E.C. No. 1414

SECOND REPORT

ESTIMATES COMMITTEE
(2004-2005)

(FOURTEENTH LOK SABHA)

MINISTRY OF FINANCE
(DEPARTMENT OF ECONOMIC AFFAIRS – BANKING DIVISION)

Action taken by Government on the recommendations contained in the Sixteenth Report of Estimates Committee (Thirteenth Lok Sabha) on the Ministry of Finance and Company Affairs (Department of Economic Affairs – Banking Division) - `Regional Rural Banks'

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Presented to Lok Sabha on 2.12. 2004

Lok Sabha Secretariat
New Delhi

December , 2004/Agrahayana ,1926

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COMPOSITION OF THE ESTIMATES COMMITTEE
(2004-2005)

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3. Shri B. Vinod Kumar
4. Shri Chander Kumar
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5.	Smt. Manju Chaudhary	-	Assistant Director

INTRODUCTION

I, the Chairman of the Estimates Committee, having been authorised by the Committee to submit the Report on their behalf, present this Second Report on action taken by Government on the recommendations contained in the Sixteenth Report of Estimates Committee (Thirteenth Lok Sabha) on the Ministry of Finance (Department of Economic Affairs – Banking Division) – 'Regional Rural Banks'.

2. The Sixteenth Report (Thirteenth Lok Sabha) was presented to Lok Sabha on 29th April, 2003. The Government furnished their replies indicating action taken on the recommendations contained in that Report on 4th December, 2003. The Draft Report was considered and adopted by the Estimates Committee(2004-2005) at their sitting held on 27th September, 2004.

3. The Report has been divided into the following Chapters:-

I. Report;

II. Recommendations/Observations which have been accepted by Government

III. Recommendations/Observations which the Committee do not desire to pursue in view of Government's replies;

IV. Recommendations/Observations in respect of which replies of Government have not been accepted by the Committee; and

V. Recommendations/Observations in respect of which final replies of Government are still awaited.

4. An analysis of action taken by Government on the recommendations contained in the Sixteenth Report of Estimates Committee (13th Lok Sabha) is given in Appendix II. It would be observed therefrom that out of 34 observations/recommendations

made in the Report, 21 recommendations i.e. 61.76% have been accepted by Government. Replies of Government in respect of 5 recommendations i.e. 14.71% have not been accepted by the Committee and replies in respect of 8 recommendations i.e. 23.53% are still awaited.

NEW DELHI;
December 1, 2004
Agrahayana 10,1926(S)

C. KUPPUSAMI
Chairman
Committee on Estimates

CHPATER I

REPORT

1.1 This Report of the Committee deals with the action taken by Government on the recommendations contained in their Sixteenth Report(Thirteenth Lok Sabha) on the Ministry of Finance and Company Affairs(Department of Economic Affairs-Banking Division) – `Regional Rural Banks'.

1.2. The Committee's Sixteenth Report (Thirteenth Lok Sabha) was presented to Lok Sabha on 29th April, 2003. It contained 34 observations/recommendations. Action Taken Notes on all these observations/recommendations have been received from the Ministry of Finance and Company Affairs(Department of Economic Affairs-Banking Division).

1.3. Replies to the observations and recommendations contained in the Report have broadly been categorised as under:-

(i) Recommendations/Observations which have been accepted by Government:

S.No. 1 to 3, 7, 10, 12, 14 to 18, 20, 22, 23, 25, 27, 29, 30 and 32 to 34

(Total 21, Chapter II)

(ii) Recommendations/Observations which the Committee do not desire to pursue in view of Government's reply:

NIL

(Total NIL, Chapter III)

(iii) Recommendations/Observations in respect of which Government's replies have not been accepted by the Committee:

S. Nos. 9, 11, 13, 21 and 31

(Total 5, Chapter IV)

(iv) Recommendations/Observations in respect of which final replies of Government are still awaited:

S. Nos. 4 to 6, 8, 19, 24, 26 and 28

(Total 8, Chapter V)

1.4 The Committee will now deal with the action taken by Government on some of the recommendations.

Appointment of Chairmen in RRBs

Recommendation/Observation(Sl. No. 9 Para No. 1.41)

1.5 Noting that in many cases, Chairmen of RRBs who are appointed to serve the institution for a short span of time resulting in poor performance of RRBs, the Committee had recommended as follows:-

> "It is an established fact that success of an institution, to a large extent, depends upon the proficiency and the interest shown by the person who is at the helm of affairs. The Chairman of RRB, being the Chief Executive of the institution, has an important role to play in the efficient functioning of the RRB and fulfilling the mandate given to it. It is distressing to note that in many cases people who are on the verge of retirement and those who lack interest and initiative are being appointed as the Chairmen of RRBs. It is also a matter of concern that many of them serve the institution for a very short span of time. The average tenure of Chairmen of RRBs has been less than twenty-one months as against the provision in RRB Act, 1976 that the tenure of the Chairman should not exceed five years. The Committee are of the firm view that in such a short span of time the Chairman would not even be able to acquaint himself with the working of the RRB. Needless to point out that during their short tenure, most of the Chairmen are unable to make any contribution to the institution. The poor performance of many of the RRBs with regard to different parameters bears eloquent testimony to this. The Committee desire that only officers having at least five years of service left should be considered for appointment to the post of Chairman of RRB. Officers on the verge of

retirement, having adverse report or any adverse comment from vigilance/administration should not be considered for the post of Chairman. The appointment should invariably be for a term of minimum three years and not exceeding five years. The proposed amendment to Section 11(6) of RRB Act, 1976 authorizing the sponsor bank instead of Central Government to appoint Acting Chairman of RRB during the absence or inability of the Chairman to carry out his duties due to any reason should also be got incorporated in the Act without further delay. The Committee also desire that necessary amendments should be made in the RRB Act expeditiously so that working of RRBs gets streamlined without further loss of time."

1.6 In their action taken reply the Ministry of Finance and Company Affairs (Department of Economic Affairs – Banking Division) has stated as follows:-

"So far as appointment of Chairman and his tenure is concerned the matter has already been taken up with the sponsor banks vide this Division letter D.O. No. 3/(5)/2001-RRB dated 7.10.2002. The CMDs/MDs of all sponsor banks have been advised that they should play more effective role in improving the management and operations of the RRBs sponsored by them.

The Committee has desired that Section 11(6) of RRBs Act, 1976 needs to be amended. The recommendation will be considered alongwith Chalapathi Rao's recommendation for amending the RRBs Act, 1976."

1.7 The Committee are not satisfied with the reply furnished by the Government. During their

interaction with the RRBs, the Committee had found that one of the main factors responsible for their poor functioning was frequent change of the Chief Executive in many of the Banks. It was noticed that people on the verge of retirement with no interest and initiative and even sometimes officers who do not enjoy good reputation were being appointed in some of the RRBs. The Committee were of the firm view that only officers having at least five years of service left and with good reputation should be considered for appointment to the post of Chairman of a RRB. The Committee had also recommended that the appointment should be for a minimum term of three years and not exceeding five years.

1.8 The Ministry in their reply have stated that they have taken the matter with sponsor banks vide letter no. 3(5)/2001-RRB dated 7.10.02 advising them to play a more effective role in improving

the management and operations of RRBs sponsored by them. The Committee are surprised to note that the letter which has been referred to by the Government in support of the reply is silent about the term of Chairmen of RRBs. While reiterating their earlier recommendation, the Committee recommend that appointment of Chairmen of RRBs should invariably be for a minimum term of three years and not exceeding five years and the proposed amendment to Section 11(6) of RRB Act, 1976 authorising the sponsor bank instead of Central Government to appoint Acting Chairman of RRBs during the absence or inability of the Chairman to carry out his duties due to any reason should be got incorporated in the Act. The Committee should be apprised of the action taken by the Government in this regard.

Low CD Ratio and High ID Ratio in RRBs

Observation/Recommendation (Sl. No. 11 and 13, Para No. 2.35 and 2.37)

1.9 Taking serious note of the low CD ratio and high ID ratio in RRBs, the Committee had stated as follows:-

> "The Committee note that out of 196 RRBs only in 41 RRBs the Credit-Deposit ratio is higher than 60%. The CD ratio in RRBs declined steadily at the rate of 3 to 4 per cent in a year from 1992 to 1999 due to stringent asset classification and income recognition norms. It is quite alarming to note that while the CD ratio in the RRBs in 1992 was 69.3%, it dipped to 41.2% in 1999. In 2002, the CD ratio was 41.3%. The Committee would like to stress on the need for higher CD ratio for the sustainability, strength and viability of RRBs. The continuous decline from 1992 to 1999 in CD ratio and its remaining almost static thereafter indicate that RRBs need to carefully appraise their credit and deposit policy. The fact that Investment Deposit ratio in RRBs is very high, viz. 67.05% as on 31.3.2001 indicates that RRBs are heavily investing their deposits and thus deviating from their primary responsibility of providing credit to small and marginal farmers and weaker sections of the society in rural areas. The Committee are not convinced with the contentions of the Secretary, Ministry of Finance (Department of Economic Affairs – Banking Division) that lack of flow of credit due to non-availability of bankable projects and borrowers was the major cause of low CD ratio. The very fact that CD ratio among the banks varied from 14.46% to 122.66% is a clear indication that there is ample

scope for improvement by RRBs with lower CD ratio. South Malabar Bank and North Malabar Bank with CD ratios of 119.41% and 122.66% respectively should be taken as model RRBs and other RRBs should take a clue from the operations of these banks. The Committee, therefore, recommend that in RRBs which are making absolute profit, the CD ratio should be as high as 75%. In RRBs, which are, making profits but still have accumulated losses, an increasing trend of CD ratio should be ensured and their investment portfolio should get reduced accordingly. Thus, the Committee desire that a two-tier system of CD ratio should be allowed.

In 1995, the RRBs were allowed to invest their surplus funds in specified avenues of Non-SLR investments to reduce the losses and eliminate their accumulated losses. As on 31.3.2001, SLR investments by all RRBs was Rs. 10259.73 crore and Non-SLR investment was Rs. 15461.84 crore. The SLR investment by the RRBs in UP alone was Rs. 2730.90 crore and Non-SLR investment was Rs. 4762.30 crore. The ID ratio in RRBs which was 60.37% as on 31.3.1999 went up to 67.05% as on 31.3.2001. It is distressing to note that in some RRBs the ID ratio went up to 96% at a certain point of time. The Committee hold the firm view that there is no justification for allowing those RRBs which have already eliminated the accumulated losses to continue to do investment banking. They desire that the Reserve Bank of India should review the trend of ID ratio among the RRBs and certain restrictions should be imposed on those RRBs which have eliminated the accumulated losses, but are still focussing on the investment route with low CD ratio. Those RRBs which are investing their funds for earning profit and thereby have low CD ratio should be identified and, as suggested by the representative of NABARD, there should be some kind of penalty attached to them. The Committee are of the view that the option of investment portfolio should not be allowed to go on for a longer period as it encroaches on rural lending. The Committee recommend that the investment portfolio should be resorted to at a minimum level and for a short period of time to make a particular RRB viable and after that they should revert back to lending portfolio. The endeavour should be to attain viability through lending and not through investments. The guidelines stipulating that Government deposits be made only in nationalised banks should be reviewed and suitably modified so that such funds could also be deposited in RRBs as the Committee feel that RRBs are in no way less safe than the sponsor banks."

1.10 In their action taken reply the Ministry of Finance and Company Affairs (Department of Economic Affairs - Banking Division) has stated as follows:-

"There is ample scope for improvement in the CD ratios of RRBs. However, the CD ratio of 75% appears to be high taking into account the SLR and CRR requirements. The ceiling should at best be between 60% to 70%.

RBI has already issued a circular to all RRBs emphasizing the need to improve their CD ratios. NABARD has also reiterated the instructions. It has been observed that the CD ratio has improved from 41.83% as on 31st March, 2002 to 44.23% as on 31st March, 2003.

The Government (DO No. 3/(5)/2001-RRB dated 7.10.2002) and RBI (circular no. RPCD.RRB.BC. 30/ 03.05.80/2003-2004 dated 29th September,

2003) have issued necessary instructions to sponsor banks and RRBs that the RRBs should concentrate more on lending than on investments and improve their CD ratio.

NABARD also through various forums keeps on impressing upon the sponsor banks and RRBs to concentrate more on financing than on investments. We agree with the observations of the Committee that RRBs, which have already eliminated their accumulated losses, should not continue to follow investment route. This is being impressed upon by NABARD in its regular meetings with the sponsor Banks and RRBs."

1.11 The low credit-deposit ratio and the increasing trend in investments by the RRBs is a matter of serious concern for the Committee. The way RRBs were resorting to investment route rather than lending for their viability was not at all healthy. Allowing the RRBs the option of investment portfolio for a longer period would result in encroaching on rural lending. The Committee had recommended that it should be made mandatory for those RRBs which are making absolute profit to revert back to lendings portfolio and achieve higher CD ratio.

However, in the case of other RRBs also increasing trend of CD ratio and proportionate reduction in ID ratio needs to be ensured.

1.12 **The Committee are constrained to note that their recommendations have not received the kind of attention they deserved from the Government. They find that the reply furnished by the Government is a mere reiteration of what was stated by the representative of the Ministry during oral evidence. They expected the RBI, NABARD and the sponsor banks to ensure better compliance of the recommendations of the Committee. While reiterating their earlier recommendations, the Committee desire that suitable guidelines should be issued to those RRBs which have eliminated their accumulated losses but are still focusing on the investment route with low CD ratio. The Committee also desire that pro-active measures should be taken to improve the CD ratio in RRBs and the**

outcome of the measures taken in this regard be intimated to the Committee.

<u>High Level of NPAs in RRBs</u>

<u>Recommendation/Observation (Sl. No. 21 and Para No. 2.45)</u>

1.13 Expressing their concern regarding the high level of NPAs in RRBs, the Committee recommended as under:-

"The Committee note that several factors contribute to the accumulation of NPAs. Factors external to the banks and borrowers, such as change in Government's policy, natural calamities, could cause default in loans. Besides this, non-repaying capacity of farmers in the event of adversity, lack of infrastructure leading to poor marketability of products, non-remunerative prices prevailing in the period immediately following the harvesting of crops, direct credit in Government Sponsored Schemes, wilful defaults, etc. are other reasons for high NPAs. The Committee note that several steps in the form of close monitoring and supervision, interaction with the borrowers to assess the hardships experienced by them in repayment of loans, compromise settlements, pre-determined policy, legal proceedings, etc. have been initiated by RRBs to bring down the NPAs. NABARD has also given the guidelines for One Time Settlement of NPAs on the lines of the guidelines issued by the RBI to the commercial banks. The Committee desire that all these measures should be pursued with utmost earnestness to bring down the NPA level to tolerable limits. It needs no emphasis that NPAs, in addition to adversely affecting the profitability of the banks, deprive other eligible borrowers from availing bank credit. The Committee, therefore, desire that RRBs should seriously address the question of reduction of NPAs through well-defined policies and strategies."

1.14 In their action taken reply the Ministry of Finance and Company Affairs (Department of Economic Affairs - Banking Division) has stated as follows:-

> "The NPAs position of RRBs is being reviewed by NABARD as well as by Sponsor Banks periodically. NABARD has issued instructions to RRBs to initiate concrete steps to improve the recovery performance and thereby reduce level of NPAs. Further RBI has proposed that the revised compromise settlement schemes for Commercial Banks upto outstanding balance of Rs. 10 lacs should be extended to RRBs also. The proposal is under active consideration with the Government. NABARD had also issued guidelines under one time settlement compromise through Lok Adalat. The recovery has started showing signs of improvement and the same has increased from 68.20% as on March 31, 2001 to 71.52% as on March 31, 2003."

1.15 The Committee note that although the recovery position has started showing signs of improvement in most of the RRBs, the position of NPAs is above the tolerable level. It is quite evident that the Government has not taken adequate steps to monitor reduction in the level

of NPAs in RRBs. A final decision should have been taken by the Government regarding the proposal for extension of the revised Compromise Settlement Scheme upto outstanding balance of Rs. 10 lakh now being implemented by commercial banks to RRBs before furnishing the action taken replies to the Committee. The Committee are of the view that operational and managerial organization of RRBs should be strengthened and accountability should be fixed for lapses in sanctioning and post-disbursement supervision of loans. While reiterating their earlier recommendation, the Committee urge that all possible measures should be initiated to reduce NPAs as it adversely affects recycling of funds, thus depriving the eligible beneficiaries, especially rural masses, from availing bank credit.

Follow-up on the Inspection Reports

Observation/Recommendation (Sl. No. 31, Para No. 3.41)

1.16 Noting that there was no proper follow-up on the inspection reports by many RRBs, the Committee observed as follows:-

> "The Committee note that the performance of RRBs is reviewed by the Government of India through half yearly review meetings conducted by the Banking Division wherein all sponsor banks, RBI and NABARD participate. NABARD also reviews the performance of RRBs through its Regional Offices and the nominee Director on the Board. NABARD also conducts inspection of the RRBs once in two years. The sponsor banks which hold full responsibility in respect of operational and managerial matters of the RRBs, hold review meetings with the RRBs on a quarterly basis. They also conduct Management Audit of the RRBs. While NABARD and the sponsor banks are expected to ensure follow-up action in respect of major findings of their audit, the Committee during on the spot visit to various RRBs were constrained to note that there was no proper follow-up on the inspection reports by many RRBs. Many of the RRBs were flouting RBI guidelines with impunity and the sponsor banks and the NABARD were not initiating any corrective measures. The Committee desire that an inbuilt system of checks be evolved by the sponsor banks within a period of three months to ensure adherence of Government of India/RBI guidelines by the RRBs from the time of presentation of the Report and regular follow-up on

the observations made by supervisory authorities like NABARD. The Committee also recommend that NABARD should conduct inspection of RRBs once in a year instead of two years. As stated in Chalapati Rao Committee Report, the supervisory authority may develop a set of model internal audit and inspection guidelines through a consultative process. Based on this model, the RRBs should frame a manual of guidelines for the internal inspection of their branches that may encompass the contents, coverage, periodicity, reporting, compliance, follow up action in case of non-compliance, etc. These guidelines must cover all aspects of the functioning of the RRBs including inter alia the general audit, concurrent audit, revenue audit, management functions at the level of Head Office, Chairman and even the Board. The guidelines should provide for computer-based branch surveillance through processing of data periodically called from branches and this exercise and the regular inspection of branches should supplement each other. RBI may have a fresh look at the guidelines for conducting inspection more meaningfully by NABARD which may include financial inspection. A provision may also be made available as part of the regulations for internal and concurrent audit in the RRBs."

1.17 In the action taken reply, the Ministry of Finance and Company Affairs (Department of Economic Affairs - Banking Division) stated as follows:-

"The conduct of a quick inspection of RRBs every year instead of existing system of once in every two years is under consideration of NABARD in respect of weak RRBs. The sponsor banks have their own system of internal audit/ inspection and the same system has been adopted by the concerned RRBs. The NABARD is in the process of studying the system obtaining in sponsor banks/RRBs and will be developing model guidelines based on such a study."

1.18 The Committee note with dissatisfaction that the reply furnished by Government does not mention any specific action taken by the Government to improve supervision of RRBs by NABARD and the sponsor banks. During the Committee's interactions with RRBs, it came out quite forcefully that there is the need for a more meaningful review and inspection of RRBs both by the sponsor bank and NABARD. The inspections should be more comprehensive and follow-up of findings of inspection more stringent and time-bound. The system of internal and concurrent audit by RRBs should also be made more effective to ensure that guidelines issued by Government/RBI are not flouted by the RRBs. The Committee expect the Government to implement their

recommendations with utmost sincerity. The Committee reiterate their earlier recommendations and desire that specific action taken on their recommendations be furnished expeditiously.

Implementation of Recommendations

The Committee would like to emphasise that they attach the greatest importance to the implementation of recommendations accepted by the Government. They would, therefore, urge that the Government should keep a close watch so as to ensure expeditious implementation of the recommendations accepted by them. In case it is not possible to implement the recommendations in letter and spirit for any reason, the matter should be reported to the Committee with reasons for non-implementation.

The Committee desire that replies in respect of the recommendations contained in Chapter V of the Report may be finalised and final replies of the Government furnished to the Committee expeditiously.

MINUTES OF SITTING OF THE ESTIMATES COMMITTEE

(2004-2005)

SECOND SITTING

The Committee sat on Monday, the 27th September, 2004 from 1100 hours to 1250 hours.

PRESENT

Shri C. Kuppusami - **CHAIRMAN**

MEMBERS

2. Shri B. Vinod Kumar
3. Shri Lalmuni Chaubay
4. Shri Jai Prakash
5. Shri Bhartruhari Mahtab
6. Shri Sanat Kumar Mandal
7. Shri Prabodh Panda
8. Shri Sukhdeo Paswan
9. Shri Annasaheb M.K. Patil
10. Prof. M. Ramadass
11. Shri K.S. Rao
12. Shri Jyotiraditya Madhavrao Scindia
13. Shri Laxman Singh
14. Shri M.A. Kharabela Swain

SECRETARIAT

1. Smt.P.K. Sandhu - Joint Secretary
2. Shri A.K. Singh - P.C.P.I.
3. Shri Cyril John - Under Secretary
4. Shri M.K. Madhusudan - Assistant Director
5. Smt. Manju Chowdhary - Assistant Director

2. XXX XXX XXX

3. The Committee then considered and adopted the following draft Reports with/without modifications as given in the Annexure :-

(i) Report on action taken by Government on the recommendations contained in the Sixteenth Report of Estimates Committee (13th Lok Sabha) on the Ministry of Finance (Department of Economic Affairs – Banking Division) – 'Regional Rural Banks (without any modification).

(ii) XXX XXX XXX

4. The Committee authorised the Chairman to finalise the Reports in the light of modifications and also to make verbal and other consequential changes, if any, arising out of factual verification by the Ministry and present the same to the House.

5. XXX XXX XXX

The Committee then adjourned.

APPENDIX II

(Vide Introduction to Report)

ANALYSIS OF THE ACTION TAKEN BY GOVERNMENT ON THE RECOMMENDATIONS CONTAINED IN THE SIXTEENTH REPORT OF THE ESTIMATES COMMITTEE (THIRTEENTH LOK SABHA)

(i)	Total Number of Recommendations/Observations	34
(ii)	Recommendations/Observations which have been accepted by Government:	
	(Nos. 1 to 3, 7, 10, 12, 14 to 18, 20, 22, 23, 25, 27, 29, 30 and 32 to 34)	21
	Percentage	61.76%
(iii)	Recommendations/Observations which the Committee do not desire to pursue in view of Government's reply:	
	NIL	
	Percentage	NIL
(iv)	Recommendations/Observations in respect of which Government's replies have not been accepted by the Committee:	
	(Nos. 9, 11, 13, 21 and 31)	5
	Percentage	14.71%
(v)	Recommendations/Observations in respect of which final replies of Government are still awaited:	
	(Nos. 4 to 6, 8, 19, 24, 26 and 28)	8
	Percentage	23.53%