Financial Intermediation and Markets

5

CHAPTER

Historically, banks have played the role of intermediaries between the savers and the investors. However, in the last few decades, the importance and nature of financial intermediation has undergone a dramatic transformation the world over. The dependence on bank credit to fund investments is giving way to raising resources through a range of market based instruments such as the stock and bond markets, new financial products and instruments like mortgage and other assets backed securities, financial futures and derivative instruments like swaps and complex options. Besides transferring resources from savers to investors, these instruments enable allocation of risks and re-allocation of capital to more efficient use. The increase in the breadth and depth of financial markets has also coincided with a pronounced shift among the ultimate lenders who have moved away from direct participation in the financial markets to participation through a range of intermediaries. These developments in international financial markets have been mirrored in the financial market in India. This chapter summarizes the main developments in this sector in India in the last year and highlights the various policy challenges.

Bank credit

5.2 Bank credit to productive sectors of the economy has a critical role in sustaining the growth process. While the spread of banking network is a continuous process, the effectiveness of the banking network also depends on the expansion in the scale of operations and the deepening of the credit facilities. The total assets of the scheduled commercial banks (SCBs) have increased from a level of Rs. 3.46 million on March 31, 2007 to Rs. 4.33 million on March 31, 2008. All categories, namely, public sector banks, old private sector banks, new private sector banks and foreign banks have increased their asset base.

5.3 A noticeable trend in the recent years is the growing importance of the competition emerging between the different categories of banks. This is reflected in the changes in the share of assets of different categories of SCBs. Though the share of public sector banks in total assets of SCBs has declined to 69.9 per cent at the end of 2007-08 from 70.5 per cent in 2006-07, they continue to play an important role in the current economic environment. The share of old private sector banks also marginally declined in 2007-08; correspondingly the share of assets of foreign banks and new private sector banks increased.

5.4 The first six months of the financial year 2008-09 witnessed inflationary pressures in the Indian economy with RBI continuing to address monetary expansion through revisions in policy rates. The second half of 2008-09 was however a period when the RBI initially took steps to ease the liquidity crunch in the money market in September / October 2008, followed up with steps to facilitate continued credit flows to the productive sectors of the economy. Reduction in policy rates were also announced to enhance the liquidity in the system and for reducing the cost of credit to business and industry.

Bank credit and investment

5.5 The continued boom in the economic activity which had for the third year in succession led to significant expansion of credit by SCBs, moderated during 2008-09. Though bank credit to the commercial sector witnessed strong growth in the first half of the year, it decelerated particularly in the second half of the year. For the full year 2008-09, bank credit to the commercial sector

Table 5.1 : Credit flow from scheduled commercial banks

(Rs. crore)

Credit flow from	Outstanding as on March 27, 2009	Variations (year-on-year) As on March 28, 2008 Amount	Per cent	As on March 27, 2009 Amount	Per cent
Public Sector Banks	20,11,591	3,07,310	22.5	3,41,442	20.4
Foreign Banks	1,69,350	36,116	28.5	6,483	4.0
Private Banks	5,23,038	78,301	19.9	51,559	10.9
All Scheduled Commercial Banks*	27,70,012	4,30,724	22.3	4,08,099	17.3

Source : RBI
*** Includes Regional Rural Banks**
Note : Data are provisional

expanded by 16.9 per cent only, as compared to a growth of 21.0 per cent in 2007-08.

5.6 During 2008-09 (March 27, 2009 over March 28, 2008), there was a moderation in the credit growth of SCBs to 17.3 per cent from a level of 22.3 per cent in the corresponding period of the previous year (Table 5.1). In terms of absolute values also, the slowdown was noticeable, in as much as the expansion in bank credit during 2007-08 was of the order of Rs. 4,30,724 crore which decelerated to Rs. 4,08,099 crore in 2008-09. Non-food credit growth as at end-March 2009 grew by 17.5 per cent as compared to 23.0 per cent growth as at end-March 2008.

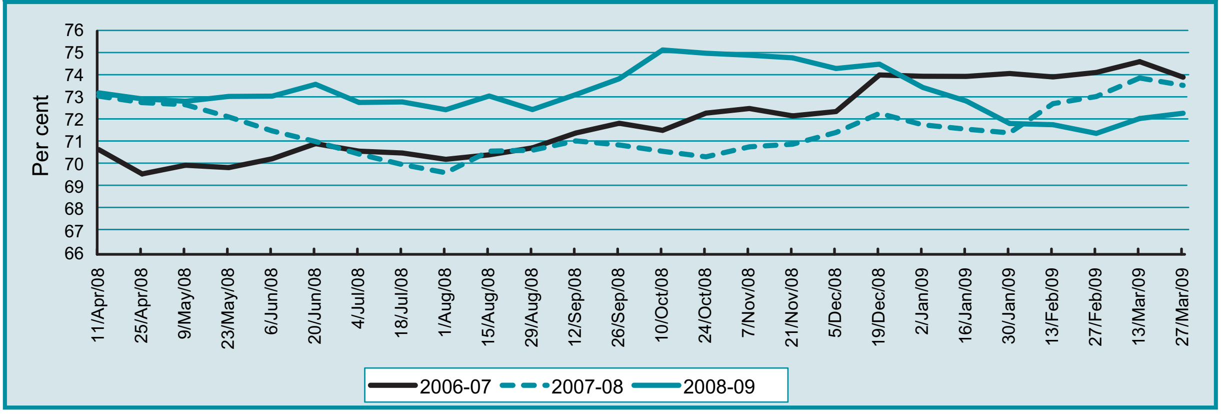
5.7 Though the growth in the different sources of funds for the SCBs during 2008-09 was lower than for 2007-08, the growth in deposits with the banking system in 2008-09 was higher than the growth of credit. This reflected in the decline in the incremental credit-deposit ratio (y-o-y) of SCBs from 73.6 per cent in end-March 2008 to a level of 64.4 per cent in end-March 2009.

5.8 The behaviour of the credit-deposit (C-D) ratio also reflected the changes in the monetary sector; C-D ratio which was at 73.9 as of March 31, 2007, marginally declined to 73.8 as of March 31, 2008. In 2008-09, it peaked to 75.2 as of October 10, 2008, but declined thereafter. It stood at 72.3 as of March 27, 2009. The movement of the C-D ratio during the last three years is given in the accompanying figure (Figure 5.1).

Scheduled commercial banks' investments

5.9 Investment by SCBs in statutory liquidity ratio (SLR) securities as per cent of their net demand and time liabilities (NDTL) continued to be higher than the stipulated level. As compared to the level of 27.8 per cent at end-March 2008, it increased to a level of 28.1 per cent at end-March 2009. As per information from RBI, after adjusting for Liquidity

Figure 5.1 : Credit deposit ratio



Adjustment Facility (LAF) collateral securities on an outstanding basis, the scheduled commercial banks' holding of SLR securities amounted to 26.7 per cent of NDTL, at end-March 2009, which was higher than the prescribed 24.0 per cent level.

5.10 Non-SLR investment by SCBs during 2008-09 (March 27, 2009 over March 28, 2008) expanded by Rs. 8,615 crore (an increase of 9.0 per cent) compared to Rs. 11,961 crore (an increase of 14.3 per cent) during 2007-08 (March 28, 2008 over March 30, 2007) indicating comfortable liquidity situation with SCBs.

5.11 The investment-deposit ratio at 34.02 as of March 31, 2006 decreased to 30.3 as of March 31, 2007 and marginally increased to 30.4 on March 31, 2008. During 2008-09, the investment-deposit ratio peaked to 31.8 on February 13, 2009 and declined thereafter to 30.4 as of March 27, 2009. The movement of the investment-deposit ratio during the last three years is given in Figure 5.2.

Sectoral deployment of bank credit

5.12 SCBs' lower overall gross non-food credit growth during 2008-09 (at 18.1 per cent as compared to 22.3 per cent in 2007-08) reflected itself in the sectoral deployment of bank credit. Data available as on March 27, 2009 is given in Table 5.2. While loans to agriculture & allied activities grew at the rate of 23.0 per cent during 2008-09 (as on March 27, 2009) compared to 19.5 per cent (as on March 28, 2008), credit to industry (comprising of large, medium and small scale sector) grew at 21.6 per cent during 2008-09 (as of March 27, 2009) compared to 24.3 per cent (as of March 28, 2008). Within industry group, the deceleration was noticeable in credit to food processing , textiles, vehicles, vehicle parts and transport equipments. Personal loans during 2008-09 (as of March 27, 2009) grew at a lower rate of 10.8 per cent compared to 12.1 per cent (as of March 28, 2008); advances under personal loans for housing and consumer durables have witnessed deceleration. Loans to commercial real estate and non-banking financial companies remained high in 2008-09, posting a growth of 44.6 per cent and 25.1 per cent respectively.

Priority sector lending

5.13 A target of 40 per cent of Adjusted Net Bank Credit (ANBC) or credit equivalent amount of Off-Balance Sheet Exposures (OBE), whichever is higher, had been stipulated for lending to the priority sector by domestic SCBs (both public and private sector). Within this, sub-targets of 18 per cent and 10 per cent of ANBC or credit equivalent amount of OBE, whichever is higher, had been stipulated for lending to agriculture and the weaker sections respectively. However, to ensure that the focus of the banks on the direct category of agricultural advances does not get diluted, the indirect lending in excess of 4.5 per cent of ANBC or credit equivalent amount of OBE, whichever is higher, are not reckoned for computing performance under the 18 per cent sub-target. All agricultural advances under the 'direct' and 'indirect' categories are reckoned in computing the performance under the overall priority sector target of 40 per cent of ANBC or Credit Equivalent amount of OBE, whichever is higher.

5.14 A target of 32 per cent of ANBC or credit equivalent amount of OBE, whichever is higher, had been stipulated for lending to the priority sector by foreign banks having offices in India. Within the overall target of 32 per cent to be achieved by foreign banks, the advances to micro & small enterprises and export sectors were not to be less than 10 per cent and 12 per cent of ANBC or credit equivalent amount of OBE, whichever is higher, respectively.

Figure 5.2 : Investment Deposit ratio

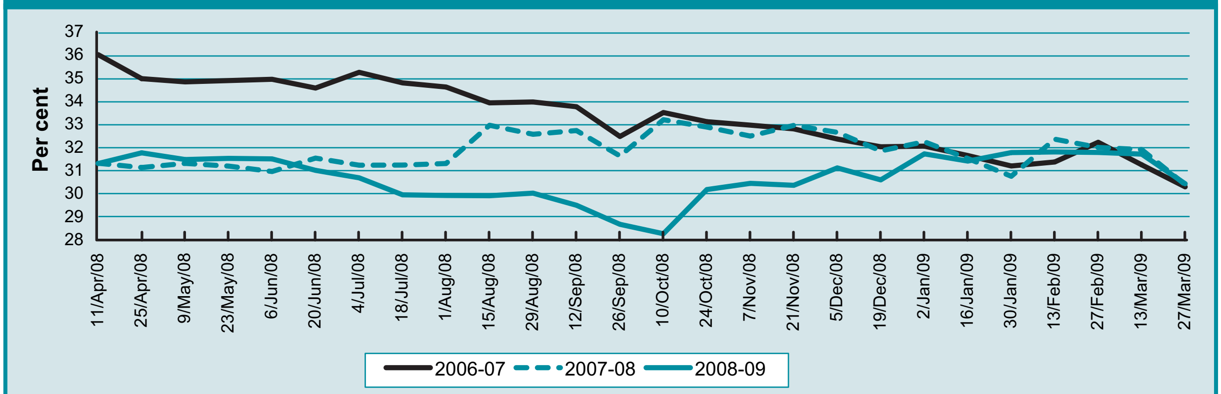


Table 5.2 : Deployment of gross bank credit by major sectors

(Rs. crore)

Sector	Outstanding as on 27-Mar 2009	Annual Variation 2007-08* Absolute	%	2008-09** Absolute	%
Non-food gross bank credit (1 to 4)	2,602,290	401,650	22.3	399,400	18.1
1. Agriculture & Allied Activities	338,656	44,966	19.5	63,313	23.0
2. Industry (Small,Medium & Large)	1,054,390	169,536	24.3	187,515	21.6
of which, Small Enterprises	257,027	76,932	65.2	62,185	31.9
3. Personal Loans	562,479	54,730	12.1	54,991	10.8
Housing	276,957	26,802	11.6	19,165	7.4
Advances against Fixed Deposits	48,676	4,170	10.2	3,671	8.2
Credit Card Outstanding	28,000	8,094	44.2	1,607	6.1
Education	28,579	5,324	35.0	8,047	39.2
Consumer Durables	8,187	-390	-4.2	-612	-7.0
4. Services	646,765	132,419	31.5	93,580	16.9
Transport Operators	39,302	9,486	33.5	1,484	3.9
Professional and Other Services	45,373	3,201	13.4	18,240	67.2
Trade	144,377	17,059	16.0	20,656	16.7
Real Estate Loans	91,575	19,235	43.6	28,261	44.6
Non-Banking Financial Companies	98,853	30,094	61.5	19,835	25.1
Priority Sector	915,886	111,414	17.5	168,506	22.5
INDUSTRY (Small, Medium and Large Scale)	1,054,390	169,536	24.3	187,515	21.6
Food Processing	53,779	9,371	23.4	4,397	8.9
Textiles	102,695	17,483	22.1	6,206	6.4
Paper & Paper Products	15,983	1,874	16.2	2,521	18.7
Petroleum, Coal Products and Nuclear Fuels	68,147	5,715	15.9	26,546	63.8
Chemicals and Chemical Products	75,555	6,560	11.7	13,095	21.0
Rubber, Plastic & their Products	13,587	1,898	20.5	2,439	21.9
Iron and Steel.	99,159	18,858	29.6	16,557	20.0
Other Metal and Metal Products	29,604	4,906	24.5	4,705	18.9
Engineering	65,807	10,690	24.4	11,355	20.9
Vehicles, Vehicle Parts and Transport Equipments	34,642	8,366	40.1	5,421	18.6
Gems & Jewellery	28,537	1,233	5.2	3,454	13.8
Construction	38,505	7,952	39.8	10,556	37.8
Infrastructure	269,972	61,745	43.1	64,852	31.6

Source : RBI

*** March 28, 2008/ March 31, 2007** **** March 27, 2009/ March 28, 2008**

Note : Data are provisional and relate to select scheduled commercial banks.

5.15 The public, private sector and foreign banks, had achieved the overall priority sector lending targets as on the last reporting Friday of March 2008. The broad picture regarding priority sector advances is given in Table 5.3.

5.16 As non-achievement of priority sector targets could be a matter of concern, suitable initiatives in the banking sector have also been taken. In order to improve and enhance the flow of credit to the priority sector, the following policy initiatives were taken during the year 2007-08:

- In order to augment the resources of Regional Rural Banks (RRBs) for the purposes of lending, all loans granted by commercial banks/sponsor banks to RRBs for on-lending to agriculture and allied activities sector were made eligible to be classified as indirect finance to agriculture in the books of commercial banks/sponsor banks. Consequently, the amount lent by RRBs out of funds borrowed from commercial banks/ sponsor banks, would not be classified by RRBs as part of their priority sector advances. The RRBs need not also include such lending as part of their bank credit for the purpose of computing achievement level under priority sector lending;
- Banks were allowed to classify 100 per cent of the credit outstanding under general credit card (GCCs) and overdrafts up to Rs. 25,000 (per account) granted against 'no-frills' accounts in rural and semi-urban areas as indirect finance to agriculture sector under the priority sector;

Table 5.3 : Particulars of priority sector advances

A. PUBLIC SECTOR BANKS (Rs. crore)

Detail	As on the last reporting Friday of		
	March 2006	March 2007	March 2008 (provisional)
Total priority sector advances	4,09,748(40.3%)	5,21,376(39.7%)	6,08,963(44.6%)
Total advances to agriculture	1,55,220(15.3%)	2,02,614(15.4%)	2,48,685(17.4%)
Total advances to micro & small enterprises *	82,434(8.1%)	1,02,550(7.8%)	1,48,651(10.9%)
Advances to weaker sections	78,158(7.7%)	93,747(7.1%)	1,26,935(9.3%)

B. PRIVATE SECTOR BANKS

Detail	As on the last reporting Friday of		
	March 2006	March 2007	March 2008 (provisional)
Total priority sector advances	1,06,586(42.8%)	1,44,549(42.9%)	1,63,223(47.5%)
Total advances to agriculture	36,712(13.6%)	52,034(12.7%)	57,702(15.4%)
Total advances to micro & small enterprises *	10,421(4.2%)	13,136(3.9%)	46,069(13.4%)
Advances to weaker sections	4,174(1.7%)	5,223(1.6%)	7,228(2.1%)

C. FOREIGN BANKS

Detail	As on the last reporting Friday of		
	March 2006	March 2007	March 2008 (provisional)
Total priority sector advances	30,439(34.4%)	37,831(33.4%)	50,301(39.5%)
Total advances to micro & small enterprises*	8,430(9.5%)	11,637(10.3%)	15,489(12.2%)
Total Export credit (includes SSI export)	17,326(19.6%)	20,711(18.3%)	29,007(22.8%)

Source : RBI

* **Figures for March 2006 and 2007 represent small scale industries. In terms of revised guidelines on lending to priority sector, micro & small enterprises defined on basis of Micro, Small and Medium Enterprises Development Act, 2006.**

Note: 1. The figures in parenthesis show percentage of advances to Net Bank Credit.
2. Indirect agriculture is reckoned only up to 4.5% of the ANBC or credit equivalent of off-balance sheet exposures, whichever is higher.

- RRBs were allowed to sell loan assets held by them under priority sector categories in excess of the prescribed priority sector lending target of 60 per cent; and
- In order to ensure that the sub-target of lending to the weaker sections is achieved, the domestic scheduled commercial banks were advised that the shortfall in achievement of sub-target of lending to weaker sections will also be taken into account for the purpose of allocating amounts for contribution to the Rural Infrastructure Development Fund (RIDF) maintained with NABARD or funds with other financial institutions, as specified by the Reserve Bank of India, with effect from April 2009.

Rural Infrastructure Development Fund

5.17 The scope of RIDF established with NABARD in April 1995 to assist State Governments/ State-owned corporations for quick completion of projects relating to minor and medium irrigation, soil conservation, watershed management and other forms of rural infrastructure (such as rural roads and bridges, market yards, etc.) was widened to include gram panchayats, self-help groups (SHGs), projects in social sector covering primary education, health and drinking water, and other eligible organizations for implementing village level infrastructure projects. Starting RIDF-X, other activities, such as minor irrigation projects/micro irrigation, flood protection, watershed development/ reclamation of waterlogged areas, drainage, forest development, market yard/ godown, Apna Mandi, rural haats and other marketing infrastructure, cold storage, seed/ agriculture/horticulture farms, plantation and horticulture, grading and certifying mechanisms such as testing and certifying laboratories, etc., community wells for irrigation purposes for the village as a whole, fishing harbour/jetties, riverine fisheries, animal husbandry, modern abattoir, etc., have been added to the list of eligible activities. Some more activities such as mini hydel projects; construction of toilet blocks in existing schools, where necessary, specially for girl students; "pay & use" toilets in rural areas; major irrigation projects (only those projects already sanctioned and under execution); village knowledge centres; desalination plants in coastal areas; small hydel projects (up to 10 MW); infrastructure for information technology in rural areas; and construction of anganwadi centres have been added to the list of eligible activities with effect from RIDF-XII.

5.18 The domestic SCBs, both in the public and private sector, which fail to achieve the priority sector and/ or agriculture lending targets are required to deposit into RIDF such amounts as may be allocated to them by the Reserve Bank of India. Pursuant to the announcement made by the Union Finance Minister in the budget speech for the year 2007-08, RIDF–XIII was set up with NABARD with a corpus of Rs. 12,000 crore along with a separate window with a corpus of Rs. 4,000 crore for the rural roads component of the Bharat Nirman Programme, with contributions from domestic banks, which had not achieved their target in lending to the priority sector and/ or agriculture as on the last reporting Friday of March 2007.

5.19 The Union Finance Minister had announced in the budget speech for the year 2008-09 the setting up of RIDF-XIV (with NABARD), with a corpus of Rs. 14,000 crore, and a separate window under RIDF-XIV for rural roads component under Bharat Nirman, with a corpus of Rs. 4,000 crore. It was also announced that certain other funds will be set up with NABARD: Short-Term Cooperative Rural Credit (STCRC) (Refinance) Fund with a corpus of Rs. 5,000 crore; SIDBI (corpuses of Rs. 2,000 crore each for Micro Small and Medium Enterprises (Refinance) Fund; and MSME (Risk Capital) Fund; NHB (Rural Housing Fund with a corpus of Rs. 1,200 crore) from contributions by SCBs which failed to achieve their obligation to lend to the priority sector. These funds were set up with the concerned agencies, with contributions from domestic banks which had not achieved their target in lending to the priority sector and/ or agriculture as on the last reporting Friday of March 2008, in June 2008 and the bank-wise allocations for depositing in these Funds were revised in August 2008. The revised corpus allocations were: Rs. 10,000 crore for RIDF-XIV, Rs. 4,000 crore for the separate window under RIDF-XIV for rural roads component of Bharat Nirman Programme and Rs. 5,000 crore for Short-Term Cooperative Rural Credit (STCRC) (Refinance) Fund with NABARD; Rs. 1,600 crore for Micro, Small and Medium Enterprises (MSME) (Refinance) Fund and Rs. 1,000 crore for MSME (Risk Capital) Fund with SIDBI; and Rs. 1,000 crore for Rural Housing Fund with NHB. The balance portion (Rs. 4,000 crore) of the corpus of RIDF-XIV shall be allocated to SCBs on the basis of shortfall in achievement of priority sector lending target/sub-targets as on the last reporting Friday of March 2009.

5.20 Since its inception, the total allocation under RIDF (I to XIV), including separate windows under RIDF for rural roads component under Bharat Nirman was of the order of Rs. 98,000 crore (Rs. 86,000 crore to states and Rs. 12,000 crore under Bharat Nirman). Cumulative sanctions to State Governments and National Rural Roads Development Agency (NRRDA) under various tranches of RIDF (I to XIV) stood at Rs. 88,385.56 crore and Rs. 12,000 crore respectively as on February 28, 2009. The cumulative disbursements to various State Governments under various tranches of RIDF (RIDF I to XIV) stood at Rs. 53,775.18 crore, as on the same date. In addition, a loan of Rs. 12,000 crore has so far been disbursed to NRRDA for funding rural roads component of Bharat Nirman. During 2008-09 (up to February 28, 2009), various State Governments were sanctioned loans aggregating Rs. 14,699.29 crore, which included Rs. 1,542.86 crore sanctioned to the distressed districts of four States viz. Andhra Pradesh, Kerala, Karnataka and Maharashtra. The disbursements under various tranches of RIDF during the year 2008-09 (up to February 28, 2009) amounted to Rs. 8180.38 crore.

5.21 Various banks had represented for either phasing the contribution to these funds over a longer period or exempting them from placements of deposits in these funds. The main contention by banks was that the allotment amount for the year 2008-09 for them was very high compared to previous years and that a large amount placed as deposit in these funds at a very low rate of interest would affect their profitability. Taking this into account, and keeping in view that the changeover to a new system would be a one-time event, the rate of interest in respect of deposits placed/ to be placed by banks in the above funds has been kept at the bank rate (6 per cent at present) uniformly for all banks, irrespective of any percentage of shortfall in achievement of priority sector lending target/ sub-targets as on the last reporting Friday of March 2008. (instead of varying rate of interest between bank rate and bank rate minus 3 percentage points).

5.22 The Annual Policy Statement of RBI (April 2008) mentioned that the shortfall in achievement of 10 per cent sub-target for lending to weaker sections by domestic SCBs would also be taken into account for the purpose of allocating amounts for contribution to RIDF maintained with NABARD or funds with other financial institutions, as specified by the Reserve Bank with effect from April 2009.

5.23 As a follow-up on the announcement made in the Union Budget 2008-09, several funds were set up such as:

- STCRC (Refinance) Fund with the NABARD with a corpus of Rs. 5,000 crore;
- MSME (Refinance) Fund and MSME (Risk Capital) Fund with SIDBI with corpus of Rs.1,600 crore and Rs.1,000 crore; and
- Rural Housing Fund with the National Housing Bank (NHB) with corpus of Rs.1,000 crore.

5.24 Consequent upon the announcement of measures by the Reserve Bank on November 15, 2008 to sustain the growth momentum in the employment-intensive sectors of micro and small enterprises and housing, the corpus of MSME (Refinance) Fund and Rural Housing Fund was enhanced by Rs. 2,000 crore (to Rs. 3,600 crore) and by Rs. 1,000 crore (to Rs. 2,000 crore) respectively. As on March 31, 2009 various SCBs have placed deposits of Rs. 4,622 crore in STCRC (Refinance) Fund, Rs. 3,326 crore in MSME (Refinance) Fund, Rs. 250 crore in MSME (Risk Capital) Fund and Rs. 1,760 crore in Rural Housing Fund.

5.25 The Interim Budget 2009-10 announced the continuation of financing of rural infrastructure projects for 2009-10 by way of RIDF-XV to be set up with NABARD with a corpus of Rs. 14,000 crore, and a separate window under RIDF-XV for rural roads component of Bharat Nirman Programme with a corpus of Rs. 4,000 crore.

Credit to Agriculture

Rural credit delivery system:

5.26 With a view to strengthen the rural credit delivery system for facilitating smooth credit flow to the rural sector in general and to agriculture in particular, a number of steps were taken by the Reserve Bank and the Government of India.

Special Agricultural Credit Plan

5.27 The public sector banks have been formulating Special Agricultural Credit Plans (SACP) since 1994-95 with a view to achieving distinct and marked improvement in the flow of credit to agriculture. Under SACP, the banks are required to fix self-set targets for achievement during the financial year. The targets fixed by banks show an increase of about 20 to 25 per cent over the disbursements made in the previous year. During the financial year 2007-2008, against the target of Rs. 1,52,133 crore, disbursements to agriculture by public sector banks under the plan aggregated at Rs. 1,33,226 crore were only 87.6 per cent of the target. This contrasts with 2005-06 and 2006-07 when the target set was exceeded. Disbursements under the SACP by public sector banks during the last three years may be seen in Table 5.4.

Table 5.4 : Credit to agriculture from public sector banks under SACP

(Rs. crore)

Year	Target	Disbursements	Achievement of target (per cent)	Year-on-Year growth in disbursements (per cent)
2005-06	85,024	94,278	110.9	44.6
2006-07	1,18,160	1,22,443	103.6	29.9
2007-08	1,52,133	1,33,226	87.6	8.81

Source : RBI

5.28 The SACP mechanism was also made applicable to private sector banks from the year 2005-06. The disbursements to agriculture by private sector banks under the plan aggregated Rs. 47,862 crore against the projection of Rs. 41,427 crore during the year 2007-08, thus constituting 115.53 per cent of the target.

Doubling of agriculture credit within three years

5.29 The Union Finance Minister had on June 18, 2004 announced certain measures for doubling of flow of credit to agriculture sector within a period of three years. The actual disbursement by banks exceeded the targets in each of the three years. For the years 2007-08, a target was fixed for Rs. 2,25,000 crore disbursement by banks, while adding 5 million farmers to their portfolio. As against this, all banks (including cooperative banks and RRBs) disbursed Rs. 2,54,657 crore forming 113 per cent of the target. During 2007-08, 75.36 lakh new farmers were financed by commercial banks and RRBs. The Union Finance Minister, in his budget speech for the year 2008-09 had also impressed on the banks to increase the level of credit to Rs. 2,80,000 crore during the year 2008-09. The amount disbursed by all banks (including cooperative banks and RRBs) during 2008-09 is placed at Rs. 2,64,455 crore (provisional) (Table 5.5).

Kisan credit cards

5.30 The Kisan Credit Card (KCC) Scheme was introduced in 1998-99 to enable the farmers to purchase agricultural inputs and draw cash for their production needs. During 2007-08, 84.7 lakh KCCs amounting with limits aggregating Rs. 88,264 crore were issued. During 2008-09 (till February 2009), a total of 47.26 lakh KCCs amounting with limits aggregating Rs. 26,828 crore were issued.(Table 5.6).

Table 5.6 : Agency-wise KCCs issued

(Lakhs)

Year	Co-operative Banks	RRBs	Public Sector Commercial Banks	Total
1998-99	1.56	0.06	6.22	7.84
1999-00	35.95	1.73	13.66	51.34
2000-01	56.14	6.48	23.90	86.52
2001-02	54.36	8.34	30.71	93.41
2002-03	45.79	9.64	27.00	82.43
2003-04	48.78	12.75	30.94	92.47
2004-05	35.56	17.29	43.95	96.8
2005-06	25.98	12.49	41.65	80.12
2006-07	22.97	14.06	48.08	85.11
2007-08	20.91	17.73	46.06	84.7
2008-09#	10.63	12.06	24.57	47.26
Total	358.63	112.63	336.74	808.00

Source : NABARD **# Up to February 28, 2009.**

Interest subvention relief to farmers

5.31 Pursuant to the announcement made by the Union Finance Minister in the Budget Speech for the year 2006-07, commercial banks were advised to grant relief of two percentage points in the interest rate on the principal amount up to Rs.1 lakh on each crop loan granted by banks during kharif and rabi of 2005-06, and credit the relief so granted to the borrower's account before March 31, 2006. Public sector banks, Regional Rural Banks and rural cooperative credit institutions were advised that with effect from kharif 2006-07, the Government would provide interest rate subvention of 2 per cent per annum to them in respect of short-term production credit up to Rs. 3 lakh provided to farmers. Government of India had provided Rs. 1,100 crore for reimbursing the claims submitted by banks in

Table 5.5 : Flow of institutional credit to agriculture and allied activities

(Rs. crore)

Institutional credit from	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09*
Cooperative banks	23716	26959	31424	39786	42480	48258	35747
RRBs	6070	7581	12404	15223	20435	25312	25852
Commercial banks	39774	52441	81481	125477	166485	181087	202856
Grand Total	69560	86981	125309	180486	229400	254657	264455

Source : NABARD
*** Provisional**

this regard. This subvention is available to public sector banks, Regional Rural Banks and rural cooperatives on the condition that they make available short-term credit at ground level at 7 per cent per annum. In case of RRBs and rural cooperatives, this is applicable only to short-term production credit disbursed out of their own funds and will exclude such credit supported by NABARD refinance.

5.32 The Government also decided to provide additional subvention, as a one-time extension, for the period April 1, 2007 to June 30, 2007 in respect of those farmers/ borrowers in the Vidarbha region, who could not pay on the due date, i.e. March 31, 2007 but repaid/ would repay before June 30, 2007. The extended subvention up to June 30, 2007 covered repayment of kharif loans.

5.33 The Government had announced at the time of presentation of the Union Budget for the years 2007-08 and 2008-09 that the 2 per cent subvention scheme for short-term crop loans would continue for the years 2007-08 and 2008-09. The Interim Budget 2009-10 announced that the Government of India would continue to provide the interest subvention in 2009-10 to ensure that farmers avail short-term crop loans up to Rs. 3 lakh at 7.0 per cent per annum.

Agricultural debt waiver and debt relief scheme, 2008

5.34 A scheme of agricultural debt waiver and debt relief for farmers with the total value of overdue loans being waived estimated at Rs. 50,000 crore and a one-time settlement (OTS) relief on the overdue loans at Rs. 10,000 crore was announced in the Union Budget, 2008-09, for implementation by all scheduled commercial banks, besides RRBs and cooperative credit institutions. The modalities of the scheme were finalized by the Government of India in consultation with RBI and NABARD, and the same was notified on May 23, 2008. The scheme covered direct agricultural loans extended to "marginal and small farmers" and "other farmers" by SCBs, RRBs, cooperative credit institutions (including urban cooperative banks) and local area banks. Accordingly, the Reserve Bank advised all the concerned banks to take necessary action towards implementation of the scheme at the earliest. NABARD had issued similar guidelines to RRBs and rural cooperatives.

5.35 In the case of a *short-term production loan*, the amount of such loan (together with applicable interest) and in the case of an *investment loan*, the instalments of such loan that are overdue (together with applicable interest on such instalments), were made eligible for debt waiver or debt relief, as the case may be, if the loan was:

- Disbursed up to March 31, 2007 and overdue as on December 31, 2007 and remaining unpaid until February 29, 2008;
- Restructured and rescheduled by banks in 2004 and in 2006 through the special packages announced by the Central Government, whether overdue or not; and
- Restructured and rescheduled in the normal course up to March 31, 2007 as per applicable RBI guidelines on account of natural calamities, whether overdue or not.

5.36 This entailed the entire "eligible amount" being waived in the case of a small or marginal farmer; in the case of "other farmers," it would be a one time settlement scheme (OTS) under which the farmer would be given a rebate of 25 per cent of the "eligible amount" subject to the condition that the farmer repays the balance of 75 per cent of the "eligible amount.". In the case of 237 revenue districts covering Drought Prone Area Programme (DPAP), Desert Development Programme (DDP) areas and PM's Special Relief Package districts, "other farmers" would be given OTS rebate of 25 per cent of the "eligible amount" or Rs. 20,000, *whichever is higher*, subject to the condition that the farmer pays the balance of the "eligible amount."

5.37 A farmer classified as "small farmer" or "marginal farmer" will be eligible for fresh agricultural loans upon the eligible amount being waived. In the case of a short-term production loan, the "other farmer" will be eligible for fresh short-term production loan upon paying one-third of his share. In the case of an investment loan (for direct agricultural activities or allied activities), the "other farmer" will be eligible for fresh investment loan upon paying his share in full.

5.38 While RBI is the nodal agency for the implementation of the scheme in respect of SCBs, urban cooperative banks and local area banks, the nodal agency in respect of RRBs and rural cooperative credit institutions is NABARD. Accordingly,the arrangement envisages the Government of India reimbursing, through RBI and NABARD, the lending institutions for waiving off of the amounts of the "small and marginal farmers" and "other farmers" dues respectively. The reimbursements are envisaged in four instalments on the basis of duly certified and audited claims submitted through the respective nodal agencies. Government of India had also decided to pay interest on the second, third and fourth instalments.

5.39 Under the Agricultural Debt Waiver and Debt Relief Scheme, the Government had agreed to provide to commercial banks, RRBs and cooperative credit institutions a sum of Rs. 25,000 crore as the first instalment. At the request of the Government and with a view to ensuring adequate financing of agricultural operations by banks, the Reserve Bank had provided temporary liquidity support aggregating Rs. 17,500 crore to RRBs and cooperatives through NABARD besides Rs. 7,500 crore to commercial banks. The limits in this regard were related to the quantum of debt waived by banks under the Agricultural Debt Waiver and Debt Relief Scheme, 2008. This liquidity support had been provided by the Reserve Bank of India under Section 17(3-B) and Section 17(4E) of RBI Act to scheduled banks and NABARD respectively. This envisaged interest is the prevailing fixed repo rate under liquid adjustment facility (LAF), repayable within a period of three weeks but not later than November 3, 2008. This facility was extended for a period up to December 5, 2008. Subsequently, the Reserve Bank revised the limits of the liquidity support availed by scheduled banks under Section 17 (3-B) of RBI Act, 1934 and by NABARD under Section 17 (4-E) of RBI Act, 1934 to Rs. 7,500 crore and Rs. 2,500 crore respectively with effect from December 6, 2008 for an extended period up to December 15, 2008 in the case of commercial banks and up to December 16, 2008 in the case of NABARD.

Agriculture insurance

5.40 Critical agro-climatic variations such as erratic rainfall distribution over time and space and increase in the frequency and severity of droughts, floods and cyclones and rising temperatures, have been causes of uncertainty and risk resulting in losses in agricultural production and of livestock population in India. The National Agricultural Insurance Scheme (NAIS) for crops was implemented from rabi 1999-2000 season with the objective of providing a comprehensive insurance solution to the farmers in the event of failure of any of the notified crops as a result of natural calamities, pests and diseases. The scheme is available to all the farmers (both loanee and non-loanee) irrespective of their size of holding and operates on the basis of "Area Approach," wherein a particular area, viz., tehsil or block or nyaya panchayat or gram panchayat etc is treated as unit of insurance instead of individual farm holdings. It envisages coverage of all the food crops (cereals, millets and pulses), oilseeds and other annual commercial/horticultural crops in respect of which past yield data are available for an adequate number of years. At present, 10 per cent subsidy in premium is available to small and marginal farmers, which is to be shared equally by the Centre and State Governments. The scheme at present is being implemented by 24 states and 2 Union Territories. Since the inception of the scheme and until rabi 2007-08 about 1,155 lakh farmers have been covered. The coverage area is 184 million hectares and the sum insured is Rs.1,21,606 crore. Claims to the tune of about Rs.11,607 crore have been reported against the premium income of about Rs. 3,626 crore benefiting nearly 302 lakh farmers.

5.41 Despite high claims ratio (1:3.2) and low premium rates, particularly for food and oilseeds crops, farmers (particularly non-loanee farmers) do not come forward to avail of crop insurance in a big way. To overcome some of the limitations and to make the scheme more farmer-friendly, a joint group was constituted to study the improvements required in the existing crop insurance schemes. The group made an in-depth study and made important recommendations like reduction in the unit area of insurance to gram panchayat for major crops, improving the basis of calculation of threshold yield, higher indemnity level, coverage of pre-sowing/ planting risks and post-harvest losses, personal accident insurance cover, etc.

Pilot scheme for weather-based crop insurance

5.42 As announced in the Union Budget for 2007-08, the Weather Based Crop Insurance Scheme (WBCIS) is being implemented in the selected areas for selected crops on a pilot basis w.e.f. kharif 2007. WBCIS intends to provide insurance protection to farmers against adverse weather incidence, such as deficit and excess rainfall which are deemed to impact adversely the crop production. It has the advantage to settle the claims within the shortest possible time. The WBCIS is based on actuarial rates of premium but to make the scheme attractive, premium actually charged from farmers has been restricted to "at par" with NAIS. The Agriculture Insurance Company of India Ltd. (AIC) has implemented the pilot WBCIS in Karnataka during kharif 2007 season, covering eight rain-fed crops, insuring 43,790 farmers and crops on nearly 50,000 ha for a sum insured of Rs. 53 crore. The total premium including the Government subsidy amounting to Rs. 7.03 crore (farmers' share of premium was Rs.1.42 crore) was collected and the claims of Rs.5.24 crore were settled to the farmers within the stipulated time. WBCIS was implemented in 2007-08 on a larger scale in selected areas of four States viz., Bihar, Chhattisgarh, Madhya Pradesh and Rajasthan, for rabi 2007-08 season. AIC insured 6.71 lakh farmers covering an area of 10.35 lakh ha for a sum insured of Rs.1,758 crore against the premium of Rs.145.5 crore (farmers' share of premium was Rs.39.23 crore). The claim amounting to Rs.106 crore has been reported for the season and paid. During kharif 2008, AIC implemented this pilot in 10 states covering 1.4 lakh farmers with 1.87 lakh ha of cropped area covered for a sum insured of Rs. 309 crore generating a premium of Rs. 31.5 crore (including subsidy, farmers' share of premium is Rs. 11.82 crore). This pilot is also being continued during rabi 2008-09. In addition to AIC, private insurers like ICICI-LOMBARD General Insurance Company and IFFCO-TOKIO General Insurance Company have also been included for implementation of the scheme in selected areas.

Micro finance

5.43 RBI issued comprehensive guidelines to banks in February 2000 for mainstreaming micro credit and enhancing the outreach of micro credit providers. The guidelines, inter alia, stipulated that micro credit extended by banks to individual borrowers directly or through any intermediary would henceforth be reckoned as part of their priority sector lending. However, no particular model was prescribed for micro finance and banks were given freedom to formulate their own model[s] or choose any conduit/ intermediary for extending micro credit.

5.44 Though there are different modes for purveying 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 the commercial banks, RRBs and cooperative banks.

5.45 Under the SHG Bank Linkage Programme, as on March 31, 2008, 50,09,794 SHGs held saving bank accounts with total savings of Rs. 3,785.39 crore as against 41,60,584 SHGs with savings of Rs. 3,512.71 crore as on March 31, 2007 indicating growth of 20.4 per cent and 7.8 per cent respectively. Thus, more than 7.01 crore poor households were associated with banking agencies under SHG Bank Linkage Programme. As on March 31, 2008, the commercial banks had the maximum share of SHGs' savings with 28,10,750 SHGs (56 per cent) and savings amount of Rs. 2,077.73 crore (55 per cent) followed by RRBs with saving bank accounts of 13,86,838 SHGs (27.7 per cent) and savings amount of Rs.1,166.48 crore (31 per cent) and cooperative banks with saving bank accounts of 8,12,206 SHGs (16.2 per cent) and saving amount of Rs. 541.17 crore (14.3 per cent). The share under the Swarnajayanti Gram Swarozgar Yojana (SGSY) in the total savings accounts was 12,03,070 SHGs forming 24 per cent of the total SHGs having savings accounts in the banks. During the year under review, the average savings per SHG with all banks decreased from Rs.8,469 as on March 31, 2007, to Rs. 7,556 as on March 31, 2008. It varied from high of Rs,8,411 per SHG with RRBs to low of Rs.6,663 per SHG with cooperative banks. As on March 31, 2008, the share of women SHGs in the total SHGs with saving bank account was 39,86,093 forming 79.56 per cent as compared to last year's share of 78.63 per cent.

5.46 During the year 2007-08, the banks financed, 12,27,770 SHGs, including repeat loans to existing SHGs, with bank loans of Rs.8,849.26 crore as against 11,05,749 SHGs with bank loans of Rs.6,570.39 crore during 2006-07 with a growth of 11.03 per cent (number of SHG) and 34.7 per cent (bank loan disbursed) (Table 5.7).

5.47 As on March 31, 2008, 36,25,941 SHGs had outstanding bank loans of Rs.16,999.90 crore as against 28,94,505 SHGs with bank loans of Rs.12,366.49 crore as on March 31, 2007 with a growth of 25.3 per cent. It included 9,16,978 SHGs (25.3 per cent) with outstanding bank loans of Rs. 4,816.87 crore (28 per cent) under SGSY as against 6,87,312 groups (23.7 per cent) with outstanding bank loan of Rs.3,273.03 crore (26.5 per cent) as on March 31, 2007. Commercial banks had the maximum share of outstanding bank loans to SHGs with a share of 67.5 per cent followed by RRBs with a share of 26 per cent and cooperative banks with 6.5 per cent. As on March 31, 2008, average bank loan outstanding per SHG was Rs. 46,884 as against Rs. 42,724 as on March 31, 2007. It varied from a high of Rs. 50,485 per SHG in case of RRBs and a low of Rs. 29,711 in case of cooperative banks.

5.48 On the basis of the data received from banks by NABARD, the gross NPAs in respect of bank loans to SHGs were 2.9 per cent of the bank loans outstanding to SHG on the basis of the data from banks which reported NPA figures. Gross non-

Table 5.7 : Progress under SHG-Bank Linkage

Year	New SHGs financed by banks			Bank loan **(Rs. crore)		
	During the year		Cumulative During the year			Cumulative
	No.	Growth (%)	No.	Amount	Growth (%)	Amount
2002-03	2,55,882	29	7,17,360	1,022.34	87	2,048.68
2003-04	3,61,731	41	10,79,091	1,855.53	81	3,904.21
2004-05	5,39,365	49	16,18,456	2,994.25	62	6,898.46
2005-06	6,20,109	15	22,38,565	4,499.09	50	11,397.55
2006-07	11,05,749*	—	28,94,505@	6,570.39	—	12,366.49
2007-08	12,27,770	11	36,25,941	8,849.26	35	16,999.90
2008-09#	6,42,636		@@	6,471.77		@@

Source : NABARD

** Includes repeat loans to existing SHGs.

Provisional

· Included existing SHGs also, which were provided repeat bank loan.

@ from 2006-07 onwards, data in respect of number of SHGs financed by banks and bank loans are inclusive of SHGs financed under the Swarnajayanti Gram Swarozgar Yojana (SGSY) and the existing groups receiving repeat loans. Owing to this change, NABARD discontinued compilation of data on cumulative basis from 2006-07. As such data from 2006-07 onwards are not comparable with the data of the previous years.

@@ Not available

performing assets (NPAs) for bank loans to SHGs under SGSY were 5.72 per cent of the total outstanding loans to SHGs.

5.49 During the year 2008-09, 6.43 lakh SHGs were provided with bank loans of Rs. 6,471.77 crore (excluding SGSY groups), out of which repeat loans of Rs. 4,294.62 crore were provided to 3.68 lakh existing groups.

5.50 Banks were earlier advised that micro credit should cover not only consumption and production loans for various farm and non-farm activities of the poor, but also include their other credit needs such as housing and shelter improvements. Consequent upon the announcement made at the time of presentation of budget for the year 2008-09, banks have been advised in April 2008, to meet the entire credit requirements of SHG members, namely, (i) income generation activities, (ii) social needs like housing, education, marriage, etc. and (iii) debt swapping.

Evaluation of self-help groups

5.51 Pursuant to the announcement made in the annual policy statement of the RBI, for the year 2007-08, all regional offices (ROs) of the Reserve Bank were advised to undertake an evaluation of the SHG-Bank Linkage Programme. This was intended to ascertain the degree of transparency in maintaining the accounts by the SHGs and their adherence to well accepted best practices. The evaluation of SHGs carried out by the ROs is reported to be completed.

5.52 The gathering momentum in the micro finance sector has brought into focus the issue of regulating the sector. A draft Micro-Financial Sector (Development and Regulation) Bill, 2007 which envisages regulation of the sector, was tabled in the Lok Sabha on March 20, 2007. The Bill provides for registration of micro finance organizations desirous of accepting thrift deposits with NABARD.

Financial performance of banks

5.53 The working results of scheduled commercial banks under different categories available up to 2007-08 are abstracted in Table 5.8.

5.54 It is observed that during 2007-08 the performance of SCBs has showed improvement as gleaned from the operational parameters. Operating expenses as per cent of net income declined in all the categories of SCBs. It was also noticed that the spreads of public sector and old private sector banks reduced, while the spreads of foreign banks and new private sector banks increased.

5.55 Interest rate income or spread defined as the difference between interest income and interest expenses of SCBs as a proportion of total assets could serve as a measure of the cost of financial

Table 5.8 : Working results of scheduled commercial banks

Items	Public sector banks		Foreign banks		Old pvt. sector banks		New pvt. sector banks		All SCB	
	2006-07	2007-08	2006-07	2007-08	2006-07	2007-08	2006-07	2007-08	2006-07	2007-08
					(Rs. Crore)					
A. Income	187869	245941	24968	34947	13042	16799	48837	71200	274716	368886
i) Interest income	164185	214025	17924	24417	11474	14694	38092	56435	231675	309570
ii) Other income	23684	31916	7044	10530	1568	2104	10745	14765	43041	59315
B. Expenditure	167717	219349	20382	28335	11920	14821	43494	63656	243514	326160
i) Interest expended	101960	148902	7603	10604	7055	9960	25802	38535	142420	208001
ii) Intermediation cost (operating expenses)	43255	46598	7745	10355	2967	3234	12353	17033	66319	77220
iii) Provisions and contingenies	22503	23849	5034	7376	1899	1627	5339	8087	34775	40939
C. Operating profit	63407	73190	12330	16967	4089	5212	17696	24578	97522	119946
D. Net profit (A-B)	20152	26592	4585	6612	1122	1978	5343	7544	31203	42726
E.. Net interest income (spread)	62225	65123	10320	13813	4420	4734	12291	17900	89255	101570
F. Total assets	2440166	3022237	274392	364099	160562	194555	584842	745594	3459962	4326486
G. Net Income (Aii+E)	85909	97038	17364	24343	5988	6839	23035	32665	132296	160885
					(As per cent of total assets)					
A. Income	7.70	8.14	9.10	9.60	8.12	8.63	8.35	9.55	7.94	8.53
i) Interest income	6.73	7.08	6.53	6.71	7.15	7.55	6.51	7.57	6.70	7.16
ii) Other income	0.97	1.06	2.57	2.89	0.98	1.08	1.84	1.98	1.24	1.37
B. Expenditure	6.87	7.26	7.43	7.78	7.42	7.62	7.44	8.54	7.04	7.54
i) Interest expended	4.18	4.93	2.77	2.91	4.39	5.12	4.41	5.17	4.12	4.81
ii) Intermediation cost	1.77	1.54	2.82	2.84	1.85	1.66	2.11	2.28	1.92	1.78
iii) Provisions and contingenies	0.92	0.79	1.83	2.03	1.18	0.84	0.91	1.08	1.01	0.95
C. Operating profit	2.60	2.42	4.49	4.66	2.55	2.68	3.03	3.30	2.82	2.77
D. Net profit (A-B)	0.83	0.88	1.67	1.82	0.70	1.02	0.91	1.01	0.90	0.99
E. Net interest income (spread)	2.55	2.15	3.76	3.79	2.75	2.43	2.10	2.40	2.58	2.35
Memo item										
1 Operating expenses as per cent of net income	50.35	48.02	44.60	42.54	49.55	47.29	53.63	52.15	50.13	48.00

Source : RBI

intermediation. High interest rate spreads could be indicative of the level of efficiency of the financial intermediation and also a relatively less competitive market. Net interest income or spread was 23 basis points lower at 2.35 per cent during 2007-08 compared to 2.58 per cent in 2006-07. Highest spread during 2007-08 at 3.79 per cent was observed in respect of foreign banks followed by old private banks (2.43 per cent), new private banks (2.40 per cent) and public sector banks (2.15 per cent).

Non-performing assets of the banking sector

5.56 The gross non-performing assets of SCBs, as proportion of total assets declined to 1.3 per cent during 2007-08 compared to 1.5 per cent during 2006-07. While this decline reflected an improvement, in terms of quantum of funds, the situation depicted a different picture. During 2006-07 the amount recovered and written off (Rs. 26,243 crore) was more than the fresh addition (Rs. 26,211 crore) of NPAs. In contrast, during 2007-08 the amount recovered and written off (Rs. 28,090 crore) was significantly less than the fresh addition (Rs. 34,420 crore) of NPAs.

5.57 Gross NPAs of SCBs, which had declined by Rs. 611 crore in 2006-07, increased by Rs. 5,949 crore in 2007-08. During 2007-08 a total of 1,86,535 cases for NPA recoveries were referred to the Lok Adalat for an amount of Rs. 2,142 crore of which

8.2 per cent was recovered. A total of 83,942 cases for NPA recoveries were referred under the SARFESI Act for an amount of Rs. 7,263 crore of which 61 per cent was recovered. A total of only 3,728 cases for NPA recoveries were referred to the Debt Recovery Tribunals for an amount of Rs. 5,819 crore of which 51.9 per cent was recovered.

Capital adequacy ratio

5.58 To prepare banks for the implementation of BASEL-II norms, a three-track approach has been adopted with regard to capital adequacy rules. On the first track, commercial banks are required to maintain capital for both credit and market risks as per BASEL-I framework; on the second track, the cooperative banks are required to maintain capital for credit risk as per BASEL-I framework and through surrogates for market risk; and the RRBs, on the third track, have to maintain minimum capital which may not be on par with BASEL-I norms.

5.59 With the introduction of stiffer prudential norms by the RBI for maintaining quality of credit necessitated due to the rapid increase in credit expansion by SCBs in the system, risk-weighted assets of SCBs at the end-March 2008 increased to Rs. 31,28,093 crore from Rs. 24,12,236 crore at end-March 2007. Concomitantly, capital funds of SCBs kept pace with the risk-weighted assets and increased to Rs. 4,06,835 crore at end-March 2008 from the level of Rs. 2,96,191 crore at end-March 2007. The capital to risk-weighted assets ratio (CRAR) during 2007-08 increased from 12.3 per cent as of end-March 2007 to 13.0 per cent as of end-March 2008. CRAR for foreign and new private sector banks was at 13.1 per cent and 14.4 per cent respectively as of end-March 2008 compared to 12.4 per cent and 12.0 per cent respectively as of end-March 2007.

Technology

5.60 Banks incur large amounts of expenditure on computerization, automation and development of communication network. The cumulative expenditure during September 1999 to March 2008 was Rs. 15,016 crore. These help in changing the image and outlook of banking sector significantly by improving the processes and procedures, rapid product development through alternative delivery channels, reduction in the transaction costs and eventually leading to higher productivity. The technology is also being leveraged to expand the banking outreach particularly to rural areas. The number of branches providing "core banking solutions" (CBS) rose rapidly to 67.0 per cent as of end-March 2008 from 44.4 per cent at end-March 2007. The number of automated teller machines (ATMs) at the end-March 2008 was 34,789 compared to 27,088 at end-March 2007.

Financial institutions

5.61 Based on the major activity undertaken by them, Financial Institutions (FIs) get classified into three broad categories (i) term-lending institutions, whose main activity is direct lending by way of term loans and investments; (ii) refinance institutions, such as the National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI) and National Housing Bank (NHB), which mainly extend refinance to banks as well as non-banking financial institutions and; (iii) investment institutions such as Life Insurance Corporation (LIC), which deploy their assets largely in marketable securities. State/ regional level institutions form another distinct group.

5.62 The combined balance sheets of select FIs (NABARD, NHB, SIDBI and EXIM Bank) expanded sharply by 19.5 per cent during 2007-08. On the liabilities side, the resources raised by way of bonds and debentures (which form a major constituent with a share of 32.5 per cent in the total liabilities) declined by 3.5 per cent during 2007-08. However, deposits and borrowings recorded a sharp increase of 54.1 per cent and 56.7 per cent, respectively. On the assets side, loans and advances continued to expand, while the investment portfolio declined (9.3 per cent). Cash and bank balances as well as other assets registered a sharp turnaround during the year.

5.63 Resources raised by FIs during 2007-08 were considerably higher than those during the preceding year. While the long-term resources raised witnessed a sharp rise during 2007-08 as compared to 2006-07, the short-term resources raised declined. Resources raised in foreign currency and from the money market also witnessed an increase during 2007-08.

5.64 Financial assistance sanctioned by FIs accelerated sharply during 2007-08 as against the deceleration witnessed during the preceding year. The acceleration in sanctions was accounted for mainly by investment institutions (especially LIC). Notwithstanding the acceleration in sanctions, the disbursements by FIs slowed down during 2007-08. (Table 5.9)

Table 5.9: Financial assistance sanctioned and disbursed by financial institutions

(Rs. crore)

Category	Amount				Percentage variation	
	2006-07		2007-08		2007-08	
	S	D	S	D	S	D
(i) All-India term-lending Institutions*	11102	10225	16181	15098	45.7	47.6
(ii) Specialised financial institutions#	—	—	—	—	—	—
(iii) Investment institutions@	18862	27757	39617	28414	110.0	2.4
Total assistance by FIs(i+ii+iii)	29964	37982	55798	43512	86.2	14.6

Source : RBI

S : Sanctions * : Relating to SIDBI and Industrial Investment Bank of India. D : Disbursements
 # Relating to IVCF and ICICI Venture. @ : Relating to LIC and GIC & erstwhile subsidiaries — : Not Available.

Note : All data are provisional.
Data for 2006-07 has been recalculated to exclude IFCI Ltd, and Tourism Finance Corporation of India Ltd. as they are being regulated as NBFCs as on March 31, 2008.

5.65 Net interest income of FIs increased by 19.7 per cent to Rs. 2,642 crore during 2007- 08 from Rs. 2,208 crore during 2006-07. In line with the trend in the previous years, non-interest income of FIs increased significantly by 71.8 per cent during the year. However, in contrast with the decline in the preceding year, the operating expenses of FIs registered a sharp rise of 46.6 per cent during the year. The operating profit recorded an increase of 30.1 per cent during the year.

5.66 In absolute terms, net NPAs of EXIM Bank and NABARD declined during 2007-08, while that of SIDBI increased. Reflecting the improvement in asset quality, NPAs in the sub-standard and doubtful category of all FIs constituted a very small share. Also none of the FIs had any assets in the 'loss' category.The capital adequacy ratio of all the FIs continued to be significantly higher than the minimum stipulated norm of 9 per cent.

5.67 In recent years, the Reserve Bank of India has taken a number of initiatives for progressive upgradation of the regulatory norms for FIs in convergence with the norms across the financial sector. Some of these include:

- A sizeable portion of exposure of SIDBI is by way of refinance to State Finance corporations (SFCs). The poor financial health of SFCs has a spillover effect on the financial health of SIDBI as well. Therefore, the risk weight in respect of SIDBI's exposure to SFCs has been raised from 100 per cent to 125 per cent. SIDBI was also instructed not to sanction refinance to SFCs that continued to show negative net worth. These measures were taken to strengthen the regulatory focus of SIDBI over the SFCs.
- The Government of India from time to time, also issues special securities (e.g. oil bonds, fertilizer bonds) which do not qualify for meeting the SLR requirements of banks. Such Government securities are governed by a separate set of terms and conditions and entail a higher degree of liquidity spread. The issue of valuation of such special securities was re-examined and in June 2008 FIs were advised that, for the limited purpose of valuation, all special securities issued by the Government of India, directly to the beneficiary entities, which do not carry SLR status, may be valued at a spread of 25 bps above the corresponding yield on Government of India securities from the financial year 2008–09.
- With a view to enhancing credit delivery to the employment intensive micro and small enterprises (MSE) sector, it was decided on December 6, 2008 to provide refinance of Rs. 7,000 crore to SIDBI and Rs. 4,000 crore for NHB.

Non-Banking Financial Companies

5.68 Non-Banking Financial Companies (NBFCs) broadly fall into three categories, viz., (i) NBFCs accepting deposits from the public; (ii) NBFCs not accepting/holding public deposits; and (iii) core investment companies (i.e., those acquiring shares/ securities of their group/holding/subsidiary companies to the extent of not less than 90 per cent of total assets and which do not accept public deposit).

5.69 Until some years back, the prudential norms applicable to banking and non-banking financial companies were not uniform. Moreover, within the

NBFC group, the prudential norms applicable to deposit taking NBFCs (NBFCs-D) were more stringent than those for non-deposit taking NBFCs (NBFCs-ND). Since the NBFCs-ND were not subjected to any exposure norms, they could take large exposures. The absence of capital adequacy requirements resulted in high leverage by the NBFCs. Therefore, since 2000, the Reserve Bank has initiated measures to reduce the scope of "regulatory arbitrage" between banks, NBFCs-D and NBFCs-ND.

5.70 Total number of NBFCs registered with the Reserve Bank, consisting of NBFCs-D (deposit-taking NBFCs), Residual Non-Banking Companies (RNBCs, Mutual Benefit Companies (MBCs), Miscellaneous Non-Banking Companies (MNBCs) and Nidhi companies, declined from 12,968 at end-June 2007 to 12,809 at end-June 2008. The number of NBFCs-D has shown a steady decline to 364 at end-June 2008, mainly due to the exit of many NBFCs from deposit taking activity (Table 5.10). The number of RNBCs declined to two at end-March 2008. Even though the public deposits declined in 2007-08 over the previous year, partly reflecting the decline in number of reporting NBFCs, total assets increased significantly by Rs. 23,019 crore (32.1 per cent), while net owned funds increased by Rs. 3,974 crore (48.0 per cent) during the same period.

5.71 Continuing the trend of the preceding year, public deposits held by all groups of NBFCs taken together, declined moderately during 2007-08. The outstanding borrowings by NBFCs increased during 2007-08. Borrowings by NBFCs were mainly from banks and financial institutions and by way of bonds and debentures and "other sources" (which include miscellaneous sources including money borrowed from other companies, unsecured loans from directors/ promoters, commercial paper, borrowings from mutual funds and any other type of funds which are not treated as public deposits). Financial performance of NBFCs improved during 2007-08 due to increases in fund-based and fee-based incomes . Continuing the trend witnessed during the last few years, gross Non Performing Assets (NPAs) as well as net NPAs (as percentage of gross advances and net advances, respectively) of reporting NBFCs declined further during the year ended March 2008.

Table 5.10 : Number of Non-banking financial companies registered with RBI

End-June	Number of registered NBFCs	NBFCs accepting public deposits	Column 3 as per cent of column 2
2003	13,849	710	5.1
2004	13,764	604	4.4
2005	13,261	507	3.8
2006	13,014	428	3.3
2007	12,968	401	3.1
2008	12,809	364	2.8

Source : RBI

5.72 Capital to risk-weighted assets ratio (CRAR) norms were made applicable to NBFCs in 1998, in terms of which, every deposit taking NBFC is required to maintain a minimum capital, consisting of Tier-I and Tier-II capital, of not less than 12 per cent (15 per cent in the case of unrated deposit-taking loan/ investment companies) of its aggregate risk-weighted assets and of risk-adjusted value of off-balance sheet items. The number of NBFCs with less than the minimum regulatory CRAR of 12 per cent increased to 44 at end-March 2008 from 20 at end-March 2007. At end-March 2008, 276 out of 320 NBFCs had CRAR of 12 per cent or more as against 354 out of 374 NBFCs at end-March 2007. The number of NBFCs with CRAR more than 30 also declined to 238 at end-March 2008 from 305 at end-March 2007. Notwithstanding this, it is noteworthy that the NBFC sector is witnessing a consolidation process in the last few years, wherein the weaker NBFCs are gradually exiting, paving the way for a stronger NBFC sector.

5.73 With a view to protecting the interests of depositors, regulatory attention was mostly focused on NBFCs accepting public deposits (NBFCs-D) until recently. Over the last few years however, this regulatory framework has undergone a significant change, with increasingly more attention now being paid to non-deposit taking NBFCs (NBFCs-ND) as well. This change was necessitated mainly on account of a significant increase in both the number and balance sheet size of NBFCs-ND segment which gave rise to systemic concerns. To address this issue, NBFCs-ND with asset size of Rs.100 crore and above were classified as systemically important NBFCs (NBFCs-ND-SI) and were subjected to "limited regulations". The NBFCs-NDSI are now subject to CRAR and exposure norms prescribed by the Reserve Bank. The CRAR prescription for such companies has been raised to 12 per cent from March 31, 2009 and further to 15 per cent by March 31, 2010.

5.74 SEBI has permitted Fixed Income Money Market and Derivatives Association of India (FIMMDA) to set up its reporting platform for corporate bonds. It has also been mandated to aggregate the trades reported on its platform as well as those reported on BSE and NSE with appropriate value addition. The FIMMDA platform has gone live with effect from September 1, 2007. All NBFCs are required to report their secondary market transactions in corporate bonds in the OTC market on FIMMDA's reporting platform since September 1, 2007.

5.75 In the wake of emergent tight liquidity scenario, the Reserve Bank of India had on October 15, 2008 announced, purely as a temporary measure, that banks may avail of additional liquidity support exclusively for the purpose of meeting the liquidity requirements of NBFCs/mutual funds (MFs) to the extent of up to 0.5 per cent of their NDTL. Further, on a purely temporary and ad hoc basis, subject to review, the banks were allowed to avail liquidity support under the LAF through relaxation in the maintenance of SLR to the extent of up to 1.5 per cent of their NDTL. This relaxation in SLR was to be used exclusively for the purpose of meeting the funding requirements of NBFCs and MFs.

5.76 Taking into consideration the need for enhanced funds for increasing business and meeting regulatory requirements, NBFCs-NDSI were permitted to augment their capital funds by issue of Perpetual Debt Instruments (PDI). PDIs could be issued in Indian rupees only and the aggregate amount to be raised by issue of such instruments has to be within the overall limits of Tier I and Tier II capital. Further as a temporary measure, NBFCs-NDSI have been permitted to raise short-term foreign currency borrowings under the approval route, subject to certain conditions like eligibility of borrowers and lenders, end-use of funds, maturity, etc. The maximum amount should not exceed 50 per cent of the net-owned funds or US$ 10 million (or its equivalent), whichever is higher.

Capital and commodity markets

5.77 The capital and commodity markets experienced downturn during 2008 against the backdrop of heightened uncertainties triggered by the international financial crisis, slowdown in the global economic growth, volatility in the international food, commodity and fuel prices and also due to volatility in international financial markets.

Capital Market

5.78 The Indian capital market began the year 2008 on a bullish note, with the BSE and NSE indices touching new peaks of 20,873 and 6,288, respectively, on January 8, 2008 but was affected adversely thereafter reflecting the impact of global financial crisis. The movement in equity prices in Indian capital market was in tandem with trends in major international equity markets; the Indian equity market weakened further during September-December 2008, following sharp decline in stock markets across the globe and perceptible shift in investor preferences. Having regard to these trends, the regulatory measures initiated during the year were aimed at ensuring the soundness and stability of the Indian capital market.

Primary Market

5.79 After recording strong growth during 2006 and 2007, the primary capital market received a set

Table 5.11 : Resource mobilization through primary market

(Rs. crore)

	Mode	Calendar Year 2005	2006	2007	2008 (P)
1.	**Debt**	66	389	594	0
2.	**Equity**	30,325	32,672	58,722	49,485
	of which, IPOs	9,918	24,779	33,912	18,393
	Number of IPOs	55	75	100	37
	Mean IPO size	180	330	339	497
3.	**Private placement**	83,812	1,17,407	1,84,855	1,75,061
4.	**Euro issues (ADR/GDR)**	9,788	11,301	33,136	6,271
	Total (1 to 4)	**1,23,991**	**1,61,769**	**2,77,307**	**2,30,877**

Source : SEBI and RBI (for Euro Issues)
P : Provisional

Table 5.12 : Trends in resource mobilization (net) by mutual funds

(Rs. crore)

Sector	Calendar Year				
	2004	2005	2006	2007	2008
1. UTI	-1,487	1,237	6,426	9,245	-2,704
2. Public Sector	-1,262	4,446	12,229	8,259	14,587*
3. Private Sector	7,524	19,735	86,295	1,20,766	12,506
4. Total (1 to 3)	**4,775**	**25,454**	**1,04,950**	**1,38,270**	**-624**

Source : SEBI

* The name of BoB Mutual Fund was changed to Baroda Pioneer Mutual Fund on August 2008. Since BoB Mutual Fund was in the public sector for 8 months of the calendar year 2008, it is considered as a public sector mutual fund till the period mentioned above.

back in 2008. The number of new issues declined sharply in 2008. Total amount of capital raised through equity issues during 2008 was Rs. 49,485 crore, recording a decline of 15.7 per cent as compared to the level in 2007. The total number of initial public offerings (IPOs) were only 37 in 2008 as against 100 in 2007. The amount mobilized by IPOs at Rs. 18,393 crore was also lower by 45.8 per cent during 2008. However, the mean IPO size increased from Rs. 339 crore in 2007 to Rs. 497 crore in 2008. There was no debt issue in 2008. Private placement amounted to Rs. 1,75,061 crore in 2008 i.e., lower by 5.3 per cent over 2007 (Table 5.11).

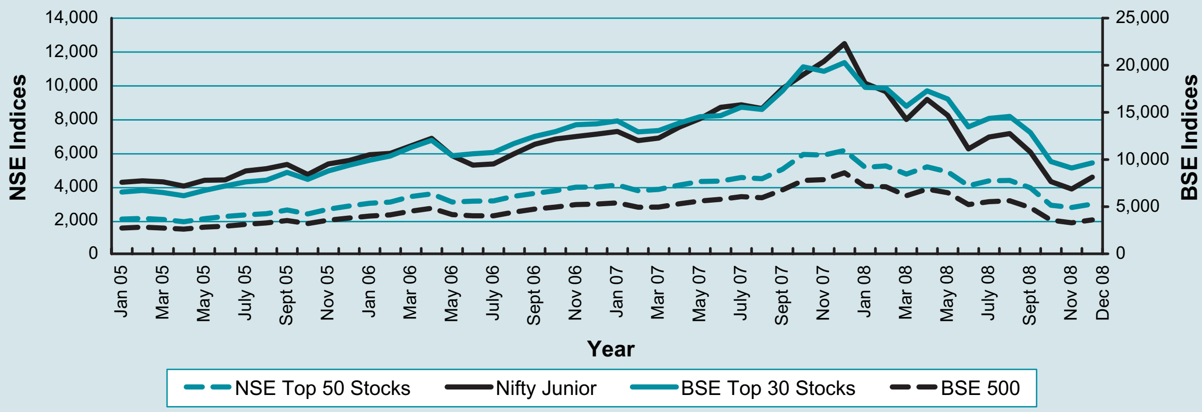
5.80 Reflecting the volatile capital market conditions, the net inflow of saving into mutual funds, which had recorded a steady rise during 2005-07, turned negative in 2008. The private sector mutual funds witnessed heavy redemption pressure in 2008 and recorded a net outflow of Rs. 12,506 crore. The Unit Trust of India (UTI) also recorded net redemption to the extent of Rs. 2,704 crore in 2008, while the public sector mutual funds (other than UTI) mobilized higher amount of Rs. 14,587 crore in 2008. The change reflected changing risk preference of investors towards public sector institutions in times of global financial crisis (Table 5.12).

Secondary market

5.81 In the secondary market segment, the market activity began on a bullish note with BSE and NSE (S&P CNX Nifty) indices scaling new peaks of 20,873 and 6,287on January 8, 2008. However, this momentum could not be sustained and the indices recorded significant downtrend in line with the decline in all the major international indices during the second half of January 2008. In fact, intraday fall of 1,968 points in absolute terms in BSE Sensex on January 21, 2008 was the highest recorded fall in the history of Sensex. Despite intermittent corrections in the stock market, the market sentiment remained bearish due to the rising domestic inflation, increasing oil prices and volatility in international financial markets (in the wake of uncertainties about US sub-prime mortgage market and credit market exposures) and negative portfolio investment flows during February-March 2008. The indices showed some improvement during April 2008 in line with positive cues from the global markets. However, the market sentiment turned cautious towards the end of May 2008 on account of increase in international crude oil prices, downward trend in major international equity markets, increasing concerns about domestic inflation, widening of trade deficit and depreciation of the rupee. The domestic stock markets exhibited an upward trend from mid-July to the first week of September 2008 but weakened thereafter and recorded losses till end-December 2008. This was attributed to volatility in international equity markets, net outflow of funds from domestic capital market by Foreign Institutional Investors (FIIs) and slowdown in domestic activity. During 2008, on a point-to-point basis, BSE Sensex and Nifty indices declined by 51.8 per cent and 52.4 per cent respectively.

5.82 Amongst the NSE indices, both Nifty and Nifty Junior recorded negative annual equity returns (current year-end index divided by previous year-end index multiplied by 100) of 51.8 per cent and 63.5 per cent respectively during the calendar year 2008 (Figure 5.3).

Figure 5.3 : Movement of indices of NSE and BSE



5.83 In terms of month-to-month movement, the NSE indices (Nifty and Nifty Junior) showed improvements during February, April and July-August 2008 and fell steeply during September-December 2008. The same pattern was observed in the movement of BSE Sensex and BSE 500 indices during the year 2008.

5.84 During 2008, the decline in indices was seen across the Asian stock markets, with the SSE Composite Index (Shanghai, China) recording a fall of 65.4 per cent to 1,821 at end-December 2008, while the BSE Sensex was lower by 52.4 per cent to 9,647 at end-December 2008 as against 20,287 at end-December 2007.

5.85 The cumulative change in global indices at end-December 2008 over end-2003 level is in sharp contrast to the earlier years and is presented in Table 5.13.

5.86 Reflecting the bearish trend in the Indian equity markets, the market capitalization of shares traded on BSE and NSE declined sharply in 2008. On a year-on-year basis, the market capitalization which had reached record levels in 2007, dipped in the range of 48.0 per cent to 54.6 per cent at end-December 2008. Market capitalization to GDP ratio improved from 85.5 per cent at end-March 2007 to 156.7 per cent on January 8, 2008 before declining to 109.5 per cent by end-March 2008 and further dipping to 49.7 per cent at the end of March 2009. The market volatility, as measured by the standard deviation of daily volatility of the Indian indices increased significantly in 2008

Table 5.13 : Cumulative change in movement of global indices*

Index	Cumulative change over end-2003 level				
	2004	2005	2006	2007	2008
BSE Sensex, India	13.1	61.0	136.1	247.4	65.2
Hang Seng Index, Hong Kong	13.2	18.3	58.8	121.2	1.1
Jakarta Composite Index, Indonesia	44.5	68.1	161.0	296.8	35.5
Nikkei 225, Japan	7.6	50.9	61.3	43.4	-22.9
Kospi Index, South Korea	10.5	69.7	76.8	133.9	25.6
Kuala Lumpur Comp Index, Malaysia	14.2	13.4	38.0	82.0	-3.3
TSEC Weighted Index, Taiwan	4.2	11.2	32.8	44.4	-25.2
SSE Composite Index, China	-15.4	-22.4	78.7	251.5	43.7

Source : Derived from various country sources.

*** End year closing.**

Table 5.14 : Equity returns, volatility, market capitalization & P/E ratio

Index	Calendar Year			
	2005	2006	2007	2008
Nifty :				
Returns (per cent)	36.34	39.83	54.77	-51.79
End-year market capitalization (Rs. cr.)	13,50,394	19,75,603	35,22,527	18,32,610
Daily volatility *	1.11	1.64	1.60	2.81
End-year P/E	17.07	21.26	27.62	12.97
Nifty Junior :				
Returns (per cent)	24.43	28.24	75.73	-63.52
End-year market capitalization (Rs. cr.)	2,18,575	3,33,693	6,43,625	2,95,471
Daily volatility *	1.22	1.96	1.71	3.15
End-year P/E	17.11	21.78	26.48	8.99
BSE Sensex :				
Returns (per cent)	42.3	46.7	47.2	-52.48
End-year market capitalization (Rs. cr.)	12,13,867	17,58,865	28,61,341	14,63,165
Daily volatility *	1.1	1.6	1.5	2.85
End-year P/E	18.6	22.8	27. 7	12.36
BSE 500 :				
Returns (per cent)	36.6	38.9	63.0	-58.74
End-year market capitalization (Rs. cr.)	22,81,579	33,36,509	64,70,881	29,40,741
Daily volatility *	1.1	1.6	1.5	2.75
End-year P/E	17.5	20.2	29.1	12.4

Source : NSE and BSE.
*** Standard deviation values.**

(Table 5.14). The price-to-earnings (P/E) ratio, which partly discounts future corporate earnings reflecting investors' expectations of corporate profit, declined in all the market segments reflecting the downward trend in stock prices.

5.87 The volatility of weekly returns of Indian indices increased in 2008 and was even higher than that of indices outside India such as S&P 500 of United States of America and Kospi of South Korea (Table 5.15).

5.88 Notwithstanding the sharp correction in the valuation of Indian stocks, the year-end valuation of stocks in terms of P/E ratio of Indian indices at 12.4-12.9 at end-December 2008 was the highest amongst select emerging market economies such as South Korea, Thailand, Malaysia and Taiwan (Table 5.16).

5.89 The price of a security depends largely on demand and supply conditions and is influenced by the impact cost, which represents the cost of executing a transaction in a given security, for a pre-defined order size, at any given point of time. The market liquidity and the impact cost are inversely related. The impact cost for purchase or sale of Nifty Junior portfolio, which had improved between 2004 and 2007, increased to 0.19 per cent in 2008.

Table 5.15 : Volatility of weekly returns on the equity markets (standard deviation)

Class of stocks	Period	
	Jan 2006 Dec 2007	Jan 2007 Dec 2008
India		
Top 50 (Nifty)	2.45	4.30
Next 50 (Nifty Junior)	2.85	4.89
Sensex	3.17	4.57
BSE 500	3.30	4.68
Outside India		
U.S (S&P 500)	1.28	3.83
Korea (Kospi)	2.17	4.19

Source : NSE and BSE

Table 5.16 : P/E ratios in select emerging markets

Index/Market	Mar. 2008	Dec. 2008
South Korea, KOSPI	14.23	10.95
Thailand, SET	16.61	7.26
Indonesia, JCI	16.90	8.26
Malaysia, KLCI	13.65	10.09
Taiwan, TWSE	18.36	9.31
India, BSE Sensex	20.11	12.36
India, S&P CNX Nifty	20.63	12.97

Source : SEBI and Bloomberg Financial Services

Table 5.17 : Equity spot market liquidity: impact cost (%)

Portfolio	Calendar year 2005	2006	2007	2008
Nifty :				
NSE impact cost				
at Rs.50 lakh	0.08	0.08	0.08	0.11
Nifty Junior :				
NSE impact cost				
at Rs. 25 lakh	0.16	0.16	0.14	0.19

Source : NSE

It was also higher for the Nifty portfolio at 0.11 per cent in 2008 as compared to the previous years (Table 5.17).

5.90 The turnover in the spot market on the NSE continued its upward trend in 2008, while the BSE spot market turnover registered a decline of 6.4 per cent. However, the turnover in the derivatives market on NSE and BSE were lower by 2.4 per cent and 65.8 per cent respectively in 2008 (Table 5.18).

5.91 The spot market turnover (one-way) for NSE and BSE amounted to Rs. 45,12,563 crore (Rs. 45,08,709 crore in 2007). The turnover in the derivatives segment for NSE and BSE, taken together, was marginally lower at Rs. 1,17,29,553 crore during 2008. The turnover in NSE spot and derivative markets, as a proportion of market capitalization of Nifty was 173.9 per cent and 635 per cent respectively. The turnover in BSE spot and derivatives was 45 and 3 per cent respectively of market capitalization of BSE (500) Index.

5.92 The institutional players, viz., FIIs and mutual funds, de-leveraged their activity in the equity market during 2008. The net investment by FIIs in spot market recorded an outflow during 2008 as against an inflow of Rs. 80,915 crore in 2007 (Table 5.19). The number of registered FIIs rose to 1,591 at the end of 2008 from 1,219 at the end of 2007. The number of sub-accounts also increased to 4,864 from 3,644 over the same period.

Table 5.18 : Market turnover

(Rs. crore)

Market	Calendar year 2005	2006	2007	2008
NSE Spot	18,88,112	19,16,227	30,93,982	31,88,510
BSE Spot	7,01,025	9,61,653	14,14,727	13,24,053
NSE Derivatives	39,26,843	70,46,665	1,19,40,877	1,16,54,375
BSE Derivatives	1,965	18,071	2,19,824	75,178

Source: NSE and BSE

Table 5.19 : Transactions of FIIs

(Rs. crore)

Transactions	Calendar year 2006	2007	2008
End-year number of FIIs	1,044	1,219	1,591
End-year number of sub-accounts	3,045	3,644	4,864
1. Equity market activity			
Spot			
Gross buy	4,75,623	8,14,877	7,21,607
Gross sell	4,39,083	7,43,391	7,74,594
Net (Gross buy-Gross sell)	36,540	71,486	-52,987
2. Debt			
Gross buy	11,061	31,418	48,020
Gross sell	7,012	21,990	36,248
Net (Gross buy-Gross sell)	4,049	9,428	11,772
3. Total FII Investment (1+2)			
Gross buy	4,86,683	8,46,295	7,69,625
Gross sell	4,46,095	7,65,380	8,10,841
Net (Gross buy-Gross sell)	40,589	80,915	-41,216

Source : SEBI

5.93 Assets under management of mutual funds declined sharply from Rs. 5,49,936 crore at the end of 2007 to Rs. 4,13,365 crore at the end of 2008. A perceptible shift was noticed from growth-oriented schemes to income/debt oriented schemes. Assets under income-oriented schemes in 2008 were almost at their previous year's level and accounted for 47.7 per cent of total assets under management at the end of 2008. Assets under growth-oriented schemes were only Rs. 99,081 crore at end-December 2008 as against Rs. 1,92,129 crore at end-December 2007. The decline in assets was seen across the schemes; the exceptions being Gilt and Gold ETF Schemes, which showed larger assets under management in 2008 (Table 5.20).

Debt market

5.94 Indian debt market has two segments, viz., Government securities market and corporate debt market.

Government securities market

5.95 The fresh issuance of Government of India (GoI) dated securities in 2008 amounted to Rs.1,76,000 crore as against Rs. 1,62,000 crore in 2007. The outstanding dated securities of the GoI increased from Rs. 13,17,133 crore at end-December 2007 to Rs. 14,16,443 crore at end-December 2008. Yields on securities showed large intra-year variations in 2008 as compared with the previous year. The range of yield-to-maturity (YTM) on one-year bond (fresh issuance) widened from 6.27-7.90 per cent in 2007 to 5.02-9.40 per cent in 2008. The range of YTM on 10-year bonds also widened to 5.61-9.54 per cent in 2008 from 7.49-8.35 per cent in 2007.

Table 5.20 : Assets under management of mutual funds

(Rs. crore)

Schemes	At the end of			
	2005	2006	2007	2008
Money market	64,711 (32.5)	97,757 (30.2)	1,12,349 (20.4)	82,776 (20.0)
Gilt	3,730 (1.9)	2,057 (0.6)	1,975 (0.4)	6,368 (1.50)
Income	52,903 (26.6)	86,349 (26.7)	1,97,342 (35.9)	1,97,132 (47.69)
Growth	67,144 (33.7)	1,19,539 (36.9)	1,92,129 (34.9)	99,081 (23.97)
Balanced	6,833 (3.4)	9,170 (2.8)	19,938 (3.6)	11,349 (2.75)
ELSS	3,927 (2.0)	8,725 (2.7)	19,063 (3.5)	11,577 (2.80)
Gold ETF	NA	NA	467 (0.1)	734 (0.18)
Other ETFs	NA	NA	6,674 (1.2)	1,761 (0.43)
FoF investing overseas				2,588 (0.63)
Total	**1,99,248**	**3,23,598**	**5,49,936**	**4,13,365**

Source : SEBI

5.96 A liquid and well developed secondary market for government securities is crucial for effective management of government debt. The volume of secondary market transactions (outright) in government securities has improved, with the turnover ratio (volume of transactions as a ratio of end-period stock) increasing to 1.4 in the calendar year 2008, compared to 0.8 in 2007.

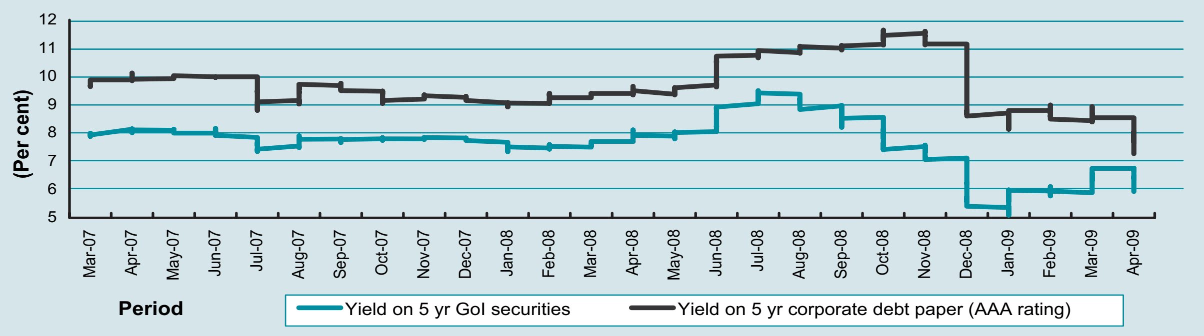
5.97 In the secondary market, the yield on dated government securities tracked the policy rate hikes during the first half of 2008 and the 10-year and 30-year yields touched their highest levels by the end of July 2008. In the second half, following the policy measures announced by the Reserve Bank, the liquidity in the system increased; the secondary market yields mirrored the impact of the emerging liquidity conditions. However, during January-March 2009, the secondary market yields edged up, attributable to higher level of borrowing of the Government of India.

Corporate debt market

5.98 In pursuance of the guidelines of the High Level Expert Committee on Corporate Bonds and Securitisation (December 2005) and the subsequent announcement made in the Union Budget 2006-07, SEBI authorised BSE (January 2007), NSE (March 2007) and Fixed Income Money Market and Derivatives Association of India (FIMMDA) (August 2007) to set up and maintain corporate bond reporting platforms for capturing all information related to trading in corporate bonds as accurately as possible. In the second phase of development, BSE and NSE put in place corporate bonds trading platforms in July 2007 to enable efficient price discovery in the market. Reflecting these developments, trading in corporate bonds increased significantly in terms of number of trades and amount in 2008-09; the increase in terms of amount was from Rs. 96,119 crore in 2007-08 to Rs. 1,48,747 crore in 2008-09.

5.99 The yield on corporate debt paper (with AAA rating) for five-year maturity ranged between 8.13

Figure 5.4 : Yield on 5 year GoI securities and corporate debt paper



per cent and 11.64 per cent during 2008-09.The spread between yield on five-year GoI bonds and Indian corporate debt paper (AAA rating) with five-year maturity, which had moved in a range of 133-223 basis points between April-August 2008, widened thereafter to reach as high as 416 basis points in November 2008, which reflected tight liquidity conditions in the market. However, it narrowed down from December 2008 and was around 200 basis points by the end of March 2009 (Figure 5.4).

Currency derivatives

5.100 RBI and SEBI had jointly constituted a Standing Technical Committee to analyze the Currency Forward and Future market around the world and lay down the guidelines to introduce Exchange Traded Currency Futures in the Indian market. The Committee submitted its report on May 29, 2008 and the operational guidelines were issued on August 6, 2008. The underlying idea was to facilitate transparency and efficiency in price discovery, eliminate counterparty credit risk, provide access to all types of market participants, standardise products and provide transparent trading platform. Trading in the currency futures segment commenced at NSE in August 2008. Later, BSE and Multi Commodity Exchange of India Ltd. (MCX) were also given permission to trade in currency derivatives. The number of contracts and traded value in the currency futures have increased considerably. During August-March 2008-09, as many as 327.39 lakh currency derivative contracts were traded at NSE. Total traded value of the contracts during the same period was Rs. 1,62,563 crore. The average daily trading value has shown an increase from month-to-month (Table 5.21).

Table 5.21 : Currency futures segment at NSE

Month/Year	No. of contracts traded	Trading value (Rs. crore)	Average daily trading value (Rs. crore)	Open interest at the end of the month	
				No. of contracts	Trading value (Rs. crore)
August 2008	65,798	291		16,332	72
September 2008	12,58,099	5,763	262	90,871	428
October 2008	22,75,261	11,142	557	1,70,202	851
November 2008	32,33,679	15,969	887	1,46,262	737
December 2008	46,81,593	22,840	1,088	1,77,520	861
January 2009	49,00,904	23,980	1,199	2,54,797	1,247
February 2009	64,16,059	31,761	1,672	3,15,317	1,612
March 2009	99,07,173	50,817	2,675	2,57,554	1,313
August-March 2008-09	**3,27,38,566**	**1,62,563**		**2,57,554**	**1,313**

Source : SEBI

Policy Developments

5.101 Some of the salient policy initiatives relating to the capital market taken during the year 2008 were:

I. Primary Market

The amendments made to the SEBI Disclosure and Investment Protection (DIP) Guidelines, 2000 included the following:

- Introduction of a supplementary process of applying in public issues, viz., the "applications supported by blocked amount" (ASBA) process for IPO applications to ensure that the funds are debited from the investors' accounts only upon confirmed allotment of securities and only to the extent of allotment made to the investor. The ASBA process was also extended to rights issues.
- Reduction in timelines for rights issues like the notice period required for calling a board meeting of the issuer to consider the rights issue; and the period stipulated for completion of allotment and commencement of listing and trading of the shares so issued.
- Expansion of the eligibility criteria for listed companies desirous of making Qualified Institutional Placement (QIP) to cover companies, which have been listed during the preceding one year pursuant to approved scheme(s) of merger/ demerger/ arrangement entered into with companies which have been listed for more than one year in such stock exchange(s).
- Modification in the pricing guidelines for QIP through change in the floor price formula and definition of relevant date and extending these guidelines to preferential allotment to QIBs, provided that the number of QIB allottees in such preferential allotment does not exceed five.
- The lock-in period of shares in preferential allotment, pursuant to exercise of warrants to be the full lock-in period of one year or three years, as the case may be, from the date of allotment of such shares.
- Permission to a listed company to make a combined offering of Non-Convertible Debentures (NCDs) with warrants through the QIP mechanism. NCDs and warrants issued pursuant to a combined offering can be listed and traded separately. The minimum contract value for trading of NCDs/ warrants was set at Rs.1 lakh.
- Timeline for completion of bonus issues by listed companies stipulated at 15 days from the date of approval by the board of directors of the issuer (in case shareholders' approval is not required) and at 60 days from the date of meeting of the board of directors wherein the bonus was announced subject to shareholders' approval.
- A simplified listing agreement for debt securities prescribed, in case the equity of an issuer is already listed.

II. Secondary Market

The salient policy initiatives concerning the secondary market segment were:

- The broad framework for short selling and securities lending and borrowing (SLB) scheme for all market participants was operationalized with effect from April 21, 2008. The key modifications made to SLB Scheme included an increase in tenure for SLB to 30 days from 7 days, extending the time for SLB session to the normal trade timings of 9:55 am to 3:30 pm, and allowing margins in SLB in the form of cash and cash equivalents.
- Margining of institutional trades was made mandatory with effect from April 21, 2008 and collection of margins from institutional investors on a T+1 basis.
- Direct Market Access facility was introduced for institutional investors, allowing brokers to offer clients direct access to the exchange trading system through the broker's infrastructure without manual intervention by the broker, subject to proper risk management of clients by the broker.
- The cross margining facility was extended to all market participants for offsetting positions in cash and derivatives market.
- The Securities Contracts "Manner of Increasing and Maintaining Public Share holding in recognized stock exchanges" (MIMPS) Regulation 2006 was amended to allow six categories of shareholders namely, public financial institutions, stock exchanges, depositories, clearing corporations, banks and insurance companies to hold directly or indirectly up to 15 per cent of the paid-up equity share capital of the concerned stock exchange. Any shareholder other than the aforesaid six categories of investors can hold directly or indirectly not more than 5 per cent of the paid-up equity share capital of a stock exchange.
- Approval was granted to NSE and BSE for operationalizing the exchange traded currency derivatives segment; and MCX Stock Exchange

Ltd. was recognized as a stock exchange for a period of one year commencing on September 16, 2008 for operationalizing the exchange traded currency derivatives segment only.

- Broad guidelines were approved for providing an exit option to regional stock exchanges whose recognition is withdrawn and/or renewal of recognition is refused by SEBI and those exchanges that are desirous of surrendering their recognition.
- Framework for recognition and supervision of stock exchanges/platforms of stock exchanges for small and medium enterprises was specified by SEBI.

III. Mutual Funds

Some of the important initiatives relating to mutual funds were:

- Allow existing mutual fund schemes to engage in short selling of securities as well as lending and borrowing of securities after making additional disclosures including risk factors in the Scheme Information Document.
- SEBI guidelines for parking of funds in short-term deposits of scheduled commercial banks were not to apply to term deposits placed as margins for trading in cash and derivatives market.
- The aggregate ceiling for overseas investments by mutual funds was enhanced from US$ 5 billion to US$ 7 billion.
- The amendments to the SEBI (Mutual Funds) Regulations, 1996 with regard to Real Estate Mutual Funds included the following:
  - ➢ Sponsors seeking to set up new mutual funds, for launching only real estate mutual fund schemes, shall be carrying on business in real estate for a period not less than five years. They shall also fulfill all other eligibility criteria applicable for sponsoring a mutual fund.
  - ➢ An existing mutual fund may launch a real estate mutual fund scheme if it has an adequate number of key personnel and directors having adequate experience in real estate.
  - ➢ A real estate mutual fund scheme is required to be close-ended and its units shall be listed on a recognized stock exchange.
  - ➢ A real estate mutual fund shall invest at least 35 per cent of the net assets of the scheme directly in real estate assets.
  - ➢ The AMC, its directors, the trustees and the real estate valuer shall ensure that the valuation of assets held by a real estate mutual fund scheme is done in good faith in accordance with the norms specified.
- In order to bring about uniformity in the contents of Abridged Scheme-wise Annual Report prepared by the mutual funds, a new format was prescribed.
- It was decided that in case of large applications for purchase of income/debt oriented schemes other than liquid fund schemes with amount equal to or more than Rs. 1 crore, the closing NAV of the day on which the funds were available for utilization would be applicable
- The units under close-ended schemes are required to be mandatorily listed. It was stipulated that a close-ended debt scheme shall invest only in such securities which mature on or before the date of the maturity of the scheme.
- It was decided in October 2008 to enhance on a case to case basis the prescribed borrowing limit of mutual funds to 40 per cent of the net assets for a period of six months to enable them to meet the redemption requests in an orderly manner.
- It was mandated that liquid fund schemes and plans should make investment in/purchase debt and money market securities with maturity up to 182 days only w.e.f. February 1, 2009 and in such instruments with maturity up to 91 days only w.e.f May 1, 2009.
- Asset management companies are required to disclose on their respective websites the portfolio of debt-oriented close-ended and interval schemes/plans as on the last day of a month, on or before the third working day of the succeeding month.

IV. Foreign Institutional Investment

- The eligible categories of the Foreign Institutional Investor (FII) applicants were expanded to allow for NRI-owned investment managers to register as FIIs subject to the condition that they did not invest their proprietary funds.
- It was decided to do away with the quantitative restrictions imposed on Overseas Derivative Instrument (ODI) issuance capabilities and restrictions on ODIs on derivatives with effect from October 7, 2008,
- In June 2008, the limit for investments in debt by the FIIs in the government securities was increased from US$ 3.2 billion to US$ 5 billion

and in corporate debt from US$ 1.5 billion to US$ 3 billion. The corporate bond investment limits were further increased to US$ 6 billion in October 2008 and to US$ 15 billion in January 2009.

- The restriction on investment of FIIs in the ratio of 70:30 in equity and debt respectively was done away with.

V. Corporate Debt Market

- In order to facilitate development of a vibrant primary market for corporate bonds in India, SEBI notified "Issue and Listing of Debt Securities Regulations" on June 6, 2008 to provide for simplified regulatory framework for issuance and listing of non-convertible debt securities (excluding bonds issued by the Government) issued by any company, public sector undertaking or statutory corporation. The new regulations prescribe rationalized disclosure norms for public and private placements, reduction of timelines involved during draft prospectus stage, enhanced responsibilities of merchant bankers for exercising due diligence, etc.
- SEBI set up a Standing Advisory Committee named "Corporate Bonds and Securitisation Advisory Committee" (CoBoSAC) under the chairmanship of Dr R.H. Patil for making recommendations to SEBI from time to time regarding the market for corporate bonds and securitized debt instruments.

VI. Regulatory Changes

- SEBI notified the SEBI (Intermediaries) Regulation, 2008 on May 26, 2008 for putting in place a comprehensive regulation applicable to all intermediaries. The registration process has been simplified. The *fit and proper* criteria has been modified to make it principle based. Apart from specifying common code of conduct, the registration granted to intermediaries was made permanent subject to the compliance of the SEBI Act, regulations, updation of relevant disclosures and payment of fees. Procedure for action in case of default and manner of suspension or cancellation of certificate has been simplified to shorten the time faced by the parties without compromising with the right of reasonable opportunity to be heard. The procedure for surrender of certificate has been simplified.
- In terms of an amendment to the SEBI (Depositories and Participants) Regulations, 1996 on August 8, 2008, the requirement of the depositories to ensure payments before effecting the transfer in the demat system was dispensed with, as the Depositories Act did not cast an obligation on the depositories to ensure that payment had been made in respect of transfer of security.
- An amendment to SEBI (Portfolio Managers) Regulations, 1993 on August 11, 2008 relaxed the criteria for considering the application for registration as portfolio manager and increased the net worth for carrying portfolio management service from Rs. 50 lakh to Rs. 2 crore.
- The SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 was amended on August 11, 2008 for facilitating the trading in currency derivatives on the platform of stock exchanges.
- The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 was amended on October 30, 2008. It was clarified that no acquirer, who together with persons acting in concert with him held 55 per cent or more but less than 75 per cent of the shares or voting rights in a target company, should acquire either by himself or through persons acting in concert with him any additional shares entitling him to exercise voting rights unless he made public announcement in accordance with the regulations.
- Clause 35 of the Equity Listing Agreement was amended in February 2009 to include details of shares pledged or otherwise encumbered by promoters and promoter group entities.

Commodity Futures Market

5.102 Commodities traded on the commodity futures market during 2008 included a variety of agricultural commodities, bullion, crude oil, energy and metal products. Several new commodities were permitted for trading in 2008, such as aviation turbine fuel, carbon credit, carbon financial instrument, red arecanut, coriander seeds, garlic, steel long (ingots/billets) and thermal coal**.** Total value of trading in the commodity futures market rose from Rs. 36,54,487 crore in 2007 to Rs. 50,33,884 crore during 2008 (Table 5.22)

5.103 The average daily value of trades in the commodity exchanges improved from Rs. 15,000 crore during 2007 to Rs. 18,500 crore in 2008. Agricultural commodities, bullion and energy products accounted for a large share of the commodities traded in the commodities futures market.

5.104 The MCX recorded the highest turnover in terms of value of trade during 2008, followed by

Table 5.22 : Turnover on commodity futures markets

(Rs. crore)

Name of the Exchange	Calendar Year 2006	2007	2008
Multi Commodity Exchange (MCX), Mumbai	20,25,663	27,30,415	42,84,653
National Multi Commodity Exchange (NMCE), Ahmedabad	1,11,462	25,056	37,272
National Commodity and Derivative Exchange (NCDEX), Mumbai	12,43,327	7,74,965	6,28,074
Others	1,04,033	1,24,051	83,885
Total	34,84,485	36,54,487	50,33,884

Source : Ministry of Consumer Affairs

National Commodity & Derivatives Exchange Ltd. (NCDEX) and National Multi-Commodity Exchange of India Ltd. (NMCE) respectively (Table 5.22).

5.105 The MCX commodity index fell by 24.7 per cent during 2008. The decline in international commodity futures indices viz., Dow Jones AIG Commodity Index (DJAIG) and Reuters/Jefferies Commodity Research Bureau (RJCRB) index was even sharper at 36.6 per cent and 36.0 per cent respectively (Figure 5.5).

Insurance and pension funds

Insurance

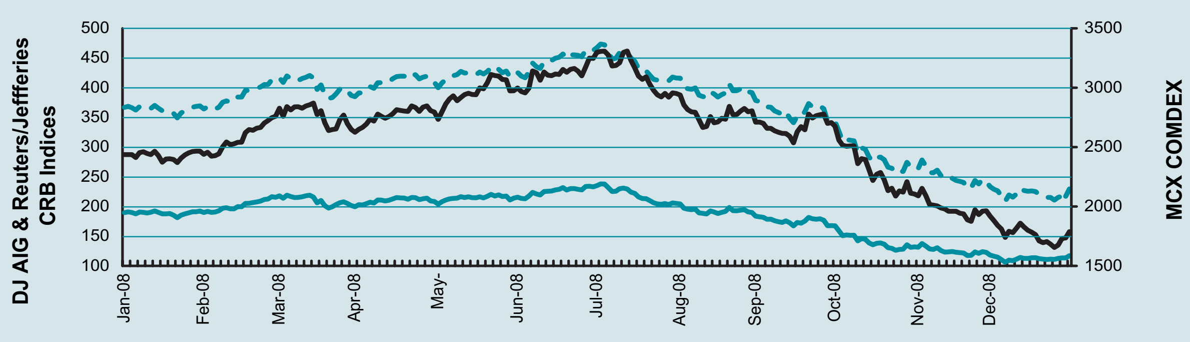
5.106 The insurance sector was opened for private participation with the enactment of the Insurance Regulatory and Development Authority Act (IRDA Act), 1999.

New entrants in the insurance industry

5.107 Before the opening up of the insurance sector in 2000, there were only six insurance companies viz., Life Insurance Corporation of India, four public sector general insurers and General Insurance Corporation of India (GIC). The number of insurers has since gone up to 44 as at end-March 2009, with 22 insurers (1 in public sector and 21 in private sector) in life insurance business, 21 insurers (6 in public and 15 in private sector) in non-life insurance business and 1 re-insurance company viz., General Insurance Corporation of India in the public sector. In non-life segment, there are two specialized public sector insurance companies viz., Export Credit Guarantee Corporation (ECGC) and Agricultural Insurance Company (AIC) besides two stand-alone health insurance companies in the private sector *viz.*, Star Health & Allied Insurance Company and Apollo DKV Health Insurance Company.

5.108 Of the 21 life insurance companies set up in the private sector since 2000, 19 are in joint venture with foreign partners. Of the 15 new private insurers in the non-life segment, 14 have been opened in collaboration with the foreign partners. In all, there are 33 insurance companies in the private sector having collaboration with established foreign insurance companies as at end-March 2009.

Figure 5.5: Movement of MCX and other international indices



Source: Bloomberg & MCX

Box 5.1 : Regulation & development of commodity futures markets

The Forward Markets Commission (FMC), the regulator for commodity futures trading under the provisions of Forward Contracts (Regulation) Act, 1952 (FCRA) continued with its proactive approach towards regulation and development of the commodity futures market. As the effectiveness of the commodity futures market in facilitating price discovery process depends on the wider participation of all the stakeholders categories, special emphasis was placed by FMC to broadbase the market The participation of farmers as hedgers, to counter-balance the speculative element in the price discovery, and increasing the awareness level of farmers and other market participants were emphasised. The commission has also been working on various models of aggregation to enable the farmers to hedge on the commodity exchanges to manage their price risk.

Considering the concerns of the Government of India about the inflationary expectations in the economy, the futures trading in chana, soy oil, rubber and potato was suspended by the FMC from May 7, 2008. However, with the easing of inflationary pressure, the suspension was allowed to lapse on November 30, 2008 and trading in these commodities resumed on December 4, 2008.

The Committee appointed earlier by the Government of India under the chairmanship of Prof. Abhijit Sen, Member, Planning Commission, to study the impact of futures trading, if any, on agricultural commodity prices submitted its report on April 29, 2008. The Committee opined that negative sentiments had been created by the decision to delist futures trades in some important agricultural commodities; however, there was no clear evidence of either reduced or increased volatility following opening of futures markets to trading in some agricultural commodities. The vibrant agriculture markets including derivatives markets could provide an early sign of future prospect of the sector.

Major policy developments initiated by the Forward Markets Commission included issuance of guidelines for the constitution of the Board of Directors and appointment of Chief Executive and Chief Compliance Officer in the Commodity Exchanges, grant of recognition to new Commodity Exchanges under the provisions of the Forward Contract Regulation Act 1952, in-principle approval granted to the MMTC and India Bulls Financial Services Ltd., for setting up of a nationwide multi-commodity exchanges in NCR (Gurgaon), directions issued to the National Exchanges regarding fixation of the transaction charges and to restrict the use of multiple client codes by a single client so as to make the violation of regulatory provisions difficult. Daily price limits of international commodities were raised to 9 per cent and the exchanges were directed to ensure that no client was allowed to trade without having Unique Identification Number.

Industry development

Life insurance industry

5.109 The total premium underwritten by the industry in the life segment has grown from Rs.1,56,076 crore in 2006-07 to Rs. 2,01,351 crore in 2007-08, recording an increase of 29.0 per cent in 2007-08 attributable to introduction of new products and channels of distribution and increasing penetration of private insurance companies in uncovered markets. It increased further by 10.8 per cent to Rs. 2,23,053 crore in 2008-09.

5.110 A fair measure of growth in life insurance sector is the addition of new business represented by the first year premium income comprising of single premiums and regular premiums. The first year premium underwritten by the life insurers increased by 23.9 per cent to around Rs. 93,713 crore in 2007-08 from Rs. 75,649 crore in 2006-07. The increase was impressive as it was achieved on top of a growth of 94.9 per cent in the first year premium recorded in 2006-07. The linked component of first year premium was also up by 64.0 per cent to Rs. 70,511 crore in 2007-08, with a corresponding rise in its share in the first year premium to 75.2 per cent (56.9 per cent in 2006-07). This reflected continued popularity of unit-linked products in the wake of sustained positive performance of the stock markets in the first half of 2007-08. Contrary to this, the first year premium underwritten by the life insurers at Rs. 87,108 crore posted a decline of 6.3 per cent during 2008-09.

5.111 The non-linked premium, which had declined by 28.9 per cent to Rs. 23,202 crore in 2007-08 from Rs. 32,646 crore in 2006-07, recorded an improvement to Rs. 42,417 crore in 2008-09.

Non-life insurance industry

5.112 Total number of policies issued by the general insurers in 2007-08 was 572.50 lakh, recording an increase of 22.7 per cent over that of 466.64 lakh in 2006-07. The non-life insurers (excluding specialized institutions like ECGC and AIC) underwrote a total domestic premium within India of Rs. 27,824 crore in 2007-08, which was higher by 11.7 per cent over that of Rs. 24,906 crore in 2006-07. Private insurers improved their market share from 34.7 per cent in 2006-07 to 39.5 per cent in 2007-08. The premium underwritten in two of the fastest growing segments viz., “motor vehicles” and “health” was Rs. 12,685 crore and Rs. 4,894 crore respectively in 2007-08 (Rs. 10,697 crore and Rs. 3,319 crore respectively in 2006-07). These segments respectively accounted for 45.6 per cent and 17.6 per cent of the premium underwritten in India in 2007-08 (42.9 per cent and 13.3 per cent, respectively in 2006-07). During 2008-09, the non-life insurers underwrote premium of Rs.30,601 crore, i.e., up by 9.9 per cent over 2007-08.

5.113 Notwithstanding a considerable rise in the non-life insurance business in terms of the number of policies, the premium amount underwritten by the non-life insurers slowed down due to detariffication and the consequent reduction in premium rates.

5.114 The public sector general insurers also underwrite premiums outside India. Total premium underwritten outside the country by the public sector general insurers was Rs. 981 crore in 2007-08 as against Rs. 1,025 crore in 2006-07.

Penetration and density

5.115 Insurance Penetration and Insurance Density are two important indicators of the potential and performance of the insurance sector. Insurance penetration is defined as the ratio of premium underwritten in a given year to the gross domestic product (GDP), while insurance density is measured as the ratio of premium underwritten in a given year to the total population. The life insurance penetration in India increased from 1.77 per cent in 2000 to 4.10 per cent in 2006, before declining to 4.0 per cent in 2007. The general insurance penetration increased from 0.55 per cent in 2000 to 0.60 per cent in 2006 and remained at the same level in 2007. The life insurance density which is premium per capita in US$ terms stood at US$ 40.4 in 2007 as against US$ 33.2 in 2006 and US$ 7.60 in 2000. The general insurance density was, however, lower at US$ 6.2 in 2007 (US$ 5.20 in 2006 and US$ 2.30 in 2000).

Recent initiatives taken in the insurance sector

5.116 During the year 2008-09, the process of reforms in the insurance sector was carried forward through a series of policy initiatives. Some of these included:

- Promoting micro-insurance as a viable business opportunity and integrating the same with the poverty alleviation programmes of the State Governments. During 2007-08, 3,275 micro-insurance agents were allowed to offer composite covers or packaged products to cater to the needs of the poor, taking the total number of micro-insurance agents to 4,584 at end-March 2008.
- Introduction of two bills in the Parliament viz., Insurance Laws (Amendment) Bill, 2008 and Life Insurance Corporation (Amendment) Bill, 2008 aimed at bringing about improvement and revision of laws relating to the insurance business.
- Institutionalising the process of a self-regulatory mechanism by IRDA for enforcement of market discipline and initiating steps to ensure that the life insurance council and the general insurance council become self-regulatory organizations.
- Establishment of a separate health section in the authority with specialists.
- Stipulation by IRDA of the rural and social sector obligations of private insurers up to the tenth year of operations. Under the rural sector obligations, life insurers are required to expand their rural coverage from 7 per cent of the total policies written direct in the first financial year to 20 per cent in the tenth financial year. The non-life insurers in the private sector are required to reach the target commencing from 2 per cent of total gross premium income written directly in the first financial year to 7 per cent from the ninth financial year onwards. Under the social sector stipulations, all insurers would have to cover 5,000 lives in the first financial year to 55,000 lives in the tenth financial year.
- IRDA issued instructions on the interpretation of pre-existing conditions in health insurance, which came into effect from June 1, 2008. The standardization of terminology would help the insured by increasing clarity and ensure comparability of health insurance products across insurers; and in resolving operational constraints in the area of claims settlement in health insurance.

5.117 As a result of the process of de-tariffication of the general insurance industry, insurers were allowed to quote rates of premium in accordance with the rate schedules and rating guidelines filed with the IRDA with effect from January 1, 2008; the premium rates for motor third party risks would continue to be regulated by the Authority. The availability of third party cover to the policyholders remained unaffected following the directive issued to the general insurers to participate in motor third party pooling arrangement for commercial vehicle segment, managed by the General Insurance Corporation. Terms and conditions of the insurance policy in respect of general insurance business, however, continue to be regulated by the IRDA.

Pension sector : Highlights

5.118 The pension sector reforms were initiated in India to establish a solid and sustainable social security arrangement in the country against the backdrop that only about 12-13 per cent of the total workforce was covered by any formal social security system. The New Pension System (NPS), which was introduced by the Government from January 1, 2004 for new entrants to the Central Government service, except the Armed Forces, was to be extended gradually to the remaining 87 per cent of the total workforce on a voluntary basis. The design features of the NPS are self-sustainability and scalability. Based on individual choice, it is envisaged as a low-cost and efficient pension system backed by sound regulation. As a pure "Defined Contribution" product with no defined benefit element, returns would be totally market-related. It could provide various investment options and choices to individuals to switch over from one investment option to another or from one fund manager to another, subject to certain regulatory restrictions.

5.119 Pension Fund Regulatory and Development Authority (PFRDA), set up as a regulatory body for the pension sector, was engaged in the process of putting in place the full NPS architecture, consisting of a Central Recordkeeping Agency, Pension Fund Managers and Trustee Bank. The National Securities Depository Limited, selected as the Central Recordkeeping Agency (CRA) by PFRDA, also commenced its operations. State Bank of India, UTI Asset Management Company and Life Insurance Corporation were appointed as Pension Fund sponsors under the NPS.

5.120 Pending the establishment of full architecture of NPS, an interim arrangement was put in place by the Government for investment of the accumulated corpus under the NPS. Contributions were credited into a public account up to March 2008 earning a return equal to the rate of General Provident Fund. As per data available, 3.65 lakh employees were covered under the NPS; the Government transferred the accumulated funds along with its matching contribution amounting to over Rs. 2,100 crore to the three fund managers appointed by PFRDA for investment management.

5.121 Efforts are underway to extend the NPS to new segments (autonomous bodies, State Governments and unorganized sector) and introducing micro-pension initiatives. NPS has been well received by the State Governments. Twenty-one State Governments have notified similar schemes for their new recruits. PFRDA had, in collaboration with other NPS intermediaries, conducted three regional workshops at Mumbai, Kolkata and New Delhi to sensitize the State Governments to the requirements of the NPS and also to enable them to log on to the PFRDA-regulated NPS architecture with ease. The appointed pension fund managers and the CRA have been in continuous dialogue with the State Governments/UTs for facilitating their entry into the NPS. As of date, the CRA has signed agreements with six State Governments.

5.122 Following the Government's decision in August 2008 to extend the NPS to all citizens including the unorganized sector workers, the PFRDA announced that it would roll out the NPS architecture during the financial year 2009-10. As part of this exercise, PFRDA appointed six pension fund managers and 22 points of presence for managing NPS contributions pertaining to all citizens, and has made available the NPS to all citizens of India from May 1, 2009. Tier-I of the NPS constituting the non-withdrawable pension account has become operational from May 1, 2009 and Tier-II (withdrawable account) of the NPS account will become operational in about six months. It is expected to help realize the full potential of the NPS in terms of economies of scale and offer benefits to the subscribers in terms of lower fees and charges and high returns.

5.123 In terms of investment guidelines, pension fund managers will manage three separate schemes. The asset classes specified for the purpose consists of (i) equity, (ii) government securities and (iii) credit risk bearing fixed income instruments. It has been decided that investment by an NPS participant in equity would be subject to a cap of 50 per cent. The fund managers will invest only in index funds that replicate either BSE sensitive index or NSE Nifty 50 index. The subscriber will have the option to consciously decide the investment composition of NPS pension wealth. In case the subscriber is unable/unwilling to exercise any choice regarding asset allocation, his contribution will be invested in accordance with the "Auto Choice" option and according to a pre-defined portfolio.

Challenges and outlook

5.124 The monetary policy during 2008-09 has been responsive to the emergent situation as a consequence of global conditions. The measures initiated on the monetary front were in the nature of an accommodative policy to ensure that there were no liquidity constraints in the economy. Coupled with the expansionary fiscal policy, the initiatives have had a favourable impact on domestic monetary, real and financial sectors. As compared to developed countries which are presently facing recessionary trends, the Indian economy has merely had a moderation in growth during 2008-09. On a preliminary assessment, the economy evinces early signs of turnaround. The flexibility in the policy framework and initiatives taken provide the environment for the resumption to sustained high growth path in the near term. The growth in credit for meeting the critical needs of the productive sectors are high on the agenda.

5.125 It is also a matter of satisfaction that the performance of the capital market has lately shown signs of revival of investor interest and confidence – both domestic and foreign institutional investors. Net investment by FIIs in equity instruments amounted to US$ 5.4 billion during April-May 2009.

5.126 A turnaround has also been noticed in the performance of mutual fund industry, which had remained subdued during 2008. Mutual fund investments (net) in equity markets turned positive in March 2009 and were Rs. 2,320 crore during April-May 2009, while they invested Rs. 36,791 crore in debt instruments during the same period. There is scope for expansion of mutual fund industry as only 7.7 per cent of total financial saving was allocated to mutual funds in 2007-08. The retail investor participation, which is presently estimated at 15 per cent, is expected to increase in the years to come as availability of products and investor education improve and the industry takes steps towards transparency and sound corporate governance practices to generate investor confidence.

5.127 The insurance sector penetration, both in life and non-life segments, has improved since the time the sector has been opened for private participation. However, the penetration rates particularly in non-life business have remained lower than those in some of the emerging economies in Asia. The IRDA has been entrusted with the responsibility of development of the industry through monitoring of consumer-related aspects like market conduct, consumer education and creation of an integrated platform for redressal of customer grievances. An important initiative in this area is the announcement of draft corporate governance guidelines for insurance companies to ensure that appropriate governance practices are in place in the insurance companies for maintenance of solvency, sound long-term investment policy and assumption of underwriting risks on a prudential basis as the insurance companies are yet to be listed.

5.128 The development of corporate bond and securitisation markets in India has been an important area, which has received policy attention in the recent past. A reasonably well developed bond market is required to supplement the banking system in meeting the requirements of the corporate sector for long-term capital investment besides raising resources for infrastructure development in the country.

5.129 PFRDA faces the challenge of covering the unorganized sector under the NPS, empowering the subscribers to take appropriate investment decisions based on their risk and return profile, provide safety and optimum returns, and to improve financial literacy levels. The success of pension reforms will not only help in facilitating the flow of long-term savings for investments and funds for infrastructure development, but would also help the government to fund its pension liabilities.