CHAPTER-3

PROFILE OF FINANCIAL SYSTEM IN INDIA

The banking sector is the lifeline of any modern economy. It is one of the important financial pillars of the financial sector, which plays a crucial role in the functioning of an economy. It is very important for development of an economic system; because it meets finance the financial requirements of trade, industry and agriculture to fulfil the high level of commitment and responsibility. Thus, the development of a country is linked with the development of its banking. In a modern economy, banks play the role of leaders of development. They play an important role in the mobilization of deposits and expense of credit to various sectors of the economy. The efficiency of banking system leads to an increase of economic efficiency by mobilizing savings and allocating them to high return investment. Research confirms that countries with a well-developed banking system grow faster than those with a weaker one. The banking system reflects the economic health of the country. The strength of an economy depends on the strength and efficiency of the financial system, which in turn depends on a sound and solvent banking system. This makes banks capable of meeting their obligation to the depositors. In India, banks are also playing a crucial role in socioeconomic progress of the country after independence. The banking sector is dominant in India as it accounts for more than half the assets of the entire financial sector. Indian banks have been going through a fascinating phase through rapid changes brought about by financial sector reforms, which are being implemented in a phased manner.[1]

The current progress of transformation should be viewed as an opportunity to convert Indian banking into a sound, strong and vibrant system capable of playing its role efficiently and effectively on their own without imposing any burden on Government. After the liberalization of the Indian economy, the Government has announced a number of reform measures on the basis of the recommendations of the Narasimham Committee to make the banking sector economically viable and competitively strong.

Background of Banks in India

[1]Uma Kaplia (2010), Indian Economy Performance and Policies, Academic Foundation New Delhi.

India has a long history of both public and private banking. Modern banking in India began in the 18^{th} century, with the founding of the English Agency House in Calcutta and Bombay. In the first half of the 19^{th} century, three Presidency banks were founded. After the introduction of limited liability in 1860, private banks began to appear, and foreign banks entered into the market. The beginning of the 20^{th} century saw the introduction of joint stock banks. In 1935, the presidency banks were merged together to form the Imperial Bank of India, which was subsequently renamed as the State Bank of India. Also that year, India's central bank, the Reserve bank of India (RBI), began operation. After independence, the RBI was made the regulatory authority over commercial banks in India. In 1959, the State Bank of India acquired the State owned banks of eight former princely states. Thus, by July 1968, approximately 31 per cent of scheduled bank branches in India became were government controlled, as part of the State Bank of India.[2]

The post war development strategy was in many ways a socialist one, and the Indian government felt that banks in private hands did not lend enough to those who needed it most. In July 1969, the government nationalized all banks whose nationwide deposits were greater than Rs. 500 million. As a result of this, 54 per cent more of the branches in India came under government control which rose to 84 per cent.

Prakash Tandon, former chairman of the Punjab National Bank (nationalized in 1969) justified the policy of nationalization as follows; 'Many bank failures and crises over two centuries and the damage they did under 'laizzez faire' condition' the needs of planned growth and equitable distribution of credit, which is privately owned banks and concentrated mainly on the controlling industrial houses and influential borrowers; the needs of growing small scale industry and farming regarding financed equipment and inputs; from all these there emerged and inerrable demand for banking legislation, some government control and a central banking authority, adding up, in the final analysis, to social control and nationalization. After nationalization, the breadth and scope of Indian banking sector expanded at a rate higher than any other country. Indian banking has been remarkably successful in achieving mass participation. Between the time of 1969 nationalizations and the March 2003 had mobilized over 9 trillion Rupees in deposits, which represent the overwhelming majority of deposits in Indian

[2]History of Banking in India, http://www.scribd.com//doc/24487141/History-of-Banking-in-India

banks. This rapid expansion had been attributable to a policy which required banks to open four branches in unbanked location for every branch opened in banked locations.

Between 1969 and 1980 the number of private branches grew more quickly than public banks, and on April, 1980 they accounted for approximately 17.5percent of bank branches in India. In April, of 1980, the government undertook a second round of nationalization, or a further 8 per cent of bank branches, in leaving approximately 10 per cent of bank branches in private hands. The share of private bank branches stayed fairly constant between 1980 to 2000.

Nationalized bank remained corporate entities, retaining most of their staff, with the exception of the board of directors, who were replaced by appointees of central government. The political appointments included representatives from the government, industry, agriculture, as well the public. Since 1980 there has been no further nationalization albeit trend appears to be reversing itself, as nationalized banks are issuing shares to the public, which amounts to a step towards privatization, There are considerable accomplishments of the Indian banking sector not withstanding advocates for privatization who argue that privatization will lead to several substantial improvements.

Recently, the Indian banking sector has witnessed the introduction of several 'new private banks' either newly founded, or created by previously existent financial institutions. The new private banks have grown quickly in the past few years and one of them has become second largest bank in India. India has also seen the entry of over two dozen foreign banks since the commencement of financial reforms. The Indian banking system has undertaken several policy changes, which can divided into three broad phases. (a) Banking system before independence (b) Banking system during 1950 to 1990 (c) Banking system from 1991, onwards or post reform period.[3]

Indian Banking System before Independence

[3]Mishra and Puri (2010), Indian Economy, Himalaya Publishing House.

The RBI was established in 1935 as private shareholders bank and started functioning with effect from 1 April, 1935; it became an effective banking regulatory agency only when it was nationalized 15 years after. In the pre-independence period, there was hardly any financial system in the country and therefore banking system was highly under-developed. It had gone through a series of crises and consequently. Its growth during the first half of the century was quite slow. At the time of independence, there were more than 400 commercial banks. There was no separate Act to control and regulate the establishment, organization and function of commercial banks in India. In the absence of banking legislation, banking system had developed many drawbacks.

The indigenous bankers played a dominate role in the provision of credit. In the conduct of their business they employed traditional and rigid practices. Despite their significance in the Indian economic system, the indigenous bankers were generally outside the domain of organized banking. In the 1930, the RBI suggested that they should give up their trading and commission business and adopt a professional approach by developing the deposit side of their money lending activity and using modern accounting and auditing system. But the indigenous bankers declined to accept these and other restrictions as well as the compensating benefits of securing accommodation from the RBI on favourable terms. During the pre-independence period the financial system was highly unorganized, neglected and directionless.

Indian Banking System: From 1950s to 1990s

This period can be termed as a phase of evolution of India's financial system which coincided with nationalization of the RBI in 1949. It extended practically over four decades from 1950sand much of the 1980s. During its initial part, that is, the 1950s and much of the 1960s the main emphasis was on development of the necessary legislative framework for facilitating reorganization and consolidation of the banking system. The banking Regulation Act was passed which conferred upon the RBI wide powers to control and regulate commercial banks. The co-operative credit structure was strengthened and institutional framework for providing long-term finance to agriculture and industry was set up. A number of financial institutions came into existence during this period such as Industrial Credit and Investment Corporation of India (ICII). Life Insurance Corporation (LIC) of India and the Unit Trust of India (UTI).A little later, some radical policy initiatives were undertaken for expanding the financial system. Simultaneously, some specialized financial institutions such as Regional Rural Banks and Export and Import Bank of India were also set up. Almost a decade later (in1988), an important policy measure was taken on the side of the securities market which had not received due attention for a long time. The Securities Exchange Board of India was established for revamping and streamlining the securities market and protecting interest of investors.

Among the bold path-breaking policy decisions, nationalization of number financial instructions in the banking and the insurance segments was the most important. As many as 14, large commercial bank were nationalized in 1969, followed by nationalization of another six banks in 1980. During this period there was also nationalization of general insurance business. A little over 100 insurance companies, both Indian and Foreign, were amalgamated and grouped into four companies.

The main objectives behind the nationalization of banks were as follows:-

- Mobilization of the savings through bank deposit.
- Widening of branch network of banks, especially in the rural and semi-urban areas.
- Re-orientation of credit flows so as to benefit the neglected sectors such as agriculture, small-scale industries and small borrowers.

In order to strengthen the social and human dimension of the development process, several important steps such as priority sector lending; differential interest rate scheme and Integrated Rural Development Programme were taken. For the implementation of these schemes the major onus was placed on the public sector banks. The government took the role of regulating the financial system and the role of social banking was assigned to the nationalized banks due to nationalization of banks, there was rapid expansion of the banking system. Major objectives of the nationalization had been mostly achieved. But these achievements inflicted a severe blow to the health of these banks. Banking efficiency deteriorated and profitability plummeted. This was due mainly to factors such as weak control system, retail lending to more risk-prone areas at confessional interest rate and higher costs and above all, misuse of funds in utter disregard to banking ethics. The excessive use of public sector banks by their political bosses as an instrument of policy implementation led to accumulation of non-performing assets in their portfolios in substantial proportion.

Indian Banking System from 1991 onwards

By the year 1990,Indian economy was facing a number of problems. The situation had become extremely uncontrollable. Fiscal deficit was constantly growing and the balance of payment situation had become extremely critical. The country was almost on the brink of default. There was pressure from the external sector for putting the domestic economy in order. The need for initiating radical structural reforms was being greatly emphasized. The moment had arrived for duly reorganizing the role of market mechanism in all spheres of economic activity and integrating the domestic economy with the global economy.

Under structural reforms, the emphasis was on relaxing restrictions which severely impeded the functioning of the market mechanism and led to inefficiency and suboptimal resource allocation. It was the period when policy measures were directed towards liberalization, privatization and globalization of the economy in selective and phased manner. Financial sector reforms constituted an important component of the structural reforms. The basic objective of these reforms was to promote a diversified, efficient and competitive financial sector for achieving improved efficiency of available savings, greater investment profitability and accelerated growth of the real sector of the economy.

A three-pronged strategy was adopted under these reforms.

1. Improving the overall monetary policy framework.
2. Strengthening the financial institutions.
3. Integrating the domestic financial system with the global economy in a phased manner.

One of the most important policy measure of this phase was the acceptance and implementation of many recommendations of far reaching implications for the financial sector, made by the Narsimham Committee Simultaneously, for strengthening the securities market, Securities and Exchange Board of India was made a statutory body and given sufficient power to deal with various fraudulent practices and scams effectively. A few years later, Insurance Regulatory and Development Authority were set up to regulate and promote the insurance business on competitive lines. In order to improve the financial strength and the profitability of the public sector banks and tone up the overall Indian financial system by examining all aspects relating to structure, organization, function and procedures, the Government of India set up two high level committees with M. Narshimham a former Governor of RBI.

The Government of India accepted all major recommendations of Narsimham Reports and started implementing them straightway, despite stiff opposition from banks unions and political parties in the country. It is primarily because of the financial sector reforms initiated during the last two decades or so that the Indian financial system is acquiring fast the shades of a vibrant, dynamic, globalized, complex system today, creating new opportunities and challenges. But still continues to be largely dominated by the presence of giant public sector particularly in banking and insurance even though the private sector has been growing at a much faster rate in the recent years, out-playing the public sector in the matter of efficiency and performance. The first committee submitted its report in 1991 and the second committee, which was set up a few years later, submitted its report in 1998.

The reports made certain recommendations for introducing radical measures. The major thrust of the recommendations was to make banks competitive and strong and conducive to the stability of the financial system. The Government was advised to make a policy declaration that there would be no more nationalization of banks. Foreign banks would be allowed to open offices in India either as branches or as subsidiaries. In order to promote competitive culture in banking, it was suggested that there should be no difference in the treatment between public sector banks and private sector banks. It was emphasized that banks should be encouraged to give up their conservative and traditional system of banking and take to new progressive functions such as merchant banking and underwriting, retail banking, mutual funds etc. The committee recommended that foreign banks and Indian banks should be permitted to set up joint ventures.

Banking Structure in India

Indian banking system consists of ‘non-scheduled banks‘and‘scheduled banks’. Non-scheduled banks refer to those that are not included in the second schedule of the Banking Regulation Act of 1965 and thus do not satisfy the conditions laid down by that schedule. Schedule banks refer to those that are included in the Second Schedule of Banking Regulation Act of 1965 and this satisfy the following conditions: a bank must (1) have paid up capital and deserve of not less than Rs. 5 lakh and (2) satisfy the Reserve Bank of India (RBI) that its affairs are not conducted in a manner detrimental to the interest of its deposits. Scheduled banks consist of "scheduled commercial banks" and scheduled cooperative banks. The former are further divided into four categories: (1) Public sector banks (that are further classified as 'Nationalized Banks and the ' State Bank of India (SBI) banks', (2) private sector banks (that are further classified as 'Old Private Sector Banks'and'New Private Sector Banks' that emerged after 1991); (3) foreign banks in India, and (4) regional rural banks that operate exclusively in rural areas to provide credit and other facilities to small and marginal farmers agricultural workers and small entrepreneurs). These schedule commercial banks except foreign banks are registered in India under the Companies Act.

The SBI banks consist of SBI and seven independently capitalized banking subsidiaries. The SBI is the largest commercial bank in India in terms of profits, assets, deposits; branches and employees and has 13head offices governed each by a board of directors under the supervision of a central board. It was originally established in 1806 when the bank of Calcutta (latter called the Bank of Bengal) was established, and then amalgamated as the Imperial Bank of India after the merger with the bank of Madras and the Bank of Bombay. The Imperial Bank of India was Nationalized and named SBI in 1955. Nationalized banks refer to private sector banks that were nationalized (14 banks in 1969 and 6 in 1980) by the central government compared with the SBI banks, nationalized banks are centrally governed by their respective head offices. Thus there is only one board for each bank and meetings are less frequent. In 1993, Punjab National Bank merged another nationalized bank, New Bank of India, leading to a decline in total number of nationalized banks from 20 to 19. Regional rural banks account for only 4 per cent of total assets of scheduled commercial banks. As at the end of March 2001, the number of scheduled banks is a follows; 19 nationalized banks, 8 SBI banks, 23 old private sector banks, 8 new private sector banks, 42 foreign banks, 196 regional rural banks and 67 co-operative banks. But number of scheduled commercial banks in India as on 31 October, 2006 as follows: 28 public sector banks, 27 private sector banks, 29 foreign banks and 102regional rural banks with multiple branches about 69471. At present 7 SBI and its associate Banks, 20 Nationalized Banks, 32 Foreign

Banks, 86 Regional Rural Banks,22 Other scheduled Banks and 4 Non Scheduled commercial Banks are working with network of 85886 bank branches all over the India. Even after having this financial depth, there is need for further development in financial system to provide the financial services to poor and unbanked people. So many initiatives are taken by Government of India.[4]

Despite the demanding operational environment, the Indian banking sector demonstrated continued revival from the peripheral spill over effects of the recent global financial turmoil. The banking sector—public and private—showed impressive increase in priority sector lending during 2010-11. The flow of agricultural credit headed north, with close to 12.5 million new farmers brought under the banking system. As of today, save 2 per cent, the rest of the Public Sector Bank branches stand fully computerized. The Self Help Group- bank linkage programme has emerged as the major micro finance programme in the country. These are some of the highlights of the Economic Survey 2011-12 presented by the Finance Minister.[5]Capital is a key measure of bank's capacity for generating loan assets and is essential for balance sheet expansion. The Economic Survey says Rs. 12,000 crore has been provided in the Revised Estimates 2011-12, under Plan, for capital infusion in Public Sector Banks (PSBs) to enable them to maintain a minimum Tier 1 CRAR at 8 per cent on 31st March 2012, and also to increase shareholding of the Government of India in the PSBs to 58 per cent. During Financial Year 2011-12 growth in bank credit extended by Scheduled Commercial Banks (SCBs) stood at 8.2 per cent as on 16 December 2011, with year-on-year growth at 17.1 per cent. The outstanding priority sector advances of PSBs rose by almost 19 per cent between March 2010 to March, 2011. The increase was from Rs 8, 63,777crore to Rs 10, 28,614crore. The advances of Private Sector Banks showed a growth of 15.9 per cent during the same period. The Economic Survey 2011-12 underlines the fact that flow of agricultural credit has been impressive. The Indian banking system disbursed credit of Rs 4,46,779crore to the agricultural sector as against a target of Rs 3,75,000 crore in-2010-11, thereby exceeding the target by around 19 per cent. The extension of credit has taken the total number of new farmers brought under the banking system to 127.26 lakhs. The Self Help Group-bank linkage programme is being implemented by Commercial Banks, Regional Rural Banks (RRBs) and Cooperative Banks. Under this, as on 31

[4]Government of India (2011-12) Basic Statistical Return, Hand Book of Statistics on Indian Economy, RBI.
[5] Economic survey 2011-12

March 2011, over 74 lakh SHGs held bank accounts with total savings of nearly Rs.7, 000 crores as against 69.5 lakh SHGs with savings of Rs 6,200 crores as on 31 March 2010. Very amazing role of computerization and adoption of core banking solutions, 98 per cent of Public Sector Bank branches are today fully computerized. In 2010-11, the number of ATMs witnessed a growth of 24 per cent over the previous year. According to the Survey, to facilitate flow of funds into infrastructure projects, broad guidelines were issued on September 23, 2011 for setting up of Infrastructure Debt Funds. Further, guidelines on credit default swaps for corporate bonds were also issued on May 23rd, 2011. The agenda of Financial Inclusion has been actively pursued by the Government. Detailed strategy and guidelines on Financial Inclusion have been issued on 21 October 2011.

The Survey notes that resource mobilization through the primary market witnessed a sharp decline over the year 2010-11, with equity public issue mobilization standing at Rs 9,683 crore as compared to Rs 48,654 crore. Upto 31 December 2011, 30 new companies (IPOs) were listed at the National Stock Exchange and Bombay Stock Exchange. The development of the financial sector is critically dependent on financial inclusion, which is seen as an important determinant of economic growth. Banks need to take into account various behavioural and motivational attributes of potential consumers for a financial inclusion strategy to succeed. Besides, access to financial products is constrained by lack of awareness, unaffordable products, high transaction costs, and products which are not customized and are of low quality. A major challenge in the times ahead would be to meet financing requirements, particularly of the unorganized sector and the self-employed in the micro and small business sector.

In Indian economic growth the importance of credit delivery and Financial Inclusion has been underlined in the Monitory Policy review.In Monitory Policy Review for the role of Credit Delivery and Financial Inclusion inIndian economic growth has been highlighted[6]. Financial Inclusion Plan for Banks; It was indicated in the Monetary Policy Statement of May 2011 that all public and private sector banks had prepared and submitted their board approved three-year financial inclusion plans (FIPs). These contained self-set targets in respect of opening of rural brick and mortar branches; deployment of business correspondents (BCs); coverage of unbanked villages with population above 2,000 as also other unbanked villages with population below

[6]Subbarao D, 'Monitory Policy', RBI, Annual Report(2011-12)

2,000 through branches/BCs/other modes; opening of no-frills accounts; kisan credit cards (KCCs) and general credit cards (GCCs) issued; and other specific products designed by them to cater to the financially excluded segments.

A brief analysis of the progress made under FIPs of banks shows that penetration of banks in rural areas has increased manifold. As against 21,475 brick and mortar branches of these banks in rural areas as in early March 2010, banks are now providing banking services in rural areas through 1,38,502 outlets comprising 24,085 rural branches, 1,11,948 BC outlets and 2,469 outlets through other modes. No-frills accounts have increased to around 99 million with an outstanding balance of above`87 billion with the addition of about 50 million new no-frills accounts since April 2010.Going forward, the focus will be more on the number and value of transactions in no-frills accounts and credit disbursed through information and communication technology (ICT) based BC outlets. For the purpose, banks have been advised that FIPs prepared by their head offices are disaggregated at respective controlling offices and further at branch levels. They were also advised to put in place a mechanism to monitor the progress at these levels periodically.

Roadmap for Provision of Banking Services in Villages with Population below 2,000

In pursuance of the announcement made in the Monetary Policy Statement of April 2010, the roadmap to provide banking services in every village with a population above 2,000 was finalized by state level bankers' committees (SLBCs). Under the roadmap, 74,414 villages with population above 2,000 were identified as unbanked, which were allocated to various banks, including regional rural banks (RRBs) for providing banking services by March 2012. Banks have covered 74,199 (99.7 per cent) of these unbanked villages. Now the challenge is to cover all the unbanked villages of the country. Accordingly, it is proposed:

- To mandate SLBCs to prepare a roadmap covering all unbanked villages of population less than 2,000 and notionally allot these villages to banks for providing banking services in a time-bound manner.

While all the efforts made for financial inclusion have expanded the access to banking services, it is also important that quality services are provided through newly set up ICT based

BC delivery model. It is, therefore, necessary to have an intermediate brick and mortar structure between the present base branch and BC locations so as to provide support to about 8-10 BC units at a reasonable distance of 3-4 kilometers. This could be in the form of a low cost simple brick and mortar structure consisting of minimum infrastructure such as a core banking solution (CBS) terminal linked to a pass book printer and a safe for cash retention for operating larger customer transactions. This will lead to efficiency in cash management, documentation, redressed of customer grievances and close supervision of BC operations. These BC outlets will be treated as bank branches only when managed by full time authorized employees of banks, in which case they will be subject to regulatory reporting.

Redefining the Priority Sector: As indicated in the SQR of October 2011, the Reserve Bank had constituted a Committee (Chairman: Shri M. V. Nair) to re-examine the existing classification and suggest revised guidelines with regard to priority sector lending classification and related issues. The Committee submitted its report in February 2012. It made the following major recommendations: (i) the existing target of the domestic scheduled commercial banks for lending to the priority sector be retained; (ii) the sector 'agriculture and allied activities' be a composite sector within priority sector; (iii) a sub-target for small and marginal farmers within agriculture and allied activities be segregated; (iv) a sub-target for micro enterprises under the micro and small enterprises (MSE) category be stipulated; (v) the priority sector target for foreign banks be increased to 40 per cent of adjusted net bank credit (ANBC) or credit equivalent of off-balance sheet exposure (CEOBE), whichever is higher with sub-targets of 15 per cent for exports and 15 per cent for the MSE sector; (vi) non-tradable priority sector lending certificates (PSLCs) be allowed on a pilot basis; (vii) bank loans to non-bank financial intermediaries for on-lending to specified segments be allowed to be reckoned for classification under priority sector, up to a maximum of 5 per cent of ANBC or CEOBE, whichever is higher; and (viii) the present system of report-based reporting may be improved through data-based reporting. The report has been placed on the Reserve Bank's website for inviting comments/suggestions. The Reserve Bank will take a view on the recommendations in the light of feedback received.

Rural Co-operatives: Licensing of Co-operatives

The Committee on Financial Sector Assessment (Chairman: Dr. Rakesh Mohan and Co-Chairman: Shri Ashok Chawla) had recommended that rural co-operative banks, which failed to obtain a license by end-March 2012, should not be allowed to operate. The Reserve Bank, along with the National Bank for Agriculture and Rural Development (NABARD) implemented a roadmap for issuing licenses to unlicensed state co-operative banks (STCBs) and district central co-operative banks (DCCBs) in a non-disruptive manner, to ensure the completion of licensing work by end-March 2012. After considering the NABARD's recommendations for issuance of licenses based on inspection/quick scrutiny, one out of 31 STCBs and 41 out of 371 DCCBs were found to be unable to meet the licensing criteria by end-March 2012. In this regard, suitable action will be initiated in due course.

Streamlining of Short-Term Co-operative Credit Structure: After recapitalization of the three-tier short-term co-operative credit structure (STCCS), 41 DCCBs having high level of financial impairment as of end-March 2012 were unable to meet the licensing criteria. In order to examine issues of structural constraints and explore strengthening of the rural co-operative credit architecture with appropriate institutions and instruments of credit to fulfill credit needs, it is proposed:

- To constitute a Working Group to review the STCCS, which will undertake an in-depth analysis of the STCCS and examine various alternatives with a view to reducing the cost of credit, including feasibility of setting up of a two-tier STCCS as against the existing three-tier structure?

Urban Co-operative Banks (UCBs)

Exposure of UCBs to Housing, Real Estate and Commercial Real Estate: At present, UCBs are permitted to assume aggregate exposure on real estate, commercial real estate and housing loans up to a maximum of 10 per cent of their total assets with an additional limit of 5 per cent of their total assets for housing loans up to`1.5 million. In order to facilitate enhanced priority sector lending, it is decided:

- To permit UCBs to utilize the additional limit of 5 per cent of their total assets for granting housing loans up to `2.5 million**,** which is covered under the priority sector.

Licenses for Setting up New Urban Co-operative Banks;As announced in the Monetary Policy Statement of April 2010, an Expert Committee (Chairman: Shri Y. H. Malegam) was constituted in October 2010 for studying the advisability of granting licenses for setting up new UCBs. The Committee was also mandated to look into the feasibility of an umbrella organization for the UCB sector. The Committee submitted its report in August 2011. The report was placed in public domain in September 2011 for comments and suggestions from stakeholders.

The Damodaran Committee had made a total of 232 recommendations. Of these, 107 recommendations have since been implemented and the IBA has issued operating guidelines to the member banks in this regard. There are another 19 recommendations that are under the accepted category where appropriate guidelines are expected to be issued by the IBA shortly. The Reserve Bank held discussions with the IBA, the BCSBI, the Institute for Development & Research in Banking Technology (IDRBT) and the National Payment Corporation of India (NPCI) to work out the modalities for taking forward the implementation task of the remaining recommendations made by the Damodaran Committee. The IBA has now constituted a sub-group to examine the implementation of the remaining recommendations after studying the relevant international standards and best practices.

Home Loans on a Floating Interest Rate Basis; Abolition of Foreclosure Charges/Prepayment Penalty: The Damodaran Committee had observed that foreclosure charges levied by banks on prepayment of home loans were resented upon by home loan borrowers across the board, especially since banks were found to be hesitant in passing on the benefits of lower interest rates to the existing borrowers in a falling interest rate scenario. As such, foreclosure charges are seen as a restrictive practice deterring the borrowers from switching over to cheaper available source. It is felt that the removal of foreclosure charges/prepayment penalty on home loans will lead to a reduction in the discrimination between existing and new borrowers and the competition among banks will result in finer pricing of home loans with the floating rate. Though many banks have, in the recent past, voluntarily abolished the pre-payment penalties on their floating rate home loans, there is a need for ensuring uniformity across the banking system in this regard. Accordingly, it is proposed:

- Not to permit banks to levy foreclosure charges/pre-payment penalties on home loans on a floating interest rate basis.

Variation in Interest Rates on Deposits to be Minimal: The Reserve Bank has stipulated, inter alia, that banks should not discriminate in the matter of interest rate paid on deposits, except in respect of fixed deposit schemes specifically meant for resident Indian senior citizens and single term deposits of `1.5 million and above. However, it is observed that there are wide variations in banks' retail and bulk deposits rates, making it unfair to retail depositors. Further, banks are offering significantly different rates on deposits with very little difference in maturities. This suggests inadequate liquidity management system and inadequate pricing methodologies. It is, therefore, advised that:

- Banks should have a board approved transparent policy on pricing of liabilities and they should also ensure that variation in interest rates on single term deposits of `1.5 million and above and other term deposits is minimal.

Unique Customer Identification Code for Banks' Customers in India: Availability of a unique customer identification code (UCIC) will help banks to identify a customer, track the facilities availed, monitor financial transactions in various accounts, improve risk profiling, take a holistic view of customer profile and smoothen banking operations for the customer. While some of the Indian banks have already developed UCIC, there is no unique number to identify a single customer across the organization in many banks. In this regard, the Government of India has already initiated some measures as a working group constituted by them has proposed the introduction of unique identifiers for customers across different banks and financial institutions. While such a system for the entire financial system is desirable, it is likely to take quite some time for a complete roll out. As a first step, banks are advised:

- To initiate steps to allot UCIC number to all their customers while entering into any new relationships in the case of all individual customers to begin with. Similarly, existing individual customers may also be allotted unique customer identification code by end-April 2013.

Access to Banking Services - Basic Bank Deposit Account; Financial inclusion has been high on the agenda of the Reserve Bank. With a view to providing fillip to this concept, banks were advised, in November 2005, to make available a basic banking 'no-frills' account with either 'nil' or very low minimum balance as well as charges that would make such accounts accessible to vast sections of the population. The nomenclature of the account in this manner has tended to signify that these accounts are opened more with a view to indicating achievement of numerical targets under the financial inclusion plans. On a review, it has been decided to modify the guidelines on opening of basic banking 'no-frills' accounts with a view to doing away with the stigma associated with the nomenclature and making the basic banking facilities available in a more uniform manner across the banking system. Accordingly, it is proposed that:

- Banks should offer a 'basic savings bank deposit account' with certain minimum common facilities and without the requirement of minimum balance to all their customers.

Regulatory and Supervisory Measures for Commercial Banks:

Strengthening the Resilience of the Banking Sector;as indicated in the SQR of October 2011, the Reserve Bank prepared the draft guidelines on Basel III – Implementation of Capital Regulations in India, which were placed on its website in December 2011, for comments/suggestions from various stakeholders. The draft guidelines provide for a roadmap for smooth implementation of Basel III capital regulations in terms of the transitional arrangements (phase-in) of capital ratios and grandfathering (phase-out) of ineligible capital instruments. The Reserve Bank is also in the process of estimating, on the basis of data collected from banks, the likely impact of the proposed Basel III norms on banks' capital position and leverage. The estimation exercise, as also the comments/suggestions from various stakeholders, will form the basis for finalizing the guidelines on capital regulations. It is proposed:

- To issue the final guidelines on the implementation of Basel III capital regulations by end-April 2012.

Implementation of Liquidity Risk Management and Basel III Framework on Liquidity Standards; Based on the documents Principles for Sound Liquidity Risk Management and

Supervision as well as Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring published by the Basel Committee on Banking Supervision (BCBS) in September 2008 and December 2010 respectively, the Reserve Bank prepared draft guidelines on Liquidity Risk Management and Basel III Framework on Liquidity Standards, which were placed on its website in February 2012 for comments and feedback. The draft guidelines consolidate the various instructions/guidance on liquidity risk management that the Reserve Bank has issued from time to time in the past, and where appropriate, harmonizes and enhances these instructions/guidance in line with the BCBS's Principles for Sound Liquidity Risk Management and Supervision. They include enhanced guidance on liquidity risk governance, measurement, monitoring and the reporting to the Reserve Bank on liquidity positions. The draft guidelines also cover two minimum global regulatory standards, *viz*., liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) as set out in the Basel III rules text.

While the enhanced liquidity risk management measures are to be implemented by banks immediately after finalization of the draft guidelines, the Basel III regulatory standards, *viz*., LCR and NSFR, will be binding on banks from January 1, 2015 and January 1, 2018, respectively. Till then, banks will have to comply with Basel III guidelines on a best effort basis. This will prepare banks for transition to the Basel III requirements. It is proposed:

- To issue the final guidelines on liquidity risk management and Basel III framework on liquidity standards by end-May 2012, after taking into account the suggestions/ feedback received.

Current Status of Financial Inclusion in India

In the recent past, The Reserve Bank of India stated that the banking sector policy during 2010-11 remained consistent with the broader objective of macroeconomic policy of sustaining economic growth. 'The RBI has introduced important policy measures of deregulation of savings bank deposit rate and introduction of credit default swap (CDS) for corporate bonds.'In recent report 'Trend and Progress of Banking in India 2010-2011'.RBI has discussed important policies like issuance of new banking license; designing the road-ahead for the presence of foreign banks and holding company structure for banks had been initiated in the 2010-11 period.

Emphasizing on financial inclusion, the RBI said that one of the most note-worthy development was the formation of board-approved financial inclusion plans by banks for a time horizon of the next three years. Going forward, the central bank said that its policy would focus on financial stability and financial inclusion.[7]

It is highlighted that RBIand the finance ministry seem to have differences on the way banks should go about ensuring financial inclusion. While both the regulator and the ministry is passionate about providing banking services at low cost to the disadvantaged, a difference of opinion between the two has confused bankers. Recently, the finance ministry told banks that every business correspondent outlet should be converted into an ultra-small branch. So far, business correspondents - agents appointed by banks to provide banking services to the financially excluded in rural India - reached out to individuals on their own and operated from home. On the other hand, the RBI, in a recent circular, told banks to set up an ultra-small branch for 8-10 business correspondents operating in an area. WhilePSU banks will make significant savings by following the RBI's diktat, they cannot completely ignore the finance ministry's directive.Bankers to Seek Clarity; State-run banks cannot ignore the finance ministry's instructions since the government holds majority stake in these lenders. Senior bankers from public sector banks are expected to raise the issue with Finance secretary. He has called the meeting to review the progress made by banks on financial inclusion. Yet another grey area is the deputation of bank officers to these branches. The finance ministry has indicated that bank officers should visit ultra-small branches once a week to review the status. However, the RBI insists that banks must depute a fulltime officer at these branches.[8]

The Centre has decided to shift its financial inclusion goalpost to accommodate a wider section of the population under the banking net, which is expected to curb leakages and generate more savings in a slowing economy. Banks have been asked to reach out to villages with population of 1,600 and above, as per the 2001 census, either through branches or business correspondents. According to the earlier government mandate, the population benchmark was 2,000. It told banks to complete implementation of the project latest by March 2013. A wider banking penetration will reduce leakages and also help bring in more savings into the economy.It

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[7] Government of India: 'Trend and Progress of Banking in India' (2010-2011) RBI.

[8] Sangita Mehta, ET Bureau(2012, May 25), ' RBI, finance ministry differ over rural bank branches'. The Economic times.

was a long requisite to route government's financial benefits to the poor through an institutional set-up.

Experts feel that a curb in leakages will transform into higher rural demand and push growth. India's annual economic growth slumped in 2011-2012 to a nine-year low of 6.5%, lower than the 6.9% forecast. Banks have brought 74,199 villages, with 2,000 or above population, under the banking network in the last couple of years. As per the 2001 census, 74,414 villages have population of 2,000 and more. India has 5.94 lakh inhabited villages. But villages with minimum population of 1,600 are not readily available. The finance ministry has observed that villages with 1,600 or more people (2001 census) are likely to have crossed the 2,000 population-mark by now. So they should be covered under 'Swabhimaan' — the name for the financial inclusion drive. The country is yet to finalise the 2011 census, and therefore, the Registrar General of India will take some more time to prepare the list of villages with 2,000 habitants. "Penetration in deeper pockets is also helping banks in mobilising low-cost deposits. State Bank of India's ratio of savings deposits to total deposits shrunk 80 basis points to 36.64%, though the country's largest lender has over 14,000 branches and runs a business correspondent network of nearly 30,000 outlets.[9]

It is also shown in the report on the status of the Financial Inclusion in the news of June 10, 2012 to august 26, 2012, No- frill, zero balance accounts rise over two- fold in last two years. "The number of no-frills or zero-balance account holders more than double to 103.21 million in the year to March 31, 2012 from 49.33 million in March 2010, RBI has said in its financial inclusion update. During March 2010-March 2012, total number of banking outlets grew to 1, 47,534, from 54,258 outlets, the Reserve Bank said in the update on financial inclusion." The Reserve Bank (RBI) has launched the financial inclusion programme to provide financial services to people in unbanked areas. It was said thatthese beneficiaries are not only inhabitants of rural villages but also comprises of urban poor and slum dwellers residing in the Urban/ Metro centres.[10] (State Level Bankers Committee)

Earlier in May, banks were asked to launch a campaign to ensure at least one bank account for each family in villages.In order to provide banking services to entire population residing in

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[9]Atmadip Ray, ET Bureau (2012,June 8). 'Government for Deeper Financial Inclusion to Boost Economy'.The Economic Times.
[10] ET Bureau,(2012, June 10). The Economic Times, P-2,

urban and Metro Centres.The 'Urban Financial Inclusion' campaign would cover urban poor, slum dwellers and inhabitants of urban/metro villages. As per 2011 census, about 58.7 per cent households had reported availing of banking facilities. Out of the 24.69 crore households, 14.48 crore reported availing banking services. Nearly 10 crore households were not availing the services. Referring to the financial inclusion drive in rural areas, the ministry further said it has been observed that some banks while opening accounts are not capturing the biometric details of the customers. Since accounts opened under the campaign would facilitate Electronic benefit transfer (EBT), banks should ensure to capture biometric details of the customer, as done under the 'Swabhimaan' campaign. The government asks banks to insure one account per family among urban poor. The government has asked banks to focus on 'Urban Financial Inclusion' to ensure at least one bank account per family among poor in cities. The directive comes at a time when the government has been "emphasizing the need" for transferring all benefits including Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) wages and various cash subsidies to beneficiaries by direct credit to their bank accounts. The board would comprise of brokers, investor representatives, and people from academic institutions, professional bodies and stakeholders from the capital markets, an exchange.

It was said that increasing broadband and mobile penetration were essential to further reduce the costs of financial inclusion India. He added that the concept of financial inclusion should be more far reaching than just making credit available for poor people. (Montek singh Ahluwalia) ‘Financial inclusion should be separate from the idea of getting credit... It means that everybody should have bank accounts, should be able to transact through them and also receive other benefits through them’. He further said that as mobile technology is integrated into various banking services the cost of providing services to customers will reduce making financial inclusion more sustainable. He added that there is need for proper utilization of financial support provided by the government to banks, post offices and mobile companies towards the cause of financial inclusion. Other panellists during the summit noted how regulatory measures by the RBI on micro-finance institutions are leading to a credit crisis in the rural areas. Panel members from micro-finance institutions and banks deliberated that even as regulations placed by the government have given recognition to micro-finance institutions as legitimate sources of credit, they needed to be tweaked to enhance access of credit to the poor. It was said that the regulatory framework is welcome but they need to be tweaked and made more flexible so that it is easier to provide credit and other services like insurance to the people.[11]

[11] ET Bureau, (2011, December 8).'Better Broadband Penetration to Help Reduce Costs of Financial Inclusion'. The Economic Times.