BANKING SECTOR – EVENT UPDATE

Recommendations on Priority Sector lending by Nair Committee

The Reserve Bank of India (RBI) on 21 February 2012 released the report of the Committee headed by Mr. M V Nair which was constituted to re-examine the existing classification and suggest revised guidelines with regard to priority sector lending and related issues. The RBI has sought recommendations from various stakeholders by March 31, 2012.

We believe that the recommendations are broadly towards directing the credit flow to the economically weaker sections of the society and can be fairly achievable in a phased manner on overall basis given the timeline for implementation. The overall targets for PSL have been retained with certain new sub-segment targets introduced, which intend to improve the lending towards agriculture segment, ensure appropriate monitoring mechanism and change of methodology for calculation of shortfall to make it more effective and transparent. We believe that the recommendations are neutral for public sector banks and more on the negative side for private banks since they may fall short in meeting many new sub-targets given that the current lending towards such segments is already at the lower end. While the introduction of the guarantee scheme for SFMF, removal of DRI scheme, increasing housing and educational limits under PSL, change in calculation of shortfall and loans to NBFC's for on-lending, buy-out & securitization classified as priority sector are positives amongst the recommendations, cap of 5% of ANBC for NBFC lending and introduction of sub-segments for meeting PSL targets are some of the negatives.

Parameters	Recommendation	Limits	Earlier Limits	Impact
Overall Priority Sector Lending target (PSL)	PSL retained for domestic banks	40% of ANBC	40% of ANBC	8 out of 46 banks have not met their overall PSL targets in FY11. Overall there shouldn't be any problem in meeting the PSL
Lending to the Agriculture sector	Entire Agri. lending covered under 'agriculture & allied activities' without any distinction between Direct & Indirect Agriculture	18% of ANBC	Of the 18% agri lending, Indirect lending should not exceed 4.5% of ANBC	Doing away with the distinction will help many private & public banks and is a positive for meeting the agri lending targets
Small and Marginal farmers (SFMF)	Of the Agri. lending, 9% for loans extended by banks would be to small and marginal farmers and is to be achieved by 2015-16	9% of ANBC	No such distinction earlier	Achieving this sub-segment could be challenging for private banks as lending to this segment is only 2.82% as on FY11 as against 6.32% by the PSBs
Lending to micro enterprises	Loans to this segment is fixed at 7% & is to be achieved in stages latest by 2013-14	7% of ANBC	No such distinction earlier	Shouldn't be much problem for PSBs. Lending to this segment is 4.67% as on FY11 as against 6.94% by the PSBs
Weaker Sections	Existing target of 10% of ANBC retained	Status quo	10% of ANBC	While the status quo has been maintained, private banks find it difficult to meet this target as 11 out of 20 banks were unable to meet 10% target in FY11
Differential Rate of Interest (DRI) Scheme	To be discontinued	Not there	1% of the total advances outstanding as at the end of the previous year	Positive for banks

Targets for Foreign Banks	PSL limit increased to 40% with sub targets of 15% each for MSE & Export credit	40% of ANBC	32% of ANBC	Relaxation in meeting the sub targets in agri such as SFMF & weaker sections to foreign banks. However increase in overall PSL will increase the PSL loan buy outs
Loans to NBFCs – On-lending	Bank loan sanctioned to non-bank financial intermediaries for on-lending to specified segments may be reckoned for classification under priority sector, up to a maximum of 5% of ANBC	5% of ANBC	Not included under priority sector except for micro finance lending since April 2011	Positive for banks as it will enable them to meet their PSL sub targets
Loans to NBFCs - buy-outs and securitization	Portfolio buy-out & securitization would be classified as priority sector. However loans extended against gold jewelleries by NBFCs will continue to be excluded as PSL		Not included under priority sector except for micro finance lending since April 2011	Positive for banks as it will enable them to meet their PSL sub targets
Interest spread cap on the underlying loans extended by the NBFCs for eligibility under priority sector	Cap on interest spreads under On-lending, Securitisation and Portfolio buy-out under Direct Assignment	Less than 3.5% for HFCs and less than 6% for AFCs	No such cap on spreads	Negative for NBFCs
Agriculture Credit Risk Guarantee Scheme	Establishment of Agriculture Credit Risk Guarantee Fund for SFMF as an efficient mechanism to address the risk in lending to agriculture sector	Proposal in line of CGTMSE (Credit Guarantee Fund Trust for Micro and Small Enterprises)	Not there earlier	Positive for banks given that loans to this category was shied away due to NPL risks
Priority Sector Lending Certificates (PSLC) in order to address concerns expressed in achieving the targets proposed for lending to SFMF & micro enterprises	Recommends non-tradable PSLCs on pilot basis that can be only transacted between domestic SCBs, foreign banks and RRBs.	Proposed in order to meet lending shortfall in sub categories though in phased manner	Not there earlier	Positive for public sector banks
Reckoning of RIDF deposits for achievement of PSL targets	Current year's penal investments will not be reckoned for PSL targets in subsequent years	Status quo though amount of such Investments made by the banks may be netted from the actual penalty for the subsequent year for non-achievement of targets other than that for SFMF & micro enterprises	Current year's penal investments will not be reckoned for PSL targets in subsequent years	
Calculation of	Recommends change in the	Higher of Shortfall in	Shortfall in Overall	Positive for banks as the

shortfall in PSL	method of calculating shortfall in the PSL in a more constructive manner by including the penalty of earlier years	Overall PSL or aggregate Shortfall in Agri + Shortfall in Weaker Section netted with the current total fund deposited as Penalty + Aggregate shortfall in target for lending to SFMF and micro enterprises	PSL target or aggregate Shortfall in Agri + Shortfall in Weaker Section whichever is higher	earlier year's penalty will now be netted of, allowing the banks to ease their investments in the low yielding investments.
Rate of interest payable on RIDF and other funds	Interest rate will now be benchmarked against Reverse Repo	Linked to Reverse Repo (7.5%)	Was linked to bank rate (6%) which only now has been revised, Eq. to MSF (9.5%)	Neutral as the bank rate has been changed very recently
Education loans under PSL	Recommends increase in limits for the educational loans	₹ 1.5mln in India & ₹ 2.5mln abroad	₹ 1mln in India & ₹ 2mln abroad	Positive for banks
Housing loans under PSL	Recommends increase in the limits for housing loans	₹ 2.5mln per individual	₹ 2.5mln per family	Positive for banks

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