Statement 8 : Recent Policy Developments

Sr. No.	Item	Recommendations of KWG (Khan Working Group)	Recommendations of Narasimham Committee	Current Policy/Status
1.	**Statutory obligations (CRR and SLR)**	a) The application of CRR should be confined to cash and cash like instruments; b) CRR should be brought down progressively within a time bound frame to international levels; c) SLR should be phased out in line with international practice.		Present levels of CRR and SLR are 11.0 per cent and 25.0 per cent, respectively. While the extant policy has the ultimate objective of moving the CRR down to the statutory minimum prescription of 3 per cent, it would be very difficult to specify a time-frame for achieving this. The SLR has already been brought down to the statutory minimum level of 25 per cent. Further reduction in SLR can be achieved only by amendments to the statute.
2.	**Priority Sector Lending**	Priority Sector obligations : There is need for an alternate mechanism to be developed for financing these sectors (Priority Sector) in the long run. In the interim the following modifications in definition were suggested – a) Definition– Infrastructure finance should be included in the defination of priority sector. b) Infrastructure lending should not be included in net bank credit while computing priority sector obligations. c) To facilitate efficient loan disbursals, the priority sector obligations should be linked to the net bank credit at the end of the previous financial year.	The Committee recommended that given the special needs of this sector, the current practice may continue. It observed that given the importance and needs of employment oriented sectors, like food processing and selected service activities in agriculture, fisheries, poultry and dairying, these sectors should also be covered under the scope of priority sector lending. It recommended that the interest subsidy element in credit for the priority sector should be totally eliminated and even interest rates on loans under Rs.2 lakh should be deregulated for scheduled commercial banks as has been done in the case of Regional Rural Banks and co-operative credit institutions.	Extant guidelines on priority sector are indicated below: **a) Indian commercial banks (both public and private sector)** Total priority sector advances:- 40% of net bank credit; Total agricultural advances:- 18% of net bank credit; Advances to weaker sections:- 10% of net bank credit. **b) Foreign banks operating in India** Total priority sector advances:- 32% of net bank credit; Advances to SSI:- 10% of net bank credit;

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2.	**Priority Sector Lending**	d) Definition of priority sector should be widened to include the whole industry/ class of activities.			Export credit:- 12% of net bank credit. Activities like food processing, fisheries, etc., are covered under priority sector if they come under the criteria of investment for SSI. The recommendation relating to doing away with interest subsidy for priority sector credit has been implemented in the Monetary and Credit Policy announced in April 1998. Presently, concessionality in interest rate is applicable only to DRI advances. While advances up to Rs.2 lakh carry interest not ex ceeding PLR, interest rate on -advances over Rs.2 lakh has been freed.

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3.	**Prudential Norms**			
	a) Capital Adequacy Norms		The Committee made the following recommendations: i) Capital adequency requirements should take into account market risks in addition to the credit risks. ii) In the next three years, the entire portfolio of government securities should be marked to market. There should be a 5 per cent weight (as against zero per cent) for market risk for government and approved securities.	In the 'Mid-Term Review of Monetary and Credit Policy for 1998-99', it was announced that, in line with the international best practices, the minimum ratio for banks should be enhanced from the existing 8 per cent to 9 per cent with effect from the year end ing March 31, 2000. Banks were also advised that investments in Government and other approved securities should be assigned a risk weight of 2.5 per cent for market risk, with effect from the year ending March 31, 2000.
			iii) The risk weight for a government advance should be the same as for other advances.	Risk weights will be assigned for Government guaranteed ad- vances sanctioned from April 1, 2000 as under: Against the guarantee of the: (a) Central Government: 0% (b) State Governments: 0%
			iv) Risk for foreign exchange open position should be integrated into the calculation of risk weighted assets and that the foreign exchange open position limits should carry a 100 per cent risk weight.	

				(c) State Governments who remain defaulters as on March 31, 2000: 20% (d) State Governments who continue to be defaulters after March 31, 2001:100%
			v) The minimum capital to risk assets ratio be in-creased from its present level of 8 per cent to 10 per cent by 2002 in a phased manner.	Foreign exchange and gold open position limits should carry 100 per cent risk weight with effect from March 31, 1999.

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	b) Income recognition, asset classification and provisioning		The Committee made the following recommendations: i) For income recognition norms, income should stop accruing when interest or instalment of principal amount is not paid within 90 days (from 180 days at present) in a phased manner by the year 2002.	With a view to moving closer to international practices in regard to asset classification and provisioning norms, banks have been advised that an asset should be classified as doubtful, if it has remained in the sub-standard category for 18 months instead of 24 months, as at present, by March 31, 2001. Banks have been permitted to achieve these norms for additional provisioning, in phases, as under:
			ii) A general provision, say, 1 per cent be prescribed in a phased manner in respect of standard assets.	As on March 31, 2001: Provisioning of not less than 50 per cent on the assets which have become doubtful on account of the new norms.
			iii) In the case of all future loans, the income recognition and asset classification and provisioning norms should apply even to Government guaranteed advances in the same manner as for any other advance.	As on March 31, 2002: Balance of the provisions not made during the previous year, in addition to the provisions needed, as on March 31, 2002. In order to strengthen the banks' efforts to recover the dues from the State Governments, after the guarantee has been invoked, as well as to discourage such practices by the concerned State Governments, provisioning norm has been introduced in respect of advances guaranteed by State Governments where guarantee has been invoked and has remained in default for more than two quarters. This measure would be effective in respect of advances sanctioned against State Government guarantee with effect from April 1, 2000. As regards provisioning requirement for

			iv) There is a need for disclosure, in a phased manner, of the maturity pattern of assets and liabilities, foreign currency assets and liabilities, movement in provision account and non-performing assets.	
			v) The RBI should direct banks to publish, in addition to financial statements of independent entities a consolidated balance sheet to reveal the strength of the group.	
			vi) An asset be classified as doubtful if it is in the 'sub-standard' category for 18 months in the first instance and eventually for 12 months and 'loss' if it has been so identified but not written--off.	

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			vii) Government guaranteed advances which otherwise would have been classified as NPAs should be separately shown as an aspect of fuller disclosure and greater transparency of operations.	To start with, banks were advised to make a general provision on standard assets of a minimum of 0.25 per cent from the year ending March 31, 2000.
			viii) The objective should be to reduce the average level of net NPAs for all banks to below 5% by the year 2000 and to 3% by 2002. For those banks with an international presence the minimum objective should be to reduce gross NPAs to 5% and 3% by the year 2000 and 2002, respectively, and net NPAs to 3% and 0% by these dates.	

			ix) For banks with a high NPA portfolio, the Committee suggested two alternative approaches to the problem. In the first approach, all loan assets in the 'doubtful' and 'loss' categories should be identified and transferred to an Asset Reconstruction Company (ARC) which would issue to the banks NPA Swap Bonds representing the realisable value of the assets transferred. The ARC could be set up by one bank or a set of banks or even in the private sector. An alternative approach could be to enable the banks in difficulty to issue bonds which could form part of Tier II capital. Such bonds should be guaranteed by the government so that they become eligible for SLR investment by banks and approved instruments by LIC, GIC and Provident Funds.	

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4.	**Management of Liquidity and Interest Rate Risks**	It recommended a proactive asset-liability management approach.	Banks should pay greater attention to asset-liability man-agement to avoid mismatch and to cover, among others, liquidity and interest rate risks.	Draft guidelines on asset-liability management (ALM) in respect of banks have already been circulated for consultations. Final guidelines on ALM are in the process of being issued. Draft ALM System in respect of DFIs is under preparation in consultation with DFIs.

5.	**Access to Short-term Funds**	The restrictions on bond issues by DFIs with either a maturity of less than 5 years or maturity of 5 years and above but with interest rate exceeding 200 basis points over the yield on Government of India securities of equal residual maturity requiring RBI approval be withdrawn. The KWG recommended that the following conditions for raising of short-term resources be removed: i) Extant overall ceiling on DFIs' mobilisation of resources by way of term deposits, CDs, borrowings from the term money market and inter-corporate deposits (ICDs); ii) Maturity ceiling of five years on deposits from the public; iii) Cap on interest rate on deposits mobilised by DFIs; and iv) Minimum size of deposits which may be accepted by DFIs.		While umbrella-limit fixed in terms of instruments, *viz.*, CDs, term money borrowings, term deposits and ICDs (where applicable) continues to be 100 per cent of NOF, a mechanism has been evolved in the form of 'Standing Committee' to clear expeditiously the references relating to the 'bond issues' of DFIs. Modifications are under discussions between RBI and DFIs.

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Sr. No.	Item	Recommendations of KWG (Khan Working Group)	Recommendations of Narasimham Committee	Current Policy/Status
6.	**Technology, Management Information System, HRD, and Risk Management System**	It recommended that IT systems and MIS of international standards be established. a) For this the legal framework has to be revisited and render it compatible with the requirements of a technology–driven banking environment;	i) Banks should be encouraged to adopt statistical risk management techniques like Value-at-Risk in respect of balance sheet items which are susceptible to market price fluctuations, forex rate volatility and interest rate changes. While the Reserve Bank may, initially, prescribe certain normative models for market risk management, the ultimate objective should be that of banks building up their own models and RBI back-testing them for their validity on a periodical	The RBI has set up an In-house Group to look into the Core Principles of Supervision and one of the aspects which will be examined by the Group is adoption of statistical risk management techniques and to prescribe broad guidelines on risk management by banks. The Group has since submitted its report. This has been placed before the Board for Financial Supervision for its guidance. Comprehensive guidelines on Risk Management Systems in banks are being issued to banks.

		b) DFIs should establish E-mail, Internet, Intranet Banking, Smart Cards and EDI in a strategically sequenced fashion; and c) A perspective plan/blue print for automation of financial sector be prepared.		It would be necessary for the Government to notify an amendment to clause 13 of the Nationalised Banks (Management and Miscellaneous Provisions) Scheme, 1970/80 to reconstitute Management Commit-tee to consist of only whole time functionaries.
		The group recommended that the reformed HRD agenda of DFIs/banks should encompass the following :	ii) An area requiring close scrutiny in the coming years would be computer audit, in view of large scale usage and reliance on information technology.	A Working Group has been set up with representation from public sector banks, technology experts to operationalise and implement the programme of computerisation of banks within a definite time frame.
		Prescient management and leadership. Broad-based recruitments both at entry level from campus as well as lateral entry of professional at higher levels. Systematic training programme. Skill-building and skill-upgradation. Market-related compensation packages. Viable and enforceable exit option for employees. It recommended a clear emphasis on the following as part of a prudent risk-return optimisation strategy: a) A clear strategy approved by the Board of Directors as to their risk management policies and procedures; b) An integrated Treasury and proactive Asset-Liability management; and c) Robust (internal) operational controls.	iii) The Committee noted that public sector banks and financial institutions have yet to introduce a system of recruiting skilled manpower from the open market. The Committee believed that this delay has had an impact on the competency levels of public sector banks in some areas and they have consequently lost some ground to foreign banks and the newly set up private sector banks. The Committee suggested that this aspect be given urgent consideration and in case there are any extant policy driven impediments to introducing this system, appropriate steps be taken by the authorities towards the needed deregulation.	Technology issues are being accorded top priority in banks and DFIs. The RBI is in the process of expediting the installation of VSAT network. RBI is also monitoring Y2K compliance. Banks are also being encouraged to put in place risk management systems which will be formalised when the ALM system is introduced.

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iv) The issue of remuneration structure at managerial levels prevailing in public sector banks and financial institutions needs to be addressed. There is an urgent need to ensure that public sector banks are given flexibility to determine managerial remuneration levels taking into account market trends.

v) The managements of Indian banks should review the changing training needs in individual banks keeping in mind their own business environment and to address these urgently.

vi) Information and control systems need to be developed in several areas like better tracking of spreads, costs and NPAs for higher profitability, accurate and timely information and strategic decisions to identify and promote profitable products and customers, risks and asset-liability management, and efficient treasury management.