I. Introduction

A major objective of the financial sector reform has been to enhance the productivity and allocative efficiency of the financial system. Accordingly, interest rate deregulation has formed a key component of financial sector reforms. In the money and government securities markets, market forces now determine interest rates to a large extent. In the banking system, on the deposit side, banks are free to determine their interest rates except for the interest rates on savings bank deposits and non-resident deposits. On the advances side too, except for a part of export credit and small loans up to Rs.2 lakh, banks are free to decide their own lending rates based on commercial judgment and risk-reward considerations. The sequence of interest rate deregulation in the financial market is set out in Annex 1. In addition to the banking system, small savings funds have played a crucial role in the Indian financial market, particularly in the retail segment of the debt market and have met the needs of small savers and investors. Small savings schemes have been instrumental in mobilising resources at the grassroot level and have thereby helped in inculcating the habit of thrift among retail investors. Notwithstanding the deregulation of interest rates in the money and debt market as also in the banking system, interest rates on small savings and provident funds remained administered and steady with attractive tax incentives until 1998-99 particularly when compared with interest rates on competing instruments.

2. Against this background, the Finance Minister in his Budget Speech for 2001-02 proposed an Expert Committee to review the system of administered interest rates and other related issues to explore a better system for determination of interest rates on the small saving schemes. Accordingly, a Committee was constituted under the Chairmanship of Dr. Y.V. Reddy, the then Deputy Governor of the Reserve Bank of India (RBI). The Committee submitted its Report to the Government on September 17, 2001. Apart from the issues of interest rate flexibility in terms of benchmarking small saving rates to market-determined rates, the Reddy Committee addressed a wide range of issues, *e.g.,* medium term vision of social security, fiscal sustainability, federal finance, rationalization of schemes and administrative

arrangements with regard to small saving schemes. The Committee, *inter alia,* made the following major recommendations:

1) benchmarking the administered interest rates on small saving schemes and GoI savings bonds to the secondary market yields on government securities (G-sec) of corresponding maturity;

2) abolition of income tax provisions on small saving schemes to ensure a level playing field in the financial market;

3) transfer of the entire net proceeds of fresh small savings to the state governments with outstanding liabilities (accumulated on the basis of sharing formula that varied from year to year) apportioned according to respective shares of the Central and State Governments; and

4) setting up of a National Small Saving Authority to administer national small saving funds with regard to all fresh flows.

3. After examining the recommendations of the Expert Committee, the Finance Minister proposed some measures in the Union Budget 2002-03 (Annex 2).

4. In order to review the implementation of the recommendations made by the Reddy Committee and to propose a future agenda, the Reserve Bank of India had constituted an informal task force in November 2003 comprising officials of the concerned departments of the RBI. The informal task force observed that the interest rates being currently offered on small saving schemes were higher than the rates that would have prevailed based on the Reddy Committee's recommendations. The interest rate structure offered under various small saving schemes during 2003-04 was also found to be not consistent with the term structure of G-sec yields. In view of the volatility of the benchmark and/or term spread, the task force proposed suitable alignment of the spreads and recommended: (i) an immediate reduction of administered interest rates by 50 basis points, (ii) rationalisation of the existing schemes while retaining at least one assured return scheme for non-tax paying rural small savers. Further, it proposed to the Government to look into aspects of tax reforms at the earliest in view of the divergence of returns between taxpayers and non-tax payers. The task force recommended the

constitution of a Working Group representing the Government, RBI and academics to advise the Government on these issues. The recommendations of the task force were forwarded to the Finance Minister for consideration in December 2003.

I.1 Constitution of the Present Advisory Committee

5. The Central Government issued an order on January 24, 2004 to set up an Advisory Committee to Advise on the Administered Interest Rate and Rationalisation of Saving Instruments with the following members :

(i)	Dr. Rakesh Mohan, Deputy Governor, Reserve Bank of India	Chairman
(ii)	Dr. Ashok Lahiri, Chief Economic Advisor, Ministry of Finance,Government of India	Member
(iii)	Shri D. Swarup,Secretary (Expenditure & Budget), Ministry of Finance, Government of India	Member
(iv)	Shri Suman Bery, Director-General, MemberNational Council of Applied Economic Research	
(v)	Professor Mihir Rakshit, Director, Monetary Research Project, Investment Information and Credit Rating Agency	Member

6. The terms of reference of the Committee were:

(i) To suggest criteria for fixing the spreads on administered interest rates over the benchmark yields recommended by the Expert Committee chaired by Dr. Y. V. Reddy, taking a view on the need to avoid excessive volatility in returns;

(ii) to make recommendations on rationalisation of existing savings instruments offered by the Government; and

(iii) to review the implementation of recommendations of the Expert Committee (Reddy Committee) on tax treatment of small savings schemes and to suggest a road-map.

7. The Committee was given the freedom to co-opt member(s) or special invitees to aid its deliberations. The Committee's secretariat was to be located

in the Reserve Bank of India. The Committee was provided with a time frame for submission of Report initially up to March 31, 2004 and later extended to May 15, 2004. A copy of the Memorandum setting up the Group is at Annex 3.

I. 2 Work Procedure Adopted by the Committee

8. An internal team was constituted within the Reserve Bank for organising the deliberations of the Committee as well as for drafting the Report. Accordingly, it was decided that the Monetary Policy Department of the Reserve Bank, would provide the secretarial assistance to the Committee. The RBI officials who acted as the resource persons to the Committee comprise: Shri V.S.Das, CGM-in-C, Department of Government and Bank Accounts, Shri H.R.Khan, CGM-in-C, Internal Debt Management Department, Shri Deepak Mohanty, Adviser, Monetary Policy Department, Dr. R.K.Pattnaik, Adviser, Department of Economic Analysis and Policy and Dr. B.K.Bhoi, Director, Department of Economic Analysis and Policy. Smt. Anuradha Prasad, Director, Ministry of Finance acted as resource person from the Government. The resource persons were special invitees to some of the meetings and prepared background papers in their respective areas to aid deliberations. The resource persons worked under the overall co-ordination of Shri D. Anjaneyulu, Principal Monetary Policy Adviser, Monetary Policy Department. Dr. Himanshu Joshi, Director from the Monetary Policy Department was nominated as the secretary to the Committee. In addition, Shri Rajib Das, Asst. Adviser, Monetary Policy Department was associated with the Secretariat. The secretariat functioned under the overall guidance of Shri Deepak Mohanty.

9. Smt. Shymala Gopinath and Smt. Usha Thorat, Executive Directors, RBI, Shri D. Anjaneyulu, Principal Monetary Policy Adviser, RBI, Dr. Narendra Jadhav, Principal Adviser, Department of Economic Analysis and Policy, RBI and Shri Deepak Mohanty, Adviser, Monetary Policy Department, RBI were special invitees to the meetings of the Committee.

10. The Committee held four meetings in Mumbai, on February 23, March 12, April 16 and May 8, 2004. In the first meeting on February 23, 2004, the

Committee broadly identified the major issues related to the determination of the appropriate level of interest rate to be offered to the depositors taking in to account various macro-economic parameters. Considering the outcome of the Reddy Committee and taking note of the financial market developments since then, the Committee placed utmost emphasis on devising appropriate rules for benchmarking interest rates and spreads thereon. Based on the discussions, members identified five areas that require close consideration during the course of the deliberations, namely, interest rate policy in India, operational issues relating to small savings, the issue relating to rationalising various small savings schemes, the rules for benchmarking and determination of spreads for interest rate reset and international experiences on savings schemes offered abroad. The Committee assigned the task of preparation of technical papers on these topics to the resource persons to facilitate informed discussions. A list of technical papers prepared by the Resource Persons is given in Annex 4. While deliberating on the rationalisation of small saving schemes, the Committee also discussed the structure of the proposed Dada-Dadi Bond announced by the Finance Minister on January 09, 2004 and made appropriate suggestions in keeping with the special nature of the scheme.

11. The Committee visualised the small savings schemes in the overall context of evolving social security, an aspect that was emphasised in the vision statement of the Reddy committee. The Committee proposed to firm up perceptions in this regard in the light of available information. During the deliberations, members examined the issue of continuation of various small saving schemes in their present form as also at their present scale of operation. Towards this end, various rationalisation proposals as well as benchmarking rules were discussed in detail. It was decided to ascertain the size of small savings liabilities by devising correct measures of scale. Further, the Committee debated extensively on the structure of the proposed Dada-Dadi Bond. The Committee deliberated at length on the nine background papers prepared by the secretariat to reach broad consensus on the approaches to be adopted on policy issues.

II. Review of Small Saving Schemes and Savings Bonds

12. Various Small Savings Schemes are framed by the Central Government under the different Acts of the Parliament, e.g., the Government Savings Bank Act, 1873, the Government Savings Certificates Act, 1959 and the Public Provident Fund Act, 1968. For each scheme, statutory rules are framed by the Central Government indicating details such as the rate of interest, maturity period etc. Post Office Savings Bank is included in the Union List vide item No. 39 of Seventh Schedule of the Constitution of India. Deposit Scheme for Retiring Government Employees, 1989 and the Deposit Scheme for Retiring Employees of Public Sector Companies, 1991 were introduced as non-statutory schemes with effect from July 1, 1989 and January 1, 1991, respectively. The “Relief Bonds” Scheme was introduced in 1987 with a view to providing relief to drought affected areas in 1987 through Central Government notifications and discontinued in 2003 and relaunched in the same year in the form of two GoI Savings Bonds; the 6.5 per cent Savings Bonds 2003 (non-taxable) effective March 24, 2003 and the 8 per cent Savings Bonds 2003 (taxable) effective March 21, 2003.

II.1 Administrative Set-up

13. The small savings schemes are administered through the agency of post offices. The Public Provident Fund (PPF) scheme is operated through post offices as well as selected branches of public sector banks whereas the Deposit Schemes for Retiring Government and Public Sector Employees are operated through nationalised banks only. These schemes are operated through a network of over 1,54,000 post offices and 8000 branches of public sector banks. As regards GoI Savings Bond, while both RBI offices and agency banks act as the receiving offices for the 6.5 per cent Savings Bonds (non-taxable) 2003, only the agency banks act as receiving offices for the 8 per cent Savings Bonds (taxable) 2003.

14. Small savings are not intended for the investment of large surplus funds of institutions. Government of India decided to discontinue institutional investments in three major small savings schemes, i.e., Kisan Vikas Patra

(KVP), National Saving Certificate (NSC) VIII-Issue and Post Office Time Deposits with effect from April 1, 1995. Registered Trusts, however, continue to be eligible to invest in, NSC, KVP and Time Deposits. Group/Institutional accounts by Provident/Superannuation/Gratuity Funds, Treasurer of Charitable Endowments for India, Registered Trusts, Regimental Funds and Welfare Funds as well as accounts by Co-operative Societies or scheduled banks on behalf their members; clients or employees are permitted in Time Deposits. Investment by Provident/Superannuation/Gratuity Funds as well as investment for encouragement of thrift or for mutual benefit of its members by a local authority or a lawfully constituted association, institution or other body is permissible in the Post Office Savings Accounts. Non-Resident Indians (NRIs) are not eligible to invest in any small savings scheme. In case of GoI Savings Bonds, category of applicants is restricted to individuals including Hindu Undivided Families (excluding Non-Resident Indians, who can, however, be nominated), although Charitable Institutions and Universities are eligible for investment in 8 per cent Savings Bonds (taxable) 2003.

II.2 Accounting Procedure

15. GoI Saving Bonds is different from small savings schemes in that the subscription amount under this bond goes to the Central Government unlike funds mobilised under small savings schemes. Prior to April 1999, a share of net collections in small savings schemes and PPF in post offices and banks were transferred to the State Governments and Union Territories (UTs) (with legislature) in the form of long-term loans with the objective that the funds would be used for financing the State Plan. The loans were repayable in 25 years with an initial 5-year moratorium on repayment of principal and carried interest rates as specified by the Government of India from time to time. The average duration of the small savings schemes is 6 years. There is thus a mismatch between the terms on which funds are borrowed by the Central Government from the public and the terms on which the funds are on lent to the State Governments (Annex 5).

16. Since April 1999, the accounting procedure of small savings schemes has undergone a change and the sums released as States' share is now treated as long-term investment and are issued as special securities of the respective State/UT Government on terms almost identical to those that were stipulated for loans granted earlier. The rates of interest on the erstwhile loans to state governments and now the special securities issued/to be issued against the share of small savings collections by the Central as well as State Governments are decided by the GOI from time to time. During the period 1999-2002, the Centre's share in the net collections was also treated as investment of National Small Saving Fund (NSSF) through issue of 'on call' special securities on the same terms and conditions as are applicable to the State Government securities.

17. The rates of interest on erstwhile loans to state governments (up to 1998-99) and the special securities issued against the share of small savings collections by the Central as well as State Governments are decided by the GOI from time to time. The rate of interest on the special securities issued to the State Governments has declined from 13.50 per cent in 1999-2000 to 9.50 per cent in 2003-04. However, as at end-December 2002, the high cost Central loans with States amounted to over Rs.1, 00,000 crore and carried an interest rate of more than 13 per cent per annum (Table 1).

Table 1: Interest Rate on Long-term Loans to States / Terms of Issuing Special Security

Year/ Security	Interest Rate (Per Cent)	Date Of Effect
1988	12.00	1.6.1988
1989	13.00	1.6.1989
1990	13.00	1.6.1990
1991	13.50	1.6.1991
1992	14.50	1.6.1992
1993	15.00	1.6.1993
1993	14.50	2.9.1993
1994	14.50	1.6.1994
1995	14.50	1.6.1995
1996	14.50	1.6.1996
1997	14.50	1.6.1997
1998	14.50	1.6.1998
1999	14.00	1.1.1999 to 31.3.99
Special GOI Securities against outstanding balances	11.50 10.50	1.4.1999 1.3.2003
Special GOI securities against reinvestment of redemption values, 2023	7.00	1.4.2003
Special GOI securities against reinvestment of redemption values, 2023	6.00	30.9.2003
Special Central/State securities issued during 1999-2000	13.50	1.4.1999
Special Central/State securities issued during: 2000-01	12.50	1.4.2000
Special Central/State securities issued during 2001-02	11.00	1.4.2001
Special State securities issued during 2002-03	10.50	1.4.2002
Special State securities issued during 2003-04	9.50	1.4.2003

Source: Ministry of Finance

II.3 Debt Swap Scheme and its Impact on NSSF

18. In order to reduce the States' interest burden, the Central Government, in consultation with the state governments, introduced a debt swap scheme in September 2002. Under this scheme, States are required to repay these high cost debts by utilising the proceeds from additional market borrowings and fresh mobilisation of small savings in the three-year period ending 2004-05.

The scheme enables the State Governments to replace/prepay their past high cost borrowings owed to the Centre, by using a part of their current share of net small savings collections and by raising additional market borrowings at current lower rates of interest. The share of current small savings transfers swapped by the states under the Debt Swap Scheme was 20 per cent during 2002-03 and 30 per cent during 2003-04. Amounts of Rs. 13,766 crore and Rs. 46,211 crore have since been swapped under the scheme during 2002-03 and 2003-04. Thus, a total amount of Rs. 59,977 crore has been swapped till March 2004. In turn, the GOI has utilised these amounts for repayment of its liabilities owed to NSSF through redemption of equivalent amount of 'on call' special GOI securities against outstanding balances (Annex 6).

19. The sums received on redemption were reinvested in special GOI securities at current market related interest rates. Special GOI securities against the redeemed amounts were issued: (i) for Rs.13,766 crore on April 1, 2003 carrying coupon of 7 per cent per annum with 20 years' term, (ii) for Rs. 32,602 crore on September 30, 2003 carrying coupon of 6 per cent per annum with 20 years' term and (iii) for Rs. 13,609 crore carrying coupon of 5.95 per cent per annum with 20 year term on March 30, 2004. The redemption of 'on call' special GOI securities bearing higher interest rate and further reinvestment of the redemption values in special GOI securities bearing lower (current market related) interest rates have resulted in decline in the interest income of the NSSF thereby increasing the revenue deficit of the Fund, as there has been no corresponding reduction in the interest rates on its liabilities. The interest rate mismatches stemming from the inability of the NSSF to restructure its liabilities ultimately impose a fiscal cost to the Central Government.

20. Another pertinent issue that needs examination is that though the cost of mobilisation under the market borrowing programme declined steeply, the States continue to pay higher rates to the Centre on special securities issued against small savings. This may be seen from Table 2, which shows that the spread (as between the latter and the former) rose to 3.4 percentage points in 2003-04 from under 1 per cent in 2000-01. The implicit spread paid by States to the Central Government (measured in terms of the difference between the

weighted average interest rate paid to the depositor under the small saving schemes and the interest rate on long-term loan/ special securities) on account of maturity transformation and guarantee offered by the Central Government to investors on behalf of the States has ranged between 1.9 and 3.8 per cent since 1998-99. It is, therefore, evident that unless the interest rates on small savings are linked to market borrowings of the Central Government, (i) the operations of NSSF will not be sustainable; and (ii) the States will have to bear the fiscal stress on account of higher interest rate paid by them to the Central Government. Hence, it becomes imperative to link the interest rates on the small savings to market related rates (Table 2).

Table 2: Implicit Interest Rate Spread Paid by States

(per cent)

Year	Weighted Average Interest Rate On State Government Dated Securities	Interest Rate On Long Term Loans /Special Securities	Weighted Average Interest Rate Paid To The Depositor Under Small Saving Schemes #	Implicit Spread Paid By State As Compared To Market Loan (3) - (2)	Implicit Spread Paid By State To Central Government (3) - (4)
(1)	(2)	(3)	(4)	(5)	(6)
1991-92	11.8	13.0 –13.5	10.2	1.2 –1.7	2.8 – 3.3
1992-93	13.0	13.5 –14.5	11.0	0.5 – 1.5	2.5 – 3.5
1993-94	13.5	14.5 –15.0	11.5	1.0 –1.5	3.0 – 3.5
1994-95	12.5	14.5	11.3	2.0	3.2
1995-96	14.0	14.5	11.1	0.5	3.4
1996-97	13.8	14.5	11.0	0.7	3.5
1997-98	12.8	14.5	11.2	1.7	3.3
1998-99	12.4	14.0 –14.5	11.4	1.6 – 2.1	2.6 – 3.1
1999-00	11.9	12.5 –14.0	10.6	0.6 – 2.1	1.9 – 3.4
2000-01	11.0	12.5 –11.0	8.7	0.6 – 0.9	2.3 – 3.8
2001-02	9.2	11.0	8.0	1.8	3.0
2002-03	7.5	10.5	7.2	3.0	3.3
2003-04	6.1	9.5	Not Available	3.4	Not Available

: Weights are based on the instrument-wise share of Gross mobilisation to the total

Source: 1. Ministry of Finance
2. Reserve Bank of India

II.4 Interest Rates on Small Savings and Savings Bonds

21. In the past, the interest rates of various small savings schemes were reviewed and revised from time to time. In the recent period, small savings interest rates were generally steady up to the late 1990s. Since 1998, all these rates have been reduced in phases (Table 3).

Table 3: Interest Rates on Small Savings and other Schemes

(per cent per annum)

Post Office (PO) Savings Deposits	2.9.93 5.5	1.1.99 4.5	15.1.2000 4.5	1.3.2001 3.5	1.3.2002 3.5	1.3.2003 3.5
PO Time Deposits	2.9.93	1.1.99	15.1.2000	1.3.2001	1.3.2002	1.3.2003
1 Yr.	10.5	9	8	7.50	7.25	6.25
2 Yr.	11	10	9	8.00	7.50	6.50
3 Yr.	12	11	10	9.00	8.25	7.25
5 Yr.	12.5	11.5	10.5	9.00	8.50	7.50
PO Recurring Deposit	2.9.93 12.5	1.1.99 11.5	15.1.2000 10.5	1.3.2001 9.00	1.3.2002 8.5	1.3.2003 7.5
Monthly Income Account*	2.9.93 13	1.1.99 12	15.1.2000 11	1.3.2001 9.50	1.3.2002 9	1.3.2003 8
National Savings Certificates: VIII-Issue	2.9.93 12	1.1.99 11.5	15.1.2000 11	1.3.2001 9.50	1.3.2002 9	1.3.2003 8
Kissan Vikas Patra	2.9.93 Amount doubles in 5½ yrs.	1.1.99 Amount doubles in 6 yrs.	15.1.2000 Amount doubles in 6½ yrs	1.3.2001 Amount doubles in 7.1/3 yrs.	1.3.2002 Amount doubles in 7 yrs. 8 months	1.3.2003 Amount doubles in 8 yrs.7 months
Public Provident Fund	1986-87 12	1.1.99 12	15.1.2000 11	1.3.2001 9.5	1.3.2002 9	1.3.2003 8
Deposit Scheme For Retiring Employees	2.9.93 10	1.1.99 9	15.1.2000 9	1.3.2001 8.5	1.3.2002 8	1.3.2003 7
Relief / Savings Bond (Non Taxable)	15.3.93 10	1.01.99 9	3.05.99 9	15.3.2001 8.5	1.3.2002 8	24.3.03 6.5
Savings Bond (Taxable)	-	-	-	-	01.10.2002 7	21.4.03 8.0

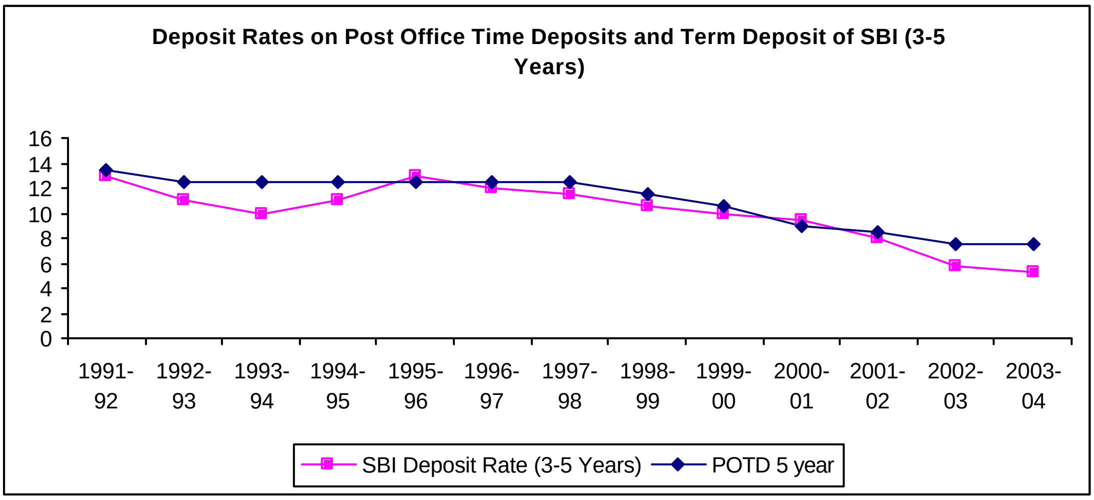
*: bonus @ 10per cent of the deposit, also payable at maturity

Source: Ministry of Finance

22. Between 1999 and 2001, the revision of interest rates was based on the recommendation of the R.V. Gupta Committee (September, 1998), which recommended benchmarking of the rates of interest on small savings schemes against the rates of interest prevalent on similar instruments/schemes offered by banks and financial institutions. Despite these adjustments, administered rates on small saving schemes tended to be less flexible than the rates on equivalent bank deposits, especially after the deregulation of the latter in the 1990s. Nevertheless, the rationalisation of

interest rates on small savings since 1999-2000 has led to a converging trend between these two sets of interest rates. After March 2002, the adjustment of the rates of interest on various small savings schemes have been based on the recommendations of Reddy Committee. These called for benchmarking the interest rates on various small savings schemes to the average secondary market yield on government securities of comparable maturity, with a positive spread of up to fifty basis points depending upon the maturity and liquidity of the instrument; the periodicity of revision being on an annual basis (Chart 1).

CHART 1



II.5 Income Tax Provisions Affecting Returns

23. Various tax benefits are available on small saving schemes / GoI Saving Bonds. Primarily, three types of benefits are available to participants in these schemes under the various provisions of the Income Tax Act. These are tax rebate governed by Section 88, tax deduction covered by Section 80L and tax exemptions allowed under Sections 10(11) and 10(15) of the Income Tax Act, 1961. The tax provisions applicable to various schemes are outlined in Table 4.

Table 4: Income Tax Incentives available under various schemes

Schemes	Tax incentives on deposits by way of credit [&]	Tax incentives on interest [^] Under
Post Office Savings Account	Nil	Section 10
Post Office Recurring Deposits	Nil	Section 80L (1)(3)(i)
Post Office Monthly Income Account	Nil	Section 80L(1)(3)(i)
Post Office Time Deposits 1 Year	Nil	Section 80L(1)(3)(i)
Post Office Time Deposits 2 Years	Nil	Section 80L(1)(3)(i)
Post Office Time Deposits 3 Years	Nil	Section 80L(1)(3)(i)
Post Office Time Deposits 5 Years	Nil	Section 80L(1)(3)(i)
National Savings Certificate VIII Issue	Section 88	Section 80L and interest accrued annually treated as 'deemed to be reinvested' under Section 88
Kisan Vikas Patra	Nil	Nil but no TDS
Public Provident Fund	Section 88	Section 10 (11)
Deposit Scheme for Retiring Employees	Nil	Section 10 (15)(iv)(i)
Relief / Savings Bond	Nil	Section 10 (15)

Source: Ministry of Finance

Although some of the liberal tax provisions are also available to competing financial instruments, assured return on small saving schemes in conjunction with sovereign guarantee make these a very attractive avenue for investors (Annex 7).

II.6 Small Savings Collections over the Years

24. There has been considerable growth in the small savings collections in the recent years both in gross as well as in net terms. The aggregate gross and net collection of small saving, which was Rs.18,920 crore and 9,104 crore during 1990-91 is likely to increase to Rs.1,65,600 crore and Rs.78,720 crore, respectively, by 2004-05 (Budgeted Estimates). Transfers to States/UTs have also grown proportionately. The gross and net collections in Small Savings

[&] Tax rebate up to the limits prescribed under Section 88 are available on deposits, and withdrawals are completely exempt under Section 10.

[^] Tax deduction up to prescribed limit available under Section 80 L.

Schemes from 1990-91 as also amounts released as States' share are given below (Table 5).

Table 5: Aggregate Mobilisation under Small Savings*

(Rs. Crore)

	Gross Mobilisation	**Net Mobilisation**	**Small Savings Loans#**	**Percentage Share of Four Major States in Aggregate Small Savings Loans***
1990-91	18920	9104	7026	53.5
1991-92	18587	6640	5481	55.1
1992-93	19374	5717	4264	50.1
1993-94	27292	9091	5000	51.1
1994-95	37491	16576	9675	45.4
1995-96	36679	12749	9990	50.0
1996-97	38111	15246	10671	51.6
1997-98	51889	24403	15732	53.9
1998-99	62157	33044	23788	56.1
1999-00	75542	36653	26937	52.5
2000-01	88739	45601	33265	50.8
2001-02	90990	44406	35018	53.8
2002-03	118586	60739	52261	49.6
2003-04	145550	71380	64500	Not Available
2004-05 (BE)	165600	78720	70000	Not Available

Source: Ministry of Finance

From Table-5, it may be observed that both the gross and net mobilization from 2001-02 to 2003-04 increased substantially despite rationalisation of interest rates. It may also be seen that the four States *viz;* Maharastra, West Bengal, Gujarat and Uttar Pradesh have accounted for almost half of the total amount mobilised under the various small savings schemes.

25. In order to assess the scale of funds mobilisation, the outstanding small saving funds, gross and net mobilisation of small savings are

---

* The amount pertains to small savings scheme mobilised through NSSF, which goes to States and does not cover the subscription amount under GoI Savings bonds. Details of mobilisation under various schemes are furnished in Annex 8.

<u>Amount due for calendar year released during the financial year:</u> The share of net small savings collections during a calendar year is released in the financial year. e.g., the share of net collections from January to December, 2004 was released during the financial year 2004-05. The amount due against January collections was released in the month of April next.

normalised to Combined Outstanding Domestic Liabilities of Centre and States (CODLCS), Gross Domestic Product (GDP), Combined Gross Fiscal Deficits of the Central and the State Governments (CGFDCS) and aggregate financial assets of household sector (AFAH). In addition, the net transfer of small saving funds is normalised to Gross Fiscal Deficits of the State Governments (GFDS) from 1993-94 to 2003-04 (Table 6).

Table 6: Scale of Small Savings Mobilisations (Per cent)

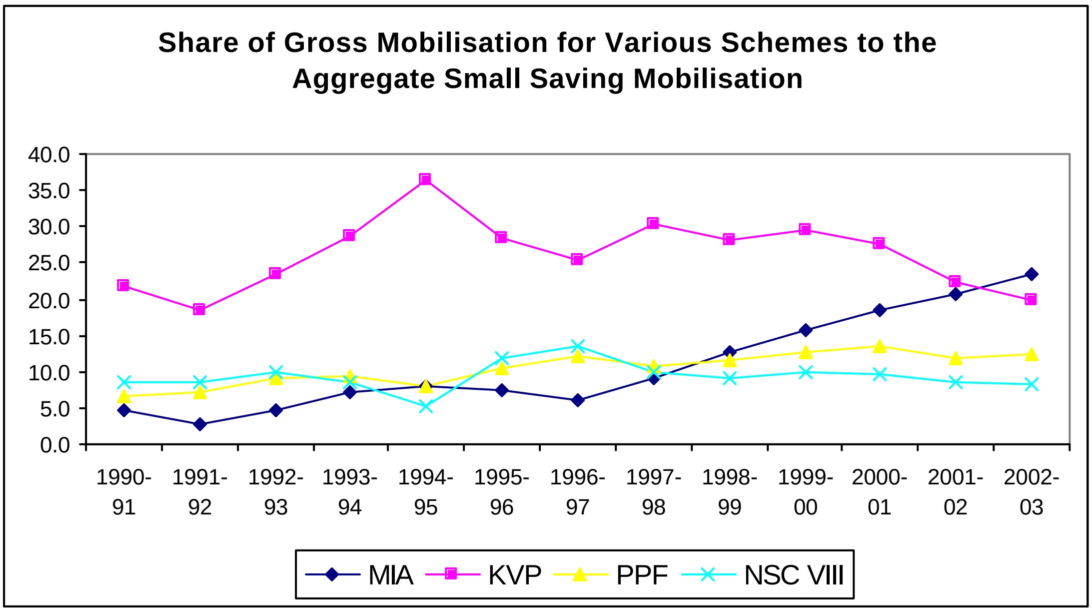
	Outstanding Small Savings Funds as a percentage share to Combined Domestic Liabilities of Centre and States (CODLCS)	Gross Mobilisation As Percentage To GDP	NET MOBILISATION AS PERCENTAGE SHARE TO			Net Transfer to States as Percentage to GFDs of States (GFDS)
			GDP	Combined GFDs of Centre And States (CGFDCS)	Aggregate Financial Assets of Household (AFAH)	
1993-94	13.3	3.5	1.2	11.2	8.3	24.3
1995-95	13.3	4.1	1.8	19.4	11.4	34.9
1995-96	14.2	3.4	1.2	13.9	10.3	31.8
1996-97	14.4	3.1	1.2	14.7	9.6	28.6
1997-98	16.6	3.7	1.8	18.3	14.2	35.6
1998-99	17.2	3.9	2.1	17.6	15.9	32.0
1999-00	15.4	4.3	2.2	18.7	16.2	29.4
2000-01	16.2	4.6	2.4	21.9	17.8	37.2
2001-02	16.7	4.3	2.1	18.7	15.2	36.5
2002-03	20.3	5.2	2.7	23.2	20.9	44.8
2003-04	21.1	5.3	2.6	27.2	n.a.	59.2

Source: 1. Ministry of Finance, 2. Reserve Bank of India

26. It may be observed that while the outstanding small saving funds as a share of CODLCS increased steadily from 13.3 per cent in 1993-94 to 21.1 per cent in 2003-04, net small saving funds as share of CGFDCS rose from 11.2 per cent to 27.2 per cent. The gross and net small savings as a percentage share of GDP have increased from 3.5 per cent and 1.2 per cent in 1993-94 to 5.3 per cent and 2.6 per cent, respectively by 2003-04. The net small saving funds as a share of aggregate financial assets of the household sector (AFAH) has increased from 8.3 per cent in 1993-94 to 20.9 per cent by 2002-03. The transfer of small savings funds from centre to the states as share of GFD of States rose sharply from 24.3 per cent in 1993-94 to 59.2 per cent in 2003-04. Thus, the various indicators of small savings show a significant increase over the years in the wake of higher effective yields offered on these instruments vis-à-vis other competing instruments.

27. The scheme-wise mobilisations of small savings from 1990-91 to 2002-03 along with withdrawal of funds and net accrual under each scheme are given in Annex 8. It may be observed that the gross mobilisation through the four schemes, *viz.*, Monthly Income Account, NSC VIII Issue, Kissan Vikas Patra and PPF constitute the bulk of the amount mobilised under the small saving schemes. The share of gross amount mobilised under these four schemes to the aggregate amount mobilised increased from 37.0 per cent in 1991-92 to 63.8 per cent in 2002-03 (Chart 2).

CHART 2



28. The composition of small savings across the four broad categories, *viz.*, (i) Short-term deposits (up to 3 years including saving deposits), (ii) Longer-term deposit (over 3 years), (iii) Certificates and (iv) PPF indicates that the amount mobilised under the deposit category accounts forms a sizeable proportion of the aggregate amount mobilised under the small savings schemes. Postal deposits, however, are subject to tax treatment on par with competing financial instruments like bank deposits. For example, mobilisation of deposits (sum of short and long-term deposits)

constituted 59.4 per cent of the aggregate small saving collection (gross) during 2002-03. Further, the share of medium to long-term instruments (sum of longer-term deposits, certificates and PPF) constituted 77.8 per cent of the total gross collection in 2002-03. Within the long-term small savings, the longer-term deposit (over 3 years) constituted 37.6 per cent, while certificates and PPF accounted for 27.9 per cent and 12.3 per cent respectively during 2002-03 (Table 7).

Table 7: Share of Various Categories of Schemes to Aggregate Gross Mobilisation Under Small Savings

(per cent)

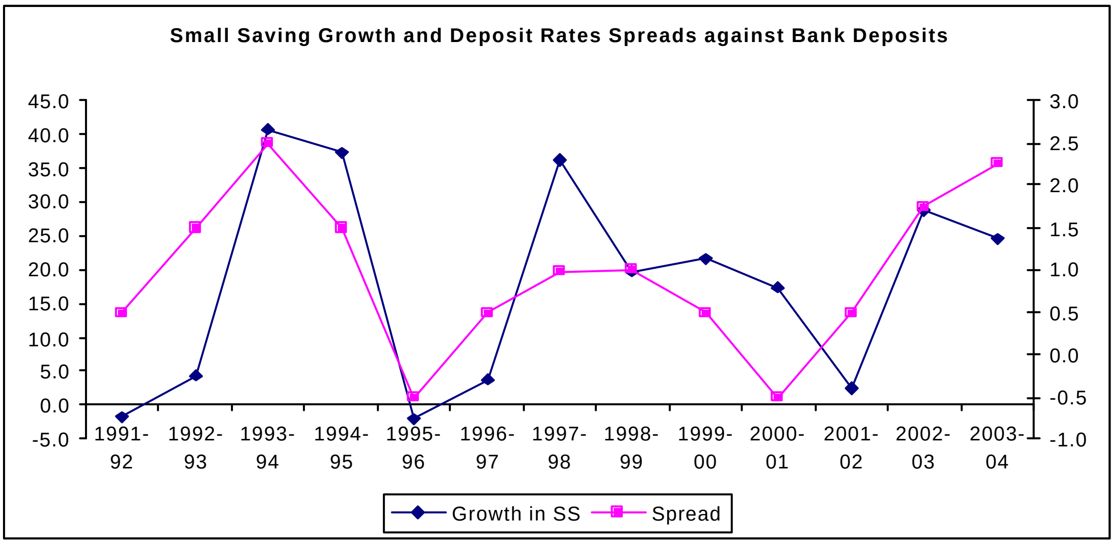
	Short-Term Deposits	Longer-Term Deposits	Certificates	PPF
1990-91	24.8	24.8	43.4	6.5
1991-92	30.9	26.0	35.7	7.1
199293	32.0	20.4	38.3	9.1
1993-94	26.3	20.7	43.5	9.3
1994-95	21.6	20.7	49.5	8.1
1995-96	23.2	20.3	45.9	10.5
1996-97	22.6	20.6	44.3	12.2
1997-98	21.8	21.8	45.4	10.8
1998-99	18.8	25.6	43.8	11.6
1999-00	16.8	29.1	41.2	12.8
2000-01	16.9	32.1	37.1	13.6
2001-02	20.9	35.9	30.7	11.8
2002-03	21.8	37.6	27.9	12.3

Source: Ministry of Finance

29. In addition, the sensitivity of small saving mobilisation to the interest rate offered on competing saving instruments (e.g., bank deposits) is also significant. For example, the correlation coefficient between the year-on-year growth of small savings and deposit rate spread (5-year post office deposit rate minus 3-5 year bank deposit rate) is over 0.6. Technical work conducted by the Committee shows that administered interest rate such as postal term deposit rates are significantly associated with commercial bank deposit rates. This finding highlights the need for alignment of interest rates, particularly, the administered interest rates vis-à-vis other market related rates so as to evolve a meaningful term structure of interest rates as also to improve the efficacy of monetary policy. This also establishes the fact that stickiness in the administered interest rates on small saving interest rates results in higher

mobilisation under small savings at a time when the market rates are falling and *vice versa* (Chart 3). This trend may be expected to continue unless administered rates are appropriately benchmarked to market rates.

CHART 3



30. Subscriptions under various issues of GoI Relief Bond and Savings Bond are given in Table 8. It may be observed that the amount outstanding under these instruments has increased substantially in recent times. For example, while the outstanding amount under 10 per cent Relief Bond 1995 amounted to Rs. 7,175 crore in August, 1999, the outstanding amount mobilised under both the issues of the GoI Savings Bond (taxable and non-taxable) 2003 has exceeded Rs. 23,000 crore as on March 29, 2004.

Table 8: Subscription under Relief Bonds (RFB) and Savings Bonds (SB)

(Rs. Crore)

Scheme	Date of Issue	Closure Date	Subscription amounts received	Position as on
9 per cent RFB 1987	01-12-87	15-06-93	1,164	5-9-94
10 per cent RFB 1993	15-03-93	01-09-93	254	18-9-97
9 per cent RFB 1993	02-09-93	03-10-93	882	18-9-97
10 per cent RFB 1995	04-10-95	31-12-98	7,175	20-8-99
9 per cent RFB 1999	01-01-99	02-05-99	10,212	11-02-03
8.5 per centRFB 2001	15-03-01	28-02-02	16,552	11-10-03
8 per cent RFB 2002	01-03-02	28-02-03	9,328	15-11-03
7 per cent SB 2003	01-10-02	28-02-03	6,106	14-11-03
6.5 per cent SB 2003 (Non Taxable)	24-03-03	On Tap	17,208	29-2-04
8.0 per cent SB 2003 (Taxable)	21-04-03	On Tap	5,856	29-2-04

Source: Reserve bank of India

II.7 Monetary / Fiscal Implication of Administered Interest Rates

31. The administered interest rates on Small Savings were raised in the first half of the 1990s, when the inflation rate and other interest rates were high. However, when the inflation rate as well as nominal interest rates softened in the latter half of the 1990s, the administered interest rates did not fall correspondingly *vis-à-vis* other rates on competing financial instruments. As the Government raises a sizeable part of its borrowing through this route (at high rates of interest), it not only imposes significant stress on the public exchequer but also introduces rigidities into the smooth conduct of monetary policy, as noted by the Reserve Bank in its recent policy Statement. Technical work conducted by the Committee showed that the deposit rates of commercial banks are significantly influenced by administered interest rates with an average sensitivity of about 35 basis points in response to a single percentage change in the latter.

32. The Committee, however, noted that the Government has been active in aligning administered interest rates progressively with market rates since January 1999. Further, in the Union Budget for 2002-03, the Finance Minister also proposed to implement the recommendation of the Reddy Committee to benchmark administered rate to secondary market yields of government

securities. This would further impart flexibility to the interest rate structure of small saving and provident funds. Despite these rationalisation proposals, the administered interest rates on small savings schemes offered by the Government remain higher than the longer-term deposit rates of commercial banks.

33. Apart from the issues relating to the level of nominal interest rates, the tax concessions on these schemes involve sizeable costs to the fisc in the form of foregone revenue. Further, it would have an adverse impact over market efficiencies in terms of appropriate price discovery. The effective tax-adjusted returns on various schemes do not have systematic relation to the tenor and the risk-free nature of these instruments owing to sovereign guarantee associated with them. This has an impact on emergence of an appropriate benchmark in the financial market in view of its distortionary effects on the term-structure in the retail segment of the debt market as also on the smooth conduct of monetary policy.

III. Criteria for Benchmarking and Setting up Spreads

34. While the Reddy Committee had suggested the benchmarking of administered interest rates against the average secondary market yields of government securities with corresponding maturity, a number of developments since the submission of the Report have rendered the issue of benchmarking somewhat difficult. Two major problems may be cited in this context. First, in a falling interest rate regime, the average yields for the previous year calculated at the beginning of the year may not entirely represent the current yields. Second, the use of the corresponding annual average yields of government securities across maturity for benchmarking could result in sudden changes in the administered interest rates from year to year in the wake of observed shifts in yield curve in the government securities market. Financial planning based on such a dispensation, therefore, becomes a difficult proposition for the small savers.

35. An Internal Task Force constituted by the Reserve Bank examined the interest rates actually offered by the Central Government during 2003-04 as compared with the rates that would have prevailed in terms of the Reddy Committee's recommendations. It was observed that the spread actually offered by the Government on various schemes is quite different from what was proposed by the Reddy Committee. More concretely, the interest rate offered by the Government on various small savings schemes (except for savings bank account) for 2003-04 was in the range of 6.25-8.0 per cent. However, if interest rates were to be computed in accordance with the recommendations of the Reddy Committee, the instruments should carry an interest rate in the range of 5.5-7.5 per cent. In view of this divergence in interest rates which mainly stem from the difficulties in the implementation of Reddy Committee recommendations in a scenario of sharp changes in the yield curve in the government securities market, the present committee decided to review the issue of benchmarking as well as the rules that govern the determination of spreads on the small saving instruments.

III.1 Benchmarking of Administered Interest Rates

36. After once again considering alternative benchmarks like inflation rate, bank deposit rate, Bank Rate, yields on government securities, etc., the Committee decided to continue with government yields as the most suitable benchmark as suggested by the Reddy Committee as they are mostly market determined, signal a measure of expected (rather than past) inflation and would facilitate rationalisation of various schemes. The Committee had also considered the possibility of inflation-linked benchmarks for some schemes keeping in view the need for providing a social safety net to the vulnerable sections of the society, e.g., schemes exclusively targeted to the senior citizens and pensioners to ensure a positive real rate of return to savers. However, inflation-linked benchmarks were discarded due to problems of measurement of inflation expectations. The use of past inflation rates for purposes of benchmarking are generally not preferred in view of their backward-looking nature in terms of rate adjustment. Moreover, the Committee considered it more appropriate to use a single benchmark across all schemes for simplicity and to achieve the medium term objective of aligning administered interest rates to market rates.

37. Apart from the inflation rate, the Committee also examined other benchmarks, such as the Bank Rate and commercial bank deposit rates. The Committee felt that at present the Bank Rate does not convey the current interest rate signal appropriately, as the Reserve Bank uses repo rate simultaneously for short-term liquidity management. Further, the Bank Rate is a medium term policy signaling rate and is itself an administered rate. As regards commercial bank deposit rates, the Committee felt that they are yet to be determined competitively as only a few leading banks play a major role in overall price determination.

38. The feasibility of benchmarking the administered rates to the interest rates on market borrowings by States was also explored. At present, the interest rate on market borrowings by States (tap issues) carries an arbitrary spread of about 50 basis points over the secondary market yield Central Government dated securities of similar maturity. However, in tap issuances, the interest rates are the same across all States, irrespective of their credit

worthiness. Besides, as the tenor of primary issuances of State Government papers was only 10-year, which was recently extended up to 12 years, the yield curve of state government papers is not complete due to low secondary market trading although the interest rates arrived at in the auctions of state Government papers, in contrast to tap issues, are market determined. Moreover, the amount mobilized by States at the auctions is not very high and mostly the relatively creditworthy States participate in auctions. Further, the divergent cut-off yields by different States would be broadly reflecting their individual creditworthiness. Given that interest rates on small savings to the savers would have to be identical across the country, using market borrowing rates of State governments – both tap and auctions – as benchmarks may not be appropriate. Also, the non-existence of a liquid and deep secondary market poses difficulty in adopting the States' papers for purposes of benchmarking.

39. In view of the above and taking note of the fiscal implications of relatively high small savings rates, the Committee felt that interest rates on these instruments may have to be linked to the cost of borrowings by the central government. Lower rates on small savings will also facilitate increasing the share of direct borrowings from the market by the States as compared to the small savings route. Therefore, the Committee preferred to continue with the secondary market yields on central government dated securities for benchmarking small savings rate, which has a deep and liquid market.

40. Instead of using any backward looking formula, the Committee also explored the need to study the movements of forward rates for the purpose of extracting underlying inflation expectation for interest rate determination. For example, many central banks exploit the forward rate as a tool for gauging inflation from (i) the level of the spot yield curve and/or (ii) the term spread. In the Indian context, however, the Committee observed that neither the level nor the spread is a reliable indicator of the future inflation rate. This is because of the absence of a long-term view as well as the influence of day-to-day liquidity conditions, transient shocks or market rumor over the yield curve across the entire maturity spectrum. Moreover, unidirectional expectations accentuate market conditions given a less diversified holding pattern of

government securities. At the present state of the market, de-linking of yield curve from economic fundamentals has become more acute in the context of sustained capital flows, which of late have become a major determinant of the shape of the yield curve in India.

III.2 Averaging of the Benchmark and the Reset Intervals

41. As the movements of yield curve and prices are susceptible to various shocks, the Committee considered the need for averaging of government securities yields and the periodicity of resetting the rates of interest broadly in line with the thinking of Reddy Committee. However, it was recognised that averaging of yields over the previous years leads to divergence of the administered rate to the prevailing yields in the market. The Committee was of the view that the time frame for averaging the benchmark should ideally be inversely proportional to the volatility of the yield. However, it may be noted that volatility in the government securities market implies either (i) fluctuations around a stable mean or (ii) movements of the mean either upward or downward without too much of fluctuation around itself. If volatility is excessive while the mean is stable, the fixation of benchmark rate may not be very difficult although the spread needs to be carefully crafted. If the interest rates turn out to be less volatile around the mean, but the mean itself shows a secular movement– either upward or downward, as is the case in India in the recent period, averaging of the benchmark rate poses a challenge. Under such circumstances, floating rate yields with shorter reset period would ensure alignment of administered rate to market rates. However, as most of the instruments offer fixed rates of interest, frequent changes in the administered rate may cause confusion among the small savers and may be administratively inconvenient as well. Besides such adjustments may lead to considerable volatility in the cash flow of savers as also the interest liability of the Government, which is not desirable from the perspective of financial planning of savers and cash management from the viewpoint of the Government.

42. The approach of the Committee, therefore, was to find the practical trade-off between the preferences for stability for the saver on the one hand and the need to keep the interest rates aligned to the market rates of interest

on the other. The Committee believed that as the market gains in depth and width and investors do not display a herd mentality, the volatility is likely to decline. An important factor that has contributed to high volatility of nominal rates is the rapid decline in inflation in the recent years – a scenario that is likely to moderate once the inflation expectations stabilised.

43. Considering all these factors and looking at the implementation of the Reddy Committee recommendations on benchmarking, the Committee preferred to use some stable benchmark by taking an average of yields as suggested by the Reddy Committee, but for a period that is longer than one year. After exploring the alternative formulae and calibrating the resultant yields with actual rates offered by the Government, **the Committee considered that two-year weighted average of government securities yields of the corresponding maturity on a calendar year basis, with 0.67 weight to the more recent year and 0.33 weight to the year before, would be taken as the benchmark**, with a final rounding off to the **nearest** quarter percentage point. Such a formula would reflect a balance between stability of the benchmark and the current market conditions. The Committee recommends that the benchmark so obtained may be applicable on an annual basis effective April 1 of the following year for administrative convenience.

III.3 Criteria for Fixing Spread

44. The Committee deliberated on two types of spread over the benchmark: (i) tenor spread and (ii) liquidity spread. Theoretically, the tenor spread, i.e. the spread of a longer maturity marketable instrument over a shorter maturity marketable instrument reflects the inflation and growth expectations. It also results from segmented markets, where preferred habitat' tendencies are exhibited by various categories of investors'. Further, market and liquidity risks also impact on yield spreads of bonds. In this respect, the Committee observed that since the mid-1990s, not only have the secondary market yields declined but also the yield curve has become increasingly flat as the yields on longer maturities have declined faster indicating increased liquidity, the requirements of insurance companies and pension funds to hold and carry long maturity papers, and decline in inflationary expectations. Under

these circumstances, if the tenor spread is kept fixed for administered rates, this would result in misalignment of small savings instruments of various maturities vis-à-vis the GoI dated securities, particularly for longer term instruments and may even lead to a distortion in the term structure of interest rates on dated Government securities. Therefore, the Committee does not find a rationale for any divergence of tenor spread between small savings instrument of similar maturities to that of GoI dated securities and indicated its preference to continue with the recommendation of the Reddy Committee to use government securities yields of corresponding maturities for benchmarking of administered interest rates.

45. Liquidity spread in the context of government securities market is measured by the yield differential between off-the-run and on-the-run government securities. In India, there are benchmark securities, which are so called because of their high liquidity *vis-à-vis* other securities. The relatively illiquid securities trade at a discount in relation to the benchmark securities implying higher yield for such securities. The yield differential for such illiquid government securities of similar maturity can be as high as 15-20 basis points. Small savings instruments are illiquid as most instruments cannot be encashed initially without paying a sizeable penalty, e.g., foregoing half of the interest receivable for premature withdrawal in case of GoI Savings Bond 2003. The saver, sometimes, may have to forsake a fraction (5 per cent) of their principal in instruments such as monthly income schemes; the rate of return may also be lower if encashed earlier. The Reddy Committee recommended that small savers might be compensated in lieu of lower liquidity to these instruments with an additional payment of a liquidity premium up to 50 basis points depending on the nature and maturity of the instruments.

46. While dealing with the issue, the Committee also considered the features of certain types of bonds like EE savings bonds of USA, where interest rate is offered at a discount to the benchmark yields. However, such bonds have guaranteed appreciation to a specified value after a long period of say, 20 years as the liquidity risk declines as the period for which the saver stays invested increases. On such bonds, the saver does not have to pay a penalty if he invests for more than 5 years. And if investors stay committed for

20 years, he gets the guaranteed rate of return irrespective of the market conditions (Annex 9).

47. Although these types of bonds would reduce the cost of borrowings to the government and would be more suitable for institutional investors, the Committee felt that in view of the liquidity attributes of instruments and investors profile, **a fixed illiquidity premium of 50 basis points over the average benchmark yields for corresponding maturities on similar lines as suggested by the Reddy Committee may be appropriate for small savings instruments.**

III.4 Case for considering a cap on Interest Rate Movements

48. In addition to the issues relating to the benchmarking of small saving rates, the Committee observed developments since 2001, which had given rise to concerns beyond the alignment of administered interest rates with market rates. While increasing attention was given to explore alternative means of reducing the interest rate rigidities in India, sharp reductions in interest rates since 2001 following strong capital inflows raised concern to protect real interest income of retirees and pensioners, particularly in view of inadequate coverage of social safety net in India. For instance, the average money market rates declined by nearly 350 basis points, long-term yield in government securities and deposit rates offered by banks declined by over 500 and 425 basis points, respectively, over last three years culminating in the real bank deposit rate turning close to zero and at times negative, notwithstanding a sharp fall in headline inflation rates. In view of such a steep and unprecedented declines in the interest rates in India, savers expressed their persistent dissatisfaction. Therefore, the issue that the Committee needed to address in this regard is as to whether nominal interest rates displayed too much of a flexibility in India in recent years – a phenomenon that largely address the perspective of savers.

49. In fact, the Finance Minister on January 9, 2004 announced his intention to introduce “Dada–Dadi” bonds, initially proposed to be launched with effect from April 1, 2004, to enable senior citizens (60 years and above) to earn a reasonable and secure income from their life-time savings. The

scheme is intended to improve the welfare of senior citizens by allowing them to live a life of dignity by offering an interest rate that is slightly higher than the market rate. The Committee propose a detail structure of the Scheme as part of its overall approach of rationalising small savings.

50. In the prevailing scenario, therefore, the approach followed by the Committee with regard to the provision of benchmarking and social security has to be somewhat different from what was foreseen by the Reddy Committee in 2001. The Reddy Committee considered benchmarking of interest rates as an interim solution, while the medium term vision envisaged by the Committee was to convert PPF as a fully funded pension scheme over a period of time to be independently managed by professional trustees with returns linked to the underlying asset of the Funds. While agreeing with the broad approach of the Reddy Committee, the present Committee recognised the fact that the rationalisation of instruments and benchmarking of interest rates on various schemes need to address explicitly the immediate concerns of savers.

51. While the Committee propose changes in the administered interest rates once a year, it was considered necessary to limit the inter-year movement of interest rate fluctuations within tolerable levels. In fact, these concerns supersede the need for aligning the administered interest rates to market rates in view of the observed movements of interest rates during the last three years in India. On a detailed consideration, keeping in view the recent interest rate scenario, **the Committee considered that an interest rate movement of a maximum of 100 basis points on either side to be the optimal tolerable band for small saving instruments.** According to this formula, the administered interest rates would be determined according to the above benchmarking (and spread) rule so long as the intra-year variation for resetting of interest rates using this rule are within the 100 basis points limit on either side. Once the rates arrived through the rule had breached the limit - below or above - for certain schemes, the rate on interest on the same should only be reduced/increased as the case may be, to a maximum of 100 basis points. For example, 5-year postal term deposit rate was set at 7.5 per cent per annum during 2003-04. On reassessment of fixation of interest rate for

2004-05 based on the benchmark and spread rule proposed by the Committee, say the interest rate for the instrument was set at 5.5 per cent per annum. Since the implied change is 200 basis points, i.e., higher than 100 basis points, the reduction on interest rate should be 100 basis points given the optimal band proposed by the Committee. Accordingly, 5-year postal deposit rate for 2004-05 should be fixed at 6.5 per cent per annum rather than 5.5 per cent. The Committee felt that such a cap on interest rate movement would make the implementation of administered interest rate feasible as it addresses the concern of depositors. Furthermore, as the financial market gains in depth and width and as the inflation rate gets stabilised, the volatility of government yields would be low so that the above cap as envisaged, would not be acting as a binding constraint. The computational aspects of the benchmark are shown in the Annex 10. A comparison of prevailing interest rates and the rates recommended on various small saving instruments for 2004-05 are set out in Annex 11.

52. Keeping in view the current trend in yields in government securities, the Committee considers the 100 basis points band on either side as optimal which could accommodate variations upto 200 basis points in benchmark interest rates. In case annual variations in benchmark are over 200 basis points, the Government may consider setting up a Committee to review the 100 basis points band proposed by this Committee.

IV. Rationalisation of Schemes

53. A number of savings instruments have been offered by the Government to fulfil investment needs of small investors. These instruments can be distinguished in terms of their tenor, returns and tax incentives, which are preferred by different classes of investors with varying needs to preserve their financial wealth. The multiplicity of overlapping instruments, high cost of borrowing and problems of tax administration make it imperative to rationalize the structure of these schemes so as to serve as an efficient means of raising resources for development while providing reasonable social security.

IV.1 International Experience on Saving Schemes

54. Internationally, in a number of countries, governments have floated different saving instruments for retail investors in order to mobilise household savings and channelised the same to finance public spending. The Indian experience has been somewhat similar. These instruments abroad are usually issued in the form of savings bonds and other non-marketable securities. While the interest rates are broadly aligned to market conditions, there are instances where the returns on such instruments are lower than yields in government securities. Some countries offer tax concessions on these products, while others offer tax breaks in case the instrument is used as a retirement plan. Owing to the attractive nature of the schemes, some countries fix limits on the amounts that can be invested in these instruments. The loss of tax revenue is generally set off against reduced State spending on social security (Annex 12).

55. Besides the issuance of these non-marketable debt instruments to the retail investors, a number of countries also mobilise savings through their postal network. According to the survey conducted by the United Nations Department of Economic and Social Affairs in 1999, about 49 countries around the world had postal savings facilities. Many of the developed countries where postal savings systems were widely in use have however, stopped offering such savings schemes on account of high cost involved in operating such shemes. In contrast, the postal schemes remain popular in Asian countries, e.g., China and Japan. Among the European countries, Italy

has a large postal savings system, which issues Postal Notes that are popular among investors.

IV.2 Rationalisation of Existing Small Savings Schemes

56. The effective cost of small savings schemes *vis-à-vis* the cost of market borrowing makes it a difficult proposition to justify their continuance in their present form. As observed by the Reddy Committee, the effective returns inclusive of tax exemptions (rebates/deductions) under various provisions of the Income Tax Act not only distort the term structure of interest rates but also impede the efficacy of the monetary transmission mechanism. For example, despite considerable alignment of interest rates, the growth in small savings collection remained significantly higher than that of growth in bank deposits during the recent years. This would partly be attributed to the preferential tax treatment on small savings schemes vis-à-vis the bank deposits. Accordingly, issues relating to taxation assume significance from the point of view of rationalisation of small saving schemes.

57. The effective returns on various small savings schemes were calculated using the internal rate of return on accruable net cash flows streams for various schemes, adjusted for different tax brackets of 0, 10, 20 and 30 per cent. It was observed that the effective yields on certain schemes at present are as high as 14.6-16.0 per cent. The nominal yields on these instruments were higher by 650-800 basis points at the highest income tax bracket. Further, while the effective yield differential for post office time deposit (5 year) for alternate income tax bracket is 7.71-10.03 per cent, the same for NSC VIII issue for almost similar maturity stands at 8.16-14.60 per cent. Thus, the system is rendered regressive in terms of the wide divergence in returns as between taxpayers and non-tax payers as well as among taxpayers in different income brackets (Annex 13).

58. The Committee, however, observed that the tax adjusted returns offered by instruments vary widely essentially on account of incentives available under Sections 88 and 10 applicable on schemes like PPF, DSRE and NSC VIII, while it views the incentives available under section 80(L) less distortionary as it is available within a limit and covers a broad spectrum of

instruments. Accordingly, the Committee observed that for most of the schemes, except NSC VIII, PPF, DSRE and 6.5 per cent GoI Savings (Tax-free) Bond 2003, the issue is more of an alignment of interest rates. The Committee, therefore, deliberated on the feasibility of those schemes, where investments are primarily motivated to obtain the benefits under section 88 and section 10 of the Income Tax Act. However, as the Public Provident Fund (PPF) is a longer-term savings scheme providing old age income security, among others, to the unorganised sector workers, the Committee considered it desirable to continue the scheme in its present form for some time. It may be indicated that the Reddy Committee had also considered this special status of PPF to suggest tax exemption on the same at the accrual stage.

59. The Committee considered continuation of most of the post office deposits in their present form like savings bank account, monthly income scheme, post office recurring deposit and time deposit (1-5 years), as these are popular in rural and semi-urban areas due to convenience, habitual preference, ease of transactions as well as more intensive penetration of post office as compared to the branch network of commercial banks. For example, as on end-March 2001, almost 1, 37,950 post offices, which consist of 90 per cent of the total post offices in India is located in rural areas, as compared with only 32,565 rural branches of commercial banks, which is less than 50 per cent of the overall branch network in India. Therefore, customers are likely to gain in terms of quality of service due to competition among banks and post-offices. Apart from that, the Committee also considered the continuance of the schemes keeping in view the common perception of the customers, who consider post office schemes as the safest avenues for small savings. So long as the tax treatment on these deposits is similar to comparative instruments in the financial market like bank deposits, the Committee recommends the continuance of these schemes in their present form with re-alignment of interest rates.

60. The Committee examined the scope for rationalising various certificates like Kisan Vikas Patra (KVP), National Savings Certificate (VII issue) within the ambit of the Government Savings Certificates Act, 1959. The rules pertaining to these certificates are framed and notified by the Central

Government under Section 2(c) of the aforementioned Act. Although KVP offers higher rate of return, it does not enjoy any tax incentives under section 88 of Income Tax Act unlike NSC VIII. However, tax is not deducted at source in case of investments made in KVP. This led to potential difficulties in tax management. The Committee felt that both these instruments are quite expensive in terms of effective cost to the Government. **The Committee, therefore, recommends the discontinuance of both NSC VIII and KVP to ensure an equitable and harmonious tax treatment across the full spectrum of medium term savings schemes.** With the discontinuance of these two, the rest of the schemes would broadly be brought on par under a single umbrella of tax treatment viz., under Section 80L. As both NSC III and KVP are medium term instruments, investors can avail the alternative choice of investing in the post office deposit schemes, which would be available as before.

61. In keeping with the approach taken for the rationalisation of the small savings schemes, the Committee recommends discontinuance of 6.5 per cent (tax free) GoI savings bond. The 8.0 per cent (taxable) bond may, however, be continued after alignment of interest rate with market rates as proposed by the Committee earlier. The continuation of the taxable 8.5 per cent GoI bond would continue to provide a vehicle of investment for charitable institutions and trusts. As the taxable bond was introduced in 2003, it may therefore be advisable to continue this scheme for some more time, i.e., until other risk free investment avenues are available to the aforementioned entities. The Committee, in the larger interest of efficient tax administration, also recommends that it would be appropriate to eventually move towards a system that would ensure tax compliance for the taxable GoI savings bond.

62. The Committee took a special view with regard to the deposit scheme for retiring government and public sector employees (DSRE) in view of the proposed introduction of “Dada-Dadi” Bonds. The DSRE scheme enjoys special tax benefits in the form of Section 10(15)(iv)(i) that exempts both the deposit amount (no wealth tax) and interest earned thereon from taxation. The mobilisation under the scheme is low as compared with other small saving schemes due to the pre-defined scope of participation. Keeping in view that

most government employees also avail of defined pension benefits and recognising the need to ensure parity among investors, **the DSRE scheme may be discontinued.** The “Dada-Dadi” scheme, which would be universally available to all classes of retired employees/senior citizens as such provides a similar alternative avenue for the investors covered under the DSRE. The Committee, however, proposes that while the DSRE scheme is discontinued in favour of Dada-Dadi scheme, it would be necessary to provide avenues of investment for those employees who retire before the age of 60 (specified as the eligible age limit for Dada-Dadi scheme). The Committee therefore recommends that government and public sector employees who retire after attaining the age of 50 years may be permitted to invest in Dada-Dadi scheme subject to proper certification from their respective employers to that effect.

V. Proposed Structure of Dada-Dadi Savings Scheme

63. Following the announcement made by the Union Finance Minister, the Reserve Bank of India (RBI) had set up an Internal Technical Group in the Monetary Policy Department to initiate the preparatory work on the formulation of a small saving instrument for senior citizens. The Group considered the feasibility of various approaches for formulating the Dada-Dadi savings scheme keeping in view the overall interest rate structure in the financial market as well as the recommendations of the Reddy Committee and the Informal Group on Interest Rates (2003). The recommendations of the Group were presented to the members of the Advisory Committee and the proposed structure of the scheme was modified based on the observations made by the members.

64. The Group had reviewed other related schemes to identify any improvements to be made in the proposed Dada-Dadi Saving Scheme, particularly keeping in view, its defined investors profile. Accordingly, it was observed that although savings schemes such as PPF, NSCs, LIC Varishtha Beema Yojana etc., offer an assured higher rates of interest, these schemes were not suitable to senior citizens as a source of regular income and in providing the requisite degree of liquidity as may be needed in the event of exigency.

65. A review of the social security across the world reveals that an adequate and regular income is fundamental to the enhancement of the capacity to older people to lead a positive and productive life during their retirement years. Therefore, many governments across the world have devised certain schemes directed exclusively for ensuring regular income to the people in their old age. The features of these schemes vary from country to country. In OECD countries, the main source of income for the senior citizens is the pension income devised on three-pillar approach popularised by the World Bank (1999).

66. In developing countries, including India, it was observed that apart from the traditional family support, old people mostly depend on the income from accumulated past savings as pension systems are limited to a small group of

population, mostly employed in the organized and government sectors. Under these circumstances, it is necessary that the social security policies of the Government facilitating regular income to retired citizens should focus on providing higher returns on the accumulated past savings. The Committee believed that existence of such a scheme would considerably mitigate the fiscal burden involved in extending defined benefit type pension policies to all citizens. Some countries have already put in place schemes which offer enhanced regular return to the senior citizens on their past accumulated savings, to supplement their income. For example, schemes like the Pensioners Guaranteed Income Bonds and Pensioners Benefit Account scheme for the retired government/armed forces employees/personnel in United Kingdom, Behbood Saving Scheme for the widows in Pakistan, Gaurawa Scheme in Sri Lanka, etc. are examples of such schemes adopted in some countries

67. On a review of the existing small savings instruments and in the light of international experience on schemes for welfare of senior citizens, the Committee recommends the following structure for the Dada-Dadi Savings Scheme (Annex 14).

V.1 Tenor of Dada-Dadi Savings Scheme

68. On a review, the Committee felt that it may not be appropriate to keep the tenor of the Scheme too long taking into consideration that the target group consist of senior citizens. Besides, a shorter maturity would reduce the need for premature withdrawals in case of exigencies faced by old age persons. It will also minimise inflation risk and reduce uncertainties on cash flow. It is, therefore, proposed to keep the tenor of Dada Dadi Savings Scheme at three years.

V.2 Interest Rate

69. While deciding the principles behind setting up the interest rate on this instrument, the Committee considered the need to keep interest rate at a slightly higher level as proposed by the Finance Minister keeping in view the overall objective of placing the interest rate within the framework of benchmarking other administered interest rates. In terms of Finance Minister's

announcement made on January 9, 2004, the Dada-Dadi scheme are being issued especially for the purpose of improving the welfare of senior citizens by allowing them to live a life of dignity by enabling them to earn a reasonable and secure income from their life's savings. Accordingly, **the Committee recommends that the interest rate on Dada-Dadi scheme could be kept at 100 bps higher than the average benchmark, or 50 bps higher than the comparable rate arrived by using the benchmark and spread rule specified by the Committee for administered interest rate on other small savings instruments, depending upon the tenor of the instruments. Besides, to add more emphasis on the objective of the scheme, the Committee also recommends that the average benchmark rate for the Dada-Dadi bonds shall be based on government security with a five-year tenor instead of three years.** The Committee felt that for each year, a new series of Dada-Dadi scheme may be issued with interest rates being determined through the above benchmarking and spread rule. New series of bonds numbered according to the year of reference would be issued each year and bonds issued in the previous years shall stand withdrawn. Accordingly, the interest rate for the scheme shall be reset at the beginning of each calendar year and would be applicable only to the new series of bonds introduced during that year. Such an exercise undertaken at the beginning of the calendar year would help in the announcement of new rate in the Union Budget before its issue by the beginning of April each year.

V.3 Tax Treatment

70. The Committee proposes that the Dada-Dadi scheme should be taxable in terms of Section 80L of Income Tax Act. This would be more equitable as the senior citizens at lower income brackets would be able to obtain higher effective rates of return than their counterparts in higher income brackets. Further, the provision should be there to allow for the tax deduction at source (TDS) to prevent possible misuse of the instrument. The Committee recommends that the Data-Dadi Savings Scheme may be designated as a small saving instrument with the proceeds entirely transferable to State Government through NSSF.

V.4 Other Operational Provisions

71. The Committee discussed other operational features of the Dada Dadi Savings Scheme and considered issues such as pre-mature withdrawal and sanction of loans/advances against the collateral security of Dada Dadi Savings Scheme, frequency of interest payments, form of issue, ceiling on investment etc. It was suggested that the scheme should be made as simple as possible. The recommendations of the Committee in regard to these operational issues are as follows:

- Premature withdrawals may be permitted after a one-year lock-in period. Premature withdrawals shall be in multiples of one thousand rupees and part withdrawals of the principal amount would be permitted subject to one withdrawal per calendar year.
- In view of the pre-mature encashment facility, the scheme may not be considered eligible as collateral security for obtaining loans/advances from banks/financial institutions.
- As Dada Dadi scheme are meant to provide regular income to senior citizens, interest income should be payable on a monthly basis.
- Dada Dadi scheme should be issued without exception on a non-cumulative basis to reiterate its utility as a source of monthly income after retirement.
- An easy re-investment option may be offered to senior citizens opting to invest in Dada-Dadi scheme.
- In order to make the scheme convenient and operationally simple, Dada Dadi scheme may be issued both by post offices and commercial banks and not by the Reserve Bank. Dada-Dadi bonds may be issued both in scrip form and as Bond Ledger Accounts (BLA) to be maintained by designated banks or Stock Holding Corporation of India Ltd. (SHCIL). In case the bonds are maintained in the BLA form, the concerned agency should provide a paper receipt to the beneficiary for his personal record.

- The Committee prescribe a ceiling of Rs 20 lakh on the investment made by an individual.
- Dada–Dadi scheme may be subscribed jointly, provided the first holder is eligible to invest in the bonds as per the age criteria for senior citizens of 60 years or above. If the first holder dies before expiry of three years, and the joint holder is below the minimum age eligibility of 60 years, the scheme shall cease to operate and the bonds shall be discharged and paid to the joint holder.
- The Investor may subscribe to the Scheme either in his name or jointly with his/her spouse. If the investor dies within a period of three years, the bonds shall be discharged and the amount shall be paid to the nominee. If the bonds are held jointly with his/her spouse or the spouse of the investor is sole nominee, the spouse will be permitted to continue to hold the bonds in his/her name on the same terms and conditions and provided he/she is eligible in terms of the age limit specified for the scheme. In order to reduce the difficulties faced by eligible kith and kin in obtaining their claims, investor may be given options to nominate suitably in the event co-decease of the holders.
- Most small savings schemes at present do not have the re-investment facility. As the tenor of Dada-Dadi scheme is relatively short at three years, a re-investment option may be made available to senor citizens investing in Dada-Dadi scheme so as to obviate the difficulties faced by frequent repayment and re-investment.
- The first holder of the scheme alone shall be liable for taxation if covered under Section 80L.
- To keep the scheme simple and hassle free, the banks issuing Dada Dadi scheme should have their own verification systems for ascertaining the age of the beneficiary placed at 60 years or above. However, as the deposit scheme for retired employees of Government and public sector is recommended for discontinuance, the Committee recommends that superannuated or otherwise retired employees below

the minimum eligible age limit may be permitted to invest in Dada-Dadi bonds subject to appropriate certification from their employers.

- An agency commission of 0.5 per cent as in case of other schemes shall be offered to agents to incentivise wider reach of the bond among senior citizens.

VI. Recommendations

72. The recommendations of the Committee are prescribed below under three broad heads, viz., (a) Benchmarking and Spread rules, (b) Rationalisation of Existing Savings Schemes and (c) Structure of the Proposed Dada-Dadi Savings Scheme announced by the Finance Minister.

VI.1 Benchmarking and Spread Rules

- The Committee recommends continuance of the G-sec yield as suitable benchmark, as suggested by the Reddy Committee.
- The Committee preferred stability to the benchmark by taking an average of yields as suggested by the Reddy Committee, but for a period longer than one year. After exploring the alternative formulae and calibrating the resultant yields with actual rates offered by the Government, the Committee recommends the use of weighted average of G-sec yields for the previous two years, with 0.67 weight to more recent year and 0.33 weight to the previous year as the benchmark. The benchmark so computed can be rounded off to the nearest quarter percentage point for convenience. This method of arriving at the benchmark is expected to reflect a balance between stability of the benchmark and the current market conditions.
- The interest rate reset period is, however, kept as an annual for administrative convenience. Resetting of interest rates can be undertaken at the beginning of each financial year on the basis of weighted average yields in the previous two calendar years. For transparency of the calculation, it is proposed that the Reserve Bank would publish the secondary market yields figure periodically in RBI Bulletin.
- The Committee does not find rationale for any divergence of tenor spread between small savings instrument of similar maturities to that of GoI dated securities and preferred to continue with the recommendation of the Reddy Committee to use G-sec yields of corresponding maturity for benchmarking administered interest rates.
- The Committee felt that in view of the relative illiquidity of small savings instruments and investors profile, a fixed liquidity spread of 50 basis points over the average benchmark yields may continue as suggested by the Reddy Committee.
- The Committee considered it necessary to limit the inter-year movement of interest rate fluctuations to a tolerable extent, which will supersede the need for aligning the administered interest rate to market rates keeping in view the movements in interest rates observed during the last three years in India. The Committee recommends placing such a cap on interest rate movement to 100 basis points on either side. According to this rule, the administered interest rates would be determined as per the above benchmarking (and spread) rule so

long as the year-on-year fluctuations using this rule are within the 100 bps limit on either side. Once the rate arrived through the rule had breached the limit- below or above- for certain schemes, the rate of interest on the same would be moderated or increased by 100 bps. The Committee felt that such a cap on interest rate movement would make the implementation of administered interest rate more feasible. Furthermore, as the financial market gains in depth and width and the inflation rate stabilised, the volatility of G-sec yields would decline and in that case, the above cap would not be acting as a binding constraint.

- The benchmark computed on the basis of the methodology proposed by the Committee shall be kept under review, especially for the purpose of revisions in the event of inordinately higher variations. The Committee accordingly recommends that the Government may consider appointing a suitable committee for the revision of the benchmark in case the movement in the benchmark exceeds more than 200 basis points.

VI.2 Rationalisation of Existing Savings Schemes

- The Committee, observed that the tax adjusted returns offered by instruments vary widely essentially on account of incentives available under Section 88 and 10 applicable on schemes like PPF, DSRE and NSC (VIII), while it viewed the incentives available under section 80(L) less distortionary as it is available within a limit and covers over a broad spectrum of instruments. Therefore, the Committee considered the removal of those schemes, where investments are primarily motivated to obtain advantages available under section 88 and section 10 of the Income Tax Act. However, as the Public Provident Fund (PPF) is a longer-term savings scheme providing old age income security, among others, to the unorganised sector workers, the Committee considered it desirable to continue the PPF scheme in its present form for some time (Annex 15).
- The Committee considered continuance of most of the deposit schemes offered by the post offices in its present form like savings bank account, monthly income scheme, post office recurring deposit and time deposit (1-5 years), as they are popular in rural and semi-urban areas due to convenience, habitual preference, ease of transactions as well as more intensive penetration of post offices as compared to the branch network of commercial bank deposits. Further, the customers are likely to gain in terms of quality of service due to competition among banks and post-offices. Apart from that, the Committee also considered continuance of the schemes taking into account the common perception of the customers, who consider post office schemes safer as compared to bank deposits. So long as the tax treatment on these deposits are similar to other instruments in the financial market like bank deposits, the Committee considers it

desirable to continue these schemes in their present form with re-alignment of interest rates.

- Kisan Vikas Patra(KVP) does not enjoy any tax incentives unlike NSC(VIII) which enjoys incentives under Section 88 and Section 80L. However, tax is not deducted at source in case of investments made in KVP leading to problems of tax compliance. Since both NSC VII and KVP are expensive in terms of their effective cost to the Government, the Committee recommends their discontinuance. As both these instruments are medium term instruments, the investors demand can be accommodated either by term deposits of banks or post offices with with different tenor.
- In keeping with the approach taken for rationalising the small savings schemes, the Committee is in favour of discontinuing the 6.5 per cent (tax free) GoI savings bond. The 8.0 per cent (taxable) bond may, however, be continued with appropriate safeguards on compliance of income tax. The interest rate, however, would be benchmarked as applicable to small saving instrument of similar tenor. The Committee, at the same time, recommends exploring means to make tax compliance effective in case of the taxable bonds.
- The Committee had taken a special view in regard to the deposit scheme for retiring employees in view of the proposed introduction of Dada-Dadi Bonds. As most Government employees also avail of defined pension benefits, the present dispensation may be discontinued in the interest of parity amongst investors. The Committee, therefore, recommends that this scheme may be discontinued with the introduction of the Dada-Dadi Scheme, which would be universally available to all classes of retired employees/senior citizens.
- In the context of the proposed Dada-Dadi Scheme, the Committee observed that in developing countries, including India, apart from the traditional family support, the old people mostly depend on the income from accumulated past savings as pension systems are limited to a small group of population, mostly employed in the organized and government sectors. Under the circumstances, it is necessary that the Government may have to consider schemes that would provide regular income to retired citizens. The Committee considered that the existence of such a scheme would considerably mitigate the fiscal burden involved in extending defined benefit type pension policies to all citizens. Some countries have already put in place schemes which offer enhanced regular return to the senior citizens on their past accumulated savings, to supplement their income.

VI.3 Structure of the Proposed Dada-Dadi Bond Scheme

- On a review, the Committee felt that it may not be appropriate to keep the tenor of the Scheme too long taking into consideration that the target group consist of senior citizens. Besides, a shorter maturity would reduce the need for premature withdrawals in case of exigencies faced by old age persons. It will also minimise inflation risk and reduce uncertainties on cash flow. It is, therefore, proposed to keep the tenor of Dada Dadi Scheme shorter at three years.
- In terms of Finance Minister's announcement made on January 9, 2004, the Dada-Dadi Scheme would be issued especially for the purpose of improving the welfare of senior citizens by allowing them to live a life of dignity by enabling them to earn a reasonable and secure income from their lifetime savings. Accordingly, as the Scheme would offer a rate of interest slightly higher than the prevailing market rate, the Committee considered the need to keep spread at a slightly higher level within the framework of benchmarking other administered interest rates. Accordingly, the Committee recommends that the interest rate on Dada-Dadi bonds could be kept at 100 bps higher than the average benchmark, or 50 bps higher than the comparable rate arrived by using the benchmark and spread rule specified by the Committee for administered interest rate on other small savings instruments. Besides, the Committee also recommends that the average benchmark rate for the Dada-Dadi bonds should be based on yield on Government security of a five-year tenor instead of three year.
- The Committee felt that for each year, a new series of Dada-Dadi Bonds may be issued with interest rates being determined through the above benchmarking and spread rule. New series of bonds numbered according to the year of reference would be issued each year and bonds issued in the previous years shall stand withdrawn. Accordingly, the interest rate for the scheme be set at the beginning of each calendar year and would be applicable only to the new series of bonds introduced during that year. Such an exercise undertaken at the beginning of the calendar year would help in the announcement of new rate in the Union Budget before its issue by the beginning of April each year.
- The Committee proposes that the Dada-Dadi bonds should be taxable in terms of section 80L of Income Tax Act. Otherwise, the senior citizens at the lower income brackets would be able to obtain lower return than their counterparts in higher income brackets. Further, the provision should be there to allow for the tax compliance to prevent possible misuse of the instrument. In order to bypass the G-sec status of the bonds on which TDS cannot be applicable as per section 194 of Income Tax Act, the Committee recommends that rather than the Government issuing the bond, it may be designating as small savings

instruments with the proceeds entirely transferable to State Government through NSSF.

- The recommendations of the Committee with regard to these operational issues for Dada-Dadi scheme are as follows.

  - Premature withdrawals shall be in multiples of one thousand rupees and part withdrawals of the principal amount would be permitted subject to one withdrawal per calendar year.
  - The conditions for pre-mature withdrawal will be as follows, (i) one year lock-in period and (ii) penal rate of interest as on one year deposit payable by the State Bank of India at the time of premature withdrawal. The penal rate of interest on the amount withdrawn shall be payable over the period of investment viz., from the date of initial investment up to the date of withdrawal. The interest already paid on this amount at higher rate will be adjusted.
  - In view of the pre-mature encashment facility, the scheme may not be considered eligible as collateral security for obtaining loans/advances from banks/financial institutions.
  - As Dada Dadi Bonds are meant to provide regular income to senior citizens, interest income should be payable on a monthly basis.
  - Dada Dadi Bonds should be issued without exception on a non-cumulative basis to reiterate its utility as a source of monthly income after retirement.
  - Dada Dadi scheme may be offered both by post offices and banks and not by RBI. Dada-Dadi bonds may be issued both in scrip form and as Bond Ledger Accounts (BLA) maintained by designated banks or SHCIL. In case the bonds are maintained in the BLA form, the concerned agency should provide a paper receipt to the beneficiary for his personal record.
  - An easy re-investment option may be offered to senior citizens opting to invest in Dada-Dadi scheme
  - Dada–Dadi scheme may be subscribed jointly provided the first holder is eligible to invest in the bonds as per the age criteria for senior citizens of 60 years or above. If the first holder dies before expiry of three years, and the joint holder is below the minimum age eligibility of 60 years, the scheme shall cease to operate and the bonds shall be discharged and paid to the joint holder.
  - Investor may subscribe the scheme either in his name or jointly with his/her spouse. If the investor dies within a period of three years, the bonds shall be discharged and amount paid to the nominee. If the scheme is subscribed jointly with his/her spouse or the spouse of the investor is sole nominee, the spouse will be permitted to continue in the scheme in his/her name on the

same terms and conditions and provided he/she is eligible in terms of the age limit specified for the scheme. In order to reduce the difficulties faced by eligible kith and kin in obtaining the claims due to them, investor may be given option to nominate suitably in the event co-decease of the holders.

- The Committee felt that it would be desirable to place an individual ceiling of Rs 20 lakh on investment made in the scheme.
- The first holder of the scheme alone shall be liable for taxation if covered under Section 80L.
- An agency commission of 0.5 per cent as in case of other schemes shall be offered to agents to incentivise wider reach of the bond among senior citizens.
- In order for keeping the scheme simple and hassle free, the banks issuing Dada Dadi scheme should have their own verification systems for ascertaining the age of the beneficiary placed at 60 years or above.
- As the deposit scheme for retired employees in the government and public sector is recommended for discontinuance, the Committee recommends that such superannuated or otherwise retired employees below the minimum eligible age limit may be permitted to invest in Dada-Dadi scheme subject to appropriate certification from their employers.
- The whole of the amount of investment made under this scheme is exempt from wealth-tax.
- An agency commission of 0.5 per cent as in case of other schemes shall be offered to agents to encourage wider reach of the scheme among the targeted beneficiaries.