APPENDIX – II

Major Recommendations of Selected Committees (1985-95)

I. COMMITTEE TO REVIEW THE WORKING OF THE MONETARY SYSTEM (Chakravarty Committee, April 1985)

1. The functioning of the monetary system must necessarily be in consonance with the national development strategy as articulated in the successive Five Year Plans. The monetary system should therefore, seek to perform the following tasks:
(a) mobilize the savings of the community and enlarge the financial savings pool.
(b) promote efficiency in the allocation of the savings of the community to relatively more productive purposes in accordance with national economic goals.
(c) enable the resource needs of the major 'entrepreneur' in the country, viz. The government, to be met in adequate measure.
(d) promote an efficient payments system.
2. It is essential to ensure that there is no mis-match between the responsibility of the central bank. i.e. the RBI, to supervise and control the functioning of the monetary system on the one hand, and its authority to do so on the other.
3. In order to maintain a viable balance of payments position, it is necessary to ensure that the domestic price level is not allowed to rise unduly, particularly since our major trading partners have had notable success in recent years in achieving price stability.
4. It would be desirable, in the Indian context, to assign to the monetary authority a major role in promoting price stability, and also to accord price stability a dominant position in the spectrum of objective pursued by the monetary authority.
5. The contribution of monetary policy to the control of inflationary pressures largely lies in the area of aggregate demand management and in facilitating allocation and effective utilization of credit in relatively more productive avenues.
6. The central bank also has a difficult task of determining the timing of its regulatory measures on the basis of its experience in regard to the legs involved. As the banking system has grown considerably over the years the cost of a delayed decision can be considerable. Similarly, while monetary breaks are to be applied it is necessary to start early and in a phased manner as the impact of regulatory measures cannot be allowed to be so drastic as to cause unintended hardship to specific sectors of the economy.
7. The inter-action between money, output and prices is very often summarized in the equation which takes the form of the demand function for real money balance on the postulate that the causation runs from real income to money. As the process of money creation is simultaneously a process of credit creation, it is necessary also to look upon the problem from the credit side since an output increase may require a certain amount of increase in credit.
8. The extent of increase in the price level associated with an increase in output and money will depend on the elasticity of output wit respect to credit and the elasticity of price with respect to money as well as output. Obviously these eleasticities themselves depend upon the structure of production and the flexibility of supply responses and can change with time.
9. An important area of concern to the monetary authority is the determination of the rate of growth of money supply, taking into account the inter-relationship between money, output and prices. In order to be acceptable to the monetary authority, the rate of growth in money supply should be conformity with the desired rate of growth in output and constrain the price increase to an acceptable level. From the operational point if view, without going into causation, it may be possible for the monetary authority to use such an equation to regulate the supply of money.
10. The single – most important factor influencing the conduct of monetary policy since 1970 is the phenomenal increase in reserve money. The major component of this increase was the increase in Reserve Bank credit to government on which the central bank had little control. In view of this,

the only feasible approach to the control of monetary expansion was to influence the value of the money multiplier by rising the Cash Reserve Ratio. This was done repeatedly and the rise in the average money multiplier was more or less arrested after the mod-seventies and stabilized at a level slightly below 3.0. This achievement fell far short of the requirements of the situation in several years during the period under review when a drastic reduction in the growth of M_3 was called for.

11. In India, the growth of high-powered money or reserve money has been largely the result of increase in Reserve Bank credit to government. Any measure to check reserve money growth and hence money supply woul, therefore, evidently impinge on the government's freedom to take recourse to central bank accommodation.

12. A feasible approach to evolving a policy framework for ensuring a desired rate of growth of government expenditure as well as desired rate of growth of reserve money and money supply involves a certain degree of coordination between government and the Reserve Bank in evolving and implementing agreed policies. Such coordination is essential and also feasible.

13. The objective of growth with social justice can be achieved in the context of reasonable price stability only when the compulsions of demand management are adequately reflected in the level of government's fiscal deficit financed by RBI.

14. There appears to be considerable scope for government to tap the savings of the public through an appropriate interest rate structure and offer of a wider spectrum of savings instruments with attractive features. This will have the desirable consequence of lowering the rate of expansion in reserve money and money supply associated with a given level of borrowing by the government.

15. An unambiguous, and economically meaningful measure of the monetary impact of fiscal operations is provided by the change in the Reserve Bank credit to government.

16. It is safe to assume that the public will gradually increase its subscription to government securities carrying coupon rates (explicit or implicit) which are higher than the present levels by an average of about 3 per cent per annum particularly if the securities are available more or less throughout the year.

17. Initially interest costs will increase as successive tranches of government borrowing carry the higher coupon rates but the net impact on the government budget need not be large in the long run to the extent that relatively price stability is achieved. Indeed this should be the outcome if the monetary system s suitably restructured.

18. The increased holding of Treasury Bills and government securities by the public would imply, other things being equal, a slower growth in bank deposits and correspondingly in bank credit reflecting the slower expansions of reserve money. Maintenance of desired levels of bank credit to the non – government sector can be achieved through a less – than – compensatory increase in reserve money as compared to the reduction in reserve money occasioned by the contraction in Reserve Bank credit to government (net), if the compensating reserve money expansions is in the form of RBI assistance to banks.

19. The complex nature of the administered interest rate structure has also resulted in reducing the scope for effecting counter – cyclical variations in interest rates.

20. Interest rates applicable to a substantial portion of bank's assets portfolio are either lower than or barely above its cost of funds. This is not a healthy situation.

21. The implementation of projects with poor rates of return needs to be discouraged through a policy of maintaining real rates of interest at realistic levels by eliminating or reducing the element of concessionality in the interest at realistic levels by eliminating or reducing the element of concessionally in the interest rates charged on long-term loans.

22. We, therefore, believe that while the policy of relying on monetary budgeting and credit budgeting to achieve desired sectoral credit allocation should continue, there does appear to be a strong case for greater reliance on the interest rate instrument with a view to promoting the effective use of credit and in short-term monetary management. We believe that the quantitative controls can be more effective if they are supported by a suitable interest rate policy which incorporates a subsidiary yet crucial rationing in the disbursement of credit.

23. The pre-occupation with concessional interest has, unfortunately, deflected attention away from the much more potent instrument of social justice which takes the form of adequate and timely of

credit to the neglected sectors, particularly in rural areas. We would, therefore, like to recommend strengthening of the credit delivery system with a view to provide adequate and timely credit to target groups covered under prioritysector lending, and the motivation to do so should not be allowed to be reduced through any undue emphasis placed on grant of credit at concessional interest rates, since such an emphasis could well prove to be counter-productive. As such only a very selective approach to the use of concessional interest rates seems to be warranted in contrast to the excessive reliance at present on concessional interest rates as a redistributive device.

24. A substantial volume of credit is pre-empted by government at relatively low interest rates. The complex operations of government can be made more efficient if a device like raising the cost of borrowings is more effectively and widely used.

25. Facilitating recourse to bill finance is another desirable method of promoting effective use of credit.

26. The supervision of the end-use of credit by banks is rendered more difficult by the widespread use of cash credit as a means of providing credit for working capital.

27. While the basic philosophy of the restructured system lies in affording greater flexibility to monetary and related institution at the micro level, the need to coordinate their activities in the interest of achieving national objectives of socio – economic policy remains, and the latter should be a major concern of the monetary authority. It is in this context that the need for the monetary authority to embark no monetary targeting in the formal sense acquires importance.

28. Formulation of monetary policy with M_3 as the monetary variable to be targeted becomes a feasible proposition in the restructured system envisaged by us.

29. The observed relationship between money, output and prices in India over the past two decades suggest a basis for determining range of targets for monetary growth. What we have in view is not mechanistic monetary targeting un-influenced by the impact of developments in the real sector, but what we might characterize as monetary targeting with feedback which enables changes in the targets to be made in the light of emerging trends in output and prices. The setting of the monetary target has to be in the form of a range rather than specific magnitude of monetary expansion.

30. We therefore recommend that the Reserve Bank of India adopt monetary targeting as an important monetary policy tool; subject to the cautions sounded by us and this would bind the Reserve Bank and the Government of India in a common effort to achieve desired rate of growth in money supply, as in the Indian situation control on monetary growth is impossible without the full support and understanding of the government.

31. It would be necessary to have an aggregate monetary budget annually as also for the period covered by the Five Year Plans in order that, over the medium term, reasonable coordination between production and credit plans is achieved.

32. A credit budget for the banking sector is also to be prepared as a part of the exercise on the monetary budget. The objective of the credit budget is to determine the permissible level of bank credit to the commercial sector and a broad profile of the sectoral deployment of credit.

33. Quantitative credit controls have come under severe stress in the absence of support from any price rationing mechanism.

34. The administered interest rate system has been found to be lacking the flexibility necessary for augmenting the pool of financial savings by effecting suitable changes in the deposit rates from time to time as the low profitability of banks has made banks wary of increasing the average cost of deposits.

35. A fair degree of regulation of interest rate is necessary so as to provide for an orderly mobilization of financial savings for purposes of planned economic developments as well as in the interest of viability of operations of banks of widely varying size in terms of deposits and advances and differing greatly in regard to the quality of their human resources.

36. In our view the Treasury Bills should be developed as an active monetary instrument and should constitute the ideal short-term paper in the money market. What comes in the way of such a development is its low yield.

37. Borrowing by way of Treasury Bills should not be construed as a convenient alternative to market loans of medium or long maturity. A short-term instrument cannot be used to finance essentially long-term requirements. The quantum of borrowing through the issue of Treasury Bills should

truly reflect the unanticipated variation between revenues and expenditure which need not always be large.

38. We recommend that the discount rate on Treasury Bills of 91 days should provide an yield which is marginally positive in real terms. This means that the nominal rate of discount would have to be higher than the expected change in the price level. Treasury Bills with a rate of discount of 4.60 per cent per annum need to be funded before new Treasury Bills are issued at revised rates of discount.

39. Medium and long dated government securities need to have yields which are in keeping with the expectations of the capital market in regard to the long-term movement of the price level.

40. We recommend that the yields on government securities with maturities not exceeding 15 years be so determined as to provide on an average over the entire spectrum of new issues an yield of 2 per cent per annum in real terms.

41. The concept of operational efficiency of commercial bank in India is associated with such diverse aspects of its operations as cost effectiveness, profitability, customer services, priority sector lending, mobilization of deposits and deployment of credit in the rural and backward regions and so on. Operational efficiency in banking has attained a wider connotation. Precisely for this reason, a generally acceptable definition of the concept, and selection of appropriate indicators are beset with difficulties. Nevertheless improvement in productivity in all aspects of banking operations has to be pursued by banks as an important management objective as it vitally affects the efficiency of the monetary system.

42. There is a need to introduce some element of price competition among banks. The 'controlled competition' which we have in view involves an 'administrated spread' between the interest of bank deposits with a maturity of 5 years and above, to be determined by the Reserve Bank and the basic lending rate which would serve as a floor to the non-concessional lending rates of banks.

43. Taking the present structure of interest rates and bank profitability as a guide, and also taking into account our recommendations in regard to the yield structure of government and other approved securities which are relevant in the context of the SLR investment of banks, we believe a 3 percentage point spread between the maximum rate on deposits and the basic (minimum) lending rate of bank should provide an acceptable spread to the banks.

44. It is desirable that the Reserve Bank determines the interest rate on banks deposits of one year maturity as also the maximum interest rate for deposits with a maturity of 5 years or more.

45. We recommend that the deposit rate to be offered by banks on deposits with a maturity of 5 years or more should be such as to offer the saver a minimum positive real return of 2 per cent per annum, and the deposit rate on deposits of one year maturity should be marginally positive in real terms; these deposit rates may be determined accordingly by the Reserve Bank.

46. Except for deposits with maturity of 5 years or more, the banks should be free to choose their maturity pattern of deposits.

47. The absence of a ceiling rate on bank loans and advances is a desirable feature which would promote better use of credit by borrowers on the one hand and competition among bank on the other, the latter being circumscribed by the prescribed basic (minimum) lending rate.

48. As regards bank lending to the priority sector, we recommend no more than two concessional rates, one being equivalent to the basic (minimum) lending rate, and the other somewhat below this rate.

49. Our recommendations relating to revision in the yield of Treasury Bills should provide banks with an acceptable short-term financial instrument and they need not depend entirely on the inter-bank call money market for meeting transient liquidity needs. Accordingly, the ceiling on the inter-bank call money rate would no longer serve any important purpose and we recommend that this ceiling should be removed.

50. The cash credit system, in out view, suffers from two serious drawbacks which have important implications for the working of the monetary system. Under the cash credit system the task of cash management is passed on by the borrower to the bank. Another related aspect of the cash credit system which has received somewhat less attention is the considerable benefit derived by the borrowers akin to interest income on their temporarily surplus funds. The surplus funds credited to

the cash credit account reduce interest costs at the rate charged which now stands at 17.5 per cent per annum, a level of return on surplus funds not available to other sectors of the economy.

51. It is possible that the prevalence of the cash credit system has slowed down, if not thwarted, the development of a bill market and indeed minimized the relevance of a money market to the borrowings community.

52. The development of a bill market has not been a reality despite its well-known advantages to lenders and borrowers alike and also despite the official policy actions aimed at promoting the use of bill finance. We would like to emphasis the urgency of removing the entirely avoidable procedural impediments to the use of bill finance.

53. Government should make it mandatory on the part of public sector and large private sector units to include an interest payment clause in all their purchase contracts with their material suppliers for payments delayed beyond a specified, such as 120 days, at a rate which is two percentage points higher than the basic (minimum) lending rate of the bank. Similar interest payments should also be provided for in all government purchase contracts for material supplies and purchase contracts with small scale and ancillary industries. Large units in the private sector too should naturally be required to make such a provision.

54. We recommend that cash credit limits covering supplies to government by industrial units and other suppliers may be earmarked for the purpose, and all payments by government and public sector agencies for supplies financed by these facilities should be invariably credited to the earmarked cash credit account. This arrangement would also remove one serious dislocating feature in the present system of monitoring credit limits to industry and trade.

55. We recommend that credit facilities needed to tide over temporary crises of an unforeseeable nature and due to reasons beyond the control of the borrowers should be expeditiously made by earmarking a second cash credit facility for the purpose, on lines similar to those pertaining to the cash credit facility relating to supplies to government.

56. The various credit limits sanctioned by a bank may be classified under Cash Credit I (covering supplies to government). Cash credit II (covering special circumstances or contingencies) and Normal Working limits covering the balance of the credit facilities. We recommend that the Normal Working Capital limits should be predominantly in the form of loans and bill finance limits.

57. We recommend that interest charges for assistance under Cash Credit I should be at the basic (minimum) lending rate of the bank and for Cash Credit II at the highest prevailing lending rate of the bank, the loan portion of the Normal Working Capital limits bearing an interest charge in between the two and a special lower rate of 2 percentage points below the basic (minimum) lending rate being applicable to bill finance.

58. In order that the intended benefits of instituting Cash Credit I actually accrue to the borrower it is however necessary that banks are required to amend their current practice of disregarding bills receivable or book debts which are due for more than six months in the computation of drawing power. We recommend that bills receivable and book debts should be included in the computation of drawing power of Cash Credit I so long as they are not more than 12 months old.

59. The large volume of credit being extended to the priority sector over a wide geographic area, the considerable variety of activities being financed, the large number of schemes for specific target groups, the number of agencies involved in drawing up programs to facilitate absorption of credit by the priority sector, the enormous increase in the number of loan accounts, are notable features of priority sector lending which have made the Indian banking experience in this regard quite unique.

60. A considerable amount of coordination among the development agencies at the district, block and even lower levels on the one hand and between these agencies and the banks on the other is a prerequisite for the efficient conduct of priority sector lending. This factor probably explains to a great extent the disparity in the results achieved under priority sector lending in different areas.

61. The extent overdues has been attracting critical attention in the course of evaluation of the performance of banks in the area of priority sector lending. The time has probably come to set maximum limits for overdues so that banks put in their best efforts to sty within these limits which would also serve as a caution to them not to extend credit in areas which happen to show high

overdues for all banks taken together. This approach would serve to elicit greater efforts from the local development agencies to improve the lending climate and the viability of priority sector projects. In this context we would like to suggest that relevant indices be developed to monitor the trends in overdues by activity and by area in respect of priority sector advances by the banking system as a whole.

62. The regulation of money supply in the developed countries is facilitated by the highly integrated money and capital markets of the developed economies. At the same time the task is rendered difficult by a high degree of integration of economic activity among these economies. In contrast several objectives need to be pursued through monetary policy in a developing economy characterized by duality in many important respects.

63. Over the years, the income velocity of M_3 has shown a steady decline. In 1950-51 the income velocity of M_3 was as high as 3.86. It came down to 3.12 in 1970-71 over a period of twenty years but exhibited a sharp decline over the next decade, its magnitude in 1980-81 being as low as 1.91 or less than one half of its level thirty year earlier. In 1983-84 the income velocity of M_3 was 1.86. This sharp drop in velocity since 1970-71 has probably been occasioned by the significant changes that have occurred in the structure of the monetary system, particularly the geographical spread of banking facilities and the relatively slower growth till recently or other financial intermediaries. It would appear that the extent of fall in velocity as a result of further expansion of banking facilities would gradually grow less and less, while the trends in the growth of other financial intermediaries may be tend to be more than offset any such fall.

64. For purpose of monetary regulation, it is important, therefore, to analyze the factors influencing change in velocity on a continuing basis as structural changes in the economy are policy-induced and could be an important source of change in velocity.

65. The major anti-inflationary factor in the long run can only be growht in output achieved through increased productivity and better technology and through an economical and effective use of credit in the economy as a whole.

66. A sustained high rate of growth in output is a strong anti-inflationary force but a policy of maintaining relatively high rates of monetary expansion on the grounds that output growth in the long run will be raised is likely to be self-defeating if price stability is endangered in the short run. A very careful balance has, therefore, to be struck in arriving at a target for monetary expansion between the compulsions of accelerating the growth rate, and the need to achieve price stability.

67. Without a detailed mod-year review it would be difficult to implement monetary regulation measures consistent with the objectives of growth, and price stability.

68. Increase in bank credit extended to industrial units should be justified by growth in sales and not merely reflect growth in inventories. Probably more attention should be given by banks to bank credit per unit of sales revenue in deciding credit requirements of their borrowers than appears to be the case at present. The use of bank credit for propping up weak and inefficient units should be reduced.

69. The availability of bank credit enables the small scale industries to continue their operations but imposes on them a burden in terms of interest cost which they find onerous. Total interest costs should be reflected in product prices, and if a part of these costs need to be absorbed by the producers at the expense of their profits, then this should be a decision to be taken by the larger producers and not forced on the small scale industries sector taking advantage of its weak bargaining power.

70. In the short run, the single most important contribution which monetary regulation measures can make towards the achievement of the goal of social justice is the maintenance of price stability.

71. A matter of concern from the point of view of monetary regulation is the high overdues which banks are contending against in the implementation of priority sector lending programs. Considering that as much as 40 per cent of total bank credit is to be allocated to priority sector advances on a sustained basis, high overdues would mean poor recycling of funds.

72. It is important also to develop an active secondary market for Treasury Bills by providing suitable support to brokers and dealers and permitting banks also to avail of their services.

73. Participation certificates provided the banks with a convenient of channel for obtaining short-term accommodation from the investment institutions who were able to provide such accommodation

during the period which intervened between their cash inflow and the disbursement of funds for capital projects. Participation certificates of this nature deserve to be encouraged. However, it might be necessary to place restrictions on the renewability of these certificates.

74. Additional institutional participants in the call money market may allowed as they do not constitute an additional source of funds to the banking system as a whole and hence do not dilute the intended effect of monetary regulation measures.

75. Development of a bill market requires an adequate supply of first class bills which alone are freely negotiable and marketable. Over the years, banks have not been encourage to co-accept bill and as a result the bill market does not have an adequate volume of first class bills. An important step that needs to be taken by the Reserve Bank is to provide the necessary guidelines to banks in regard to co-accepting of bills.

76. An active bill market will relieve pressure on banks for extending credit facilities to seller or buyers while providing banks with a financial instrument of acceptable liquidity, safety and return. The facilities of bill rediscounting may be extended by the Reserve Bank to the commercial banks according to the stance of monetary policy at any given time.

77. Evening our liquidity imbalances in the corporate sector through the development of the inter-corporate funds market would provide a means of reducing the variability in the demand for bank credit and hence providing greater maneuverability to monetary regulation measures.

78. Basically, the parallel economy represents an additional source of funds to the economic agents who fail to obtain their requirements from the normal sources, or who need the funds to support activities for which they expect no assistance from the official agencies and other sources. This represents, therefore, a dilution of the effectiveness of credit control measures, and also involves a mis-direction of resources.

79. A credit delivery system which succeeds in meeting the genuine requirements of borrowers for approved purposes in time and in adequate measure would reduce the spil-over of credit demand and make the operations of the parallel economy less relevant for the monetary system.

80. We recommend that the practice of stipulating an additional CRR requirement on incremental deposits be adopted very sparingly, for short durations, and only in special circumstances requiring drastic monetary control measures. Even if an incremental CRR is imposed, it should be converted to an average at an appropriate time.

81. Our recommendations aimed at facilitating the sale of government securities to the non-institutional public as an additional channel of market borrowing by government would lend an element of flexibility to the SLR instrument.

82. In the restructured monetary system which we have outlined, reserve money expansion is not likely to be occasioned by large increases in Reserve Bank credit to government unlike in the past. In this context the refinance instrument could be effectively use in conjuction with other measures of monetary regulation, since greater variation in the quantam of refinance would become a feasible proposition.

83. The role of open market operations as an instrument of credit control will assume importance in the restructured monetary system recommended by us. With the interest rate offered on government securities becoming truly competitive, a broad enough securities market may emerge for the Reserve Bank to use open market operations as an instrument of credit control.

84. In the restructured monetary system which we have outlined there would be scope for improving the effectiveness of Bank Rate as an instrument of monetary regulation particularly if necessary steps are taken to develop an active money market as recommended by us. Further, if bank's recourse to Reserve Bank accommodation rises as a result of our recommendations relating to regulation of reserve money expansion the Reserve Bank will be in a better position to influence bank's operations through Bank Rate policy. Again, the interest rates on Reserve Bank credit to the commercial sector could be specified only in relation to the Bank Rate.

85. The business community can and does take recourse to other sources of finance outside the organized money market and thus thwart the objectives of selective credit control. It would perhaps be inappropriate to judge the efficacy of selective credit control measures in terms of their impact on prices.

II WORKING GROUP ON THE MONEY MARKET (Vaghul Committee, January 1987)

Call Money

1. The present interest rate ceiling on the call money fixed by the IBA should be abolished and the call money rates should be left to be determined by market forces. The call money rates should be freed only for inter-bank transactions and the ceiling rate of 10 per cent should continue to be maintained for borrowings from non-bank participants in the market, if any.
2. It would be necessary for the Reserve Bank to counsel the surplus banks to ensure that call money operations are not disruptive to the banking system and the call money rates do not rise to stratospheric levels over prolonged periods.
3. The call money market should strictly be an inter – bank market. The LIC and the UTI may be permitted to remain in the market. The position could be reviewed, if need be, by the Reserve Bank of India in April 1988.
4. The interest rate on inter – bank term deposits should also be determined by market forces.
5. The measures relating to the call money and inter-bank term deposit rates should be implemented with inception of the slack season at the end of April 1987.
6. There is no need for brokers to be re – introduced into the call money market. To the extent that broker services are felt necessary after the freeing of the call and inter – bank term deposit rates. the proposed Finance House could usefully provide this service.

Bills Rediscounting

7. There is need to take a number of positive measures of facilitate the emergence of a genuine bill culture.
8. The government should direct departmental undertakings and public sector organizations that payments for all credit purchases should be in the form of bills which should be strictly honoured on the due dates. Failure to pay a bill on the due date should attract a uniform penal rate of 2 percentage points above the maximum lending rate of banks. A similar procedure should be followed in the case of CAS parties. In the event of three instances of defaults on payment of bills, the working capital limits should be reduced suitably.
9. The working capital limits of large parties should be scaled down and the interest rates increased if bill acceptances are less than a stipulated percentage of credit purchases.
10. It would be necessary to move away form receivable financing to bill financing and accordingly a program commencing from April 1988 should be stipulated for phasing out receivable financing. Of the total receivable, the proportion of receivables eligible for financing under the cash credit / overdraft facilities should be 75 per cent from April 1, 1988, 50 percent from April 1, 1989 and 25 per cent from April 1, 1990. The rest of the receivables should be financed only through demand / usance bill limits.
11. Within the CAS discipline, banks should be given the discretion to increase bills limits for temporary periods.
12. The stipulation on unsecured advances should be made applicable to bill financing.
13. The maximum discount rate on bills should be such that it does not exceed an equivalent effective interest rate of 16 per cent. This should be implemented at the end of April 1987 and after a year an assessment could be made as to whether the maximum discount rate could be freely determined by the banks.
14. As at the end of April 1987, the ceiling on the rediscount rate should be increased from 11.5 per cent to 12.5 per cent.
15. A review as to whether the ceiling on the discount rate should be removed could be undertake in April 1988.

16. Institution and other units such as companies, trusts etc. which can satisfactory demonstrate to the Reserve Bank that they have a resource surplus of a monthly average of at least Rs. 5 crores per annum should be allowed to participate in the bill rediscounting market.
17. Further rediscounting by the institutions should be freely permitted.
18. The producers for rediscounting bills should simplified by the end of April 1987.

Short- Term Commercial Paper

19. The time is appropriate for starting with a limited introduction of commercial paper. Initially. access to the commercial paper market should be given to 'A' rated companies.
20. The interest rate on commercial paper should be freely determined by market considerations.
21. The commercial paper market should function within the overall discipline of The Reserve Bank Should administer the entry in the market, the amount of each issue and the total quantum that be raised in a year.
22. There should be no restriction on the participants in the commercial paper market. The size of any single issue should not be Rs. 1 crore and the size of each note should not be less than Rs. 5 lakhs.
23. Commercial paper should be executed from the stipulations on unsecured advances in the case of banks.
24. The framework set out for developing a commercial paper market in India could be adopted and necessary legislative/ administrative changes should be completed so as to enable commercial paper to be operative by April 1, 1988. The authorities should take an early decision to commit themselves to a time 0 – bound introduction on commercial paper.

Government Paper

25. For an active secondary market in 182 Days Treasury Bills, it would be necessary for a large number of participants to bid regularly in the auctions and to build up a portfolio of varying maturities. Suitable measures need to be taken to ensure that the Treasury Bill rate remains flexible. The periodicity of the auction should be increased.
26. A Treasury Bill Refinance Facility should be introduced by the end of April 1987 and the refinance rate should be at least 1.5 percentage points above the prevailing Treasury Bill rate. In the event of the proposed facility being introduced, the stand-by refinance facility should be terminated.
27. Inter-bank transactions in dated securities on a buy-back basis should be encouraged and interest rates on such transactions should not be subject to interest rate control.
28. An autonomous public limited company called the Finance House of India should be set up jointly by the Reserve Bank, the public sector banks and the financial institutions to deal in short – term money market instruments. The finance house should have back-up facilities with banks and the Reserve Bank. In view of the schedule of other policy responses which are to be implemented in the slack season of 1987, the Finance House of India should be operative not later than July 1, 1987. Over period of time, there would be need for more than one finance house.

Development of New Instruments

29. There should be a continuing development and refinement of money market instruments. Each new instrument coming into the market must be specifically approved by the Reserve Bank.

Inter – Bank Participation Certificates

30. From the end of April 1987, inter – bank participation certificates should be introduced in modified form.

Certificate of Deposit

31. The introduction of Certificate of Deposit is not recommended at this stage. In the context of the various changes proposed by the Working Group and the introduction of the 182 Days Treasury Bill, the structure of short-term deposit rates up to one year as well as the number of maturities could be reviewed by the end of April 1987 and in the light of his review, the feasibility of introducing Certificates of Deposit could be reconsidered.

Factoring Services

32. The banks and private non-bank financial institutions should be encouraged to provide factoring services. A few Factoring Divisions should be set up by July 1, 1987.

Legislative Changes

33. In the interest of developing a strong financial and banking system, the government of India should take necessary measures to abolish the stamp duty on bills.
34. The viability of the new instrument of commercial paper would be better ensured if commercial paper is exempt from stamp duty.
35. Suitable amendments may need to be effected in the Reserve Bank of India Act to enable the Bank to provide refinance to the Finance House of India.

Time Frame of Implementation

36. While the measures recommended from an integrated package, there is a need for a well chalked out phased program and accordingly, a time schedule for implementing the Working Group's recommendations has been set out below.

III. REPORT OF THE COMMITTEE ON THE FINANCIAL SYSTEM (Narasimham Committee, November 1991)

1. The committee's approach to the issue of financial sector reform is to ensure that the financial services industry operates on the basis of operational flexibility and functional autonomy with a view to enhancing efficiency, productivity and profitability. A vibrant and competitive financial system is also necessary to sustain the ongoing reform in the structural aspects of the real economy. We believe that ensuring the integrity and autonomy of operations of banks and DFIs is by far the more relevant issue at present than the question of their ownership. SLR and CRR

2. The committee is of the view that the SLR instrument should be deployed in conformity with the original intention of regarding it as a prudential requirement and not be viewed as a major instrument for financing the public sector. In line with the Government's decisions to reduce the fiscal deficit to a level consistent with macroeconomic stability, the Committee recommends that the SLR be brought down in a phased manner to 25 per cent over a period of about five years, starting with some reduction in the current year itself.
3. As regards the cash reserve ratio (CRR), the Reserve Bank should have the flexibility to operate this instrument to serve its monetary policy objectives. The Committee believes that given the government's resolve to reduce the fiscal deficit, the occasion for the use of CRR to control the secondary expansion of credit should also be less. The Committee accordingly proposes that the Reserve Bank consider progressively reducing the CRR from its present high level. With the deregulation of interest rates there would be more scope for the use of open market operations by the Reserve Bank with correspondingly less emphasis on variations in the CRR.
4. The Committee proposes that the interest rate paid to banks on their SLR investments and on CRR in respect of impounded deposits above the basic minimum should be increased. As discussed

later, the rates on SLR investments should be progressively market – related while that on CRR above the basic minimum should be broadly related to bank's average cost of deposits. However, during the present regime of administered interest rates, this rate may be fixed at the level of bank's one year deposit rate.

Direct Credit

5. The committee recognizes that in the last two decades and credit policies have been deployed with a objective. However, the Committee believes that the pursuit of such objectives should use the instrumentality of the fiscal rather than the credit system. Accordingly, the Committee proposes that the directed credit programs should be phased out. This process of phasing out would also recognize the need that for some time it would be necessary for a measure of special credit support through direction. The Committee therefore, proposes that the priority sector be redefined to comprise the small and marginal farmer, the tiny sector of industry, small business and transport operators, village and cottage industries, rural artisans, and other weaker sections. The credit target for this redefined priority sector should henceforth be fixed at 10 per cent of aggregate credit which would be broadly in line with the credit flows to these sectors at present. The Committee also proposes that a review may be undertaken at the end of three years to see if directed credit programs need to be continued. As regards medium and large farmers, and the larger among small industries, including transport operators, etc. who would not now constitute part of the redefined priority sector, the Committee proposes that to further encourage banks to provide credit to these erstwhile constituents of the priority sector, the Reserve Bank and other refinancing agencies institute a preferential refinance scheme in terms of which incremental credit to these sectors would be eligible for preferential refinance subject to normal eligibility criteria.

Interest Rates

6. The committee is of the view that the present structure of administered interest rates is highly complex and rigid. This is so in spite of the recent moves towards deregulation. The Committee proposes that interest rates be further deregulated so as to reflect emerging market conditions. At the same time, the Committee believes that a reasonable degree of macroeconomic balance through a reduction in the fiscal deficit is necessary for successful deregulation of interest rates. Premature moves to market – determine interest rates could, as experience abroad has shown, pose the danger of excessive bank lending at high nominal rates to borrowers of dubious credit – worthiness, eventually creating acute problems for both the bank as well as the borrowers. Accordingly, the Committee recommends that for the present, interest rates on bank deposits may continue to be regulated, the ceiling in such rates being raised as the SLR reduced progressively as suggested by us earlier. Similarly, the interest rate on government borrowing may also be gradually brought in line with market – determined rates which would be facilitated by the reduction in SLR. Meanwhile, the Committee would recommend that concessional interest rates should be phased out. The structure of interest rates should bear a broad relationship to the Bank rate which should be used as an anchor to signal the Reserve Bank's monetary policy stance. It would be desirable to provide for what may be called a prime rate, which would be the floor of the lending rates of banks DFIs. The spreads between Bank rate, the bank deposit rates, the government borrowing rates and the prime rate may be determined by the RBI broadly in accordance with the criteria suggested by the Chakravarty Committee so as to ensure that the real rates of interest remain positive.

7. The inadequacy of capital in the banking system is a cause for concern. While progress towards BIS norms is desirable, the Committee recognizes that this will have to be phased over time. The committee suggests that the banks and financial institutions should achieve a minimum 4 per cent capital adequacy ratio in relation to risk weighted assets by March 1993, of which Tier 1 capital should be not less than 2 percent. The BIS standards of 8 per cent should be achieved over the period of the following three years, that is, March 1996. For those banks with an international presence it would be necessary to reach these figures even earlier.

8. The Committee believes that in respect of those banks whose operations have been profitable and which enjoy a good reputation in the markets, they could straight away approach the capital market for enhancement of their capital. The Committee therefore, recommends that in respect of such banks, issue of fresh capital to the public through the capital market should be permitted. Subscribers to such issues could include mutual funds, profitable public sector undertakings and employees of the institutions besides the general public. In respect of other banks, the government could meet the shortfall in their capital requirements by direct subscription to capital or by providing a loan which could be treated as subordinate debt.

9. Before arriving at the capital adequacy ratio for each bank, it is necessary that assets of the banks be evaluated on the basis of their realisable values. The committee proposes that the banks and financial institutions adopt uniform accounting practices particularly in regard to income recognition and provisioning against doubtful debts. There is need also for adopting sound practices in regard to valuation of investment on the lines suggested by the Ghosh Committee on Final Accounts.

Income Recognition

10. In regard to income recognition the Committee recommends that in respect of banks and financial institutions which are following the accrual system of accounting, no income should be recognized in the accounts in respect of non performing assets. An asset would be considered non-performing if interest on such assets remains past due for a period exceeding 180 days at the balance sheet date. The Committee further recommends that banks and financial institutions be given a period of three years to move towards the above norms in a phased manner beginning with the current year.

Provisioning

11. For the purpose of provisioning the Committee recommends that, using the health code classification which is already in vogue in banks and financial institution, the assets should be classified into four categories namely, Standard, Sub-standard, Doubtful and Loss Assets. In regard to Sub – Standard Assets, a general provision should be created equal to 10 per cent of the total outstandings under this category. In respect of Doubtful Debts, provision should be created to the extent of 100 per cent of the security shortfall. In respect of the secured portion of some Doubtful Debts, further provision should be created, ranging from 20 per cent to 50 per cent, depending on the period on for which such assets remain in the doubtful category. Loss Assets either be fully written off or provision be created to the extent of 100 percent. The Committee is of the view that a period of four years should be given to the banks and financial institutions to conform to these provisioning requirements. The movement towards these norms should be done in a phased manner beginning with the current year. However, it is necessary for banks and financial institutions to ensure that in respect of doubtful debts 100 per cent of the security shortfall us fully provided in the shortest possible time.

12. The Committee believes that the balance sheets of banks and financial institutions should be made transparent and full disclosures made in the balance sheet as recommended by the International Accounting Standards Committee. This should be done in a phased manner commencing with the current year. The Reserve Bank, however, may defer implementation of such parts of the standards as it considers appropriate during the transitional period until the norms regarding income recognition and provisioning are fully implemented.

13. The Committee suggests that the criteria recommended for non – performing assets and provisioning requirements be given due recognition by the tax authorities. For this purpose, the Committee recommends that the guidelines to be issued by the Reserve Bank if India under Section 43 D of the Income Tax Act should be in line with our recommendations for determining of non – performing assets. Also, the specific provisions made by the banks and institutions in line with our recommendations should be made permissible deductions under the Income Tax Act. The Committee further suggests that in regard to general provisions, instead of deductions under Section 36 (1) (viia) being restricted to 5 per cent of total income and 2 per cent of the aggregate

average advances by rural branches, it should be restricted to 0.5 per cent of the aggregate average non-agricultural advances and 2 per cent of the aggregate advance by rural branches. This exemption should also be available to banks having operations outside India in respect of their Indian assets, in addition to the deductions available under Section 36 (1) (viii)

Assets Reconstruction Fund

14. Banks, at present, experience considerable difficulties in recoveries of loans and enforcement of security charged to them. The delays that characterize our legal system have resulted in the blocking of a significant portion of the funds of banks and DFIs in unproductive assets, the value of which deteriorate with the passage of time. The committee, therefore, considers that there is urgent need to work out a suitable mechanism through which the dues to the credit institutions could be realized without delay and strongly recommends that Special Tribunals on the pattern recommended by the Tiwari Committee on the subject by set up to speed up the process of recovery. The introduction of legalization for this purpose is long overdue and should and should be proceeded with immediately.

15. While the reform of accounting practices and the creation of Special Tribunals are essential, the Committee believes that an arrangement has to be worked out under which at least part of the bad and doubtful debts of the banks and financial institutions are taken off the balance sheet so that the banks could recycle the funds realized through this process into more productive assets. For this purpose, the establishment, if necessary by special legislation, of an Asset Reconstruction Fund (ARF) which could take over from the banks and financial institutions a portion of the bed and doubtful debts at a discount, the level of discount being determined by independent auditors on the basis of clearly stipulated guidelines. The ARF should be provided with special powers for recovery somewhat boarder than those contained in Sections 29-32 of the State Financial Corporation's Act 1951. The capital of the ARF should be subscribed by the public sector banks and financial institutions.

Structure of Banking System

16. In regard to the structure of the banking system, the committee is of the view that the system should evolve towards a broad pattern consisting of:
   (a) three or four large banks (including the State Bank of India) which could become international in character;
   (b) eight to ten national banks with a network of branches throughout the country engaged in 'universal' banking;
   (c) Local Banks whose operations would be generally confirmed to specific region; and
   (d) Rural banks (including RRBs) whose operations would be confirmed to the rural areas and whose business would be predominantly engaged in financing of agriculture and allied activities.

   The Committee is of the view that the move towards this revised system should be market –driven and based on profitability considerations and brought about through a process of mergers and acquisitions.

17. The Committee is of the view that the structure of rural credit will have to combine the local character of the RRBs and the resources, skills and organizational / managerial abilities of the commercial banks. With this end in view the Committee recommends that each public sector bank should set up one or more rural banking subsidiaries, depending on the size and administrative convenience of each sponsor bank, to take over all its rural branches and, where appropriate, swap its rural branches with those of other banks. Such rural banking subsidiaries should be treated on par with RRBs in regard to CRR/SLR requirements and refinance facilities from NABARD and sponsor banks. The 10 per cent for directed credit which we have recommended as a transactional measure should be calculated on the basis of the combined totals of the parent banks and their subsidiaries. The committee purposes, that while RRBs should be allowed to engage in all types of

banking business, their focus should continue to be to lend to the target groups to maintain, at a minimum, the present level of their lending to these groups. With a view to improving the viability of their operations, the Committee proposes that the interest rate structure of the RRBs should be in line with those of the commercial banks. The committee would leave the option open to the RRBs and their sponsor banks as to whether the RRBs should retain their identity so that their focus on lending to the target groups is not diffused or where both the RRBs and the sponsor banks wish to do so they could be merged with the sponsor banks and the sponsor banks in such cases should take them over as 100 per cent subsidiaries by buying out the shares from other agencies at a token price, and eventually merge them with the rural banking subsidiaries which we have proposed. For those RRBs that retain their identity and whose viability would need to be improved, we propose that instead of investing in Government bonds as part of their SLR requirements, they could place the amounts stipulated under SLR as deposits with NABARD or some special federal type of agency that might be set up for this purpose. This would also be consistent with the statutory requirements in this regard and NABARD or this agency could pay interest on such balances by investing or deploying these funds to the best advantage on their behalf and thus help to augment the income of the RRBs.

18. The Committee proposes that government should indicate that there would be no further nationalization of banks. Such an assurance will remove the existing disincentive for the more dynamic among the private banks to grow. The Committee also recommends that there should be any difference in treatment between the public sector and the private sector banks. The Committee would purpose that there be no bar to new banks in the private sector being set up provided they conform to the start-up capital and other requirements as may be prescribed with regard to accounting, provisioning and other aspects of operations. This in conjunction with the relevant statutory requirements governing their operations would provide adequate safeguards against misuse of bank's resources to the detriment of the depositor's interests.

Branch Licensing

19. The Committee recommends that branch licensing be abolished and the matter of opening branches or closing branches (other that rural branches for the present) be left to the commercial judgement of the individual banks.

20. The committee also believes that, consistent with other aspects of Government policy dealing with foreign investment, the policy with regard to allowing foreign banks to open offices in India either as branches or, where the Reserve Bank considers it appropriate, as subsidiaries, should be more liberal, subject to the maintenance of minimum assigned capital as may be prescribed by the Reserve Bank and the statutory requirements of reciprocity. Joint ventures, between foreign banks and Indian banks could also be permitted, particularly in regard to merchant and investment banking, leasing and other newer forms of financial services.

21. Foreign banks when permitted to operate in India should be subjected to the same requirements as are applicable to domestic banks. If, in view of certain constrains such as absence of branch network, the foreign banks are unable to fulfil certain requirements such as directed credit (of 10 per cent of aggregate credit) the Reserve Bank should work out alternative methods with a view to ensuring a level playing field.

22. The Committee is of the view that the foreign operations of Indian banks need to be rationalized. In line with the structure of the banking system visualized above, there would seem to be scope for one or more of the large banks, in addition to the SBI, to have operations abroad in major international financial centres and in regions with strong Indian ethic presence. Pending the evolution of a few Indian banks with an international character, the Committee recommends as an interim measure that those Indian banks with the largest presence abroad and strong financial position could jointly set up or more subsidiaries to take over their existing branches abroad. The SBI operations abroad can continue and indeed be strengthened in course of time. The Government may also consider the larger banks increasing their presence abroad by taking over existing small banks incorporated abroad as a means of expanding their international operations.

23. The Committee believes that the internal organization of banks is best left to the judgement of the management of individual banks, depending upon the size of the bank, its branch spread and range of functions. However, for the medium and large national banks the Committee proposes a three-tier structure in terms of head office, a zonal office and branches. In the case of very large banks, a four – tier organization, as is the case with the State Bank, with head office, zonal office, regional and branch may be appropriate. Local banks may not need an intermediate tier between the branch and the central office.

Computerization

24. The Committee endorses the view of the Rajgarajan Committee on Computerization that there is urgent need of a far greater use of computerized system than at present. Computerization has to be recognized as an indisposable tool for improvement in customer service, the institution and operation of better control systems, greater efficiency in information technology and the betterment of the work environment for employees. These are essential requirements for banks to function effectively and profitably in the increasingly complex and competitive environment which is fast developing in the financial services segment of the economy.

25. The Committee believes that there has to be a recognition on the part of managements and trade unions that the system cannot hope to be competitive internally and be in step with the wide – ranging innovations taking place abroad without a radical change in work technology and culture and greater flexibility in personnel policies. We have been reassured to know that organized labour is as much convinced of the importance of enhancing the viability and profitability of the banking industry and providing efficient customer service. It is equally incumbent on management of banks to adapt forward looking personnel policies which would help to create a satisfying work environment.

26. The Committee recommends that the various guidelines directives issued by the Government of the Reserve Bank in regard to internal administration of the banks should be reviewed to examine their continuing relevance in the context of the need to ensure the independence and autonomy of banks. Such guidelines which relate to matters of internal administration such as creation and categorization of posts, promotion procedures and similar matter should be rescinded

27. The Committee believes that the Indian banking system, at present, is over-regulated and over – administrated. Supervision should be based on evolving prudential norms and regulations which should be adhered to rather than excessive control over administrative and other aspects of bank organization and functioning. The Committee would also like to place greater emphasis on internal audit and internal inspection systems of banks. The inspection by the supervisory authorities should be based essentially on the internal audit and inspection reports. Their main concern should be to ensure that audit and inspection machinery (which will cover the credit appraisal system and its observance) is adequate and conforms to well laid down norms.

Duality of Control

28. The Committee is firmly of the opinion that the control over the banking system between the Reserve Bank and the Banking Division of the Ministry of Finance should end and that the Reserve Bank should be the primarily agency for the regulation of the banking system. The supervisory function over the banks and other financial institutions, the Committee believes, should be hived off to a separate authority to operate as a quasi – autonomous body under the aegis of the Reserve Bank but which would be separate from other central banking functions of the Reserve Bank. The Committee recognizes that as long as the Government has proprietary interest in banks and financial institutions, it would be appropriate for the Ministry of Finance to deal with other Government departments and Parliament and discharge its other statutory obligations but not to engage in direct regulatory functions.

29. Central to the issue of flexibility of operations and autonomy of internal functioning is the question of depoliticising the appointment of the chief executive (CMD) of the banks and the board of the banks and ensuring security of tenure for the CMD. The committee believes that

professionalism and integrity should be the prime considerations in determining such appointment and while the formal appointments have to be made by Government, they should be based on a convention of acception the recommendations of a group of eminent persons who could be invited by the Governor of the Reserve Bank to make recommendations for such appointments. As regards the boards of public sector banks and institutions, as long as Government owns the banks, it would be necessary to have a Government director to take care of 'proprietorial' concerns but we believe that there is no need for the Reserve Bank to have a representative on the boards.

Development Financial Institutions (DFIs)

30. As regards development financial institutions, the main issue with regard to their operations are to ensure operational flexibility, a mearure of competition and adequate internal autonomy in matters of loan sanctioning and internal administration. The Committee proposes that the system recommended for commercial banks in the matter of appointment of chief executives and boards should also apply to DFIs. The present system of consortium lending has been perceived as operating like a cartel. The Committee believes that consortium lending should be dispensed with and, in its place, a system of syndication or participation in lending, at the instance not only, as now, of the lenders but also of the borrowers, should be introduced. The Committee also believes that commercial banks should be encouraged to provide term finance to industry, while at the same time, the DFIs should increasingly engage in providing core working capital. This will help to enhance healthy competition between banks and DFIs. The Committee proposes that the present system of cross holding of equity and cross representation on the boards of the DFIs should be dine away with. The Committee welcomes the removal of the tax concession enjoyed by IDBI as an important step in ensuring equality of treatment between various DFIs. As a further measure of enhancing competition and ensuring a level playing field, the Committee proposes that the IDBI should retain only its apex and refinancing role and that is direct lending function be transferred to a separate institution which could be incorporated as a company. The infected portion of the DFIs portfolio should be handed over to the ARF on the same terms and conditions as would apply to commercial banks.

New Institutions

32. In the last decade several new institutions have appeared on the financial scene. Merchant banks, mutual funds, leasing companies, venture capital companies and factoring companies have now joined hire purchase companies in expanding the range of financial services available. However, the regulatory framework for these new set of institutions has still to be developed.

33. The Committee recommends that the supervision of these institutions which form an integral part of the financial system should come within the purview of the new agency to be set up for this purpose under the aegis of the RBI. The control of these institutions should be principally confined to off-site supervision with the on-site supervision being restored to cases which call for active intervention. The SEBI which is charged with the responsibility of ensuring orderly functioning of the market should have jurisdiction over these institutions to the extent their activities impinge on market operations. In regard to mutual funds there is a good case for enacting new legislation on the lines obtaining in several countries with a view to providing an appropriate legal framework for their constitution and functioning. The present guidelines with regard to venture capital companies are unduly restrictive, and affecting the growth of this business and need to be reviewed and amended.

34. As in the case of banks and financial institutions there is need to lay down prudential norms and guidelines governing the functioning of these institutions. These prudential guidelines should relate, among other things, to capital adequacy, debt equity ratio, income recognition provisioning against doubtful debts, adherence to sound accounting and financial policies, disclosure requirements and valuations of assets. The eligibility criteria for entry, growth and exit should also be clearly stipulated so that the growth of these institutions takes place on proper lines.

Sequencing of Reforms

35. The Committee would like to emphasis that a proper sequencing of reforms is essential. Deregulation of interest rates can only follow success in controlling fiscal deficits. Asset reconstruction, institution of capital adequacy and establishment of prudential norms with a good supervisory machinery have to be proceeded with in a phased manner over the next 3 to 5 years but, we believe, it is important that the process must begin in the current year itself.

36. The Committee's approach thus seeks to consolidate the gains made in the Indian financial sector while improving the quality of the portfolio providing greater operational flexibility and most importantly greater autonomy in the internal operations of the banks and financial institutions so as to nurture a healthy, competitive and vibrant financial sector. This will above all else, require depoliticisation of appointments, implying at the same time a self-denial by Government and the perception that is has distanced itself from the internal decision making of the banks and the financial institutions. The proposed deregulation of the financial sector and the measure aimed at improving it health competitive vitality would, in the Committee's view, be consistent with the steps being taken to open up the Indian economy, enable the Indian financial sector to forge closer links with the global financial markets, and enhance India's ability to take competitive advantage of the increasing international opportunities for Indian trade, industry and finance.

IV. TASK FORCE ON MONEY MARKET MUTUAL FUNDS (MMMFs) (Basu Committee, Jnauary 1992)

1. To begin with, MMMFs be set up only by schedule commercial banks and public financial institutions as defined under Section 4A of the Companies Act, 1956 directly or through their existing mutual funds/subsidiaries engaged in funds management.
2. MMMFs can be set up either as a part of a bank in the form of a Division / Department, i.e. 'in house' MMMFs or it could be set up as a separate entity as a 'Trust'.
3. MMMFs Scheme canbe usually in two forms such as 'Money Market Deposit Account' (MMDA) or 'Money Market Mutual Funds' (MMMFs). MMDA Scheme can be operated either by issuing deposit receipts or through issue of a 'Pass Book'. The 'modus operandi' of the MMMF Scheme could be left to the individual institutions. The Pass Book Account Scheme should be without cheque book facility to being with.
4. MMMFs would have combined features of 'open' and 'close' ended schemes. However, if some banks/institutions like to formulate schemes of either 'close' or 'open' ended fund, adhering to the overall limit stipulated by the Reserve Bank of India, it should be left to their option to do so.
5. Smaller banks could be allowed to set up MMMFs jointly.
6. For setting up of MMMFs at the initial stage, prior authorization from the Reserve Bank of India is desirable. The Reserve Bank should, however, formulate guidelines which are transparent and, inter alia, based on financial, managerial and operational aspects of banks/financial institutions.

Mobilization of Resources by MMMFs

7. In case of MMMFs set up the banks, the limit for raising resources by MMMFs may be fixed on the basis of their overall deposit size. The limit for MMMF may be fixed at 2 per cent of the fortnightly average aggregate deposits of the bank concerned in the previous financial year of Rs. 50 crore, whichever is higher. The limit will apply to MMMFs set up by them directly or through their Mutual Funds / subsidiaries engaged in funds management. The norm for determining the size of MMMFs should be reviewed by the Reserve Bank periodically.
8. In case of public financial institutions the limit for MMMFs may be related to their total long-term domestic borrowing; the size could be specified at 2 per cent of long –term domestic borrowings as indicated in their audited balance sheet. As in the case of banks, this limit will apply also to MMMFs set up through their Mutual Funds / funds management subsidiaries.

9. As regards minimum size of investment by individuals or others in MMMFs, the Task Force suggests that no minimum size either for individual investors or other needs to be specified and the matter should be left to the discretion of MMMFs.
10. The minimum lock-in period for investment in MMMFs should be reduced from 3 months to 46 days. The Task Force would urge the Reserve Bank of India to examine the feasibility of further reducing or even removing the minimum lock – in period at a future date.

Investment Pattern of MMMFs

11. Liquidity consideration be given top priority by the MMMFs while deciding on the types of instruments for investment.
12. MMMFs should not deploy their funds in capital market instrument, even if maturing within a year, so that their investments are not exposed to under risks.
13. The Task Force feels that though dated Government securities are not money market instruments, considering the security aspects, MMMFs could be allowed to invest in dated. Government securities having an unexpired maturity of up to one year. Furthermore, MMMFs coule also be allowed to invest in dated Government securities on 'Repo' basis for a period not exceeding one month. The investments in dated Government securities including on 'Reop' Basis should not exceed 25 per cent of investible funds of MMMFs at any point of time.
14. The minimum investment in 182 Days Treasury Bills laid down in the guidelines should be raised from 20 per cent to 25 per cent, while the maximum investment in call / notice money market should also be raised from 20 to 30 per cent of total investible funds of MMMFs. In this context, the 'Task Force would urge the Reserve Bank of India to consider ways of increasing the yield on 182 Days Treasury Bills to enhance the attractiveness of this instrument.
15. The exposure to CP should not be more than 15 per cent of the total investible funds of the MMMFs and the exposure to CP issued by a particular company should not be more than 20 per cent of the investible funds of MMMFs in CP.
16. MMMFs should rediscount only those bills which are accepted or co – accepted by banks. For commercial bills accepted or co – accepted by banks too, the exposure should not be more than 20 per cent of the total investible funds so as to minimize any possible risk to MMMFs.
17. MMMFs may be allowed to invest/ trade in instrument of other MMMFs as underlying assets of all MMMFs would generally be of similar qualities and there would be no additional risk involved. A cap of 10 per cent of investible funds may be prescribed for investments by one MMMF in shares/units of others.

Management of MMMFs

18. In – house MMMFs should take adequate and effective measures to ensure that management, accounting and custody of their assets should be kept distinct and separate from those relating to the investments of the bank and accounts should be subjected to separate audit.
19. MMMFs should not give any guarantee to the public as to the rate of return on investments while announcing any scheme. MMMFs may distribute their net earnings either by way of periodic income distribution or by quoting appropriate bid prices or a combination of both.
20. MMMFs should calculate Net Assets Value (NAV) of each scheme and disclose the NAV of each of the schemes and the method of valuation for the benefit of the concerned subscribers. To start with, MMMFs may determine and disclose 'NAV' of Found once in a week. Thereafter 'NAV' may be determined more frequently.

Regulatory Measures

21. The MMMFs to be set up by banks, their subsidiaries, public financial institutions and non-bank institutions like the existing Mutual funds, be required to comply with the guidelines and directives that may be issued from time to time by the Reserve Bank of India only.

Legislative Changes

22 The provision of exemption from payment of income tax should be extended to MMMFs set up by private sector banks and subsidiaries of public sector banks and private sector banks by suitable amendment to sub-section (23D) of Section 10 of the Income Tax Act, 1961.

23. The Reserve Bank of India may consider exempting in – house MMFs set up by banks from a reserve requirements. To begin with, the Reserve Bank of India could prescribe that a statutory minimum SLR of 25 per cent under the Banking Regulation Act, 1949 be maintained by investment, inter alia, in 182 Days Treasury Bills as envisaged in the prudential investment guidelines.

24. The units/ shares of MMMFs may be exempted from stamp duty at the time of issue of instruments and at the time of transfer of instruments in the secondary market. This would provide impetus to the development of the secondary market for money market instrument. Accordingly, the Task Force suggests that the Reserve Bank of India should request the Government of India to remit stamp duty to such instruments.

25. The stamp duty chargeable in respect of all money market instruments, such as CDs, CPs, etc. be remitted as in the case of Commercial Bills and the Reserve Bank of India may take up this aspect with the Government of India.

V. WORKING GROUP ON NON-BANKING FINANCE COMPANIES (A.C. Shah Committee, September 1992)

1. Growth and diversification of non-banking financial companies (NBFCs) is an integral part of the development process of the financial market the economy. The approach of the Group revolves round the conviction that a thriving, healthy and growing non-banking financial sector is necessary for promoting the growth of an efficient and competitive economy. From the angle of depositors' protection and efficacy of monetary and credit policy, what is really required is a well – integrated regulatory framework which, while monitoring and supervising the operations of NBFCs, recognizes and even encourages the emergence of new types of financial services and products.

2. In the last two decades, non-banking financial sector has witnessed a marked growth. Some of the factors which have contributed to this growth have been, lesser regulation over this sector vis-à-vis the banking sector, higher deposit interest rates offered by this sector, higher level of customer orientation, the speed with which it caters to customer needs and so forth.

3. Number of NBFCs increased from 7,063 in 1981 to as much as 24,009 in 1900, thus registering compounded annual growth of about 14 per cent. Deposits with these companies grew ten fold during this period.

4. Non-bank deposits as a ratio of gross financial savings of the house – hold sector went up from 2 per cent in 1981-82 to 7.9 per cent in 1980-90. Although, the magnitude of deposits, with non-banking financial companies in relation to total bank deposits still forms a small percentage, there is enough evidence of acceleration in the growth of these deposits which underlines the need for effective regulation.

5. Although, the number of non-bank financial intermediaries, both in the organized and unorganized sector is very large, only about 1600 companies with constitute 21 per cent of the reporting companies account for as much as 97 per cent of total deposits.

6. The need for bringing NBFCs under the regulatory framework arises not only for ensuring their healthy growth but also improving the efficacy of the credit and monetary policy as well as for inculcating healthy financial discipline among both providers and users of credit.

7. The Group recommends dismantling of the category-classification of NBFCs and application of uniform regulation for all NBFCs.

8. The group recognizes the need for effective regulation of all deposit – taking entities, howsoever small they may be. However, due to the large number of operators in this filed and the limited size

of administrative infrastructure, the Group advocates that regulatory attention be confined to those large-size companies which account for a lion's share of total non – banking financial companies' deposits.

9. All the existing deposit – taking companies with net owned funds of Rs. 50 lakh and over should compulsory register with the regulatory authority. This cut-off point may be reviewed subsequently. Companies with net owned funds below this cut-off point may, if they so prefer, opt for registration. Registered companies will be allowed to accept public deposits up to a multiple of their net owned funds. Unregistered companies with net owned funds of less than Rs. 50 lakh will be allowed to accept public deposits at a lower level, i.e. in accordance with procisions of Section 58 A of the Companies Act, 1956.

10. The Group facours prescription of entry norms for all new NBFCs such as (a) minimum net owned fund of Rs. 50 lakh at the time of commencement; (b) registration with the regulatory authority; (c) restriction on deposit – acceptance activity at the level permitted to unregistered companies in first two full financial years of operation, and (d) permission for deposit acceptance at par with the existing registered companies after completion of this period, on the basis of track record, quality of management, methods of operation etc.

11. The Group is of the opinion that the function of registration and regulation be undertaken by the proposed High Powered Supervisory Board.

12. The Group advocates that the focus of NBFC – regulation be shifted from liability side to asset-side of NBFC balance sheet and is in facour of prescribing capital adequacy standard based on risk-weighted assets prescribed for commercial banks. The Group recommends that the regulatory authority; in co-ordination with the representatives of NBFCs, Self Organizations and the Institute of Chartered Accountants, may complete the exercise of computing risk weights and credit conversion factors by March 31, 1994 and that capital adequacy ratio at the rate of 8 per cent of the risk weighted assets and off-balance sheet items be introduced by March 31, 1995.

13. Until the time, capital adequacy framework is introduced, the existing limits on deposit acceptance may be continued subject, however, to an overall debt equity ratio of 15:1.

14. The Group recommends placing restrictions on the portfolio management activities of these companies.

15. In addition, the Group facours that NBFCs be required to (a) maintain liquidity ratio of 10 per cent of their total deposit liabilities, (b) limit their risk exposure to single and group borrowers to 15 and 25 per cent of their net owned funds respectively, (c) transfer at least 20 per cent of their net profit to reserves every year unit reserves equal the company's share capital, and (d) refrain from investing in certain undesirable activities as defined by the regulatory authority.

16. The Group favours that until the time commercial bank deposit interest rate are regulated, NBFC interest rate also continue to be regulated and that the latter be pegged two to three per cent above the former. The Group also favour that NBFCs be allowed to accept deposits for periods ranging between 12 to 84 months as against the existing range of 24 to 120 months.

17. The Group favours abolition of the existing distinction between the terms 'exempted' and 'regulated' deposits for the purpose of calculating the gearing ratio and instead suggests that a distinction be made between 'borrowings' and 'deposits'. The regulatory authority may, if it deems fir, create a distinction between 'exempted' and 'regulated' deposits for the purpose of tenor of deposit, rate of interest etc. Deposit insurance is not recommended at this stage.

18. The Group recommends making credit rating compulsory for all registered companies, not in the immediate future but after a period of five years. The Group also recommends relaxations in the Advertisement Rules.

19. The Group suggest prescription of norms regarding income recognition, disclosure or transparency of accounts, provision for bad and doubtful debts, etc. A committee may be constitute for formulating these norms. Suitable reporting formats may also be devised to that effective supervision may be undertaken by the regulatory authority.

20. The Group facvours assignment of greater role to auditors in the supervisory process. Periodical statements to be submitted by NBFCs to regulatory authorities will need certification by the auditors. Based on the rule of exception, NBFCs may be inspected by the regulatory authority.

21. The regulatory authority should be empowered to suspend/cancel registration of these companies and even move for winding up where it so deems necessary.
22. As regards unicorporated entities, apart form the existing restriction on the number of depositors, the Group recommends prescription of ceiling on the quantum of deposits they can accept. A Standing Advisory Committee may be constituted for reviewing regulatory requirements for these bodies.
23. The regulatory authority should publish the list of all NBFCs periodically.
24. The Group recommends that the regulatory authority and the self regulating organizations may initiate a public awareness program for educating the depositors about the risks associated in placing deposits with various kinds of non-banking financial companies.

VI. COMMITTEE ON CONSORTIUM LENDING (J. V. Shetty Committee, August 1993)

1. The Committee recognizes the need to shift to market – driven banking from the present practices. Approach of the Committee has, therefore, been to ensure smooth transformation of the banking system during the current period of transition. The objectives behind the recommendations have, therefore, been to ensure financial discipline on the part of the borrowers together with improvement in the services offered by the banking system in the interregnum till the system completely switches over to market – driven banking. The Committee therefore, recommends introduction of syndication together with continuation of the existing consortium arrangement, in the case of consortium arrangement with substantial modifications to ensure that it becomes simpler and more flexible to meet quickly the credit needs of trade and industry.
2. In order to usher in market – driven banking the Committee recommends enhancement of the present threshold limit of Rs. 5 crors with immediate effect and to Rs. 25crore or above by March 31, 1996, for mandatory formation of a consortium when a borrower enjoys fund – based credit limits from more than on bank. The Committee also recommends that in the light of the experience gained the desirability of dispensing with the concept of threshold limit itself may be considered in due course.
3. The Committee recommends introduction of syndication for borrowers enjoying fund – based working capital limit of Rs. 25 crore or above from the banking system.
4. With the objective of ensuring financial discipline the Committee recommends that borrowers availing of credit facilities under multiple banking should submit details of credit facilities already availed of from different banks duly certified by their auditors, each time a fresh facility/ enhancement is sought for.
5. Considering the basic objective for forming consortium / syndication, i.e. dispersal of risks, the Committee recommends that banks can voluntarily form consortium even in cases where total limits are below the proposed enhanced threshold limits.
6. The need for expeditious disposal of credit proposals to meet the working capital requirements is well recognized and the following maximum time – frame has been prescribed for this purpose

	Maximum time frame for disposal of over-all credit proposals	Maximum time frame for disposal of export credit requirement
Proposal for sanction of fresh/enhanced credit limits	60 days	45 dyas
Proposal for renewal of existing credit limits	45 days	30 days
Proposal for sanction of ad-hoc credit limits	30 days	15 dyas

7. One of the main reasons for delay in arriving at decisions has been non – submission of data and information, particularly, the audited accounts. The Committee, therefore, recommends that banks

may review borrowal accounts during the first quarter of the current year (April to June) based on the audited statements for the year before last provisional statements for the last year, current year estimate and projections for the next year and consider releasing 50 per cent of the additional requirement of credit subject to submission of audited accounts at a later date for release of the balance account.

8. To expedite the process of disposal of proposals, banks should delegate sufficient power to their functionaries attending consortium meetings.

9. As a meaningful participation in a consortium should be determined based on the extent of share of a member in the credit limits rather than by limiting to total number of banks in a consortium should be dispensed with and banks should instead take a minimum share of 5 per cent of the fund – based working capital limits or Rs. 1 crore, whichever is more.

10. The set of documents under single window concept of lending for meeting the requirements of a borrower in a consortium has been revised and the same has been approved by the Managing Committee of Indian Bank's Association. The Committee recommends that the Reserve Bank of India may please adopt the revised set of documents and consider issuing of suitable instructions to this effect to the banks.

11. In order to ensure credit requirements of borrowers are met fully and within the maximum time – frame prescribed, borrowers will be free to induct new banks into a consortium. However, the entry of a new bank will be subject to its fulfilling certain procedural requirements to ensure financial discipline.

12. Banks will also have freedom to leave a consortium after a minimum period of two years subject to certain conditions. Further, it will be left to an individual bank in a consortium to decide about acceptance of its enhanced share for meeting additional credit requirements of a borrower.

13. The present discipline of banks being not permitted to extend any type of credit facility to borrowers, where they are not member of the consortia, or where such borrowers are not their regular constituents, will continue.

14. The terms and conditions governing the sanction of credit in a consortium should be uniformly applied by all members and are equally applicable to the rate of interest for different categories of advances.

15. At present of loans and advances by individual memner-banks in a consortium is not possible. With advent of market – driven banking and hence market – determined interest rates, it should be possible for banks to adopt independent pricing in due course. A beginning in this regard can be made now by adopting 'pricing' for facilities to be extended under syndication.

16. The lead bank should be vested with the responsibility of arranging for sanction and disbursal of credit (including documentation) as also for monitoring the account in the matter of advancing operative limits, verification of security, etc. The view of the lead bank and the bank having the next largest share will prevail in cases of disputes arising among members relating to terms and conditions of sanction.

17. The lead bank should have the freedom to sanction additional credit by a pre-determined percentage to meet emergent situations/ contigenicies.

18. The lead bank should be entitled to a fee, say 0.25 per cent of the limits per annum, to be borne by the borrower, for services rendered.

19. For assessment of credit requirements, borrowers having multi – division / multi product companies should be treated as one single unit, unless there is more than one published/ audited balance sheet and should be financed by one consortium. Similarly in the case of mergers one consortium should finance the merged unit.

20. The lending norms for arriving at the maximum permissible bank finance should henceforth be regarded as guidelines. Banks must have discretion to apply these norms with more flexibility.

21. Commercial paper should be made more popular by increasing its tenure to 360 days and developing an active secondary market for the instrument. CP should continue to be carved out of maximum permissible bank finance, as hitherto, as standby facilities / restoration of credit limits provide better investor confidence.

22. The legal framework permitting public limited and public sector companies to issue debentures for augmenting their long-term sources for working capital requirements to the extent of only 20

per cent of their gross current assets, loans and advances should be reviewed to consider raising this ceiling.

23. Inter – bank participation certificates could be made a more effective and popular money market instrument by marketing it freely transferable 'with risk' and/or 'without risk' as also permitting its issue on usance beyond 90 days. Further, an active secondary market for the instrument could be created by allowing money market mutual funds to invest in them.

VII. WORKING GROUP ON CASH CREDIT SYSTEM
(R. Jilani Committee, October 1993)

1. The existing borrowers enjoying fund – based working capital limits of Rs. 10 crore and more from the banking system should be subjected to a minimum current ratio of 1.5. The excess borrowings or the shortfall in the net working capital of the borrower arising out of the enhanced current ratio should be carved out of the cash credit account of the borrower and kept in a separate loan account. The balance in the loan account together with interest thereon should be repaid by the borrower within a period of three to five years, depending upon the cash generating potential and the capacity to service long – term debt.
2. The resultant MPBF to which the borrower is entitled should represent the cash credit (including packing credit) and / or bills limits or Commercial Paper.
3. Interest on both the components, i.e. the loan carved out of the original cash credit account as well as the resultant balance in the cash credit account should be charged at the same rate. In the case of default in repayment of the installments in respect of the newly created loan, banks should charge interest on the amount in default at a rate slightly above the normal rate of interest.
4. The borrowers enjoying working capital limits of Rs. 50 lakhs and above but below Rs. 10 crore should be subjected to a minimum current ratio of 1.5 in a phased manner within a period of three years.
5. In respect of the new borrowers availing themselves of fund based working capital limits of Rs. 10 crore and above from the banking system, a minimum current ratio of 1.5 should be insisted upon ab initio. All India Financial Institutions may be advised to take note of this while appraising the large projects.
6. When the current ratio of a borrowing unit is higher than 1.5 slip – back in the current ratio upon the level of 1.5 may be allowed provided tha bank is satisfied about the genuineness of the reasons.
7. To ensure proper end use of funds by the borrowers, utilization of funds should be strictly monitored on the basis of the quarterly information statements.
8. In the case of seasonal industries MPBF is at present calculated on the basis of maximum deficit in the monthly / quarterly cash budget. Under the proposed system, at least on – third of this deficit should be financed from the long – term sources of borrowers.
9. In view of the need boost exports, the existing facility of 100 per cent financing at the post – shipment stage should continue.
10. Steps should be take to promote bill culture to a greater extent in respect of both purchases and sales. Vigorous efforts should be made to persuade Government Departments, public sector undertakings and large industrial establishments to accept bill drawn on them.
11. The Group believes that with the emergence of several new money market instruments as adjuncts to bank credit in the last one decade and the gradual dismantling of the protective environment, the dependence of borrowers on bank credit is bound to show a diminishing trend in the coming years The lesser dependence of borrowers on bank credit will result in reduction of the quantum of advances granted by banks by way of cash credit. The Group, therefore, concludes that the measures recommended above, will help achieve better end use of funds, instill better financial discipline, improve the quality of bank advances, facilitate better management of bank's funds and will be in line with the reforms in the financial sector currently taking place.

VIII. COMMITTEE TO REVIEW IRDP

(D. R. Mehta Committee, November 1994)

1. The poor without skills and experience in handling assets should be segregated into a separate category by a committee comprising the representatives of blocks, Panchayats, lead banks, school masters, postmasters, prominent villagers and grass – root NGOs; such poor people should be initially provided wage employment under various schemes of State Governments and Jawahar Rozgar Yojana. They should also be supported by providing for greater social consumption expenditure. They would be provided with assistance under IRDP subject to their acquiring or upgrading their skills. The other segment of the poor, i.e. families above the poorest of the poor which has reasonable measure of skills and experience may be provided assistance under IRDP straight away. The relatively new entrants to job market may be provided training under TRYSEM or other programs followed by assistance under IRDP.
2. For doing away with leakages and malpractices, the Committee recommends switch over from front-end to back – end system of subsidy. The benefit of subsidy should also be available to borrowers who prefer to avail themselves of working capital finance.
3. For improving recovery, Government of Indian may consider liking of certain percentage of subsidy allocation to recovery performance. Special recovery officers may be appointed by Governments. Enactment of Model Bill as recommended by Talwar Committee by remaining State Governments may be expedited. Loan waivers may not be declared. DRDA, Vos and SHGs may help banks in recovery. Utilization – Reporter – cum – Recovery Facilitators may be appointed on commission basis.
4. The work relating to identification of investment opportunities and preparation of project profiles may be undertaken by district level Technical group to be set up by DRDAs.
5. DRDAs must prepare a perspective plan of infrastructure in consultation with DCC and BLBC. The limit of expenditure for setting up of infrastructure may be raised to 20 per cent of budgetary allocation. Atleast one mini ITI or Rural Polytechnic may be set up in each block for imparting training to poor rural youth. Private sector may be associated with the task of setting up such institutions. Additional shifts for TRYSEM should be opened in all it is and other training institutions.
6. Democratic character of IRDP should be restored and strengthened by ensuring greater involvement of Panchayats and village population as also by imparting to the process of identification of beneficiaries a greater degree or transparency.
7. Banks may be authorized to finalize targets in respect of IRDP under service area plans on the basis of previous years' actual figures after adding 10 per cent for cushioning, without waiting for targets from Government of India.
8. Banks should fix realistic repayment schedules and provide for gestation period where required. Working capital assistance in the form of cash credit limits may also be provided where necessary The repayment for IRDP loans should not be less than 5 years. Banks may encourage group loans for various activities under IRDP. The limit for non – obtention of mortgage may be fixed at Rs 25,000 for all activities under IRDP. Collateral security may not be insisted for loans up to Rs 50,000. Banks may be given freedom to select the beneficiaries from BPL list on a pilot basis.
9. The level of per family / enterprise investment under IRDP should be enlarged by providing larger credit as also higher amount of subsidy.
10. Non-farm, tiny/small enterprises and services sector may be further promoted under IRDP.
11. DRDAs must be recognized into compact teams of professional and technical experts.
12. Voluntary organizations and Self – Help Groups may be associated with the implementation of IRDP. In the case of projects approved by CAPART a few VOs can be on pilot basis given list of BPL families for identification of borrowers, ensuring availability of backward/forward linkages. as also verifying end use of credit.
13. Banks should provided loans under IRDP for acquisition of land.
14. Cash disbursement under IRDP may be extended throughout the country. Family Credit Plan Scheme should be further encouraged.
15. Supplementary does of assistance under IRDP may be provided to beneficiaries who have not crossed the poverty line with initial assistance.

16. Panchayti Raj Institutions at grass – root or middle levels should be involved in the implementation of IRDP.
17. A new dimension should be added to IRDP through Information Education and Communication for which a separate budget should be provided.

IX. COMMITTEE ON TECHNOLOGICAL ISSUES (W. S. Saraf Committee, December, 1994)

1. An Electronic Funds Transfer (EFT) system be setup. The BANKNET communication network may be the carrier. The fund settlement may be effected at the originating and the destination centers through the accounts of banks, maintained at the banks managing the respective clearinghouses.
2. The ultimate goal of tne EFT is to facilitate funds transfer between two bank branches. To start with, message transfers to the destination centers may be in a batch mode. High value institutional fund transfers (Rupees 10 million and above) may be batched every hour while the retail customers transfers may be batched at the end of the day.
3. The scheme may cover all important centers in a phased manner, starting with the 4 metropolitan centers.
4. For operationalizing the EFT scheme banks may install the necessary computer and communication infrastructure (a PC/AT, a printer, a modem and direct telephone line) at their Service/Main branches. They should also have connectivity to BANKNET.
5. Steps may be initiated by RBI to enact suitable legislation on the lines for Electronic Fund Transfer Act 1978 in the USA and Data Protection Act 1984 in UK.
6. A DVP System in SGL transactions may be introduced at the Public Debt Office, Bombay. This may later be extended to other major centers.
7. The DVP System will cover SGL accounts of all those institutions who are also having current accounts at the Reserve Bank (Deposit Accounts Departments).
8. Settlement may be on gross basis both for securities (i.e. SGL) transactions in the Public Debt officer and current account (i.e. funds) transactions in the Deposit Accounts Department.
9. Relevant provisions in Public Debt Act 1944, public Debt Rules 1946 and Bankers' Books of Evidence Act 1891 may be amended to empower RBI to revise the SGL transfer from and in due course introduce screen based reporting of such transactions.
10. The concept of 'Clearing Bank' may introduced for extension of DVP mode to all trading in Government Securities.
11 The "Clearing Bank" will be required to maintain a clear distinction between operations on its own account and those in behalf of its clients.
12. Once the DVP system stabilized, the system of screen based reporting of SGL transactions should be introduced. SGL Transfer Form may be replaced by electronic screen formats.
13. RBI may explore the feasibility of using NICNET for electronic reporting of currency chest transaction Dial-up connectivity through Modem may also be used.
14. The currency chest branches with STD facility may transmit the currency chest data to both the Issue Officer of RBI and their respective Link Officers either through NICNET (by dialing the local NICNET node) or through PSTN lines. The branches not having STD facility may report the data by telephone / telegram to their district headquarters branch, which in turn would transmit these data to the Issue Officer of the RBI and its Link Office.
15. Later, when STD facility becomes available at the remaining currency chest branches, all currency chest may transmit these data to the Issue Office of the RBI and its Link Office.
16. RBI will, on a daily basis, make available the currency chest data received during the day to the local Link Offices of the respective banks, before the closing hours.
17. Fund Settlement in respect of Government transactions may be delinked from submission of scrolls and documents (challans/paid cheques) to the Pay and Accounts Offices (PAO) of Government Departments. Reporting of transactions to RBI for fund settlement and forwarding of scrolls to PAO may take place simultaneously.

18. Bank branches undertaking Government business may communicate the net receipt and payment position by PC Modem/telex/telegrams to their respective focal point branches on the same day, for further communication of the consolidate figures electronically to their Link Cells at Nagpur. The link cells would consolidate and forward the data files on floppies, tapes or directly to the computer to CAS, Nagpur before a prescribed time of fund settlement. This will ensure a T+1 system.
19. Link Cells of all banks at Nagpur, all focal point branches, State Government link offices should be computerized.
20. Repetitive or low value transactions like interest, dividend, refund of primary issue subscriptions, salary, pension, etc. may be effected electronically, by introducing "Electronic Clearing Service (ECS)". The facility may be extended to all corporate bodies/Govt. Departments, Debit clearing should also be introduced for pre – authorized debits for payments like insurance premia, taxes, loan installments etc.
21. A "Bills Payment System" may be introduced which will enable the customers of utility services to pay their bills by debit to their accounts in the banks. The Utility service agencies may redesign the formats of their bills to enable automatic data capture of the paid bills at the debiting branch/bank level. The settlement may be effected at the RBI on the basis of the data supplied by banks. Suitable costing of the bank's services may be done for charging the utility ageincies.
22. Cheque clearing work may be decentralized by introducing "Clearing Bank" concept of efficient cheque processing. Member banks of clearing house may join one of the Clearing banks Group. Each Group may have its own in-house, cheque processing facilities and other infrastructure. At Bombay, there should be atleast three Clearing Groups while at other MICR centers, there should be two Clearing Groups.
23. "Clearing Banks" will provide mutual backup to each other in case of disaster at any cheque processing site.
24. All MICR instrument should be of a uniform size. MICR codeline should be modified to include an additional field to indicate minimum control information (e.g. the scroll number) of the presenting banks.
25. Banks should equip their Service Branches and other large branches with computer and communication infrastructure (PC/AT, printer, network software, dial – up capabilities etc.) so as to enable them to present and receive the cheque clearing data (both outward and inward) electronically.
26. At Bombay, all inter – bank payments which are now settled through inter – bank clearing at the end of the day should be settled by on – line computer links between RBI and the banks Such fund transfers may be on a gross basis.
27. Cheque Transaction System should be introduced initially for Intra – bank cheques of value up to Rs. 5000. In due course, it may be extended to inter – bank instruments. Suitable changes in the Negotiable Instruments Act and other relevant acts may be initiated.
28. MICR clearing should be introduced at Ahmedabad, Bangalore, Hyderabad, Pune, Baroda and Surat at the earliest and dependable back-up arrangements should be planned right from the beginning.
29. Cheque clearing centers should be financially self supporting.
30. All centers having more than 100 bank branches should be taken up for MICR clearing.
31. The system of "Floppy Input Clearing" may be introduced as an interim measure pending MICR clearing at these centers.
32. Clearing arrangements should be set up all centers with five or more banks.
33. National Clearing cells of RBI may use the BANKNET for reporting the particulars of unpaid items of inter – city clearing on the network to the originating centers and for sending the credit advises to the banks. The collection cycle in RBI's National Clearing service can further be reduced by adopting this system.
34. Coverage of RBI's National Clearing of inter – city cheques may be extended. To start with. the centers which are already connected in one way clearing may be linked for two way clearing.
35. State Bank of India may organize inter – city clearing at centers not served by RBI on the lines of National Clearing Services of RBI.]

36. Standard codeline structure should be prescribed for non – MICR cheques also to facilitate data processing of outstation cheques.
37. The physical reach of the network should be extended to all centers where the RBI has officers and also to other centers which have at least 100 bank offices.
38. Branches covered under Total Branch Computerization (TBC) and the Service branches of banks should be equipped with BANKNET nodes.
39. The 'COMET' (the communication software for BANKNET) should provide for the following additional functionalities:

    (a) Dial – up support;
    (b) File transfer – ASCII and BINARY
    (c) End – to end encryption/authentication of messages and files.
    (d) Adoption of CRC/XOR/Checksum feature to ensure data integrity;
    (e) PING (Packet Inter Groper) facility;
    (f) Notification for messages;
    (g) Split Screen Visual communication with remote user;
    (h) System and messages status log;
    (i) Screen Printer;
    (j) Batch Input/Output Interface;
    (k) BACKUP and RESTORE facility;
    (l) Bridge between BANKNET and SWIFT

40. Switchover from voice grade transmission to high speed transmission facilities like, VSAT technology, fiber, optics, radio frequency etc. may be targeted.
41. BANKNET users may keep the BANKNET machines powered up on all working days all the time to facilitate the Automode function of COMET to log in to the host IBM system at pre – set interval and collect the messages.
42. For enhancing the reliability of the Network, dependence on a particular IBM system to act as the message host may be overcome by providing the facility of automatic fall back on any other IBM system if one of them is down.
43. RBINET, the communication software developed inhouse at RBI may be installed at all RBI offices. All Central Office Departments / Divisions and Regional Offices nay be provided with RBINET nodes. Further all banks may use this software for their communication with the RBI as also with their major branches, controlling offices.
44. National Institute of Bank Management (NIBM), Pune may organize training capsules on BANKNET and RBINET or crash basis to train Bank officers in the user of network.
45. All banks and financial institution authorized by RBI to deal in foreign exchange business (84 at present) may join SWIFT. At present 41 authorized dealers have taken SWIFT membership
46. All 'A' category branches (181 in all) of banks authorized to deal in foreign exchanges may be linked to their respective SWIFT Operating Centers at Bombay. All 'B' category forex dealing branches (1918 in all) may also be connected to the respective SWIFT Operating Centers at Bombay in a phased manner.
47. Banks connected to SWIFT may utilize the network oprimally.
48. To meet the training gap on SWIFT operations, SWIFT may be requested to have tie up arrangements with one of the training institutions in India (preferably NIBM, Pune) for conducting training programs on a regular basis.
49. To promote acrd culture in India, a Society of Card Issuers may be constituted. The Indian Bank Association may take the initiative in forming such a Society. This Society could be useful to establish proper procedures on prevention of fraud, monitor merchant establishments and make card business more profitable.
50. For effective utilization of the resources of the proposed SPNS, the ATM card to be issued may be multipurpose card. Besides ATM card this network may also connect Point of Sale (POS) terminals, Branches Teller Machines (BRMs) and cash dispensers. The network should alsp provide connectivity to smart card as also other cards such as VISA, Mastercard and AMEX.

51. Electronic Fund Transfer at Point or Sale (EFTPOS) and use of smart cards may be promoted to develop at plastic money / electronic money culture.
52. Training at the work place should be organized for certain routine applications like copying / deleting of files, virus protection, E – Mail etc. Emphasis should be on local presence of the trainers.
53. In – house training institutions should be strengthened for higher technology inputs in all training programs by providing state of the art infrastructure and skilled faculty.
54. National Institute of Bank Management (NIBM), Pune may design intensive and specialized training programs of 4 to 6 months duration for EDP managers, database administrators and other specialists. National Center for Software Technology and National Informatics Center may also be requested to organize training programs, specially designed for bank personnel.
55. An institute on banking technology may be setup with the objective of imparting high – level technology training to the bankers. It may be an autonomous institute offering professional level courses.
56. Banks may sponsor high level academic courses in information technology with specialization in banking technology at the premier institute of learning such as IIT, IIM, ISI. Sabbaticals for acquiring IT qualifications may be encouraged.
57. NIBM may take lead in preparing self –learning video material on commonly used banking application packages.
58. IBA may start monthly magazine on banking technology.
59. A Standing Committee on Technology Uses in Banks should be set up under the aegis of RBI to periodically review the technology status in the Banking industry.

X. EXPERT GROUP ON FOREIGN EXCHANGE MARKETS (O. P. Sodhani Committee, June 1995)

Relaxations to Existing Regulations

1. Corporates should be permitted to take a hedge upon declaring the existence of genuine exposure.
2. The banks may be permitted to decide open position limits subject to their earmarking capital to the extend of 5 per cent of open exposure limit. The current cap of Rs. 15 crores on open exchange position may be withdrawn.
3. The discipline relating to aggregate gap limits, ideally, should encompass rupee transactions also. While this is the ultimate goal, to begin with, the banks should be permitted to fix their own gap limits based on capital, risk bearing capacity, etc.
4. Authorized dealers may on application to RBI be permitted to initiate cross currency positions overseas.
5. In order to impart depth and liquidity to the forward markets, banks should be allowed to lend or borrow short – term funds up to six months in the overseas markets up to specific limits.
6. The number of market participants should be increased by permitting financial institutions like IDBI, IFCI etc. to trade in the forex market.
7. Market intervention by RBI should be selective rather than continuous, Forex, swaps may be used as a tool by RBI to control the forward margins.
8. Banks should have the freedom to determine the interest rate and maturity period of FCNR (B) deposits subject to a cap being put in place by RBI.
9. Exporters should, subject to liquidation of outstanding advances, be permitted to retain 100 per cent of export earnings in foreign currency in India.
10. Inter – bank borrowings should be exempt from statutory pre – emptions to help the emergence of a rupee term money market and a deep and liquid debt / forex market.

11. Corporates should be permitted to cancel and re – book option contracts and hedge any genuine contingent exposure using options.
12. Banks should be permitted to offer lower cost option strategies like "range forwards" and "ratio range forwards"
13. Tax laws relating to withholding tax should be unambiguous and derivative transactions should not be subject to any withholding tax. This matter may be taken up with the Government of India.
14. Banks should have greater freedom to use derivative products for their own asset - liability management.
15. Banks can be given general permission to offer hedging products, like caps, floors, swaps etc. subject to post – facto reporting.
16. Corporates having EEFC accounts should be permitted to user amounts therein as margin for executing trades that will enable them access to hedging products overseas which are not available in India.
17. Subject to reforms the money market and permitting short-term investment / borrowings overseas, RBI may invite proposals from banks for offering rupee – based derivatives.
18. In the long run, authorized dealers may be permitted to offer all types of derivative products subject to their putting in place comprehensive risk management systems on the basis of RBI guidelines. A fresh set of guidelines for forex and derivative risk management should be framed by the RBI to replace the existing Internal Guidelines.
19. In view of the complexity of derivative products and attendant risks, an association of professionals or FEDAI should ensure that uniform documentation and market practices are followed by all the market participants.

20. The Group has apprehensions that some of the corporates have converted exposure management function into profit centre without having adequate control systems.It is there important that all market participants should put in place risk management policies and internal control systems before being allowed to transact in forex and interest rate derivative produucts.

21. Accounting of derivative transactions (including forwards) should specifically differentiate between its use for trading from for hedging.

22. Accounting standards for all market participants should be developed by the Institute of Charted Accountants of India (ICAI) for forex/derivative products to cover accounting and disclosure norms. As an interim measure, ICAI should issue a guidance note or statement of recommended practices (SORP) covering accounting and disclosure norms. In case an organisationdoes not adhere to the guidance note, the departure should be suitably commented upon by the auditor.

23. Proper disclosure of interest rate and forex rate risk should be made in the financial reports. The disclosure should include a clear statement on the risk management of derivatives and the company's accounting policy for derivatives.

24. The accounting practices recommended by the ICAI should be accepted by tax authorities for the determination of tax incidence.

25. All market participants may follow the recommended "best practices" for managing various risks while undertaking forex/derivative transactions. Boards of Directors of end-users should approve and implement a policy for the use of derivatives for financial risk management which sets the boundaries of their derivatives operations.

26. The netting of settlements and the related pre-settlement risk should be made legally enforceable. A study group may be set up to eximine the issue in all its ramifactions.

27. To ensure that banks and others contemplating derivatives dealing activity are not unprepared for the potential capital requirements for market price risks, as recommended should be followed by all the authorised dealers permitted to deal in derivatives.

Miscellaneous

28. RBI may set up a foreign exchange market committee to advise in on policy issues relating to foreign exchange, effecting improvement in the quality of risk management and preparing issue papers on specific market related topics.

29. Off-share banking units may be set up in Bombay.

30. RBI should take the initiative in collecting and publishing on a daily basis critical data on foreign exchange transactions.

31. The proposed Forex Clearing House in Bombay may be set up early considering the substantial benefits this transactions.

32. FEDAI's role may be reviewed and enalarged specifically to focus on training and preparing the stage for further relaxations in the forex/derivatives market.

33. With a view to offer the best possible exchange rates to smaller entities, banks should keep their forex dealing branches updated on rate variations or consider decentralising dealing operations.