

# **India's Response to the Global Financial Crisis and Current Issues in Deposit Insurance**

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# Overview

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- India: third largest economy in Asia
- Banking system in India had **no direct exposure to the sub-prime mortgage assets** or to the failed institutions
- **Deposit Ins Corp was not warranted to rescue banks**
- Growth driven predominantly by **domestic consumption** and domestic investment
- External demand, % of merchandise exports, was around 15% of GDP in 2008
- Despite the above mitigating factors, India was partially hit by the crisis due to globalisation; merchandise exports plus imports, as a proportion of GDP, grew from 21.2% in 1997-98, the year of the Asian crisis, to 34.7% cent in 2007-08
- Contagion spread through 3 channels - financial, real and confidence channels
- The impact of the crisis was addressed through monetary policy and fiscal stimulus measures by the Reserve Bank of India (RBI) and the Union Govt

# Monetary Policy Measures

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- RBI targeted to 1) maintain a comfortable local currency (rupee) liquidity position; 2) augment foreign exchange liquidity; and 3) maintain a policy framework that would support credit delivery so as to stop growth moderation
- The Cash Reserve Ratio was reduced from 9% (Sep 2008) to 5% by early Jan 2009, injecting primary liquidity in the system
- The policy rates were cut - the reverse repo rate from 9.00% to 4.75%
- Forex liquidity measures included increase in interest rate ceilings on non-resident deposits and easing of restrictions on external commercial borrowings and on short-term trade credits

# Monetary Policy Measures

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- Special refinance facility to banks from RBI up to 1.0% of each bank's deposits
- Term repo facility under the LAF to enable banks to ease liquidity stress faced by mutual funds, non-banking including Housing Finance Companies
- Reduction in Statutory Liquidity Ratio by one percentage point from 25 to 24%
- Extension of pre and post-shipment rupee export credit by 90 days each
- Increase in the eligible limit of the export credit refinance for scheduled banks from 15% to 50% of the outstanding export credit
- Monetary and liquidity measures, taken together released liquidity amounting to 9 per cent of GDP between mid-Sep 2008 and Apr 2009 (Rs 4,900 bn)

# Forex Measures

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- Constitution of special market operations to meet the foreign exchange requirements of public sector oil marketing companies against oil bonds as India petroleum, crude and related products constitute 31% of India's total imports
- Increase in interest rate ceiling on export credit in foreign currency to LIBOR plus 350 basis points
- Permitting banks to borrow funds from their head offices, overseas branches and overdrafts in nostro accounts up to 50% of their unimpaired Tier 1 capital as against 25%

# Forex Measures

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- The all-in-cost ceiling for ECBs of average maturity period of three to five years and over five years was enhanced to 300 basis points above LIBOR and 500 basis points above LIBOR respectively
- ECBs up to US\$ 500 million per borrower per financial year were permitted for rupee/foreign currency expenditure for permissible end-uses
- NBFCs exclusively involved in financing of the infrastructure sector were permitted to avail of ECBs

# Fiscal Stimulus Measures

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- India undertook fiscal measures in terms of reduction in central excise duty and additional expenditure
- **Stimulus packages** announced by the Union Government during Dec 2008-Feb 2009 and the additional expenditure amounted to **2.4% of GDP** (revenue loss due to tax cuts, investment expenditure and other exp were 0.2%, 0.8% and 1.4% respectively); GDP in 2008-09 was Rs. 56,300 bn
- During 2009-10, fiscal stimulus measures as per cent of GDP amounted to 1.8; of the expenditure measures, revenue exp constituted around 84%
- India embarked on Fiscal Responsibility framework with the enactment of **Fiscal Responsibility and Budget Management (FRBM) Act** by the Union Government in 2003, followed by the sub-national Govts subsequently

# Current Fiscal Issues

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- The crisis related fiscal stimulus measures warranted the postponement of targets set for fiscal balance under FRBM rules from the year 2009-10 (3% gross fiscal deficit); now the 3% target has been set to be achieved by 2017-18
- The **quality of government expenditure and resources for financing infrastructure are important issue**
- The **tax GDP ratio** needs an improvement as it remained stagnant for a long time (at 10% in 2015-16)
- Tax reforms esp the introduction of uniform tax for the entire country (goods and services tax) is vital for improving the competitiveness of the manufacturing in particular and economy in general



# Policy Measures - 2013

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- RBI took liquidity monetary measures in **2013** to address volatility included
  - Hike in Marginal Standing Facility rate/Bank Rate
  - **Restriction on banks' access to funds under LAF repo**
  - **Open Market Operation sales**
  - Maintenance of minimum daily **CRR** balances by scheduled commercial banks at **99** per cent of the requirement
  - Capping of Primary Dealers' access to LAF at 100 per cent of their individual net owned funds

# Forex measures - 2013

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- The announcement of gradual reduction in quantitative easing programme (FED May 22, **2013**) led to **capital outflows**
- RBI and Government took following measures
  - Offered a window for the banks to **swap fresh FCNR (B) dollar funds with RBI**
  - **Increased overseas borrowing limit** from 50 to 100 per cent of the unimpaired Tier 1 capital of banks (with the option of swap with RBI)
  - Permitted corporates to avail of external commercial borrowings under approval route from their foreign equity holder company for general corporate purposes

# Strengthening of Financial Sector

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- Various regulatory and supervisory measure were undertaken by the Central Banks to strengthen the banking sector and also the **non-banking finance Companies** in particular over a period of time
- Keeping in view the rising role of NBFCs domestically, RBI focussed on addressing gaps in regulation of NBFCs and harmonising regulations to enable delivery of innovation and last mile connectivity in credit
- The revised regulatory framework for NBFCs issued in November 2014 aligns NPA n other norms for NBFCs with that of banks in a phased manner (incl non-performing loans to 90 days)

# Corporate Governance in Banks

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- In pursuance of the recommendations of the Committee to Review **Governance of boards of banks**, set up by RBI, guidelines were issued to banks on:
  - fixing of upper age limit for whole time directors of pvt sector banks
  - replacing the calendar of reviews with **seven key themes**; and compensation for non-executive directors of private sector banks
  - Post of Chairman and Managing Director (CMD) has been split into **an executive managing director (MD) and a non-executive chairman**

# Bankruptcy Procedures

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- At present, there is no comprehensive policy/ law on corporate bankruptcy in India
- Bankruptcy law reforms have been identified as a key priority; proposal in pipeline for a **comprehensive Bankruptcy Code** in line with global standards to provide for necessary judicial capacity by the Government
- It is envisaged to bring about legal certainty, speed and also improve the **ease of doing business**

# How is India different from other EMEs

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- **Share of external finance to meet deficit of the Government is very low at 1.9%, which provides economic stability**
- **Banks are subject to strong and sound prudential regulatory norms**; limits in lending to real estate sector and equity markets
- India followed a prudent policy in management of its external sector
  - **Limits on foreign currency borrowing by banks**
  - **Hierarchy of capital flows: Foreign Direct Investment is preferred over portfolio flows; equity to debt; long-term debt is preferable over short-term debt**
- There are ceilings on foreign currency borrowings by corporates
- These policy levers served country well in times of crisis
- Macroeconomic performance set to be robust - **GDP projected at 7.6% in 2015-16** from 7.2 % in 2014-15

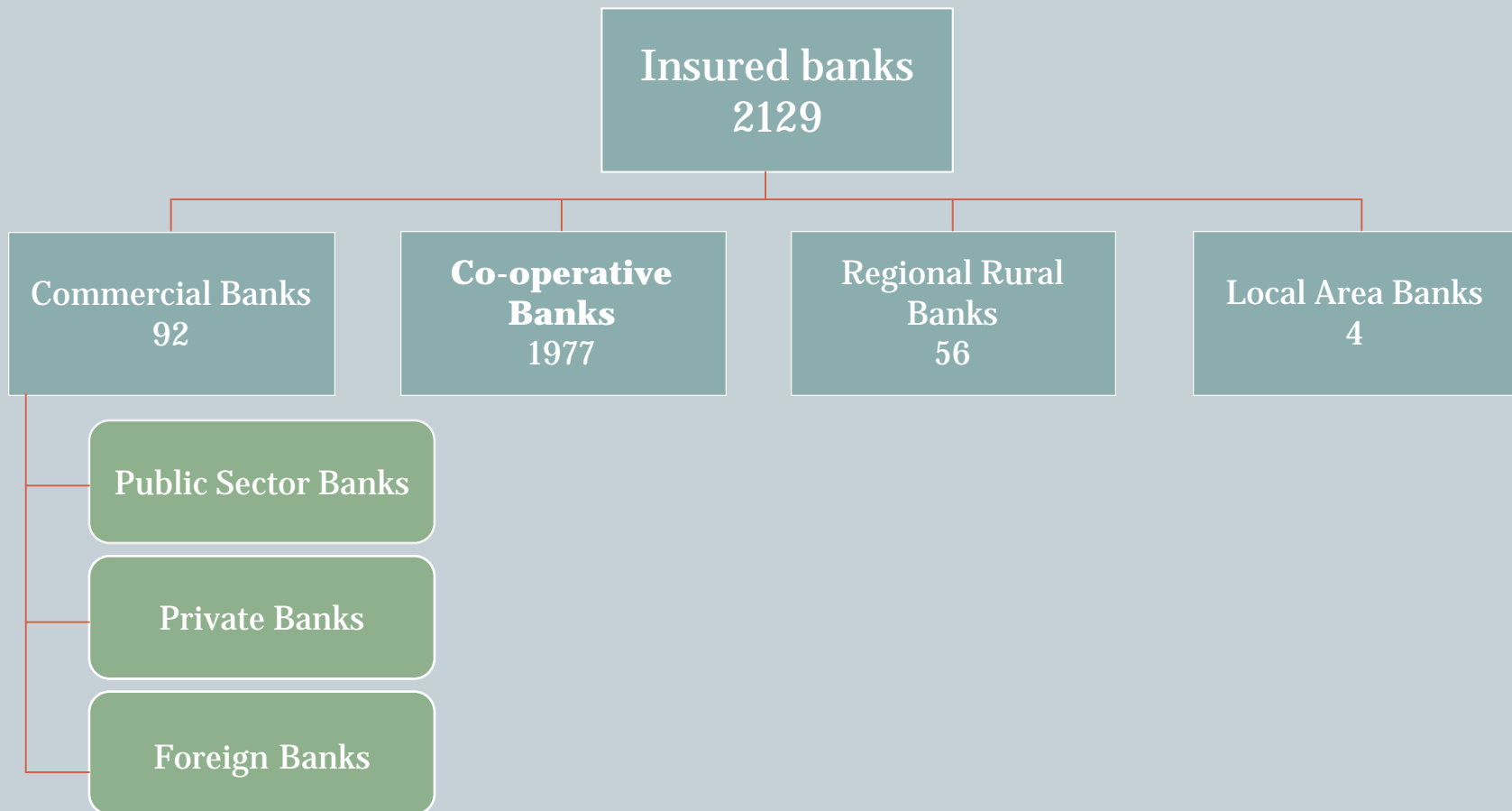
# Macro economy at a Glance (%)

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Indicator	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Gross Value Added (%)	9.3	6.7	8.6	8.9	6.7	4.9	6.6	7.2	7.1
CPI Inflation (%)	6.2	9.1	12.2	10.4	8.4	<b>10.4</b>	<b>9.7</b>	<b>6.4</b>	<b>5.8</b>
Gross Fiscal Deficit (% to GDP)	<b>2.5</b>	<b>6.0</b>	<b>6.5</b>	4.8	<b>5.8</b>	<b>4.9</b>	<b>4.4</b>	<b>4.0</b>	<b>3.9</b>
Rate of Gross Domestic Saving	34.6	<b>36.8</b>	<b>32.0</b>	<b>33.7</b>	<b>33.0</b>	<b>31.1</b>	<b>30.0</b>	-	-
Current Account Deficit (% to GDP)	-1.3	-2.3	-2.8	-2.8	-4.2	-4.8	-1.7	-1.4	-1.4
External debt (% to GDP)	18.0	20.3	18.2	18.2	20.9	22.3	23.6	23.7	25.3
Total Public debt (% to GDP)	58.9	58.6	56.3	52.1	51.9	51.9	51.1	50.0	49.3

# Deposit Insurance - Sep 2015

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# Deposit Insurance in India

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- DICGC is one of the earliest DI systems established in 1961 second only to FDIC
- Deposit insurance is currently a **pay-box system** in India in practice
- In its pay-box function, DICGC is fully or largely compliant on all core principles; however, weaknesses in overall insolvency framework that are outside the control of the DICGC make the overall compliance with many core principles limited
- **Pay box plus role:** occasionally DICGC plays role even before liquidation of a bank, recovery sequence etc.

# Current Issues in Deposit Insurance

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- The pay outs by DICGC on account of claims are primarily in respect of urban cooperative banks (UCBs); however, such payouts are very small i.e. 0.01 per cent of total insured deposits during the last five years. The UCBs are spread over essentially five provinces and account for 7% of total insured deposits
- The regulatory and supervisory norms for UCBs have been strengthened and efforts are on to bring them on par with commercial banks

# Financial Safety net

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- Prudential Regulation/Supervision is the first 'Line of defence' in the Financial System Safety Net
- Followed by Lender of Last Resort and Failure Resolution measures
- Deposit Insurance is one of the instruments of Financial Safety Net

# Current Issues in Deposit Insurance

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- The Financial Sector Legislative Reforms Commission (FSLRC) (March 2013) recommended the creation of Resolution Corporation for the entities under different regulators in the financial system
- The Working Group on Resolution Regime on Financial Institutions recommended the setting up of a Financial Resolution Agency (FRA) either transforming the present DICGC into FRA or by setting up a new authority
- The Government of India set up a Task Force in September 2014 for the establishment of a Resolution Corporation; the work is in progress
- **Attempts are being made to create resolution framework for banks on par with international standards through reforms and if needed minimum legislative changes** as the establishment of RC for the entire financial sector would involve considerable time

# Issues in Appointment of Liquidators

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- Provincial Government jurisdiction; delay in appointment of liquidators; Liquidators generally don't represent professional body
- Delay in submission of claim list by Liquidator; lack of use of technology
- Tendency to prolong settlement process during which period the realisable value of assets get eroded

# Differential Premium for banks

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- Provides incentives to avoid excessive risk taking, minimises moral hazard and introduces fairness into the premium assessment process
- While most deposit insurance systems initially adopt a flat-rate premium which is simple to design, implement and administer, there has been an increasing recognition globally about the need for introduction of a differential premium system (DPS) **based on the risk profile of banks**
- FDIC made a beginning in 1993 by introducing DPS; as per Int'l Association of Deposit Insurers, 26 of the 79 member jurisdictions have adopted DPS (IADI Survey 2013)

# Differential Premium for banks

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- A Committee on Differential Premium System for Banks submitted the Report in Sep 2015 for the introduction of DPS in India
- Major recommendations of the Committee cover the aspects like number of categories for assigning premium rates, institution of DICGC's management information system for the member banks for collection of model related information mainly based on audited balance sheet data, periodic review of rating system for premium collection etc
- Major recommendations are being examined for implementation in near future

# Other Issues

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- Submission of returns by banks to DICGC
- Timely remittance of premium
- **Bunching of receipts and payments**
- Recoveries
- Investment guidelines
- Up gradation of IT system





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