

PRIORITY SECTOR LENDING CERTIFICATES

The Raghuram Rajan Committee on Financial Sector Reforms had, inter alia, recommended introduction of “priority sector lending certificates (PSLCs)” to implement the priority sector lending in the country. The Committee believed that the process by which the priority sector mandates are implemented should be reformed to emphasize efficiency and ease of compliance, and once the new process is in place, the mandate should be strictly enforced. The focus should be on actually increasing access to services for the poor regardless of the channel or institution that does this—large banks may or may not be the best way to reach the poor, and while the mandate may initially force them to pay. Hence, the following scheme was recommended by the Committee to allow a more efficient implementation of the priority sector lending mandate

Any registered lender (including microfinance institutions, cooperative banks, banking correspondents, registered moneylenders etc.) who has made loans to eligible categories would get ‘Priority Sector Lending Certificates’ (PSLC) for the amount of these loans. The criteria suggested by the Committee for certification (say by NABARD or its agents) would simply be whether the loan is to an eligible sector, whether the interest rate follows the norms below including transparency, and whether the loan duration is greater than 180 days. After an initial period of verification, institutions should be allowed to self-certify, with periodic random monitoring to ensure adherence to criteria. Separate certificates could be issued for enforceable sub categories (e.g., direct agricultural credit, weaker section lending etc), and these may carry a different price.

A market would be opened up for these certificates for buying and selling. In the PSLC market, the banks deficient in priority sector lending target can buy certificates to compensate for their shortfall in lending. Importantly, the loans would still be on the books of the original lender, and the deficient bank would only be buying a right to undershoot its priority sector-lending requirement/target by the amount of the certificate. If the loans default, for example, no loss would be borne by the certificate buyer. The merit of this scheme is that it would allow the most efficient lender to provide access to the poor, while finding a way for banks to fulfill their norms at lower cost. While all

PSLCs could be used towards meeting overall norms, the PSLC issued against lending under sub-target like direct agriculture, weaker section etc may be used to meet respective targets.

If Banks find priority sector lending is unprofitable, there will be a high price for the certificates in the market and it is expected that more lenders will be attracted towards priority sector lending. If the price is low or zero after the market is given time to stabilize, it would mean that priority sector requirements, as set, are not onerous. All the entities lend to eligible categories in the priority sector may be offer PSLCs. Banks with shortfall of priority sector obligations may be allowed to buy the PSLC and submit it towards fulfillment of their target.

At present the domestic and foreign banks are having different priority sector lending targets. The targets and sub-targets set under priority sector lending for domestic and foreign banks operating in India are furnished below:

Sl. No.	Target/Sub-Target	Domestic banks (both public sector and private sector banks)	Foreign banks operating in India
1	Overall priority sector advances	40 per cent of NBC	32 percent of NBC
2	Total agricultural advances	18 percent of NBC	No target
4	SSI advances	No target	10 percent of NBC
5	Export credit	Export credit does not form part of priority sector	12 percent of NBC
6	Advances to weaker sections	10 percent of NBC	No target

Note: NBC denotes net bank credit}

The Foreign banks may not have the branch infrastructure to provide agricultural credit. The Priority Sector Lending Certificate scheme will help them bear their share of obligations without a branch network. Given the magnitude of need to provide credit to underserved segments/poor, all banks may be obligated to uniform priority sector lending.

The PSLC provides market-driven interest subsidy to those who make priority sector loans. In case NGO and other charitable institutions want to participate in financial inclusion, they may be allowed to enter and buy in this market. The Government can play role to facilitate this market by purchase of certificates or stabilizing the price of certificate or by specifying its target volume of purchase etc.

The PSLCs are different from the Inter-bank participation certificates (IBPCs). The IBPCs are a form securitization of loans through which a bank buys the assets of another bank for a stipulated period. In IBPCs, the buyer has to take on the credit risk of the loans, which is high in the case of the underserved priority sector. Further, the loans are to be securitized have to be standardized, well documented, and serviced. This may also be a problem in case of loans to the needy and poor. On the other hand, the PSLCs separate the objective of transferring priority obligations from the credit risk transfer and refinancing aspects.

In this connection, Reserve Bank of India has constituted a working group under the chairmanship of Shri V.K. Sharma in November 2009 to examine the issues involved in the introduction of PSLCs and make suitable recommendations. The terms of reference of the Group include, among others, to make suitable recommendations on introduction of PSLCs and their trading in the open market and to examine pros and cons of inclusion of bank lending to MFIs under priority sector lending. The Working Group has submitted its report to the RBI in August 2010. The Working Group submitted its report to the RBI in August 2010. However, considering the more recent developments in the MFI space, a Sub-Committee of the Central Board of the Reserve Bank (Chairman: Shri Y. H. Malegam) has been constituted to examine the various issues relating to micro-finance extended by non-banking financial companies (NBFCs) while also taking

into account the recommendation of the Sharma Working Group. The Sub-Committee (Y. H. Malegam Committee) has submitted its report to the RBI in January 2011. The RBI is expected to take a holistic view on issues relating to PSLCs and bank lending to MFIs under priority sector lending based on this report.

GURUJI24.COM