Financial Intermediation and Markets

5
CHAPTER

The financial markets today encompass not only traditional banking institutions, but also many other financial entities such as insurance companies, pension funds, mutual funds, venture capital funds and stock and commodity exchanges that perform the function of financial intermediation. This development has been accompanied by the advent of market-based instruments of the stock and bond markets, financial products such as asset-backed securities, financial futures and derivative instruments. While reducing the dependence of investors on bank credit to fund their investments, these have also contributed to reallocation of risks and putting of capital to more efficient use. Financial markets also serve the need for greater financial inclusion. The recent experience from the global financial crisis, has however, shown that, despite the variety of instruments and the sophistication of the markets, they may not remain immune to crisis, if the investors/institutions do not pay adequate attention to the fundamentals or if the pricing of risk and the ratings for these instruments are not transparent, and if the regulatory oversight is poor. An efficient and healthy financial market, should therefore avoid the shortcomings as gleaned from the experience of the global financial markets in the last couple of years. The deepening and broadening of financial markets also underscores the importance of institutional safeguards for monitoring and analysing the domestic as well as external developments to ensure that the regulatory system is efficient and effective. This chapter summarizes the developments in the financial sector in India in the last year, which has remained relatively immune to the global financial turbulence through a proactive response to the challenges.

Bank Credit

5.2 The accommodative monetary policy stance adopted by the Reserve Bank, post-September 2008, in response to the global financial crisis, continued during 2009-10. Though the policy focused on maintaining a market environment conducive to the flow of credit to the productive sectors of the economy, growth in bank credit remained low during 2009-10. The prevalent economic conditions as well as the cost of funds appear to have contributed to the slowdown in non-food bank credit from the banking sector. In addition, banks also reined in credit to the retail sector due to perceptions of increased risk on account of the general slowdown and to guard against bad loans.

5.3 While the overall credit demand of the manufacturing sector from the banking sector slowed down during the 2009-10, corporates could access non-bank domestic sources of funds and external financing (which had almost dried up earlier during the crisis period) at lower costs. Thus, while bank credit during 2009-10 continued to decelerate, there was a turnaround in financing from non-bank domestic sources. It is likely that revival of growth in bank credit would manifest in the near-term economic recovery process.

5.4 As against an increase of 22.3 per cent in 2007-08, bank credit increased by 17.5 per cent in 2008-09. Non-food credit during the same periods was 23.0 per cent and 17.8 per cent respectively. During 2009-10, on financial-year basis, growth in bank credit extended by scheduled commercial banks (SCBs) stood at 8.4 per cent (end March 2009 to January 15, 2010), as compared to 11.9 per cent during the corresponding period in 2008-09 (Table 5.1). This

Table 5.1 : Flow of bank credit

As of January 15, 2010

	Outstanding as in end March					Financial year so far		Year on year	
	Rs. crore					(Percentage variation)			
	2007	2008	2009	16-Jan-09	15-Jan-10	2008-09	2009-10	2008-09	2009-10
1. Bank Credit	19,31,188	23,61,914	27,75,549	2642077	3008909	11.9	8.4	22.0	13.9
(a) Food Credit	46,520	44,399	46,211	49,695	42,534	11.9	-8.0	26.8	-14.4
(b) Non-food Credit	18,84,668	23,17,515	27,29,338	2592382	2966375	11.9	8.7	21.9	14.4
2. Aggregate Deposits	26,11,932	31,96,940	38,34,110	3630875	4242574	13.6	10.7	20.1	16.8
(a) Demand Deposit	4,29,730	5,24,310	5,23,085	448440	540660	-14.5	3.4	-1.6	20.6
(b) Time Deposit	21,82,202	26,72,630	33,11,025	3182435	3701914	19.1	11.8	23.9	16.3
3. Investments (SLR)	7,91,517	9,71,715	11,66,410	1139279	1380157	17.2	18.3	19.5	21.1
(a) Government Securities	7,76,058	9,58,662	11,55,785	1128489	1366055	17.7	18.2	20.0	21.1
(b) Other Approved Securities	15,459	13,053	10,625	10,790	14,102	-17.3	32.7	-18.3	30.7

Source : RBI.

is also below the Reserve Bank's indicative projected trajectory for the full year, of 20.0 per cent as set out in the First Quarter Review and 18.0 per cent in the Second Quarter Review for 2009-10. The year-on-year growth in bank credit as on January 15, 2010 was 13.9 per cent as against 22.0 per cent on the corresponding date of the previous year. Growth in non-food credit so far in 2009-10 on financial-year basis and on year-on-year basis was lower than the previous year's levels. Growth in aggregate deposits in 2009-10 was broadly compatible with the growth in the previous year. The lower expansion in credit relative to the significant expansion in deposits during 2009-10 has resulted in a decline in the credit-deposit ratio to 70.92 on January 15, 2010 from 72.4 in end-March 2009. (Figure 5.1).

5.5 During 2009-10, public-sector banks (PSBs) were observed to be faring better in terms of growth in credit extended as compared to the deceleration in private banks and decline in foreign banks. Higher market borrowing by the Government, low credit growth and the ample liquidity in the system led to banks' investment in statutory liquidity ratio (SLR) securities. Commercial banks' holdings of such securities close to 30 per cent of their net demand and time liabilities (NDTL) remained higher than the

Figure 5.1 Credit-deposit ratio

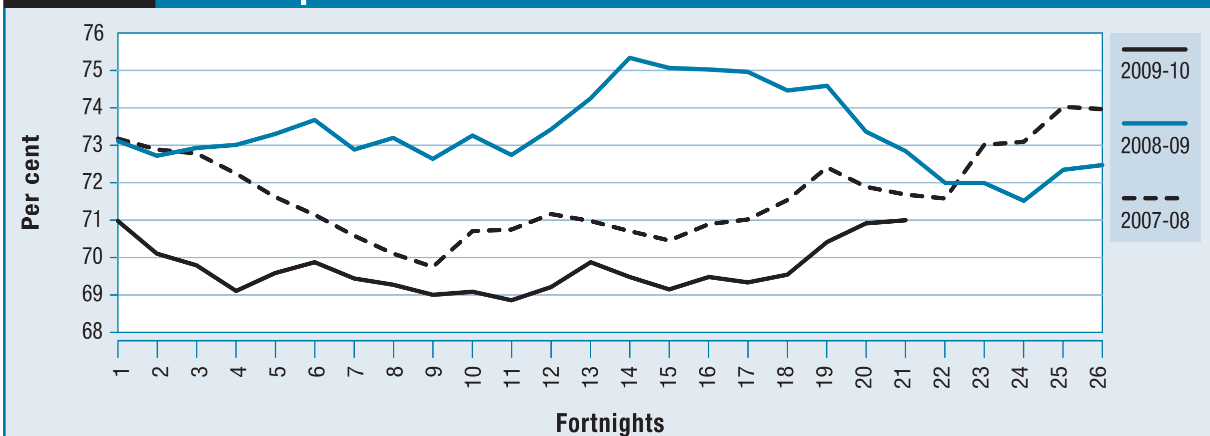
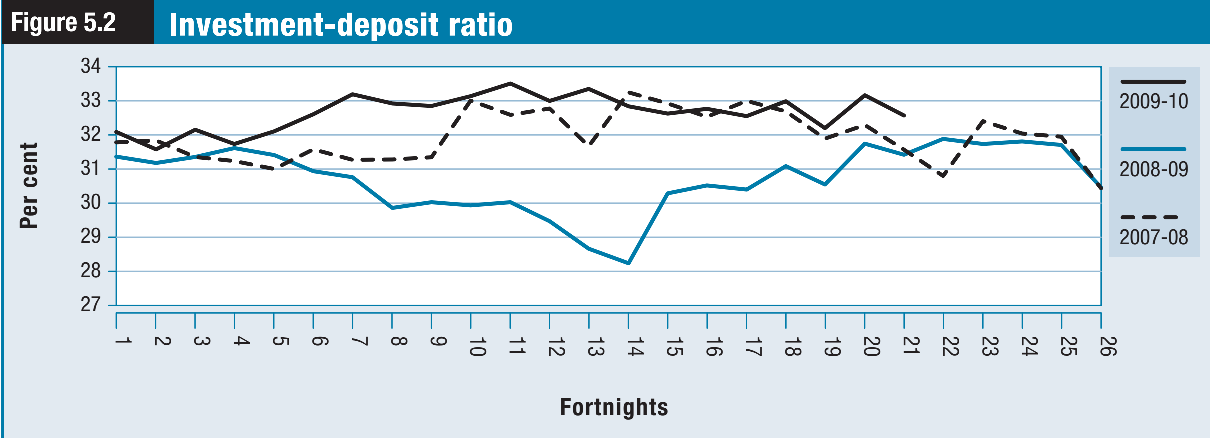


Figure 5.2 Investment-deposit ratio



stipulated SLR level of 24 per cent (25 per cent with effect from November 7, 2009). Consequently, the investment-deposit ratio increased from 30.4 per cent in end-March, 2009 to 32.53 on January 15, 2010 as SCBs preferred to invest their resources in SLR securities (Figure 5.2).

Interest rates

i. Domestic Deposit Rates

5.6 Deposit rates of SCBs softened during 2009-10. Interest rates offered by PSBs on deposits of maturity of one year to three years declined from the 8.00-9.25 per cent range in March 2009 to 6.00-7.25 per cent in December 2009, while those on deposits of maturity of above three years came down from the 7.50-9.00 per cent range to the 6.25-7.75 per cent during the same period. The term deposit rates of private-sector banks and foreign banks on deposits of maturity of one year up to three years also declined from the 7.50-10.25 per cent and 2.50-9.50 per cent range respectively in March 2009 to the 5.25-7.50 per cent and 2.25-7.75 per cent range in December 2009 (Table 5.2).

Table 5.2 : Movements in deposit and lending rates

(per cent)

Interest rates	Mar.-08	Sep.-08	Dec.-08	Mar.-09	Dec.-09
Term Deposit Rates					
PSBs					
a) Up to 1 year	2.75-8.50	2.75-10.25	2.75-10.25	2.75-8.25	1.00-6.50
b) 1 year up to 3 years	8.25-9.25	8.75-10.25	8.50-10.75	8.00-9.25	6.00-7.25
c) Over 3 years	8.00-9.00	8.50-9.75	8.50-9.75	7.50-9.00	6.25-7.75
Private-Sector Banks					
a) Up to 1 year	2.50-9.25	3.00-9.75	3.00-10.00	3.00-8.75	2.00-7.00
b) 1 year up to 3 years	7.25-9.25	8.30-10.50	9.00-11.00	7.50-10.25	5.25-7.50
c) Over 3 years	7.25-9.75	8.25-10.25	8.50-11.00	7.50-9.75	5.75-8.00
Foreign Banks					
a) Up to 1 year	2.25-9.25	3.50-9.75	3.50-9.75	2.50-8.50	1.25-7.00
b) 1 year up to 3 years	3.50-9.75	3.50-10.50	3.50-11.25	2.50-9.50	2.25-7.75
c) Over 3 years	3.60-9.50	3.60-11.00	3.60-11.00	2.50-10.00	2.25-8.50
BPLR					
PSBs	12.25-13.50	13.75-14.75	12.50-14.00	11.50-14.00	11.00-13.50
Private-Sector Banks	13.00-16.50	13.75-17.75	13.00-17.25	12.75-16.75	12.50-16.75
Foreign Banks	10.00-15.50	10.00-16.00	10.00-17.00	10.00-17.00	10.50-16.00

Source: RBI.

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ii. Lending Rates

5.7 The benchmark prime lending rates (BPLRs) of PSBs moved from the 12.25-13.50 per cent range in March 2008 to 11.50-14.00 per cent in March 2009 and 11.00-13.50 per cent in December 2009. The BPLRs of PSBs, private-sector banks and foreign banks decreased from their September 2008 levels in March 2009 and further declined in December 2009. However, the movement in the BPLRs does not fully and accurately reflect the changes in effective lending rates as nearly two-thirds of banks' lending takes place at sub-BPLR rates; the share of sub-BPLR lending of all SCBs (excluding export credit and small loans) was nearly 67.0 per cent in March 2009, and increased further to 70.4 per cent in September 2009. To address this anomaly, the Reserve Bank announced the constitution of the Working Group on BPLR in its Annual Policy Statement of 2009-10 to review the system and suggest changes to make credit pricing more transparent. The Group submitted its report on October 20, 2009. The Working Group has recommended replacing the existing BPLR system with a base rate system. With the proposed base rate system, banks will not need to lend below the base rate as it would represent the bare minimum rate below which it would not be viable for them to lend. The proposed base rate may include all those cost elements which can be clearly identified and which are common across borrowers. The actual lending rates charged to borrowers could work out to be the base rate plus borrower-specific charges that would include product-specific operating costs, credit risk premium and tenor premium.

iii. NRE/FCNR(B) Deposits

5.8 To encourage the inflow of foreign funds, interest rate ceilings on Foreign Currency Non Resident Bank accounts {FCNR(B)} and Non Resident (External) Rupee Account {NR(E)RA} deposits of all maturities were revised upwards by 50 basis points each on September 16 and October 15, 2008. After a review, the Reserve Bank further increased the interest rate ceiling on FCNR(B) and NRE deposits by 75 basis points each on November 15, 2008. At present, the interest rate ceiling on such deposits stands at Libor/Swap rates plus 100 basis points and Libor/Swap rates plus 175 basis points, respectively.

iv. Rupee Export Credit

5.9 In view of the difficulties being faced by exporters on account of the weakening of external demand, the Reserve Bank on November 15, 2008 extended the period of entitlement of the first slab of pre-shipment rupee export credit, which was available at a concessional interest rate ceiling of the BPLR minus 2.5 percentage points from 180 days to 270 days. Furthermore, on November 28, 2008 the period of entitlement of the first slab of post-shipment rupee export credit was extended from 90 days to 180 days for availing of a concessional interest rate ceiling of the BPLR minus 2.5 percentage points. On December 8, 2008, the Reserve Bank extended the concessional interest rate ceiling of the BPLR minus 2.5 percentage points to overdue bills up to 180 days from the date of advance. The validity of the reduction in the interest rate ceiling to 250 basis points below the BPLR on pre-shipment rupee export credit up to 270 days and post-shipment rupee export credit up to 180 days has been further extended up to April 30, 2010.

5.10 Factoring in the prevalent economic scenario, the Government of India extended interest rate subvention of 2 percentage points with effect from December 1, 2008 till March 31, 2010 on pre- and post-shipment rupee export credit, for certain employment-oriented export sectors. Banks have been allowed to charge the identified sectors interest rates not exceeding the BPLR minus 4.5 percentage points on pre-shipment credit up to 270 days and post-shipment credit up to 180 days on the outstanding amount for the period December 1, 2008 to March 31, 2010. However, the total subvention will be subject to the condition that the interest rate, after subvention, will not fall below 7 per cent, which is the rate applicable to the agriculture sector under priority-sector lending. Banks are also required to ensure that the benefit of the 2 per cent interest subvention is passed on completely to the eligible exporters.

Sectoral Deployment Of Credit

5.11 Disaggregated data on sectoral deployment of gross bank credit from 49 banks accounting for about 95 per cent of bank credit and non-food credit available up to November 20, 2009 showed that among the major sectors, credit (year-on-year) to agriculture recorded a growth of 21.4 per cent (23.0 per cent in March 2009), while that to industry

Table 5.3 : Sectoral deployment of gross bank credit

Sl. No.	Item	Outstanding as on		Absolute variation	% variation	
		Mar. 27, 2009	Nov. 20, 2009	Mar. 27, 2009 over Mar. 28, 2008	Mar. 27, 2009 over Mar. 28, 2008	Nov. 20, 2009 over Nov. 21, 2008
		(amount in Rs. crore)				
	Gross Bank Credit	26,48,501	27,58,069	4,01,212	17.9	9.9
1	Public Food Procurement Credit	46,211	41,852	1,812	4.1	-15.3
2	Non-Food Gross Bank Credit	26,02,290	27,16,217	3,99,400	18.1	10.4
	a) Priority Sectors	9,15,886	9,49,428	1,68,506	22.5	15.4
	i. Agriculture	3,38,656	3,43,070	63,314	23.0	21.4
	ii. Micro and Small Enterprises (MSEs)	3,09,196	3,35,654	57,119	22.7	19.3
	iii. Other Priority Sectors	2,68,034	2,70,704	48,073	21.9	4.7
	b) Industry (Medium & Large)	8,85,393	9,65,057	1,25,330	18.6	12.8
	c) Wholesale Trade (Other than Food Procurement)	67,425	80,922	11,723	21.0	27.4
	d) Other Sectors	7,33,586	7,20,810	93,841	12.9	0.3
	Of Total Non-Food Gross Bank Credit,					
	1. Housing	2,76,957	2,91,760	19,165	7.4	7.3
	2. Consumer Durables	8,187	8,028	-612	-7.0	-11.8
	3. Real Estate Loans	91,575	88,581	28,261	44.6	15.3
	4. Tourism and Hotels and Restaurants	13,625	15,667	1,420	11.6	22.7
	5. Loans to Individuals against Shares, Debentures, Bonds,etc.	2,286	2,347	-1,891	-45.3	-36.8

Source : RBI.
Note : Data are provisional and relate to select banks which account for around 95 per cent of the gross bank credit of all SCBs. Figures are as on the last reporting Friday of the month.

(medium and large) recorded a growth of 12.8 per cent (as against 18.6 per cent in March 2009). Credit to wholesale trade recorded a growth of 27.4 per cent (as against 21.0 per cent in March 2009).

5.12 Credit to the priority sector grew by 15.4 per cent (year-on-year) in November 2009 as compared to 22.5 per cent in March 2009. Among the priority sub-sectors, credit to micro and small enterprises (MSEs) (including service-sector enterprises) recorded a growth of 19.3 per cent (year-on-year) in November 2009 as compared to 22.7 per cent in March 2009. (Table 5.3).

Priority-sector Lending

5.13 Domestic SCBs, both in the public and private sectors are required to meet a target of 40 per cent of their adjusted net bank credit (ANBC) or credit equivalent amount of off-balance sheet exposures (OBEs), whichever is higher, for lending to the priority sectors. Within this, sub-targets of 18 per cent and 10 per cent of ANBC or credit equivalent amount of OBE, whichever is higher, have been stipulated for lending to agriculture and the weaker sections respectively. In respect of foreign banks having offices in India, the target for lending to the priority sector has been kept at 32 per cent of ANBC or credit equivalent amount of OBE, whichever is higher. Within the overall target of 32 per cent to be achieved by foreign banks, advances to the MSE and export sectors should not be less than 10 per cent and 12 per cent of the ANBC or credit equivalent amount of OBE, whichever is higher, respectively. The outstanding advances by PSBs, private-sector banks and foreign banks to the priority sector as on the last reporting Fridays of March 2007, 2008 and 2009 are given in Table 5.4.

5.14 Though the public, private-sector and foreign banks, as individual groups, achieved the overall priority-sector lending targets as on the last reporting Friday of March 2009, there were shortfalls in all the categories included in the priority sector.

5.15 Out of 27 public-sector banks, three did not achieve the overall priority-sector lending target of 40 per cent as on the last reporting Friday of March

Table 5.4 : Particulars of advances to the priority sector

A. PUBLIC SECTOR BANKS (Rs crore)

Detail	As on the last reporting Friday of		
	March 2007	March 2008	March 2009 (provisional)
Total priority sector advances	5,21,376	6,10,450	7,20,083
	(39.7%)	(44.7%)	(42.5%)
Total advances to agriculture #	2,02,614	2,49,397	(17.2%)
	(15.4%)	(18.3%)	2,98,211
Total advances to micro & small enterprises *	1,02,550	1,51,137	1,91,307
	(7.8%)	(11.1%)	(11.3%)
Advances to weaker sections	93,747	1,21,740	1,67,041
	(7.1%)	(8.9%)	(9.8%)

 # Indirect agriculture is reckoned only up to 4.5 per cent of the ANBC or credit equivalent of OBEs, whichever is higher.

B. PRIVATE SECTOR BANKS

Detail	As on the last reporting Friday of		
	March 2007	March 2008	March 2009 (provisional)
Total priority sector advances	1,44,549	1,64,068	1,90,207
	(42.9%)	(47.8%)	(46.8%)
Total advances to agriculture#	52,034	58,567	76,062
	(12.7%)	(17.0%)	(15.9%)
Total advances to micro & small enterprises *	13,136	46,912	47,916
	(3.9%)	(13.7%)	(11.8%)
Advances to weaker sections	5,223	7,152	15,832
	(1.6%)	(2.0%)	(3.9%)

 # Indirect agriculture is reckoned only up to 4.5 per cent of the ANBC or credit equivalent of OBEs, whichever is higher.

C. FOREIGN BANKS

Detail	As on the last reporting Friday of		
	March 2006	March 2007	March 2008 (provisional)
Total priority sector advances	37,831	50,254	55,483
	(33.4%)	(39.5%)	(34.3%)
Total advances to micro & small enterprises*	11,637	15,489	18,138
	(10.3%)	(12.2%)	(11.2%)
Total Export credit (includes SSI export)	20,711	28,954	31,511
	(18.3%)	(22.7%)	(19.4%)

Source : RBI

*** Figures for 2007 represent small-scale industries. In terms of revised guidelines on lending to the priority sector, MSEs are defined on basis of the Micro, Small and Medium Enterprises Development (MSMED) Act 2006.**

Figures in parentheses for the year 2007 show percentage of advances to net bank credit while those for the years 2008 and 2009 show percentage to ANBC.

2009. As regards lending to agriculture by PSBs, only 14 banks achieved the target of 18 per cent. In the case of private-sector banks, out of 22 banks, five did not achieve the overall priority- sector lending target of 40 per cent and only eight achieved the target of 18 per cent for lending to agriculture. While the target for lending to the weaker sections (10 per cent) was achieved by 15 PSBs, only four private-

sector banks achieved the same as on the last reporting Friday of March 2009. Out of 27 foreign banks, only four did not achieve the overall priority-sector lending target of 32 per cent as on the last reporting Friday of March 2009. The number of foreign banks, which did not achieve the targets of 10 per cent and 12 per cent for lending to the MSE and export sectors respectively, stood at six.

5.16 In order to improve and enhance the flow of credit to the priority sector, a number of policy initiatives were taken during 2009-10 including the following:

Housing

Banks were advised that loans granted to housing finance companies (HFCs) for on-lending to individuals for purchase/construction of a dwelling unit per family be classified as housing loans under the priority sector, provided the housing loans granted by HFCs do not exceed Rs 20 lakh per dwelling unit. Eligibility under this measure was restricted to 5 per cent of the individual bank's total priority-sector lending, on an ongoing basis. This special dispensation is made applicable for loans granted by banks to HFCs up to March 31, 2010.

Small-scale Sector

Banks have been advised that loans granted for certain activities under micro and small (service) enterprises would be included within the priority sector provided such enterprises satisfy the definition of micro and small (service) enterprises in respect of investment in equipment (original cost excluding land and building, furniture, fittings and other items not directly related to the service rendered or as may be notified under the MSMED Act 2006) (i.e. not exceeding Rs10 lakh and Rs 2 crore respectively).

5.17 The activities which would be included within the priority sector are, consultancy services including management services, composite broker services in risk and insurance management, third-party administration (TPA) services for medical insurance claims of policy holders, seed grading services, training-cum-incubator centres, educational institutions, training institutes, retail trade, practice of law, i.e. legal services, trading in medical instruments (brand new), placement and management consultancy services and advertising agency and training centres.

5.18 There will be no separate retail trade category under the priority sector. Loans granted by banks for retail trade [*i.e. advances granted to retail traders dealing in essential commodities (fair price shops), consumer cooperative stores; and advances granted to private retail traders with credit limits not exceeding Rs 20 lakh]* would henceforth be part of the small (service) enterprises.

Rural Infrastructure Development Fund (RIDF)

5.19 The Government of India initiated the setting-up of an RIDF to be raised from the commercial banks to the extent of their shortfall in agricultural lending. The Fund has since been continued, with its corpus being announced every year in the budget. Over the years, coverage under the RIDF has been made broad based in each tranche and ,at present, a wide range of 31 activities under various sectors is being financed. The annual allocation of funds announced in the Union Budget has gradually increased from Rs 2,000 crore in 1995–96 (RIDF I) to Rs 14,000 crore in 2009-10 (RIDF XV). The aggregate allocations have reached Rs 1,00,000 crore. Further, a separate window has been created under the RIDF with a corpus of Rs 4,000 crore, with annual replenishment, for partly funding the rural roads and bridges components of the Bharat Nirman Programme from 2006–07 to 2008-09. This amount was raised to Rs 4,500 crore in 2009-10.

Table 5.5 : Sanctions and disbursements Under the RIDF and Bharat Nirman

(As on December 31, 2009) (Rs crore)

Region	Sanctions	Disburse-ments	Disburse-ments as per cent of sanction
South	27,068.41	17,417.90	64.35
West	14,354.92	10,042.81	69.96
North	27,997.49	18,513.68	66.13
Central	8,956.38	5,607.56	62.61
East	16,901.57	8,825.99	52.22
North-eastern Region & Sikkim	4,375.76	2,415.68	55.21
Total	99,654.53	62,823.62	63.04
Bharat Nirman	16,500.00	14,080.70	85.34
Grand Total	**1,16,154.53**	**76,904.32**	**66.21**

Source : NABARD (National Bank for Agriculture and Rural Development).

5.20 As against the total allocation of Rs1,00,000 crore, encompassing RIDF I to XV, sanctions aggregating Rs 99,654.53 crore have been accorded

Table 5.6 : Disbursements during 2009-10

(As on December 31, 2009) (Rs crore)

Region	Disbursement Target	Disbursement Achievement	Achievement(%)
South	4,235	1,367.15	32.28
West	2,350	795.27	33.84
North	4,450	261.23	58.81
Central	1,200	392.74	32.73
East	3,100	1,384.91	44.67
North-eastern Region & Sikkim	680	214.12	31.49
RIDF Total	16,015	6,771.42	42.28
New Delhi–NRRDA	4,500	2,081.70	46.26
Grand Total	**20,515**	**8,853.12**	**43.15**

Source: NABARD.

to various State Governments, and disbursements under the Fund amounted to Rs 62,823.62 crore, up to end December 2009. The National Rural Roads Development Agency (NRRDA) was sanctioned during the tranches RIDF XII to RIDF XV and it has so far availed of a disbursement of Rs 14, 080.70 crore. (Table 5.5).

5.21 During 2009-10 the aggregate disbursement to the States amounted to Rs 8,853.12 crore till end December 2009 and that to the NRRDA was Rs 2,081.70 crore (Table 5.6).

Agricultural Credit

Flow of Agricultural Credit

5.22 As against the target of Rs 2,80,000 crore (provisional) for agricultural credit in 2008-09, the banking system disbursed credit of Rs 2,92,437 crore to the agricultural sector, thereby exceeding the target by around 4 per cent. Commercial banks and regional rural ranks (RRBs) together extended credit to 81.02 lakh new farmers during 2008-09. In addition to this, cooperative banks provided loans to 13.88 lakh new farmers during the period, thus taking the total number of farmers financed by the banking system to 94.90 lakh.

5.23 The total credit flow to agriculture during 2009-10 up to October 31, 2009 by commercial banks, cooperative banks and RRBs was of the order of Rs 1,65,439.37 crore, amounting to 51 per cent of the annual target of Rs 3,25,000 crore (Table 5.7).

Kisan Credit Card Scheme (KCC)

5.24 The KCC scheme has become a widely accepted mechanism for delivery of credit to farmers. The banking system has issued 878.30 lakh KCCs as of November 30, 2009. The scheme now also covers borrowers of the long-term cooperative credit structure. The KCC has thus become a single window for a comprehensive credit product. The year-wise and agency-wise break up of the cards issued since inception is given in Table 5.8.

Initiatives For The Agricultural Sector

Personal Accident Insurance Scheme (PAIS)

5.25 In order to safeguard the interests of KCC holders, NABARD has allowed banks the discretion to opt for any insurance company of their choice. The banks have, however, to keep in mind the guiding principles of PAIS, especially the premium- sharing formula,and coverage while negotiating with insurance companies.

Table 5.7 : Flow of institutional credit to agriculture and allied activities

(Rs crore)

Sl. No.	Agency	2004-05	2005-06	2006-07	2007-08	2008-09^	2009-10*
1.	Cooperative Banks$	31,424	39,786	42,480	48,258	36,762	32,925
	% share	**25**	**22**	**18**	**19**	**13**	**20**
2.	RRBs	12,404	15,223	20,435	25,312	26,724	20,065
	% share	**10**	**8**	**9**	**10**	**9**	**12**
3.	Commercial Banks	81,481	1,25,477	1,66,486	1,81,088	2,28,951	1,12,449
	% share	**65**	**70**	**73**	**71**	**78**	**68**
Total (1+2+3)		**1,25,309**	**1,80,486**	**2,29,401**	**2,54,658**	**2,92,437**	**1,65,439**

Source : NABARD.
$: Including Others ^ : Provisional * : Up to October 31, 2009.

Table 5.8 : Agency-wise KCCs issued and amount sanctioned (as of November 30, 2009)

Agency	Cards issued (lakh)					Amount sanctioned (Rs. crore)				
	2006-07	2007-08	2008-09	2009-10	Total#	2006-07	2007-08	2008-09	2009-10@	Total#
Cooperative Banks	22.97	20.91	13.44	12.17	373.61	13,141	19,991	8,428	5,241	1,38,229$
RRB	14.06	17.73	14.15	11.02	125.73	7,373	8,783	5,648	5,512	4,93,44$
Commercial Banks	48.08	46.06	58.34	8.45^	378.96	26,215	59,530	39,009	6,657^	1,93,497*
Total	**85.11**	**84.70**	**85.93**	**31.64**	**878.30**	**46,729**	**88,262**	**53,085**	**17,329**	**3,81,070**

Source : NABARD
\# Since inception of the scheme in 1998. ^: Data up to 30 June 2009
@ Break-up i.e term loan is not available
$ Total amount sanctioned includes Rs 2,859 crore for term loan under KCC for 2008-09.
$$ Total amount sanctioned includes Rs 2,304 crore for term loan under KCC for 2008-09.
* Total amount sanctioned includes Rs 10,279 crore for term loan under KCC for 2008-09.

Enlargement of the scope of KCC

5.26 With a view to making it more user-friendly, NABARD has enlarged the scope of the KCC scheme to cover term loans for agriculture and allied activities, including a reasonable component for consumption needs, besides the existing facility of providing crop loan limit.

Crop Insurance on KCC

5.27 Crop loans disbursed under the KCC Scheme for notified crops are covered under the Rashtriya Krishi Bima Yojana (National Crop Insurance Scheme), introduced to protect the interests of the farmer against crop loss caused by natural calamities, pest attacks, etc.

MICRO FINANCE

Self-Help Groups (SHGs)

5.28 In an effort to mainstream micro credit and increase its outreach, the RBI had issued comprehensive guidelines in February 2000 stipulating that micro credit extended by banks to individual borrowers directly or through any intermediary would henceforth be reckoned part of their priority-sector lending. Banks were given the freedom to formulate their own model[s] or choose any conduit/intermediary for extending micro credit. The SHG-Bank Linkage Programme implemented by commercial banks, RRBs and cooperative banks has emerged as the major micro- finance programme in the country.

5.29 Under the SHG-Bank Linkage Programme, as on March 31, 2009, 61,21,147 SHGs held savings bank accounts with total savings of Rs 5,545.62 crore as against 50,09,794 SHGs with savings of Rs 3,785.39 crore as on March 31, 2008. Thus more than 8.06 crore poor households were associated with banking agencies under the SHG- Bank Linkage Programme.

5.30 As on March 31, 2009, commercial banks had the maximum share of SHG savings with savings of 35,49,509 SHGs (58 per cent) amounting to Rs 2,772.99 crore (50 per cent); this was followed by RRBs with savings bank accounts of 16,28,588 SHGs (26.6 per cent) and savings amount of Rs1,989.75 crore (35.9 per cent) and cooperative banks with savings bank accounts of 9,43,050 SHGs (15.4per cent) and savings amount of Rs 782.88 crore (14.1 per cent).

5.31 The share of the Swarnajayanti Gram Swarozgar Yojana (SGSY) in SHG savings accounts was 15,05,581 SHGs, forming 25 per cent of the total SHGs having savings accounts in banks. During 2008-09, the average savings per SHG with all banks increased from Rs 7,556 as on March 31, 2008 to Rs 9,060 as on March 31, 2009, varying between a high of Rs 12,218 per SHG with RRBs and a low of Rs 7,812 per SHG with commercial banks. As on March 31, 2009, the share of women SHGs in total SHGs with savings bank accounts was 48,63,921, accounting for 79.46 per cent as compared to the previous year's share of 79.56 per cent.

5.32 During 2008-09, banks financed 16,09,586 SHGs, including repeat loans to existing SHGs, as against 12,27,770 SHGs during 2007-08—a growth of 31.1 per cent (number of SHGs). As on March 31, 2009, 42,24,338 SHGs had outstanding (cumulative) bank loans of Rs 22,679.85 crore as against 36,25,941 SHGs with outstanding bank loans of Rs16,999.90 crore as on March 31, 2008 (Table 5.9). This included 9,76,887 SHGs (6.5 per

Table 5.9 : Progress under SHG-Bank Linkage

Year	New SHGs financed by banks					Bank loan**
	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#	16,09,586*	31.1	42,24,338	12,256.51	38.5	22,679.85$

Source : NABARD

* Include existing SHGs also, which were provided repeat bank loan.

** Includes repeat loans to existing SHGs.

\# Provisional $ Outstanding. $$ Amount in Rs. Crore.

@ 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.

cent) with outstanding bank loans of Rs 5,861.72 crore (21.7per cent) under the SGSY as against 9,16,978 SHGs with outstanding bank loans of Rs 4,816.87 crore as on March 31, 2008. Commercial banks had the maximum share of around 70 per cent of outstanding bank loans to SHGs followed by RRBs with a share of 23 per cent and cooperative banks with the balance. As on March 31, 2009, the average bank loan outstanding per SHG was Rs 53,689 as against Rs 46,884 as on March 31, 2008. It varied from a high of Rs 57,037 per SHG in the case of commercial banks to a low of Rs 31,460 per SHG in the case of cooperative banks.

5.33 Pursuant of the announcement made in the Reserve Bank's Annual Policy Statement 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 accounts by SHGs and their adherence to best practices. The evaluation of SHGs carried out by the ROs revealed that there was scope for improvement in the area of maintenance of books of accounts. It also brought out that rotation of group leaders was generally not followed by SHGs. However, other best practices like strict adherence to attendance of group meetings, recording minutes of the meetings and prompt repayment of bank loans were being followed.

5.34 The momentum of growth in the micro-finance sector has brought into focus the importance of regulating the sector to function in an efficient and orderly manner. There would be need for greater transparency in their functioning and for facilitating their reach to un-banked population of the country.

Financial Performance Of Banks

5.35 The balance sheets of SCBs in India available as of 2008-09 indicate that the SCBs remained robust. However, the Indian banking sector was not completely insulated from the effects of the slowdown in the economy in 2008-09.

5.36 The consolidated balance sheets of SCBs expanded by 21.2 per cent as in end-March 2009 as compared to 25.0 per cent in the previous year. While the balance sheets of PSBs maintained their growth momentum, private-sector and foreign banks registered a deceleration in growth. The working results of SCBs under different categories are abstracted in Table 5.10.

5.37 During 2008-09, the growth rate of banks' lending to industries, personal loans and services witnessed a deceleration, while the growth rate of banks' lending to agriculture and allied activities increased substantially. Overall, the incremental credit–deposit (C-D) ratio declined sharply reflecting the slowdown in credit growth.

Table 5.10 : Working results of scheduled commercial banks

Items	PSBs		Foreign banks		Old pvt. sector banks		New pvt. sector banks		All SCB	
	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09
	(Rs Crore)									
A Income	2,45,872	3,15,608	35,005	45,213	16,798	21,572	71,199	81,443	3,68,874	4,63,836
(i) Interest Income	2,13,075	2,73,428	24,417	30,322	14,614	18,783	56,377	66,283	3,08,483	3,88,816
(ii) Other Income	32,797	42,180	10,588	14,891	2,184	2,789	14,822	15,160	60,391	75,020
B Expenditure	2,19,280	2,81,215	28,392	37,704	14,821	19,163	63,654	72,985	3,26,147	4,11,067
(i) Interest Expended	1,48,902	1,93,447	10,604	12,817	9,960	12,834	38,535	44,123	2,08,001	2,63,221
(ii) Intermediation Cost (Operating Expenses)	46,663	55,190	10,353	12,299	3,235	3,939	17,032	17,840	77,283	89,268
(iii) Provisions and Contingencies	23,715	32,578	7,435	12,588	1,626	2,390	8,087	11,022	40,863	58,578
C Operating Profit (A - Bi - Biii)	73,255	89,583	16,966	19,808	5,212	6,348	24,577	26,298	1,20,010	1,42,037
D Net Profit (A-B)	26,592	34,393	6,613	7,509	1,977	2,409	7,545	8,458	42,727	52,769
E Net Interest Income (Spread) (Ai - Bi)	64,173	79,981	13,813	17,505	4,654	5,949	17,842	22,160	1,00,482	1,25,595
F Total Assets	30,21,924	37,66,716	3,64,099	4,47,149	1,94,544	2,32,001	7,45,599	7,95,464	43,26,166	52,41,330
G Net Income (Aii + E)	96,970	1,22,161	24,401	32,396	6,838	8,738	32,664	37,320	1,60,873	2,00,615
	(As per cent of total assets)									
A Income	8.14	8.38	9.61	10.11	8.63	9.30	9.55	10.24	8.53	8.85
(i) Interest Income	7.05	7.26	6.71	6.78	7.51	8.10	7.56	8.33	7.13	7.42
(ii) Other Income	1.09	1.12	2.91	3.33	1.12	1.20	1.99	1.91	1.40	1.43
B Expenditure	7.26	7.47	7.80	8.43	7.62	8.26	8.54	9.18	7.54	7.84
(i) Interest Expended	4.93	5.14	2.91	2.87	5.12	5.53	5.17	5.55	4.81	5.02
(ii) Intermediation Cost (Operating Expenses)	1.54	1.47	2.84	2.75	1.66	1.70	2.28	2.24	1.79	1.70
(iii) Provisions and Contingencies	0.78	0.86	2.04	2.82	0.84	1.03	1.08	1.39	0.94	1.12
C Operating Profit (A - Bi - Biii)	2.42	2.38	4.66	4.43	2.68	2.74	3.30	3.31	2.77	2.71
D Net Profit (A-B)	0.88	0.91	1.82	1.68	1.02	1.04	1.01	1.06	0.99	1.01
E Net Interest Income (Spread) (Ai - Bi)	2.12	2.12	3.79	3.91	2.39	2.56	2.39	2.79	2.32	2.40
Memo Item										
1 Operating Expenses as Per Cent of Net Income	48.12	45.18	42.43	37.96	47.31	45.08	52.14	47.80	48.04	44.50

Source: RBI.

5.38 The consolidated balance sheets of SCBs, expanded by 21.2 per cent as in end-March 2009, as compared to 25.0 per cent in end-March 2008. The growth rate of aggregate deposits of SCBs decelerated to 22.4 per cent as in end-March 2009 from 23.1 per cent as in end-March 2008. The growth rate of aggregate loans and advances of SCBs decelerated to 21.2 per cent as in end-March 2009 from 25.0 per cent in the previous year. Apart from cyclical factors which led to slowdown after a period of high credit growth, the deceleration was accentuated this year because of the overall slowdown in the economy in the aftermath of the global financial turmoil. The capital to risk-weighted assets ratio (CRAR) of SCBs improved to 13.2 per cent as in end-March 2009 from 13.0 per cent as in end-March 2008, remaining significantly above the stipulated minimum of 9.0 per cent.

5.39 Growth in investments by banks decelerated to 23.1 per cent as of end-March 2009. However, the share of investments under the SLR category increased during 2008-09, due to banks' preference to park their funds in low-risk and low-return instruments against the backdrop of prevailing

uncertainties. On other hand, growth of banks' investments in non-SLR securities (i.e. bonds/ debentures/ shares and commercial papers) decelerated. The total flow of funds from SCBs to the commercial sector comprising credit and non-SLR investments increased by 17.5 per cent (Rs 4,21,091 crore) in 2008-09 as compared to 22.6 per cent (Rs 4,44,807 crore) in 2007-08.

5.40 SCBs did not raise any resources from the equity market during 2008-09 though they accessed the debt market for the purpose. The return on assets (ROA) remained at the previous year's level of 1.0 per cent, while the return on equity (ROE) increased to 13.3 per cent during 2008-09 from 12.5 per cent during 2007-08.

5.41 The Indian banking sector was, however, not completely insulated from the effects of the slowdown in the economy as evident from the financial performance of the SCBs. The growth rates of income as well as expenditure of the SCBs slowed down, leading to deceleration in growth of net profits.

Capital Adequacy Ratio

5.42 One of the major indicators suggesting that the Indian banking system has withstood the pressure of global financial turmoil is the improvement in the CRAR. The overall CRAR of all SCBs improved to 13.2 per cent by end-March 2009 from 13.0 per cent a year earlier, thus remaining significantly above the stipulated minimum of 9.0 per cent. While the CRAR of as many as 78 banks was above 10 per cent, that of only one bank was in the range of 9 to 10 per cent.

5.43 All commercial banks in India excluding RRBs and local area banks have become Basel II compliant as of March 31, 2009. To begin with, the Standardised Approach for Credit Risk, Basic Indicator Approach for Operational Risk and Standardised Duration Approach for Market Risk have been implemented in India. However, the implementation of advanced approaches under the Basel II framework would bring about the upgradation of the risk management framework as well as capital efficiency in the Indian banking system.

Non-performing Assets (NPAs) of the Banking Sector

5.44 Indian banks recovered a higher amount from NPAs during 2008-09 as compared to the previous year, pointing towards efforts for improvement in the asset quality of banks. The total amount recovered and written-off in 2008-09 was Rs 38,828 crore However, though this was higher than the Rs 28,283 crore written off in 2007-08, it was lower than the fresh NPAs added (Rs 52,382 crore) during the year. Though some slippage was to be expected in the current global context, it has been moderate as compared to the problems faced by banks all over the world. Among the various channels of recovery available to banks for dealing with bad loans, the SARFAESI Act and the Debt Recovery Tribunals (DRTs) have been the most effective.

5.45 The gross NPAs to gross advances ratio for SCBs remained constant at 2.3 per cent during 2008-09 as in 2007-08. However, though the gross NPA to gross advances ratio of PSBs declined from 2.2 per cent in March 2008 to 2.0 per cent as of March 2009, that of old private banks increased from 2.3 to 2.4 per cent and that of foreign banks from 1.8 to 4.0 per cent in March 2009 over the level of March 2008. The net NPA ratio (net NPAs as percentage of net advances) increased marginally from 1.0 to 1.1 in the case of SCBs in March 2009.

Technological Developments in Banks

5.46 Banks in India are using Information Technology (IT) not only to improve their own internal processes but also to increase facilities and services to their customers. Efficient use of technology has facilitated accurate and timely management of the increased volumes of transactions of banks, consistent with a larger customer base.

5.47 During 2008-09, the transmission of clearing data—both for cheque and electronic clearing services—and collation of inputs from currency chests as part of the Integrated Currency Chest Operations and Management System (ICCOMS) was done using secured websites. The prevalent IT system to process the accounting requirements of the State and Central Governments was replaced by the Centralised Public Accounts Department System (CPADS), which is considered more robust and user friendly.

5.48 To facilitate a smoother and faster bidding in the Primary Dated Securities Auctions held by the Reserve Bank, a new version of the Negotiated Dealing System Auction module, developed and hosted by the Clearing Corporation of India, was developed in 2008-09, leading to its launch with effect from May 11, 2009.

5.49 One of the major achievements during 2008-09 was the increase in the number of branches providing Core Banking Solutions (CBS). The total

number of branches of PSBs that have implemented CBS increased from 35,464 as on March 31, 2008 to 44,304 as on March 31, 2009.

5.50 The computerization of the banking sector, which is regarded as the precursor to other technological initiatives, is almost in completion stage. The proportion of PSB branches that achieved full computerization increased from 93.7 per cent as of end-March 2008 to 95.0 per cent as of end-March 2009. That continuous progress is being made by banks is reflected in the increase in the number of banks moving into the 'more than 90 per cent but less than 100 per cent' category. During 2008-09, the total number of automated teller machines (ATMs) installed by banks grew by 25.4 per cent.

Non-banking Financial Institutions (NBFIs)

5.51 While banks account for a major share of the Indian financial system, NBFIs also play an important role in providing a wide range of financial services. While banks have an edge in providing payment- and liquidity-related services, NBFIs tend to offer enhanced equity and risk-based products. The major intermediaries that are included in the NBFI group are development finance institutions (DFIs), insurance companies, non-banking financial companies (NBFCs), primary dealers (PDs) and capital market intermediaries such as mutual funds. The NBFIs provide medium- to long-term finance to different sectors of the economy.

Financial Institutions (FIs)

5.52 Based on the major activity undertaken by FIs, they could be classified into three broad categories, namely (i) term-lending institutions whose main activity is direct lending by way of term loans and investments (e.g. EXIM Bank); (ii) refinance institutions which mainly extend refinance to banks as well as NBFIs (e.g. NABARD, the Small Industries Development Bank of India [SIDBI] and National Housing Bank [NHB]); (iii) investment institutions which deploy their assets largely in marketable securities (e.g. the Life Insurance Corporation of India [LIC]).

5.53 In the context of the emergent liquidity constraints following the onset of the global financial crisis, the RBI in December 2008, provided a window for refinance facilities of Rs 7,000 crore, Rs 5,000 crore and Rs 4,000 crore for SIDBI, EXIM Bank and the NHB respectively. Accommodation under this facility was to be charged at the repo rate under the Liquidity Adjustment Facility (LAF) of the RBI. The amount outstanding under the special refinance facility remained small up to February 2009 for each institution, but picked up in the subsequent months (Table 5.11).

Table 5.11 : Utilization of refinance facilities

(Amount in Rs crore)

AIFIs	Re-finance sanction-ed	Cumulative amount drawn up June 26, 2009	Cumulative amount disbursed up to June, 26, 2009	No.of bene-ficiaries
SIDBI	7,000	5,684	4,971	33*
		988	1,043	22**
		7,747	1,841	5,179
Exim Bank	5,000	3,000	3,478	35
NHB	4,000	3,979	3,979	14#
Total	16,000	21,398	15,312	5,283

Source: RBI
* State Finance Corporations (SFCs) and banks.
** Non Banking Finance Companies
# Housing Finance Companies

5.54 The 'umbrella limit' for aggregate borrowings by financial institutions (FIs) (through five specified instruments, namely term deposits, term money borrowings, certificates of deposits [CDs], commercial papers [CPs] and inter-corporate deposits [ICDs]) which was stipulated not to exceed 100 per cent of their net owned funds (NOFs) at any time, as per their latest audited balance sheets, was also raised to 200 per cent of NOFs for one year with effect from December 8, 2008 for EXIM Bank and from January 15, 2009 for the NHB, subject to review and subject to the asset liability management (ALM) guidelines of the Reserve Bank.

5.55 During 2008-09, though there was increase in financial assistance both sanctioned and disbursed by FIs, the increase in disbursements (93.3 per cent) was more pronounced than that in sanctions (70.2 per cent). A major part of the increase in financial sanctions and disbursements was accounted for mainly by investment institutions (especially the LIC) followed by term-lending institutions (Table 5.12).

5.56 Resources raised by the FIs during 2008-09 were considerably higher than those during the previous year. The increase was largely in the short-term mode, while the raising of long-term and foreign currency resources declined as compared to the preceding year. Resources raised by FIs from the money market rose sharply during 2008-09 with the

Table 5.12 : Financial assistance sanctioned and disbursed by financial institutions

(Rs crore)

Category		Amount				Percentage variation	
		2007-08		2008-09		2008-09	
		S	D	S	D	S	D
(i)	All-India Term-Lending Institutions*	18,696	17,379	33,660	31,604	80.0	81.9
(ii)	Specialised Financial Institutions#	366	189	597	283	63.1	49.7
(iii)	Investment Institutions@	39,670	28,460	65,731	57,086	65.7	100.6
	Total assistance by FIs(i+ii+iii)	58,732	46,028	99,988	88,973	70.2	93.3

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

All data are provisional.

utilization of the "umbrella limit" reaching 58.0 per cent in 2008-09 as compared to 22.9 per cent in the preceding year. External sources contributed 30.7 per cent of sources of funds during 2008-09 as compared to 51.7 per cent during the preceding year.

5.57 FIs recorded improvement in their asset quality during 2008-09. In terms of net NPA to net loans ratio, the asset quality of SIDBI and EXIM Bank improved during the year. The net NPA ratio of NABARD increased marginally. None of the FIs had any assets in the 'loss' category as of end-March 2009.

5.58 Net interest and non-interest incomes of FIs increased by 22.5 per cent and 31.1 per cent respectively during 2008-09. The operating profit increased by 33.5 per cent during the year. The net profit of FIs also increased despite higher provisions for taxation. The capital adequacy ratio of all the FIs continued to be significantly higher than the minimum stipulated norm of 9 per cent.

Non-banking Financial Companies (NBFCs)

5.59 The NBFCs as a whole account for 9.1 per cent of the assets of the total financial system. In the wake of the recent global financial crisis and its fallout for FIs, the RBI undertook measures to preserve financial stability and arrest the moderation in the growth momentum. As a measure aimed at expanding rupee liquidity, the Reserve Bank provided a special repo window under its LAF for NBFCs. In addition, an existing special purpose vehicle (SPV) was used as a platform to provide liquidity support to NBFCs. In December 2008, systemically important non-deposit taking NBFCs (NBFCs-ND) were permitted, as a temporary measure, to raise foreign currency short-term borrowings under the approval route subject to certain conditions.

5.60 The total number of NBFCs registered with the Reserve Bank, consisting of deposit-taking NBFCs (NBFCs-D), residuary non-banking companies (RNBCs), mutual benefit companies (MBCs), miscellaneous non-banking companies (MNBCs) and Nidhi companies, declined from 12,809 in end-June 2008 to 12,740 in end-June 2009. The number of NBFCs-D also declined from 364 in end-June 2008 to 336 in end-June 2009, mainly due to the exit of many NBFCs from deposit-taking activity (Table 5.13).

5.61 The ratio of deposits of reporting NBFCs to the aggregate deposits of SCBs dropped to 0.53 per cent in end-March 2009 from a level of 0.73 per cent in end- March 2008, mainly due to the decline in deposits of reporting NBFCs.

Table 5.13 : Number of NBFCs Registered with the RBI

End June	Number of registered NBFCs	Number of NBFCs-D
2004	13,764	604
2005	13,261	507
2006	13,014	428
2007	12,968	401
2008	12,809	364
2009	12,740	336

Source: RBI.

5.62 Total assets of NBFCs declined to Rs 95,727 crore during 2008-09 from Rs 99,014 crore in the preceding year. Public deposits also recorded a decline to Rs 21,548 crore in end- March 2009 from Rs 24,400 crore in end-March 2008. The NOFs of NBFCs witnessed a growth of 8.8 per cent and stood at Rs13,458 crore as in end-March 2009. The share of RNBCs in NBFCs in terms of total assets, public deposits and NOFs recorded marginal decline during 2008-09 over the preceding year.

5.63 Total assets/liabilities of NBFCs (excluding RNBCs) expanded at the rate of 1.3 per cent during 2008-09 as compared to 53.6 per cent during 2007-08. Borrowings, which are the major source of funds for NBFCs, increased by 9.3 per cent during the year, while public deposits declined by 4.9 per cent indicating the continuing shift in the pattern of raising of resources. On the assets side, hire purchase assets and loans and advances, which are major items of assets, witnessed growth of 6.3 per cent and 12.0 per cent respectively in 2008-09, as compared to 27.9 per cent and 70.2 per cent respectively, during the earlier year. Growth of total investments of NBFCs decelerated mainly due to deceleration in investment in approved securities. Other investments increased by 37.4 per cent during 2008-09 as compared to 30.0 per cent during 2007-08.

5.64 Among NBFC groups, asset finance companies (AFCs) held the largest share in total assets/liabilities (70.3 per cent), followed by loan companies (28.9 per cent), hire purchase companies (0.6 per cent) and equipment leasing (0.3 per cent). The increase in assets/liabilities of AFCs was mainly on account of reclassification of NBFCs, which was initiated in December 2006.

5.65 Of the total deposits held by all NBFCs, AFCs held the largest share in total deposits of NBFCs (70.5 per cent); loan companies and hire purchase companies accounted for low shares of 19.9 per cent and 9.6 per cent respectively.

5.66 Continuing the trend of the previous year, public deposits held by all groups of NBFCs taken together declined moderately during 2008-09. This trend is indicative of the shift in preference of NBFCs from public deposits to bank loans/ debentures. The decline in public deposits was mainly evident in the case of loan companies and equipment-leasing companies due to reclassification of some of these companies as asset finance companies. Deposits of asset finance companies increased by 17.5 per cent during 2008-09.

5.67 The asset size of NBFCs varied significantly between less than Rs 25 lakh to above Rs 500 crore. The asset-holding pattern remained skewed in 2008-09, with 12 NBFCs with asset size of “above Rs 500 crore” holding 95.8 per cent of the total assets of all NBFCs, while the remaining 263 NBFCs held only about 4.2 per cent in end-March 2009.

5.68 Financial performance of NBFCs in terms of income and net profit improved during 2008-09. While growth in expenditure decelerated over the previous year, it, however, witnessed higher growth than income, resulting in a decline in operating profit by 2.2 per cent. Net profit registered a moderate growth mainly due to lower provisioning for tax. The cost to income ratio deteriorated from 68.9 per cent in 2007-08 to 74.1 per cent in 2008-09. Non-interest cost at 97.6 per cent continued to constitute the dominant share in the total cost of NBFCs during 2008-09. Concomitantly, the interest cost accounted for a small share.

5.69 Gross NPAs (as percentage of gross advances) of asset finance, equipment leasing, investment and hire purchase companies declined during 2008-09. Net NPAs (as percentage of net advances) increased marginally in the case of asset finance companies and hire purchase companies, while those of equipment leasing and investment companies decreased. NPAs of loan companies remained negative during 2008-09 also. Asset quality of various types of NBFCs as reflected in various categories of NPAs (substandard, doubtful and loss) showed that there was sharp improvement in the asset quality of equipment leasing companies and deterioration in the asset quality of hire purchase companies during 2008-09 over the previous year.

5.70 CRAR norms were made applicable to NBFCs in 1998, in accordance with which every deposit-taking NBFC is required to maintain a minimum capital, consisting of Tier-I and Tier-II 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 declined to 9 in end-March 2009 from 47 in end- March 2008. In end-March 2009, 198 out of 207 NBFCs had CRAR of 12 per cent or more as against 280 out of 327 NBFCs in end-March 2008. The number of NBFCs with CRAR more than 30 also declined to 168 in end- March 2009 from 239 in end-March 2008.

5.71 Regulation of non-banking entities is being progressively strengthened and the process had started before the onset of the global financial crisis. Issues relating to the level playing field between bank-sponsored NBFCs and non-bank associated NBFCs and other issues of regulatory convergence and regulatory arbitrage were examined with respect to systemic implications. NBFCs-ND with asset size of Rs100 crore and above are defined as systemically important and an elaborate prudential framework has been put in place to regulate these entities.

5.72 Initially, with a view to protecting the interests of depositors, regulatory attention was mostly focused on NBFCs accepting public deposits (NBFCs-D). Over the years, however, this regulatory framework has been widened to include issues of systemic significance. The sector is being consolidated and while deposit-taking NBFCs have decreased both in size as well as in terms of the quantum of deposits held by them, NBFCs-ND have increased in terms of number and asset size. NBFCs-ND with asset size of Rs100 crore and above are subject to CRAR and exposure norms prescribed by the RBI.

5.73 A reclassification of NBFCs was effected in December 2006, whereby companies financing real/ physical assets for productive/ economic activities are classified as AFCs, while the other two categories are loan companies (LCs) and investment companies (ICs).

5.74 In July 2008, the Reserve Bank revised the approach towards monitoring of frauds in NBFCs which was earlier issued in March 2008. NBFCs have been advised to report frauds in their subsidiaries and affiliates/joint ventures, and directions were also issued in January 2009, requiring them to adopt an interest rate model which precludes high interest rates and at the same time be transparent to the customers.

5.75 The final guidelines regarding non-deposit taking systemically important NBFCs (NBFC-ND-SI) were issued on August 1, 2008. According to these guidelines, the minimum CRAR for each NBFC-ND-SI was raised from the existing 10 per cent to 12 per cent to be reached by March 31, 2009 and 15 per cent to be reached by March 31, 2010. In view of the economic downturn and based on several requests received, this requirement has been postponed for one year. The NBFCs-ND-SI were required to make additional disclosures relating to CRAR, exposure to the real estate sector and the maturity pattern of assets and liabilities in their balance sheet from the year ending March 31, 2009.

5.76 In October 2008, taking into consideration the need for enhanced funds for increasing business and meeting regulatory requirements, the Reserve Bank decided that NBFCs-ND-SI may augment their capital funds by issue of perpetual debt instruments (PDIs). Such PDIs are eligible for inclusion as Tier I capital to the extent of 15 per cent of total Tier I capital as on March 31 of the preceding year.

5.77 In December 2008, systemically important NBFCs-ND-SIs were permitted, as a temporary measure, to raise foreign currency short-term borrowings under the approval route subject to certain conditions. In this connection, all the NBFCs-ND-SI that have availed of short-term foreign currency loans were advised to furnish a monthly return as per the prescribed format within ten days from the end of the month to which it pertains.

5.78 To enable the RBI to verify that "fit and proper" management of NBFCs is continuously maintained, it has been decided that any takeover/acquisition of shares or merger/ amalgamation of an NBFC-D with another entity or any merger/amalgamation of an entity with an NBFC-D that would give the acquirer/ another entity control of the NBFC-D, would require prior permission of the RBI with effect from September 17, 2009.

5.79 To hedge the underlying exposures of NBFCs, directions were issued covering the framework for trading of interest rate futures by NBFCs in exchanges in India recognized by the Securities Exchange Board of India (SEBI) subject to RBI/SEBI guidelines.

5.80 The turbulence in the international financial markets in 2008 also affected the domestic financial sector including NBFCs sector, particularly a few NBFCs-ND-SI. These entities have been financing long-term assets with short-term commercial paper and non-convertible debentures which were subscribed to mainly by mutual funds (MFs). Such NBFCs-ND-SI faced difficulties as MFs were not in a position to roll over these instruments during the crisis period. The measures undertaken by the Reserve Bank in respect of the NBFC sector following the financial crisis were as follows:

i) NBFCs-ND-SI were permitted as a temporary measure to raise short-term foreign currency borrowings under the approval route subject to fulfillment of certain conditions. While the resources raised were to be used only for refinancing of short-term liabilities and not for creation of fresh assets, it was also advised that the maturity of such borrowing should not

exceed three years and the maximum amount should not exceed 50 per cent of the NOF or US$10 million (or its equivalent), whichever was higher.

ii) Banks were permitted, on a temporary basis, to avail of liquidity support under the LAF window through a relaxation in the maintenance of SLR up to 1.5 per cent of their NDTL, exclusively for meeting the funding requirements of NBFCs and mutual funds.

iii) The risk weight on banks' exposure to NBFCs-ND-SI was reduced to 100 per cent from 125 per cent irrespective of credit rating, while exposure to AFCs which attracted a risk weight of 150 per cent was also reduced to 100 per cent.

iv) NBFCs-ND-SI were permitted to augment their capital funds by the issue of PDIs. The amount of PDI raised by NBFCs-ND-SI would not be treated as 'public deposit' within the meaning of Reserve Bank directives.

v) The proposed increase in the CRAR to be maintained by NBFCs-ND-SI to 12 per cent and subsequently to 15 per cent was deferred by one year, i.e. 12 per cent by March 31, 2010 and 15 per cent by March 31, 2011.

vi) The RBI provided direct lending facility as a lender of last resort (LOLR) to NBFCs-ND-SI against their rated CPs through an SPV by subscribing to its bonds. The facility was operationalized in January 2009 through an SPV called 'IDBI SASF Trust' to provide liquidity support against investment grade paper of NBFCs, subject to their fulfilling certain conditions. It was designed as an LOLR facility to allow an orderly downsizing of the balance sheets of financially sound NBFCs which faced short-term temporary liquidity requirement. The facility has been availed of by only one NBFC so far, which has drawn Rs1,040 crore under the scheme and there is no outstanding balance as of date. The Government of India had extended the facility for any paper issued till September 30, 2009 and the SPV would cease to make fresh purchases after December 31, 2009 and would recover all dues by March 31, 2010.

The NBFC sector has been witnessing a consolidation process in recent years, wherein the weaker NBFCs are gradually exiting, paving the way for a stronger NBFC sector.

Capital And Commodity Markets

5.81 The capital and commodity markets exhibited buoyancy during 2009 as the markets recovered and gained strength against the backdrop of a distinct improvement in the risk appetite of investors leading to a sharp rise in international capital flows to emerging markets including India. Positive domestic factors, namely better than expected performance of corporates and banks and higher GDP growth during the second quarter (Q2) of 2009-10 also supported an uptrend in the Indian capital market.

Capital Market

5.82 The Indian equity markets, which had declined sharply during 2008, reflecting the volatility in international financial markets and foreign institutional investment outflows, began the year 2009 on a subdued note. The market remained range bound during April-March 2009 but exhibited signs of recovery from April 2009. With the revival of foreign institutional investors' (FIIs) interest in emerging market economies including India, the equity markets gained strength during May-July 2009. There was a fresh spell of bullish sentiment in September 2009, with the Bombay Stock Exchange (BSE) Sensex recording a high of 17,126.84 during the month. The Indian equity markets closed lower at 15,896.28 in end-October 2009, before showing an improvement during November-December 2009. The movement in equity indices in the Indian capital market was in line with trends in major international equity markets, a sign of increasing integration. Against the backdrop of these trends in Indian equity markets, the regulatory measures initiated during the year were clearly in the direction of introducing greater transparency, protecting investors' interests and improving efficiency in the working of Indian equity markets, while also ensuring the soundness and stability of the Indian capital market.

Primary Market

5.83 Though resource mobilization from the primary market through equity investments was sluggish in 2009 both in terms of number of issues and amount raised through public rights issues and follow-on public offerings, there was an increase in debt market activity and private placements. The total number of initial public offerings (IPOs) declined to 20 in 2009 from 37 in 2008. The total amount mobilized through equity issues in 2009 was lower at Rs 23,098 crore as compared to Rs 49,485 crore raised in 2008. The amount raised through IPOs, however, increased

Table 5.14 : Resource mobilization through the primary market

(Rs crore)

Mode	Calendar Year			
	2006	2007	2008	2009(P)
1. Debt	389	594	0	3,500
2. Equity	32,672	58,722	49,485	23,098
of which, IPOs	24,779	33,912	18,393	19,296
Number of IPOs	75	100	37	20
Mean IPO size	330	339	497	965
3. Private Placement	1,17,407	1,84,855	1,55,743	2,38,226
4. Euro Issues (ADR/GDR)	11,301	33,136	6,271	15,266
Total (1 to 4)	**1,61,769**	**2,77,307**	**2,11,499**	**2,80,090**

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

Table 5.15 : Trends in resource mobilization (net) by MFs

(Rs crore)

Sector	Calendar Year			
	2006	2007	2008	2009
1. UTI	6,426	9,245	-2,704	12,056
2. Public Sector	12,229	8,259	14,587	17,624
3. Private Sector	86,295	1,20,766	-12,506	1,14,095
4. **Total (1 to 3)**	1,04,950	1,38,270	-624	1,43,775

Source : SEBI

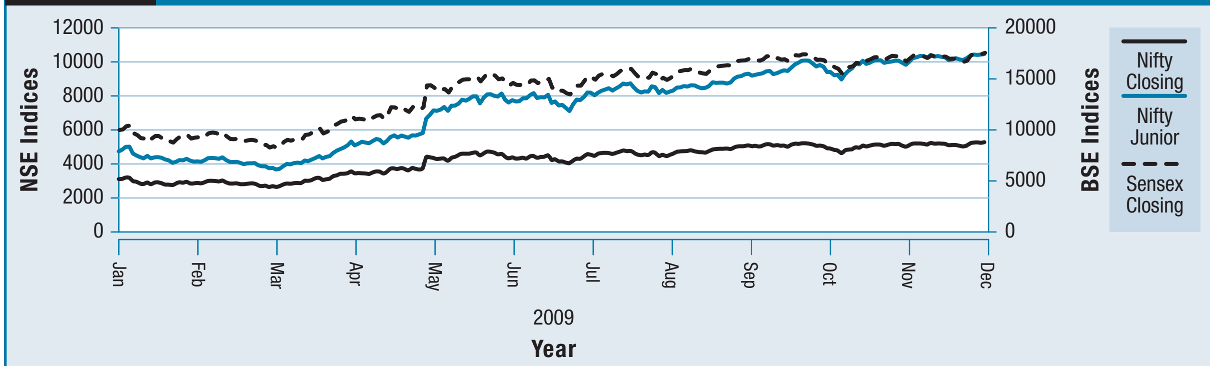
slightly in 2009 to Rs 19,296 crore from Rs 18,393 crore in 2008. The mean IPO size increased to Rs 965 crore in 2009 from Rs 497 crore in 2008. There was no debt issue in 2008. The total amount mobilized through three debt issues during 2009 was Rs 3,500 crore. The total amount raised through private placement of debt in 2009 at Rs 2,38,226 crore was higher by 53.0 per cent than its previous year's level of Rs 1,55,743 crore. Total resources mobilized through the primary market at Rs 2,80,090 crore recorded an increase of 32.4 per cent in 2009 (Table 5.14).

5.84 During 2009, total net resources mobilized by MFs increased to Rs 1,43,775 crore as compared to net redemptions amounting to Rs 624 crore in 2008. Private-sector mutual funds, which had witnessed heavy redemption pressure in 2008, recorded a turnaround with total net resource mobilization of Rs 1,14,095 crore in 2009 as against a net redemption of Rs12,506 crore in 2008. Total funds mobilized by public-sector mutual funds were marginally higher at Rs 17,624 crore in 2009 (Rs 14,587 crore in 2008). The Unit Trust of India (UTI), which had recorded net redemptions of Rs 2,704 crore in 2008, mobilized Rs12,056 crore in 2009 (Table 5.15).

Secondary market

5.85 Indian equity markets witnessed a revival in the secondary market segment, which had recorded a sharp decline in the wake of the global financial crisis during the later half of 2008 (Figure 5.3). The secondary market staged a handsome recovery in 2009 following stimulus measures implemented by the Government and resurgence of foreign portfolio flows displaying renewed interest by foreign investors. The subdued global commodity prices in the beginning of 2009 also lifted the sentiments in the Indian capital market. Furthermore, election results announced in May 2009 removed uncertainty on economic policies and as such boosted Indian equity markets and both benchmark and sectoral indices rallied. The equity markets gained further till September 2009 on positive cues from the global markets, before declining during October 2009. Market sentiments improved during November-December 2009, leading to gains in equity prices and an uptrend in equity market indices.

Figure 5.3 Movement of indices of NSE and BSE



5.86 Amongst the National Stock Exchange (NSE) indices, both Nifty and Nifty Junior recorded positive annual equity returns (current year-end index divided by previous year-end index multiplied by 100) of 75.8 per cent and 128.6 per cent in 2009 as against negative annual equity returns of 51.8 per cent and 63.5 per cent respectively during the calendar year 2008.

5.87 In terms of month-to-month movement, the NSE S&P CNX Nifty index showed improvements during March-May, July-September and November–December 2009. The S&P CNX Nifty index moved up from its previous year's closing level of 2,959 to 5,201 on December 31, 2009, recording an increase of 75.8 per cent over the year. Nifty junior was on an uptrend in terms of month-end values from March to December 2009, except a marginal decline in its value in end-October 2009. The rise in the Nifty Junior index, on a point-to-point basis, was 128.6 per cent in end-December 2009. The movement in the BSE Sensex and BSE 500 indices was more or less in the same direction as in the case of Nifty indices during the year 2009.

5.88 During 2009, the Asian stock markets were on a recovery path. The cumulative change in global indices in end-December 2009 over the end-December 2003 level revealed a significant rise in these indices across countries. The Jakarta Composite index (Indonesia) registered a rise of 264.1 per cent to 2,510 at end-December 2009, while the BSE Sensex was up by 199.1 per cent to 17,465 in end-December 2009. Nikkei 225, Japan, however remained lower than its end-December 2003 level. Notwithstanding an improvement in global stock indices during the year, they were still lower than the levels reached in 2007 (Table 5.16).

5.89 Market capitalization of shares traded on the BSE and NSE increased sharply in 2009. Market capitalization, which had reached record levels in 2007, recovered in the case of Nifty, Nifty junior, the BSE Sensex and BSE 500 by end-December 2009. It surpassed the 2007 level in the case of Nifty junior, while for other indices it remained lower than 2007 levels (Table 5.17).

Table 5.16 : Cumulative change in movement of global indices*

Index	Cumulative change over end-2003 level					
	2004	2005	2006	2007	2008	2009
BSE Sensex, India	13.1	61.0	136.1	247.4	65.2	199.1
Hang Seng Index, Hong Kong	13.2	18.3	58.8	121.2	1.1	74.2
Jakarta Composite Index, Indonesia	44.5	68.1	161.0	296.8	35.5	264.1
Nikkei 225, Japan	7.6	50.9	61.3	43.4	-22.9	-5.3
Kospi Index, South Korea	10.5	69.7	76.8	133.9	25.6	104.4
Kuala Lumpur Comp. Index, Malaysia	14.2	13.4	38.0	82.0	-3.3	58.7
TSEC weighted Index, Taiwan	4.2	11.2	32.8	44.4	-25.2	32.3
SSE Composite Index, China	-15.4	-22.4	78.7	251.5	43.7	116.9

Source : Derived from various country sources.
*** End year closing.**

Table 5.17 : Equity returns, volatility, market capitalization & P/E ratio

Index	Calendar Year			
	2006	2007	2008	2009
NNifty :				
Returns (per cent)	39.83	54.77	-51.79	75.76
End-year Market Capitalization (Rs cr.)	19,75,603	35,22,527	18,32,610	33,14,447
Daily volatility *	1.64	1.60	2.81	2.14
End-year P/E	21.26	27.62	12.97	23.17
Nifty Junior :				
Returns (per cent)	28.24	75.73	-63.52	127.91
End-year Market Capitalization (Rs cr.)	3,33,693	6,43,625	2,95,471	6,55,899
Daily volatility *	1.96	1.71	3.15	2.23
End-year P/E	21.78	26.48	8.99	16.28
BSE Sensex :				
Returns (per cent)	46.7	47.2	-52.48	76.35
End-year Market Capitalization (Rs cr.)	17,58,865	28,61,341	14,63,165	26,49,482
Daily Volatility *	1.6	1.5	2.85	2.19
End-year P/E	22.8	27. 7	12.36	22.36
BSE 500 :				
Returns (per cent)	38.9	63.0	-58.74	85.34
End-year Market Capitalization (Rs cr.)	33,36,509	64,70,881	29,40,741	56,87,505
Daily Volatility *	1.6	1.5	2.75	2.05
End-year P/E	20.2	29.1	12.4	21.9

Source: BSE and NSE.

*** Standard deviation values.**

P/E—price to earnings ratio.

5.90 Market volatility, as measured by the standard deviation of daily volatility of the Indian indices, declined significantly in 2009. However, the volatility of weekly returns of Indian indices, namely Sensex and BSE 500, in 2009 was even higher than that in 2008, while Nifty indices, namely Nifty and Nifty junior, recorded lower volatility in 2009 (Table 5.18).

5.91 The P/E ratio of the major stock market indices, which partly discounts future corporate earnings reflecting investors' expectations of corporate profit, witnessed a sharp increase in 2009. The valuation of stocks in terms of P/E ratios of the Sensex and Nifty increased to 22.36 and 23.17 respectively as on December 31, 2009 as against 12.36 and 12.97 respectively as on December 31, 2008. This trend was also seen in P/E ratios of stock indices across select emerging market economies (EMEs) during 2009. Moreover, the differences in valuation of stocks in terms of P/E ratios amongst EMEs were not very sharp (Table 5.19).

5.92 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

Table 5.18 : Volatility of weekly returns on the equity markets (standard deviation)

Class of stocks	Period	
	Jan 2008 Dec 2008	Jan 2009 Dec 2009
India		
Top 50 (Nifty)	4.30	3.89
Next 50 (Nifty Junior)	4.89	4.39
Sensex	4.57	5.12
BSE 500	4.68	5.29

Source : NSE and BSE

Table 5.19 : P/E ratios in select emerging markets

Index/market	Dec. 2008	Nov. 2009
South Korea KOSPI	10.95	21.32
Thailand SET	7.26	25.23
Indonesia JCI	8.26	26.46
Malaysia KLCI	10.09	22.18
Taiwan TWSE	9.31	N.A
India BSE Sensex	12.36	21.53
India S&P CNX Nifty	12.97	22.37

Source : SEBI

Table 5.20 : Equity spot market liquidity: Impact cost (%)

Portfolio	Calendar year			
	2006	2007	2008	2009
Nifty				
NSE Impact Cost				
at Rs 50 lakh	0.08	0.08	0.11	0.06
Nifty Junior				
NSE Impact Cost				
at Rs 25 lakh	0.16	0.14	0.19	0.09

Source : NSE

predefined order size, at any given point of time. Market liquidity and impact cost are inversely related. The impact cost for purchase or sale of Nifty and Nifty Junior portfolios was lower than in the previous three years (Table 5.20).

5.93 The turnover in the spot and derivatives segment on the NSE recorded an increase of 19.6 per cent and 33.6 per cent respectively in 2009. The BSE spot market turnover in 2009 declined further by 3.8 per cent over and above a decline of 6.4 per cent in 2008. The turnover in the derivatives market on the BSE was only Rs 36 crore in 2009 as against Rs 75,178 crore in 2008 (Table 5.21).

5.94 The spot market turnover (one way) for the NSE and BSE at Rs 50,86,096 crore in 2009 was higher by 12.7 per cent over its previous year's level of Rs 45,12,562 crore in 2008. The turnover in the derivatives segment for the NSE and BSE, taken together, at Rs 1,55,65.799 crore, also posted a rise of 32.7 per cent in 2009. The turnover in the NSE spot and derivative markets, as a proportion of market capitalization of the Nifty, was 115 per cent and 470 per cent respectively. The turnover in the BSE spot market was 22 per cent of market capitalization of the BSE (500) Index.

5.95 The number of registered FIIs rose to 1,706 at the end of 2009 from 1,594 in 2008. The number of sub-accounts also increased to 5,331 from 4,872 during the same period. The FII in the spot market increased to Rs 83,424 crore in 2009 as compared to withdrawals of Rs 52,987 crore in 2008. Further, net investment in debt was lower at Rs 4,563 crore in 2009 as compared to Rs 11,772 crore in 2008. Total net investment by FIIs in equity and debt markets taken together, increased considerably to Rs 87,987 crore in 2009 compared to a net decline of Rs 41,216 crore in 2008 (Table 5.22).

5.96 The cumulative assets under management of mutual funds increased by 60.9 per cent to Rs 6,65,146 crore as on December 31, 2009 from Rs 4,13,365 crore as on December 31, 2008. The share of income- /debt-oriented schemes in total assets under management was higher at 54.2 per cent in 2009 as against 47.7 per cent in 2008. The assets under management of equity- /growth-oriented schemes during 2009 accounted for 26.3 per cent of the total assets under management (23.9 per cent during 2008). However, the share of assets under money market schemes in total assets under management declined to 12.0 per cent during 2009 from 20.0 per cent during 2008 (Table 5.23).

Debt Market

5.97 The Indian debt market has two segments, namely Government securities and corporate debt.

Government Securities

5.98 The fresh issues of Government of India (GoI) dated securities in 2009 amounted to Rs 4,89,000 crore as against Rs 2,04,317 crore [including securities issued under the Market Stabilisation Scheme (MSS)] in 2008. The outstanding dated securities of the GoI increased from Rs 14,16,443 crore in end-December 2008 to Rs 18,26,774 crore in end-December 2009. Yields

Table 5.21 : Market turnover

(Rs crore)

Market	Calendar year			
	2006	2007	2008	2009
NSE Spot	19,16,227	30,93,982	31,88,509	38,12,031
BSE Spot	9,61,653	14,14,727	13,24,053	12,74,065
NSE Derivatives	70,46,665	1,19,40,877	1,16,54,375	1,55,65,763
BSE Derivatives	18,071	2,19,824	75,178	36

Source: NSE and BSE

Table 5.22 : Transactions of FIIs

(Rs crore)

Transactions	Calendar year		
	2007	2008	2009
End-year Number of FIIs (in numbers)	1,219	1,594	1,706
End-year Number of Sub-accounts (in numbers)	3,644	4,872	5,331
1. Equity Market Activity			
Spot			
Gross Buy	8,14,877	7,21,606	6,24,238
Gross Sell	7,43,391	7,74,593	5,40,814
Net (Gross Buy-Gross Sell)	71,486	-52,987	83,424
2. Debt			
Gross Buy	31,418	48,019	1,11,772
Gross Sell	21,990	36,248	1,07,209
Net (Gross Buy-Gross Sell)	9,428	11,772	4,563
3. Total FII Investment (1+2)			
Gross Buy	8,46,295	7,69,625	7,36,010
Gross Sell	7,65,380	8,10,841	6,48,023
Net (Gross Buy-Gross Sell)	80,915	-41,216	87,987

Source : SEBI

Table 5.23 : Assets under management of mutual funds

(Rs crore)

Schemes	At the end of			
	2006	2007	2008	2009
Money Market	97,757 (30.2)	1,12,349 (20.4)	82,776 (20.0)	80,102 (12.0)
Gilt	2,057 (0.6)	1,975 (0.4)	6,368 (1.50)	3,609 (0.5)
Income	86,349 (26.7)	1,97,342 (35.9)	1,97,132 (47.7)	3,60,469 (54.2)
Growth	1,19,539 (36.9)	1,92,129 (34.9)	99,081 (23.9)	1,74,680 (26.3)
Balanced	9,170 (2.8)	19,938 (3.6)	11,349 (2.8)	17,602 (2.7)
ELSS	8,725 (2.7)	19,063 (3.5)	11,577 (2.8)	23,198 (3.5)
Gold ETF	NA	467 (0.1)	734 (0.2)	1,352 (0.2)
Other ETF	NA	6,674 (1.2)	1,761 (0.4)	1,031 (0.2)
FoF Investing Overseas			2,588 (0.6)	3,103 (0.5)
Total	**3,23,598**	**5,49,936**	**4,13,365**	**6,65,146**

Source : SEBI
Figures in parenthesis show percentage share.

on securities showed relatively lower intra-year variations in 2009 as compared to the previous year. The cut-off yield-to-maturity (YTM) range on fresh issuances during the year narrowed from 6.24-10.03 per cent in 2008 to 4.86-8.43 per cent in 2009. The weighted average yield on primary issuances of dated securities declined to 7.10 per cent in 2009 from 8.20 per cent in 2008. The weighted average maturity of dated securities was shorter at 11.5 years in 2009 (13.1 years in 2008).

5.99 The volume of secondary market transactions (outright) in government securities marginally improved during the year, with the turnover ratio (volume of transactions as a ratio of end-period stock) increasing to 1.7 in the calendar year 2009 from 1.5 in 2008.

5.100 In the secondary market, the yields on dated government securities hardened during the year, particularly after July 2009, reflecting the impact of the announcement of a relatively large government borrowing programme for the year 2009-10. Yields gradually moved up during the course of the year. Yields on dated securities of five and 10-year maturities increased to 7.30 per cent and 7.59 per cent respectively in end-December 2009 from 5.41 per cent and 5.25 per cent respectively in end-December 2008.

Corporate debt

5.101 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 authorized the 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

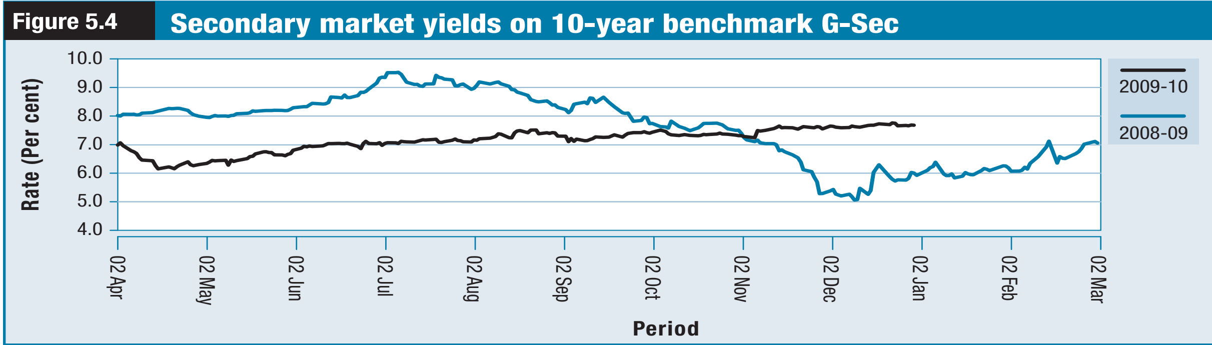


Figure 5.4 Secondary market yields on 10-year benchmark G-Sec

Figure 5.5 Yield on 5 year G-sec and corporate debt paper

platforms for capturing all information related to trading in corporate bonds as accurately as possible. In the second phase of development, the BSE and NSE put in place corporate bonds trading platforms in July 2007 to enable efficient price discovery in the market. This was followed by operationalization of a DvP-I(trade-by-trade)- based clearing and settlement system for over-the-counter trades in corporate bonds by the clearing houses of the exchanges. In view of these market developments, the Reserve Bank of India announced in its Second Quarter Review of the Annual Policy Statement for 2009-10 in October 2009 that the repo in corporate bonds can now be introduced. In pursuance of the same, the RBI issued 'Repo in Corporate Debt Securities (Reserve Bank of India) Directions, 2010' on January 8, 2010 which will come into force with effect from March 1, 2010.

5.102 Total traded volume in corporate bonds during April-December 2009 was Rs 2,42,686 crore, that is higher by 173.4 per cent over the Rs 88,750 crore during April-December 2008.

5.103 During 2009-10 up to December 2009, the yield on corporate debt paper (with AAA rating) for five-year maturity moved in the range of 7.71-8.94 per cent. The yield on corporate debt paper softened till mid-May 2009 but remained above the 8.0 per cent level thereafter. The spread between yield on five-year GoI bonds and corporate debt paper (AAA rating) with five-year maturity, which was around 330 basis points in the beginning of 2009, narrowed down to 150 basis points by end-June and further to around 110 points by end-December 2009.

Currency derivatives

5.104 Exchange Traded Currency Futures were introduced in the Indian market following guidelines issued by the Standing Technical Committee set up jointly by the RBI and SEBI 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, standardize products and provide a transparent trading platform. Trading in the currency futures segment commenced at the NSE in August 2008. Later, the BSE and the Multi Commodity Exchange of India Ltd. (MCX) were also given permission to trade in currency derivatives. Trading in Currency Futures (INR/US$ contract) started on the NSE, the BSE and the Multi Commodity Exchange- Stock Exchange (MCX-SX) on August

Table 5.24 : Currency futures segment at the NSE and the MCX-SX

Month/year	NSE		MCX-SX	
	January-December 2009	August-December 2008	January-December 2009	August-December 2008
No. of Contracts Traded	226,362,368	11,514,000	224,273,548	8,876,000
Trading Value (Rs crore)	1,082,258	56,005	1,071,583	43,572
Average Daily Trading value (Rs crore)	4,473		4,433	

Source : SEBI

29, 2008, October 1, 2008 and October 7, 2008 respectively.

5.105 The total number of contracts traded and traded value at the NSE were 2,263.62 lakh and Rs 10,82,258 crore in 2009, while the MCX-SX recorded 2,242.74 lakh contracts with traded value of Rs 10,71,583 crore during 2009 (Table 5.24). The month-to-month average daily traded value at both the exchanges increased—from Rs 1,199 crore in January 2009 to Rs 9,115 crore in December 2009 at the NSE and from Rs 1,221 crore to Rs 9,452 crore at the MCX-SX for the same period. Trading volumes at the BSE were not significant during the year under consideration.

5.106 In order to facilitate direct hedging of risk in major currency pairs by market participants, the Reserve Bank of India proposed in October 2009 that the recognized stock exchanges be permitted to offer currency futures contracts in currency pairs of euro-INR, Japanese yen-INR and pound sterling-INR, in addition to US dollar-rupee contracts which are already permitted. Accordingly, SEBI issued a circular on January 19, 2010, permitting eligible stock exchanges to introduce currency futures on euro-INR, pound sterling-INR and Japanese yen-INR.

Exchange Traded Interest Rate Futures

5.107 Exchange traded interest rate futures (IRFs) contracts on a 10-year notional coupon bearing Government of India security started trading at the NSE on August 31, 2009. Market participants include banks and primary dealers, mutual funds, insurance companies, corporate houses, brokers, FIIs and retail participants. IRFs enable banks and primary dealers to mitigate risk and improve process efficiency, while mutual funds, insurance companies and corporates can use them to manage risk pertaining to volatility in interest rates. The minimum contract size for an IRF is Rs 2 lakh. The trading volumes in IRFs have, however, remained low. LIC and Central Bank of India have recently come forward to support transactions in the IRF market by buying securities from various market participants who wish to liquidate the securities received as part of their IRF obligations. The NSE has announced new steps, namely narrowing the basket of deliverable securities to exclude the more illiquid ones and delaying the settlement date to the last business day of the month, so that participants have more trading days than previously, aimed at increasing traded volumes in IRFs.

Policy Developments during 2009-10

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

I. Primary Market

- In its continuing endeavour to make the existing public issue facility more efficient, SEBI introduced Applications Supported by Blocked Amount (ASBA Phase I) as a supplementary facility which was available to retail individual investors in public issues only. ASBA Phase I was subsequently extended to rights issues. It has been decided to introduce ASBA Phase II, which will be applicable to all public issues and rights issues with single payment option which are opening on or after January 1, 2010.
- The amended SEBI (Disclosure and Investor Protection) Guidelines 2000 provide that an unlisted company making an IPO shall list the securities being issued through the IPO on at least one stock exchange having nationwide trading terminals. A concept of Anchor Investor in public issues through book building has also been introduced.
- The existing listing requirements for IDRs (Indian Depository Receipts) issued by issuing companies from countries whose securities

market regulators are signatories to the Multilateral Memorandum of Understanding (MMOU) of the International Organization of Securities Commissions (IOSCO) were simplified. Accordingly, a Model Listing Agreement containing listing requirements for listing of IDRs of such issuing companies was specified.

- In order to enhance disclosures regarding shareholding pattern in a listed Company and also to bring more transparency and efficiency in the governance of a listed company, it has been decided to introduce a uniform procedure for dealing with unclaimed shares and dividend declarations by listed companies and reduce the notice period for all corporate actions like dividend and bonus for all scrips, whether in demat or physical, whether in the F&O segment or not. The notice period for record dates and board meetings has been reduced to seven and two working days respectively. The listing agreement should disclose the shareholding pattern for each class of shares and voting rights pattern in the company. Listed companies have been prohibited from issuing shares with superior voting or dividend rights vis-à-vis the rights on equity shares that are already listed.

II. Secondary Market

- It is mandatory for the transferee(s), in case of securities market transactions and off-market/ private transactions involving transfer of shares in physical form of listed companies, to furnish a copy of the PAN card to the Company/RTAs for registration of such transfer of shares.
- In order to bring in more transparency in the grievance redressal mechanism available in stock exchanges, it was decided that they will henceforth disclose the details of complaints lodged by clients/investors against trading members and companies listed in the exchange, on their website. The aforesaid disclosure shall also include details pertaining to arbitration and penal action against the trading members.
- With a view to instilling greater transparency and discipline in dealings between clients and stockbrokers, stockbrokers have been advised to register a client by entering into an agreement with him. The registration requirements include both mandatory and non-mandatory documents. The former include (a) a member-client agreement (MCA)/tripartite agreement in case a sub-broker is involved, (b) a know-your-client (KYC) form and (c) a risk disclosure document (RDD). A copy of all the documents executed by the client shall be given to him, free of charge, within seven days from the date of execution of the documents by him.
- In case a stock exchange has no trading for a period of less than six months, it shall ensure that necessary regulatory requirements have been complied with before resuming trading and the matter may be placed before its Board with reasons, if any.
- Stock exchanges have been permitted to set their trading hours (in cash and derivatives segments) subject to the condition that these are between 9 am and 5 pm and the Exchange has in place a risk-management system and infrastructure commensurate with the trading hours.
- Taking note of the fact that stock exchanges had reduced/waived transaction charges, they were advised, while revising such transaction charges, to ensure that their systems were capable of handling additional load and it did not affect the existing risk- management system. The revised charges should be uniformly applied to trades of similar nature and implemented in a fair and transparent manner.
- SEBI-registered stockbrokers (including trading members) of stock exchanges have been allowed to provide access to clients through authorized persons.
- It was decided that in case of a buy transaction in the cash market, VaR margins, extreme loss margins and mark-to-market losses together should not exceed the purchase value of the transaction. However, in case of a sale transaction in the cash market, the existing practice would continue, namely VaR margins and extreme loss margins together shall not exceed the sale value of the transaction and mark-to-market losses would also be levied.
- It was decided to bring in parity between domestic venture capital funds and foreign venture capital investors (FVCIs). Applicants desirous of registering with SEBI as FVCIs are required to obtain firm commitment from their investors for contribution of an amount of at least US$ 1 million at the time of submission of applications seeking registration.

III. Corporate Bonds

- In order to develop the primary market for corporate bonds in India, it has been decided to put in place a Simplified Listing Agreement for Debt Securities. Where the equity of an issuer is listed, and such an issuer seeks listing of debt securities (whether by way of public issue or private placement), minimal incremental disclosures related to the debt security issuance would be sufficient, since a large amount of information is already in the public domain.
- All trades in corporate bonds between specified entities, namely mutual funds, FIIs/ sub-accounts, venture capital funds, FVCIs, portfolio mangers, and RBI-regulated entities as specified by the RBI should necessarily be cleared and settled through the National Securities Clearing Corporation Limited (NSCCL) or the Indian Clearing Corporation Limited (ICCL). This is applicable to all corporate bonds traded over the counter (OTC) or on the debt segment of stock exchanges on or after December 1, 2009. However, trades in corporate bonds that are traded on the capital market segment/equity segment of stock exchanges and are required to be settled through clearing corporations/ clearing houses of stock exchanges are exempt from these guidelines.
- The Simplified Listing Agreement for Debt Securities put in place by SEBI has been amended, requiring issuers to maintain 100 per cent asset cover sufficient to discharge the principal amount at all times for the debt securities issued; submit half-yearly certificates regarding maintenance of 100 per cent asset cover (banks, NBFCs and issuers of Government-guaranteed bonds are exempt from this stipulation); furnish a half-yearly statement on deviations in use of issue proceeds, if any, to the stock exchange; deposit 1 per cent of the amount of debt securities offered for subscription to the public; submit/publish financial statements to the exchange.

IV. Derivatives

- Stock exchanges have been allowed flexibility to set the expiry date/day for equity of derivative contracts while at the same time ensuring that there is no change in contract specifications or the risk-management framework and the integrity of the market is not affected in any manner.
- It was decided to introduce an exchange-traded 10-Year notional coupon bearing GoI security futures.

V. FIIs

- The overall limit for investments by FIIs and sub-accounts is US$ 5 billion for government securities and treasury bills and US$ 15 billion for corporate debt. Investments by FIIs/ sub-accounts in debt-oriented mutual fund units (including units of money market and liquid funds) are considered corporate debt. A major part of the debt limit is allocated to FIIs/sub-accounts on an open bidding platform provided by the stock exchanges. The auction process is performed alternatively on NSE and BSE offered platforms. Maximum and minimum limits vary as per the total amount available for auction. The limits availed of in this process need to be utilized within 45 days. The remaining part of debt limit is allocated on a 'first-come-first-served' basis subject to ceiling. The limits availed of in this process need to be utilized within 11 working days.

VII. Mutual Funds

- In order to empower investors to decide the commission to be paid to distributors in accordance with the level of service received, to bring about more transparency in payment of commissions and to incentivize long-term investment, it was decided that there should be no entry load for all mutual fund schemes; the scheme application forms should carry a suitable disclosure to the effect that the upfront commission to distributors will be paid by the investor directly to the distributor, based on his assessment of various factors including service rendered; of the exit load charged to the investor, a maximum of 1 per cent of the redemption proceeds should be maintained in a separate account which can be used by the Asset Management Companies to pay commissions to the distributor and to take care of other marketing and selling expenses. Any balance should be credited to the scheme immediately.
- It was decided that no distinction among unit holders should be made based on the amount of subscription while charging exit loads.
- Considering the importance of a systems audit in the technology-driven asset-management activity, it was decided that mutual funds should

have a systems audit conducted by an independent CISA/CISM-qualified or equivalent auditor once in two years. For the financial years April 2008–March 2010, the systems audit should be completed by September 30, 2010.

- Units of mutual fund schemes were permitted to be transacted through registered stockbrokers of recognized stock exchanges.
- All intermediaries of mutual funds units have been advised to follow the code of conduct strictly.
- It was decided that no mutual fund should invest more than 30 per cent of net assets in money market instruments of an issuer. In case of existing schemes where the investments in money market instruments of an issuer are not in compliance with this guideline, the AMC should ensure compliance within a period of three months from the date of notification.
- It was clarified that mutual funds can invest in IDRs [Indian Depository Receipts as defined in Companies (Issue of Indian Depository Receipts) Rules 2004] subject to compliance with SEBI (Mutual Funds) Regulations 1996 and guidelines issued thereunder, specifically investment restrictions as specified in the Seventh Schedule of the Regulations.
- With a view to ensuring that the value of debt securities reflects the current market situation in the calculation of net asset value, it was decided to indicate the discretionary markup and markdown in the case of rated and unrated debt securities. It was also decided that the discretionary mark up or down limit, as detailed in a circular dated June 12, 2009, should be applied for valuation of securities purchased after its issuance.

VII. Regulatory Developments

- The SEBI (Delisting of Equity Shares) Regulations 2009 notified on June 10, 2009 provide a mechanism for voluntary as well as compulsory delisting of equity shares of a company and listing of delisted equity shares.
- The SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009 provide for, inter alia, offer for sale by listed companies and stipulate that the allotment/refund period in public issues should be 15 days and issue period for all types of issuers 10 days. Under these regulations, exemption from eligibility norms for making an IPO earlier available to a banking company, corresponding new bank and infrastructure companies, and firm allotment in public issues has been removed.
- In order to facilitate the issuance of IDRs, SEBI has laid down a regulatory structure by carrying out suitable amendments to the SEBI (Custodian of Securities) Regulations 1996 (to enable the custodian to undertake the activity of domestic depository for IDRs), SEBI (Depository Participants) Regulations 1996 (to make IDRs eligible as security for dematerialization), SEBI (Foreign Institutional Investor) Regulations 1995 (to allow FIIs also to invest in IDRs).
- The fees payable by some of the intermediaries and market participants, namely custodian of securities, FIIs, FVCIs, mutual funds and stockbrokers and sub-brokers, have been modified.
- The SEBI (Mutual Funds) Regulations 1996 have been amended in April and June 2009 to make listing of close-ended schemes mandatory and to provide that the units under close-ended schemes shall not be repurchased before maturity. Close-ended debt schemes have been allowed to invest in securities of initial or residual maturities not exceeding their own maturity. Furthermore, a mutual fund scheme can invest only up to 30 per cent of its net assets in money market instruments of an issuer. However, this limit is not applicable to investments in Government securities, treasury bills and collateralized borrowing and lending obligations.

Commodity Futures Market

5.109 Commodities traded in the commodity futures market during 2009 included a variety of agricultural commodities, bullion, crude oil, energy and metal products. Several new commodities were introduced for futures trading in 2009, such as almond, imported thermal coal, carbon credits and platinum. The total value of trades in the commodity futures market rose from Rs 50.34 lakh crore in 2008 to Rs 70.90 lakh crore during 2009.

5.110 The average daily value of trades in the commodity exchanges improved from Rs 16,400 crore during 2008 to Rs 23,200 crore in 2009. Agricultural commodities, bullion and energy accounted for a large share of the commodities traded in the commodity futures market.

Table 5.25 : Turnover on commodity futures markets

(Rs crore)

Name of the exchange	Calendar year		
	2007	2008	2009
Multi Commodity Exchange (MCX), Mumbai	27,30,415	42,84,653	59,56,656
National Commodity and Derivatives Exchange (NCDEX)	7,74,965	6,28,074	8,05,720
National Multi Commodity Exchange, (NMCE)	25,056	37,272	1,95,907
Others	1,24,051	83,885	1,32,173
Total	36,54,487	50,33,884	70,90,456

Source : Ministry of Consumer Affairs

Box 5.1 : Regulation and development of commodity futures markets

The year 2009 began on an optimistic note for the commodity futures market with the revocation of suspension of futures trading in chana, soy oil, rubber and potato in December 2008. This was followed six months later, in May 2009, by the revocation of suspension of trading in wheat. However, futures trading in sugar was suspended on May 26, 2009 for a period of six months till December 31, 2009, which was further extended to September 30, 2010. Agricultural commodity futures staged a remarkable recovery, recording a trading value of Rs10.88 lakh crore in 2009, displaying growth of 48 per cent over the previous year. During the year, a new national commodity exchange, i.e. the ICEX became operational.

The Forward Markets Commission (FMC), the regulator for commodity futures trading under the provisions of the Forward Contracts (Regulation) Act 1952 continued its efforts to broad-base the market. The emphasis was on participation of physical market participants, especially farmers, as hedgers, to counterbalance the speculative element in price discovery and to increase the awareness level of farmers and other market participants. The Commission undertook various regulatory measures to facilitate hedgers' participation and promote delivery in agricultural commodities, such as introduction of the Exchange of Futures for Physicals (EFP) and Alternate Futures Settlement Mechanism, allowing higher position limits to NAFED to facilitate hedging and delivery by it and introduction of an early delivery system in select commodities. In addition, efforts were made to develop an "aggregation" model in collaboration with commodity exchanges to promote participation of farmers. The FMC also undertook several regulatory initiatives to prevent market manipulation and ensure market integrity, financial integrity and customer protection. Major policy developments initiated by the Forward Markets Commission included the issuance of guidelines for bringing members of the commodity exchanges under the purview of the Money Laundering Act and guidelines for divestment of the equity by the existing national exchanges after five years of their operation. A price dissemination project was initiated by the FMC, under which spot and future prices of agricultural commodities would be made available to farmers on a real-time basis on price ticker boards placed at Agricultural Produce Marketing Committees.

Source: Ministry of Consumer Affairs.

5.111 The MCX, Mumbai, recorded the highest turnover in terms of value of trade during 2009, followed by the National Commodity & Derivatives Exchange Ltd.(NCDEX) and National Multi Commodity Exchange of India Ltd.(NMCE) respectively. (Table 5.25)

Insurance And Pension Funds

Insurance

5.112 The insurance sector was opened for private participation with the enactment of the Insurance Regulatory and Development Authority Act 1999. While permitting foreign participation in ventures set up by the private sector, the Government restricted participation of the foreign joint venture partner through the foreign direct investment (FDI) route to 26 per cent of the paid-up equity of the insurance company.

New entrants in the insurance sector

5.113 Since the opening up of the sector, the number of participants has gone up from six insurers (including LIC of India, four public-sector general insurers and the General Insurance Corporation as the national reinsurer) in the year 2000 to 44 insurers operating in the life, non-life and reinsurance segments (including specialized insurers, namely the Export Credit Guarantee Corporation [ECGC] and Agricultural Insurance Company [AIC]). Two of the general insurance companies, namely Star Health and Alliance Insurance Company and Apollo DKV function as standalone health insurance companies.

Box 5.2 : Development of electronic spot exchanges

The Government and FMC have allowed the national commodity exchanges to set up three spot exchanges in the country, namely the National Spot Exchange Ltd. (NSEL), NCDEX Spot Exchange Ltd. (NSPOT) and National Agriculture Produce Marketing Company of India Ltd. (NAPMC). During 2009, there was significant expansion of spot exchanges' trading facilities in India. These spot exchanges have created an avenue for direct market linkage among farmers, processors, exporters and end users with a view to reducing the cost of intermediation and enhancing price realization by farmers. They would also provide the most efficient spot price inputs to the futures exchanges. The spot exchanges would encompass the entire spectrum of commodities across the country and would bring home the advantages of an electronic spot trading platform to all market participants in the agricultural and non-agricultural segments. On the agricultural side, the exchanges would enable farmers to trade seamlessly on the platform by providing them real-time access to price information and a simplified delivery process, thereby ensuring them the best possible prices. On the buy side, all users of the commodities in the commodity value chain would have simultaneous access to the exchanges, which would be able to procure at the best possible prices. Therefore, the efficiency levels attained as a result of such seamless spot transactions would result in major benefits for both producers and consumers. Thus the exchanges would enhance the efficiency of the existing OTC markets in the country

So far, Maharashtra, Karnataka, Gujarat, Rajasthan, Orissa and Madhya Pradesh have given licences to the spot exchanges to undertake electronic spot trading. The agricultural commodities traded on the spot exchange platform are cotton, castor seed, desi channa, guar seed, RM seed, wheat, barley, red arecanut, maize, yellow peas, urad, lemon tur, soyabean, jeera, ground nut, sugar, moong and pepper. In the process, farmers' realization has increased by 4-5 per cent. The total turnover of the three exchanges during 2009 was Rs 2,810 crore.

Source: Ministry of Consumer Affairs.

Of the 21 insurance companies that have set up operations in the life segment post opening up of the sector, 19 are in joint venture with foreign partners. Of the 15 insurers who have commenced operations in the non-life segment, 14 are in collaboration with foreign partners. The two standalone health insurance companies have been set up in collaboration with foreign joint venture partners. Thus, as of date, 33 insurance companies in the private sector are operating in the country in collaboration with established foreign insurance companies from across the globe.

Life insurance

5.114 The post-liberalization period has been witness to tremendous growth in the insurance industry, more particularly so in the life segment. However, in 2008-09, on account of the financial meltdown, the life insurance segment saw a downward trend. The first-year premium, which is a measure of new business secured, underwritten by the life insurers during 2008-09 was Rs 87,006 crore as compared to Rs 93,713 crore in 2007-08, registering a negative growth of 7.2 per cent. In terms of linked and non-linked business during the year 2008-09, 50.9 per cent of the first-year premium was underwritten in the linked segment while 49.1 per cent was in the non-linked segment as against 75:25 in the previous year. The shift towards the traditional segment is significant during the year 2008-09.

Non-life insurance

5.115 The non-life insurers (excluding specialized institutions like the Export Credit Guarantee Corporation and Agriculture Insurance Corporation and the standalone health insurance companies) underwrote premium of Rs 30,352 crore in 2008-09 in India, as against Rs 27,824 crore in 2007-08.

Insurance Penetration

5.116 Insurance penetration is defined as the ratio of premium underwritten in a given year to GDP. Insurance penetration in the year 2000 when the sector was opened up to the private sector was 2.32 (life 1.77 and non-life 0.55), and it has increased to 4.60 in 2008 (life 4.00 and non-life 0.6). The increase in levels of insurance penetration has to be assessed against the average growth of over 8.2 per cent in the GDP in the last five years.

Initiatives taken in the insurance sector

5.117 The initiatives taken by the insurance authority in the sector include the following:

- **Amendment to Insurance Legislation:** The Insurance Laws (Amendment) Bill 2008 introduced in Parliament recently, proposes to amend the Insurance Act 1938, the Insurance Regulatory and Development Authority (IRDA) Act 1999 and the General Insurance Business (Nationalization) Act 1972. The amendments to

the Insurance Act and the IRDA Act focus on the current regulatory requirements; the proposed changes provide for more flexibility in operations and are aimed at deletion of clauses that are no longer relevant in the present context. The amendments also provide for enhancement of enforcement powers and levy of stringent penalties.

- **De-tariffing:** The road map for de-tariffing was notified by the IRDA on September 23, 2005, based on the demand from various stakeholders that continuance of the tariff regime was inconsistent with the opening up of the sector to provide healthy competition. As a first step, de-tariffing was confined to decontrol of rates only and terms and conditions of the policy were not permitted to be changed till March 31, 2008. De-tariffing of the non-life industry was notified with effect from January 1, 2007. In order to moderate the impact of tariff increase on commercial vehicle owners, the IRDA has retained the powers to determine the rates of motor-third party premium for commercial vehicles, and to ensure that all insurers undertake commensurate exposure to this line of business, a Motor Pool has been created under Section 34 of the Insurance Act 1938. All non-life insurers are required to collectively participate in a pooling arrangement to share in all motor-third party insurance business for commercial vehicles underwritten by them with effect from April 1, 2007. The IRDA decided to permit the general insurers to file variations in deductibles from those prescribed under the erstwhile tariffs subject to written disclosures and acceptance by the insured prior to finalization of the insurance policy and add-on covers over and above the erstwhile tariff covers with appropriate additional premiums with effect from January 1, 2009. The insurers were also permitted to extend engineering insurances to mobile/ portable equipments. Industrial All Risk (IAR) policies could now be issued to all industries including the petrochemical industry with the sum insured less than Rs100 crore. However, the general insurers were not permitted to abridge the scope of standard covers available under erstwhile tariffs.

- **Micro Insurance:** Micro insurance is widely accepted as one of the essential ingredients of financial inclusion packages to provide a hedge against unforeseen risks. Micro-insurance regulations issued by the IRDA have provided a fillip to propagating micro insurance as a conceptual issue. With the positive and facilitative approach adopted under micro-insurance regulations, it is expected that all insurance companies would come out with a progressive business approach and carry forward the spirit of the regulations thereby extending insurance penetration to all segments of society. Nine insurance companies have filed 26 micro-insurance products both in the individual and group segments. It may be mentioned that some of the insurers had been selling products that fall within the parameters stipulated for eligibility as micro insurance even prior to notification of micro-insurance regulations.

- **Amendments to the Regulations on Rural and Social Sector Obligations:** The obligations of the new insurers towards the rural and social sectors for the sixth to tenth years of their operations have been linked to their past performance in the said sectors. With a view to giving a fillip to micro insurance, the performance in these sectors has now been benchmarked to the insurance policies satisfying the definition of ‘micro insurance’ as laid down in the Micro Insurance Regulations 2005. The regulations have been further amended to provide for relaxation in obligations based on whether the insurance company had commenced operations in the first or second half of the financial year. For insurance companies commencing operations in the first half of the financial year, the applicable obligations for the first year shall be 50 per cent of the obligations as specified in the Regulations. In case of companies which commence operations in the second half of the financial year and are in operation for less than six months, it is stipulated that no rural- or social-sector obligations shall be applicable for that year and the annual obligations as indicated in the Regulations shall be applicable from the next financial year of operations.

- **Guidelines on the Anti-Money Laundering (AML) Programme:** The IRDA issued guidelines on the AML Programme to the insurance industry on March 31, 2006, in terms of which insurers were advised to put a proper AML policy framework in place in case of life insurance companies and non-life insurance companies effective from August 1, 2006 and January 1, 2007 respectively. The AML Programme

emphasizes KYC norms and requires insurers to document identity, residence, sources of funds etc. as part of the due diligence process. While the guidelines are applicable to life insurance companies on all contracts, in the case of general insurance companies, the compliance is required at the payout stage, i.e. during claims/refunds of over Rs1.00 lakh. Cash acceptance thresholds have been fixed at Rs 50,000, beyond which premium/proposal deposits have to be remitted through banking channels.

- **Data Warehouse:** The IRDA has initiated steps to design, build and manage a data warehouse for the insurance industry recognizing that data will help the insurers design new products and allow scientific underwriting, further calculations of actuarial risks, price setting and various aspects relating to claims settlement, management of hazards, etc. As a first step, the IRDA has designed a data set relating to health and motor vehicle insurance. The IRDA also proposes to put in place a formal data warehouse to enable access by various stakeholders across the industry.
- **Consumer Grievance Redressal Cell:** The Grievance Redressal Cell of the IRDA looks into complaints from policyholders. Complaints against life and non-life insurers are handled separately. This Cell plays a facilitative role by taking up complaints with the respective insurers.
- **Public Awareness Campaigns/Programmes:** The IRDA's strategy for consumer awareness/ education includes campaigns through external media, i.e. mass media, mainly print, television and the Internet and internal initiatives such as an exclusive consumer education web page and sample booklets on various insurance-related topics, containing generic information, which insurers would also be advised to publish and distribute.
- **Cap on ULIP Charges**: The insurance industry has introduced unit-linked insurance plans (ULIPs) which have found favour with insurance customers in India. These products prescribe certain charges, which are deducted either from contributions or from the fund. In order to simplify and to ensure that the charges are reasonable, relevant to the services being provided and clearly understandable by the customers, the IRDA has mandated an overall cap on all charges put together. Care has been taken to ensure that the insurers have freedom to distribute charges across the term of the policy. This also imparts flexibility and facilitates product innovation.
- **Corporate Governance Guidelines for Insurance Companies:** Corporate Governance guidelines have been rolled out for insurance companies, which are effective from April 1, 2010. The objective of the guidelines is to ensure that the structure, responsibilities and functions of the Board of Directors and senior management of the company fully recognize the expectations of all stakeholders as well as those of the regulator. The guidelines broadly cover major structural elements of corporate governance in insurance companies.

Pension Sector: Highlights

5.118 Pension-sector reforms were initiated in India to establish a robust and sustainable social security arrangement in the country seeing that only about 12-13 per cent of the total workforce was covered by any formal social security system. The New Pension System (NPS) was introduced by the Government from January 1, 2004 for new entrants to the Central Government service, except the Armed Forces, and was extended to the general public from May 1, 2009 on a voluntary basis. The features of the NPS design are self-sustainability, portability 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. The NPS provides various investment options and choices to individuals to switch over from one option to another or from one fund manager to another, subject to certain regulatory restrictions.

5.119 The Pension Fund Regulatory & Development Authority (PFRDA), set up as a regulatory body for the pension sector, is engaged in consolidating the initiatives taken so far regarding the full NPS architecture and expanding the reach of the NPS distribution network. The full NPS architecture comprising a Central Recordkeeping Agency (CRA), pension fund managers (PFMs), trustee bank, custodian and NPS Trust has been put in place and is fully operational. The National Securities Depository Limited (NSDL) has been selected as the CRA. The PFRDA has also appointed six Pension Fund Managers (PFM) for

the unorganized sector, namely UTI Retirement Solutions Limited, SBI Pension Funds Pvt. Ltd., ICICI Prudential Life Insurance Company Ltd., IDFC Asset Management Company Ltd., Reliance Capital Asset Management Ltd. and Kotak Mahindra Asset Management Company Ltd., as pension fund sponsors under the NPS.

5.120 NPS implementation in the Central Government has stabilized with more than 5.64 lakh employees already covered. Reconciliation of data pertaining to the period prior to coming into force of the CRA is on the verge of completion. Currently, the total amount under management of the three fund managers appointed by the PFRDA for Central Government employees is over Rs 3,200 crore. These PFMs are SBI Pension Fund Private Ltd., UTI Retirement Solution Ltd. and LIC Pension Fund Ltd. The NPS has also been well received by the State Governments and 23 State Governments/ Union Territories have notified similar schemes for their new recruits under the ambit of the NPS. The PFRDA has been working with all the States to enable them to log on to the NPS architecture with ease. NPS Trust and CRA have been in continuous dialogue with State Governments/Union Territories for facilitating their entry into the NPS. As of date, the CRA has already signed agreements with 11 State Governments whereas the NPS Trust has signed agreements with nine State Governments.

5.121 Efforts are under way to extend the reach of the NPS to new segments like Central and State autonomous bodies and the organized sector and introduce micro-pension initiatives focusing on a low cost model of the NPS to be implemented through SHGs and similar bodies. More than 250 Central autonomous bodies have evinced interest in joining the NPS. Several State Government autonomous bodies and undertakings are in dialogue with the PFRDA for extending the NPS to their employees. The PFRDA has also launched a scheme for management of the pension corpus of various corporates under the NPS architecture.

5.122 For all citizens including workers in the unorganized sector, the NPS is currently available through nearly 900 service provider (SP) branches of 21 Points of Presence (PoP). The PFRDA has also recently appointed the Department of Posts as PoP in addition to seven other financial institutions which will expand the PoP-SP network by more than five times. While Tier I, the non-withdrawable pension account under the NPS has been in operation since May 1, 2009, Tier II, the withdrawable account has been made operational from December 1, 2009. The PFRDA has also enhanced the maximum entry age into the NPS from 55 years to 60 years. These initiatives are expected to help realize the full potential of the NPS in terms of economies of scale and benefit the subscribers in terms of lower fees and charges and higher returns.

5.123 The pension fund managers manage three separate schemes consisting of three asset classes, namely (i) equity, (ii) Government securities and (iii) credit risk-bearing fixed income instruments, with the investment in equity subject to a cap of 50 per cent. The fund managers will invest only in index funds that replicate either the BSE sensitive index or NSE Nifty 50 index. The subscriber will have the option to decide the investment mix of his 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 with a predefined portfolio.

5.124 Pension reforms in India have made substantial progress. With the extension of the NPS to all citizens from May 1, 2009, every citizen in the country now has the opportunity to participate in a regulated pension market. This will contribute significantly to old age income security in the country.

Challenges And Outlook

5.125 Institutional players and corporates constitute major players in the Indian capital market. The retail investor participation remains limited in the corporate debt market and mutual funds. The interdependence between corporate and mutual funds has recently raised concerns relating to volatility in financial markets.

5.126 The recent global financial turmoil raised many issues about governance of financial intermediaries and awareness of investors. Investor awareness is a prerequisite for investor protection. In fact, investor protection and education are two sides of the same coin. Neither will have the desired impact in isolation. A simultaneous and coordinated effort on both fronts would help investors take well-informed financial decisions besides protecting their interests and ensuring orderly conditions in markets. Greater effort therefore is needed for investor education and promoting investors' protection.

5.127 Pension reforms in India have generated widespread interest internationally. The PFRDA faces the challenge of expanding the distribution network of the NPS to cover the entire unorganized sector in the country, educate citizens to take appropriate investment decisions, based on their risk and return profile, and contribute to improved financial literacy levels. Provision of a statutory status to the pension regulator would help the PFRDA perform its regulatory and developmental roles effectively. The success of pension reforms will not only facilitate the flow of long-term savings for development, but also help establish a credible and sustainable social security system in the country.

5.128 Capital market solutions for catastrophe risk insurance are another area that needs focus. This essentially transfers insurance risk of natural calamities like earthquakes, hurricanes and floods to the capital markets through issue of catastrophe bonds. The instrument is widely used in advanced countries and there is scope for introducing it in countries like India to provide insurance against contingencies.