Chapter 5

Borrowing Activities

5.1 Introduction

The borrowing activities envisage all the activities from the estimation of the required borrowing to the actual borrowing of the funds either from the domestic markets or from the external markets.

The Budget division, DEA, MOF was responsible for preparation of budget estimates (BE) and revised estimates (RE) in respect of internal borrowings, external borrowings and other receipts on the basis of inputs received from RBI, CAAA and other departments.

The borrowing calendar for market borrowings was prepared half-yearly on the basis of the estimates of market borrowing, cash inflows, cash outflows and the likely funding gap of the Union Government. The borrowing calendar indicated the amount of securities to be issued through weekly primary auctions during the ensuing half year and was issued with the approval of the MGCDM.

The information on each primary auction was posted on RBI website as a press release indicating the details of auctions such as notified amount, date and timings for electronic bidding, type of auction (multiple/uniform; yield based/price based), norms for non-competitive bids, settlement date, when issued trading, etc.

Treasury bills, which were generally issued for 91 days, 182 days and 364 days, offered short term investment opportunity to financial institutions, banks etc. The amount of weekly auction of treasury bills was notified in indicative quarterly calendars.

Government borrowings from external sources were primarily from multilateral and bilateral sources and were long-term in nature. The principal sources of multilateral external assistance to India were the WB, the ADB, the International Fund for Agricultural Development (IFAD) etc. Bilateral sources of external assistance included direct borrowing from foreign countries. The external loans were contracted through negotiations with the concerned multilateral agencies and/or the countries.

5.2 Devolvement of Union Government Dated Securities on Primary Dealers

Primary auctions of government securities were conducted on the E–Kuber platform by RBI. Within ten minutes of the closure of the auction window, the result was processed and the various reports giving details such as amount received under competitive /non-competitive route, cut off yield/price, weighted average yield/price were generated and put up to the Auction Committee for approval. The Auction Committee[4] decided the cut-off price/yield. Once the cut off was decided by the Auction Committee, the same was marked off in the E-Kuber system and allotment was done by the system without any manual intervention. A system of underwriting[5] for market lending was also operating in the government securities markets in India through the mechanism of Primary Dealers (PDs).

The underwriting commitment on dated securities of Union Government was divided into two parts- (i) Minimum Underwriting Commitment (MUC) and (ii) Additional Competitive Underwriting (ACU). The MUC amounted to 50 *per cent* of the notified amount of each issue. This was distributed equally amongst all the PDs. The remaining portion of the notified amount was underwritten through ACU auction. In the ACU auction, each PD was required to bid for an amount at least equal to its share of MUC, but not exceeding 30 *per cent* of the notified amount. Thus, there was 100 *per cent* underwriting of the government auction. The PDs were also required to bid in the primary auctions of government securities for an amount not less than its total underwriting obligation. Thus, in the existing arrangement, bid cover ratio of primary auctions would not be less than one implying that there was no possibility of bonds remaining unsubscribed. Hence, it appeared that the devolvement[6] depended on the decision of the Auction Committee and not on the amount remaining unsubscribed. A perusal of auction of Union Government dated securities during 2009-10 to 2014-15 revealed that in 71 auctions, an amount of ₹ 49,654.48 crore was devolved on underwriting PDs.

Audit observed that there were no criteria for devolvement of securities in a particular case. In the absence of such criteria, Audit could not verify the necessity or otherwise of the devolvement. There were also no criteria for deciding the cut–off rate or the reasons for deciding a particular cut-off rate though various factors like market clearing rate, Fixed Income Money Market and Derivatives Association of India (FIMMDA)[7] previous day closing yield, secondary market yield just before the auction and poll rate etc., were considered.

RBI in their reply stated (July 2015) that devolvement decision was taken after careful consideration of market conditions, bidding pattern and cash/budget management needs when the bidding in the auctions did not reflect the price of the security. RBI reiterated (September

[4] Auction Committee consisted of Executive Director (ED) in charge of IDMD and Chief General Managers (CGMs) of IDMD, Department of External Investments and Operations (DEIO), Financial Markets Operation Department (FMOD) and Monetary Policy Department (MPD)

[5] Engaging to buy all the unsubscribed securities/ bonds in case of issue of securities/bonds

[6] Devolvement is a process whereby if an investment issue is undersubscribed, an underwriter is required to subscribe to the remaining securities / bonds. The outstanding unsubscribed amount devolves onto the underwriter.

[7] For illiquid securities where there is no trading or volumes are very low, FIMMDA comes out with model price.

2015) their earlier reply and stated that they would further strengthen the documentation in devolvement cases to ensure that appropriate detailed recording was done. It added that general principles could be laid down for deciding on the devolvement of issues.

In the Exit Conference, RBI stated that a policy framework to indicate broad criteria for devolvement was under finalization. Subsequently RBI informed (May 2016) that a policy on devolvement criteria had been prepared which *inter alia* incorporated the factors to be considered for arriving at the devolvement decision.

5.3 Variation between the Revised Estimate (RE) and Actuals with respect to External Assistance

Audit observed that there were variations between RE and Actuals in respect of External Assistance as mentioned in **Table 5.1** below:

Table 5.1: Variation between RE & Actuals in respect of External Assistance

(₹ in crore)

Year	BE	RE	Actuals	Variation between RE and actuals (in Percent)
2009-10	16,047	16,535	11,038	(-) 33
2010-11	22,464	22,264	23,556	6
2011-12	14,500	10,311	12,449	21
2012-13	10,148	2,214	7,201	225
2013-14	10,560	5,440	7,292	34
2014-15	5,734	9,705	12,933	33

(*Source: Receipt Budgets and Finance Accounts of GOI)*

From the above, it can be seen that the RE of external assistance varied from the actual external assistance in the range of (-)33 *per cent* to 225 *per cent.* Thus, it appeared that the system of preparation of BE and RE in respect of external debt was not robust.

5.4 Approval of External Assistance Proposals without considering Knowledge Transfer, Technology Transfer and Best Practices Transfer from International Experience

DEA was the nodal agency for posing projects to WB, ADB and the IFAD. No proposal for external assistance was posed directly by any Central Ministry or State Government to the multilateral/bilateral funding agency. A Screening Committee[8] in DEA (constituted in August 2009) decided proposals to be posed to WB, ADB and IFAD.

[8] Screening Committee consisted of Joint Secretary (MI), DEA and other Officers from DEA.

DEA vide its circular dated 01 September 2011 instituted a new set of principles and 'Finance Plus' criteria to govern the selection of projects to be posed to the WB, ADB and the IFAD. The goal of instituting the criteria was to maximize access and leverage of Multilateral Financial Institutions' (MFIs')/Multilateral Development Banks' (MDBs') knowledge base, international experience and familiarities with best practices making the best use of limited available external resources.

The 'Finance Plus' criteria formed the main approach for accessing assistance from the WB, ADB and IFAD. The criteria, *inter alia*, included that knowledge transfer, technology transfer and best practices transfer from international experience should be envisaged with adequate long term engagement for ensuring sustainability of the projects in the context of India. This could be considered the crux of 'Finance Plus' criteria going a long way in realizing the goal of instituting this criteria. The Screening Committee had, in one of its meetings (01 December 2011), also underscored the fact that external assistance should not be taken only for resources, reiterating the spirit of the criteria cited above.

Scrutiny of minutes of the Screening Committee meetings held after the issue of the 'Finance Plus' criteria, i.e., after 01 September 2011, provided to audit revealed that the Screening Committee had deferred two[9] proposals for loan assistance due to lack of knowledge transfer, technology transfer and best practices transfer from international experience. However, the minutes of the meetings of the Screening Committee did not indicate whether knowledge transfer, technology transfer and best practices transfer from international experience were considered while approving 60 projects **(Annexure-I)** out of a total of 82 approved projects for external assistance.

DEA in their reply (April 2015) stated that Screening Committee examined the preliminary proposal for financial assistance from multilateral agencies received from State Governments/ Central Ministries, in consultation with Central Line Ministries (in case of State projects) and Planning Commission/NITI Aayog (in case of Central projects), and decided about their suitability for external funding. It was added that during the meetings of the Screening Committee, a preliminary presentation on Finance Plus elements was made that ultimately took shape after the complete design of the project. In the Exit Conference, DEA accepted that in some cases, the verification of these criteria was not documented but added that they were considered in all cases.

[9] Drinking Water Supply Scheme, Madhya Pradesh (Meeting dated 03 February 2013) and Rehabilitation and Upgradation to two – lane, Uttarakhand (Meeting dated 22 August 2014)

Audit noticed that in 60 proposals/projects approved by the Screening Committee, the minutes of the meetings of the Screening Committee did not indicate that knowledge transfer, technology transfer and best practices transfer were considered. This was contrary to the provisions of the circular cited above. Thus, in the absence of documentation, Audit could not draw an assurance that the goal of instituting the criteria, to maximize access and leverage of MFIs/MDBs knowledge base, international experience and familiarities with best practices had been fulfilled.

5.5 Cash Management

Cash management mainly entails cash flow forecasting, arranging temporary liquidity, maintaining target balance in the Government account, investment of surplus balance over and above the target balance in the market etc. The market borrowing undertaken for budget execution may contribute to large build up of surplus cash balance in the Government account making it challenging for the cash management to deploy these surplus balances efficiently.

In India, RBI was entrusted with the cash management of Government of India under Sections 17, 20 and 21 of the RBI Act, 1934 which they performed in coordination with the Ministry of Finance, Government of India.

The key features of the cash management operations were as under:

- There was treasury single account (TSA)[10] with RBI and all the transactions (i.e. receipts and payments) were routed through this account. GOI maintained minimum balance of ₹ 100 crore on each reporting Friday and RBI's annual closing day and ₹ 10 crore on all other days.
- RBI forecast the weekly inflows and outflows in GOI account based on past trends, information given in the budget and any other information provided by the MOF, GOI from time to time.
- The mismatches between inflows and outflow in TSA were rough tuned through issuance of cash management instruments, viz., treasury bills and further fine tuned through availing Ways and Means Advances (WMA)/ Overdraft (OD) and issuing cash management bills (CMBs). WMA are the advances made by the RBI to the

[10] A TSA (Treasury Single Account) is a unified structure of government bank accounts that gives a consolidated view of government cash resources. Based on the principle of unity of cash and the unity of treasury, a TSA is a bank account or a set of linked accounts through which the government transacts all its receipts and payments.

Government. Limits on the WMA are fixed on a half yearly basis. OD is similar to WMA and can be resorted to for maximum 10 days at a stretch, when limit of WMA is crossed. CMBs were non-standard, discounted instruments issued for maturities less than 91 days. The half yearly limits of WMA for the period 2009-10 to 2014-15 are mentioned in **Table 5.2** below:

Table 5.2: WMA Limits of GOI

(₹ in crore)

Year	April-September	October-March
2009-10	20,000	10,000
2010-11	30,000	10,000
2011-12	30,000 (45,000*)	10,000 (20,000**)
2012-13	50,000 (Q1) 45,000 (Q2)	20,000
2013-14	30,000	20,000
2014-15	35,000	20,000
*** Raised from April 21 to June 30, 2011** **** Raised for October-December 2011**		

(*Source: Records of DEA & RBI*)

- Surplus cash balances in GOI's account were invested up to ₹ 50,000 crore in the government securities through sale of securities to GOI from RBI's investment account. With effect from 16 December 2014, RBI had put in place a mechanism for investing surplus cash balances (above precautionary balance of ₹ 20,000 crore) of the GOI in variable rate repo instruments[11]. The end of day balance was placed in reverse repo instruments [12] with RBI.

5.5.1 Deficiencies in Projected Cash Balances

Examination of Weekly Projected Cash Balance and Actual Cash Balance for the period 2010-11 to 2014-15 revealed that:

(i) In at least 40 weeks in each year, the variations between the weekly projected cash balances and the actual cash balance were more than ₹ 10,000 crore as reflected in **Table 5.3** below :

[11] Repo instrument means an instrument for borrowing funds by selling securities with an agreement to repurchase the said securities on a mutually agreed future date at an agreed price which includes interest for the funds borrowed.

[12] Reverse repo instrument means an instrument for lending funds by purchasing securities with an agreement to resell the said securities on a mutually agreed future date at an agreed price which includes interest for the funds lent.

Table 5.3: Number of Instances of Variations in Weekly Projected Cash Balance and Actual Cash Balance

Year	Variation of more than ₹ 10,000 crore
2010-11	47
2011-12	40
2012-13	49
2013-14	41
2014-15	41

(*Source*: *Records of RBI*)

(ii) As reflected in **Table 5.4** below, the weekly projected cash balance was negative in many instances:

Table 5.4: Instances of Weekly Negative Projected Cash Balance

Year	Number of Instances
2010-11	16
2011-12	30
2012-13	26
2013-14	04
2014-15	19

(*Source*: *Records of DEA/RBI*)

From the above, it appears that the system of forecast of inflow and outflow in TSA of GOI was not robust.

RBI replied (August 2015) that though their endeavour was to project cash balances with fair degree of accuracy, there were occasions when the actual balances differed from projections. RBI stated that the GOI's cash balances were projected at least six months in advance and were impacted by multiple factors including spending by GOI departments/units across the country, spending by States (reflected by withdrawal from Intermediate Treasury Bills), etc. It was added that RBI and GOI were continuously striving to improve the efficacy of the cash forecasting. RBI further stated that issuance of dated securities and Treasury Bills were generally evenly distributed across the weeks to enable successful auctions without distorting the market and yield movements. It was further stated that issue of huge amount just to meet the funding requirement may impact cost of issuances and hence, there might be instances wherein cash balances could turn out to be negative and such mismatches in funding would be met by WMA / OD and /or issuance of Cash Management Bills.

DEA replied (September 2015) that the purpose of forecasting GOI balances for the purpose of Debt Management was not forecasting actual cash (as might be done for the purpose of cash management in a commercial institution), but to ensure that GOI balances are between WMA limits to a reasonable surplus, generally to prepare itself for bulky payments. It was added that due to uncertainties involved in the forecasting and as market might not be able to fund a very large requirement in a short period, it was prudent to allow negative GOI balances upto permissible WMA limit.

The reply of RBI and DEA needs to be seen in the light of the fact that WMA/OD was for the purpose of fine tuning the actual mismatches between the inflows and outflows and should not be considered for forecasting cash balances. The purpose of the forecast was to ascertain the possible position of cash so that appropriate steps could be taken to bridge the gap between projected cash requirement and projected cash availability, if any. A wide variation between the projected and the actual cash balance defeated the purpose of this projection.

In the Exit Conference, DEA stated that a Cash Coordination Committee had been set up to strengthen cash flow forecasting and cash management.

5.5.2 Issuance of CMBs and Availing WMA/OD

As stated in the preceding paragraphs, the fine tuning of mismatches in TSA may be done through CMBs/ WMA/ OD. The instances of fine tuning of the mismatches during the period from 2009-2010 to 2014-2015 are presented in **Table 5.5** below:

Table 5.5: Issuance of CMBs and Availing WMA/OD

Year	CMBs (No. of Instances)	WMA (No. of days)	OD (No. of days)
2009-10	-	76	28
2010-11	2 (35 days, 28 days)	57	02
2011-12	14(35 -77 days)	263	74
2012-13	-	40	0
2013-14	13 (7-56 days)	42	9
2014-15	1(42 days)	74	25

(*Source*: *Records of DEA and RBI*)

5.5.2.1 Issuance of CMBs for Monetary Policy Objectives

CMBs were introduced in 2009 to meet temporary cash flow mismatches of the Government. However, it was observed that during August and September 2013, CMBs worth ₹ 96,000 crore were issued to meet monetary policy objectives as shown in **Table 5.6** given below:

Table 5.6: CMBs Issued for Monetary Policy Objectives

(₹ in crore)

Sl. No.	Date	Amount of CMBs issued for monetary purpose	Discount (Cost)
1	13 August 2013	11,000	119.49
2	14 August 2013	11,000	119.38
3	20 August 2013	11,000	100.91
4	21 August 2013	11,000	98.46
5	27 August 2013	11,000	167.64
6	28 August 2013	11,000	169.18
7	03 September 2013	11,000	166.65
8	04 September 2013	11,000	163.19
9	06 September 2013	8,000	87.71
Total		**96,000**	**1192.61**

(*Source: Records of RBI*)

In this regard, DEA had also communicated (14 August 2013) to RBI that use of debt instruments for monetary policy objectives would interfere with the Government's debt strategy apart from fiscal implications. DEA advised that RBI may examine the option of using non–debt instrument for the purpose of monetary policy. However, DEA approved issuance of CMBs by RBI for monetary policy objectives.

RBI in their reply accepted (May 2015) the audit view with the remarks that the exchange rate of the Indian Rupee (May 2013) had come under intense pressure, depreciated significantly and was viewed by markets as the worst performing emerging market currency (with a maximum depreciation of about 19 *per cent* during a short span of about three months between 22 May to 28 August 2013) warranting the issue of CMBs.

The above facts need to be seen in the light of:

- CMBs were to be issued to meet temporary cash flow mismatches.
- In such a scenario, even the monetary objectives may not be achieved as liquidity absorbed through regular issuance of CMBs remained available with the GOI for spending as the money impounded through CMBs got injected back into the system.

5.5.2.2 Issuance of CMBs on consecutive days

It was seen from the records that in anticipation of the government account not coming out of overdraft within stipulated period of 10 consecutive working days, RBI had proposed (2 November 2011) to the GOI to issue CMBs in two tranches, i.e., for ₹ 6,000 crore on 3 November 2011 and for ₹ 8,000 crore on 8 November 2011. RBI reassessed the position as the Government had not issued the proposed first tranche on 3 November 2011 and proposed that the Government may issue CMBs for ₹ 10,000 crore on 8 November 2011. However, it was observed that the GOI decided to issue the CMBs on two consecutive days, i.e., 8 and 9 November 2011. RBI informed DEA vide their letter dated 25 November 2011 that in such an environment, the cash management operation could have serious implications for the remaining portion of market borrowing programme as well as the financial system including primary dealers. Further, RBI had proposed (November 2011) that cash management operations, especially issuance of CMBs, might be planned well in advance, preferably as soon as WMA reaches 75 *per cent* of the limit.

RBI in their reply (May 2015) stated that it was suggested that the issuance of CMBs on consecutive days should be avoided in the best interest of the market borrowing programme as well as the stability of the financial system, as the market reads such move adversely. However, RBI stated that the yields had not hardened very much in the subsequent days as expected indicating that the yield had hardened by 20 basis points.

The reply of RBI should be viewed in light of the fact that RBI had informed the DEA (even when RBI was aware that the yield had hardened by only 20 basis points) that the timing of issuance of CMBs on two consecutive days, i.e., on 8 November 2011 and 9 November 2011, when the Government had utilized OD for eight and nine working days had dampened the market sentiment and pushed the yields upwards across the maturity in government securities market.

RBI further furnished (April 2016) copies of correspondence with the DEA wherein it was stated that they would endeavour to ensure that the GOI will not be availing OD. RBI had again proposed that they will trigger issuance of CMBs as soon as WMA reaches 75 *per cent* based on assessment of market conditions which indicates that the previous proposal of the RBI has not yet been acted upon.

It is recommended that a decision on issue of CMBs as soon as WMA reaches 75 *per cent* be taken expeditiously.

Recommendation:

2. ***Conditions of 'Finance Plus' criteria aimed at maximizing access and leverage of Multilateral Financial Institutions'/Multilateral Development Banks' knowledge base, international experience and familiarities with best practices may be applied in deciding on the projects for external assistance and the same should be properly documented.***