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NON SLR INVESTMENTS BY INDIAN BANKS AN EMPIRAL STUDY OF PUBLIC AND PRIVATE SECTOR BANKS

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Abstract

Banks raise money in the form of deposits, capital and external liabilities and deploy these in banking assets for gainful purpose, in lending and investment operations. The objective of making these investments is to comply with statutory exposure, diversification of risk, providing liquidity when so required and finally availing of profitable opportunities in the market. The return which banks get on advances is more than that in investment portfolio in case of Indian banks, though operating cost for investment function is much less. Banks have to keep a specified percentage in designated securities, known as Statutory Liquidity Ratio (SLR). Apart from this mandatory exposure, banks also make non SLR investments in various kinds of instruments. Such non SLR investments are regulated as per guidelines issued by Reserve Bank of India (RBI) and disclosed in respective annual reports of the banks. These disclosures indicate the risk element inherent therein and soundness of decision taken by bank in such exposure. This paper examines various nuances of non SLR investments made by public and private sector banks in India.

Keywords: Bank investments, non SLR securities, Private Sector Banks, Public Sector Banks SLR securities, Statutory Liquidity Ratio.

JEL Classification: G2.

1. INTRODUCTION

Banks are critical business entities in the economic development of a country. They raise money in the form of deposits, capital and external liabilities and deploy these in banking assets for gainful purpose. Banking Regulation Act, 1949, (BR Act, 1949), the main legislative instrument that helped create a robust banking infrastructure in India and forms the main regulating legislation in the country, provides following definition of "Banking" - "banking" means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or other wise.

Apart from lending or credit, investment forms another important activity, in which banks deploy their funds. Though lending is main operation in banks, they

do take exposure in investments in various kinds of securities. The objective of making these investments to comply with statutory exposure, diversification of risk, providing liquidity when so required and finally availing of profitable opportunities in the market. The return which banks get on advances is more than that in investment portfolio in case of Indian banks, though operating cost for investment function is much less. In the matter of investments, banks follow the policy that is approved by their Board of Directors. Bhavet et al (2013) highlighted that an investment policy should ensure maximum profit and minimum risk. A sound lending & investment policy is not only prerequisite for a bank's profitability but also crucially significant for the promotion of commercial savings of a developing country like India. Mihir Dash et al (2009), analysed performance of banks on CAMEL framework and found that "private/foreign banks fared better than public sector banks on most of the CAMELS factors in the study period. The two contributing factors for the better performance of private/foreign banks were management soundness and earnings and profitability".

This paper specifically examines the pattern of investments made by Indian banks in non SLR securities.

2. SLR AND NON SLR INVESTMENTS

Reserve Bank of India Act, 1934 (RBI Act, 1934) prescribes all scheduled commercial banks in India to maintain a cash reserve of 4% of demand and time liabilities with RBI. The ratio can be changed by RBI from time to time as part of monetary policy decision. Banks are not given any interest on these deposits with RBI. In addition, Banking Regulation Act (BR Act, 1949) enjoins upon all scheduled commercial banks to keep a specified percentage of demand and time liabilities, not exceeding 40%, in securities as prescribed by RBI. The present rate is 19.5%.

The securities prescribed for this purpose are cash, gold, treasury bills and dated securities of Government of India, state development loans and securities issued by various State Government agencies like Electricity Boards, Finance corporations, Housing Boards etc. The list of securities is amended by RBI from time to time. In addition to mandatory exposure in SLR securities, which are reasonably secured investments, banks undertake investment operations in other instruments which may comprise Government securities, private corporate equities and debt instruments, exposure in their own subsidiaries or joint ventures. This paper examines various aspects of non SLR investments of public and private sector banks in India.

3. REGULATORY PROVISIONS CONCERNING INVESTMENTS BY BANKS

RBI has been issuing guidelines from time to time to regulate and monitor investments, both SLR and non SLR, made by banks. Bank Boards are responsible

to formulate an investment policy that guides the investment operations of banks. Banks have to ensure that operations in securities are conducted in accordance with sound and acceptable business practices (RBI, 2015). Banks have to create clear walls between trading, settlement and accounting. The internal control has to be effective and so also the internal audit in respect to investment functions. Keeping in view the risk element inherent in investment exposure, banks have to perform same level of credit analysis in their cases as applicable for credit proposals. Banks have also to maintain an effective tracking system for issuer's financial position on regular basis. As far as investments in non SLR securities are concerned, banks normally take exposure in such securities of more than one year maturity. Bank's investment in unlisted non-SLR securities cannot exceed 10 per cent of its total investment in non-SLR securities at the close of the previous financial year, and proper disclosure requirements and risk management system are to be implemented.

The prudential guidelines issued by RBI, enjoin on banks that their total exposure to capital markets should not be in excess of 40% of bank's networth and investment in different instruments like shares, debentures, mutual funds can not exceed 20% of its networth (RBI, 2015).

Further, banks are required to disclose their total exposure, in respective balance sheet, separately for:

- (i) Government securities,
- (ii) Other securities,
- (iii) Shares,
- (iv) Debentures,
- (v) Subsidiaries/joint ventures,
- (vi) Others.

Banks have to classify all investment in three categories. First is Held to Maturity (HTM) which constitute investments acquired for the purpose of holding them till maturity. Such investments can not normally be in excess of 25% of total investments and mainly comprise SLR segment of all banks. The other category is Held for Trading (HFT). These are securities which are purchased for trading and make gains from price movements. The last category, known as Available for Sale (AFS) falls for those which could not get into first two categories. The second and third segments are marked to market. The category in which any security will fall is decided at the time of its purchase.

4. INVESTMENT PATTERN OF TOTAL INVESTMENTS

Before starting the study of non SLR investment pattern of bank investments, a view may be taken of general trend in total investment exposure of banks in India. Credit Deposit ratio (CD) and Investment Deposit ratio (ID) are two important parameters which indicate the proportion of deposits deployed in credit (lending) and investment. Latest available data shows that CD Ratio for all scheduled commercial banks in India was 73% and corresponding ID Ratio was

32%. The CD Ratio was much higher in respect of private sector banks at 82% and ID ratio was highest for foreign banks in India at 52% (RBI Tables, 2017).

Almost 95% of investment by banks is made in Indian securities though banks are allowed to make investments outside India as well. Of total assets, banks deploy 65-70% in advances as the same is main operation of banks and further return on advances is better by about 1.5%. A study of Indian banks by Rimpay Kaur et al (2012) also brought out that Indian banks were concentrating more on advances as compared to investment. "There was also a downfall in the income of banks, because ROI was lesser as compared to interest income".

The major share of bank investments (75-85%) is in Government securities for the reason that 19.5% of demand and time liabilities of banks are required to be investment as SLR funds which is constituted mainly by Government securities.

5. INDIAN BANKING STRUCTURE

The banking infrastructure in India is quite widespread and robust. Government of India nationalised many banks in 1970s and 1980s which now constitutes a major bank group along with earlier existing State Bank group, owned by the Government. There are 20 Nationalised Banks, also called public sector banks which form part of this study. In 1990s, in the post reforms era, Government allowed entry of new private sector banks as a result of which numbers of such banks were set up by well known business groups.

Only seven of such banks presently survive and are covered in this study as private sector banks. Two recently set up banks have also been excluded. Earlier in pre reforms period, about 13 private sector banks were also operating in the country. These banks are of relatively smaller size with low investment component and are not covered in the study.

6. OBJECTIVE OF STUDY

The study aims to analyse the pattern of non SLR investments of Indian banks in terms of proportion with SLR investments, issuer wise pattern, type of instruments etc.

7. DATA AND METHODOLOGY

For the purpose of study, secondary data relating to public sector banks and private sector banks has been derived from respective web sites of banks. Data has been transformed into tables for examination of trends observed in this regard.

8. NON SLR COMPONENT OF INVESTMENTS

In addition to mandatory SLR investments, banks employ their surplus funds in other securities for liquidity purposes and also for profitable opportunities as part of treasury operations. The funds employed for such investments differ from bank to bank and also depends on bank's risk management and expertise level in this kind of security transactions. Out of total investments, the non SLR deployment of banks is reflected in the following table:

Table 1. Composition of SLR and non SLR investments: Public Sector Banks

sr no	Bank	Mar 2017	
		% non SLR investments	% SLR investments
1	ALLAHABAD BANK	14.2	85.8
2	ANDHRA BANK	8.7	91.3
3	BANK OF BARODA	15.2	84.8
4	BANK OF INDIA	14.1	85.9
5	BANK OF MAHARASHTRA	18.7	81.3
6	CANARA BANK	15.5	84.5
7	CENTRAL BANK OF INDIA	21.4	78.6
8	CORPORATION BANK	16.5	83.5
9	DENA BANK	13.7	86.3
10	IDBI BANK LIMITED	17.1	82.9
11	INDIAN BANK	13.6	86.4
12	INDIAN OVERSEAS BANK	16.1	83.9
13	ORIENTAL BANK OF COMMERCE	16.4	83.6
14	PUNJAB AND SIND BANK	24.0	76.0

15	PUNJAB NATIONAL BANK	22.7	77.3
16	SYNDICATE BANK	11.4	88.6
17	UCO BANK	17.5	82.5
18	UNION BANK OF INDIA	21.5	78.5
19	UNITED BANK OF INDIA	28.6	71.4
20	VIJAYA BANK	10.6	89.4
	Average	16.9	83.1

Source: Compiled from Annual Reports of respective banks(2017)

The non SLR investments of public sector banks are generally in the range of 10-20% of total investments with average around 17%. Only in 20% of public sector banks, non SLR component is higher than 20%, maximum being 28%. The lowest non SLR proportion is 8.7% only. Consequently, the SLR investments are in the width of 70 % to 90 % with an average of 83%.

Table 2. Composition of SLR and non SLR investments: Private Sector Banks

		Mar 2017	
sr no	Bank	% non SLR investments	% SLR investments
1	AXIS BANK	30.7	69.3
2	DCB BANK	18.0	82.0
3	HDFC BANK.	24.3	75.7
4	ICICI BANK	32.5	67.5
5	INDUSIND BANK	14.5	85.5
6	KOTAK MAHINDRA BANK	20.4	79.6
7	YES BANK	29.2	70.8
	avg	24.2	75.8

Source: Compiled from Annual Reports of respective banks (2017)

The average non SLR investments in private sector banks are relatively at higher level of 24% and corresponding SLR component is lower at 76%. In ICICI Bank, Axis Bank and Yes Bank, non SLR portion of investments is on higher side being around 30% or above. Private sector banks are thus more dynamic and aggressive in this segment of business.

9. CLASSIFICATION OF NON SLR INVESTMENTS IN BANKS

The non SLR investments of banks have their inherent risk and banks have responsibility to exercise prudence in subjecting such investment proposals to same degree of credit analysis as for credit proposals. RBI guidelines for bank investments also lay stress on this aspect.

Banks are tempted to make non SLR investments in a variety of instruments, many of which may not have proper disclosures or credit ratings or may be in non listed companies. In some cases, these investments may be in bonds issued by corporate who may not be customers of banks and or in privately placed securities. Banks use their internal rating system in making such investments and do regular monitoring on them. Banks have therefore to work within the limits of prudential guidelines set by RBI and their own Boards or Investment Committees as part of overall risk management system.

Generally banks can invest in non SLR securities if the original maturity of instrument is more than one year (RBI, 2015). Banks' investments in unlisted non SLR securities can not exceed the limit of 10% of total non SLR amount with an additional 10% being allowed for securitization companies and reconstruction companies. In all these cases, proper diligence is required to be adhered to. Banks have to disclose their non SLR composition as shown below for last financial year:

Table 3. Classification of non SLR investments: Public Sector Banks

sr no	Bank	Private placement (%)	Sub investment grade securities (%)	Unrated securities (%)	Unlisted securities (%)
1	ALLAHABAD BANK	59.3	2.4	0.8	25.2
2	ANDHRA BANK	97.2	3.3	0.0	1.0
3	BANK OF BARODA	43.9	6.2	2.3	2.9
4	BANK OF INDIA	42.8	3.9	5.7	2.0
5	BANK OF MAHARASHTRA	98.0	2.7	0.0	0.0
6	CANARA BANK	69.0	0.4	0.0	0.0
7	CENTRAL BANK OF INDIA CORPORATION	3.5	4.3	48.2	35.7
8	BANK	95.0	1.5	1.3	1.0
9	DENA BANK	79.6	0.0	0.3	0.4

10	IDBI BANK LIMITED	31.9	10.3	60.1	74.6
11	INDIAN BANK	90.2	4.5	1.4	1.3
12	INDIAN OVERSEAS BANK	85.9	0.7	0.1	0.5
13	ORIENTAL BANK OF COMMERCE	47.4	2.0	28.9	44.1
14	PUNJAB AND SIND BANK	91.3	0.0	84.7	26.3
15	PUNJAB NATIONAL BANK	0.2	0.0	3.2	0.8
16	SYNDICATE BANK	54.3	12.9	0.0	0.0
17	UCO BANK	86.8	4.6	2.4	5.7
18	UNION BANK OF INDIA	4.9	0.0	0.0	0.0
19	UNITED BANK OF INDIA	84.9	0.0	1.9	7.2
20	VIJAYA BANK	78.2	16.8	52.4	0.4
	avg	62.2	3.8	14.7	11.5

Source: Compiled from Annual Reports of respective banks (2017)
(Note: the figures are not mutually exclusive)

Many public sector banks have made large proportion of their non SLR investments in privately placed securities. Half the banks have more than 75% of such investments in privately placed securities. Three banks have less than 10% of non SLR investments in privately placed instruments. The proportion of sub investments grade exposure, a risky component, is less than 10% in most of these banks. Similarly, investment in unrated investments is rather low, generally in single digit, showing circumspection in approach.

Exceptions are in the cases of four banks where it is more than 48%. Large exposure in such securities is owned by Punjab and Sind bank (85%), IDBI Bank (60%), VijayaBank (52%) and Central Bank of India (48%). The component of unlisted securities is also low, being less than 10% in most banks except that in five banks, it is more than 25%. However, IDBI bank has relatively larger investments in unlisted securities at 75%, possibly the bank being saddled with large investments undertaken as part of project financing activities in the past.

Table 4. Classification of non SLR investments: Private Sector Banks

sr no	Bank	Private placement (%)	Sub investment grade securities (%)	Unrated securities (%)	Unlisted securities (%)
1	AXIS BANK	79.4	4.1	1.9	29.3
2	DCB BANK	1.1	0.0	0.0	1.1
3	HDFC BANK.	95.1	0.0	0.1	7.3
4	ICICI BANK	68.3	10.0	0.7	1.6
5	INDUSIND BANK	99.9	0.0	0.0	0.1
6	KOTAK MAHINDRA BANK	75.2	10.7	19.0	43.4
7	YES BANK	78.4	0.4	1.3	27.9
	avg	71.1	3.6	3.3	15.8

Source: Compiled from Annual Reports of respective banks (2017)

(Note: the figures are not mutually exclusive)

For private sector banks also, a large proportion of non SLR investments is deployed in privately placed instruments, more than 75%. In HDC Bank and Indusind Bank, privately placed investments are at a very high level of 95% or more.

These banks also have low exposure in sub investment grade and unrated securities with Kotak Mahindra Bank displaying somewhat more aggressive approach. Investment in unlisted securities presents a mixed picture, as three banks show exposure in excess of 25% and the rest three less than 10%.

10. ISSUER WISE CLASSIFICATION OF BANKS' NON SLR INVESTMENTS

It will be pertinent to examine non SLR investments in terms of their issuer status as risk averseness varies based on that. The issuer wise composition of non SLR investments for banks is as shown below:

Table 5. Issuer wise classification of bank non SLR investments: Public Sector Banks

sr no	Bank	Public Sector under takings (%)	Financial Institutions (%)	Banks (%)	Private corporate (%)	Subsidiaries/JV (%)	Others (%)
1	ALLAHABAD BANK	21.7	6.4	31.0	38.5	2.2	0.2
2	ANDHRA BANK	20.8	14.5	2.4	35.2	6.8	20.3
3	BANK OF BARODA	4.6	15.2	22.0	12.5	8.8	36.8
4	BANK OF INDIA	14.7	9.4	3.6	16.3	6.4	49.5
5	BANK OF MAHARASHTRA	5.5	0.8	44.7	12.9	1.1	35.0
6	CANARA BANK	12.9	11.9	7.4	16.8	3.9	47.0
7	CENTRAL BANK OF INDIA	24.6	1.5	1.8	30.0	2.1	40.1
8	CORPORATION BANK	10.8	32.3	41.0	7.7	0.7	7.5
9	DENA BANK	63.1	10.0	6.6	10.7	0.3	9.2
10	IDBI BANK LIMITED	5.1	1.8	0.8	52.4	4.4	35.6
11	INDIAN BANK	48.4	26.6	4.8	18.4	1.0	0.8
12	INDIAN OVERSEAS BANK	42.2	3.4	2.6	45.6	1.7	4.5
13	ORIENTAL BANK OF COMMERCE	20.1	27.5	9.0	33.3	2.2	7.7
14	PUNJAB AND SIND BANK	82.4	2.7	6.6	8.1	0.0	0.1
15	PUNJAB NATIONAL BANK	25.0	32.1	10.8	18.0	5.4	8.2
16	SYNDICATE BANK	25.2	17.7	17.9	37.4	0.3	1.4
17	UCO BANK	65.9	10.4	1.3	20.3	1.4	0.7
18	UNION BANK OF INDIA	47.1	5.2	1.3	35.7	3.1	7.6
19	UNITED BANK OF INDIA	11.1	22.4	50.2	12.4	0.0	3.8
20	VIJAYA BANK	57.1	10.5	8.9	15.2	0.0	8.2
	avg	30.4	13.1	13.7	23.9	2.6	16.2

Source: Compiled from Annual Reports of respective banks (2017)

The pattern in this regard is varied and diverse. Non SLR investments of public sector banks in public sector undertakings, which are considered relatively safer, are as low as 4.6% and as high as 82%. Seven banks have more than 40% share in this segment. In financial sector, which covers financial institutions and banks, non SLR investment range is 0.8-32% and 1.3-50% respectively. Corporation Bank has relatively higher proportion of 73% in this category, with Punjab National Bank and United Bank of India also showing higher propensity. Eight banks have exposure in securities of private corporates above 30%. The public sector banks have very limited exposure in their subsidiaries or joint ventures, being less than 10% in all banks.

Table 6. Issuer wise classification of bank non SLR investments: Private Sector Banks

March 2017							
sr no	Bank	Public Sector under takings (%)	Financial Institutions (%)	Banks (%)	Private corporate (%)	Subsidiaries / JV (%)	Others (%)
1	AXIS BANK	21.7	14.9	6.1	43.5	3.6	10.1
2	DCB BANK	1.0	2.9	0.0	0.2	0.0	96.0
3	HDFC BANK.	4.3	2.7	1.3	78.8	7.4	5.5
4	ICICI BANK	2.2	17.9	4.9	19.3	19.7	36.0
5	INDUSIND BANK	4.7	0.0	27.1	57.5	0.0	10.7
6	KOTAK MAHINDRA BANK	1.7	0.0	4.4	64.9	9.7	19.3
7	YES BANK	8.7	24.4	2.4	47.3	0.3	16.9
	avg	6.3	9.0	6.6	44.5	5.8	27.8

Source: Compiled from Annual Reports of respective banks (2017)

In the case of private sector banks, the largest share of non SLR investments comes from private corporate sector being 45% on the average, almost double of public sector banks. In five banks, it is more than 40% and very low at 0.2% in one bank. Their exposure in their subsidiaries is at the same low level of 5.8%. The PSU exposure of private sector banks is very low at about 6.3% compared to public sector banks having much larger share of 30%. Obviously, public sector banks look for more secure investments like public sector undertakings which are duly reflected in the pattern depicted in the above statements. The exposure in other unclassified instruments is also higher than their public sector counterparts.

11. CONCLUSION

In public sector banks, non SLR securities account for 8-20% (average 17%) of total investments and this proportion in private sector banks is relatively higher in the range 14-32% (average 24%), implying that latter category has higher appetite for treasury profits. In non SLR category, public sector banks have generally invested more in privately placed securities though dispersion is visible in individual banks. Their share in privately placed instrument is quite high at 62%. As far as private sector banks are concerned, their share is even larger being about 71%. All banks have been cautious in making investments in sub investment grade assets as also in unrated and unlisted securities except five banks which have taken relatively higher exposure in these securities.

The issuer wise non SLR composition shows that public sector banks have more exposure in public sector undertakings at 30%, for obvious reasons, as compared to much less exposure of 6% by private sector banks. However, there is some variation seen in some banks. Public sector banks have commitment of 27% in banks and financial institutions from non SLR quota and same for private sector banks is less at 15%. The private sector banks' non SLR interest is much pronounced for private corporate instruments at 45%, nearly twice of same for public sector category, reflecting latter's conservative tilt for corporate securities. Overall, the non SLR investment pattern of banks depict a varied pattern that is guided by various factors that include their expertise level in securities markets, regulatory provisions, business strategies and fund position from time to time.

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