CHAPTER 4

POLICY FRAMEWORK
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The origin of priority sector lending for banks can be traced at the meeting of the National Credit Council held in 1968 where it was emphasized that commercial banks should finance Priority Sector, viz. agriculture and small scale industries on priority basis. Since then, the scope and extent of priority sector has undergone several changes over the time period. In this chapter, an attempt has been made to study the major changes regarding priority sector over the time period selected for the study and the present policy framework of RBI in this regard.

The Committee on the Financial System under the chairmanship of Sh. M. Narasimham had recommended in 1991 to phase out the directed credit programmes and redefine priority sector to include small and marginal farmers, the tiny sector of industry, small business and transport operators, village and cottage industries, rural artisans and other weaker sections (RBI, 2005). The committee also recommended that gradually the credit facilities to priority sector should be brought down to 10 per cent within a specified period because of increased overdues and adverse profitability of the banks. But this recommendation was not accepted.

After banking sector reforms, several changes were inserted in the definition and scope of all the components of priority sector. In their policy measures for promoting and strengthening agriculture sector major changes were inserted, which included-extension of credit limit for short term loans to farmers and for financing distribution of inputs such as cattle feed, poultry feed etc., for allied activities, incorporation of finance to dealers in drip irrigation/sprinkler irrigation system/agricultural machinery, loan to food and agro-based processing units, loan to distressed urban poor to repay their debt to non-institutional lender, loan to Non-Banking Financial Companies for on-lending to agriculture sector, loan granted to NGOs/MFIs for on-lending to individual farmers or their SHGs/JLGs and 50 per cent of the credit outstanding under loan for general purpose under General Credit Cards.

Few changes were also inserted in the definition of small scale industries. Limit for investment in plant and machinery for small scale industries/ancillary units and original cost
of equipment used for financing small business were extended. Further it included incorporation of credit to SIDCs/SFCs for financing small scale industries, to SIDBI by way of rediscounting of bill of small scale industries sector and to NBFCs for the purpose of on-lending to small scale industries sector.

Over the time period, many changes took place in the definition and scope of other priority sector which included extending credit limit for housing sector, education sector, private retail traders, professional and self employed persons and extending vehicle limit for the purpose of advances to small road and water transport operators. The clause of lending to SHGs, minority communities, viz. Sikhs, Muslims, Christians, Zoroastrians and Buddhists, NBFCs for financing of truck for the purpose of on-lending to SRWTOs and Micro Credit to individual borrowers were inserted under the definition of other priority sector.

Reserve Bank set up Internal Working Group under the chairmanship of Shri C. S. Murthy in September 2005 to examine, review and recommend changes in the present policy on priority sector lending. On the basis of recommendations, it was decided to include only those sectors which impact large sections of the population, the weaker sections and employment-intensive sectors, such as agriculture, and tiny and small enterprises. Accordingly, the broad categories of priority sector for all scheduled commercial banks since April 2007 are as under:

4.1 Agriculture

Agricultural credit includes two categories, i.e., direct agricultural finance and indirect agricultural finance.

Direct Finance

4.1.1 Finance to individual farmers [including Self Help Groups (SHGs) or Joint Liability Groups (JLGs), i.e. groups of individual farmers, provided banks maintain disaggregated data on such finance] for Agriculture and Allied Activities (dairy, fishery, piggery, poultry, bee-keeping, etc.)

(i) Short-term loans for raising crops, i.e., for crop loans. This includes traditional/non-traditional plantations and horticulture.

(ii) Advances up to Rs. 10 lakh against pledge/hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months, irrespective of whether the farmers were given crop loans for raising the produce or not.
(iii) Working capital and term loans for financing production and investment requirements for agriculture and allied activities.

(iv) Loans to small and marginal farmers for the purchase of land for agricultural purposes.

(v) Loans to distressed farmers indebted to non-institutional lenders, against appropriate collateral or group security.

(vi) Loans granted for pre-harvest and post-harvest activities such as spraying, weeding, harvesting, grading, sorting, processing and transporting undertaken by individuals, SHGs and co-operatives in rural areas.

4.1.2 Finance to others [such as corporates, partnership firms and institutions] for Agriculture and Allied Activities (dairy, fishery, piggery, poultry, bee-keeping, etc.)

(i) Loans granted for pre-harvest and post-harvest activities, such as spraying, weeding, harvesting, grading, sorting and transporting.

(ii) Finance up to an aggregate amount of Rs. one crore per borrower for the purposes listed at 1(a), (b), (c) and 2(a) above.

(iii) One-third of loans in excess of Rs. one crore in aggregate per borrower for agriculture and allied activities.

Indirect Finance

4.1.3 Finance for Agriculture and Allied Activities

(i) Two-third of loans to entities covered under 2 above in excess of Rs. one crore in aggregate per borrower for agriculture and allied activities.

(ii) Loans to food and agro-based processing units with investments in plant and machinery up to Rs. 10 crore, undertaken by those other than 1(f) above.

(iii) (a) Credit for purchase and distribution of fertilizers, pesticides, seeds, etc.

(b) Loans up to Rs. 40 lakh granted for the purchase and distribution of inputs for the allied activities, such as cattle feed, poultry feed, etc.

(iv) Finance for setting up of Agriclinics and Agribusiness Centres.

(v) Finance for hire-purchase schemes for distribution of agricultural machinery and implements.

(vi) Loans to farmers through Primary Agricultural Credit Societies (PACS), Farmers’ Service Societies (FSS) and Large-sized Adivasi Multi Purpose Societies (LAMPS).
(vii) Loans to co-operative societies of farmers for disposing of the produce of members
(viii) Financing the farmers indirectly through the co-operative system (otherwise than by subscription to bonds and debenture issues).
(ix) Existing investments as on March 31, 2007, made by banks in special bonds issued by NABARD with the objective of financing exclusively agriculture/allied activities may be classified as indirect finance to agriculture till the date of maturity of such bonds or March 31, 2010, whichever is earlier. Fresh investments in such special bonds made subsequent to March 31, 2007 will, however, not be eligible for such classification.
(x) Loans for construction and running of storage facilities (warehouse, market yards, godowns, and silos), including cold storage units designed to store agriculture produce/products, irrespective of their location.

If the storage unit is registered as SSI unit/micro or small enterprise, the loans granted to such units may be classified under advances to Small Enterprises sector.
(xi) Advances to Custom Service Units managed by individuals, institutions or organisations who maintain a fleet of tractors, bulldozers, well-boring equipment, threshers, combines, etc., and undertake work for farmers on contract basis.
(xii) Finance extended to the dealer in drip irrigation/sprinkler irrigation system/agricultural machinery, irrespective of their location, subject to the following conditions:

(a) The dealer should be dealing exclusively in such items or if dealing in other products, should be maintaining separate and distinct records in respect of such items.
(b) A ceiling of up to Rs. 30 lakh per dealer should be observed.
(xiii) Loans to Arhtias (commission agents in rural/semi-urban areas functioning in markets/mandis) for extending credit to farmers, for supply of inputs as also for buying the output from the individual farmers/SHGs/JLGs.
(xiv) Fifty per cent of the credit outstanding under loans for general purposes under General Credit Cards (GCC).
(xv) The deposits placed in RIDF with NABARD by banks on account of non-achievement of priority sector lending targets/sub-targets and outstanding as on April 30, 2007 would be eligible for classification as indirect finance to agriculture sector till the date of maturity of such deposits or March 31, 2010, whichever is earlier.
(xvi) Loans already disbursed and outstanding as on April 30, 2007 to State Electricity Boards (SEBs) and power distribution corporation/companies emerging out of bifurcation/restructuring of SEBs, for reimbursing the expenditure already incurred by them for providing low tension connection from step down points to the individual farmers for energising their wells were classified as indirect finance to agriculture till the dates of their maturity/repayment or March 31, 2010, whichever is earlier.

(xvii) Loans to National Co-operative Development Corporation (NCDC) for on-lending to the co-operative sector for purposes coming under the priority sector will be treated as indirect finance to agriculture till March 31, 2010.

(xviii) Loans to Non-Banking Financial Companies (NBFCs) for on lending to individual farmers or their SHGs/JLGs.

(xix) Loans granted to NGOs/MFIs for on-lending to individual farmers or their SHGs/JLGs.

4.2 Small Scale Industries

The small enterprises are classified into two parts: Direct finance and indirect finance.

Direct Finance

4.2.1 Direct Finance in the small enterprises sector comprises of credit to:

(i) Manufacturing Enterprises

(a) Small (manufacturing) Enterprises

Enterprises engaged in the manufacture /production, processing or preservation of goods and whose investment in plant and machinery (original cost excluding land and building) does not exceed Rs. 5 crore.

(b) Micro (manufacturing) Enterprises

Enterprises engaged in the manufacture /production, processing or preservation of goods and whose investment in plant and machinery (original cost excluding land and building) does not exceed Rs. 25 lakh, irrespective of the location of the unit.
(ii) **Service Enterprises**

(a) **Small (service) Enterprises**

Enterprises engaged in providing/rendering of services and whose investment in equipment (original cost excluding land and building and furniture, fittings and other items not directly related to the service rendered) does not exceed Rs. 2 crore.

(b) **Micro (service) Enterprises**

Enterprises engaged in providing/rendering of services and whose investment in equipment (original cost excluding land and building and furniture, fittings) does not exceed Rs. 10 lakh.

(iii) **Other Service Enterprises**

The small and micro (service) enterprises shall include small road & water transport operators, small business, professional & self-employed persons, and all other service enterprises.

(iv) **Khadi and Village Industries Sector (KVI)**

All advances granted to units in the KVI sector, irrespective of their size of operations, location and amount of original investment in plant and machinery. Such advances would be eligible for consideration under the sub-target (60 per cent) of the small enterprises segment within the priority sector.

(v) In order to encourage securitization of loans to SSI sector, it has been decided that investments made by banks in securitized assets representing direct lending to the SSI sector would be treated as their direct lending to SSI sector under priority sector, provided it satisfies the following conditions:

(a) The pooled assets represent direct loans to SSI sector which are reckoned under priority sector, and

(b) The securitized loans are originated by banks/financial institutions.
Indirect Finance

4.2.2 Indirect finance to the small (manufacturing as well as service) enterprises sector include credit to:

(i) Persons involved in assisting the decentralized sector in the supply of inputs to and marketing of outputs of artisans, village and cottage industries.

(ii) Advances to co-operatives of producers in the decentralized sector viz. artisans village and cottage industries.

(iii) Existing investments as on March 31, 2007, made by banks in special bonds issued by NABARD with the objective of financing exclusively non-farm sector would be classified as indirect finance to Small Enterprises sector till the date of maturity of such bonds or March 31, 2010, whichever is earlier. Investments in such special bonds made subsequent to March 31, 2007 will, however, not be eligible for such classification.

(iv) The deposits placed with SIDBI by foreign banks, having offices in India, on account of non-achievement of priority sector lending targets/sub-targets and outstanding as on April 30, 2007 would be eligible for classification as indirect finance to Small Enterprises sector till the date of maturity of such deposits or March 31, 2010, whichever is earlier.

(v) Loans granted by banks to NBFCs for on-lending to small and micro enterprises (manufacturing as well as service).

4.3 Other Activities/Borrowers

These include the following components:

4.3.1 Retail Trade

(i) Advances granted to retail traders dealing in essential commodities (fair price shops), consumer co-operative stores, and

(ii) Advances granted to private retail traders with credit limits not exceeding Rs. 20 lakh.
4.3.2 Micro Credit

Micro Credit is defined as the provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve living standards.

(i) Loans of very small amount not exceeding Rs. 50,000 per borrower provided by banks either directly or indirectly through a SHG/JLG mechanism or to NBFC/MFI for on-lending up to Rs. 50,000 per borrower.

(ii) Loans to distressed persons (other than farmers) to prepay their debt to non-institutional lenders, against appropriate collateral or group security, would be eligible for classification under priority sector.

4.3.3 State Sponsored Organisations for Scheduled Castes/Scheduled Tribes

Advances sanctioned to State Sponsored Organisations for Scheduled Castes/Scheduled Tribes for the specific purpose of purchase and supply of inputs to and/or the marketing of the outputs of the beneficiaries of these organisations.

4.3.4 Education

(i) Educational loans granted to individuals for educational purposes up to Rs. 10 lakh for studies in India and Rs. 20 lakh for studies abroad. Loans granted to institutions would not be eligible to be classified as priority sector advances.

(ii) Loans granted by banks to NBFCs for on-lending to individuals for educational purposes up to Rs. 10 lakh for studies in India and Rs. 20 lakh for studies abroad.

4.3.5 Housing

(i) Loans up to Rs. 20 lakh, irrespective of location to individuals for purchase/construction of a dwelling unit per family, excluding loans granted by banks to their employees.

(ii) Loans given for repairs to the damaged dwelling units of families up to Rs. 1 lakh in rural and semi-urban areas and up to Rs. 2 lakh in urban and metropolitan areas.

(iii) Assistance given to any governmental agency for construction of dwelling units or for slum clearance and rehabilitation of slum dwellers, subject to a ceiling of Rs. 5 lakh of loan amount per dwelling unit.
(iv) Assistance given to a non-governmental agency approved by the NHB for the purpose of refinance for construction/reconstruction of dwelling units or for slum clearance and rehabilitation of slum dwellers, subject to a ceiling of loan component of Rs. 5 lakh per dwelling unit.

4.3.6 Weaker Sections

Weaker sections under the priority sector include the following:

(i) Small and marginal farmers with land holding of 5 acres and less, and landless labourers, tenant farmers and share croppers.

(ii) Artisans, village and cottage industries where individual credit limits do not exceed Rs. 50,000.

(iii) Beneficiaries of Swanjayanti Gram Swarozgar Yojana (SGSY).

(iv) Scheduled Castes and Scheduled Tribes.

(v) Beneficiaries of Differential Rate of Interest (DRI) scheme.

(vi) Beneficiaries under Swarna Jayanti Shahari Rozgar Yojana (SJSRY).

(vii) Beneficiaries under the Scheme for Liberation and Rehabilitation of Scavengers (SLRS).

(viii) Advances to Self Help Groups.

(ix) Loans to distressed poor to prepay their debt to informal sector, against appropriate collateral or group security.

(x) Loans granted under (a) to (i) above to persons from minority communities as may be notified by Government of India from time to time. In States, where one of the minority communities notified is, in fact, in majority, item (j) would cover only the other notified minorities. These States/Union Territories are Jammu & Kashmir, Punjab, Sikkim, Mizoram, Nagaland and Lakshadweep.

4.3.7 Export Credit

This category will form part of priority sector for foreign banks only (RBI, 2007).

4.4 Targets/Sub-targets of Priority Sector Lending

To have strict regulation over the banking system and to ensure the sincere efforts of the banks with respect to priority sector, targets and sub-targets were set under priority sector for different categories of banks which have been reviewed and revised periodically. These
targets and sub-targets for domestic and foreign banks operating in India at present are furnished below:

<table>
<thead>
<tr>
<th>Total Priority Sector Advances</th>
<th>Domestic Commercial Banks</th>
<th>Foreign Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>40 per cent of Adjusted Net Bank Credit (ANBC*) or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.</td>
<td>32 per cent of Adjusted Net Bank Credit (ANBC*) or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Agricultural Advances</th>
<th>Domestic Commercial Banks</th>
<th>Foreign Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>18 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher. Of this, indirect lending in excess of 4.5% of ANBC* or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher, would not be reckoned for computing performance under 18 per cent target. However, all agricultural advances under the categories 'direct' and 'indirect' would be reckoned in computing performance under the overall priority sector target of 40 per cent of ANBC* or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.</td>
<td>No target.</td>
<td></td>
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<table>
<thead>
<tr>
<th>Small Enterprise Advances</th>
<th>Domestic Commercial Banks</th>
<th>Foreign Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advances to small enterprises sector would be reckoned in computing performance under the overall priority sector target of 40 per cent of ANBC* or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.</td>
<td>10 per cent of ANBC* or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.</td>
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<thead>
<tr>
<th>Micro Enterprises within Small Enterprises Sector</th>
<th>Domestic Commercial Banks</th>
<th>Foreign Banks</th>
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</thead>
<tbody>
<tr>
<td>(i) 40 per cent of total advances to small enterprises sector should go to micro (manufacturing) enterprises having investments in plant and machinery up to Rs. 5 lakh and micro (service) enterprises having investment in equipment up to Rs. 2 lakh;</td>
<td>Same as for domestic banks</td>
<td></td>
</tr>
<tr>
<td>(ii) 20 per cent of total advances to small enterprises sector should go to micro (manufacturing) enterprises with investments in plant and machinery above Rs. 5 lakh and up to Rs. 25 lakh, and micro (service) enterprises with investment in equipment above Rs. 2 lakh and up to Rs. 10 lakh (Thus, 60 per cent of small enterprises advances should go to the micro enterprises).</td>
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<thead>
<tr>
<th>Export Credit</th>
<th>Domestic Commercial Banks</th>
<th>Foreign Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export credit would not be a part of priority sector for domestic commercial banks.</td>
<td>12 per cent of ANBC* or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.</td>
<td></td>
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</tbody>
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<table>
<thead>
<tr>
<th>Advances to Weaker Sections</th>
<th>Domestic Commercial Banks</th>
<th>Foreign Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 per cent of ANBC* or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.</td>
<td>No target.</td>
<td></td>
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<table>
<thead>
<tr>
<th>Differential Rate of Interest Scheme</th>
<th>Domestic Commercial Banks</th>
<th>Foreign Banks</th>
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<tbody>
<tr>
<td>1 per cent of total advances outstanding as at the end of the previous year. It should be ensured that not less than 40 per cent of the total advances granted under DRI scheme go to scheduled casts/scheduled tribes. At least two third of DRI advances should be granted through rural and semi-urban branches.</td>
<td>No target.</td>
<td></td>
</tr>
</tbody>
</table>

Source: Guidelines on Lending to Priority Sector (Revised), Reserve Bank of India, Mumbai, 2007

Note: *Adjusted Net Bank Credit (ANBC) (Net Bank Credit plus investments made by banks in non-SLR bonds held in HTM category) or Credit Equivalent Amount of Off-Balance Sheet Exposure (OBSE), whichever is higher, as on March 31 of the previous year. The outstanding FCNR (B) and NNRN deposits balances will no longer be deducted for computation of ANBC for priority sector lending purposes. Investments made by banks in the Recapitalization Bonds floated by Government of India will not be taken into account for the purpose. Existing investments, as on April, 2007, made by banks in non-SLR bonds held in HTM category will not be taken into account for calculation of ANBC, up to March 31, 2010. However, fresh investments by banks in non-SLR bonds held in HTM category will be taken into account for the purpose.
4.5 Penalty Provisions

Initially, no penalties were prescribed for non-achievement of priority sector targets. Such penalties were first of all imposed on foreign banks in 1993 in the form of maintaining deposits with SIDBI, an amount equivalent to the shortfall for a period of one year. Thereafter, in 1995, public and private sector banks were required to deposit amounts equivalent to the shortfall in the RIDF with NABARD.

Thus, it can be concluded that, being a regulatory authority of banking system in India, RBI issues the guidelines from time to time to expand the credit flow to priority sector. After banking sector reforms RBI made major changes in lending to agriculture sector followed by other priority sector and small scale industries sector. With the passage of time, changes have also being made in targets and sub-targets of priority sector lending by RBI.
References


Reserve Bank of India (2007), Guidelines on Lending to Priority Sector (Revised), Rural Planning and Credit Department, Mumbai, April, pp. 7-12.