Financial Foresights

Views, Reflection and Erudition

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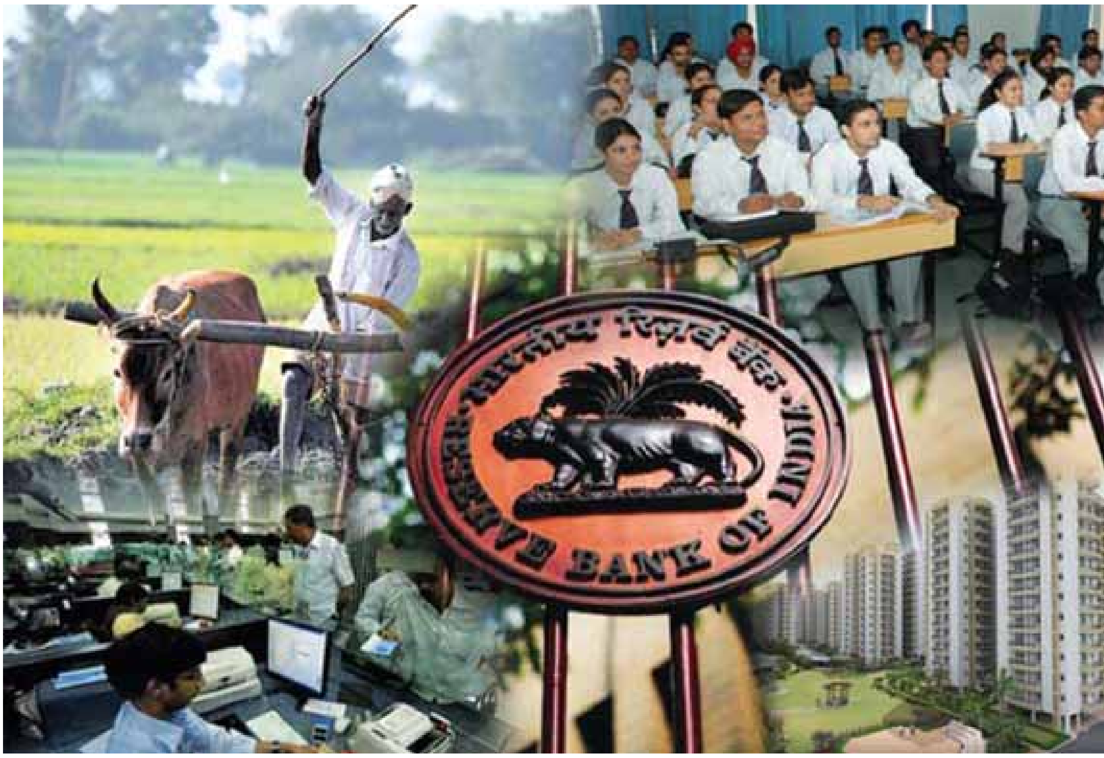

Priority Sector Lending and Inclusive Growth

FEDERATION OF INDIAN CHAMBERS OF COMMERCE AND INDUSTRY

Industry's Voice for Policy Change

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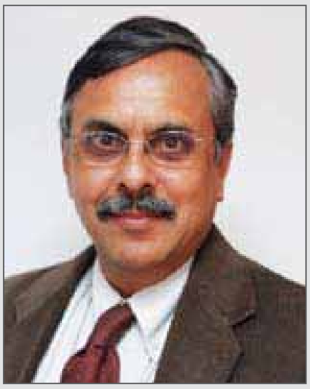
Preface



'Financial Foresights' is FICCI's Financial sector's flagship research based initiative which aims at being a 'Knowledge Repository' to facilitate a comprehensive forum for dialogue amongst the Indian Inc. and the government, thereby providing necessary directions to policy makers and business processes. Currently in its fourth year of publication, this Digest has gone a long way in providing invaluable inputs for FICCI's extensive network of industry members and stakeholders on various topics concerning the financial sector. Given our quality of content and extent of influence, we were recently approached by EBSCO International database, Washington (which is widely used in Libraries across the world) and we have partnered with them to take our deliberations to a global audience.

This Issue will focus on Priority Sector Lending (PSL) which is an important mandate given to banks by RBI for providing a specified portion of the bank lending to few specific sectors which include agriculture, micro and small enterprises, micro-credit, education loans, housing loans to name a few. Priority Sector Lending impacts huge population segments, sectors that are labour-intensive and sectors that are essential for the overall development of the economy.

RBI's Annual Report 2012-13 notes that as many as 16 public sector banks and 10 private sector banks missed meeting their PSL targets. With prospective new players waiting to enter the market, it is imperative to understand the challenges banks face in meeting the PSL requirements. Some of the major challenges banks have been facing include maintaining additional manpower requirements for supervision of small loans, mounting over dues, poor recovery of advances and rising volume of non-performing assets (NPAs) are other major concerns.

The success of the NBFC-MFI model has been an eye-opener to what the banking industry can achieve in the coming days. For inclusive growth, we believe, it is imperative that PSL norms should be aligned with the priority sectors of the country and must be dynamic in the sense that it must allow for accommodating the changing needs of the economy. PSL is expected to improve the structural weakness of the country in terms of education and employment among other priority sectors by facilitating easier access to credit.

It is against this backdrop that this issue of FICCI's Financial Foresights, through the voice of some of India's leading names in the financial sector, will take a closer look at Priority Sector Lending (PSL) and endeavour to bring to light ways and means to meet the objectives of PSL with special focus on promoting 'Inclusive Growth'.

We look forward to your views and suggestions to help us improve the content of the digest and make it more relevant and informative.

Dr. A. Didar Singh
Secretary General

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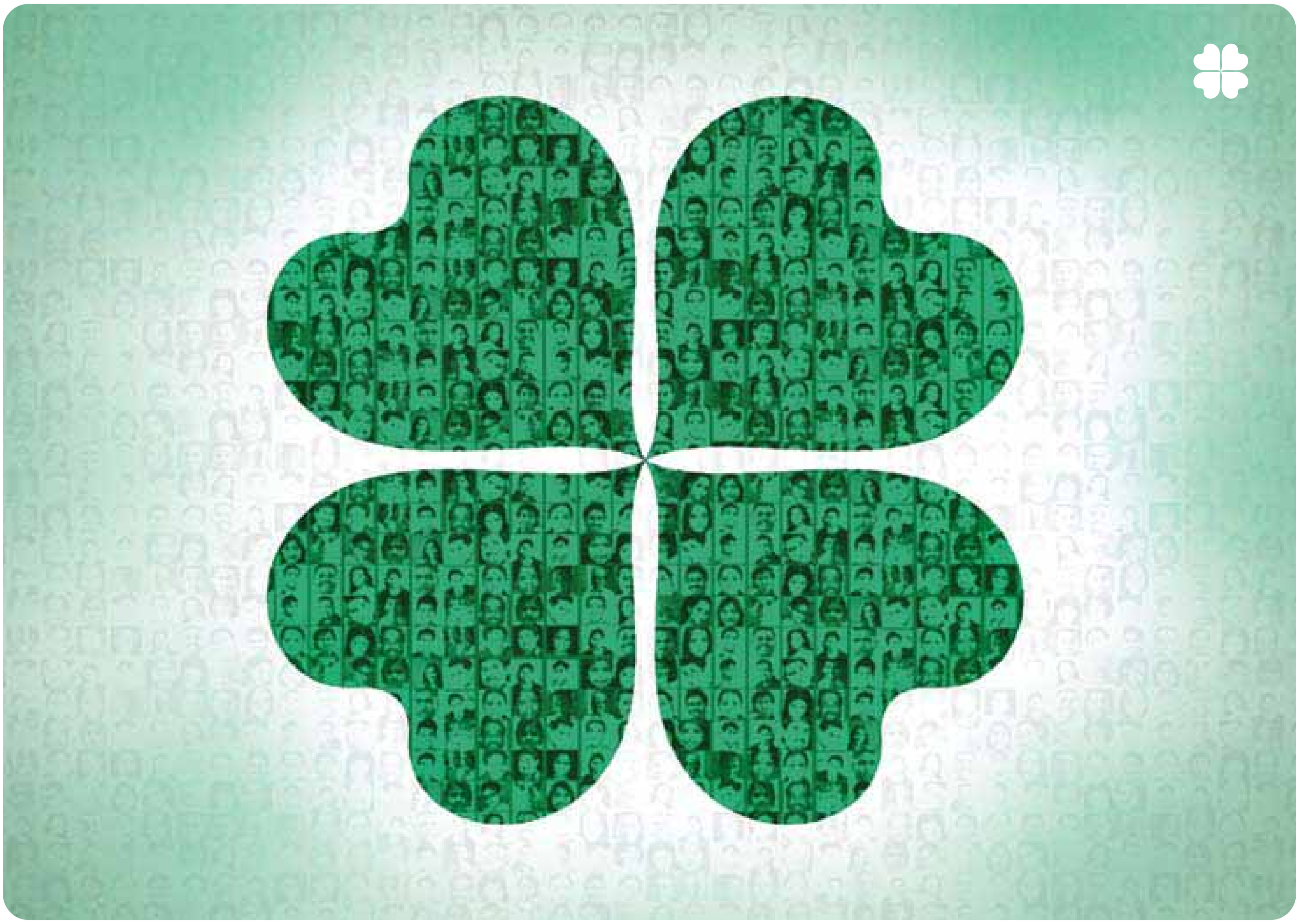

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Priority Sector Lending & Inclusive Growth

Mr. Kavi Arora
Chief Executive Officer, Religare Finvest Limited

Across variety of business and corporate world in India, the issuance of new banking licenses is being the most talked about subject. There is a clear reason for such an agenda by the policy makers at this time of domestic and international environment. The purpose of having a robust financial inclusive model is the need of the hour especially when the dependence on the acumen of western banking systems has been challenged after 2008 crisis. Emerging market like ours is a prominent market place both in consumption as well as production & for either of the processes; you need a steady capital and financial system. All the reforms from all regulatory bodies be it RBI, SEBI, IRDA and others, are cumulatively aimed at reaching every nook and corner of the country and thus building an inclusive model.

Banking which is the core of capital and financial markets has to reach to its next orbit by reaching to strata of society that has been devoured to traditional channels of the money supply. Segments like agriculture, smallenterprises, education, export credit, housing and others have been categorized under the Priority Sector Lending by RBI. Directed lending through programs such as the Priority Sector Lending (PSL) program of the RBI have had a well-established history across many countries at different points in their development curve with different purposes. In India, the PSL Policy has also been an important intervention to ensure that

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certain sectors deemed as important for national development receive adequate credit. The PSL program has been implemented by the RBI since 1974, when banks were advised to raise credit to priority sectors to the level of 33.3% by March 1979. Today this number stands at 40%, out of which direct agriculture lending has to be 18%. The queries from all stakeholders wrt the need of the program is no more the top of the mind question rather how the structure of this program should be built so that the end beneficiaries get their slice and eventually contribute to the real cause.This is a form of sponsored mechanism to push certain social and economic agenda through banking channel. As proposed in Paragraph 94 of the Monetary Policy Statement 2011-12, the Reserve Bank of India in August 2011 set up a Committee to re-examine the existing classification and suggest revised guidelines with regard to PSL classification and related issues (Chairman: Shri M V Nair). The Committee submitted its report in February 2012, which was placed in public domain for comments. Since the report has been out on the domain there have been various viewpoints around it. There is much of representation from the end user of these guidelines such as agribusiness, export oriented enterprises, housing finance institutions, education funding and micro finance. The guidelines are intended towards building an ecosystem of promoting efficient flow of capital to the sectors that matter most in terms of socio-economic inclusion through employability, education and commerce. The efforts as mentioned in the committee report are directed towards the end users of these guidelines, clarity on the providers of capital, especially NBFCs is something on which the following passages would aim.

At Religare, we have been running a successfulNBFC, with focus on Small and Medium Enterprises. We

have financed the entrepreneurial dreams of more than 20,000 SMEs across important business clusters of the country. Our own organizational setup is highly enterprising wherein senior financial services professionals with considerable experience are based out of clusters and thus building a robust credit mechanism. Like us there are many NBFCs who have been contributing to the cause of building robust lending machinery by reaching to places where formal banking system has not yet made its presence. NBFCs are also playing a vital role in furthering the cause of Financial Inclusion and in credit dispensation to customers who require credit but are thin on collateral.

Efforts by RBI are highly commendablefor itseffortsin framing revised guidelinesfor priority sector lending so as to keep a continuous focus on and further bolster the agenda of financial inclusion and poverty alleviation. Since independence, NBFCs have played a stellar role in providing organized credit at affordable interest rates to the demanding segment in the rural/ semi-ruralareas who either did not have access to the credit or were forced to approach unorganized money lenders for all their credit needs. Thus, NBFC were the pioneers in following the financial inclusion model to help uplift the vulnerable segment and provide them means for livelihood by providing finance for productive assets/activities. NBFCplay a key role in the last mile connectivity to the needy sectionsof the society and thus are a vital constituent in achieving the objective of the Government as well as RBI to provide credit to the informalsegmentswhich are largely excluded from the banking universe and thus broadening the market for automobile, mining equipment and tractor manufacturers. Today India has comparable size of the market in the world due to wider financing availability in remotest corners of the country.Nair committee had also recognized theimportant role played by NBFC and had recommended certain percentage of net bank credit in the priority sector to be routed through NBFCs.

It is also heartening to see that RBI has provided this benefitto NBFC-MFIs by way of extension of priority sector benefits to banks for on-lending to this segment of NBFCs to expand the financial inclusion. The latest notification, as published by RBI on 25-Nov-2013, of adding advances to medium manufacturing enterprises to qualify as priority sector advances is a milestone judgment and would be highly helpful in holistic growth of MSME sector.

On the other hand, the other avenues to raise funding by NBFCs are not developed in India and will take more time as efforts to deepen the corporate bond market by RBI also bear fruits.

Restoration of priority sector benefits for on-lending by NBFCs is very essential with due qualifying criteria to avoid any misuse thereof and channel the flow of credit to the desirable end borrower. The reason for withdrawal of this priority sector status to the bank lending to NBFCs for on lending to the priority sectoris understandable as ensuring the end use of the funds so lent by banks to NBFCs is a concern area by the regulator. The same can be easily done by asking NBFCs to submit documentary evidence to this effect for end use of these funds in a more diligent fashion. To be noted here is to reward NBFCs who well behave and abide to guidelines and also to penalize the one who does not.

In one of the pioneering thoughts by members of IFMR, the PSL requirement may then be viewed not necessarily as a subsidy but as a 'policy nudge' to bankers that amongst the various equally profitable opportunities that they are faced with, they should give higher priority to the PSL sectors, in larger national interest. The authors of the article also says that we need to increase the size of the financial sector and to complement banking sector resources with local debt capital markets as well so that all sectors can optimally absorb credit.

The recommendations to be implemented might be a time taking task, the clarity on the recommendations are yet to see its final avatar. There is no clear policy articulation of why certain sectors and activities are included and others not. In the same article a mention about a quote by Aditya Puri in his recently-published book on contemporary banking in India, argues that the share of agriculture and allied activities as a percentage of GDP in India has come down from 32% in 1990-91 to 15% in 2011-12, whereas the target of 18% of NBC to agriculture under PSL has remained unchanged over the decades.

Also to implement the guidelines in a meaningful manner it is important to provide the complete ecosystem of services to end users as only this can ensure that the final usage of the PSL funds would be as per the guidelines. Abhijit Banerjee in his remarkable book 'Poor Economics' has demonstrated the concept of poverty trap using an example of a poor enterprising family where in the family falls into poverty trap due to financial reasons not only due to business failure but also due to issues related health, legal and social prejudices. Banking guidelines can only provide access to finance and can function as a catalyst to support that growth. Agencies involved need to be more proactive while building policies where in PSL can act as a generator of opportunities. Also, India being a different country after every 200 kms is culturally rich and diversified and thus PSL guidelines should also accommodate the geographic constraints. The states may promulgate the agenda basis their own priorities and thus this could defeat the overall purpose of the policy. An audit process of all the stakeholders is a must for this package for an inclusive implementation.

The same media release has some interesting insights that has points to ponder. There are also significant problems in the manner in which the PSL policy is actually implemented. For example, in terms of the way PSL compliance is measured, while for commercial banks the cash reserve ratio maintenance is tracked weekly, PSL is tracked only on the last Friday of March. This policy position seems to be directly responsible for some of the 'March phenomenon' that takes the perverse form of credit being available in plenty during this window and in short supply for the rest of the year. If the intent is to help farmers with liquidity when they need it, it is not clear how a credit peak in March helps. PSL non-performing assets (NPAs) as a percentage of total NPAs are now approximately 50%. PSL NPA policies encourage banks to maintain very soft budget constraints and perhaps allow them to overstate the true value of the assets on their books.A product like Kisan Credit Card is a significant aspect of banks' PSL strategy today with loans outstanding of over Rs 1,50,000 crore. It is structured as an overdraft facility and there is really no way to accurately estimate the quality of these loans. There might be

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longerterm consequences of this policy. In particular, this would be of concern vis-a-vis large and systemically-important banks, particularly as the size of the NPA problem becomes larger than what budgetary resources can bear.Finally, volume targets are perhaps not the most onerous aspect of PSL policy today. It is the fact that PSL policy also takes a view on exactly how this must be achieved by banks, thus tying their hands as far as strategy to achieve these targets is considered.

Finally, I would like to present a three tier recommendation to bring this discussion to a conclusion, 1. Provide more clarity to the entire participants of the PSL guidelines, 2. Give more teeth to NBFCs who are supporting the said sectors by giving special status as NBFC-PSL and opening the funding lines to them with tighter reporting requirements and 3. Collaborative endeavor by FIs to implement PSL in real sense and not merely as a bottom line strategy.

To implement the guidelines in a meaningful manner it is important to provide the complete ecosystem of services to end users as only this can ensure that the final usage of the PSL funds would be as per the guidelines.

Kavi Arora
Chief Executive Officer
Religare Finvest Limited

Mr. Kavi Arora joined Religare Finvest Limited in year 2008 to spear head the group's lending division. It was his vision and farsightedness to focus on Small & Medium Enterprises (SME) lending as the core customer segment.

The company under his able leadership has traversed into being one of key SME lending financial institutions in India supporting entrepreneurs realize their dreams and thus evidencing true to the organizations vision of ' in your success lies ours'. With nearly 20 years of diverse experience within the financial services, Kavi has been associated with reputed companies such as ABN Amro Bank, ATS Services, CitiFinancial, 20th Century Finance, Consortium Finance and GE Capital. During his career Kavi has managed assignments of high repute both at domestic as well as international locations.

He has been recognized for his outstanding performance through many accolades and awards during the course of his career. His academic qualifications include a Bachelor's Degree in Commerce from Panjab University, a Diploma in Systems Management from NIIT and a Master's Degree in Business Management from University Business School, Chandigarh.

Kavi has also contributed in various SME focused forums and has written articles and whitepapers on subjects related to entrepreneurship such as Family Managed Businesses & Business Planning Tips for SMEs.

Priority Sector Lending & Inclusive Growth

***Shri R K Dubey**, Chairman & Managing Director, Canara Bank*

In India, economic growth improved significantly in the last two and half decades particularly in the post-reform period. The experience of the economic reforms in the last 25 years indicate though there have been improvements in economic growth, foreign exchange, IT revolution, export growth etc, the income distribution has been unequal and only some sections of the population benefited more from higher growth and prosperity. Exclusion continued in terms of low agriculture growth with increasing visibility in farmers' suicides, low quality employment growth, inadequate development of women and children, concentration of poverty and low human development both geographically and in terms of social categories, increase in rural urban divides and regional disparities

Inclusive growth as per the literal meaning of two words refers to both the pace and pattern of the economic growth of a country. Inclusive growth as a strategy of economic development received attention owing to a rising concern that the benefit of economic growth has not been equitably shared. Inclusive growth grants people to contribute to and benefit from economic growth. In the 12th Five Year Plan (2012-2017) the planning commission focuses on encouraging inclusive growth.

Priority Sector Lending:

The priority sector lending mainly refers to those sectors which do not get

In a country where around 50% of population is in agriculture related activities, 29.8% of population below national poverty level and only 35.5% Indians avail bank facility, the RBI has identified this as a vital step towards economic development of the country by inclusive growth.

sufficient credit on time due to lack of 'special dispensation'. Those who are directly affected comprises of mainly weaker sections of society like farmers and small scale industries.

RBI has identified certain sectors as priority sectors for easier credit. In a country where around 50% of population is in agriculture related activities, 29.8% of population below national poverty level and only 35.5% Indians avail bank facility, the RBI has identified this as a vital step towards economic development of the country by inclusive growth.

The National Credit Council in July 1968 emphasized that commercial banks should increase their involvement in the financing of priority sectors, viz., agriculture and small scale industries. The description of the priority sectors was later formalized in 1972 on the basis of the report submitted by the Informal Study Group on Statistics relating to advances to the Priority Sectors constituted by the Reserve Bank in May 1971. On the basis of this report, the Reserve Bank prescribed a modified return for reporting priority sector advances and certain guidelines were issued in this connection indicating the scope of the items to be included under the various categories of priority sector. Although initially there was no specific target fixed in respect of priority sector lending, in November 1974, the banks were advised to raise the share of these sectors in their aggregate advances to the level of 33 1/3% by March 1979. Subsequently, all commercial banks were advised to achieve the target of priority sector lending at 40% of aggregate bank advances by 1985. Sub-targets of 18% and 10% were also specified for lending to agriculture and weaker sections within the priority sector. Since then, there have been several changes in the scope of priority sector lending and the targets and sub-targets applicable to various bank groups. Only those sectors that impact large sections of the population and weaker sections and the sectors which are employment-intensive, such as agriculture, and tiny and small enterprises are included as part of the priority sectors. Presently, the broad categories of priority sector are agriculture, small enterprises, retail trade, micro credit, education loans, housing loans, etc.

Agriculture:

A comprehensive credit policy was announced by the Government of India on June 2004, containing measures for doubling agriculture credit flow in the next three years and providing debt relief to farmers affected by natural calamities. Credit flow to agriculture sector is targeted to increase at the rate of 30 per cent per year. Since 2005, the government has been subsidizing the commercial banks and NABARD to enable provision of short-term credit at 7% interest rate to the major segment of farmers. There have been vigorous and determined efforts towards expansion of priority sector credit, especially through rural banking. The Kisan Credit Card (KCC) Scheme has immensely improved farmers' access to bank credit while banks have disbursed credit for non-farm entrepreneurial activity under the GCC Scheme.

Micro, Small & Medium Enterprises (MSME):

Government of India has also announced certain measures in August 2005 for stepping up credit to small and medium enterprises enabling a paradigm shift from small scale industry to small and medium enterprises.

The MSMEs are the best vehicle for inclusive growth, to create local demand and consumption and also to fight with the global meltdown. Public policy has rightly accorded high priority to this sector in order to achieve balanced, sustainable, more equitable and inclusive growth in the country. Cluster based approach to lending is intended to provide a full-service approach to cater to the diverse needs of the MSE sector which may be achieved through extending banking services to recognized MSE clusters. A cluster based approach may be more beneficial (a) in dealing with well-defined and recognized groups (b) availability of appropriate information for risk assessment (c) monitoring by the lending institutions and (d) reduction in costs. United Nations Industrial Development Organisation (UNIDO) has identified 388 clusters spread over 21 states in various parts of the country. The Ministry of Micro, Small and Medium Enterprises has

also approved a list of clusters under the Scheme of Fund for Regeneration of Traditional Industries (SFURTI) and Micro and Small Enterprises Cluster Development Programme (MSE-CDP) located in 121 Minority Concentration Districts.

MSME sector faces several threats like access to adequate and timely credit at a reasonable cost especially by new generation entrepreneurs, inadequate availability of infrastructure, technology and skilled manpower in tune with the global trends, lack of access to alternate sources of capital (like angel funds/risk capital),delayed realization of receivables etc. There has been a burst of entrepreneurship across the country, spanning rural, semi-urban and urban areas. With increasing competition, introduction of new products and stringent regulatory environment, the role of banks needs to change from mere lenders to partners in business. There is a need for greater participation of banks in the affairs of their constituents by convergence of credit services and non credit services. The bank's staff need to trained and sensitized through customized training programmes to meet the diverse needs of MSMEs.. Time has come to build up a specialised cadre of MSME officers to give handholding and to increase credit flow to the sector in the same line how Banks have groomed Agriculture Officers for improving credit flow to Agriculture sector.

Financial Inclusion:

RBI's has initiated several Policy measures to foster Financial Inclusion. Relaxation in branch authorisation policy, promoting agent Banking models like - Business Correspondent/ Business Facilitators, simplified/ Relaxed KYC norms etc. A Bouquet of Financial services products like savings cum overdraft account, a remittance product to facilitate EBT and other remittances were introduced to make the growth more inclusive. The recent introduction of direct benefit transfer, leveraging the Aadhaar platform, will help facilitate delivery of social welfare benefits by direct credit to the bank accounts of beneficiaries.

All these efforts of the banking system in the expansion of priority sector credit led to employment generation and economic upliftment across the country. There has been a huge increase in the agriculture and industrial production coupled with substantial capital formation in agriculture and industrial fields. Despite the exponential population growth, the country is self-sufficient in food grain production. Poverty incidence has come down in rural areas.

Rapid pace of growth is unquestionably necessary for substantial poverty reduction, but for this growth to be sustainable in the long run, it should be broad-based across sectors, and inclusive of the large part of a country's labor force. In the future, the thrust of expanding priority sector credit should be in the fields which encourage diversification in agriculture, water conservation, rain fed farming, horticulture, technology resulting in increased average yields, export oriented agriculture, post-harvest technology and value addition to agriculture produce, alternate rural employment with special emphasis on micro and small industrial units, service providers, rural housing, rural infrastructure, etc.

Nearly 77.7% of India's land holdings are small and marginal farmers and fall into the category of tenant farmers, share croppers and agricultural labourers. They own very small and uneconomical land holdings, often without proper records, accessing credit from non institutional sources. For this segment of farmers, marketing of their produce is the main problem apart from credit availability and output price fluctuations. Reaching out to this section is very essential to ensure inclusive growth that we

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are envisaging in the 12th Five Year Plan. Though we have made enough inroads by way of financial inclusion and direct benefit Transfer, a lion's share of population is still away from formal banking system due to many reasons. Fear of technology, lack of awareness, illiteracy, Knowledge gap, Credit deterrence, past bad experience are the few quoted reasons. Hence, there is a need to look for efficient models to overcome these problems while achieving economies of scale for the small farmers. It is challenging to organize small and marginal farmers for collective growing/marketing and linking them to credit institutions..

Banking sector has focused more on individual approach/lending during the initial phases of financial inclusion. Though a vast population was financially included by the series of initiatives, financial deepening was lacking due to various reasons. Having improved the reach to masses in remote areas which were earlier excluded from Banking services, Banks shall now focus on financial deepening for faster and more inclusive growth.

New Initiatives:

India has ventured on many novel concepts since independence to face the various challenges of credit dispensation like SHGs, JLGs, farmer co-operatives, Farmer Producer Organisations (FPO), cluster farming etc. Extensive & careful lending to a group of beneficiaries will be more effective for inclusive growth than lending to individuals..

Self-Help Group (SHG)-Bank Linkage Programme is one of the most successful and important programmes for promoting financial inclusion through micro-finance. It has enabled banks to assist in meeting the credit needs of very poor people without sacrificing their funds and has especially helped rural women to empower themselves, both economically and financially.

Like self-help groups, the joint liability group (JLG) is yet another interesting institutional intervention that is being tried and implemented in India. Absence of the ability to provide adequate collateral security works as a major hurdle for landless/ tenant farmers in securing loans. The inability of this section of farmers to provide collateral often excludes them from the purview of the formal credit cover. Keeping this in view, financing JLGs was initiated for developing effective credit products for such clients. These products not only reduce the risk and transaction costs for banks but also allow a greater degree of flexibility for credit users to determine their credit needs and priorities. SHG which may borrow from institutions and utilize the funds for any activity specified for benefits of its members.

Co-operative Farming implies pooling together of small plots of land and their joint management. When the cultivator becomes a member of the co-operative society, he can meet his credit requirements from financial assistance extended by it. Farmers co-operatives are found to be very successful in some states in taking up minor irrigation projects.

Collectivization of producers, especially small and marginal farmers, into producer organisations has emerged as one of the most effective pathways to address the many challenges of agriculture but most importantly, improved access to investments, technology and inputs and markets. Govt. of India has identified farmer producer organisations registered under the special provisions of the Companies Act, 1956 as the most appropriate institutional form around which to mobilize farmers and build their capacity to collectively leverage their production and marketing strength. A Farmers Produce Company or Society, apart from crop production, can take up any activity in the value chain for the welfare of the members which may

Recent rupee freefall has again pointed to the fact that Indian service led economy is still dependant on the West and any policy changes have detrimental effect on our country. Hence the people have to be made resilient to such external shocks by improving small scale industries, exports and education level.

include processing, providing non agricultural services and exports.

Contract Farming is another initiative to allow accelerated technology transfer, capital inflow and assured market for crop and live stock production. Contract farming is carried out according to an agreement between a buyer and farmers, which establishes conditions for the production and marketing of a farm product or products.

The scheme of "CLUSTER FARMING FINANCE" comprehensively finds the solutions for overcoming the bottlenecks in a better manner from production to realisation. Bankers in this model can act as catalysts, right from formation to cash management, bringing together all the parties- from government agencies to suppliers, and providing access to better markets. It does not have the disadvantages of Contract Farming as the prices of farm produce are not pre determined and there is no possibility of prices going below the market prices. Since the loans are sanctioned on individual basis, liability will be limited to the individual farmers' level unlike continuance of liability in case of cooperatives / group loaning / SHGs which encourages the farmers to be prompt in repayment and get their securities released.

There is no doubt that the sectors presently identified under priority sector lending are relevant with regard to the changing scenario of the Indian economy. With the much needed focus on cluster based lending, let it be agriculture, MSME, or services sector, the classification of activities within the priority sector is getting highly complicated and the line of distinction among the sub sectors is getting narrowed. Though the share of agriculture and allied activities in real GDP has narrowed to 13.70% in 2012-13, more than 50% of population still depends on agriculture for livelihood and hence the thrust presently given to this sector needs to be continued.

Leveraging Technology for Rural Growth:

The benefits accruing from the widespread adoption of information and communication technologies (ICTs) enhance the effectiveness of inclusive growth as complementary tools. With the improvement in educational level and electricity in the rural areas, Banks can leverage their technological advantage to good use. Future is with those banks who capitalize the strengths of technology in serving the mass. Enabling farmers' accounts with debit cards will deliver convenience banking which will bring more persons to the banking channel.

Online loan application facility with tracking system for all segments of priority sector will ensure fast and fair reach to the needy. Mobile technology can be used for providing value added service to farmers other entrepreneurs by providing market information which will ensure increased market access and improved opportunity for price discovery. There are many innovations in ICT from Indian Corporate sector like e-Choupal (an initiative of ITC Limited) which link the corporate directly with rural farmers via the Internet for procurement of agricultural and aquaculture products. Gaining popularity of Social media in rural area will enable farmers to take informed decision not only related to formal credit but many other information related to production technology and price movements as well. Knowledge-kiosks which are being set up in Panchayats enable rural people to access the external world of knowledge and markets. Induction of ICT at the Panchayats level on such a large scale would lead to building an ICT culture at the level of the masses and contribute to "Inclusive Growth" through "Inclusive Governance"

The Indian banking industry received lot of accolades around the world for being resilient to the 2008-09 global financial crises. But there are opportunities galore to go a step ahead by providing inclusive growth to the society. Today, we have an explosion in banking wherein a bank's most trusted customers are not the rich but the poor. In dealing with the needs of farmers and small and medium enterprises, banks have to look for new delivery mechanisms. They must economize on transaction costs and provide better access to the currently under-served. To serve new rural credit needs, innovative channels for credit delivery will have to be found. Improvement in PSL will instill confidence among the weaker section as they will get loans at a preferred rate. However, care should be taken that such advances are not misused by people other than the needy. The risk of NPA might also increase at certain times, but the long term benefits will eventually win over short term losses. While fiscal measures like Food Security Bill will take care of primary needs, PSL will improve the structural weakness of the country in terms of education and employment. Recent rupee freefall has again pointed to the fact that Indian service led economy is still dependant on the West and any policy changes have detrimental effect on our country. Hence the people have to be made resilient to such external shocks by improving small scale industries, exports and education level. The issuance of new banking license will make the banking industry more competitive, and the existing banks have to use the early mover advantage by tapping the priority sector. Priority sector lending will remain a liability if banks remain short-sighted and follow their cliché methods of lending. It will become a plethora of opportunities the moment banks reach economies of scale in the remote areas.

R K Dubey
Chairman and Managing Director
Canara Bank

Shri Dubey is the Chairman and Managing Director of Canara Bank. Prior to this, he was the Executive Director of Central Bank of India.

He started his banking career with PNB during 1977 as Management Trainee and rose to the level of General Manager during March 2008 after working at different levels both in operation and administration.

He is the Chairman of domestic subsidiaries / Joint Ventures of Canara Bank. He is also the member of Managing Committee of IBA, Negotiating Committee for X Bipartite Settlement on Wage Revision of Bank employees, and IBA Committee on Agro Business and MSME for the year 2012-13.

He has won prestigious 'Golden Peacock HR Excellence Award – 2012' in recognition of the Bank's committed endeavours on excellence in HR Policies and Procedures and "Best Banker Award 2012" by Dr. K.C. Chakrabarty, Deputy Governor, RBI on ensuring growth of SMEs for Better Future.

Shri Dubey holds a Bachelor degree in Science, M.A. in English, followed by CAIIB from Indian Institute of Bankers. He also pursued Bachelor of Law & Masters in Business Administration – both from Bhopal University. Did PG Level Course from Development Banking from IDPM, Victoria University, Manchester (U.K.). He also completed a specialized course in strategic management of financial institutions from Christ College, Cambridge (U.K.). He was also a part of Advanced Management Programme on Leading Change: Organizational Issues & Challenges by MDI Gurgaon in Europe and London (U.K.).

Role of RBI in promoting Priority Sector Advance

Shri Shyam Srinivasan, *Managing Director & CEO, Federal Bank Ltd &*
Mr. Thampy Kurian, *General Manager, Federal Bank Ltd*

Introduction:

It is believed that banking system is the life blood of the financial system of the economy and it touches the lives of millions through inclusive growth. It has to be inspired by larger social purpose and has to sub-serve national priorities and objectives such as the rapid growth of agriculture, small scale industries and exports raising employment levels, encouraging new entrepreneurship and development of backward regions. In turn restoring sectoral balance in banking facilities and also channelizing finance to the excluded.

Major objective of priority sector lending is to ensure lending from the banking system flows in an increasing measure to those preferred sectors of the economy. It is to be noted that though these sectors contribute to a significant proportion of GDP, these sectors have not received adequate support of institutional finance in the past. The regulatory targets of priority sector were imposed as a measure to dispense banking credit prudently and socially to various preferred channels. Commercial Banks were mainly concentrating on lending to low risk large industrial houses. Eventhough Agricultural sector is the main feeder of raw material for major industrial activities and also 50% of population are taken agriculture operation as their

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livelihood, this sector was more or less neglected in getting a preferred status for financing. Consequently, there was negative growth in industrial sector and subsequently Government of India felt the need to boost Agriculture and small and cottage industries for overall growth of the economy.

Major Sectors coming under Priority Sector:

1. Agriculture
2. Micro/Small Enterprises
3. Medium Enterprises (As per new RBI guidelines valid upto 31-03-2013)
4. Education
5. Housing
6. Loan to weaker section/Govt. Sponsored schemes

Priority Sector targets and sub targets:

- The stipulated share of priority sector to Adjusted Net Bank Credit (ANBC) is
- 40% towards Priority Sector
- Out of which
- 18% to Agriculture
- 10% to Weaker sections

Interest subsidy:

The interest rate policy under priority sector and non priority sector has been stipulated. Concessional rates of interest for the priority sector advances and relatively higher rate of interest for other sectors have been special features. This is known as cross subsidization policy. Here the losses arising on concessional loans are met out of the profits from other loans. This has facilitated flow of credit at relatively lower rates of interest to the weaker and neglected sections of the economy.

Credit Guarantee:

Financing of loan accounts under priority sector may entail risk of default. Hence a separate insurance scheme guaranteeing a part of the loan of commercial banks was introduced in 1970 and the DICGC was established. The Corporation also provides deposit insurance to the depositors up to a prescribed limit. The Corporation operates various credit guarantee schemes relating to eligible credit institutions for their priority sector advances.

Regulatory initiatives to boost Priority Sectors:

A more comprehensive definition of priority sector was adopted in 1977. It was realized in the early 1980s that even within priority sectors credit flow was more to the affluent sections. So the concept of weaker section was adopted within priority sector. Eventhough Narashimhan Committee suggested for bringing down the priority sector target from 40 percent to 10 percent, this was not accepted by the Government.

There were many changes brought in by the RBI in the recent past and major changes in guidelines were revised in the year 2007 based on the recommendations made in September 2005 by the Internal Working Group of the RBI. Reserve Bank of India in August 2011 set up M V Nair Committee to re-examine the existing classification and the following changes were effected.

Major changes in different sectors:

1. Agriculture

Agri processing industries and export of agricultural produce are taken out of agriculture definition. Hence forth export is not a separate category but made within the ambit of Priority Sector. However, export of own cultivated commodities has made as part of Agriculture finance. Agro processing excluded from Agriculture sector, of course can be included in Priority Sector if it complies with stipulations specified by RBI under MSME Act 2006.

Loans to dealers / sellers of fertilisers, pesticides, seeds, cattle feed, poultry feed, agricultural implements and other inputs, the limit was raised from Rs1 Crs million to Rs 5 Crs per borrower.

- Direct Agriculture advance upto Rs. 2 crores to corporate are treated as direct agriculture advance.
- Loan limits to farmers against pledge/hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months was increased from Rs. 25 L to Rs. 50 L both under direct and indirect agriculture.
- Loans to dealers/sellers of fertilisers, pesticides, seeds, cattle feed, poultry feed, agricultural implements and other inputs, the limit was raised from Rs1 Crs million to Rs 5 Crs per borrower.

2. Major changes Industrial Sector

- In the case of SME Manufacturing enterprises, there is no upper cap in limit provided original cost of investment in Plant and Machinery does not exceed Rs. 5 Crs.
- In the case of SME Service enterprises, the upper cap of limit sanctioned is Rs. 5 Crs. Provided the original cost of investment in equipment does not exceed Rs. 2 Crs.

In order to further ease the short term credit delivery to MSME Medium sector, incremental growth in MSME medium enterprises in which investment in Plant & Machinery and

Equipments upto 10 Crores is added to Priority Sector from 14-11-2013 till 31st March, 2014. This is a major relief to the Commercial Banks.

3. Other Inclusions to priority Sector

- Existing priority sector limit for Education Loans enhanced to Rs. 10 Lakhs for pursuing studies in India and upto Rs. 20 Lakhs for studies abroad. Similarly Housing loan upto Rs. 25 L in metropolitan centres and Rs. 15 L in rural and semi-urban centres are brought under Priority Sector.
- It is also decided that loan taken on the security of FCNR/NRE deposits with a maturity period of 3 years and above shall be deducted from the calculation of ANBC.

Reserve Bank of India continued to fine-tune the prudential and supervisory policies to ensure that the banking system remained sound, resilient and inclusive. In order to achieve this objective, several policy measures were initiated as cited above.

Reserve Banks of India keeps a close eye on the implementation process by banks to ensure that the exact purpose is served. It also makes in built checks to curtail short cut methods adopted by banks in achievement of Priority sector targets.

Recommendations/ Suggestions for a structured approach towards Priority Sector lending:

- Planning Commission of India is formulating national priorities for economic development and focus areas are well explained in the 12th Five Year Plan. These shall be the focussed areas for Priority Sector lending. Presently many such national priority areas are not getting attention in new PSA guidelines.
- Presently there are separate caps for each priority sector segment. This cap is fixed for a spectrum of activities arbitrarily without assessing the actual requirements. There shall be limit for each activities and it shall be capped based on actual requirements.
- Some relaxations and interest subsidisations are attached to certain schemes to benefit the beneficiaries. In the run for achieving the targets, some Banks are concentrating mainly on segments with interest subvention as short cut for achieving overall target. It should be strictly curtailed with cap for such segments.
- Presently our economy is saddled with huge budgetary allocation for subsidies. It would be better to substitute interest subsidy with investment subsidy wherever possible.
- Agricultural sector segment has given top tag in the Priority Sector advance. It would empower farmer fraternity if agricultural processing is also included in agri sector which finally result in value addition.
- Most of the states in India have backward and progressed area. There should a system of accelerated credit dispensation to backward areas. Major chunk of allocation should be focussed towards the backward area.
- As a strategy to boost Infrastructure credit requirement, RBI may consider include certain percentage of total exposure to infrastructure sector as Priority Sector with a stipulated cap.
- Certain sectors lack clarity in defined terms. Eventhough fisheries sector is considered as part of agriculture allied activities, export of marine product is totally out of Agriculture allied activities, since none of the fishing processing units are actually into fishing. As such Export of marine products is excluded. It has to be revisited.
- Incentive for prompt repayment of loans shall be given encouragement by way of incentive to ensure better utilisation and repayment avoiding loan accounts turning into NPA.
- Presently Banks meet the shortfall in Priority Sector Targets by way of bulk Purchase/buy-out/Inter Bank Participation Certificates/Securitisation etc.

We would suggest that there should be a cap in the investment on those inorganic business achievements.

- RBI stipulated compulsory deposit in low yielding RIDF for non-achievement of Priority Sector targets for the shortfall. These deposits in RIDF are invested in different priority sector segments channelized through different agencies. Presently the investment on such deposit does not count for the Priority Sector investment by the Banks. We suggest that RIDF deposit shall be included in total figure of Priority Sector advance.
- Allocation of target to Priority Sector shall be based on presence of each bank in each state.

Conclusion:

Regulator/Banks/Govt. Agencies should join and put their head together for effective implementation of Priority sector preferences of the country and thereby fulfilling the dreams of the nation.

Shyam Srinivasan
Managing Director & CEO
Federal Bank Ltd

Shri Shyam Srinivasan has taken charge as the Managing Director & CEO of the Bank with effect from 23rd September 2010. He joined Federal Bank after having worked with leading multinational banks in India and overseas across Middle East, India and South East Asia, where he has gained significant experience in retail lending, wealth management and SME banking.

Before joining Federal Bank, Shyam Srinivasan was with Standard Chartered Bank, the largest foreign bank in India, where he was responsible for strategy, development and management of the bank's Consumer Banking Business spread across a large network of branches in India, employing over 6,000 people.

Prior to that, he was Country Head of Standard Chartered Bank's Consumer franchise in Malaysia, where he focused on broad-basing the revenue streams and delivered significant increase in profitability while developing a strong team of local professionals.

Shri Shyam Srinivasan is an alumnus of the Indian Institute of Management, Kolkata and Regional Engineering College, Tiruchirapally. He has completed a Leadership Development Program from the London Business School and has served on the Global Executive Forum (the top 100 executives) of Standard Chartered Bank from 2004 to 2010.

Thampy Kurian
General Manager
The Federal Bank Ltd

Mr. Thampy Kurian, General Manager, the Federal Bank Ltd is currently the national head of following verticals namely Priority Sector Advance, Financial Inclusion & Payment and Technology Products at the Federal Bank.

He has been heading the all India operations of the bank in financing Agriculture, MSE sector, Implementation of Financial Inclusion Initiatives viz. ICT model saving bank account 'FedJyothi', Establishment and overseeing of Federal Ashwas Financial Literacy Centres, Implementation of Direct Benefit Transfer (DBT), Aadhaar Payment Bridge System (APBS), Aadhaar Enabled Payment System(AEPS) also various electronic payment system viz. internet Banking, mobile banking, ATMs, IMPS etc. Mr. Thampy Kurian joined Federal Bank in 1976 and has performed under various capacities and roles. He has been in charge of taking care of HR matters including recruitment, promotion, posting etc. He excelled as the branch head of various branches across the country. He was also in the role of regional head of Kolhapur region and also served Large Corporate Department in its market operations at Mumbai.

Mr. Thampy Kurian is a graduate in commerce and is an ardent reader, writer and a passionate speaker. He is acknowledged as a leader and source of motivation.

Priority Sector Lending & Inclusive Growth

Mr. Rajiv Sabharwal
Executive Director, ICICI Bank

The objective of Priority Sector Lending (PSL) is providing credit to the underserved segment of population, which has got potential for growth but strives to get access to organized flow of credit. A quote from Adam Smith is apt illustration of the driver behind directed lending-"Money says the proverb, makes money. When you have got little, it is often easy to get more. The great difficulty is to get that little". In my mind, financial inclusion and priority sector lending are closely interconnected and should go hand in hand.

Today, rural India is evolving rapidly and is changing character. It has diversified from agriculture to manufacturing and service sectors. The share of agriculture in rural GDP has reduced from 42% in 2001 to 27% in 2011*. Rural India has the potential to be a sustainable growth engine of the economy. At the same time, unlocking this potential requires investment in infrastructure across the agricultural value chain.

The Bank has been actively investing to harness this growth potential. We have increased our rural and semi urban branches by about 50% in the last 18 months taking the proportion of these branches to over half of the Bank's network. We have opened about 400 brick & mortar branches in unbanked villages. We have put in place a comprehensive product suite covering the entire agricultural value chain including loans to seed/input

Financial inclusion and priority sector lending are closely interconnected and should go hand in hand.

dealers, crop loans, loans for farm equipment, agricultural term loans for irrigation and dairy and farmer warehouse receipt finance. A team of 10,000 employees are dedicated to serving this market.

The regulatory guidelines lay a strong emphasis on increasing credit flow to rural and semi urban markets and small businesses. To emphasize the same, several guidelines have been issued by the regulator from time to time to direct flow of credit to the sector. These include prescription of PSL targets for commercial banks and opening of atleast 25% of the total branches in the unbanked areas. Another recent example of the same is extension of the interest subvention scheme to the private sector banks that was earlier applicable only to public sector banks. Such directives have and will consistently contribute towards a growth in the priority sector lending. The total banking industry advances to this sector have grown from ` 0.45 trillion at March 1991 to about ` 16 trillion at March 2013. However, we feel that to further propel this growth, PSL guidelines should continue to evolve along with the market requirement.

Few recommendations can be considered in the current context to further increase the flow of credit:

1. Agri value chain - ICICI Bank has always believed in financing the farmer across the value chain. We offer solutions for financing input providers, crops, farm mechanization, irrigation and funding for setting up of facilities for processing of agricultural produce. Our experience shows that the farm sector benefits significantly with a robust input delivery system and by value addition to agricultural output.

Food processing industry is increasingly seen as a strong driver for rural economy. In order to make a product reach the consumer or user, there often are many processes or steps involved. At each stage, some additional transformation or enhancement is made to the product. The "Amul" story is a classic example of millions of small farmers benefiting from a well organized value chain with appropriate backward and forward linkages.

However, the level of processing is currently low in India. For example, as per a recent article of College of Agriculture Banking (CAB), 2.2% of the total production of food and vegetables is processed in India, as compared to 65% in the United States and China. Though India is a key producer of food products, the productivity levels are among the lowest amongst the BRIC countries. Further, only 2% of produce is stored in temperature controlled environment which shows that there is a significant need for investment in processing infrastructure. *(Source: Journal of College of Agriculture Banking, RBI- Volume 38 Issue 3 (July–Sept, 2013)*

Thus, to ensure that entire agriculture value chain gets adequate funding, agri processing should be made a part of direct agriculture in the priority sector guidelines. With this, the bank credit which is currently concentrated on specific areas would get evenly distributed across the value chain and will facilitate development of market infrastructure such as cold storage, grading facilities, processing units and quality certification.

2. Micro and Small Enterprises (MSEs) - MSEs across the country have high employment potential and contribute significantly to total output, however, only 5 per cent of total 26 million MSEs units are covered by institutional finance *(Source: Report of Nair Committee on PSL)*. Presently, regulatory guidelines have defined MSEs based on investment cap in plant & machinery in addition to the cap on the size of the loan to specified sectors. To ensure adequate flow of credit to the sector, it is required that cap on the loan size may be removed. It should also be ensured that cap on plant and machinery is revised periodically considering the changes in price index, cost of inputs and relevance in value chain. The inclusion of lending to medium enterprises within a priority sector on November 25, 2013 is a welcome change made by the regulator considering the importance of the sector.

3. Lending to infrastructure sectors- Absorption capacity of loans in rural areas depends on development of infrastructure like irrigation, roads, power, dams and bridges. We have seen that agricultural credit flow per unit of land is proportional to availability of irrigation facilities in the particular geography.

I believe that in order to sustain the long term growth momentum, India needs significant investment in the infrastructure sector for overall growth and development of rural economy. A recent KPMG report cites the Planning commission projection of infrastructure investment requirement in 12th Five year plan as ` 40 trillion*. To ensure that the rural market achieves the required infrastructural growth and development, infrastructure sector should be made eligible for funding under priority sector lending.

4. Leveraging networks at the bottom of the pyramid- Micro Finance Institution (MFI) and Self Help Promoting Institution (SHPI) based models have been playing a major role in providing credit in various underserved locations and have collectively reached out to millions of households. Banks should leverage these networks to reach out to the needy. We believe that the ultimate rationale of PSL is that the credit should reach the needy whatever may the channel of loan disbursement. Thus, if the end use of the loan intermediated by such an organisation is for agriculture, the same should be classified under direct agriculture whatever may be the modus of loan disbursement by the bank, whether, by on-lending or otherwise.

In conclusion, I would like to say that "Inclusive growth has to encompass all segments of the population not only by income but also by where they live, be it urban or rural India. The penetration of financial services and adequate flow of the same in the underserved segment is an important pillar of inclusive growth."

Rajiv Sabharwal
Executive Director
ICICI Bank

Mr Rajiv Sabharwal is the Executive Director on the Board of ICICI Bank. He is responsible for Retail Banking, Rural Banking and Financial Inclusion Business. He is also a director on the board of ICICI Prudential Life Insurance Company Limited.

Mr Sabharwal joined ICICI Group in 1998 and has held leadership positions in credit policy, debt management, business analytics, mortgage finance, consumer loans, credit cards, rural and microfinance lending and financial inclusion. His contribution in the growth of mortgage and retail business is widely acknowledged in industry circles and within ICICI Group. He also has considerable knowledge in securities and portfolio management segments as he has been on the investment advisory committee of ICICI Prudential Asset Management Company's Real Estate PMS since 2007.

Prior to joining ICICI Group, Mr Sabharwal worked in the Consumer Durables Marketing, Commercial Finance and Retail Finance business at Godref, SRF Finance and GE Capital respectively. In January 2009 he joined Sequoia Capital, a leading venture/growth capital company and worked as Operating Partner focussing on the financial services sector.

Mr Sabharwal received an MBA from the India Institute of Management Lucknow, and Mechanical Engineering from the Indian Institute of Technology in Delhi.

Priority Sector Lending (PSL) and Inclusive Growth

Mr. R Raghuttama Rao,
Managing Director & Chief Executive Officer, IMaCS[1]

As per the Reserve Bank of India (RBI), "Priority Sector" refers to those sectors of the Indian economy that may not get timely and adequate credit in the absence of a special dispensation. Typically, these are small value loans to farmers and allied agricultural activities, micro and small enterprises, poor people for housing, students for education, and low income groups and weaker sections. Besides, Priority Sector (PS) also includes other categories of loans as announced by the RBI from time to time. The origins of Priority Sector Lending (PSL) can be linked to the voiced need in the late 1960s in India for "social control over banking" in line with the prevailing socialistic political mood in the country. The idea gaining currency was that banks should be allocating more credit to social sectors of the economy. Post the first round of bank nationalisation in 1969, PSL was introduced in 1972 on the basis of recommendations of the Informal Study Group constituted by the RBI. In 1974, RBI advised banks to increase PSL to one third of their overall credit by March 1979. As per currently prevailing norms, every domestic bank with greater than

Legislating behaviour by binding all banks to extend PS loans, irrespective of their capabilities to do so or independent of the credit-worthiness of the borrower, is either likely to result in gross shortfalls or a lot of bad loans or both.

[1] IMaCS is a wholly-owned subsidiary of ICRA Limited, and focuses on Policy and Strategy Consulting

20 operating branches should ensure that at least 40% of its Adjusted Net Bank Credit[2] is lent to specific segments that qualify for PSL, of which Agricultural segments should comprise at least 18%, and Advances towards Weaker Sections another 10%. For foreign banks with less than 20 branches, the corresponding norms for PSL are 32% for overall exposure with no specific sub-targets for Agriculture or Weaker sections.

Even after 30-35 years of PSL prescriptions, most banks have struggled to comply. This begs the question as to why is it that despite the regulator's repeated directives, the PSL regime has not resulted in inclusive banking as desired. Today, banks are seen as a commercial entities, and regulation is pushing them towards maximising profits to enhance their viability and the collective stability of the banking system; on the other hand, the PSL regulation is pushing banks to make developmental loans which do not recover their full costs. Is it the case that conflicting prescriptions of being profitable and poor-friendly create confusion in the minds and actions of bankers? In the aftermath of bank nationalisation, the concept of subordinating profits gelled with banking objectives, but that is not the case today. Despite pushing hard the norms of PSL in more or less the same garb for 35 years, if less than 40% of the country is financially served by the formal banking system, the reasons are not hard to see – money will not flow to places where the return path is not obvious or cannot be protected. Legislating behaviour by binding all banks to extend PS loans, irrespective of their capabilities to do so or independent of the credit-worthiness of the borrower, is either likely to result in gross shortfalls or a lot of bad loans or both. The reality is that loans given to marginal borrowers who are not bankable does not reduce poverty or create employment in a sustainable manner as much as making well-appraised loans to borrowers, large or marginal, rural or urban who eventually pay back the loans and seek more for growth. This article talks of three specific points to bring some more clarity to the difficult area of PSL.

1. The Committee[3] which reviewed the PSL regime in 2012, and came up with a comprehensive set of recommendations, did not change the basic existing architecture of PSL regulation. The Committee analysed several facets of PSL, and eventually concluded that the prevailing objectives are relevant to the cause of economic and social development of the country, and essentially made changes to the form rather than the substance of the guidelines. There should be no quarrel on whether PSL is required, but one should deeply think why it has not succeeded in deepening banking activity as much as desired for four decades and therefore, what substantive changes might be in order. When the PSL norms were first mooted four decades ago, they were in line with the then national priorities, such as food shortage, low industrial base, shortage of foreign exchange, under-developed financial system, and so on. Surely, the national priorities have changed over the last four decades, as India has moved up to middle income level status and integrated much more with the global economy. E.g. the emphasis now should be to increase employability and skill upgradation and not as much employment protection of specific set of persons, or to create basic infrastructure and improve competitiveness of the economy, thus creating more jobs. The size of agriculture relative to overall GDP has been shrinking and therefore there is a case for reviewing the share of credit to agriculture in the PS dispensation. The nature of agriculture has also changed significantly in this period requiring re-direction of credit – E.g. there is increasing functional consolidation of landholding (without change of ownership commensurately), contract farming has grown, there is greater application of modern technologies, and there is rising automation in several states. However, the accent of PSL seems to be towards marginal and small farmers who are working under difficult conditions, which make the loans risky and bankers reluctant to lend. Instead, PSL norms should nudge bankers to incentivise marginal farmers to adopt modern methods and viable models of farming rather than direct bankers to lending more to marginal farmers compulsively to maintain an unviable status quo. Another indication of anachronismis that today about 60% of the national economic activity is centred in urban areas, where there is a steady migration of persons and the PSL norms do

The overall objective of the PSL regime of making banking more inclusive is correct, but the rigidities of classification of various sub-segments and a lack of congruence between the targets and banker's interests make it hard to comply.

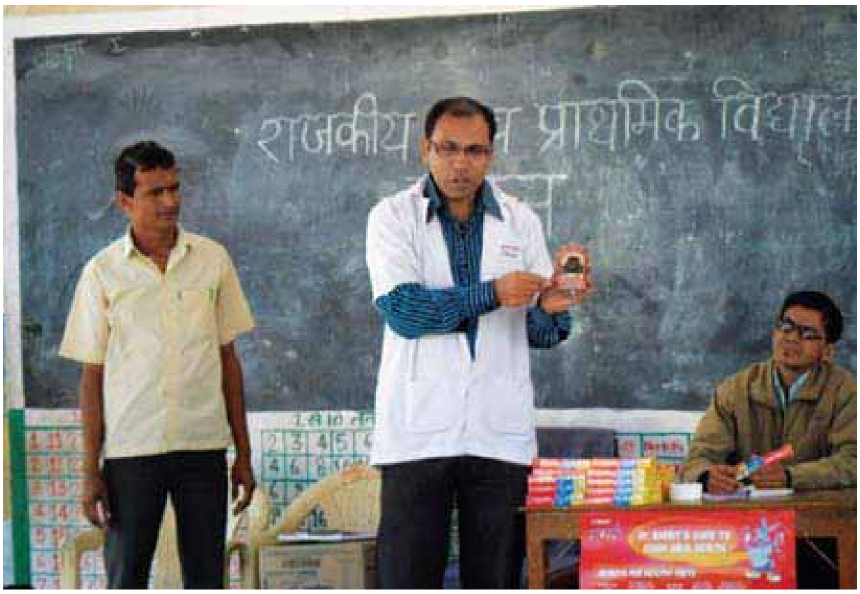
2 Computation would be based on greater of Aggregate Net Bank Credit or Credit Equivalent of Off-balance sheet exposure.

3 Chaired by Mr. M.V. Nair, then CMD of Union Bank of India

not do enough here. In many urban centres, a good fraction of the working population is migrant but only a few sub-segments of these qualify for PSL category. Most of them are self-employed or work in the unorganised sector, and banks prefer not to lend to them as they do not fit the traditional borrower's template (lack of collateral or proof of identity etc.), and are therefore targeted by the non-banks, micro finance entities or the local money lenders. Third, most lending to Infrastructure sector is not considered as PSL, while by nature, infrastructure assets enhance social inclusion. Fourth, despite the rightful inclusion and stress on lending to MSME sector, the same has not benefitted from adequate credit from the banking sector. One of the ideas in the Nair Committee was to not encourage banks lending to "medium" sized MSME units, as they were found to be getting sufficient funds for growth. Instead, bank lending to "micro" segment has been made a specific target under the PSL. Again, this kind of regulation incentivises small units not to grow and attain scale and competitiveness as bank funding would be denied to them as they grow larger. Successful entrepreneurs tend to create multiple small units rather than consolidate operations.In turn, the banks are pushed by regulation towards the wrong end of the MSME scale which only increases scepticism towards micro-borrowers. A win-win situation could be created if the PSL regulation could nudge banks to lend to those 'micro' and 'small' units who put in the right governance structures to become bigger ('medium' units) and more competitive. Clearly, directing credit to small units (many of which are unviable with no incentive to get better) cannot be a prescription to deepen inclusiveness.

In essence, the overall objective of the PSL regime of making banking more inclusive is correct, but the rigidities of classification of various sub-segments and a lack of congruence between the targets and banker's interests make it hard to comply.

2. Regulation must recognise that commercial banks are not always the best vehicles to extend all the PSLs that this country requires. Unlike two or three decades ago, today there are several non-banking organisations that have scaled their operations in financial services, including NBFCs, private equity funds, Housing Finance companies, micro-finance institutions, cooperative banks, etc. Surely, their services can be more enlisted by the RBI to deepen financial inclusiveness. Over the years, the emphasis of PSL regulations seems to be that banks should make the loans directly on their balance sheets, and not through other intermediaries. Instead the basic objective of RBI's priority sector lending programme should be to enable all subsegments of economy (in particular, those that would not get commercially lent to) gain access to finance at reasonable rates (again "reasonableness" has to judged from the point of view of affordability to both lender and borrower, and also what the alternative is). It cannot be the case that the best way to reach loans to the under-banked is that each commercial bank should lend 40% of its net bank finance to a set of specified borrowers irrespective of whether it is profitable or cost effective to do so. In the era of specialisation and cooperation between different organisations, it will serve the system better if banks could partner with other entities that are better suited to provide PSLs, and confine their direct lending to their own areas of strength. Bank lending (refinancing) to other specialised entities should be encouraged and such lending should be counted as part of PSL in a more active manner than is the case now.



With regards to the small value loans, especially those made to farmers and rural households, it has been demonstrated over the past two decades that micro-finance institutions have been very successful in both offering and recovering such loans. While the MF sector did have its share of turbulence in the past few years, there are signs that most of the leading players have overcome the problems and with the new regulation stabilising, micro-finance loans are growing again. Clearly, micro-finance calls for expertise of a special kind for indentifying local issues, engaging with borrowers in their language, conducting risk appraisals on the basis of understanding local context, making the disbursements and managing a large number of small ticket loans economically – all of which most commercial banks are clearly not geared to do for various organisational reasons. Therefore, there is a good argument for banks taking on the portfolios/loans ofMFIs by way of PCs/securitisation on a large scale rather than doing it on one's own balance sheet.

Mortgage finance has world over been accepted as one of the engines of economic growth, and involves specialised operational capabilities. Banks in India have entered this segment only in the last one decade or so. There are more than 50 specialised housing finance companies, some of which have developed deep expertise in this area. Again, this is a case where securitisation can be implemented and encouraged by making such portfolios eligible for PS status. On the other hand, one sees several banks trying their hands at manufacturing mortgage products, and not very successfully at that. It would be better if banks lending to mortgage finance companies can be treated as PSL, provided the finance companies adhere to certain norms and standards. A similar case can also be made for treating bank loans to NBFCs that lend to transport operators as PSL. Clearly, banks are not geared for lending to this segment, and several NBFCs (which are regulated by the RBI) have proven their good standing in this area over decades of successful operations.

3. A related third change required for making PSL regime more effective is that RBI should encourage the use of innovative financial mechanisms that enable the separation of manufacture and distribution of financial products to various priority sector sub-segments, including the informal sector. The Business Correspondent model is a good beginning, but the definition of BC should be wider and include other players in the financial sector. All banks do not have the same capabilities to "manufacture" various types of PS loans. Some banks have developed expertise in evaluating the

needs of specific borrowers and the associated risks, while not having the expertise to structure other types of PS loans. Mandating all banks to achieve the same level of PS norms irrespective of internal capabilities to do so, results in misdirected loans of a high order. Instead, it would be desirable if banks could share portfolios (risk and return) without necessarily sharing the customer relationships with other entities, by use of appropriate instruments (credit derivatives, PTCs, PCs, etc.) and qualifying for PS norms.

Even the Nair Committee while recommending the use of participatory certificates at a pilot level, appears to prefer individual banks to manufacture PSLs themselves rather than take over PSLs from other banks. Non-banks are largely out of contention for creating PSLs on a systemic basis, which is a restrictive use of the capabilities of the Indian financial system. NBFCs onlend a good part of the aggregate credit of the Indian banking system, directing the credit to several segments, such as road transport operators, construction equipment operators, infrastructure assets, micro consumer loans, and small businesses and industries in large measure. Many of these segments can be construed to be priority sector in some manner, although they do not so count, unless lent to directly by banks. One may ask, how do such loans become any less priority just because these borrowers chose to borrow from NBFCs and not banks directly? In more ways than one, these NBFCs bring capabilities that banks do not possess in adequate measure to lend to the concerned segments. Securitisation is an acceptable mechanism for distributing loans created in one bank/institution to other institutions; however, PSL regulations have not consistently recognised securitised loans and second, the securitisation guidelines do not enable viability of securitisation business in India. Another mechanism that has been occasionally discussed is the concept of tradable permits within banks. It is not clear why such a system that is overseen by the RBI cannot be implemented, as it would bring a market-based solution with incentives and disincentives built in to move credit to priority sectors. It will also incentivise a few banks that are better placed in terms of capabilities and networks to originate PSL to get better at this, while for banks that are not so good at it, will be forced to pay a market price for acquiring the necessary amount of permits.

Conclusions:

Given that Basel II (and now Basel III) norms are forcing banks to increase internal profits to cover risks and provide for additional capital towards unforeseen risks, the PSL guidelines should also enable banks to make such loans profitable. Else, it would be better if Government provides for subventions in a transparent manner (e.g. a bulk subsidy to a bank for a given volume of PSL or direct financial transfer to the borrower) so that PSLs are fully priced and banks are not confused with regards to pricing or recoveries. The guarantee funds for MSME units and the proposed fund for guaranteeing agriculture loans are in the right direction, and if implemented well, should yield positive results.

PSL is a regulatory stipulation of the social banking era of the 1960s. Little has changed in the manner it was conceived and structured and over the years, RBI has largely tinkered at the edges. Indian Banking industry has evolved significantly over the years, and at present, several momentous changes are being contemplated in terms of a new licensing policy for private banks and opening of the sector to foreign banks. Inclusiveness in the Banking industry has gathered significant speed, and several bankers are converting to the view that inclusive banking and profitable banking need not be mutually exclusive. It is in this context, that RBI has to restructure comprehensively the edifice of Priority sector lending by making a more comprehensive use of the Indian financial system rather than just forcing every bank to lend 40% of its ANBC towards PSL.

R Raghuttama Rao
Managing Director, IMaCS

Mr. R Raghuttama Rao is the Managing Director of IMaCS (ICRA Management Consulting Services Limited). He has a Post Graduate Diploma in Management from IIM Ahmedabad, and is a Bachelor of Technology (Mechanical Engineering) from IIT Madras.

He is a qualified Cost Accountant and was a Fulbright Scholar at Carnegie Mellon University, Pittsburgh, USA.

Mr. Rao is a member of ICRA's start-up team, and has contributed to developing many areas of ICRA, including Credit Rating, Management Consulting, Analytics, IT, and Research. He has served on ICRA's Rating Committee for about ten years, and has experience across several sectors, including infrastructure, banking/finance, structured finance, manufacturing, and energy.

Mr. Rao has been the driving force behind diversification of ICRA into management consulting, which has now been demerged into a separate entity IMaCS. Mr. Rao has wide consulting experience in areas of Strategy, Public Policy, Risk management, and Governance. He has consulted with organisations in many countries across Asia, Europe, North America, and Africa. Mr. Rao is a regular speaker in domestic and international conferences.

Priority Sector Lending & Inclusive Growth – The Top Fortes of Futuristic Indian Banking

Shri Mahesh Kumar Jain
Executive Director, Indian Bank

Priority Sector Lending is an accepted concept amongst Indian Bankers and Inclusive growth (a changed banking landscape) is the "Tharaka Mantra" for the present day bankers. Banks are the cornerstones of the strategy for the achievement of development objectives of the Government and the concept of Priority Sector has been in this country for the past 39 years. The nationalization changed the orientation of commercial Indian banking from "class banking" to "mass banking." There are very few parallels in the history of banking in the world where such large-scale geographical expansion and functional diversification of banking (with social and developmental orientations) took place. Indian Commercial banking which started with 8262 branches in 1969 touched 1,02,343 branches in 2013. It is said that a robust banking sector is seen vital to meet the aspirations of the economy through adequate and affordable credit delivery system to the needy agriculturists, landless labourers, micro and small entrepreneurs

Despite thrust paid by Govt. and regulator on one side and the willingness of the Bankers to open branches on the other side, the penetration of Banking into villages still remains far from satisfactory.

Priority Sector Lending by banks (Amount in Rs. billion)			
As on the Last Reporting Friday of March	Public Sector Banks	Private Sector Banks	Foreign Banks
2011	10,215 (41.0%)	2,491 (46.7%)	667 (39.7%)
2012	11,299 (37.4%)	2,864 (39.4%)	805 (40.8%)
Figures in parentheses are percentages to ANBC or credit equivalent of off balance sheet exposure (OBE), whichever is higher, in the respective groups.			

(Source: RBI Annual Report 2012)

and the like who are at the bottom of the pyramid.

The definition of Priority sector has been evolved over a period of time. Starting with Weaker Sections of Society, it branched out to all farming activities, micro and small scale industries, housing, education, retail trade and other smaller sectors. The following table presents the position of Priority Sector Lending by the Indian Banks.

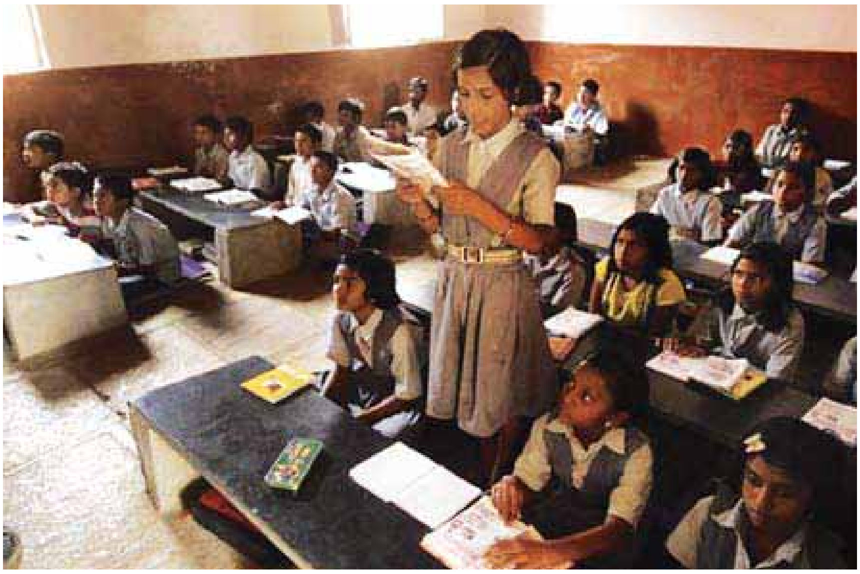
The domestic banks, both, public and private sector, could not achieve the target of 40 % for the year 2012 as is visible from the above table. Despite thrust paid by Govt. and regulator on one side and the willingness of the Bankers to open branches on the other side, the penetration of Banking into villages still remains far from satisfactory. The proportion of rural branches to total branches of scheduled commercial banks (SCBs) has seen a sharp decline from 57.16% in 1994 to 37.18% in 2013. It was observed that there was decrease in the allocational efficiency despite the fact that improving operational efficiency and access to technology over this period had enhanced the capability of banks to better serve rural habitations *(Source: Speech by Dr. K C. Chakrabarty, 2013 at FIBEC 2013)*. Though branches of Indian scheduled commercial Banks have been increased, still around 6.4 lac villages do not have a bank branch. This untapped geography represents over 720 million mostly defined as rural or semi urban, mostly working in informal sector, many of them being women and gen next waiting in the fence for an opportunity to get a taste of basic banking services. The sector wise projected growth rates of agriculture, industries and services during the 12th FYP (2012-17) are 4.0, 9.0 and 10.0 percentages respectively.

As per 59th NSS Survey, households with 2 hectare or less land accounted for 84% of all farmer households. The percentages of such small and marginal famers who have access to credit is only 46.3%. Only 320 million out of wide 120 billion population have Basic Savings Bank accounts. The availability of Commercial Bank Branches per 1 lakh adults is 11.38; Loan Accounts with Commercial Banks per 1000 adults is 151.06 indicating the need to create more avenues to reach the unreached *{Source: Report of NSS 68th Round (2013)}*. In a recent data released by FIBAC & RBI, there is a clear indication that the proportion of bank credit going to agriculture and SSI sectors has seen a steady decline from 30.03% in 1994 to 17.95% in 2013 *(Source: RBI Dy, Governor's speech at FIBAC 2013)*. The year 2012-13 was marked by a slowdown in the growth of credit to all productive sectors, viz., agriculture, industry and services. The slowdown was the sharpest for agriculture and allied activities. In 2012-13, credit to priority sectors by public and private sector banks was 36.3 per cent and 37.5 per cent respectively. In 2012-13, the retail loans portfolio continued to grow in double digits.

The Sectoral (Occupation-wise) credit growth in respect of different priority sector *(Source: Sectoral & Industrial Deployment of Bank Credit Return – Oct, 2013)* showed that credit to agriculture increased by 13.2%; Industry by 15.9% and Services by 21.7% and 'Housing Loans' increased by 14.6 % while personal loans by 16.4% as compared to Oct. 2012. Some of the concerns of Priority Sector lending are listed below:

- Timely and cost effective credit
- Significant slowdown in economic activity and exports after 2009
- Creation & maintenance of quality assets especially in MSEs
- Very high risk perception lending to SME sector
- Lack of reliable and transparent data / information
- Lack of technically skilled personnel in the banking system
- Technological progress has not been accompanied by internal reforms in bank
- Failure to adopt Business Process Re-engineering by the banking system
- Security concerns of the technology to protect against the frauds and hackings.

The market demand of the mass market needs to be analyzed in terms of products, size, stock of financial services and population. As regards the credit services, the rural credit demand is projected/ extrapolated from micro credit demand. About Rs. 3.85 lakh cr. is just smeared over 48% of the farms. Micro credit demand is extrapolated at 3 lakh cr. for 200 million households earning less than 1 $ a day and in terms of rural credit it may need to be extrapolated to the needs of 110 million farms in India. With regard to farm credit, the present stock of Rs. 6 lakh cr. represents the needs of 40% of the 110 million farms; 70% of 110 million holdings may need farm credit which translates into 77 million farms and with the average need of Rs 50000 per farm, it comes to Rs. 38,50,000 crores which is ten times of the present stock. *(Source : BANCON 2013 Publication).*



The Road Forward:

- Similar to Joint Liability Groups, formation of Farm Producing Organizations can be one way out to increase productivity in agriculture. These organizations can form Farm Production Groups with 10 - 50 farmers per group and they can be lent as Farm Joint Liability Groups. Banks can finance such groups for on-lending to farmers which will reduce the NPAs too as the organizations will ensure creation of quality assets as well monitor the farms too.
- Encouraging Contract Farming is a vital element at raising the level of food processing from 2% to 10% in the next 10 years. India will need an investment of Rs.1.4 lac cr. to achieve this. The share of the nation in the global agriculture market is expected to touch at least 10% annual growth over the next 5 years.
- Standardization of farm credit systems and procedures needs immediate attention as Indian agriculture is an embodiment of varied crop cultures influenced by monsoons. Developing Scoring models for various farm financing activities should be a better proposition.
- Creation of more irrigation potentials especially micro-irrigation systems and encouraging Private participation / Joint venture participation through Special Purpose Vehicle (SPV) in agriculture. The "Pani-Panchayat Models" of Maharashtra can be best followed and banks can finance them.
- Encouraging private investment in seed production, cold chains and establishment of large and sophisticated controlled atmosphere cold storages, construction of market yards and all infrastructure for post- harvest operations will facilitate smooth financial flow to this sector.
- Enlarging the scope for Hi Tech Agriculture (like tissue culture, cut flower production through green/poly-houses, computer controlled poultry units, modernized cold storages, agro/food processing units as value added proposition) and financing end-to-end solutions in agriculture.
- The demand for milk is likely to reach 180 million tonnes by 2022. To supply the market, an average incremental increase of 5 million tonnes per annum over the next 15 years is required – a doubling of the average incremental rate achieved over the past 15 years. *(Source: World Bank Report, July 2012)*. This needs to be addressed by focusing on financing dairy development which will add value to Dairy industry through application of new processes, packaging and mechanised manufacturing systems.

MSME Sector:

- India is the fourth largest economy in the world (in PPP terms) and the second largest in developing Asia. India accounts for 22 % of GDP, 33.8 % of population and 32.5 % of potential workforce in developing Asia. In the next 10 years the country will add 120 million to the region's workforce, accounting for 53 % of the incremental addition. Its growth story is evident from the increased investment in infrastructure, abundant job opportunities in big and small cities, healthy balance sheets of companies and the heightened growth of consumerism *(Source: D & B Report, India 2020- Economy Outlook-2012)*. The MSME sector represents about 45 % of manufacturing output, 95 % of the industrial units, employment to almost 60 million people and

40 % of exports and is the largest source of employment after agriculture sector. Development of this sector, thus, holds key to inclusive growth and plays a critical role in India's future.

- If we have to achieve GDP growth of around 8 to 8.5%, we have to focus on SME Sector and provide necessary support. SMEs are promoter driven companies with limited resources. Over 90 % of MSME sector is represented by Micro enterprises. There are more than 100 lakh MSME units in India with an investment of more than Rs 1 lakh crore that produce more than 8000 products. The sector has recorded double digit growth in the last four years. However, SME sector expects an incremental shortfall of 240 million to 250 million people by 2022 in 20 high growth sectors of the Indian economy. Over 13 million people are required every year in 90 skill categories. It is to be indicated that 12.8 million youth enter the job market every year *(Source: Innovation: Changing MSME Landscape, CII Oct 2011)*.

Potential in Service Sector:

- India's economic growth during the current decade is expected to be driven by the buoyancy in the services sector. According to India's Macro-economic outlook 2020 *(Source: D& B: India 2020: Macro Economic Outlook 2020: d&b. co.in)*, the services sector is expected to record a growth level of 10.2% by FY20. While the growth in trade, hotels, transport and communication segment is expected to drive the growth, it would be the strong growth in the financing, insurance, real estate & business services segment which would lead to the higher growth in the services sector.
- The thrust in infrastructure, increased focus in services export, major initiatives for financial inclusion and increase in per capita income would help boost the services sector. The proposed measures in the 12th plan to sustain the IT-ITeS industry's growth momentum through creating an enabling policy environment, supporting the small and medium enterprises, providing competitive edge through fiscal benefits, creating innovation fund and incubation, building world-class infrastructure in identified tier II & tier III cities would provide a considerable push to Service sector.

Financial Inclusion and Inclusive Growth:

- Financial Inclusion is no longer a dream but a reality in India. Govt. of India and RBI have taken lots of initiatives in making India a strong inclusive growth country. Accordingly, the Financial Inclusion Plan was drawn and being implemented all through India. However the market demand indicates the following: Currently 300 million households are covered with savings services accounting for 27% of the demand and a huge potential of 110 million farms and 850 million households earning less than $ 2 a day offer a huge opportunity for banks to design need based savings product. 90% of the Indian population & 88% of the Indian workforce (the majority of the unorganised workforce) are still excluded from any kind of insurance and pension and the scope for pension service is of the magnitude of Rs. 201.3 bn per year. Micro Credit has the potential of 3 lakh cr. and the present coverage is Rs. 26,000 cr. *(Source: BANCON Compendium - 2013)*.
- Today multiple options are available to reach the unreached from brick and mortar banking to

90% of the Indian population & 88% of the Indian workforce (the majority of the unorganised workforce) are still excluded from any kind of insurance and pension.

branchless banking. The models target the mass markets through Branch banking, Self Help Groups, Micro Finance Institutions, BCs and PoS terminals, Internet Kiosks, Mobile banking, Ultra Small Branches (USBs), Onsite and Off-site ATMs, Micro ATMs, Mobile ATMs with ICT-enabled Mobile Banking Van (MBV), White labelled ATMs, Smart cards and electronic Kisan Credit Cards.

The Road Forward:

- The financial inclusion on liabilities side of the households are covered to a certain extent. However on asset side of the households is yet to take place. In the absence of past history or informations, banks are facing problem in assessing the credit worthiness of small income groups of rural and semi-urban households. However, there is an imperative need to create a micro socio- economic status data base if the credit needs are to be really assessed by the Bankers. Developing score cards for various micro-economic activities under Financial Inclusion can add value to Financial Inclusion.
- Strengthening the existing Business Correspondent models using internet based kiosk banking model will migrate the BCs to kiosk banking system.
- MFIs provide services to over 200 million people around the globe, and most financially excluded people still lack access to finance. The availability of 3300 MFIs with 33000 cr. is a small drop in ocean when compared to the actual demand forecasted at 3,00,000 cr. on this micro segment *(Source: Report of the 67th Standing Committee on Finance 2012-13*). Micro finance needs to be leveraged to advance financial inclusion by creative partnerships, models and products.
- Up-gradation of Information Technology: Banks modified their approach towards low value accounts of vast neglected mass population and started adopting "High Volume – Low Margin – High Profit" business models backed by technology. Techno-products like mobile banking, Internet banking, ATMs, ICT enabled Mobile vans etc. have the fastest reach. Priority Sector clients expect banking at a low transaction cost and at their doorsteps. The operating costs of the available lending models are far higher than the margin of profits they generate. There is a mismatch between the costing and pricing. With the advancement of technology and creation/ combination of available products, the pricing structure should be realigned to create profitable model/s to suit different clientele needs as is being followed in Thailand and Indonesia and some of the Asian countries.
- Indian mobile subscriber base has shown a year on year growth of 43.23%. According to recent reports, with 903.09 tele-subscribers in India and among 873.36 million, only 431 million have bank accounts. The projected tele-density by this year end is 1.159 billion covering 97% of population *(Source: Report of Telecom Regulatory Authority of India, June 2013)*. It is said that banks can reach larger masses through Unstructured Supplementary Service Data (USSD) based Mobile Banking.
- In India, the financial transactions through ATMs is around 77.1% and the share of non-financial transactions is 22.9%. The total onsite and offsite ATMs operated are 1,21,617. The market size of ATM cash management system in India is INR2,105.3 cr. However the ATMs per 1 lakh adults is 11.21 which by itself explains the need for extensive growth. As you travel through remote corners of India, you realize just how difficult it is to find an ATM. This is because of high cost of installation and maintenance of ATMs. But the solar-powered Gramateller Duo ATM that consumes lesser non-air conditioned space and power is set to bring in a transformation. With 35-40% lesser initial cost and a power consumption of 300-600W, the operational cost

will be just Rs.600-700 which is 10 times lesser than the exiting ATMs. World Bank's IFC expects the ATM market in India will grow three-fold over the next three years with the bulk of machines bound for remote areas. The immediate demand for the solar ATMs reflects and empowers quietly surging Indian rural economy, estimated to be worth about US$450 billion which is expected to overtake the urban market in size by 2017. The investment in Mobile ATMs embedded with ICT-enabled Mobile Banking Vans (MBV) have enormous scope to reach the unreached.

- Banks can devise small cash micro-loans products as part of the contractual arrangements for a basic bank account that is also designed to receive batch-processed G2P (Government to Person) social transfers.

Financial Inclusion and Financial Literacy are two sides of the equation. While Financial Literacy stimulates the demand side, financial Inclusion acts from supply side by providing financial market/services that people demand. Therefore, access to financial services and Financial Education must happen simultaneously. It must be continuous and ongoing process and must target all sections of the population. Banks should organize Financial Literacy Programs through Financial Literacy Centres on line with Adult Literacy Programs organized through Functional Adult Literacy Centres of the past.

By 2025, India could become a $5 trillion economy and among the "top five in the world". Banks should prioritize their priority sector lending portfolios. When agriculture, micro and small scale industries can bring transformations to this rural based country, which accepts that technological innovations alone could bring prosperity to the livelihoods, introducing innovations towards a complete inclusive growth should be a visible happening than a dream. What we will become depends on us and the choices that we make and to make or break is our choice.

Mahesh Kumar Jain
Executive Director
Indian Bank

Shri Mahesh Kumar Jain, aged 52 years assumed charge as Executive Director of Indian Bank on 27th September, 2013. He holds M.Com., MBA, CAIIB, CFA and FRM to his academic credit. He acquired CFA from the Institute of CFA, Hyderabad in 1993, MBA from FMS, Delhi University in 2004 and FRM from Global Association of Risk Professional (GARP), USA in 2005.

Prior to joining Indian Bank, he was the General Manager of Syndicate Bank. He has worked in several parts of the country and acquired vast experience and expertise by handling important portfolios that include Credit, Operations, Risk Management etc.

In Syndicate Bank, he headed the Mumbai Region, the largest in the Bank, worked as alternate GM of Treasury and International Banking and as Chief Risk Officer of the Bank. He was a member of all the important committees of the Bank and set up the Integrated Risk Management Systems in the Bank. He developed and patented Credit Rating Models for the benefit of the Bank. He was instrumental in the highly successful issue of Bank's MTN Bond programmes and finalizing the Bancassurance JV. He coordinated with high profile consultants and vendors such as BCG, E & Y, IBM, SAS, POLARIS, WIPRO etc. on different projects of the Bank.

He contributed for the progress of the Banking Industry as well, as a member of the Steering Committee on Risk Management of IBA and as Member of the IBA working group on Risk Management and implementation of Basel II and III. He was also the Secretary & Coordinator to Basant Seth Committee on Review & Revamp of Internal & Concurrent Audit System in PSBs. He has delivered a number of lectures as Panelist in reputed Institutions such as CAFRAL, ASSOCHAM, SAS, IBM, IIM Bangalore etc.

He is widely traveled and has visited a number of countries that include England, Netherlands, Germany, Switzerland, Singapore, Malaysia, Thailand, Hongkong and Singapore.

NPAs and the need for healthy markets for credit risk instruments

Dr. V Shunmugam
Chief Economist, MCX Stock Exchange

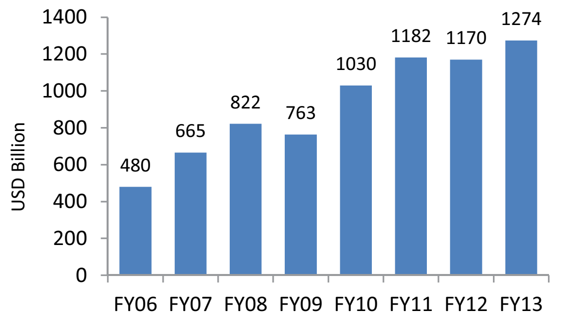
Introduction:

India's modern banking sector had undergone various stages of transformation starting from early years of independence facing varied challenges of an underdeveloped economy into a more liberalized, emerging and a globalizing economy. During the decade of sixties it was felt by the policy making that banking is a public function and the banks would have to be nationalized to make banking accessible to the unbanked population of India and to appropriately direct scarce capital towards planned development. According to the RBI report on Evolution of Banking in India (2008), "the problem of lopsided distribution of banks and the lack of explicit articulation of the need to channel credit to certain priority sectors was sought to be achieved first by social control on banks and then by the nationalization of banks between 1969-80." The economic liberalization of 1990's ushered the new era of privatization with the entry of new private banks which used technology to transform and revitalize banking operations in India.

Since then, the banking sector has grown at a healthy pace with strong support from domestic savings, rising

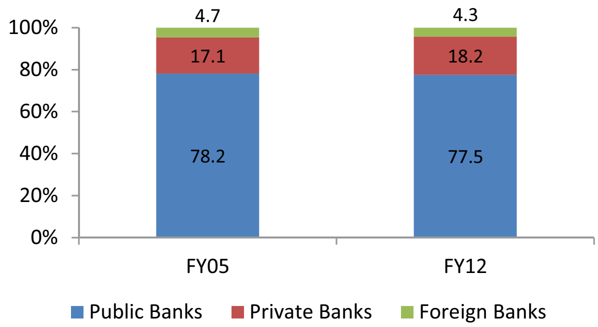
Despite a strong growth in domestic financial savings, its channelization to fund economic activities in sectors such as agriculture, micro and small enterprises, and low income groups remained fairly low.

Chart 1: Growth in deposits over the past few years



Source: RBI

Chart 2: Market Share of Bank Groups by Deposits



Source: RBI

disposable incomes, strong economic growth, increasing formalization of Indian economy, and easy access to banking services. According to RBI's discussion paper on Banking Structure in India - The Way Forward (2013), the size of the Indian economy in terms of GDP at market prices has increased by almost fifteen times, whereas the household financial savings have expanded by sixteen times and the gross domestic savings by almost seventeen times during the same period since 1991.

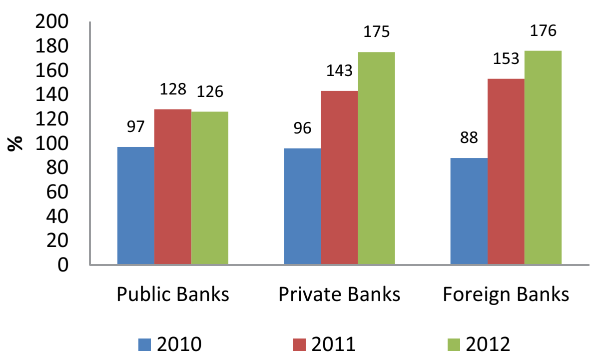
Privatization of the 90s and the rapid adoption of technology for making banking a household task led to a more rapid growth among the private banks. This is evident from the fact that the share of public sector banks in total deposits have declined from 78.2% in 2005 to 77.5% in 2012, indicating that private banks have been capturing an increasing share of deposits. It is also evident from the growth of the asset base of the banking sector. Public sector bank's asset base grew at an average of 7.5%, whereas private sector expanded at a CAGR of 11.3%. Going forward, central bank is considering more licenses to private sector players to increase competition in the banking industry and improve transactional efficiency in the economy.

Marginalization of economically weaker sections and the need for improving financial access:

Historically, despite a strong growth in domestic financial savings, its channelization to fund economic activities in sectors such as agriculture, micro and small enterprises, and low income groups remained fairly low. During 1960s, the concept of social control gained importance to ensure an equitable distribution of credit keeping in view the relative priorities of developmental needs. The description of the priority sectors was formalized in 1972 with the help of the National Credit Council (NCC), set up in 1968 to assist the RBI and the Government to allocate credit according to plan priorities. It was made mandatory for banks to lend to the identified priority sectors.

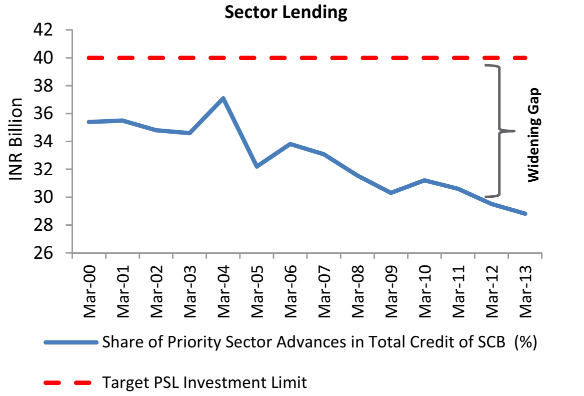
Typically, priority sector lending refers to providing small value loans to the high risk category of agriculture and allied activities, micro

Chart 3: Return on Assets : Bankwise break up

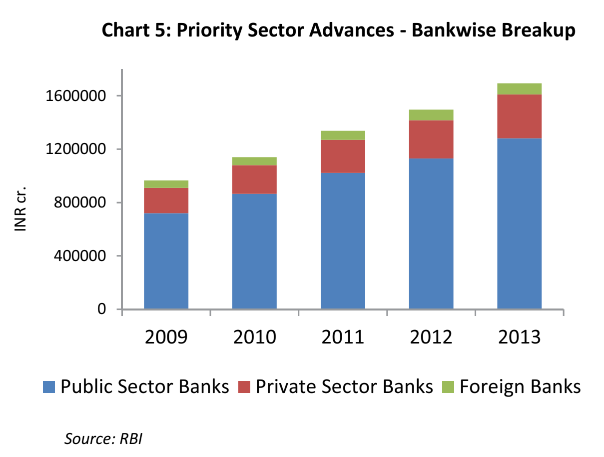


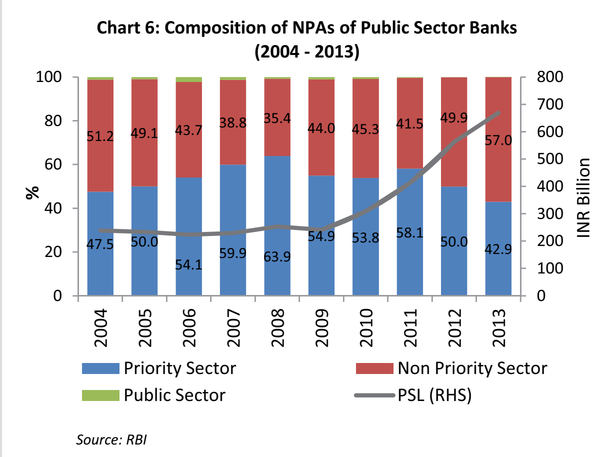
Source: RBI

Chart 4: Progress of Commercial Banks w.r.t Priority Sector Lending



Source: RBI





and small enterprises, poor people for housing and other low income groups and socially weaker sections for their varied economic activities. Added to the high risk is the mandated low cost of lending which broadens the risk reward gap to be met through income from the rest of the funds that can be lent to the non-priority sectors or to be written off as losses to be augmented by cash infusion as the deposits collected are protected. As per the revised RBI guidelines of September 2012, domestic commercial banks and foreign banks with 20 and above branches would have to compulsorily lend 40% of Adjusted Net bank Credit (ANBC) or credit equivalent of off-balance sheet exposure, whichever is higher. During 2005-13, total lending under PSL by scheduled commercial banks has amounted to INR 87.5 Trillion, growing at a CAGR of 20.4%. However, the widening gap between the target and achievement above over the past few years as per Chart 3 indicates that SCBs are shying away from taking an exposure directly towards the priority sector. PSL has been witnessing a declining trend even when the total deposits and credit of commercial banks have been growing at a healthy pace, indicating increasing avoidance of banks towards exposure to priority sectors and rather to principal protected avenues at a lower income as provided by the mandate.

Why are banks not lending to Priority sectors?

According to the study released by Assocham and Resurgent India on Indian Banking Industry: Sustaining Growth with Equity (2013), one of the key reasons explaining bank's hesitation to lend to priority sectors is lack of detailed financial information and appropriate performance analysis of small firms. Also, banks incur higher costs associated with PSL, higher lending risks due to lack of transparency of financial conditions and subsequent rise in non-performing assets (NPA), constraints to availability of funds, lowering of credit ratings, resulting in reduced profitability of the banking sector. It has been vindicated by a recent RBI Report on Operations and Performance of Commercial Banks (2013), which estimates a gross NPA ratio at the aggregate level stood at 3.6% at end-March 2013, a rise from previous year's 3.1%.

Securing transparency of financial conditions of the borrowers influences decisions for financing loans. But the sustainable growth of the Indian economy depends on how we leverage our financial sector to make it a broad based phenomenon. In the absence of lending to all types of economic activities and stakeholders taking into account the risk they pose to the principal in a more appropriate manner, growth is likely to be narrower. Hence, it is necessary to augment the risk taking ability of banks by introducing an efficient market for credit risk transfer (CRT) instruments which have gained significance in the recent past. Banks would stand to benefit from credit derivative instruments (CRT) due to two reasons – efficient utilization of capital and flexibility in developing/ managing a target risk portfolio. Currently, Indian Banks face two broad sets of issues

With PSL, higher lending risks due to lack of transparency of financial conditions and subsequent rise in non-performing assets (NPA), constraints to availability of funds, lowering of credit ratings, resulting in reduced profitability of the banking sector.

with respect to their credit asset portfolio especially at a time when the entire business cycle is at a low due to prevailing economic conditions that leads to blockage of capital and loss of revenue earning opportunities.

Globally, credit derivatives have become important CRT instruments and are integral to the risk management functions of several firms, driven by established standards of documentation, standardization and diversified participation. With the shift of these instruments to transparent clearing platforms, the so called risks of CDOs that led to the Lehmann collapse can be mitigated through appropriate control measures before such lending or trading activity takes systemic proportions. This has been proposed by the G20 led Financial Stability Board, implemented by the Dodd-Frank Bill of the US and the forthcoming regulations of European Securities Markets Authority.

Evolving Regulatory Framework - A Global Perspective:

CDS are bilateral over-the-counter derivative contracts which have had minimal regulatory oversight in the US and Europe since the inception of trading. In the US, bilateral transactions like CDS between counterparties have been excluded till recently from regulation under Commodities and Futures Modernisation Act of 2000. However, post 2009 financial crises, the US government had introduced a broad range of regulatory regime for OTC derivatives including CRT instruments which are largely traded in the OTC markets to move the OTC traded CRT instruments into a transparent reporting and clearing regime. The EU authorities are also reported to be working on similar initiatives to move OTC derivatives including CRT instruments to mandatory reporting and clearing regime. Additionally, in line with the G20 recommendations, the EU regulators have also proposed that standardized OTC derivative contracts be developed for trading on electronic trading platforms (or exchanges) and cleared through central counterparties.

Market for CRT instruments – Developmental Initiatives in India:

Policy makers in India took fairly cautious steps while introducing CDS to defer it twice (in 2003 and 2007) before finally introducing single-name OTC CDS for corporate bonds as announced in the Monetary Policy Review of Q2FY10. After the submission of report on introduction of credit derivatives in India by working group, draft guidelines for the functioning of CRT instruments were introduced in March 26, 2003. This was further revisited in 2007 with an indication that credit derivatives would be introduced in a calibrated manner as a part of the broader process of financial sector liberalization in India. The final version of CDS for corporate bonds were required to report to a centralized trade reporting platform, with an aim of bringing them on to a central clearing platform i.e. the Clearing Corporation of India Limited. According to the RBI report on introduction of credit default swaps for corporate bonds (2011) that followed the announcement made in the Q2FY10 review, "the objective of the measure is to provide credit risk transfer tool to the Indian market participants and enable them to manage credit risk in an effective manner through redistribution of risk." RBI further expanded the scope of the credit default swaps (CDS) market by allowing CDS for unlisted corporate bonds in January 2013. Additionally, CDS were permitted to be introduced on securities with original maturity up to one year like Commercial Papers, Certificates of Deposit and

Non-Convertible Debentures with original maturity less than one year as reference/deliverable obligations. In an effort to broad base participation and to enable stakeholder risk management, SEBI had also permitted mutual funds to participate in CDS market.

Issues pertaining to development of CDS markets in India:

Globally, while credit default swaps are valuable tools for managing risk, it has been debated that untamed trading in CDS instruments on opaque OTC markets could lead to significant systemic risks. CDS contracts are only traded in the OTC markets and not on transparent exchange traded platforms, raising concerns over counterparty risks as it happened during the last financial crisis and Lehmann collapse.

The failure of one important participant in the CDS market can destabilize the financial system by inflicting significant losses on many trading partners simultaneously. In India though CDS was introduced in Dec 2011 after series of deliberations only on Corporate Bonds, with stringent regulations, however the market did not pick up further due to inherent constraints in development of CDS markets.

According to the IOSCO report on The Credit Default Swap Market (June 2012), globally the growth of the CDS market has been fostered by the development of a self-regulatory environment, promoted by the initiatives of the ISDA, which resulted in contract standardization, aimed at facilitating back office and contract management operations, and in reduction of legal disputes. The major issue has been that the CDS markets are still quite opaque and not well regulated. Making transparent the CDS markets would help regulators benefit from better access to information on trade data both from the perspective of financial stability, assessing clearing/ systemic risks emerging out of the CDS markets and potential market abuse by the players.

Though CDS market has not picked up in India, if it could be activated, it could help the banks augment lending to the economically weaker sections through cost effective credit risk management on market based CRT instruments. Available research suggests that CDS play an important role in reducing funding costs for entities of lower credit quality and introduction and development of CDS markets have always contributed to reduction of funding costs in the underlying debt markets. Lack of default statistics and empirical data on the past about any particular category of priority sector would make it difficult for the participants to price the risk if at all CDS against bank lending to PSL category is introduced. However, a Brickwork Ratings and City of London Report (2011) indicates that the standardization of

industry practice with respect to the loan assessment and disbursement is still lacking and unless this happens it will be difficult to allow CDS on loans. The onus is on the industry to move to standardized loans, which would enable the introduction of CDS with loans as underlying. Also information asymmetry caused by the existence of strong 'Chinese walls' between different departments within a lending bank and a buyer and the seller is expected to be a constraint to the development of CDS markets in India. Additionally, standardization of the underlying market would also make it all the more difficult to launch a standard CDS instrument and multiple CDS instruments would lead to fragmentation of liquidity leading to development of illiquid markets. Critics also indicate that lack of strong bankruptcy regulations would also further prevent development of CDS markets. Prevention of naked selling will remain a constraint to development of liquid market in credit default instruments. Further, implementation of a standardized margining policy and central counterparty settlement could go a long way in settling issues associated with problems in collateral availability and its management in the most efficient way and to catalyze liquidity development in the CDS markets.

The way forward:

According to a study jointly conducted by Assocham and Resurgent India on Indian Banking Industry: Sustaining Growth with Equity (2013), as high as 75% of India's Micro, Small and Medium Enterprises (MSMEs) are deprived of access to banks or institutional financing channels, highlighting the fact that financing gap has widened given the significant demand-supply constraints. This signifies the need for creating a sustainable pathway for accessing mainstream financing at affordable rates for the economically weaker sections of the population and micro, small and medium enterprises. Introduction of CRTs would help the banks, especially the private banks to manage the credit exposure against PSL targets to earn principal protection than resorting to alternative means of meeting the PSL targets mandated on them. Existence of liquid markets for CRT instruments against standardized PSL lending exposures may in fact, enthuse the existing private banks and the yet to be licensed private banks to augment their balance sheets and also manage capital in a Basel compliant manner. In the current liberalized scenario, where even the scheduled commercial banks are also expected to be left to the market forces, existence of such a market for credit risk hedging instruments would augment access to finance even for the economically weaker sections representing priority sector lending. However, if the world were to innovate in standardizing a CDS instrument to be traded on the exchange platforms that has the potential to be the benchmark for the entire markets for CRT instruments, it would herald a new era in improvement of efficiency of the markets for CRT instruments and to make it a common practice among the lenders to manage risks in a more efficient way and deliver value to the economic stakeholders besides paving way for achieving the policy objective of equitable growth.

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Dr. V Shunmugam
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Dr. Shunmugam V has a rich global experience in intensive pol icy matters, developmental economics & research and working in close proximity with policymakers and market regulators. He is a prominent figure in the industry, foreseeing and proposing policy changes for its impending impact on larger business environment. A thought leader and trained macro-economist with a wealth of network across ranks and files in Government, regulators, business, academics, he has expertise in dealing with multiple regulators, markets, products and strategic communication with various industry stakeholders.

In his role as Chief Economist at MCX-SX and at MCX prior to that, he has structured pragmatic policy recommendations based on the foresight about its linkages with various aspects of the economy and its impact on economic stakeholders, investors, producers, savers, intermediaries and institutions, leading to balanced and sustainable growth of the economy. He plays a key role in interfacing with regulators, product development & research, risk mapping and product design. Before his stint in India, Dr. Shunmugam worked with the US Government where he played a robust role of connecting the Governments of India and the US through trade relations, commodity market dynamics, trade & policy matters and facilitating workshops, conferences, and official missions. He also engaged in resolving several non-tariff barriers, helping industries and importers establish appropriate forward and backward linkages in financial markets ecosystem value chain of India.

Dr. Shunmugam has authored several reports, analyses, papers and articles on various subjects related to financial markets, regulation, dark markets, market micro-structure in various media and journals of international and national repute. He is a Ph.D. in Agricultural Economics from Indian Agricultural Research Institute, New Delhi (1997) and M.Sc. in Agricultural Economics (Gold Medalist, 1993). He was selected for Senior Fellowship award under Indian Council of Agricultural Research and also associated with Ford Foundation Research Project on Natural Resource Economics.

Challenges Faced by Existing / New Entrants in Meeting PSL Requirements

Shri A Krishna Kumar, *Managing Director & Group Executive (National Banking), State Bank of India*

The classical model of any country's economic growth predicates the co-existence and growth of three sectors - Primary (Agriculture and Allied Activities), Secondary (Mining and Industry) and Tertiary (Services). In India, during the last fiscal, the Primary Sector contributed 13.7% of the GDP growth, and the Secondary Sector contributed 27% of the GDP growth. A large number of people are employed in these two sectors, and there are challenges in catering to their over-all requirements.

Financial intermediaries, such as Banks, have come to play an important role in the World economy, and India is no exception. However, official statistics reveal that rural India had only seven Bank branches per 100,000 adults in 2011, in sharp contrast with most of the developed and even other BRICS economies where this number is over 40. Thus vast swathes of India are deprived of banking facilities, including plain vanilla Deposits and Loans products.

It is in this context that Reserve Bank of India (RBI) has mandated that all Banks operating in the country have to provide a specified portion of their lending to such of those sectors and segments who do not have ready access to Bank Finance. This is popularly called Priority Sector Lending (PSL).

The new players with a limited reach in the country, but existing ones as well, will need to appreciate the challenges in achieving the targets under PSL and will have to devise strategies for their achievement.

RBI has identified Priority Sectors as consisting of agriculture (direct and indirect), small scale industries (SSI), small road and water transport operators, small business, professional and self-employed persons, education, housing, micro-credit, weaker sections, and exports, among others. Typically, PSL to these segments is done with specified limits up to which loans can be granted.

Priority Sector Lending Requirements:

To achieve this objective, RBI way back in March 1985 set bench-marks for Banks' lending under Priority Sector. These bench marks and sub-targets under PSL were periodically revised and now are as under:

- All the Banks operating in the country including the Foreign Banks (with 20 or more branches) have to achieve a PSL target of 40% of their total lending, by financing under-served sectors during the financial year.
- 18% of the total lending should be extended to Agriculture (min.13.50% under Direct Agri and 4.50% under Indirect Agri). A sub-target of 10% of the total lending should go to the weaker sections of the society.
- Export credit is not treated as a separate category. Export credit to eligible activities under agriculture and MSE is reckoned for priority sector lending under respective categories.
- The Foreign Banks (with less than 20 branches) have to mandatorily achieve 32% of ANBC under Priority Sector. However, these banks will have to achieve the targets within a maximum period of 5 years starting from April 1, 2013 and ending on March 31, 2018.
- Further, the banks have been advised to achieve a 20% year-on-year growth in credit to micro and small enterprises, a 10 per cent annual growth in the number of micro enterprise accounts and 60% of total lending to MSE sector as on preceding March 31st to Micro enterprises.
- RRBs have a target of 60 per cent of their outstanding advances for priority sector lending. Further, of the total priority sector advances, at least 25% (i.e. 15 percent of the total advances) should be extended to weaker sections of the society.

New Entrants in The Banking Industry:

In the present economic scenario, the new generation Banks have been making their presence felt in the Indian economy. But in the present stressful conditions, the expectations are much more from them. The new players with a limited reach in the country, but existing ones as well, will need to appreciate the challenges in achieving the targets under PSL and will have to devise strategies for their achievement. There have been concerns expressed, and rightly so, on the under-achievement by the Banking Sector in this matter - 16 Public Sector Banks and 10 Private Sector Banks last year failed to comply with the PSL targets.

In the last few years, various private players have entered the banking space with a limited reach in rural areas, making it necessary for RBI to stipulate that at least 25% of new branches must be opened in unbanked rural areas.

Challenges faced by the Banks:

The elongated cyclical downturn in the economy, as a result of the current global financial crisis, has resulted in the growth rate of GDP in India falling to 5% in 2012-13. This obviously has had a deleterious impact on the Primary and Secondary Sectors of the economy.

The entities constituting the Priority Sector, i.e. Agriculture and Allied Activities and Small Entrepreneurs, are mostly unorganised. Even today, many of them do not have ready access to banking facilities. The census of 2010-11 said that we had 137.80 million farmers in our country, of whom, only 43.67 million farmers (about a third) have been covered by Public Sector Banks as on March 2013. Similarly, of the total of 29.8 million enterprises in various industries only 7.46 million are covered by the Public Sector Banks and 11.17 million units by All Scheduled Commercial Banks as on March 2013. This clearly reveals that people in rural and remote areas still rely on the local money lenders for their fi-

nancial requirements. One basic reason is the quick availability of money from these sources without any legal formalities. Moreover, despite the existence of Banking Facilitators (BFs) and Banking Correspondents (BCs), the Banking system has yet to gain acceptability among this section of the population.

Banks, especially the new entrants, will have to use technology to reach out to these far flung places. This is bound to increase operational costs, and will act as a deterrent for many players to expand their network in rural areas.

The road for achieving the PSL norms has become rocky with the ever increasing NPAs in the Banking Industry. The Banks have recorded Gross NPAs of Rs. 2.06 trillion (or 3.65%) as on 30.06.2013 as against Rs. 1.93 trillion (or 3.23%) as on 31.03.2013. This figure shows no signs of moderation. Besides, many more borrowers are under stress and their loans may turn Non-Performing if immediate measures are not taken to recover the dues. The only silver lining is that NPAs in retail segments are coming down.

The lower recovery and mounting overdues has resulted in a continuous strain on the profitability of Banks. Priority Sector Lending predicates that Banks maintain additional manpower for supervision and follow-up of small value loans. This additional expenditure, on top of the poor recovery and rising volume of NPAs, has led to most Banks being unable to reach the prescribed targets of lending to the priority sector. Nevertheless, the demand for funds and the scope for deployment of funds for the priority sector are enormous.

The biggest challenge being faced today by various Banks is to reach out to remotest of the areas and finance those people under the ambit of Priority Sector in such a way that the health of the assets does not deteriorate in due course. The Banks have to show due diligence in appraising the loans

sourced, and put in place effective systems for monitoring and follow-up of these loans.

Strategies to give more Focus to Priority Sector Lendings:

As of now the Banks are under tremendous pressure to achieve the Priority Sector targets. Failure to do so means that they have to pay a penalty in the form of depositing funds with SIDBI and NABARD at lower interest rates for longer periods (up to 7 years). The dilemma faced by Banks is to decide whether they should focus on low value loans under Priority Sector which have a higher propensity to turn Non-Performing, or reduce financing to this sector and instead deposit funds with SIDBI and NABARD. The latter is the easy way out and akin to what is actually "lazy banking", and would certainly not help in inclusive growth in the Indian economy. The Banks' strategies should be so oriented towards attracting more of the under-privileged and the needy into the Banking system, and provide them with need-based finance. Indulging in a pure "number game" just to achieve arbitrary targets would be counter-productive. The idea should be to focus on increasing both the customer base and the area of operations so as to expand the coverage of the Banking system. This in turn will give a real growth and a boost to the economy.

To overcome such situations and to achieve the desired growth in PSL, some radical steps need to be adopted so that the Banks look at this portfolio as a profit-making and lucrative business and not as a losing proposition. For this, the undernoted measures can be effective:

- Incentives should be given to the Banks for achieving PSL targets. The percentage achievements in PSL can be linked to the other incentives forBanks like granting licences for opening new branches at choice-centres or reducing the statutory deposit requirements with RBI and so on.
- Some branches should be identified at every centre where skilled people may be entrusted to deal with advances under Priority Sector like we have for Corporates, SME and P-segment loans.
- Services sector which contributes the highest in MSME segment (almost 71%) should be targetted for financing as this area is still largely untapped. The organised retail segment in India is huge and growing at

30%-35% annually. This segment if appropriately tapped can take the Banks nearer in achieving the PSL targets.

- Agencies like National Small Industries Corporation (NSIC), a nodal agency under the Ministry of MSME which renders services to Micro, Small and Medium enterprises across the country, should come to the forefront and impart basic training in regard to raw material distribution, technology development, marketing intelligence, etc. to the MSME customers. Even Banks should consider imparting training and conducting workshops for youth to help them set up their own ventures.
- Financial Institutions like NABARD and SIDBI should play a prominent role in increasing the portfolio of Priority Sector in the field of agriculture and SME respectively. They should open branches at intensive centres and should actively finance the customers directly. This will also pave the way for increased financial inclusion.

Conclusion:

These measures if implemented in the right spirit can really be a game changer in Priority Sector Lending and help boost the economy. With RBI liberalising the Branch licensing policy, and new aspirants queuing up for a Banking license, Banking operations in India are poised to undergo a metamorphosis.

A Krishna Kumar
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Shri A Krishna Kumar, presently holding the post of Managing Director & Group Executive (National Banking) in State Bank of India, is a career banker with more than 38 years of rich experience in all facets of banking. He joined the Bank in 1975 as a Probationary Officer. Prior to the present assignment, Shri Krishna Kumar has handled a number of other important assignments. As a Deputy General Manager he was in-charge of Commercial Banking at Ahmedabad, and later held the position of Circle Financial Officer in the Hyderabad Circle of the Bank. Thereafter he was one of the first team leaders of Business Process Re-engineering Project of the Bank. As a General Manager, he was in-charge of Learning and Development in the Human Resources Department at the Bank's Corporate Centre. In September 2004, he was posted as General Manager in the Bank's Chandigarh Circle, where he was in-charge of more than 300 branches spread over 22 districts of Punjab. On his next promotion, he handled the Mid Corporate Group of the Bank as its Chief General Manager. Later, in October 2007, he was posted as the Chief General Manger of the Bank's Patna Circle and was in-charge of the Bank's business spread over the states of Bihar and Jharkhand. His further promotion as Deputy Managing Director brought him back to the Bank's Corporate Centre, where he headed the Bank's Information Technology Department from July 2009 onwards.

He has been elevated as Managing Director & Group Executive in April 2011 and has also been appointed as Director to the Central Board of the Bank. He is also on the Boards of SBI Life Insurance and SBI Cards, subsidiaries of State Bank of India. He is one of the key persons in policy making and formulating the strategies for the Bank. Presently, he heads National Banking Group (NBG), controlling more than 15250 branches of the Bank and handles and develops the Bank's entire SME and Retail Business including Commercial Loans, Agricultural Loans, Home Loans, Auto Loans and other Retail Loans.

RBI's recent measures for MSMEs: Liquidity eases but challenges likely to limit impact

Mr. Parag Patki, *Chief Executive Officer, SMERA Rating Limited*

Executive Summary:

The Reserve Bank of India (RBI), in November 2013,announced three special policy measures to extend liquidity support to Micro, Small and Medium Enterprises (MSMEs).

- Rs.50 billion refinance fund specifically for Micro and Small Enterprises (MSEs).
- Enhancement of the exposure limit for MSEs to Rs.100 million from Rs.50million and;
- Extensionof the priority sector lending (PSL) status to incremental loans to medium enterprises (MEs) till March 2014.

In SMERA's opinion, the above-mentioned measures are much-needed and are likely to ease liquidity pressures faced by small and medium enterprises. Extending PSL benefits to medium enterprises, even for a temporary duration, is an important step in increasing and deepening credit flow to the MSME sector as a whole. PSL status will lead to increasing willingness of banks to lend to MEs, which is important because credit growth to MEs has been stagnant over the past few years.

However, the impact of these measuresis likely to be limited given its temporary nature andthe limited headroom available to banks in accommodating MSME loans in the existing PSL book. SMERA believes

The growth of the MSME sector hinges on availability of funds. Therefore, it is essential that the intended measures should have a lasting impact in both deepening and broad-basing credit availability to the sector.

that the above-mentioned measures should be evaluated in light of the potential crowding out of credit availability for micro and small enterprises and the asset quality concerns in the medium and large enterprise loans.

Measures taken by RBI:

InNovember 2013, the RBI took the following policy measures for facilitating liquidity support to MSMEs.

- A refinance fund worth Rs.50 billion, specifically for MSEs. The refinance will be available for direct/indirect liquidity support to MSEs by SIDBI or select intermediaries. This facility will be available for a period of one year i.e. up to November 13, 2014 against receivables outstanding as on November 14, 2013 onwards. The facility is available at prevailing 14-day term repo rates for a period of 90 days (with a rollover option).
- Enhancing the exposure limit (from Rs.50 million to Rs.100 million)of MSEs qualifying under priority sector lending. This dispensation will remain in force up to March 31, 2014.
- Extending PSL status to medium enterprises (MEs) to ease liquidity pressures faced by MEs, whichwere hitherto out of the purview of PSL. This measure will also enhance credit delivery to MEs. The facility will be available upto March 31, 2014 and will be within the overall PSL target of 40 per cent.

The key rationale for these measures is to improve credit delivery and ease the liquidity pressure that MSMEs are currently facingdue to slower economic growth and stretched receivables.

Impact of the measures:

Measure 1 – Rs.50 billion refinance window

The refinance measure is likely to ease liquidity stress faced by the MSEs and comes at an opportune time. The sector is affected by stretched working capital cycles and demand slowdown. Moreover, the delivery mechanism of this fund through both the direct (SIDBI) and indirect (refinancing of banks through SIDBI) route has ensured that the liquidity support is broad-based. Considering the revolving nature of the credit, the cumulative impact of the refinance window is likely to be three to four times the fund amount or closer to Rs.200 billion.

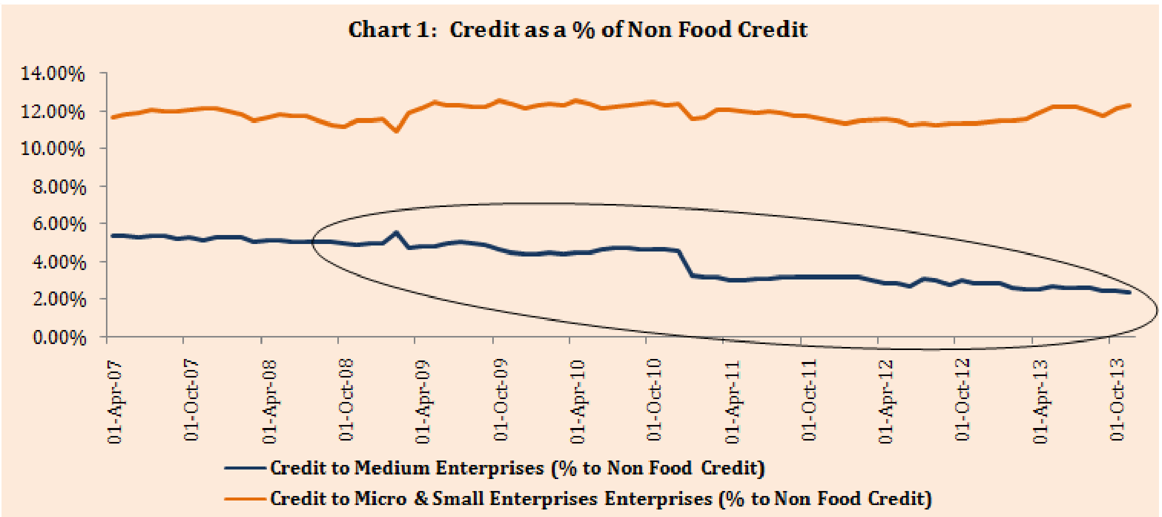
Measure 2 – Enhancing limits for MSE to Rs.100 million from Rs.50 million

The enhancement of the exposure limit is also likely to incentivise banks to increase credit flow to the MSME sector.This measure is likely to bring some relief to the MSEs that are currently under PSLcategory,as incremental loans to these MSEs are now eligible for the benefits associated with PSL. Further, this measure is expected to particularly benefit those MSEs that have exposure limits ranging between Rs.50 million to Rs.100 million and have been out of the purview of PSL till now.

Measure 3 – Extending PSL benefits to medium enterprises...

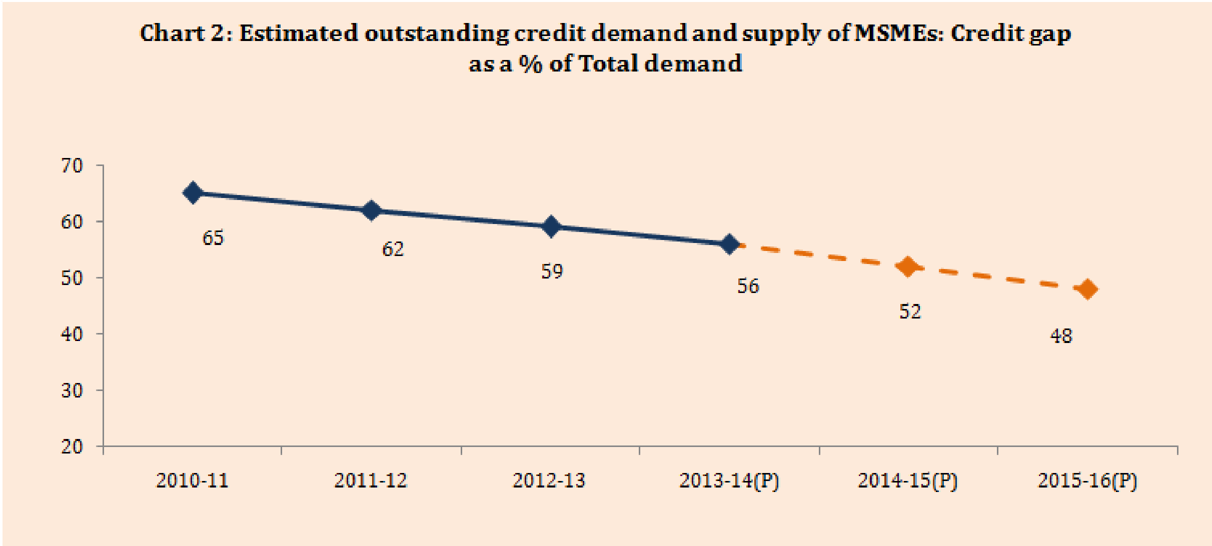
Extending PSL benefits to loans given to MEs may lead to improvement in credit growth to ME sector. Our analysis shows that credit growth to ME sector has been declining over the years. Credit to MEs as a proportion of non-food credit has less than halved to 2.4 per cent in November

Improved credit flow (much needed) to medium enterprises expected



Source: RBI

Moreover, the credit demand-supply gap for funding of MSMEs remains high at around 60 per cent (see chart 2).



Source: Report of the Private Sector Investment for MSME Sub Group under Working Group for the 12th Five Year Plan (2012-2017)

2013 from 5.4 per cent in April 2007 (see chart 1).

...however, the measure is expected to have limited impact

SMERA believes that granting PSL status to incremental ME loans is a vital step towards increasing and deepening credit flow to the MSME sector. However, the measure is likely to have limited impactgiven the small headroom available to banks for lending to MEs and the associated challenges in lending to the MSME sector.

Limited headroom available for incremental lending to MEs in PSL

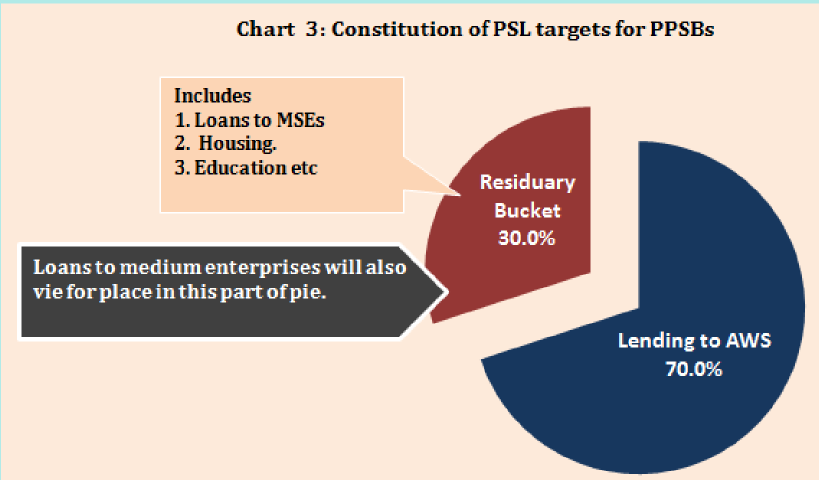
Public and private sector bank (PPSBs) account for over 90 per cent of the total lending of all scheduled commercial banks. As per the RBI, 70 per cent of priority sector targets for PPSBsare to be met through lending to agriculture and weaker sections (AWS) (See Chart 3), while balance 30 per cent share is left for MSME loans and other asset classes such as education and affordable housing. Hence,MSME lending does not have any dedicated quota in overall PSL targets and hence couldend up competing for a portion of the residual 30 per cent share.

Limited room for MSMEs in total PSL bucket, the room remains unchanged post inclusion of MEs

Further, banks report routine shortfalls in meeting PSL targets.As on March 2013, a total of 26 PPSBs, including 16 public sector banks (PSBs), were reported to have under-achieved their PSL targets, which can be ascribed tothe availability of small headroom under PSL for MSMEs.Howeverthis isnot the case, as a deeper analysis reveals that the shortfall in achieving PSL targets wasdue to a shortfall in lending to the AWS category. Thus,in order to achieve their PSL targets, PPSBs have to extend credit to AWS. Hence, lending to MSMEs may not enable the PPSBs tofulfil their PSL targets.

Unlike PPSBs, foreign banks have flexibilityin achieving its PSL targets and are thus favourably positioned to exploit the PSL benefits extended

Foreign banks unlikely to play a major role in extending liquidity to MSMEs



to MEs. However, their limited reach and strategic choices could inhibit their fulfilment of PSL targets. As on June 2013, the total outstanding credit of foreign banks stood at Rs.2793.9 billion whereas the entire banking sector's total outstanding credit to MEs stood at Rs.1,321.1 billion (approximately 47 per cent of the total outstanding credit of foreign banks.)

Challenges associated with implementing the measures

Although banks have been routinely lending to the MSME sector, inclusion of MEs in the PSL ambit could throwsome challenges tothe banking sector and henceit would be interesting to observe banking sectors' ability toovercome these challenges while extending credit to this category. The primary challenges the banking sectorcould face while implementing the measures are related to:

Associated challenges need to be overcome for these measures to be effective

- Restricting the potential crowding out of the lendable funds to MSEs by the loans being made available to MEs
- Maintaining the asset quality of the MSME portfolio

Challenge # 1: Restricting the potential crowding out of the lendable funds to MSEs by the loans being made available to MEs

Given that more asset classes jostle for space in the residuary PSL bucket, lending to medium enterprisesmay result in lower credit availability (crowding out) to the remainder of the PSL bucket (not covered under AWS), viz. micro and small enterprises, low-cost housing loans or education loans.

Thus, in a slower credit growth scenario (lower than 15 per cent) for PPSBs, any incremental lending to MEs may not help a bank to achieve its total PSL targets. Even if banks choose to classify incremental loans to MEs as priority sector lending, they would have to alter the share of other loans (MSEs, education etc.) in the residuary PSL bucket in order to accommodate lending to MEs. Consequently, credit to the segments in the residuary bucket may get restricted as banks may not be motivated to extend loans to this segment(as it does not help meeting the overall PSL targets).

Table 1: Impaired Assets Ratio (in %)					
Segment	**Mar-09**	**Mar-10**	**Mar-11**	**Mar-12**	**Mar-13**
Micro+ Small	10.7	10.6	9.4	9.7	10.6
Medium+ Large	7.8	9.4	8	11.2	14.8
Impaired Assets ratio = (GNPA + Restructured Standard Advances +Cumulative write off) to (Total Advances + Cumulative write off)					

Source: RBI

Challenge #2: MEs and large companies have weaker asset quality

A recent study by the RBI has highlighted that medium and large assets have led to higher bad asset stress on the banking system than MSEs as an asset class (Table 1).

Since adetailed breakup of asset quality within medium and large assets is unavailable it is difficult to judge the extent of stress caused due to lending to medium enterprises. Nevertheless, the deteriorating asset quality and increasing NPAsdue to weak economic scenario could affect banks'attempts in enhancing credit to the ME sector. Thus, if banks choose to push lending to this sector due to the new PSL benefits,then inclusion of such loans in the PSL bucket may lead to higher stress on asset quality& restrict credit to the other sectors (like MSEs)

Concluding thoughts:

SMERA believes that even though RBI's measure may lead to some positive impact for MEs, it could pose challengesinensuring adequate credit flow to MSEs and other entities and maintain theresultant asset quality of the PSL portfolio.RBI's measures are definitely intended to reduce the stress faced by a key segment of the Indian economy, however its impact could be limited as the measures are temporary in nature, given the timeline of March 2014 for the incremental credit to the ME sector to account for PSL.

The RBI'smeasures also acknowledge and highlight the structural impediments faced byMSME sector in availing credit. Credit flow to MSMEs has been exhibiting downward trenddespite growthin credit to the other sectors of the economy. The growth of the MSME sector hinges on availability of funds.Therefore, it is essential that the intended measures should have a lasting impact in both deepening and broad-basing credit availability to the sector.

Parag Patki
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Priority Sector Lending and Inclusive Growth

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India in her quest for inclusive growth has experimented with a variety of policy mix since gaining independence in 1947. Initial years of policymaking in India witnessed a focus on developing indigenous capacity in critical sectors of economy by having a large public sector. India's second five year plan (FYP 1956-61), prepared in the guidance of Professor P C Mahalanobis, eminent statistician and planner, laid the foundations of rapid industrialization with particular emphasis on the development of basic and heavy industries in India. However, it was seen only a means to achieve inclusive prosperity. "Second Five Year Plan seeks to rebuild rural India, to lay the foundations of industrial progress, and to secure to the greatest extent feasible opportunities for weaker and under-privileged sections of our people and the balanced development of all parts of the country", an excerpt from introduction to 2nd FYP document, should put to rest doubts, if any, about diluted focus on inclusion in India's policy paradigm ever.

Policymaking, however, evolves based on experience gained on previous efforts, in success and failures, and moves on reflecting changing priorities over time. Government had earlier tried several schemes with varying degree of success in order to enable the financially disadvantaged sections of society. By the end of the 1960s, however, there was a felt need for state intervention in order to push

It is often heard that basic form and structure of Priority Sector Guidelines are not in sync with changed structure of the economy.

credit into areas where it would not flow ordinarily agriculture and small scale industries were credit starved sectors and thus were identified as priority sectors for directed lending.

In the initial years, the RBI did not prescribe any specific targets to be achieved under Priority sectors lending. Its suggested quantum of lending was more like indication for banks to give priority in lending to the identified sectors. However, the political and social demands of the time warranted that apportionment of credit to the priority sectors become inevitable. With Prime Minister Indira Gandhi deciding in favour of nationalization in July 1969, there started a new era in Indian banking as Government had now tools to direct credit to such sectors. In 1974, the government accepted a target of 33.3 per cent for lending to priority sectors in a planned manner, such that the overall target could be achieved by public sector banks by the end of the Fifth Plan period, i.e. by the end of March 1979. Political pressures and constant push from the RBI yielded good results in a decade following Nationalization: The priority sector advances of banks doubled from 15 per cent of total advances in 1969 to 33.3 per cent in 1979.

With 1980 elections returning Indira Gandhi led Government in power at Centre, banks were asked to raise the proportion of their advances to the priority sector to 40 per cent by 1985. Over the time, scope of priority sector was enhanced to cover other sectors like exports, and weaker sections of society too. Moreover, within the overall 40 percent requirement, subtargets were given to encourage lending to such sectors. It was instructed to make 40 percent of total priority sector advances to agriculture & allied activities, which meant 16 percent of total bank credit was directed to agriculture & allied activities. Further, direct advances to 'weaker sections' in agriculture and allied activities were to constitute at least 50 per cent

of the total direct lending to agriculture (including allied activities) by March 1983. It is in this period of early 1980s that priority sector lending got its regulatory superstructure which, with some modifications, has survived till date.

Three decades have passed since formal 40 per cent requirements under priority sector lending were put in place. There have come structural changes in economy meanwhile. Although, there have been some changes in priority sector guidelines, particularly within sub-sector targets, to make it re-align with changing macro-dynamic, it is often heard that basic form and structure of guidelines are not in sync with changed structure of economy. For example, in early 1980s, Agriculture & Allied activities contributed about 35 percent share in annual gross domestic product (GDP) of India. However, three decades later, in early 2010s, the share of Agriculture & Allied activities have come down to 15 percent. Meanwhile, share of workers employed in Agriculture sector have come down to about 50 percent now from 67 percent in early 1980s. Many banks have found it difficult to meet priority sector targets for agriculture sector. There is argument that agriculture sector may not have as much of credit demand as is required to be disbursed under priority sector guidelines, 18 percent of adjusted net bank credit (ANBC) currently. However, there has been argument that Agriculture and Allied sector suffers distinct exclusion in financial intermediation vis-à-vis other sectors of economy and it is thus imperative to keep the targets at current level to help deepening financial intermediation in the sector.

With gradual dismantling of a license-permit raj, India experienced rising growth over last three decades. Real GDP growth has averaged 6.3 percent in three decades since 1980. While annual GDP growth averaged 5.6 percent in 1980s, it rose to average 5.8 percent in 1990s and then further to average 7.2 percent in decade of 2000s. However, there have been spectacular heterogeneities in growth inter and/ intra sectors of economy. Services sector, including construction, have grown at average 7.5 percent annual growth for three decades, while Agriculture and Industry have noted annual average growth of 3.5 percent and 6.4 percent respectively. Consequently, share of Services sector in India's GDP have grown to 67 percent now from 45 percent three decade ago. Industry share meanwhile have been around 18-20 percent. Accordingly, workers employed in sectors which noted relatively faster growth, like Services, have prospered faster than the workers which remained employed in low growth sectors, like Agriculture. Though there have been inter-sectoral pulls that have resulted into labour migration from low productivity sectors to higher productivity sectors, the pace of such migration has been slower. Importantly, manufacturing, which is known for its higher labour absorptive capacity, have been laggard in all these years.

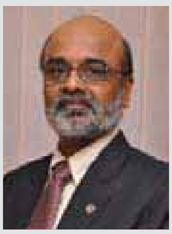
Economies are seen rising on efficiency ladder as they make gradual transition from resource-rich-but-technologically-backward economy to resource-scare-but-technologically-superior economy. From inclusion perspective, there could be two readings from such a growth dynamic. First, sectors that have witnessed a relative stagnation in national income share, like manufacturing, need more policy enablement to overcome the hurdles and raise earnings prospects of the employed. Second, sectors that have proved to be growth tigers need incentives to be broader based and employment sensitive to make the large section of society share in gains. Indian policymaking should be driven with such considerations where there is constant focus on raising and sustaining growth in income and equity concerns are served as well.

Assessing the prevailing priority sector lending norms from such a framework could help us have a view on whether we are moving on inclusive way or otherwise. Current regulatory norms on priority sector require domestic scheduled commercial banks (SCBs) to make loans amounting 40 percent of their ANBC in the sectors identified as priority sectors and foreign banks with less than 20 branches in India at 32 percent of ANBC. Categories under priority sector include :(i) Agriculture, (ii) Micro and Small Enterprises, (iii) Education, (iv) Housing, (v) Export Credit, and (vi) Others. Agriculture sector continues commands 18 percent of ANBC under priority sector guidelines. Within agriculture, the targets under direct and indirect agriculture are at 13.5 percent and 4.5 percent, respectively. In the current guidelines, bank financing of agriculture through non-financial intermediaries such as Primary Agricultural Credit Societies (PACS), Farmers' Service Societies (FSS) and Large-sized Adivasi Multi Purpose Societies (LAMPS) ceded to or managed or controlled by such banks, has also been treated as direct agriculture. This dispensation is expected facilitating direct agricultural finance by banks which are having limited presence in rural areas and would, otherwise, have struggled to meet the targets. However, credit to institutions has been treated as indirect finance and credit to food and agro processing industries has been shifted from agriculture to micro and small enterprises. Acknowledging that Services sector is not being served its finance needs in proportion to its importance and size in the economy, the RBI has expanded the definition of services sector to include services which were not specifically listed earlier, with the rider that credit limit is fixed at Rs.5 crore. Such changes are expected to nudge banks to tap opportunities in large but unorganized services sector in India's rural and semi-urban markets. Recently, the RBI decided to include incremental bank loans to medium manufacturing enterprises (as defined in the MSMED Act, 2006), up to the credit limit of Rs.10 crores, extended after November 13, 2013, as priority sector advances. Moreover, similar incremental loans to micro and small service enterprises up to the credit limit of Rs.10 crores, (as against the present ceiling of Rs.5 crores), shall also be treated as priority sector advances. While such dispensation is available till end-March, 2014 only, measures like these are indeed warranted to make priority sectors truly reflect the priorities of India.

The RBI has been very positive with its approach, giving all stakeholders due time and space for expressing their concerns and resolving difficulties in meeting the targets.

Rationalizing priority sector norms such that it meets genuine requirements of sectors which otherwise would not get sufficient credit flow and sectors which are important from employment generation perspective have been an ongoing concern for the RBI. The RBI has been a very positive with its approach giving all stakeholders due time and space for expressing their concerns and resolving difficulties in meeting the targets. The RBI deserves all the respect for its efforts in deepening inclusion among the disadvantaged sections of our society as also underserved, needy and productive sectors of economy. A lot has been achieved over the years; a lot remains to be done. We must strive together to make dream of a financially inclusive society come true in near future.

Acknowledgment:
The assistance provided by Shri Sujit Kumar, Manager, EID, Union Bank of India is heartily acknowledged.



K Subrahmanyam
Executive Director
Union Bank of India

Shri K. Subrahmanyam is Executive Director at Union Bank of India since January, 2013. Prior to joining Union Bank of India, he served for thirty-seven years in Indian Overseas Bank including two-year stint as Chief Executive of its Singapore operations. He is Graduate in Commerce, a Gold Medalist, from Berhampur University, Orissa. Shri Subrahmanyam is an avid reader and a ardent admirer of Carnatic music.

Priority Sector Lending & Inclusive Growth

Shri H S Upendra Kamath,
Chairman & Managing Director, Vijaya Bank

It was on 14.12.1967, when Shri Morarji Desai, the then Deputy Prime Minister and Minister of Finance observed in Lok Sabha that Priority sectors like Agriculture and Small Scale Industries in India were not receiving due share of bank credit, it was probably the beginning of thinking on Priority Sector lending in the country.

In the Credit Policy for 1967-68 that followed, it was emphasised that commercial banks should focus on financing Priority Sectors viz., Agriculture, Small Scale Industries and Exports, as the banks were at that time largely urban oriented meeting credit needs of large industries, wholesale trade and commerce, with only disproportionately small share towards lending to Agriculture, Small Scale Industries and Retail trade. The agricultural credit had a miniscule share of just 2% in 1967, which was also mainly to large plantations.

To nurture the objective of ensuring credit flow to hitherto neglected sectors with wider spread, Nationalisation of 14 Banks in 1969 was a major step in the sphere of Priority Sector lending.

The Lead Bank Scheme introduced in December 1969 was the next step which followed to ensure co-ordination among various banks and Governmental agencies for promoting developmental efforts requiring

It is necessary that the policymakers should ensure that the guidelines on classification of priority sectors remain dynamic.

bank credit, under which Banks were allotted among Public Sector banks and a few private sector banks to function as Lead Banks.

The description of Priority Sector was formalised in 1972 on the basis of the Report on Internal Study Group on Statistics relating to Priority Sectors constituted by the Reserve Bank of India. The Priority Sector prescriptions were both from the point of allocation of credit as well as concessions in rate of interest to such sectors.

The second phase of Bank Nationalisation of 6 more banks and establishment of Regional Rural Banks are the further steps towards expanding the Priority Sector / Rural credit.

As recommended by the Working Group constituted under the Chairmanship of Dr.K S Krishnaswamy, the then Dy. Governor of RBI, RBI stipulated that the Banks should increase the share of Priority Sector advances to 40% and agricultural credit to 15% by March 1985.

Working Group constituted in 1982 under the Chairmanship of Shri A Ghosh, the then Dy. Governor identified 12 out of 20 points in the new 20 Point programme having direct relevance to the banking system. The working group also recommended at increasing weaker section advances to not less than 25% of Priority Sector advances and also revised the definition of weaker section categories.

Service Area Approach was introduced from 1st April 1989 allotting designated area for each rural and semi urban branch of commercial banks with responsibility of lending for productive purposes with a view to bring about economic development in their designated service areas with the support from developmental agencies/ departments of the State Govt.

Though the Committee on Financial Sector Reforms (Shri M Narashimham) recommended for phasing out directed lending by reducing the Priority Sector credit to 10% of total credit, by focusing only on redefined group like small and marginal farmers, small business, tiny and village industry etc., was however not accepted by the Government.

With the introduction of SHG-Bank linkage programme from 1994 onwards, there has been altogether a new dimension for rural lending offering much needed solution to twin issues i.e recovery of rural credit and also high transaction cost. Since then the SHG- Bank linkage programme has grown manifold.

Though the Financial Inclusion initiatives were started right from the days of Nationalisation by considerably reducing the coverage of population served per branch and also extending priority sector credit to remote villages, as it was found out that large part of the villages are still unbanked and also that large part of the population still do not have access to basic banking facilities, Financial Inclusion programme was initiated by the RBI in 2004 with an objective of inclusive growth.

The Priority Sector guidelines were further revised by the RBI in 2007 based on the recommendations of C S Murthy Internal Working Group Committee of the RBI so as to include only those sectors that impact large sections of the population, the weaker sections and the sectors which are employment intensive such as agriculture, and tiny and small enterprises.

Malegam Committee constituted in November 2010 to study the issues and concerns in the Micro Finance Institutions sector, brought in certain criteria for considering bank loans to MFIs for onlending to continue as Priority Sector advances.

During 2012-13, the RBI revised the Priority Sector definitions based on the recommendations of M V Nair Committee, which re examined the existing classification.

The fact that the prescriptions of Priority Sector credit under Directed lending which has been continuing since late sixties and also the financial inclusion prescriptions which started from 2004 onwards clearly indicate that Banks in India have not fully achieved the objective and task of equitable distribution of credit and also inclusive growth in our country. However, with the changes that have taken place over the years on the country's economic front and the country transforming from the underdeveloped tag to developing and now emerging economy, being the third largest Asian economy, emphasis now needs to be shifted to view it as an engine for economic growth in the areas of agriculture, Micro and Small Enterprises, Housing and Education rather than only as a poverty alleviation tool.

If we go back to the origin of Priority Sector lending, it can be seen that directed credit through Priority Sector dispensation was introduced as a major public policy intervention for ensuring that the segments of economy which were hitherto neglected for bank finance get adequate funding and through this mechanism, the excluded sections are brought to financial mainstream.

However, it is also necessary that the policymakers should ensure that the guidelines on classification of priority sectors remain dynamic. The country has made rapid strides in economic development and with change in the very structure of economy several segments which were not a matter of priority could turn out to be one. Export and Infrastructure are the case in point. While there could be many reasons and rationale for including or excluding a particular segment from out of the list of Priority Sectors, the idea is not to simply make it a watertight compartment without any scope for change. In fact, the recent attempt to modify the definition of Priority Sector is an attempt in this regard but if the whole process becomes a matter of periodical review to accommodate emerging scenario, the attempt to prioritise distribution of scarce resources for funding will become more meaningful. In otherwords, the policymakers, financiers and intermediaries will act as per the need of the hour and it will result in directed growth.

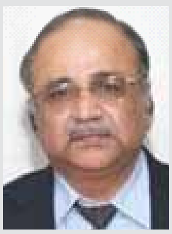
At the same time, it is also essential to introduce some element of flexibility in Priority Sector lending by permitting the banks to lend to the various segments according to their core competency, funds availability pattern, geographic spread of the branch network and built in expertise rather than merely following the same model on the concept of 'one size fits all'. This will perhaps enthuse the lenders to involve wholeheartedly in extending need based finance, which will be most suited from their own point of view too. The policymakers may however keep some basic targets mandatory and sacrosanct, which everyone needs to achieve. But, flexibility within the overall target would allow the banks to plan, target and perform well in Priority Sector lending subject to overall targets.

Even in well developed metros there is severebe financial exclusion and that too on a substantial scale.

At present the financial inclusion drive focuses on taking the banking services to the hitherto excluded sections and the targets are mainly villages. No doubt, under the current circumstances, there is an urgent need to bring these excluded sections to national financial mainstream, at some later date the focus of inclusion should also cover areas not necessarily at villages but the society/country as a whole. In otherwords exclusion is

not geographically specific or location specific. Even in well developed metros there is severebe financial exclusion and that too on a substantial scale. There is imminent need to target them also. Obviously, the Priority Sector lending guidelines should also be properly aligned to cover these exclusions also. If needed there could be a reworking of segments and targets to suit this changing need.

Overall, the approach should be to make Priority Sector lending serve as a medium to achieve the main objective of financial inclusion and thus ensuring equitable development and hence, the guidelines, approaches and strategies should be drafted and redrafted accordingly to suit the need of the hour and that will ensure greater involvement of all concerned and realise the objectives.



H S Upendra Kamath

Chairman & Managing Director
Vijaya Bank

Shri H S Upendra Kamath assumed charge as the Chairman & Managing Director of Vijaya Bank in April 2011. Prior to joining Vijaya Bank, he was Executive Director in Canara Bank since 2009. He has been a professional banker for over 37 years with a very rewarding and eventful stint at Union Bank of India. He is a B.Com, CAIIB.

He has been a recipient of numerous awards and recognitions , has attended several Global Seminars and Conferences, widely travelled – USA, Europe, Middle and far East and was a member of delegation along with the the Hon'ble President of India during China visit in 2010.

His extensive knowledge in the entire gamut of Banking practices has always stood in good stead in discharging his duties. He is a proven leader who would always enhance the strength of an organization.

The Policy Pulse

Banking Sector

Mid Quarter Review of Monetary Policy – December, 2013

RBI in its mid quarter review of Monetary Policy kept the key policy rates unchanged. Repo Rate at 7.75%, Cash Reserve Ratio at 4%, Reverse Repo Rate at 6.75%, Marginal Standing Facility Rate and Bank Rate at 8.75%.

Bharatiya Mahila Bank, India's first all-women bank, opens

The launch of the Bharatiya Mahila Bank is a small step towards empowerment of women. The bank, a pioneering initiative announced in the Union Budget, was launched with a corpus of Rs 1,000 crore and will have seven branches in major cities to start with. The BMB will be a universal bank which will have unique products designed for women and devote special attention to the funding needs of over 60 lakh self-help groups.

Women account for a paltry 7.3 percent of total credit in the financial system. The bank will try to overcome problems faced by women, such as difficulty in furnishing collateral because property not registered in their names, and ensure that deserving women get credit. The Mahila Bank, which has seed capital of Rs 1,000 crore from the government, will offer a higher interest rate of 4.5 per cent on savings account deposits till Rs 1 lakh and 5 per cent above Rs 1 lakh.

RBI releases guidelines for setting up Wholly Owned Subsidiary Model by foreign banks

RBI released of guidelines for the setting up of Wholly Owned Subsidiaries (WOS) by foreign banks in India. These much awaited guidelines will pave the path for foreign banks' branch expansion and their active contribution towards furthering financial inclusion.

"Domestic incorporation of foreign banks has multiple advantages. It will ensure parity of treatment with private and public sector banks in terms of branch expansion and regulation; offer foreign banks an opportunity to increase banking penetration and contribute towards financial inclusion; bring about superior governance practices and allow for RBI to regulate the banking sector with greater transparency and ease.

The aftermath of the 2008 financial crisis had resulted in many foreign banks shrinking their operations in India because their parent companies had to be bailed out with taxpayer funds. It had also become difficult to determine the assets that would be available in the event of the bank's failure to satisfy local creditors' claims. Local incorporation of foreign banks is a step in the right direction to ensure an effective and sound banking regulatory architecture.

RBI's move towards WOS will buffer the country against financial shocks and ensure financial sector stability. This model will also protect the interests of the local depositors and protect the preserve the trust and integrity of the banking sector should another financial crisis ever repeat itself.

Advisory group set up for national bill payment system

The Reserve Bank of India has constituted an advisory group to implement a national bill payment system, so that households will be able to use bank accounts to pay school fees, utilities, medical bills and make remittances electronically.

The terms of reference of the advisory group, which is headed by Umesh Bellur, Professor at IIT Bombay, include suggesting the nature of the organisation to undertake Giro-based bill payments and framing guidelines for setting up and operating the system.

Giro involves payment transfer from one bank account to another bank account. The advisory group will recommend the criteria (financial, governance, ownership, technical and operational, among others) for the entity to seek authorisation to set up bill payments system in the country under the Payment & Settlement System Act 2007.

If the group is of the opinion that a new organisation be created on the lines of an entity like the National Payments Corporation of India, then it will have to make recommendations, among others, on the nature of the organisation; membership composition; capital structure and contributions by stakeholders.

The RBI, in a statement, said the Advisory Group would submit its report by end-December 2013.

RBI allows banks to pay interest at shorter intervals

The RBI has allowed banks to revise the periodicity of interest payments on saving bank accounts and term deposits. "As all commercial banks are now on core banking platforms, it has been decided to give banks the option to pay interest on savings deposits and term deposits at intervals shorter than quarterly intervals," RBI GovernorRaghuram Rajan said in its Second Quarter Review of Monetary Policy 2013-14.

Presently, banks are required to pay interest on savings and term deposits at quarterly or longer intervals.

While giving banks this freedom, the RBI had said a uniform rate will have to be offered on deposits of up to Rs 1 lakh. On higher amounts, banks are allowed to offer differential rates to depositors.

RBI prods banks for recovery of bad loans

The Reserve Bank of India's crackdown on rising bad loans may include incentivising banks to set up an early warning system for likely defaults and not allowing them to use restructuring as a ploy to defer providing for such non-performing assets (NPAs) and thus window-dressing their balance sheets. It is important to move away from restructuring.

RBI opens more credit windows for small, medium sector

The Reserve Bank of India has opened the refinance tap to the Small Industries Development Bank of India to ease the liquidity pressure faced by micro and small enterprises.

The RBI will provide refinance aggregating to Rs 5,000 crore to SIDBI, which will in turn use the funds for direct as well as onward lending to banks.

Further, to encourage banks to lend more to medium enterprises, the RBI has decided to include incremental credit extended to these units by scheduled commercial banks (excluding regional rural banks) under the ambit of priority sector lending.

The RBI's refinance facility will be available for direct liquidity support to finance receivables, including export receivables, to the small-scale units by SIDBI or for liquidity support through select intermediaries — banks, Non-Banking Financial Companies (NBFCs) and State Finance Corporations (SFCs).

Capital Markets Sector

December 2013

Rationalization of Periodic Call Auction for Illiquid Scrips

In April 2013, SEBI had introduced the periodic call auction system through a separate window in a bid to check manipulation. SEBI has now tweaked norms for periodic call auction system for illiquid shares by increasing, among others, the threshold limits for such scrips and excluding certain class of profitable companies. A stock would be illiquid if its average daily trading turnover is less than Rs 2 lakh in the previous two quarters and the scrip is classified as illiquid at all exchanges where it is traded. The call auction will not apply to scrips where company is profitable in at least two out of last three years, and not more than 20 percent of promoters shareholding is pledged in the latest quarter and book value is three times or more than the face value. The new rules also exclude companies which have a market capitalisation of at least Rs 10 crore or which have paid a dividend in at least two out of the last three years. A stock can exit from the call auction mechanism to the normal trading session provided they have remained in session for at least one quarter, as opposed to two quarters earlier, and are not illiquid.

Norms eased for FIIs using complex models to invest in India

Relaxing its norms for foreign investors, SEBI allowed overseas entities using complex multi-fund structures, such as multi-class share vehicle (MCV) or protected cell companies (PCCs), to invest in India, if they need to use such models due to regulations in their home country and they are ready to provide details of actual beneficiary of funds. Any FII seeking registration in India would not be considered to have an "opaque" structure if it is required by its regulator or under any law to ring fence its assets and liabilities from other funds/sub-funds. This would be subject to certain conditions, including the overseas entity being regulated in its home jurisdiction, each fund/sub-fund of the entity satisfying broad based criteria, and the entity giving an undertaking to provide information regarding its beneficial owners as and when sought by SEBI.

Deposit Requirements for members of the Debt Segment

In January 2013, SEBI had announced a separate debt segment on bourses and had amended norms to enable registration of stock broker, proprietary trading member, clearing member and self clearing member on the platform. In a recent circular, SEBI has said that base minimum capital requirements as per the norms for stock brokers and proprietary trading members would be applicable for the debt segment as well. The base minimum deposit requirements, as per the profile of the members, range from Rs 10 lakh to Rs 50 lakh for members of stock exchanges having nation-wide trading terminals.

Exchange Traded Cash Settled Interest Rate Futures (IRF) on 10-Year Government of India Security

In 2009, SEBI permitted stock exchanges to launch physically settled futures on 10-Year Government of India (GoI) Security. It has now been decided to permit stock exchanges to introduce cash settled Interest Rate Futures on 10-Year Government of India Security. The cash settled 10-year IRF is being introduced on a pilot basis and the product features would be reviewed based on the experience gained.

Simplification of demat account opening process

SEBI has further simplified and rationalized the demat account opening process. The existing Beneficial Owner-Depository Participant Agreements shall be replaced with a common document "Rights and Obligations of the Beneficial Owner and Depository Participant". This will be mandatory and binding on all the existing and new clients and depository participants. This will harmonize the account opening process for trading as well as demat account. This will also rationalise the number of signatures by the investor, which he is required to affix at present on a number of pages.

Illustrative format of Statement of Assets & Liabilities in SEBI (ICDR) Regulations, 2009

SEBI has issued a circular giving the Illustrative format of Statement of Assets & Liabilities. Regulation - (2)(IX)(B)(9)(f) of Part-A of Schedule VIII of SEBI (ICDR) Regulations, 2009 provides for the illustrative format of Statement of Assets and Liabilities in the offer document which is in accordance with the erstwhile format of Schedule VI of the Companies Act, 1956. After the notification and implementation of the revised Schedule VI of Companies Act, 1956, the aforesaid format has been updated and brought in line with the requirements of the Companies Act, 1956. The revised format is also in line with the requirements of Companies Act, 2013 as Schedule III of Companies Act, 2013 has adopted the same format as notified under revised Schedule VI of Companies Act, 1956.

November 2013

Extension of timeline for alignment of employee benefit schemes with the SEBI (ESOS and ESPS) Guidelines, 1999

SEBI issued a circular stating that the time line for alignment of existing employee benefit schemes with the SEBI (ESOS and ESPS) Guidelines, 1999 has been extended to June 30, 2014. The time line was earlier extended to December 31, 2013.

Circular on Infrastructure Debt Fund (IDF) – FIIs as long term investors

In April 2013, SEBI had designated the following categories of FIIs as long term investors for the purpose of IDF (a) Foreign Central Banks, (b) Governmental Agencies, (c) Sovereign Wealth Funds, (d) International/Multilateral Organizations/ Agencies, (e) Insurance Funds and (f) Pension Funds. Another circular has now been issued to state that regulated foreign feeder funds, having at all times, at least 20% of their assets under management held by investors belonging to one of more of the above categories of FIIs, shall also be categorized as FIIs which are long term investors, for the purpose of IDF.

Investments by FIIs/QFIs in Credit Enhanced Bonds

Companies issue 'credit enhancement bonds' to obtain better terms for their outstanding debt. In early November 2013, RBI had allowed Foreign Institutional Investors (FIIs) and Qualified Foreign Investors (QFIs) to invest in credit enhancement bonds up to a limit of $5 billion, of the overall limit of $51 billion earmarked for corporate debt. In light of the RBI decision, SEBI has asked depositories to monitor FII/QFI investments in credit enhanced bonds, so as to ensure that their aggregate investments remain within this specified limit.

Compliance with the provisions of Equity Listing Agreement by listed companies – Monitoring by Stock Exchanges

SEBI has directed the stock exchanges to monitor contents of disclosures made by companies more effectively in compliance with the provisions of the equity listing agreement. The existing mechanism is considered inadequate and inaccurate. The listing agreement mandates companies to make periodic and event-based disclosures that are price sensitive in nature and have a bearing on the companies' performance or operations.

Annual System Audit of Stock Brokers / Trading Members

In a circular issued by SEBI, exchanges have been advised to keep track of findings of system audits of all brokers on quarterly basis and ensure that all major audit findings, specifically in critical areas, are rectified / complied in a time bound manner failing which follow up inspection of such brokers may be taken up for necessary corrective steps / actions thereafter, if any. The circular also includes the new framework to be followed for annual system audit by stock brokers.

October 2013

Norms eased for primary issuance of debt securities

SEBI has relaxed norms for primary issuance of debt securities by companies in a bid to develop the country's corporate bond market. As per the new measures, cash flows emanating from the debt securities would have to be disclosed in the prospectus or the disclosure document by way of an illustration. Other relaxations include the following - if the coupon payment date of the debt securities falls on a Sunday or a holiday, the payment would be made on the next working day and in the case the maturity date of the debt securities, falls on a Sunday or a holiday, the redemption proceeds would be paid on the previous working day. Besides these, SEBI has allowed frequent debt issuers - who are in compliance with listing norms -to disclose unaudited financials with limited review report in the offer document instead of audited results.

Disclosure of Investor Complaints on websites of Stock Exchanges

In order to bring more transparency in the disclosure of complaint redressal status of the stock brokers on the website of stock exchange, it has been decided to modify the format by including following information - number of active clients of each stock broker, percentage of number of complaints received as against number of active clients of the stock broker, percentage of complaints resolved as against complaints received by the stock broker.

Standardisation and Simplification of Procedures for Transmission of Securities

SEBI has simplified the procedure for transfer of securities from the account of a deceased person and raised the threshold limit for such transactions in demat format to Rs 5 lakh (earlier limit was Rs 1 lakh). The move is aimed at making transmission of securities in both dematerialised and physical modes more efficient and investor friendly. Transmission refers to the transfer of securities from the account of a deceased holder to that of surviving joint holder, nominee or legal heir.

Listing of specified securities of small and medium enterprises (SME) on the Institutional Trading Platform in a SME Exchange without making an initial public offer

SEBI has come out with a legal framework for listing and trading of specified securities on the Institutional Trading Platform (ITP) in an SME Exchange, without having to go through an initial public offer of shares. The ITP will be a platform for listing and trading of specified securities of small and medium enterprises, including start-up companies in a 'SME Exchange' as defined under ICDR regulations. The ITP will be accessible only to informed investors who are either individuals or institutions and the minimum trading lot on the platform would be Rs10 lakhs. Companies listed on ITP are restricted from making a public issue of its securities.

General Information Document for investing in IPOs

SEBI has asked companies planning to float IPOs/FPOs to give them an abridged prospectus with key information, and provide generic details in a separate document. It has also asked merchant bankers to the IPOs/FPOs to print an information document which is generic in nature and not specific to the issuer. The updated general information document (GID) would also need to be uploaded on the websites of the stock exchanges and the lead managers. The GID would contain information on IPOs/FPOs, eligibility criteria, mode of applying for the issue, allotment and refund procedure.

Centralized database for Corporate Bonds/ Debentures

To bolster debt market in the country, SEBI today asked depositories National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL) to jointly create and maintain a centralised database of corporate bonds and debentures, which can be accessed by the general public and others free of cost. At present, the information in respect of various bonds/debentures issued is available in a fragmented manner and available at multiple sources such as websites of credit rating agencies, depositories, stock exchanges, among others.

Formats under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (Regulations)

In order to ensure that adequate disclosures are made to help investors in taking an informed decision, SEBI has modified the formats for disclosures under regulation 29 (1), 29 (2) and 31 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

Gold Exchange Traded Fund Scheme (Gold ETFs) and Gold Deposit Scheme (GDS) of Banks

SEBI has allowed Gold Exchange Traded Funds (ETFs) to invest in gold deposit schemes of banks, as part of overall efforts to utilise idle assets of the precious metal for more productive purposes. It has allowed gold ETFs of mutual funds to invest in Gold Deposit Scheme (GDS) of banks, subject to certain conditions including that the total investment in GDS would not exceed 20 per cent of total asset under management of such schemes.

Know Your Client Requirements

In August 2012, SEBI had advised that Aadhaar Letter issued by UIDAI would be admissible as Proof of Address in addition to it being recognized as Proof of Identity. In consultation with Unique Identification Authority of India (UIDAI) and the market participants, it has now been decided to accept e-KYC service launched by UIDAI also, as a valid process for KYC verification. The information containing relevant client details and photograph made available from UIDAI as a result of e-KYC process shall be treated as sufficient proof of Identity and Address of the client. However, the client shall have to authorize the intermediary to access his data through UIDAI system.

Facilitating transaction in Mutual Fund schemes through the Stock Exchange Infrastructure

SEBI has decided to facilitate transactions in mutual fund schemes through the stock exchange infrastructure. The new model would allow distributors to buy or sell mutual fund units on the exchange, provided the distributor is approved by the Association of Mutual Funds in India (AMFI). Additionally, the distributors can purchase or redeem units directly from the mutual fund or the asset management company. Further, the distributors will not handle the payout and pay in either of the fund or the units on behalf of the investors. The units shall be credited and debited directly from the demat account of investors.

SEBI Discussion Papers – Oct- Dec 2013

In the period October - December 2013, SEBI put the following discussion/ consultation papers on its website for public comments:

- Consultation Paper on Infrastructure Investment Trusts
- Report of the High Level Committee to review the Insider Trading Regulations
- Consultation Paper on Proposed Regulation of Research Analysts
- Proposals for allowing certain class of companies to file shelf prospectus for public issuance of non-convertible debt securities
- Discussion Paper on 'Review of guidelines governing stock related employee benefit schemes'
- Draft Regulations -SEBI (Procedure for Search and Seizure) Regulations, 2013
- Consultation paper on draft SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2013
- Discussion Paper on SEBI (Real Estate Investment Trusts) Regulations, 2013
- Discussion Paper on 'Review of policy for trade cancellation / annulment'

Insurance Sector

January 2014

25% of new policies sold by life insurers are in rural areas: IRDA

According to Insurance Regulatory and Development Authority's (IRDA) annual report for 2012-13, all the 23 private sector life insurance companies had fulfilled their rural sector obligations. According to IRDA rules, these insurers should underwrite 25 per cent of their policies in the rural sector.

Insurance density, penetration show decline

The Insurance Regulatory and Development Authority (IRDA), in its annual report for 2012-13, said insurance penetration stood at 3.96 per cent, while insurance density stood at $53.2 for 2012, down from 4.10 per cent in 2011. Similarly, insurance density fell $53.2 in 2012 compared to $59 in 2011.

The measure of insurance penetration and density reflects the level of development of the sector.

Insurance companies to pay service tax for services like registration and renewal news

According to an IRDA notification, the regulator is required to collect service tax from its insurance companies, brokers and agents. The services being offered by the Insurance Regulatory and Development Authority (IRDA) will be costlier from now on, thanks to the levy of service tax.

The Authority, in its board meeting, approved the collection of applicable service tax on various services rendered with effect from January 1, 2014.

Private Banks too may be allowed to sell policies of multiple insurers

In the new bancassurance policy, private sector banks are likely to be brought on par with their public sector counterparts. The policy aims to allow banks to sell insurance policies of various companies as against the existing arrangement which permits them to sell policies of only one company.

IRDA plans pilot to roll out small policies through e-Seva

The Insurance Regulatory and Development Authority (IRDA) will soon launch a pilot project involving all the insurance companies to sell small premium insurance products essentially targeting rural and small income household needs. These would be sold through e-Seva in Andhra Pradesh and similar customer service centres elsewhere in the country.

The idea is to sell the products that are simple in nature on technology platforms like e-Seva as small premium products are not usually pushed by the agent-led selling system.

December 2013

Health insurance grid might cut costs for getting covered

The health grid will also be beneficial for the customers. The Insurance Information Bureau (IIB), along with the Insurance Regulatory and Development Authority (IRDA), plans to engage with hospitals, insurance companies and third-party administrators (TPAs) to maintain a health insurance and information grid. This, say insurers, will enable them to plug the loopholes in the health insurance space.

Insurance broking: Banks divided over Finance Ministry move

Although customers will now have more choice while buying insurance from banks, the bankers are divided on the impact of the move to turn them into brokers for multiple insurance companies.

Bancassurance has been a significant channel in insurance. It accounted for 40 per cent of total premiums collected by private insurers in 2012-13.

FinMin asks all public sector lenders to act as insurance brokers

The finance ministry has asked all public sector banks to act as insurance brokers to boost insurance penetration in the country.

The finance ministry's recent circular has been cheered by a large chunk of insurance companies. However, some insurers with existing shareholder agreements said that all joint-venture partners may not be supportive of this move. While Insurance Regulatory and Development Authority (IRDA) had also earlier proposed the concept of open architecture of bancassurance, there were conflicting views in the industry on the same.

Insurance plans for HIV-infected to cost more: IRDA

Persons suffering from HIV/AIDS or other pre-existing illness will have to pay higher premium for life insurance, as the pricing will be based on commercial considerations, regulator IRDA has said.

Adopt reasonable font size in policy forms: IRDA to insurers

Insurance regulator advised the insurers to maintain a minimum font size equivalent to 'Times New Roman size number 7 so that the policy holders are not at discomfort while reading forms.

"In order to ensure that the policyholders and beneficiaries of insurance policies are not at discomfort while using the forms with insignificant prints, there is a need to maintain a reasonable font size in all the forms by all insurers," IRDA said in a circular.

Standard protocol must for health insurance, says IRDA

Absence of a standard protocol for treatment has led to lack of uniformity in cost of treatments and there is a need to make affordable insurance products, a member of insurance sector regulator IRDA said.

November 2013

IRDA to sort out issues related to repository system

Industry for uniform cost of repository maintenance. The Insurance Regulatory and Development Authority (IRDA) is likely to fix the processes related to the newly-launched repository system after meeting the Life Insurance Council, insurers and the five repositories this month. The KYC (Know Your Customer) norms, free-look period, guidelines and cost of repositories are among the aspects to be approved by the regulator.

IRDA's new guidelines on life insurance: Moving towards transparency and efficiency

Over the past couple of years Insurance Regulatory and Authority had been driving the agenda of customer centricity in Indian life insurance industry. While the regulator has brought about several regulatory changes, life insurers have taken several steps to enhance customer focus.

Partner Exchange

'Insurance Clearing House' proposed by IRDA: Now, inter-company insurance settlements will be easier, quicker.

Insurance companies can now settle their inter-company balances in a quicker and easier manner, with the Insurance Clearing House (ICH), proposed by the Insurance Regulatory and Development Authority (IRDA).

In a draft proposal released recently, IRDA had said inter-company balances in reinsurance and coinsurance businesses were at very high levels and still rising. In order to enable timely and effective reconciliation of these balances as well as to achieve transparency, the insurance regulator said a clearing house be established.

RBI eases insurance JV norms for NBFCs

The relaxation is subject to compliance by the NBFC with all regulatory conditions. The Reserve Bank of India has relaxed norms for non-banking finance companies (NBFCs) in insurance joint ventures by allowing them to hold more than 50 per cent in such companies.

"On a review, it has been decided that in cases where Irda issues calls for capital infusion into the insurance JV company, the bank (RBI) may, on a case-to-case basis, consider need-based relaxation of the 50 per cent group limit," the Reserve Bank of India said. The relaxation is subject to compliance by the NBFC with all regulatory conditions, it said.

IRDA plans 'use and file' regime for product approvals

Insurance watchdog IRDA is planning to allow industry players to sell some products first and then take approvals as per 'use and file' regime in its bid to allow tailor-made products.

IRDA hikes insurance provisioning to 210%

Domestic general insurers want the insurance regulator to cut back the steep hike in provisioning it has made for the part of motor insurance which is compulsory. The higher provisioning will not raise premium rates for people buying motor insurance but it will raise costs for insurance companies.

The Insurance Regulatory and Development Authority (Irda) has asked companies to charge themselves a 210 per cent provisioning for a high risk category of third party motor insurance risks. It is 110 per cent so far.

IRDA chief meets SEBI officials on IPOs by insurance companies

Mr. T.S. Vijayan, the Chairman of Insurance Regulatory Authority of India addressed senior SEBI officials on various policy issues.

These included coordination among regulators and IPOs of insurance companies, including loss-making ones to enable greater transparency and accountability. Consumer protection, new product guidelines and distributor commissions, were other issues that the IRDA chief deliberated upon at the meet.

IRDA plans unique ID for hospitals

The Insurance Regulatory and Development Authority (IRDA) is in the process of issuing unique identity numbers to hospitals to determine pricing patterns for various diseases. There is currently no such coding for hospitals through the ministry of health or municipal corporations. The new system is expected to provide a better understanding of protocol and cost standards.

New insurance scheme for farmers from Rabi season

Private insurance sector will now have a bigger play in rolling, execution of insurance schemes along with Agricultural Insurance Company of India. The government will roll out new national crop insurance programme for the twelfth plan period across India in the ensuing Rabi 2013-14 seasons. Agricultural Insurance Scheme (NAIS), Weather Based Crop Insurance Scheme (WBCIS), Pilot modified National Agricultural Insurance Scheme (MNAIS), and pilot Coconut Palm Insurance Scheme.

A salient feature of the flagship scheme - Modified National Agricultural Insurance Scheme (MNAIS) is that private insurance sector will have a bigger play in rolling and execution of the insurance schemes along with Agricultural Insurance Company of India.

General Insurers can double their exposure to liquid mutual funds: IRDA

India's insurance regulator has decided to double the investment limit in liquid mutual funds for general insurers. At present, general insurance companies are allowed to invest 1.5% of assets into liquid mutual funds under the approved investment category where the size of the fund is above Rs 2,000 crore. Now, they will be allowed to invest an additional 1.5% or Rs 3,500 crore.

E-KYC to be accepted for verification: IRDA

Insurance Regulatory and Development Authority (Irda) said that the e-KYC (electronic know-your-customer) services operationalised by the Unique Identification Authority of India (UIDAI) will be accepted as valid KYC process for insurance. Earlier, Irda had informed insurers that a letter issued by the UIDAI containing details such as name, address and Aadhaar number was a valid document for customer identification.

FICCI's Data Centre

Indian Economy-An Update

Key Economic Indicators

GDP	4.8% - Q2 FY14 4.4% - Q1 FY14
Headline Inflation	Headline inflation index for the month of November 2013 registered a growth of 7.5% y-o-y (14-month high), vis-à-vis 7.0% in October, 2013
IIP	The Index of Industrial Production contracted by 1.8% in October 2013
Current RBI Rates*	Bank Rate: 8.75% (w.e.f. 29/10/2013) Repo Rate under LAF: 7.75% (w.e.f. 29/10/2013) Reverse Repo Rate under LAF: 6.75% (w.e.f. 29/10/2013) Cash Reserve Ratio: 4.00% (wef 09/02/2013) Statutory Liquidity Ratio (SLR): 23% (w.e.f 11/08/12) Marginal Standing Facility (MSF): 8.75% (w.e.f. 29/10/2013)
Exchange Rate	Rupee regained stability September 2013 onwards and continues to be in the 61/62 to a $ range

Source: MOSPI, RBI

Highlights

Recently released GDP data for Q2FY14 indicated marginal recovery in growth numbers, which was led by an exemplary performance of the agriculture sector. Q2FY14 registered 4.8% GDP growth y-o-y, vis-à-vis 4.4% growth witnessed in Q1FY14. The second half of the year is likely to see continuation of this improvement and the same was also reported in FICCI's latest Economic Outlook Survey. The industrial sector clocked a growth of 1.6% in Q2 FY14, which was better than the negative growth seen in Q1 FY14. Nonetheless, this is much below the potential rate and needs to be given a thrust through policy impe-tus.

Index of Industrial Production for October 2013 once again pointed towards a fragile recovery and it seems growth has not yet bottomed out. The Index of Industrial Production contracted by 1.8% in October 2013, despite witnessing some recovery in September 2013.The decline was primarily led by the poor performance in mining and manufacturing sectors. Growth in electricity sector though low, managed to be in the positive terrain.

Inflationary pressures continue to persist with Wholesale Price Index registering a growth of 7.5% in November 2013, a 14 month high. Food article prices continue to be elevated despite a normal monsoon and good agriculture production estimates. Supply side is clearly the key bottleneck and remains a concern. The Central Bank chose to stay muted on the policy rates in the recently announced mid quarter monetary policy review. Amid weak industrial production, it is imperative that growth is given a clear priority.

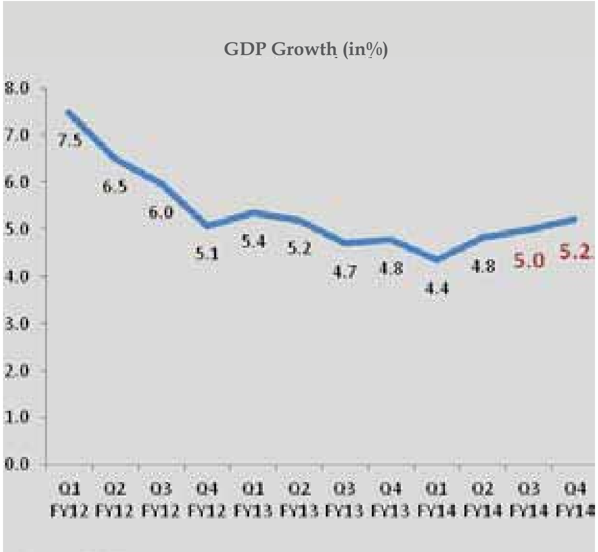
The external sector, which was a key risk factor until some time back has seen a discernible improvement. Exports have re-bounded strongly over the past five months. Trade deficit in November 2013 stood at $9.2 billion; half of the amount a year ago. Efforts should be made to sustain this to achieve the export target of $325 billion in FY14.

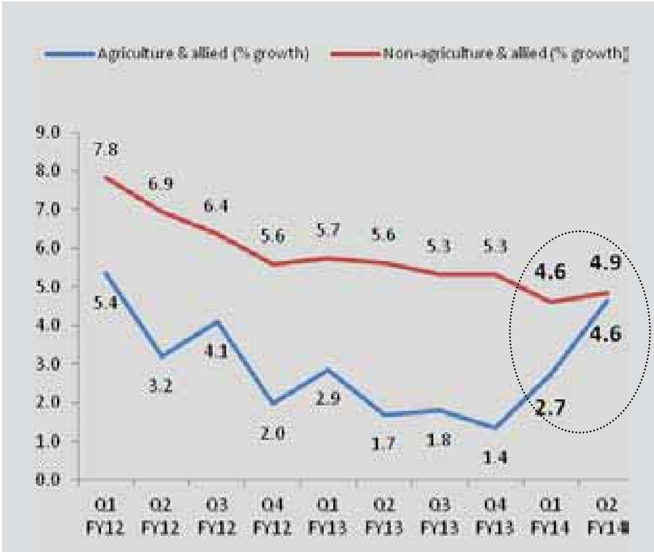
Gross Domestic Product (GDP)

The latest data released for Q2 FY14 indicated a marginal improvement in growth numbers. GDP growth was 4.8% in Q2 FY14, marginally higher than 4.4% growth witnessed in Q1 FY14. This improvement is likely to continue in the second half of the fiscal year as well. According to the latest round of FICCI's Economic Outlook Survey, growth in Q3 is estimated at 5.0% and at 5.2% in Q4 of the current fiscal.

Improved performance of agriculture and allied activities this year has been

Gross Domestic Product (GDP)





Source MOSPI

a key booster to GDP growth. The sector registered a growth of 4.6% in Q2 FY14, vis-à-vis 2.7% growth in previous quarter. The annual forecast for the sector's growth for FY14 as put out by FICCI's Economic Outlook Survey is 3.8%, with a range of 3.2% and 6.0%.

Data for the industry sector reported marginally better growth in Q2 of this fiscal year; the growth numbers by and large remain moderate and do not reflect return in buoyancy. Industry sector reported a growth of 1.6% in Q2 FY14, vis-à-vis (-) 0.9% growth in Q1 FY14.

In fact what is equally worrisome is the continuous decline in services sector growth. In Q2 FY14, the services growth declined to 5.8% (vis-à-vis 6.2% growth in Q1 FY14); this was the third consecutive quarter of decline.

Demand situation in the economy is still is a concern and was also indicated in FICCI's latest Business Confidence Survey. Private final consumption expenditure registered a growth of 2.2% in Q2 FY14 marginally up from 1.6% in the previous quarter but less than 3.5% in Q2 FY13.

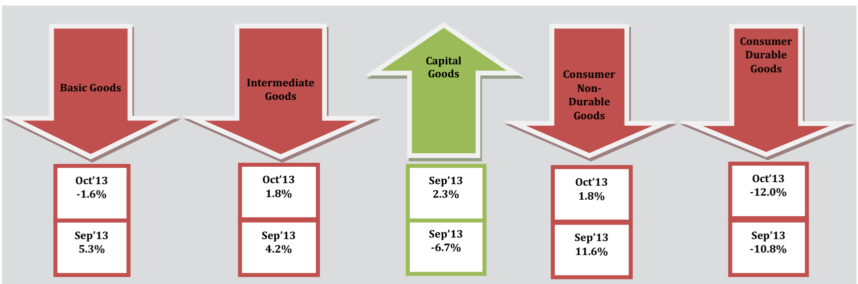
Index of Industrial Production (IIP)

IIP data for the month of October 2013 registered negative 1.8% growth y-o-y after recording positive growth for three consecutive months between July and September 2013. The corresponding growth in October 2012 was 8.4%.

Low growth in the factory output in October can be attributed to high base effect and some revisions in October 2012 index. Mining and manufacturing sector recorded (-) 3.5% and (-) 2.0% growth respectively, while electricity registered a low yet positive growth of 1.3% in October 2013. The growth in the electricity sector plummeted from 12.9% in September 2013, which was a 22 month high.

Among 22 sub-sectors of the manufacturing group, 12 sub-sectors reported positive growth in October 2013. 'Electrical machinery & apparatus

Index of Industrial Production (IIP)



Source: MOSPI

n.e.c.' recorded the highest positive growth of 34.2%, followed by 14.7% in 'Other transport equipment' and '9.3% in 'Medical, precision & optical instruments, watches and clocks'. On the other hand 'Furniture; manufacturing n.e.c.' has shown the highest negative growth of (-) 28.9%, followed by (-) 27.2% in 'Office, accounting & computing machinery' and (-) 23.0% in 'Radio, TV and communication equipment & apparatus'.

As per use-base classification, intermediate goods, capital goods and consumer non-durables goods sector witnessed a growth of 1.8%, 2.3% and 1.8%, respectively in October 2013. However, basic goods and consumer durable goods sector recorded negative 1.6% and 12.0% growth respectively in October 2013. Consumer durable goods sector witnessed negative growth for the 11th consecutive month. This can be attributed to slow pace of recovery in the economy and rising inflation which has taken a toll on consumer's pocket.

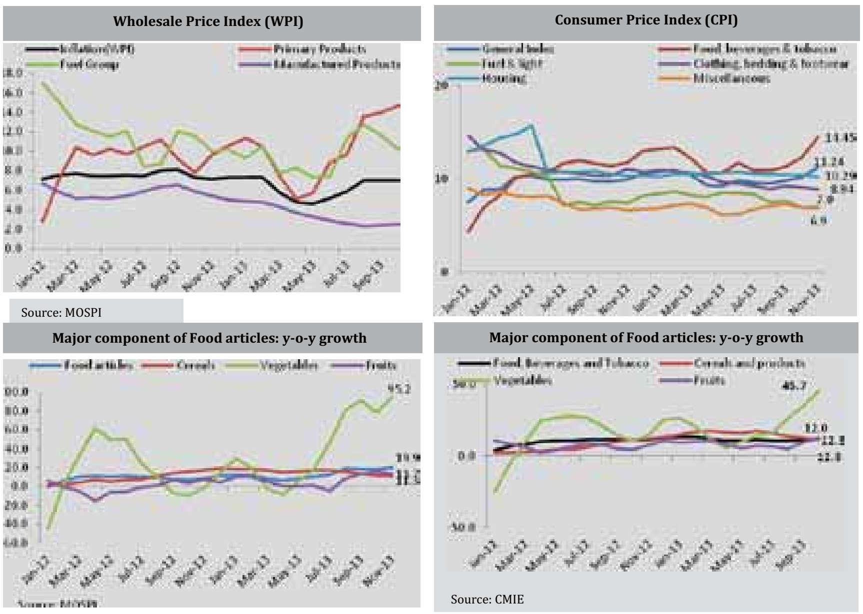
Headline inflation index for the month of November 2013 registered a growth of 7.5% y-o-y (14-month high), vis-à-vis 7.0% in October, 2013. This is the fourth consecutive month with inflation breaching 7.0%, with food and fuel segments exerting pressure on the overall prices.

Inflation

Primary articles segment recorded a growth rate of 15.9% in November 2013, a 33-month high. This was led by rise in food article inflation (mainly vegetable prices increasing by 95.2% in Nov'13) which witnessed an increase by 19.9% in November 2013 vis-à-vis 18.2% in October 2013. Nevertheless, food inflation is expected to ease in December with prices of vegetables likely to cool off with the onset of winter season.

As for the other two segments, fuel group inflation rose to 11.1% y-o-y in November, 2013, vis-à-vis 10.3% growth in October 2013. And the manufactured-products segment prices registered a growth of 2.6% in November 2013 vis-à-vis 2.5% in October 2013.

Inflation

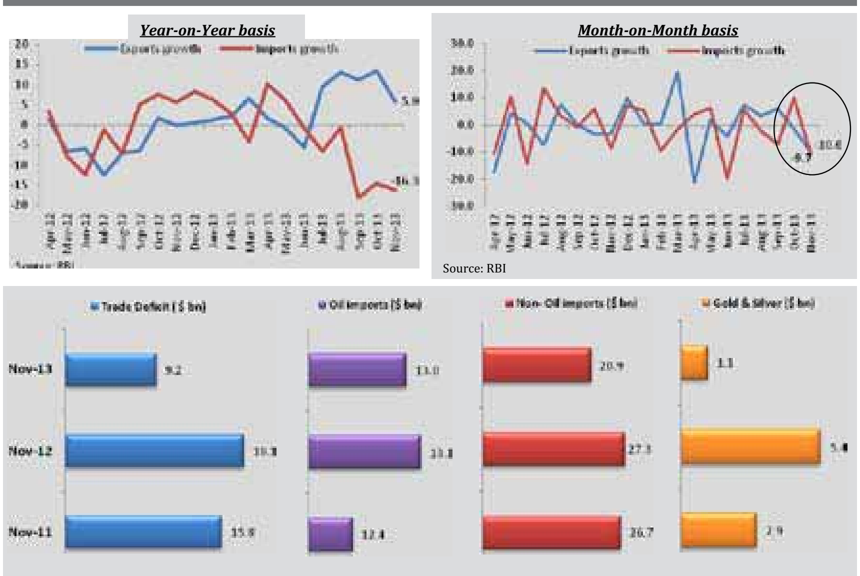


Consumer price inflation continues to be in the double digit terrain. The consumer price index increased by 11.2% in November 2013 vis-à-vis 10.2% in October 2013. This was once again on account of rise in food, beverages & tobacco segment prices, which has been attributed the maximum weightage (49.71) in the CPI index. The food segment prices increased by 14.5% in November vis-à-vis 12.4% in October 2013.

Foreign Trade

Latest export data released for the month of November 2013 witnessed some moderation, moving away from the double digit growth witnessed in the previous three months. Exports registered a growth of 5.9% y-o-y in November 2013 vis-à-vis 13.5% in October 2013. Imports on the other hand remained in the negative terrain for the sixth consecutive month, recording (-) 16.3% growth rate in November 2013, vis-à-vis (-) 14.5% growth in October 2013.

Foreign Trade



Given that India's trade deficit fell to $9.2 billion in November 2013 vis-à-vis $10.5 billion in October 2013. India's trade deficit at $18.1 billion was double a year ago. There has been a conspicuous decline in gold and silver import demand as well. The latter fell to $1.1 billion in November 2013, vis-à-vis $1.4 billion in the previous month.

Oil imports declined by 1.1% in November 2013 y-o-y. Oil imports stood at $13.0 billion in November 2013, vis-à-vis $13.1billion in November 2012. Non-oil imports declined by 23.7% to $20.9 billion in November 2013, vis-à-vis $27.3 billion in November 2012.

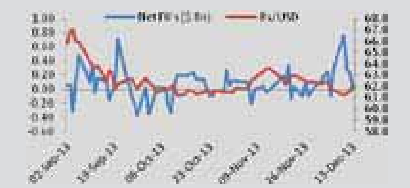
Further, current account deficit narrowed sharply in Q2 FY14. The CAD to GDP ratio was 1.2% in Q2 FY14, vis-à-vis 4.9% in Q1 FY14. In fact, the government's target of taming CAD to under $50 billion in FY14 seems attainable.

Cumulative numbers indicate that India's exports between April and November 2013 amounted to USD 204.4 billion. Further, if are able to sustain this growth, going ahead the export target of $325 billion for FY14 will not be difficult to achieve.

Foreign Investments

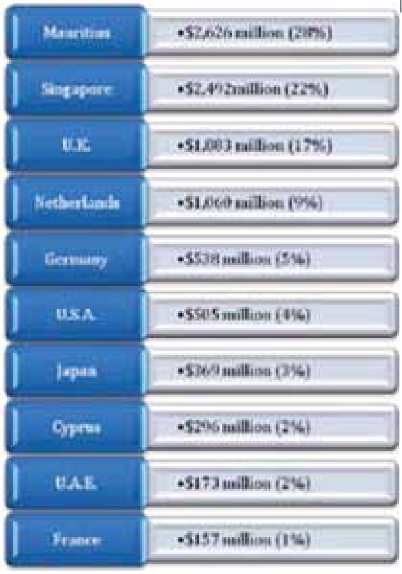
	(Net) Foreign Direct In-vestment (USD Million)	(Net) Portfolio Investment (USD Million)	Total Foreign Investment Inflows (USD Million)
Oct-12	1213	2921	4134
Nov-12	439	2002	2442
Dec-12	453	4858	5311
Jan-13	2701	6042	8743
Feb-13	2210	4101	6311
Mar-13	822	1171	1993
Apr-13	2773	1621	4395
May-13	1859	6783	8642
June -13	1827	-8627	-6800
July-13	1932	-4716	-2783
Aug-13	1663	-2031	-368
Sep-13	3290	145	3435
Oct-13	2048	-377	1671
Apr-Oct 2012-13	13193	8716	21909
Apr-Oct 2013-14	15393	-7203	8190

Source: Reserve Bank of India



Source: Reserve Bank of India and Securities and Exchange Board of India

Top 10 investing countries FDI Equity inflows (Apr-Sep 2013-14)



Note: (%share)

Source: DIPP

Foreign Investments

Cumulative foreign investment inflows for April-October 2013 amounted to $8190 million, vis-à-vis $21,909 million for April-October 2012. The decline primarily has been on account of a fall in portfolio investments which stood at (-) $7203 million in April-October 2013, vis-à-vis $8716 million in Apr-Oct 2012.

The net foreign direct investment in-flows, however, witnessed an increase over the same period. The cumulative flows amounted to $15.3 billion between April-October 2013, an increase of about 16.7% over the same period last year.

The daily data for foreign institutional investors made available by SEBI however indicates some return in optimism. During November and mid December, the FIIs injected around $5.2 billion into India.

Exchange Rate

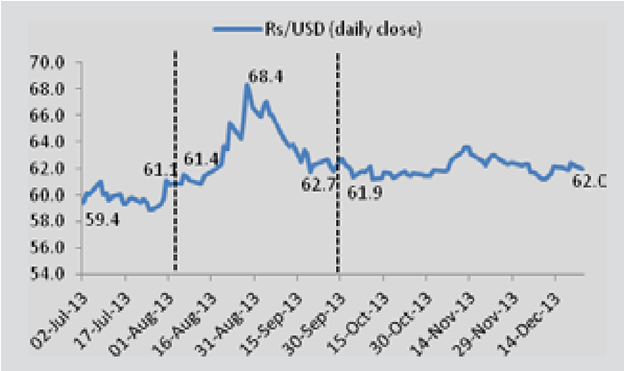
Rupee regained stability September 2013 onwards and continues to be in the 61/62 to a $ range. This is indeed positive as the measures undertaken by Government and RBI seem to have paid off well.

All qualms related to the much anticipated announcement of US tapering its quantitative easing program and the cor-responding impact on the exchange rate have been put to rest. In the recently held meeting, US Federal Reserve finally announced reducing the amount of bond purchases January 2014 onwards from $85 billion to $75 billion. Following this we did not see any erratic movement in the Rupee value, which was encouraging.

According to the recently conducted

Exchange Rate

Source: Reserve Bank of India



FICCI's Economic Outlook Survey, a majority of the participants felt that the Rupee value has bottomed out and is around its fair value. With a lower current account deficit and some replenishment of re-serves through the measures announced, we have been able to handle the announcement in a much better way. The Rupee value would remain settled around 61-62 towards the end of this year (March 2014).

Foreign Exchange Reserves

The total foreign exchange reserves rose to $291.3 billion in November 2013 vis-à-vis $282.9 billion in October 2013. The corresponding number in No-vember last year was $294.5 billion.

Increase in Forex reserves was mainly driven by sharp rise in foreign currency assets in November 2013. Foreign currency assets increased to $263.7 in No-vember 2013 vis-à-vis $254.5 in October 2013.

Gold reserves remained almost flat for two consecu-tive months at $21.2 billion in November and October 2013, vis-à-vis $27.8 billion in November 2012.

Measures announced by RBI in September 2013 to boost sentiments in foreign exchange market via making special concessional swap windows available is having an impact.

Total foreign exchange reserves as on December 13, 2013 stood at $295.5 billion.

Foreign Exchange Reserves

	Total foreign exchange reserves (USD Bn)	Foreign Currency Assets (USD Bn)	Gold (USD Bn)	SDRs (USD Bn)	Reserve Tranche Position (USD Bn)
Nov-12	294.5	260.0	27.8	4.4	2.3
Dec-12	295.6	261.7	27.2	4.4	2.3
Jan-13	295.5	261.7	27.0	4.4	2.4
Feb-13	290.9	257.9	26.3	4.4	2.3
Mar-13	292.0	259.7	25.7	4.3	2.3
Apr-13	293.9	263.3	24.0	4.4	2.2
May13	287.9	258.5	22.8	4.3	2.2
Jun-13	282.5	254.4	21.6	4.3	2.2
Jul-13	277.6	250.3	20.7	4.4	2.2
Aug-13	275.5	247.4	21.7	4.3	2.0

Source: Reserve Bank of India

Fiscal Position

The fiscal deficit during the first eight months of the current financial year stood at Rs 5,09,557 crores, 93.9% of the budgeted amount.

The revenue receipts of government rose by 12.7% during first eight months of FY14 as compared to the same period previous fiscal.

Net tax revenue collections registered growth of 7.2% during April-November 2013, whereas non-tax revenue recorded a growth 39.8% up to November 2013.

The total expenditure stood at Rs. 10,21,195 crores during April-November 2013, owing to rise in both plan and non-plan expenditure.

Plan expenditure rose by 19.6% and non-plan ex-penditure rose by 17.0% over the same period.

Fiscal Position

Indicators	Budget Estimates 2013-2014*	Actuals@ up to Nov 2013	% of Actuals to Budget Estimates	
	Rs. Crore	Rs. Crore	Current	Corresponding Period of the Previous Year
Revenue Receipts	1056331	502691	47.6%	47.6%
Tax Revenue (Net)	884078	396166	44.8%	47.9%
Non-Tax Revenue	172252	106525	61.8%	46.3%
Total Receipts	1122799	511638	45.6%	46.5%
Non-Plan Expenditure	1109975	730203	65.8%	64.4%
Plan Expenditure	555322	290992	52.4%	46.7%
Total Expenditure	1665297	1021195	61.3%	58.2%
Fiscal Deficit	542499	509557	93.9%	80.4%
Revenue Deficit	379838	393019	103.5%	91.2%
Primary Deficit	171814	295123	171.8%	118.7%

Source: Controller General of Accounts

Key Policy Announcements

- **RBI kept key rates unchanged** – The Reserve Bank of India kept the policy rates unchanged in the Mid-Quarter Monetary Policy Review announced on December 18, 2013.
- **Lokpal Bill passed in both Lok Sabha and Rajya Sabha** – The Lokpal and Lokayuktas Bill were passed in the Winter Ses-sion with the Lok Sabha and Rajya Sabha giving their nod to the anti-corruption legislation.
- **Government approves draft Regulatory Reform Bill** – The government has given its go ahead to the proposed Draft Regulatory Reform Bill, 2013 which aims to make regulators across key infrastructure sectors accountable to the Parliament besides giving them power of licensing.
- **FDI in railways likely to be UPA govt's New Year gift** – UPA government is going to allow foreign direct investment (FDI) in railways. The original proposal had mooted 100 per cent FDI in the railways, but this cap could be lowered to 74 per cent in some areas.
- **Land Acquisition Act to come into force from January 1, 2014** – The new Land Acquisition Act has come into force from January 1, 2014. Consultations on the Draft Rules related to the new LARR Act are underway and these rules are likely to be finalized by February 15, 2014.

Investment Banking Updates

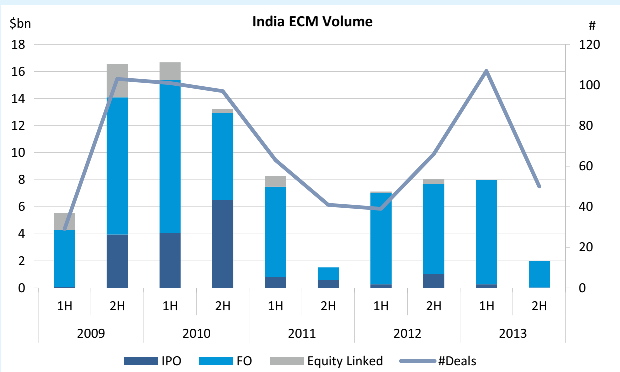
Equity Capital Markets

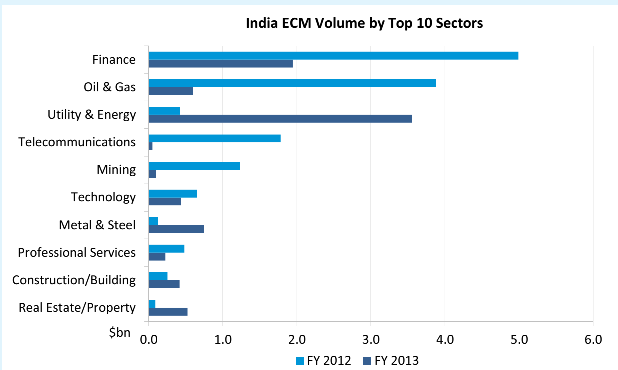
In association with dealogic

- **Indian ECM** volume stood at $10.0bn via 157 deals in 2013, a 34% decrease on the $15.2bn (via 105 deals) raised in 2012
- **IPO** volume totaled $295m (via 38 deals) in 2013, down 77% on the $1.3bn (via 25 deals) for 2012. There were no convertible issuance for 2013
  - **Follow-on** volume dropped by 28% to $9.7bn in 2013 compared to $13.4bn in 2012. However, number of deals rose to 119 versus 75 deals for 2012
- **NTPC's** $2.2bn follow-on via bookrunners **Citi, Goldman Sachs, Deutsche Bank, Kotak Mahindra, Morgan Stanley and State Bank of India** is the largest ECM transaction for India in 2013

Top 10 ECM Deals in 2013

Date	Issuer	Sector	Deal Type	Deal Value ($m)	Bookrunners
7-Feb	NTPC Ltd	Utility & Energy	FO	2,160	MS, GS, CITI, DB, KOTAK, SBI
10-Dec	Power Grid Corp	Utility & Energy	FO	1,143	SBI, CITI, ICICI, KOTAK, UBS
29-Jan	Axis Bank	Finance	FO	1,027	AXIS, CITI, JPM
1-Feb	Oil India Ltd	Oil & Gas	FO	591	CITI, HSBC, KOTAK
15-May	DLF Ltd	Real Estate	FO	341	SCB,DB,BAML, JPM, HSBC, KOTAK,UBS, CITIC
20-Feb	Shriram Transport Finance Co Ltd	Finance	FO	305	GS
22-Mar	Steel Authority of India Ltd - SAIL	Metal & Steel	FO	279	AXIS, DB, HSBC, JPM, KOTAK, SBI
11-Feb	WNS Holdings Ltd	Professional Services	FO	185	BAML, WELLS FARGO
22-May	Oracle Financial Services Software	Technology	FO	183	DB, MS
5-Jun	Adani Ports & Special Economic Zone Ltd	Transportation	FO	177	BAML,MS, SCB, IDFC, SBI, AXIS, CITI, DB, MCQ, GS





Equity Capital Market Tables

India ECM 2013

Pos.	Bookrunner Parent	Deal Value ($m)	No.	% Share
1	Citi	1,342	11	13.4
2	Kotak Mahindra Bank Ltd	1,093	15	11.0
3	State Bank of India	877	16	8.8
4	AXIS Bank	804	17	8.1
5	Goldman Sachs	683	3	6.8
6	Deutsche Bank	602	8	6.0
7	Morgan Stanley	592	6	5.9
8	JPMorgan	588	8	5.9
9	ICICI Bank	522	19	5.2
10	UBS	468	8	4.7

India FO and Conv. 2013

Pos.	Bookrunner Parent	Deal Value ($m)	No.	% Share
1	Citi	1,259	10	13.0
2	Kotak Mahindra Bank Ltd	1,093	15	11.3
3	State Bank of India	861	15	8.9
4	AXIS Bank	804	17	8.3
5	Goldman Sachs	683	3	7.1
6	Deutsche Bank	602	8	6.2
7	JPMorgan	588	8	6.1
8	ICICI Bank	522	19	5.4
9	Morgan Stanley	510	5	5.3
10	UBS	468	8	4.8

India Block Trade ECM 2013

Pos.	Bookrunner Parent	Deal Value ($m)	No.	% Share
1	Citi	670	7	13.2
2	Goldman Sachs	665	2	13.1
3	Kotak Mahindra Bank Ltd	661	8	13.1
4	State Bank of India	524	7	10.3
5	Deutsche Bank	506	4	10.0
6	Morgan Stanley	492	4	9.7
7	HSBC	243	2	4.8
8	AXIS Bank	211	7	4.2
9	UBS	186	5	3.7
10	ICICI Bank	167	11	3.3

India Industry 2013

Pos.	Industry	Deal Value ($m)	No.	% Share
1	Utility & Energy	3,555	5	35.6
2	Finance	1,946	24	19.5
3	Metal & Steel	747	12	7.5
4	Oil & Gas	602	3	6.0
5	Real Estate/Property	523	6	5.2
6	Technology	437	9	4.4
7	Construction/Building	418	15	4.2
8	Transportation	379	8	3.8
9	Consumer Products	233	11	2.3
10	Professional Services	227	8	2.3

India Deal Sub-Type 2013

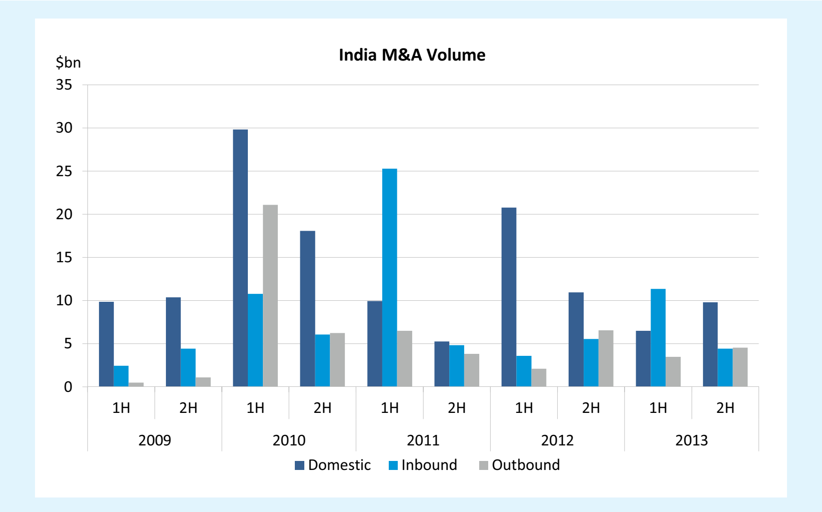
Pos.	Deal Sub-Type	Deal Value ($m)	No.	% Share
1	FO - Accelerated Bookbuild	5,063	81	50.7
2	FO - Fully Marketed	3,878	25	38.9
3	FO - Rights Offer	740	12	7.4
4	IPO - Open Price	215	2	2.2
5	IPO - Fixed Price	80	36	0.8
6	FO - Cash Placing	6	1	0.1

India Withdrawn / Postponed Deals 2013

Withdrawn/ Postponed Date	Issuer	Deal Type	Deal Nationality	Total Value $m	Industry	Bookrunner	Withdrawn/Postponed Comment
22-Apr-13	Sahara Prime City Ltd	IPO	India	1,022	Real Estate/Property	JM Financial, Kotak, Axis	Failed to submit clarifications sought by the regulator.
18-Feb-13	Sai Silks (Kalamandir) Ltd	IPO	India	20	Textile	Ashika Cr. Cap., Vivro Fin. Serv.	Not being able to raise the required subscription.
25-Apr-13	Ramky Enviro Engineers Ltd	IPO	India	200	Utility & Energy	Kotak, JPM, BoAML, IDFC, SBI, Edelweiss	Due to market conditions.
23-Jan-13	Jaypee Infratech Ltd	FO	India	28	Construction/Building	JPM	Due to unusual fall in the share price.
07-Mar-13	Multi Commodity Exchange of India	FO	India	45	Finance	CITI	Due to poor investor interest.
03-May-13	Scotts Garments Ltd	IPO	India	23	Textile	Keynote Corporate Services	Due to investor disinterest.
17-May-13	Tata Teleservices (Maharashtra) Ltd	FO	India	8	Telecommunications	Tata Securities Ltd	Cancelled by the seller.
31-May-13	Green Grid Group Pte Ltd	IPO	India	na	Technology	National Bank Financial	Due to uncertain market condition.

Mergers & Acquisitions

- **India** remained the fifth targeted nation in Asia Pacific region in 2013 with $32.0bn, down considerably compared to $40.9bn announced in 2012
- India **Outbound M&A** volume dropped to a five year low of $8.0bn in 2013 since 2009 ($1.6bn). Volume also dropped on an yearly comparison with 2012 ($8.7bn)
- India **Inbound M&A** volume rose substantially to $15.8bn in 2013 from the $9.2bn in 2012
- **Domestic M&A** volume dropped considerably by 49% to $16.3bn in 2013, compared to $31.7bn for 2012. Deal activity was also on a low of 741 deals compared to 937 deals for 2012
- **Unilever plc.'s** acquisition of 14.8% stake in **Hindustan Unilever Ltd.** for$3.5bn via advisors **Citi, HSBC** and **UBS** is the largest M&A transaction for India in 2013

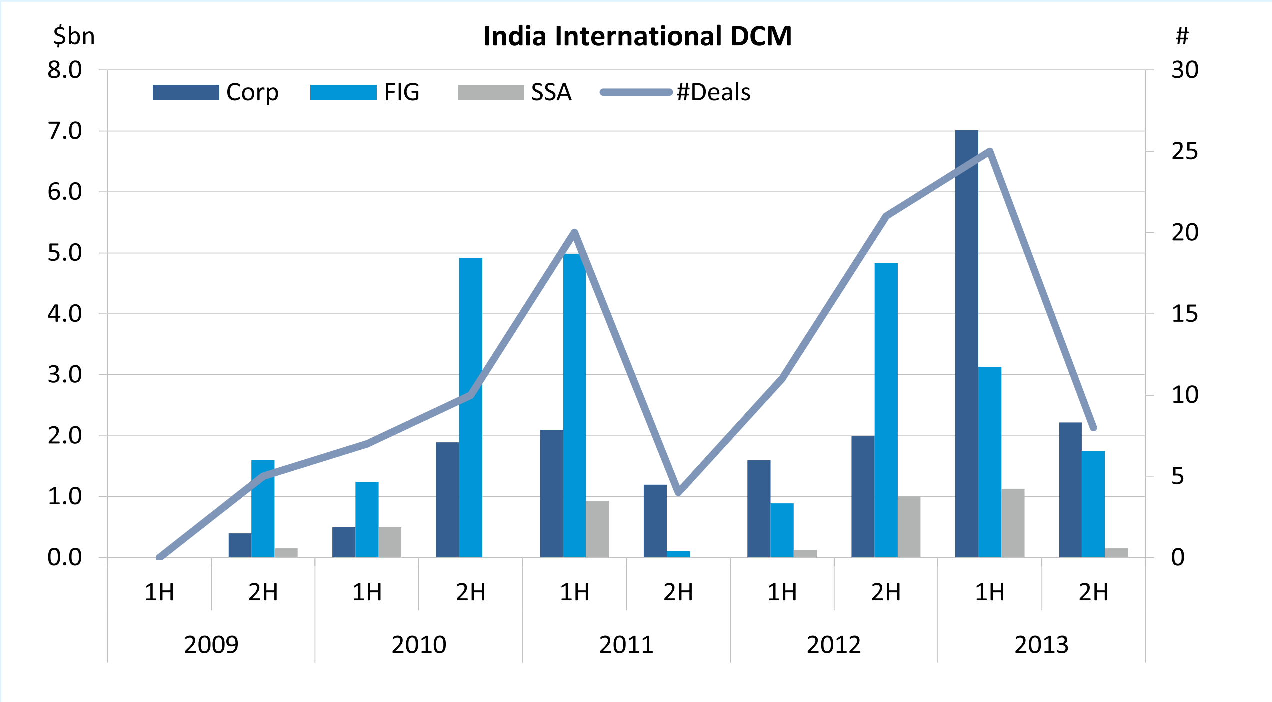


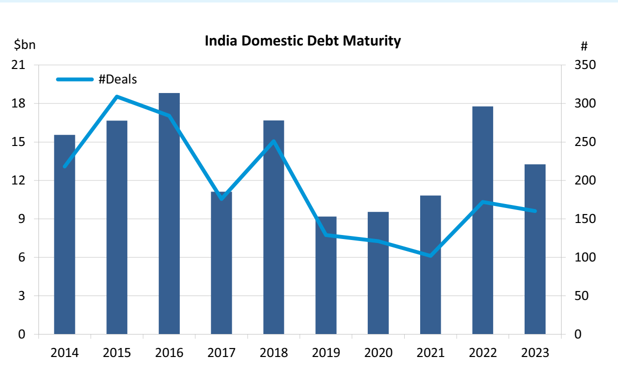
India Announced M&A Advisory Ranking 2013				
Pos.	**Advisor**	**Value $m**	**# Deals**	**% Share**
1	Citi	5,385	5	16.8
2	HSBC	3,926	2	12.2
3	UBS	3,851	2	12.0
4	Morgan Stanley	2,463	7	7.7
5	Barclays	2,133	3	6.7
6	Axis Bank	2,121	9	6.6
7	Jefferies LLC	2,000	1	6.2
8	Goldman Sachs	1,909	4	6.0
9	PwC	1,891	13	5.9
10	Kotak Mahindra Bank Ltd	1,364	15	4.3

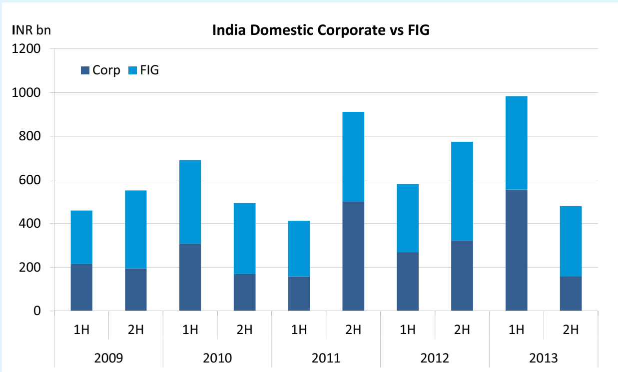
India Financial Sponsor Buyout Ranking 2013				
Pos.	**Financial Sponsor**	**Value $m**	**# Deals**	**% Share**
1	KKR & Co LP	825	2	29.6
2	Baring Private Equity Partners Ltd	644	2	23.1
3	Vulcan Capital Management	160	1	5.7
4	Apollo Global Management LLC	156	1	5.6
5	Carlyle Group LP	156	1	5.6
6	Blackstone Group LP	100	1	3.6
7	ChrysCapital	66	2	2.4
8	ICICI Venture Funds Management Co Ltd	62	4	2.2
9	Morgan Stanley Global Private Equity	57	1	2.0
10	Citigroup Private Equity	57	1	2.0

Debt Capital Markets

- **India DCM** issuance for 2013 reached $51.7bn via 522 deals, up 9% on the $47.4bn raised in 2012 also marking the highest yearly volume on record
- **Corporate IG** and **Agency** bonds accounted for 58% and 22% of the total DCM volume with $30.0bn and $11.6bn, respectively for 2013
  - **Bharti Enterprises Ltd.** led the offshore issuer table for 2013 with a 16% share, while **Power Finance Corp** topped the domestic issuer ranking with a 17% share
- India **Domestic DCM** volume reached a record INR2.07tr for 2013, up 5% from the INR1.97tr raised in 2012. Activity increased to 489 deals in 2013 from the 462 recorded for 2012 and marked the busiest year on record
- **International** issuance for 2013 recorded an all-time yearly high of $15.4bn, up 47% on the 2012 volume of $10.4bn. Activity increased to 33 deals compared to 32 deals for 2012

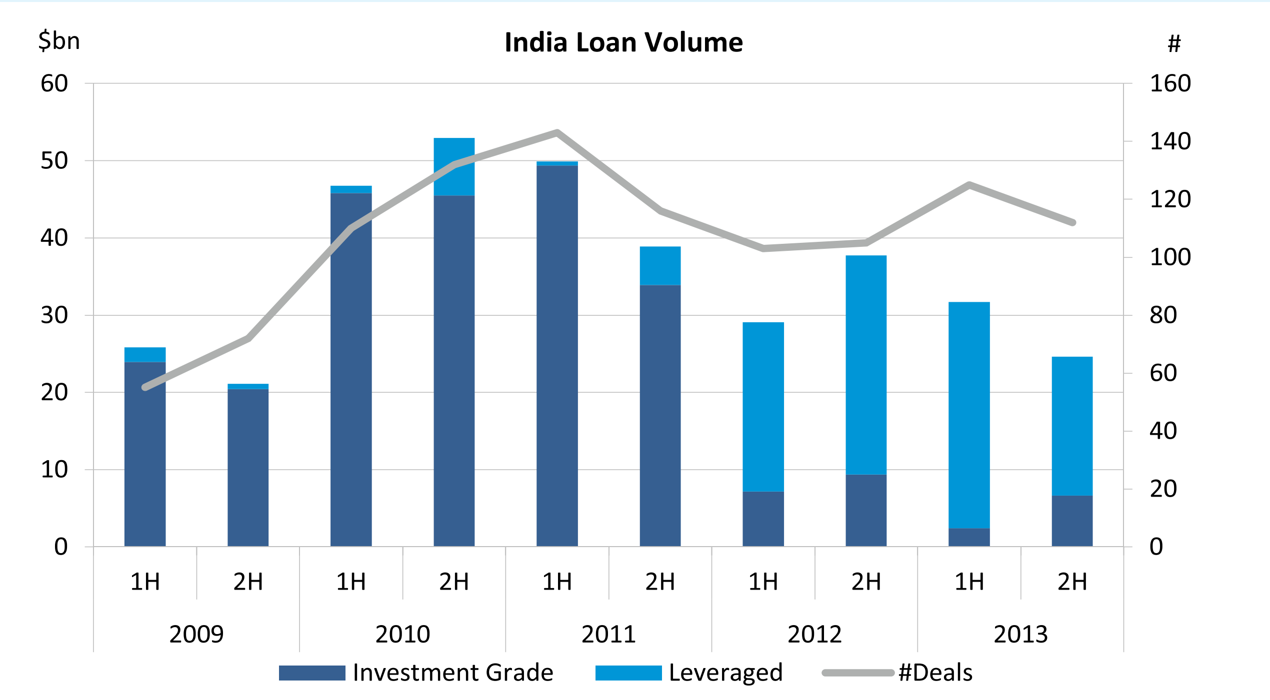


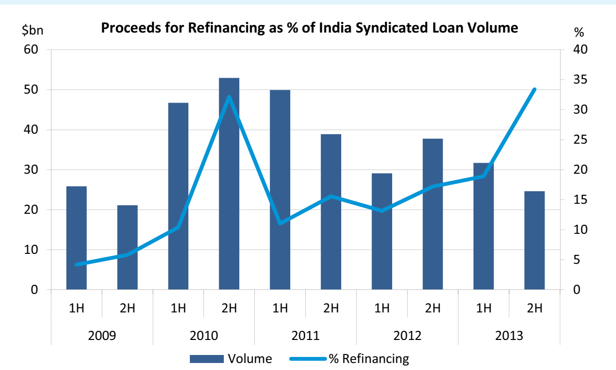


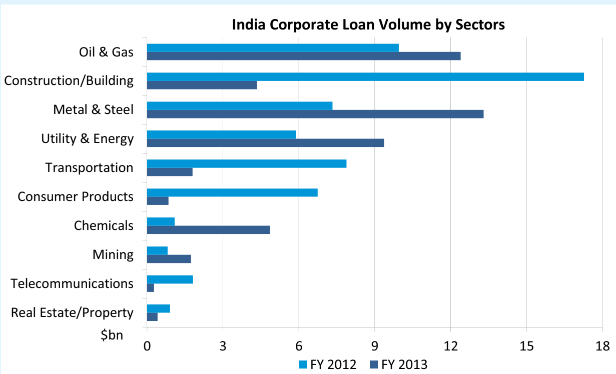


Loan Markets

- **India loan** volume reached \$56.3bn for 2013, down 16% on the \$66.8bn for 2012. However, number of deals increased to 237 compared with 208 deals for 2012
  - **Leveraged** loan volume dropped 6% to \$47.3bn via 209 deals, compared to \$50.3bn (157 deals) for 2012
  - **Investment grade** loan volume also dropped considerably by 45% to \$9.0bn versus \$16.6bn for 2012
- Among the corporate borrowers, **Metal & Steel** sector topped the industry ranking for 2013 (\$13.3bn) with a 25% share
- **Tata Steel's** \$4.1bn leveraged deal in May 2013 by arrangers **SBI, Axis, HDFC, ICICI and Punjab National Bank,** is the largest loan transaction in 2013







Project Finance

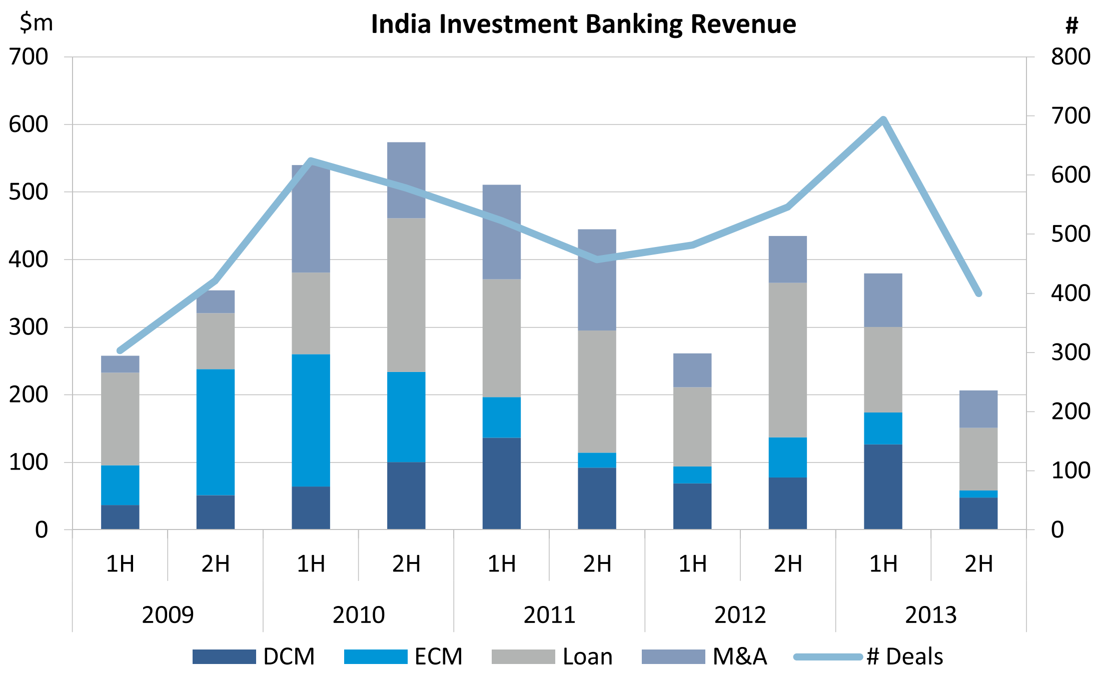
India Project Finance Loans Ranking 2013				
Pos.	Mandated Lead Arranger	Value $m	# Deals	% Share
1	State Bank of India	13,006	52	49.8
2	Axis Bank Ltd	2,511	17	9.6
3	ICICI Bank Ltd	2,440	13	9.4
4	IDBI Bank Ltd	1,720	15	6.6
5	Punjab National Bank	1,085	6	4.2
6	HDFC Bank Ltd	905	3	3.5
7	IDFC Ltd	806	9	3.1
8	Yes Bank Ltd	645	12	2.5
9	Central Bank of India	396	7	1.5
10	Standard Chartered plc	391	4	1.5

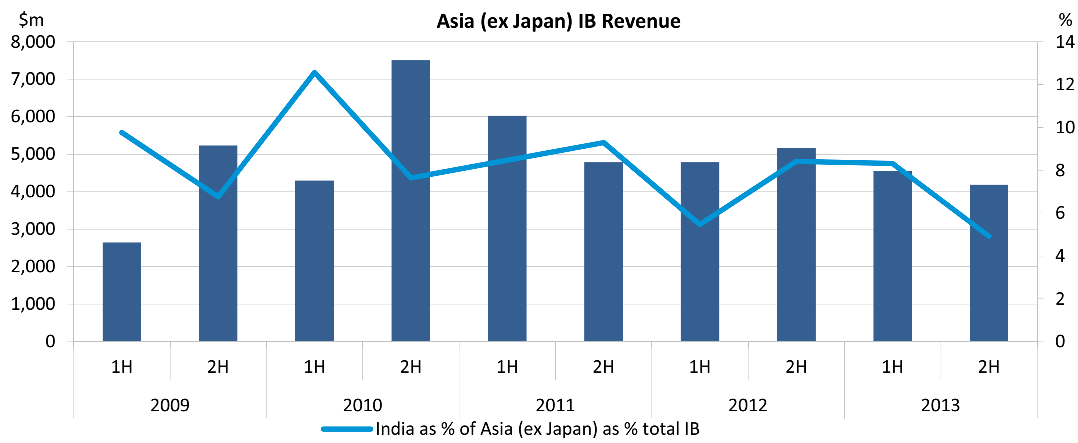
India PFI/PPP Project Finance Loans Ranking 2013				
Pos.	Mandated Lead Arranger	Value $m	# Deals	% Share
1	IDBI Bank Ltd	654	5	15.8
2	State Bank of India	649	7	15.7
3	IDFC Ltd	617	6	15.0
4	Axis Bank Ltd	464	5	11.2
5	ICICI Bank Ltd	259	4	6.3
6	Yes Bank Ltd	216	1	5.2
7	Central Bank of India	211	3	5.1
8	Standard Chartered plc	206	2	5.0
9	Bank of India	178	2	4.3
10	China Development Bank Corp / ICBC *	160	1	3.9

Top 10 Indian Project Finance Deals 2013				
Financial Close Date	Borrower	Project Name	Sector	Value $m
22-May	Tata Steel Odisha Ltd	Orissa Kalinganagar Steel Plant Project	Steel mill	5,927
29-Jan	ONGC Petro-additions Ltd	Opal SEZ Petrochemical Complex Dahej Project	Petrochemical/Chemical Plant	3,965
29-Aug	Hindalco Industries Ltd	Aditya Aluminium Smelter and Power Plant Refinancing	Processing plant	1,941
20-Mar	HPCL-Mittal Energy Ltd	Guru Gobind Singh HPCL Mittal Refinery Project	Oil Refinery/LNG and LPG Plants	1,684
17-Mar	MRPL	Mangalore Petrochemical Complex Project Expansion 2	Petrochemical/Chemical Plant	1,540
25-Mar	Hinduja National Power Corp Ltd	Hinduja National Power Plant Additional Financing 3	Power	1,352
24-Jul	Jindal Power Ltd	Jindal Chhattisgarh Thermal Power Plant Additional Financing	Power	1,297
28-Feb	Indiabulls Realtech Ltd	Nashik Indiabulls Thermal Power Project	Renewable fuel	1,208
22-Apr	Adani Power Maharashtra Ltd	Adani Power Maharashtra Plant Development PPP Refinancing	Power	925
16-Jan	Jindal Steel & Power Ltd	Jindal Angul Steel Plant and Plate Mill Project Refinancing	Steel mill	902

IB Revenue

- **India IB revenue** reached $586m via 1094 deals in 2013, which is down by 16% in comparison with 2012 ($696m) and marks the lowest since 2009 ($612m)
- **Syndicated Loan fees** accounted for 37% of total India IB revenue in 2013 with $219m, the lowest since 2009 ($220m)
  - Despite the record share, revenue at $219m during 2013, is down from the $346m earned during 2012
- **DCM revenue** reached $175m in 2013, a record high since 2011 ($229m) and also up by 19% compared to 2012 ($147m)
- **ECM fees** accounted for the lowest share of India IB revenue with $58m and a 10% share in 2013
- M&A fees reached $134m via 171 deals in 2013, up 13% compared to 2012 ($119m via 219 deals)





Markets Watch

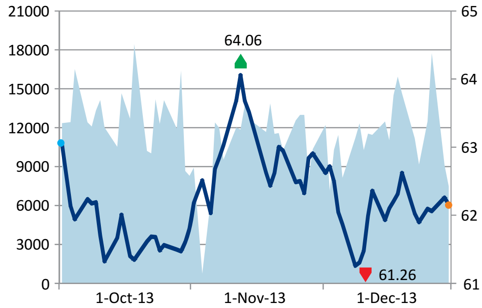
Powered by MCX SX India's New Stock Exchange

USD-INR

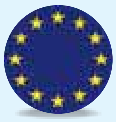
OCT-DEC 13

Turnover* (₹/cr)
7,25,621.70

Volume* (in lots)
16,69,27,694



Open: 62.24 | High: 64.06 | Low: 61.26 | Close: 62.16 — Price ▒ Volume
Currency futures prices from MCX-SX. *Combined turnover and volume of all exchanges compiled from exchange websites. *(Data till Dec 31, 2013)*

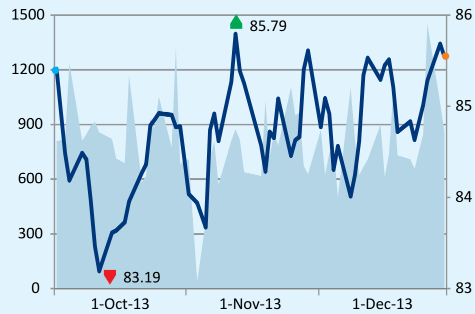


EUR-INR

OCT-DEC 13

Turnover* (₹/cr)
49,875.81

Volume* (in lots)
58,58,852



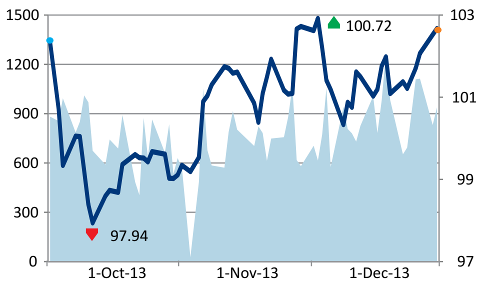
Open: 84.73 | High: 85.79 | Low: 83.19 | Close: 85.54 — Price ▒ Volume
Currency futures prices from MCX-SX. *Combined turnover and volume of all exchanges compiled from exchange websites. *(Data till Dec 31, 2013)*

GBP-INR

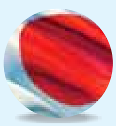
OCT-DEC 13

Turnover* (₹/cr)
48,061.28

Volume* (in lots)
47,32,166



Open: 100.72 | High: 102.92 | Low: 97.94 | Close: 102.67 — Price ▒ Volume
Currency futures prices from MCX-SX. *Combined turnover and volume of all exchanges compiled from exchange websites. *(Data till Dec 31, 2013)*



JPY-INR

OCT-DEC 13

Turnover* (₹/cr)
16,378.29

Volume* (in lots)
26,18,794

Open: 62.09 | High: 64.48 | Low: 59.22 | Close: 59.23 — Price ▒ Volume
Currency futures prices from MCX-SX. *Combined turnover and volume of all exchanges compiled from exchange websites. *(Data till Dec 31, 2013)*

Market Commentary

Indian Rupee witnessed an extremely volatile year 2013. Rupee was among the worst performing currencies, hitting a low of 68.85 against the US Dollar due to weak domestic economy and speculation over Federal Reserve's decision to scale back the stimulus programme, which started in 2008.

The Rupee was trading in the ranges of 61-62 levels towards the end of the year, showing a gain of nearly 10 per cent since August record low.

During the fourth quarter of 2013, the Rupee traded in the range of 61.00 to 64.00 as growth initiatives taken by The Reserve Bank of India helped it to stabilise, although uncertainty over The Federal Reserve tapering its quantitative easing programme stopped Rupee from appreciating beyond 61.00 levels.

In the third week of December 2013, Federal Reserve began its long-awaited tapering and announced plans to cut its monthly bond purchases to $75 billion from $85 billion.

However, losses were minimal as the Rupee became less vulnerable due to sharply lower current account deficit. India's current account deficit fell to $5.2 billion in July-September quarter, down 75 per cent from $21 billion recorded in the corresponding quarter of last year.

Outlook

Rupee is likely to see some volatility in the short term as US Fed's decision to scale back its monetary stimulus will tighten liquidity conditions in emerging economies.

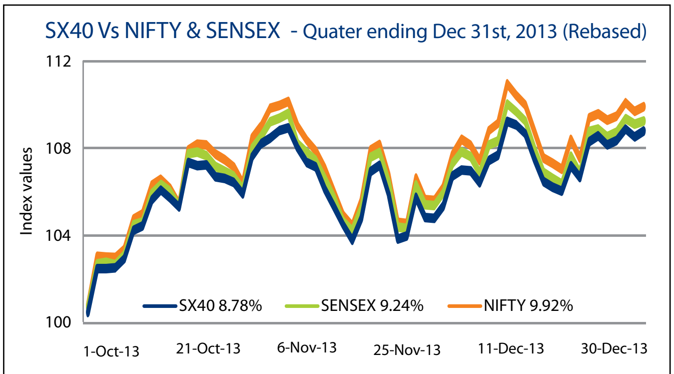
In the Technical Charts of USDINR, the pair is well bid around 61.00 and well offered around 63.00. Now USDINR may depreciate only below 60.50. If prices break the 60.50 level, then it may test 58.50. On the upside, immediate resistance is at 63.00, above that the pair may resume its bullish tone and may test 63.70, 65.00 levels.

- Rekha Mishra,
AVP - Research (Currency Derivatives),
Bonanza Portfolio Ltd.

Index Characteristics (as on December, 31th, 2013)	
Index Universe	Large Cap Companies
No. of Companies	40
Base Value	10,000
Base Date	31/03/2010
Industry Classification	ICB®
Minimum Free Float	10%
Review	Semi – Annually
Industry Capping	20%
Weight of Largest Constituent	09.46%
Top 10 Holding	62.93%

Computed Period	SX40	NIFTY	SENSEX
FY 2010-11	11.70%	11.14%	10.94%
FY 2011-12	– 8.84%	– 9.23%	– 10.50%
FY 2012-13	8.31%	7.31%	8.23%
FY 2013-14*	14.09%	10.94%	12.40%
FY 2010-13	10.29%	8.26%	7.46%
Return Since launch*	25.83%	20.10%	20.78%

*Till 31st Dec, 2013 | Source: Exchanges Website



Source: Bloomberg

Industry Weights Industry Name	SX40 Weights (%)
Industrials	14.70
Consumer Goods	16.91
Telecommunications	2.81
Oil & Gas	12.42
Health Care	6.20
Basic Materials	3.31
Technology	20.00
Financials	19.83
Utilities	3.03
Consumer Services	0.80

As on September, 30th, 2013

SX40™ INDEX OF INDIA

MCX Stock Exchange Limited (MCX-SX) is India's new full-fledged stock exchange, which will complete one year of its operations in Equity and Derivatives segment on February 11, 2014. SX40, the flagship index of the exchange is a free float based index constituting of 40 large-cap and liquid stocks representing diverse sectors of the economy. It is designed with to measuring the economic performance with better representation of various industries and sectors, based on global standards from the ICB classification.

Global macroeconomic uncertainties had risen in 2013 with the indication by US Federal Reserve to taper its QE3 (May 22, 2013). This led to series of events in the emerging economies adversely impacting its capital and currency market, as they also suffered from weak domestic demand, large current account deficit and declining exports. India has been no exception to this situation coupled with pressure from rising inflation. However, in these turbulent times SX40 outperformed its peers with a significant margin. One week post the QE3 tapering announcement (December 18, 2013) SX40 posted returns of 0.89% for its investors. SX40 has also outperformed during the calendar year 2013, giving 10.51% returns to its investors. As industry capping (20%) eliminates industry bias from the SX40 Index any industry specific impact does not influence the performance of this Index. Since its launch SX40 has posted 25.83% returns.

In these times of macroeconomic challenges faced by India and measures being taken by regulators to bring in stability, SX40 has emerged as an outperformer providing better returns to its investors.

Synopsis of past events

FICCI's 15th Annual Insurance Conference

24th October 2013, Mumbai

L to R: Ms. Nirupama Soundararajan, Additional Director, FICCI ; Mr. Renny Thomas, Senior Partner and Head of India Financial Institutions Practice, McKinsey & Co ; Mr. Bhargav Dasgupta, Co-Chair, FICCI's Insurance & Pensions Committee and Managing Director & CEO, ICICI Lombard General Insurance Company Ltd ; Mr. M. Ramaprasad, Member(Non-Life), Insurance ; Mr. S K Roy, Chairman, Life Insurance Corporation of India ; Mr. Alpesh Shah, Senior Partner & Director, BCG India and Mr. Amitabh Chaudhry, Chairman, FICCI's Insurance & Pensions Committee and Managing Director & CEO, HDFC Life Insurance Company Ltd

Federation of Indian Chambers of Commerce and Industry (FICCI) organized the Annual Insurance Conference on 24th October 2013. The conference in its 15th edition was organized under the aegis of FICCI's Insurance & Pensions Committee.

This year for the first time, the conference saw dedicated parallel sessions on Life and Non Life Insurance to provide greater focus on the issues for discussion. The Conference deliberations highlighted areas of industry performance and benchmarking vis-à-vis channel productivity, insurance penetration, process efficiency, fraud prevention and management, Human Resource, Digital and other pertinent areas under each sector.

Mr. T. Nanda Kumar, Member, National Disaster Management Authority gave a special address on Insurance and Disaster Management and the important role Insurance can play to uplift the economy during these times. Mr. M. Ramaprasad, Member (Non-Life), Insurance Regulatory and Development Authority and Mr. S K Roy, Chairman, Life Insurance Corporation of India also gave special addresses during the conference.

Two significant reports on the sector were released during the conference, details of which are given below:

Report on India General Insurance "Vision 2025": This report entails a fact-based view on the current state of the General Insurance industry, the key trends that will shape it in the next decade and its potential evolution.

Report on India Life Insurance: Negotiating The Troublesome Teens: This report outlines an action agenda for the Life Insurance industry to come out stronger from the present phase.

FICCI's 10th Annual Capital Markets Conference viz. CAPAM

15th November 2013, Mumbai

Mr. U.K. Sinha, Chairman, Securities & Exchange Board of India (SEBI) (Centre) releasing The Experts' Voice on 'The Changing Regulatory Paradigm & the Road Ahead' at CAPAM 2013. Also, seen are (L to R) Dr. A. Didar Singh, Secretary General, FICCI; Mr. Sunil Sanghai, Chairman, FICCI's Capital Markets Committee and M.D., Head of Banking-India, HSBC; Ms. Chitra Ramkrishna, M.D. & CEO, National Stock Exchange and Mr. Anup Bagchi, Co-Chairman, FICCI's Capital Markets Committee and M.D. & CEO, ICICI Securities Ltd.

FICCI organized the 10th edition of its Capital Markets Conference viz. CAPAM on November 15, 2013 in Mumbai. The theme for this year's Conference was 'The Changing Regulatory Paradigm & the Road Ahead'.

In his inaugural address, Mr. U. K. Sinha, Chairman, SEBI called on the business community to acknowledge that the prevailing emphasis in the changing regulatory paradigm was on transparency and accountability, and this was true not only nationally, but also globally. Across the world, those in power were being evaluated comprehensively and continuously by the public in a very effective manner. He stated that SEBI would announce new norms to bring about greater scrutiny of the way in which companies adhered to disclosure requirements. He pointed out that the Indian capital markets would deepen if pension money was allowed to be invested and if 15 per cent of the EPFO (Employees Provident Fund Organization) money that can be invested does actually get invested. He also highlighted that SEBI was reviewing guidelines on delisting of companies and those relating to preferential allotment of shares.

Dr. A. Didar Singh, Secretary General, FICCI delivered the welcome address. Other senior dignitaries who spoke at the Conference include Mr. Ashok Chawla, Chairman, Competition Commission of India; Mr. Ramesh Abhishek, Chairman, Forward Markets Commission; Mr. Rajeev Kumar Agarwal, Whole Time Member, SEBI; Justice B N Srikrishna, Chairman, FSLRC; Mr. R. Gandhi, Executive Director, RBI; Mr. Santosh Shukla, Joint Legal Adviser, SEBI; Dr. C K G Nair, Adviser-Capital Markets, Union Ministry of Finance; Ms. Chitra Ramkrishna, M.D. & CEO, National Stock Exchange; Mr Sunil Sanghai, M.D., Head of Global Banking-India, HSBC; Mr Anup Bagchi, M.D. & CEO, ICICI Securities Ltd.

The Conference also saw the release of a publication titled 'The Experts' Voice' on the Conference theme 'The Changing Regulatory Paradigm & the Road Ahead'. The publication contains the views of FICCI's Capital Markets Committee members on the impact of the recently enacted and proposed regulations on the Indian capital markets and possible solutions to some of the challenges that may also arise as a result of these regulatory challenges.

The Conference witnessed senior level representation from the industry, financial institutions, FIIs, brokers, banks, stock exchanges, merchant banks, financial analysts, fund managers, investors, economists and academia.

Alternative Investment Summit – India, 2013

18th December 2013, Mumbai

L to R: Panel discussion on reviewing the market landscape for alternative investments in India, Ms. Arpita Vinay, Senior Vice President, Centrum Wealth Management; Mr. Navneet Muhnot, Chief Investment Officer, SBI Mutual Fund; Mr. Karan Bhagat, Managing Director & Chief Executive Officer, IIFL Private Wealth; Mr. Andrew Holland, Chief Executive Officer, Ambit Investment Advisors; Mr. Manish Makharia, Executive Director, TVS Capital

Alternative Investments Summit – India, 2013 was organised in Mumbai on 18th December, 2013 by The Association of International Wealth Management of India (AIWMI). Federation of Indian Chambers of Commerce and Industry (FICCI) supported the event as Industry Partner. This programme was a first of its kind and attracted a great deal of participants from all the major stakeholders in the field of investments including asset managers, tax & law professionals, institutional investors, wealth managers, regulators, academicians & media facilitating a rounded discussion with multiple viewpoints, and an exceptionally high quality of debate. The Summit was inaugurated by Mr. Aditya Gadge, CEO, AIWMI and Mr. Sandip Ghose, Director, National Institute of Securities Markets (NISM) was chairman of the Summit.

The event was an interesting mix of panel discussions and session workshops including – Introduction to Alternative Investments, The alpha story in the Indian market, AIF Filing, Real Estate, Portfolio Construction through Alternative Investments and Alternative Investments beyond borders. Eminent panellists for the event included Arpita Vinay (Centrum), Shahzad Madon (Reliance Capital), Vibhor Gujarati (Edelweiss Alternative Investments), Karan Bhagat (IIFL Wealth) , Navneet Munot (SBI AMC), Andrew Holland (Ambit), Radhika Gupta (Forefront Capital), Manish Makharia (TVS Capital) among many other prominent names in the industry. This summit brought together more than 250 business leaders and executives working in the areas of investments. The Alternative Investments Summit garnered tremendous interest from public and has gained immense popularity on media front.

Events Calendar for FICCI's Financial Sector 2014

Event	Tentative Date	Tentative Venue	Point of Contact
Commodities Conference 2014	April /May	**New Delhi**	**Apoorv Srivastava** Email: apoorv.srivastava@ficci.com Tel: 91-11-2348 7424
Financial Sector Conclave 2014	July	**Hyderabad**	**Arindam Goswami** Email: arindam.goswami@ficci.com Tel: 91-11-2348 7568/2335 7246
FIBAC 2014 (FICCI - IBA Banking Conference)	August/September	**Mumbai**	**Supriya Chhatwal** Email: supriya.chhatwal@ficci.com Tel: 91-11-2348 7525
Insurance Conference 2014	August/September	**Mumbai**	**Nidhi Tomar** Email: nidhi.tomar@ficci.com Tel: 91-11-2348 7324/2335 7246
CAPAM 2014 (Capital Markets Conference)	August/September/ October	**Mumbai**	**Sunita Rattan** Email: sunita.rattan@ficci.com Tel: 91-11-2348 7413

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