery transactions

5.62 Following the announcement in Union Budget 2012-13, the rate of the securities transaction tax (STT) has been revised downwards by 20 per cent to 0.1 per cent from 0.125 per cent for delivery-based transactions in the cash market, effective 1 July 2012.

Regulatory framework for governance and ownership of stock exchanges, clearing corporations, and depositories

5.63 Based on the recommendations of the Dr. Bimal Jalan Committee, new Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations 2012 were notified on 20 June 2012 to regulate recognition, ownership, and governance in stock exchanges and clearing corporations. Further, the Securities and Exchange Board of India (Depositories and Participants) (Amendment) Regulations 2012 have been brought into effect from 11 September 2012 to regulate ownership and governance norms of depositories.

Box 5.3 : RGESS

The Rajiv Gandhi Equity Saving Scheme (RGESS) will give tax benefits to new investors whose annual income is up to ₹ 10 lakh for investments up to a maximum of ₹ 50,000. The investor will get 50 per cent deduction of the amount invested from taxable income for that year. Salient features of the scheme are as follows:

- The scheme is open to new retail investors identified on the basis of their permanent account numbers (PAN).
- The tax deduction allowed will be over and above the ₹ 1 lakh limit permitted allowed under Section 80 C of the Income Tax Act.
- In addition to the 50 per cent tax deduction for investments, dividend income is also tax free.
- For investments up to ₹ 50,000 in the sole RGESS demat account, if the investor opts for a basic service demat account, annual maintenance charges for the demat account are zero and for investments up to ₹ 2 lakh, ₹ 100.
- Stocks listed under BSE 100 or CNX 100, or stocks of public-sector undertakings (PSUs) that are Navratnas, Maharatnas, and Miniratnas will be eligible under the scheme. Follow-on public offers (FPOs) of these companies will also be eligible.
- IPOs of PSUs, which are scheduled to get listed in the relevant financial year and whose annual turnover is not less than ₹ 4,000 crore for each of the immediate past three years, will also be eligible.
- Exchange-traded funds (ETFs) and MFs that have RGESS-eligible securities as their underlying and are listed and traded in the stock exchanges and settled through a depository mechanism have also been brought under the RGESS to provide the advantage of diversification and consequent risk minimization.
- To benefit the small investors, investments are allowed in instalments in the year in which tax claims are made.
- The total lock-in period for investments will be three years including an initial blanket lock-in of one year.
- After the first year, investors will be allowed to trade in the securities. Investors are free to trade / churn their portfolios for around 90 days in each of the years following the first year of investment.
- Investors would, however, be required to maintain their level of investment during these two years at the amount for which they have claimed income tax benefit or at the value of the portfolio before initiating a sale transaction, whichever is less, for at least 270 days in a year.
- The general principle under which trading is allowed is that whatever is the value of stocks / units sold by the investor from the RGESS portfolio, RGESS-compliant securities of at least the same value are credited back into the account subsequently. However, the investor is allowed to take benefit of the appreciation of his RGESS portfolio, provided its value remains above the investment for which he has claimed income tax benefit.
- In case the investor fails to meet the conditions stipulated, the tax benefit will be withdrawn.

The broad provisions of the Scheme and the income tax benefits under it have already been incorporated as a new Section-80CCG- of the Income Tax Act 1961, as amended by the Finance Act 2012. The operational guidelines were issued by SEBI on 6 December 2012.

Initiatives to attract foreign investment and External Commercial Borrowings

Expansion of Qualified Foreign Investors (QFIs) Scheme

5.64 In Budget 2011-12, the government, for the first time, permitted qualified foreign investors (QFIs), who meet the know-your-customer (KYC) norms, to invest directly in Indian MFs. In January 2012, the government expanded this scheme to allow QFIs to directly invest in Indian equity markets. Taking the scheme forward, as announced in Budget 2012-13, QFIs have also been permitted to invest in corporate debt securities and MF debt schemes subject to a total overall ceiling of US$ 1 billion. In May 2012, QFIs were allowed to open individual non-interest-bearing rupee bank accounts with authorized dealer banks in India for receiving funds and making payment for transactions in securities they are eligible to invest in. In June 2012, the definition of QFI was expanded to include residents of the member countries of the Gulf Cooperation Council (GCC) and European Commission (EC) as the GCC and EC are the members of the Financial Action Task Force (FATF).

Initiatives to attract FII Investment

5.65 As regards FII investment in debt securities, there has been progressive enhancement in the quantitative limits for investments in various debt categories. In June 2012, the FII limit for investment in G-Secs (government securities) was enhanced by US $ 5 billion, raising the cap to US $ 20 billion. The scheme for FII investment in long-term infra bonds has been made attractive by gradual reduction in lock-in and residual maturity periods criteria. In November 2012, the limits for FII investment in G-Secs and corporate bonds (non-infra category) have been further enhanced by 5 billion each, taking the total limit prescribed for FII investment to US$ 25 billion in G-Secs and US$51 billion for corporate bonds (infra+non-infra). FII debt allocation process has also been reviewed for bringing greater certainty among foreign investors and helping them periodically re-balance their portfolios in sync with international portfolio management practices.

Liberalization in External Commercial Borrowings Policy during 2012-13

5.66 The important steps taken in the arena of external commercial borrowings (ECB) policy liberalization include:

- Enhancing the limit for refinancing rupee loans through ECB from 25 per cent to 40 per cent for Indian companies in the power sector
- Allowing ECB for capital expenditure on the maintenance and operation of toll systems for roads and highways so long as they are a part of the original project subject to certain conditions, and also for low cost housing projects
- Reducing the withholding tax from 20 per cent to 5 per cent for a period of three years (July 2012- June 2015) on interest payments on ECBs
- Introducing a new ECB scheme of US $10 billion for companies in the manufacturing and infrastructure sectors
- Permitting the Small Industries Development Bank (SIDBI) as an eligible borrower for accessing ECB for on-lending to the micro, small, and medium enterprises (MSME) sector subject to certain conditions
- Permitting the National Housing Bank (NHB)/ Housing Finance Companies to avail themselves of ECBs for financing prospective owners of low cost / affordable housing units

Sovereign Credit Rating of India

5.67 India's sovereign debt is usually rated by six major sovereign credit rating agencies (SCRAs) (Table 5.19). These are Fitch Ratings, Moody's Investors Service, Standard and Poor's (S&P), Dominion Bond Rating Service (DBRS), Japanese Credit Rating Agency (JCRA), and Rating and Investment Information Inc., Tokyo (R&I). The government is taking a number of steps to improve its interaction with the major SCRAs so that they make informed decisions.

Financial Stability and Development Council

5.68 With a view to strengthening and institutionalizing the mechanism for maintaining financial stability, enhancing inter-regulatory coordination, and promoting financial-sector development, the government has set up an apex-level Financial Stability and Development Council (FSDC) in December 2010, in line with the G 20

Table 5.19 : Sovereign Ratings assigned by Rating Agencies as on 15.1.2013

Rating agency	Date of affirmation of ratings	Foreign currency		Local currency	
		Ratings	Outlook	Ratings	Outlook
JCRA	30.11.2012	BBB+	Stable	No ratings were given for local currency	
Moody's	26.11.2012	Baa3	Stable	Baa3 (upgraded from Ba1)	Stable
R&I	22.11.2012	BBB (LT)a-2 (ST)	Stable	No ratings were given for local currency	
DBRS	06.08.2012	BBB (low) (LT)	Stable	BBB (low) (LT)	Stable
Fitch	15.06.2012	BBB- (LT)F3 (ST)	Negative	BBB-	Stable
S&P	25.04.2012	BBB- (LT) A-3 (ST)	Negative	No ratings were given for local currency	

initiatives. The Council is chaired by the Finance Minister and has heads of financial-sector regulatory authorities, the Finance Secretary and/or Secretary, Department of Economic Affairs, Secretary, Department of Financial Services, and the Chief Economic Adviser as members. Without prejudice to the autonomy of regulators, the Council monitors macro-prudential supervision of the economy, including functioning of large financial conglomerates, and addresses inter-regulatory coordination and financial-sector development issues. It also focuses on financial literacy and financial inclusion.

Insurance and Pension Funds

Insurance

5.69 Since the opening up of the insurance sector, the number of participants in the insurance industry has gone up from seven insurers (including the Life Insurance Corporation of India [LIC], four public-sector general insurers, one specialized insurer, and the General Insurance Corporation as the national re-insurer) in 2000 to 52 insurers as on 30 September 2012 operating in the life, non-life, and re-insurance segments (including specialized insurers, namely the Export Credit Guarantee Corporation and Agricultural Insurance Company [AIC]). Four of the general insurance companies, viz. Star Health and Alliance Insurance Company, Apollo Munich Health Insurance Company, Max BUPA Health Insurance Company, and Religare Health Insurance Company function as standalone health insurance companies. Of the 23 insurance companies that have set up operations in the life segment post opening up of the sector, 21 are in joint ventures with foreign partners. Of the 21private insurers who have commenced operations in the non-life segment, 18 are in collaboration with foreign partners.

Life Insurance

5.70 From being the sole provider of life insurance till financial year 1999-2000, LIC is today competing in an industry with 23 private-sector insurers who have commenced operations over the period 2000-12. The industry which reported an annual growth rate of 19.8 per cent during the period 1996-7 to 2000-1 has, post opening up of the sector, reported an annual growth rate of 18.85 per cent during 2001-2 to 2011-12. The life insurers underwrote new business of ₹ 1,13,942 crore during financial year 2011-12 as against ₹ 1,26,398 crore during the year 2010-11, recording a decline of 9.85 per cent. Of the new business premium underwritten, the LIC accounted for ₹ 81,862.25 crore (71.85 per cent market share) and private insurers for ₹ 32,079.92 crore (28.15 per cent market share). The market share of these insurers was 68.84 per cent and 31.16 per cent respectively in the corresponding period of 2010-11.

Non-life Insurance

5.71 The industry which reported a growth rate of around 10 per cent during the period 1996-7 to 2000-1 has, post opening up of the sector, reported average annual growth of over 15 per cent over the period 2001-2 to 2011-12. In addition, the specialized insurers Export Credit Guarantee Corporation and AIC are offering credit guarantee and crop insurance respectively. The premium underwritten by the non-life insurers during 2011-12 was ₹ 52,875.8 crore as against ₹ 42,576.5 crore in 2010-11, thus recording a growth of 24.19 per cent. The growth was satisfactory, particularly in view of the across-the-board cuts in tariff rates. The private insurers underwrote premium of ₹ 22,315.03 crore as against ₹ 17,424.6 crore in 2010-11, reporting growth of 28.07 per cent vis-a-vis 24.67 per cent in 2010-11. The public-sector insurers, on the other hand, underwrote a premium of ₹ 30,560.74 in 2011-12 as against ₹ 25,151.8 crore in 2010-11, i.e. a growth of 21.5 per cent as against 21.84 per cent in 2010-11. The market shares of the public and private insurers are 57.80 and 42.20 per cent in 2011-12 as against 59.07 and 40.93 in the previous year.

Insurance Penetration

5.72 The growth in the insurance sector is internationally measured based on the standard of insurance penetration defined as the ratio of premium underwritten in a given year to the gross domestic product (GDP). Insurance density is another well-recognized benchmark and is defined as the ratio of premium underwritten in a given year to total population (measured in US dollars for convenience of comparison). The Indian insurance business has in the past remained underdeveloped with low levels of penetration. Post liberalization, the sector has succeeded in raising the levels of insurance penetration from 2.7 (life 2.15 and non-life 0.56) in 2001 to 4.1 (life 3.4 and non-life 0.7) in 2011.

5.73 Despite the growth in the insurance sector that was witnessed during the last few decades, insurance penetration and density remained low as compared to other developing countries of the world. It was felt that various legislative provisions were archaic and needed revision in line with the changing market conditions. Accordingly, the government introduced the Insurance Laws (Amendment) Bill 2008 in the Rajya Sabha on 22 December 2008.Based on the recommendations of the Standing Committee, the official amendments to the Insurance Laws (Amendment) Bill 2008 are proposed to be introduced at the earliest.

Pension Sector

5.74 The New Pension System (NPS) was introduced for the new recruits who join government service on or after 01January 2004. Till 5 January 2013 a total of 42.17 lakh subscriptions have been enrolled with a corpus of ₹ 26,189 crore. From 1May 2009, the NPS was opened up for all citizens in India to join on a voluntary basis. Although the NPS is perhaps one of the cheapest financial products available in the country, in order to make it affordable for the economically disadvantaged, the government in September 2010 introduced a lower cost version, known as Swavalamban Scheme, which enables groups of people to join the NPS at a substantially reduced cost. As per existing scheme under NPS, Swavalamban could be availed either in unorganized sector or in NPS Lite. NPS Lite is a model specifically designed to bring NPS within easy reach of the economically disadvantaged sections of the society. NPS Lite is extremely affordable and viable due to its optimized functionalities available at reduced charges. Under the Swavalamban scheme, the government provides subsidy to each NPS account holder and the scheme has been extended until 2016-17. A customized version of the core NPS model, known as the NPS Corporate Sector Model was also introduced from December 2011 to enable organized-sector entities to move their existing and prospective employees to the NPS under its Corporate Model. All the PSBs have been asked to provide a link on their website to enable individual subscribers to open online NPS Accounts.

Challenges and Outlook

5.75 India has been a late starter in the process of reforming financial markets. Nevertheless, beginning the 1990s, a package of reforms comprising measures to liberalize, regulate, and develop the country's financial sector by adopting best international practices has been initiated. The results of these reforms have been encouraging and the country now has one of the most vibrant and transparent capital markets in terms of market efficiency, transparency, and price discovery process. However, there are still certain challenges in the development of the Indian financial sector which need to be addressed to make it an important avenue for productive chanelisation of savings by domestic investors and a preferred investment destination for international investors.

5.76 A reasonably well-developed corporate bond market is very much required in any economy to supplement banking credit and the equity market and to facilitate the long-term funding requirement of corporate sector as well as infrastructure development in the country. Though, the development of the corporate bond market, has been an important area and has received greater policy attention in recent times,it is yet to take off in a significant manner. Some of the issues that need to be addressed in this regard include drawing up a road-map for a structural shift from a bank-dominated financial system to a more diverse financial system where top-rated corporates access finance from capital markets, strengthening of the legal framework for regulation of corporate debt by necessary amendments in rules/regulations, and relaxation of investment guidelines for pension, provident, and insurance funds to enable the participation of long-term investors in the corporate bond market. Introduction of new products and making nascent products such as covered bonds, municipal bonds, credit default swaps, credit enhancements, and securitization receipts more attractive may be considered for public issuance of bonds at reduced cost. Improving the market infrastructure for enabling liquidity, transparency in price discovery, and stimulating growth in trading volumes also need to be suitably addressed.

5.77 The need for long-term finance for infrastructure projects is another issue that needs to be looked into in the context of the limitation of banks to finance such projects. Infrastructure projects, given their long pay-back period, require long-term financing in order to be sustainable and cost effective. However banks, which have been the main source of funding these projects, are unable to provide long-term funding given their inherent asset-liability mismatch. Moreover banks are also approaching their exposure limits. In this regard, infrastructure development funds (IDF) through innovative means of credit enhancement are expected to provide long-term low-cost debt for infrastructure projects by tapping into savings like insurance and pension funds which have hitherto played a comparatively limited role in financing infrastructure. By refinancing bank loans of existing projects, IDFs are also expected to take over a fairly large volume of the existing bank debt that will release an equivalent volume for fresh lending to infrastructure projects.

5.78 The recent global financial crises have raised certain issues relating to governance of financial intermediaries and awareness of investors. As investors' awareness is a precondition for their protection, attempts are being made to address this issue through the financial literacy campaign. A simultaneous and coordinated effort on both fronts is needed to enable investors, especially the small investors, to take informed decisions and ensure orderly conditions in the market. The ongoing efforts need to be scaled up in a coordinated way for spearheading financial literacy and promoting investors' protection.

5.79 The enactment of the Banking Laws (Amendment) Act 2012 is expected to make the regulatory and supervisory powers of the RBI more effective and facilitate banks in raising funds from the capital market required for expansion of banking business. It will also facilitate finalization of guidelines by the RBI for providing licences for new banks, which is essential for achieving the objective of financial inclusion in the current perspective. This needs to be expedited accordingly.

5.80 Pension reforms in India have generated widespread interest internationally. They will not only facilitate the flow of long-term savings for development but also help establish a credible and sustainable social security system in the country. Lower levels of financial literacy, particularly among workers in the unorganized sector, non-availability of even moderate surplus, and lukewarm response so far from most of the state / UT governments to a co-contributory Swavalamban Scheme are the major challenges to universal inclusion of poorer sections of Indian society into the pension network. On the supply side, the lack of awareness about the NPS and of access points for people to open their accounts individually have been major inhibiting factors which should be addressed by the pension regulator immediately. As far as the insurance products are concerned, limited choice and high cost of providing covers and assessing claims are some of the issues that need to be suitably addressed to make insurance funds an effective means of channellizing savings to investments.

5.81 In the global context, the performance of the financial sector in India will be influenced by both short-term and long-term factors. In the long run, a strong growth in global output will be essential for sustaining investment activities across the globe, including India. In the short run, factors like expectation of higher relative returns, risk perception of investors, and global liquidity will decide the level of flow of funds to the domestic equity market. According to the World Bank's Global Economic Prospects (GEP), January 2013, conditions in the global financial markets have eased significantly since July 2012 reflecting substantial progress in improving fiscal sustainability and the mutual support mechanism in the European Union. The decline in financial market tensions is reflected in terms of international capital flows to developing countries reaching a new high, decline in developing country bond spreads (EMBIG), and rise in developing country stock index. Overall the global economic environment remains fragile and prone to further disappointment, although the balance of risk is now less skewed to the downside than it has been in recent years.