Quadrant II – Transcript and Related Materials

Programme: B. Com

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Paper Code: COD 130

Paper Title: Credit and Risk Management in Banking

Unit 2: Lending to different customers and regulations

Module Name: Various Committees to Control Regulation of Finance

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Notes

Various Committees to Control Regulation of Finance

1. **Tandon Committee**

In August 1974 a committee headed by Shri P. L Tandon the ex-chairman of PNB, was constituted. In order to suggest improvement in the existing cash credit system. It submitted its report on guidelines for follow up credit in August 1974.

Three methods of lending were suggested;

1st Method of lending:

Banks would finance up to a max. of 75% of the working capital gap and the balance 25% of the WCG considered as margin is to come out of long-term source i.e., owned funds and term borrowings (WCG = the total current assets – current liabilities other than bank borrowing). This will give rise to a minimum current ratio of 1.17:1. The difference of (1.17-1) represents the borrower's margin which is popularly known as NWC of the unit (NWC = Net Working Capital).

2nd Method of lending:

Bank will finance maximum up to 75% of total current assets (TCA). Borrower has to provide a minimum of 25% of total current assets as the margin out of long-term sources. This will give a minimum current ratio of 1.33:1.

3rd Method of lending:

Same as second method but excluding core current assets from total assets and the core current assets be financed out of long-term funds. Core current assets refers to the absolute minimum level of investment in current assets which is required at all times to carry out minimum level of business activity. The current account ratio is further improved i.e.,1.79:1.

Other recommendations of the committee are:

- **Inventory holding norms for 15 major industries was proposed.**
- **Classification guidelines for current asset & current liability for calculation of MPBF (Maximum Permissible Banking Finance).**
- **Implementation of information system, modified by Chore committee recommendations afterwards.**
- **Bifurcation of limit into cash credit and demand loan component.**

2. **Chore Committee**

The RBI constituted in April 1979 a working group under the Chairmanship of Shri K. B. Chore. In order to review the system of cash credit with particular reference to the gap between sanctioned limit and the extent of their utilization. It was also asked to suggest alternative type of credit facilities. This would ensure greater credit discipline and enable the banks to relate the credit limits to increase in output or other productive activities.

Recommendations of Chore committee are as follows:

- **obtaining of quarterly statement in the prescribed format from all borrowers from working capital credit limit of Rs 50 lacs or above**
- **periodical review of the bank of the limits of Rs 10 lacs or above**
- **bifurcation cash credit account into demand loan and cash credit component**
- **penal interest of one percent on total amount outstanding on non-submission of the quarterly report**
- **discourage of sanctioning of temporary limit**
- **fix separate credit limit for peak level and non-peak level**
- **take steps to convert cash credit limit into bill limits for financing sales**

3. Nayak Committee

This committee was headed by Shri. P. R. Nayak. It examined the adequacy of institutional credit to SSI sector and gave its recommendations as follows:

- **Banks should give preference to village, tiny industries and other SSI units that order.**
- **For aggregate fund based working capital limits up to Rs. 200 lakhs from the banking system to these units, norms for inventory and receivables and the first method of lending will not apply.**
- **These SSI units would be required to bring 5% of their turnover as margin money.**
- **The companies/organisations marketing/trading in the products of village tiny and SSI sector will henceforth be subject to the first method of lending while assessing their MPBF subject:**
- ❖ **Borrowing unit is 100% dealing with products manufactured by village, tiny and SSI units.**
- ❖ **Dues of the small village, tiny and SSI units should be settled by such borrowers within 30 days from date of supply.**
- **A single financial agency should meet both working capital and term credit requirements for SSI.**
- **Single window scheme of SIDBI enables the same.**
- **All SSI applications must be disposed of within 15 days and 8 weeks for applications beyond Rs. 25,000.**
- **Rejection of application for fresh limits/enhancement of existing limits should not be done without the approval of the next higher authority.**

4. Kannan committee

This committee was appointed by RBI. It suggested that prescribed uniform formula for MPBF should be done away with and banks should have the discretion to determine the borrowing limits of corporates. The recommendations of the committee are as under:

- **Modalities of working capital assessment of the borrowers may be left to the individual bank who may devise flexible system under overall regulatory guidelines of RBI.**
- **For borrower with WC requirement up to Rs. 25 lakhs assessment may be made upon an overall study of existing and projected business.**

- **For WC limit between Rs. 25 lakhs and Rs. 500 lakhs Nayak Committee method may be followed.**
- **When WC requirement is more than Rs. 500 lakhs, cash budget method may be followed.**