Chapter III

Policy Environment

The policy framework for the financial sector during 2009-10 was guided by an array of global initiatives aimed at strengthening prudential controls to avoid the odds of future crises. Prescription of enhanced capital charges and liquidity requirements, improved regulatory and supervisory practices and the resolution of systemically important financial institutions including cross border cooperation across national jurisdictions have received concerted focus from G-20 and other standard setting bodies. During the year 2009-10, the policy environment in India was marked by the efforts directed at improving transparency and efficiency of the financial system, financial inclusion and stability. Further, following the recovery in economy, the Reserve Bank undertook measures towards normalization of monetary policy to address inflationary concerns while continuing to encourage economic recovery, financial stability and inclusion. The financial markets, in general, exhibited intermittent corrections during the year but remained stable nonetheless. The Government of India and the Reserve Bank undertook measures to ease the flow of credit particularly for small and marginal farmers and micro and small enterprises to increase self employment. Initiatives for improving financial literacy and inclusion in seven focus states formed an important part of the policy agenda. The supervisory practices in respect of concerns related to banking frauds, overseas operations, financial conglomerates, electronic banking and technology risk were also addressed. At the same time, focussed attention was placed on improving customer service and the efficiency of payments and settlement system. Among important legal measures, the Securities and Insurance Laws (Amendment and Validation) Bill was passed by the Parliament to provide a joint mechanism to resolve inter-regulatory differences in opinion.

1. Introduction

3.1 During 2009-10 as against 2008-09, the policy focus of the Reserve Bank shifted from crisis management to recovery management. By the beginning of 2009-10, it was apparent that the risk of contagion to the Indian financial system was minimal, even though sustained weakness in the real economy put some stress on the financial system. To enable a faster recovery, the growth supportive fiscal and the monetary policy stances continued during first half of the year. Financial market activities recovered ahead of GDP, and with the return of capital inflows, the Rupee also appreciated. With the signs of revival of growth process in the second half of 2009-10, the Reserve Bank initiated a process of calibrated exit from the accommodative monetary policy and *ad hoc* measures from October 2009 onwards.

3.2 Against this background, this chapter provides important policy measures undertaken by the Reserve Bank during 2009-10 (March-April) and 2010-11 so far. The monetary policy measures during the period are presented briefly in Section 2, followed by a review of the initiatives taken in the area of credit delivery in Section 3. Section 4 details the various measures initiated to promote financial inclusion. Measures taken in the areas of prudential regulation and supervision are discussed in Sections 5 and 6. The initiatives pertaining to Regional Rural Banks (RRBs) are set out in Section 7. Policy initiatives with regard to cooperative banks - Urban Cooperative Banks (UCBs) and rural credit cooperatives are highlighted in Section 8. Measures relating to non-banking financial institutions are presented in Section 9. The developments in the area of financial markets are covered in Section 10. The developments in the area of customer service by banks are covered in Section 11. Similarly, measures relating to the payment and settlement systems and technological developments are outlined in Section 12 and Section 13, respectively. Section 14 outlines legal developments and Section 15 summarises the broad conclusions drawn from the chapter.

2. Monetary Policy[1]

3.3 The liquidity constraint that emerged in September 2008 in the wake of global financial crisis paved the way for an accommodative monetary policy stance by the Reserve Bank, which continued during first half of 2009-10. The earlier pre-emptive measures comprised a series of downward revisions in policy rates covering repo rate, reverse repo rate, CRR, SLR as well as specific refinancing windows for accommodating the distressed sectors of the economy. Although, the monetary policy stance during 2009-10 was conditioned by the changing dynamics of growth-inflation outlook and the uncertainty about both domestic and global economic recovery.

3.4 The calibrated exit from monetary expansion started in October 2009 which continued in subsequent quarterly policy reviews during 2010-11. The Reserve Bank had to strike a judicious balance amongst its various objectives of monetary policy such as growth, inflation and fininacial stability. On balancing the policy priorities during the exit phases, it had become important to raise the policy rates to the neutral levels in a calibrated manner, in view of the altered growth-inflation configuration by the end of 2009-10.

3.5 The dominant concern that shaped the monetary policy stance in the First Quarter Review of 2010-11 was high inflation. Even as food price inflation and, more generally, consumer price inflation showed some moderation, the existing range was in double digits. Non-food inflation rose and demand-side pressures were evident. In view of broad-based domestic recovery, the First Quarter Review revised upward the baseline projection of real GDP growth for 2010-11 to 8.5 per cent. The baseline projection for WPI inflation for March 2011 was raised to 6.0 per cent. Consistent with this assessment, the repo rate was hiked by 25 basis points and the reverse repo rate by 50 basis points. Furthermore, the Reserve Bank also introduced mid-Quarter Reviews of Monetary Policy intended to be announced in the form of press releases in June, September, December and March every year. The first mid-Quarter Review was announced on September 16, 2010, wherein the repo and reverse repo rates were increased by 25 and 50 basis points, respectively. During 2010-11 so far, the monetary policy actions were intended to moderate inflation by reining in demand pressures and inflationary expectations while maintaining financial conditions conducive to sustaining growth.

3.6 Thus, since the exit began in October 2009, the reverse repo rate has been raised by 175 basis points to 5.0 per cent and repo rate has been raised by 125 basis points to 6.0 per cent. The cash reserve ratio (CRR) was raised by 100 basis points to 6.0 per cent. The liquidity in the system has transmited from a surplus mode to more balanced mode, and in the process, the repo rate has emerged as the policy rate. The overnight interest rates have also settled around the repo rate.

3. Credit Delivery

3.7 Ensuring adequate flow of credit to agriculture, micro, small and medium

[1] For a detailed discussion, refer to the Reserve Bank's Annual Report 2009-10 and the various Policy Documents.

enterprises, and the export sector has been a policy thrust for achieving the objective of sustainable and inclusive economic growth. In the wake of the global crisis, several measures were initiated to facilitate credit delivery and thereby contain the adverse impact on small and medium enterprises (SMEs) as well as exports.

3.8 The recommendations of the Working Group on BPLR (Chairman: Shri Deepak Mohanty) were implemented with the introduction of the Base Rate with effect from July 1, 2010. As the Base Rate construed as the minimum rate below which it will not be profitable for banks to lend, banks were not permitted to resort to any lending below the Base Rate. At the same time the ceiling of BPLR for loans up to ₹2 lakh was withdrawn. The deregulation of lending rates is expected to improve transparency in the pricing of credit and step up flow of credit to small borrowers at reasonable rates.

Priority Sector Lending

3.9 Commercial banks have been advised to link the tenor of loans to Housing Finance Companies (HFCs) in line with the average portfolio maturity of housing loans up to ₹20 lakh extended by HFCs to individual borrowers, otherwise such loans would not be eligible for classification under priority sector. Banks have been advised to ensure the end-use of funds strictly as per the guidelines on lending to priority sector.

Flow of Credit to Agriculture

Guidelines for Interest Subvention Relief to Farmers

3.10 In 2006-07, the Government had announced to extend interest subvention of 2 per cent per annum in respect of short-term production credit up to ₹3 lakh to farmers so that such credit could be made available by banks at 7 per cent. The Union Budget for 2009-10 had announced that the Government would provide an additional subvention of one per cent as an incentive to farmers who repay short-term crop loans on schedule. The Union Budget for 2010-11 announced an interest subvention of 1.5 per cent and raised the additional interest subvention to 2 per cent.

Agricultural Debt Waiver and Debt Relief Scheme, 2008

3.11 The Union Budget for 2008-09, announced the Agricultural Debt Waiver and Debt Relief Scheme 2008 under which the entire 'eligible amount' was waived for the small and marginal farmers. The 'other' farmers were eligible for a one time settlement (OTS) Scheme under which the farmer will be given a rebate of 25 per cent of the 'eligible amount' subject to the condition that the farmer pays the balance of 75 per cent of the 'eligible amount'.

3.12 As per the Scheme announced by the Government of India, the last date for the 'other farmers' to pay their portion (75 per cent) was June 30, 2009. However, due to the late arrival of monsoon, it was proposed in the Union Budget 2009-10 to extend this period by six months up to December 31, 2009. Further, in view of drought in certain parts of the country and heavy rains in other parts, the Union Budget 2010-11 further extended this date till June 30, 2010.

Waiver of Security/Margin Norms for Agricultural Loans

3.13 The limit for waiver of margin/security requirements for agricultural loans has been enhanced from ₹50,000 to ₹1 lakh *vide* RBI circular dated June 18, 2010. The provision of waiver of margin/security requirements for agricultural loans up to ₹1 lakh also applies, *inter alia*, to the tenant farmers, share croppers and oral lessees.

Flow of Credit to Micro and Small Enterprises

3.14 A High Level Task Force was constituted by the Government of India (Chairman: Shri T. K. A. Nair) to consider various issues relating to the Micro, Small and Medium Enterprises (MSMEs). Pursuant to the recommendations of the Task Force, SCBs have been advised on June 29, 2010 to achieve the share of Micro enterprises in MSE lending of 60 per cent prescribed in stages.

3.15 To further ease the credit flow to this sector, RBI constituted a Working Group (Chairman: Shri V. K. Sharma) to review the working of the Credit Guarantee Scheme of Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE). Major recommendations of the Working Group include mandatory doubling of the limit for collateral free loans to micro and small enterprises (MSEs) sector to ₹10 lakh from the existing ₹5 lakh, increase in the extent of guarantee cover, absorption of guarantee fees for the collateral free loans by CGTMSE subject to certain conditions, simplification of procedures for filing claims with CGTMSE and increasing awareness about the scheme. Following the recommendations of the Working Group, banks have been mandated on May 6, 2010, not to accept collateral security in the case of loans up to ₹10 lakh extended to units in the MSE sector.

Scheme of 1 per cent Interest Subvention on Housing Loans up to ₹10 lakh

3.16 The Union Budget for 2009-10 had announced a scheme of 1 per cent interest subvention in respect of individual housing loans up to ₹10 lakh, provided the cost of unit does not exceed ₹20 lakh, operative initially for a period of one year effective from October 1, 2009 to September 30, 2010. Further, the Union Budget for 2010-11 announced extension of the scheme till March 31, 2011.

Measures for Improving Banking Penetration

High Level Committee to review the Lead Bank Scheme

3.17 The High Level Committee on Lead Bank Scheme constituted by the Reserve Bank (Chairman: Smt. Usha Throat) to review the Lead Bank Scheme has submitted its report on August 20, 2009. Comprehensive guidelines on the implementation of the recommendations were issued to SLBC convener banks and lead banks. CMDs of all the State Level Bankers' Committee (SLBC) convenor banks have been advised to initiate undernoted actions to revitalise SLBC meetings:

(i) State Chief Ministers may be encouraged to attend at least one SLBC meeting in a year. CMDs have, therefore, been requested to bestow their personal attention in the matter and liaise with State Government to facilitate Chief Minister's participation in at aleast one SLBC meeting during the year.

(ii) CMDs have further been requested to arrange workshops for district administration on the subject, in the light of recommendations of High Level Committee to review Lead Bank Scheme.

Rural Self Employment Training Institutes (RSETIs)

3.18 The Government has resolved to set up RSETIs in each district all over the country to tap the BPL youth from the rural hinterland. The Ministry of Rural Development desired to support establishment of one Rural Development and Self-Employment Training Institute (RUDSETI) type of institution in each district of the country by 2011. National Institute of Rural Development (NIRD), Hyderabad, has been appointed the Nodal Agency for setting up RSETIs. As per data received from NIRD, there were 319 RSETIs set up by various banks as on end-March 2010.

Financial Literacy and Credit Counselling Centres (FLCCs)

3.19 A model scheme on Financial Literacy and Credit Counselling Centres (FLCCs) was formulated and communicated to all SCBs and RRBs with the advice to set up the centres as distinct entities, maintaining an arm's length from the bank, so that the FLCCs' services were available to even other banks' customers in the district. Up to March 2010, banks had reported setting up 135 credit counselling centres in various States.

Export Credit

3.20 In the wake of the global crisis and the problems being faced by exporters, the Reserve Bank had reduced the interest rate ceiling to 250 bps below BPLR on pre-shipment rupee export credit up to 270 days and post-shipment rupee export credit up to 180 days. This facility was available up to June 30, 2010. On top of this, the Government of India extended interest rate subvention of 2 per cent on pre- and post-shipment rupee export credit, for certain employment oriented export sectors, such as, handicrafts, carpets, handlooms and small and medium enterprises. The Union Budget for 2010-11 extended the 2 per cent interest rate subvention to the select sectors up to March 31, 2011. On August 9, 2010, the interest rate subvention scheme was further extended to leather and leather manufacturers, jute manufacturing including floor covering, engineering goods and textiles for the period from April 1, 2010 to March 31, 2011. With the introduction of the Base Rate, the lending rates charged on rupee export credit were deregulated with effect from July 1, 2010. However, the Reserve Bank has stipulated that banks may reduce the interest rate chargeable as per the Base Rate in the sectors specified above by the subvention available, even if the interest rate charged to exporters goes below the Base Rate.

4. Financial Inclusion

3.21 The Reserve Bank has taken several initiatives in recent years for promoting financial inclusion. A significant step in this direction was the issue of RBI guidelines in January 2006 for engagement of Business Correspondents (BCs) by banks for providing banking and financial services in addition to the traditional 'brick and mortar' model. Under this BC Model, banks have been permitted to use the services of various entities like Non-Governmental Organisations/Self Help Groups (NGOs/SHGs), Micro Finance Institutions (MFIs) and other Civil Society Organisations (CSOs), companies registered under Section 25 of the Companies Act, 1956, retired Government/bank employees and ex-servicemen to act as BCs.

3.22 Based on the recommendations of the Working Group constituted to examine the experience of the BC Model and suggest measures to enlarge the category of persons that can act as BCs. Keeping in view the regulatory and supervisory framework and consumer protection issues, the banks were allowed to appoint as BCs: individual owners of kirana/medical/Fair Price shops/individual PCO operators, agents of small savings schemes of GoI/Insurance companies, individuals who own petrol pumps, retired teachers, authorized functionaries of well run self help groups which are linked to banks and any other individuals including those operating common service centre as BCs.

3.23 As announced in the Annual Policy Statement for the year 2010-11, a discussion paper on engagement of 'for profit' companies as BCs was placed on RBI website on August 2, 2010. Taking into consideration the feedback received from various quarters, banks have now been permitted to engage 'for profit' companies as BCs excluding Non Banking Financial Companies (NBFCs), in addition to the individuals/entities permitted earlier.

3.24 Regional Rural Banks (RRBs) continued to take initiatives in the area of financial inclusion by opening "No–frills Accounts", issuing Kisan Credit Cards (KCC) and General Credit Cards (GCC) and dispensing micro credit through formation and credit linkage of SHGs. In respect of opening of Regional Offices (ROs) by RRBs, distinction between amalgamated and stand alone RRBs was dispensed with. All RRBs (both amalgamated and stand alone) would be allowed to open one RO for every 50 branches. Further, RRBs having up to 50 branches will be under the direct control of Head Office, without any intermediate tier. Also, request for relaxation, if any, in this regard will be examined by State Level Empowered Committee on RRBs.

3.25 As recommended by the Rangarajan Committee, two Funds have been set up with NABARD, *viz*., 'Financial Inclusion Fund' (FIF) for meeting the cost of developmental and promotional interventions of financial inclusion and 'Financial Inclusion Technology Fund' (FITF), for meeting the cost of technology adoption. Each Fund consists of an overall corpus of ₹500 crore, to be contributed by the Government of India (GoI), Reserve Bank and NABARD in the ratio of 40:40:20 in a phased manner over five years, depending upon utilisation of funds. In the Union Budget for the year 2010-11, the corpus of each of these funds has been enhanced by another ₹100 crore.

3.26 The guidelines for these two funds have been formulated and circulated among stakeholders. As on March 31, 2010, 50,255 villages were covered under financial inclusion through FIF and FITF.

NABARD-UNDP Collaboration for Financial Inclusion

3.27 In addition to financial inclusion initiated under FIF/FITF, NABARD and UNDP entered into collaboration for financial inclusion in seven focus states, *viz*., Bihar, Chhattisgarh, Jharkhand, Madhya Pradesh, Orissa, Rajasthan and Uttar Pradesh. This collaboration was part of the Country Programme Action Plan (CPAP) signed between Government of India (GOI) and UNDP. A fund for the collaboration, *viz*., 'UNDP – NABARD Financial Inclusion Fund' was established in NABARD with UNDP support. The overall objective of the collaboration is to provide better access to financial products and services to reduce risks and enhance livelihoods for the poor in at least two states, especially women and men from SC and ST groups, minorities and the displaced.

Financial Inclusion through grass-root Cooperatives

3.28 It was announced in the Annual Policy Statement for the year 2010-11 that there was a need for better understanding of the functioning of grass-root level rural co-operatives, which have the potential to play an important role in financial inclusion. Accordingly, it was decided to conduct a study of select 'well functioning' rural co-operatives (around 220) across the country through the Regional offices in association with the Regional offices of NABARD and the concerned State Governments under the overall guidance of Reserve Bank.

3.29 In November 2009, the Reserve Bank has advised banks to draw up a roadmap to provide banking services through a banking outlet in every village having a population of over 2,000 by March 2011. Such banking services may not necessarily be extended through a brick and mortar branch but can be provided through any of the various forms of ICT-based models including through BCs. The target date for achievement of above has been revised to March 2012 in alignment with the Budget announcements. Banks are further advised that March 2011 may be considered as an intermediate target. As at end June 2010, about 73,000 villages have been allocated to various banks for the provision of banking facilities in villages having population of more than 2000.

3.30 With a view to increasing banking penetration and promoting financial inclusion, domestic commercial banks, both in the public and private sectors, were advised in January 2010 to draw up specific Board approved Financial Inclusion Plans (FIP) with a view to rolling them out over the next three years. Banks were advised to devise FIPs matching with their business strategy and to make the FIPs an integral part of their corporate plans. The Reserve Bank has not imposed a uniform model to allow each bank to build its own strategy in line with its business model and comparative advantage.

3.31 Given the strategic positioning of RRBs, the Reserve Bank directed their sponsor banks to implement Core Banking Solutions (CBS) in all RRBs speedily and fully as well as adhere to the deadline of September 2011. This is expected to give a further fillip to financial inclusion efforts given the penetrative outreach of the RRBs in the rural areas.

5. Prudential Regulation

Implementation of Advanced Approaches under Basel II

3.32 With regard to the necessary up-gradation of risk management framework, as also capital efficiency to accrue to the banks by adoption of advanced approach envisaged under Basel II framework and the emerging international trend in this regard, it was considered desirable in July 2009 to lay down a timeframe for implementation of the advanced approaches in India. This was expected to enable the banks to plan and prepare their migration to the advanced approaches for credit risk and operational risk, as also for the Internal Models Approach (IMA) for market risk. The time schedule for implementation of the advanced approaches for the regulatory capital measurement has been laid down as under:

3.33 Accordingly, banks were advised to undertake an internal assessment of their preparedness for migration to advanced approaches, in the light of the criteria envisaged in the Basel II document, and take a decision on their migration to the advanced approaches. Banks were further advised to invariably obtain prior approval of the Reserve Bank for adopting any of the advanced approaches.

3.34 The guidelines on 'The Standardised Approach' (TSA) and 'Alternative Standardised Approach' (ASA) for operational risk, largely based on Basel Committee on Banking Supervision (BCBS) document, were issued on March 31, 2010. The banks interested in migrating to TSA/ASA have been advised to approach the Reserve Bank with a write up in support of their compliance with the provisions of the stipulated guidelines.

3.35 The guidelines on Internal Models Approach for Market Risk were issued on April 7, 2010. Basel II Framework offers a choice between two broad methodologies in measuring market risks for the purpose of capital adequacy: (i) measure market risk in a standardised manner as per the Standardised Measurement Method (SMM), which is being used by banks in India since March 31, 2005; (ii) the alternative methodology known as Internal Models Approach (IMA) allows banks to use risk measures derived from their own internal market risk measurement models. Banks interested in migrating to IMA for market risk have been advised to assess their preparedness with reference to the guidelines, and approach the Reserve Bank for approval for adopting the same.

Sl. No.	Approach	The earliest date of making application by banks to the Reserve Bank	Likely date of approval by the Reserve Bank
1.	Internal Models Approach (IMA) for Market Risk	April 1, 2010	March 31, 2011
2.	The Standardised Approach (TSA) for Operational Risk	April 1, 2010	September 30, 2010
3.	Advanced Measurement Approach (AMA) for Operational Risk	April 1, 2012	March 31, 2014
4.	Internal Ratings-Based (IRB) Approaches for Credit Risk (Foundation- as well as Advanced IRB)	April 1, 2012	March 31, 2014

3.36 Recent developments in Basel Committee on Banking Supervision on Liquidity Risk Management framework have been discussed in Box III.1.

Issue of Subordinated Debt for Raising Tier II Capital

3.37 In September 2009 banks were permitted to issue subordinated debt as Tier II capital with call and step-up options subject to compliance with certain terms and conditions.

Investment in Unlisted Non-SLR Securities

3.38 Since there is a time lag between issuance and listing of securities, which are proposed to be listed but not listed at the time of subscription, banks may not be able to participate in primary issues of non-SLR securities. It was therefore decided that investment in non-SLR debt securities (both primary and secondary market) by banks where the security is proposed to be listed on the

Box III.1: Recent Developments in Basel Committee on Banking Supervision – Liquidity Risk

A key characteristic of the financial crisis was the inadequate/ineffective management of liquidity risk. In recognition of the need for banks to improve their liquidity risk management and control their liquidity risk exposures.The Basel Committee has developed two internationally consistent regulatory standards for liquidity risk supervision as a corner stone of a global framework to strengthen liquidity risk management and supervision. The work of the Basel Committee on these two standards is contained in the Consultative Paper issued by the Committee in December 2009 on *"International framework for liquidity risk measurement, standards and monitoring"*. These two standards are explained briefly below:

Liquidity Coverage Ratio (LCR)

The ratio aims to ensure that a bank maintains an adequate level of unencumbered, high quality assets that can be converted into cash to meet its liquidity needs for a 30-day time horizon under an acute liquidity stress scenario specified by supervisors. At a minimum, the stock of liquid assets should enable the bank to survive until day 30 of the proposed stress scenario, by which time it is assumed that appropriate actions can be taken by the management and/or supervisors.

$$\text{Liquidity Coverage Ratio} = \frac{\text{Stock of high quality liquid assets}}{\text{Net cash outflow over a 30 day period}}$$

The specified scenario entails both institution-specific and systemic shocks built upon actual circumstances experienced in the global financial crisis. The scenario entails: (i) a significant downgrade of the institution's public credit rating; (ii) a partial loss of deposits; (iii) a loss of unsecured wholesale funding; (iv) a significant increase in secured funding haircuts; and (v) increases in derivative collateral calls and substantial calls on contractual and non-contractual off-balance sheet exposures, including committed credit and liquidity facilities.

Net Stable Funding Ratio (NSFR)

To promote more medium and long-term funding of the assets and activities of banks, the Net Stable Funding Ratio (NSFR) has been developed. This ratio establishes a minimum acceptable amount of stable funding based on the liquidity characteristics of an institution's assets and activities over a one year time horizon. This standard is designed to act as a minimum enforcement mechanism to complement the liquidity coverage ratio standard and reinforce other supervisory efforts by incenting structural changes in the liquidity risk profiles of institutions away from short-term funding mismatches and toward more stable, longer-term funding of assets and business activities.

$$\text{Net Stable Funding Ratio} = \frac{\text{Available Stable Funding (ASF)}}{\text{Required Stable Funding (RSF)}}$$

Available Stable Funding (ASF) is defined as the total amount of an institution's: (i) capital; (ii) preferred stock with maturity of equal to or greater than one year; (iii) liabilities with effective maturities of one year or greater; and (iv) that portion of "stable" non-maturity deposits and/or term deposits with maturities of less than one year that would be expected to stay with the institution for an extended period in an idiosyncratic stress event.

The required amount of stable funding is calculated as the sum of the value of the assets held and funded by the institution, multiplied by a specific required stable funding (RSF) factor assigned to each particular asset type, added to the amount of OBS (off-balance sheet) activity (or potential liquidity exposure) multiplied by its associated RSF factor. The RSF factor applied to the reported values of each asset or OBS exposure is the amount of that item that supervisors believe should be supported with stable funding.

The finer details relating to these two standards, *viz.*, the definition of liquid assets, the run-off and roll-over factors, etc. to arrive at net cash outflows under LCR and the ASF and RSF factors under NSFR are being calibrated.

Exchange(s) may be considered as investment in listed security at the time of making investment. However, if such security is not listed within the period specified, the same will be reckoned for the 10 per cent limit specified for unlisted non-SLR securities.

Investments by Banks in Bonds Issued by Companies engaged in Infrastructure Activities

3.39 With a view to providing incentive to the SCBs for financing infrastructure, investment by them in the long-term bonds with a minimum residual maturity of seven years, issued by companies engaged in executing infrastructure projects was allowed to be classified under Held to Maturity (HTM) category in non-SLR bonds.

Modifications to Prudential Norms governing Banks' Exposure to Infrastructure Sector

3.40 In April 2010, Banks were permitted to treat annuities under Build-Operate-Transfer (BOT) model in respect of road/highway projects and toll collection rights, where there are provisions to compensate the project sponsor if a certain level of traffic is not achieved, as tangible securities, subject to the condition that banks' right to receive annuities and toll collection rights is legally enforceable and irrevocable. Unsecured infrastructure loan accounts which are classified as sub-standard will attract a provisioning of 15 per cent instead of the current prescription of 20 per cent.

Computation of NPA Levels

3.41 In order to ensure uniformity in reporting of Gross NPA across SCBs, banks were advised in September 2009 that on classification of an account as NPA, interest already debited to the NPA accounts but not collected should be reversed and further application of interest should also stop.

Counter-Cyclical Provisioning Norms

3.42 As part of the policy measures adopted to deal with the contagion from the global crisis, the risk weights and provisioning prescriptions had been relaxed in November 2008 as a countercyclical measure. However, in view of large increase in credit to the commercial real estate sector over the last one year and the extent of restructured advances in this sector, the provision required on standard assets in the commercial real estate sector was increased from 0.40 per cent to 1 per cent in November 2009 for building up cushion against likely deterioration in asset quality. It was decided in October 2009 that banks should augment their provisioning cushions consisting of specific provisions against NPAs as well as floating provisions, and ensure that their total Provisioning Coverage Ratio, including floating provisions, is not less than 70 per cent by September 2010.

Modification to Prudential Norms for Projects under Implementation

3.43 Asset classification guidelines as applicable to 'projects under implementation' were modified in March 2010 so as to provide some flexibility in cases where completion of projects particularly the infrastructure projects got delayed. An infrastructure project loan where the project is not able to commence operations on due date, can now continue to be classified as standard asset for a maximum period of four years (against two years allowed earlier) from the original date of commencement of commercial operations. Similarly, non-infrastructure project loans not being able to commence commercial operations on due date can also continue to be classified as standard assets up to a maximum period of one year (against six months allowed earlier). These modifications are subject to certain conditions including a requirement for higher provision.

Compromise/Negotiated/One Time Settlement of Non Performing Assets

3.44 Banks were advised in June 2010 that adequate care should be taken to ensure that the compromise settlements are done in a fair and transparent manner and in full compliance with the RBI guidelines. It was also decided that, henceforth, the officer/authority sanctioning a compromise/one time settlement should append a certificate stating that the compromise settlements are in conformity with the Reserve Bank guidelines.

Sale of Investments Held under Held-to-Maturity (HTM) Category

3.45 It was decided in August 2010 that if the value of sales and transfers of securities to/from HTM category exceeds 5 per cent of the book value of investments held in HTM category at the beginning of the year, banks should disclose the market value of the investments held in the HTM category and indicate the excess of book value over market value for which provision is not made.

Classification in the Balance Sheet - Capital Instruments

3.46 Banks were advised to adopt the following classification in the balance sheet from the financial year ending March 31, 2010:

Under Schedule 1 - Capital: Perpetual Non-Cumulative Preference Share (PNCPS)

Under Schedule 4 - Borrowings (i) Innovative Perpetual Debt Instruments (IPDI); (ii) Hybrid debt capital instruments issued as bonds/ debentures; (iii) Perpetual Cumulative Preference Shares (PCPS); (iv) Redeemable Non-Cumulative Preference Shares (RNCPS); (v) Redeemable Cumulative Preference Shares (RCPS); (vi) Subordinated Debt.

Additional Disclosures by Banks in Notes to Accounts

3.47 Additional disclosures were prescribed to be made by banks in Notes to Accounts in the banks' balance sheets, in the formats prescribed in the circular dated March 15, 2010. These related to the areas of Concentration of Deposits, Advances, Exposures and NPAs; Sector-wise NPAs; Movement of NPAs; Overseas Assets, NPAs and Revenue and Off-balance Sheet SPVs sponsored by banks.

3.48 Banks are required to disclose the total deposits/advances/exposure to twenty largest depositors/borrowers and total exposure to top four NPA accounts, apart from the disclosure of sector-wise NPAs (percentage of NPAs to Total Advances in that sector); information about movement of NPAs, *viz.*, additions, upgradations, recoveries and write-offs, disclosures on the overseas assets, NPAs and revenue and information on the Off-Balance Sheet SPVs sponsored by the banks.

Presence of Foreign Banks in India

3.49 In the first phase, during March 2005 – March 2009 foreign banks willing to have presence in India for the first time could either choose to operate through branch or set up a 100 per cent Wholly-Owned Subsidiary (WOS). Foreign banks already operating in India were also allowed to convert their existing branches to WOS while following the one-mode presence criterion. The WOS was to be treated on par with the existing branches of foreign banks for branch expansion in India. No foreign bank, however, applied to establish itself as a WOS or to convert to a WOS during the first phase.

3.50 When the revision of presence of foreign banks in India was due in April 2009, the global financial markets were in turmoil and there were uncertainties surrounding the financial strength of banks around the world.

Accordingly, the Annual Policy Statement of April 2009 indicated the intent to continue with the current policy and procedures governing the presence of foreign banks in India and to review the roadmap after due consultation with the stakeholders once there was greater clarity regarding stability and recovery of the global financial system.

Issue and Pricing of Shares by Private Sector Banks

3.51 RBI has issued guidelines in April 2010 spelling out the approval mechanism in respect of Qualified Institutional Placements (QIPs). Henceforth, private sector banks need to approach Reserve Bank for prior 'in principle' approval in case of QIPs. Once the allotment is complete, the banks will also be required to furnish complete details of the issue to RBI for post facto approval.

Prudential norms on Investment in Zero Coupon Bonds (ZCBs)

3.52 As per the guidelines issued by the Reserve Bank in September 2010, banks should henceforth not invest in ZCBs unless the issuer builds up sinking fund for all accrued interest and keeps it invested in liquid investments/ securities.

6. Supervision and Supervisory Policy

3.53 Supervision of financial entities presumes equal importance as regulation, since it will ensure compliance with the various regulatory policies prescribed by the Reserve Bank towards strengthening the banking system and maintaining financial stability. The Board for Financial Supervision (BFS) was constituted in 1994 to provide undivided attention to the supervision of financial entities. Major issues dealt with by the BFS during 2009-10 included frauds monitoring, supervision of overseas operations of banks, supervision of financial conglomerates, among others.

Consolidated Supervision and Financial Conglomerate (FC) Monitoring Mechanism

3.54 In India, Financial Conglomerates (FC) monitoring mechanism is in place since June 2004 following the recommendations of the Working Group (Convenor: Smt. Shyamala Gopinath) on monitoring of Systemically Important Financial Intermediaries. The FC monitoring framework primarily has two major components: (i) off-site surveillance through quarterly reporting requirements, and (ii) half-yearly discussions with the Chief Executive Officers of the major entities of the FCs in association with other principal regulators.

Recent Supervisory Initiatives for Financial Conglomerates Supervision

3.55 In terms of BFS directions, an Internal Group in the Bank recommended a set of proposals for strengthening the regulatory/ supervisory framework for the Financial Conglomerates (FCs). After due approval from BFS and the other regulators (SEBI and IRDA), steps have been taken for implementation of these proposals. The progress in implementation of the proposals is as under:

Revision in FC Reporting Format

3.56 The revised quarterly off-site reporting format for the FCs under the Reserve Bank jurisdiction has been introduced from the quarter ended March 2010. In addition to the Intra-group Transactions & Exposures, the revised return also seeks to capture information on gross/net NPA or bad debts, provisions held against 'impaired assets', frauds and 'other assets'.

Identification of FCs for monitoring

3.57 A Group is included in the list of identified FCs if it has significant presence in at least two financial market segments comprising Banking, Insurance, Securities (Mutual Fund), deposit taking and non-deposit taking NBFCs.

3.58 In April 2010, the Bank issued certain guidelines for monitoring market risk in terms of which banks can apply the Internal Models Approach (IMA) to their market risk positions across the entire bank (solo level) including overseas branches on a net basis, except for the branches located in jurisdictions where there are obstacles to the quick repatriation of profits or where there are legal and procedural difficulties in carrying out the timely management of risks on a global basis. Further, individual banks should also continue to monitor the market risks of their overseas operations separately.

Development in Monitoring of Frauds in Banks

Fraud Risk Management System in banks - Role of Chairman/Chief Executive Officers

3.59 A circular was issued to banks on September 16, 2009 prescribing, *inter alia*, that the fraud risk management and the fraud investigation function must be owned by the bank's CEO, its Audit Committee of the Board and the Special Committee of Board, at least in respect of high value frauds. Accordingly, they should own responsibility for systemic failure of controls or absence of key controls or severe weaknesses in existing controls which facilitate exceptionally large value frauds and sharp rises in frauds in specific business segments leading to large losses for the bank. Banks have been advised to frame, with the approval of their respective Boards, internal policy for fraud risk management and fraud investigation function.

Constitution of High Level Group on Electronic Banking Controls, Governance and Technology Risk Management Standards

3.60 Fraud Monitoring Cell had conducted a Special Study covering various facets of frauds in ATM/Debit cards and Internet Banking Operations of the banks. It was revealed that the incidence of such frauds was showing a rising trend. Based on the findings of the study which covered, *inter alia*, the factors/loopholes that facilitated cyber frauds, the Annual Monetary Policy Statement 2010-11 announced the constitution of a High Level Working Group under the Chairmanship of Shri G. Gopalakrishna, Executive Director, to examine the following and suggest appropriate regulatory response.

- Suggest enhancement to RBI guidelines to commercial banks pertaining to IT and Information security governance and related processes;
- Examine IT related implications for banks arising out of recent legislations in India;
- Analysis of e-banking related frauds and suggest suitable enhancements in relevant controls and processes;
- Review the existing guidelines issued by various departments on e-banking and suggest improvements, if any;
- Suggest ways and means to enhance customer awareness regarding e banking systems.

Anti Money Laundering

3.61 An evaluation of India's Anti Money Laundering/Combating Financing of Terrorism (AML/CFT) framework was undertaken by a joint evaluation team of the Financial Action Task Force (FATF) and Asia Pacific Group on Money Laundering (APG) during November-December 2009. Their report identified areas where the AML/CFT framework had gaps/shortcomings needing statutory and/or regulatory action as also noted areas where tangible progress was made.

3.62 The evaluation report found the supervisory regime for financial institutions to be sound and acknowledged penal action taken by the Reserve Bank for systemic as well transaction related violations committed by banks. The FATF standards with respect to foreign branches and subsidiaries of Indian banks are fully complied with. Following the recommendations of the report, banks were advised that where there was a suspicion of money laundering/terrorist financing or they felt the customer did not pose a low risk they should carry out full Customer Due Diligence (CDD). Further, in the matter of client accounts opened by professional intermediaries, it has been clarified that banks should not allow opening or continuation of accounts where the professional intermediary is under obligation not to disclose the true identity of its customers or purpose of transactions. Banks were also advised not to enter into correspondent relationships with Shell banks or with such banks that allow Shell banks to use their accounts.

3.63 The Government also carried out amendments to the Prevention of Money Laundering Rules, 2005 to address gaps identified in regulations. An amendment was made to define a 'non-profit organization' (NPO) and requiring banks to report all receipts by NPOs amounting to more than ₹10 lakh. Banks and FIs are now also required to verify the identity of a non account-based customer who makes a transaction in excess of ₹50,000 as a single transaction or several transactions that appear to be connected.

3.64 India has been admitted as a member of the Financial Action Task Force (FATF) in June 2010.

New Bank Guidelines

3.65 Subsequent to the announcement in Union Budget for 2010-11, the Reserve Bank in its Annual Policy Statement 2010-11 announced to prepare a discussion paper on international practices, the Indian experience as also the extant Ownership and Governance (O&G) guidelines on licensing of new banks and place it on Reserve Bank's website for wider comments and feedback. The discussion paper was placed on Reserve Bank's website on August 11, 2010 for comments and detailed guidelines will be finalised based on the feedback.

7. Regional Rural Banks

3.66 Regional Rural Banks (RRBs) form an integral part of the Indian banking system with focus on service to rural areas. The process of amalgamation of the RRBs was initiated by Government of India in September 2005 in a phased manner. Prior to the process of amalgamation, 196 RRBs sponsored by 27 SCBs and one State Cooperative Bank were operating in the country with a network of 14,484 branches spread over 523 districts as on March 31, 2005. Consequent upon the amalgamation, the number of RRBs declined to 82 operating in 26 States and in one Union Territory covering 619 districts with a network of 15,475 branches as on March 31, 2010.

Recapitalisation of RRBs

3.67 The Government of India had constituted a Committee in September 2009 (Chairman: Dr. K. C. Chakrabarty) to study the current level of Capital-to-Risk-Weighted Assets Ratio (CRAR) of RRBs and to suggest a roadmap for achieving a CRAR of 9 per cent by March 2012. The Committee was also required to suggest the required capital structure for RRBs given their business level, so that their CRAR is sustainable and provides for future growth and compliance with regulatory requirements. The Committee submitted its Report to the Government of India on April 30, 2010 (Box III.2).

Box III.2: Recommendations of the Committee on Recapitalisation of RRBs

The following are the main recommendations of the Committee on Recapitalisation of RRBs:

(i) The Committee carried out an assessment of capital requirement for all 82 RRBs to enable them to have CRAR of at least 7 per cent as on March 31, 2011 and at least 9 per cent from March 31, 2012 onwards. The recapitalisation requirement would be Rs.2,200 crore for 40 out of the 82 RRBs. This amount may be released in two instalments, *i.e.*, Rs.1,338 crore in 2010-11 and Rs.863 crore in 2011-12. The remaining 42 RRBs will not require any capital and will be able to maintain CRAR of at least 9 per cent as on March 31, 2012 and thereafter on their own.

(ii) The Committee noted that some of the weak RRBs, particularly those in the North Eastern and Eastern regions, might not be able to fully meet all the projected business parameters despite generally achieving acceptable growth. The Committee, therefore, suggests that an additional amount of Rs.700 crore may be kept to meet such contingencies and need based additional capitalisation provided to such RRBs once their draft balance sheets are prepared.

(iii) The recapitalisation of Rs. 2,200 crore to 40 RRBs should be a one-time measure, and released subject to signing of Memorandum of Understanding (MoU) by the Chairman of the RRB and on achieving the performance parameters specified in the MoU.

(iv) As per Section 5 of the RRB Act, the authorised capital of RRB is Rs. 5 crore. As a result, recapitalisation amounts are kept as share capital deposit. The Committee has recommended that the accumulated losses as on March 31, 2010 may be written off against the available share capital deposits, and the balance amount of share capital deposit may be appropriated as paid-up capital. Further, in view of the expanding business of the RRBs, the Committee recommended to increase in the authorised capital of RRBs to Rs.500 crore.

(v) In order to build public confidence, in due course, RRBs with higher net worth may be allowed to access capital from the market.

(vi) For improving the functioning of the RRB, change of sponsor banks may be considered, wherever required.

(vii) RRBs with a net worth of Rs. 100 crore or more as on March 2009 may be permitted to pay dividend from April 1, 2013 onwards. RRBs to be recapitalised in the current phase may be allowed to pay dividend only after achieving a sustainable CRAR of at least 9 per cent.

(viii) RBI may prescribe 'fit and proper' criteria for the Chairmen of RRBs. The Sponsor Bank may depute officers conforming to such criteria as Chairman on a tenure basis and wherever needed, such officers may be recruited by them from open market and then deputed to the RRBs. The compensation of Chairman may be de-linked from existing salary structure of commercial banks and be more market-oriented and a system of incentives and disincentives linked to performance benchmarks approved by the Board may be built in the compensation package.

(ix) The Board as a body as well as individual Board members may be made accountable for the bank's performance and individual Board members need to be assigned specific responsibilities as per their expertise.

(x) Wherever required, sponsor banks may recruit suitable persons from the market, including staff of the RRBs in their own service and then depute them as General Managers in RRBs.

(xi) RRBs may constitute Audit Committee of the Board and conduct of Concurrent Audit and Management Audit in RRBs may be encouraged.

(xii) A fund of Rs. 100 crore may be set up for training and capacity building of the RRB staff.

(xiii) The Governments, both Central and State, may include RRBs for keeping their deposits under various schemes.

(xiv) Performance of RRBs may be monitored at National and State levels on half-yearly basis. The Sponsor Bank and NABARD may review the performance on quarterly basis. The Board of RRB will review the performance on regular basis.

Technology Up-gradation of RRBs

3.68 In order to prepare RRBs to adopt appropriate technology and migrate to Core Banking Solutions (CBS), a Working Group was constituted by the Reserve Bank (Chairman: Shri G. Srinivasan) for technology up-gradation of RRBs. The report, *inter alia*, set September 2011 as the target date for all RRBs to move towards CBS. It was also stipulated that all branches of RRBs opened after September 2009 to be CBS compliant from day one. As per the status report received from sponsor banks, 22 RRBs have implemented CBS in full and for the remaining 60 RRBs, CBS is under implementation.

Classification of investments by RRBs

3.69 The exemption granted to RRBs up to the financial year 2008-09 from 'mark to market' norms in respect of their investments in SLR securities was extended by one more year, *i.e.*, for the financial year 2009-10.

Provisioning Requirement for Standard Assets

3.70 For RRBs, it has been decided to increase the provisioning requirement for advances to the commercial real estate sector classified as 'standard asset' to 1 per cent. As regards other standard assets, it has been decided that while the provisioning requirements for direct advances to agriculture and SME sectors would remain unchanged at 0.25 per cent, the same for all other loans and advances would be 0.40 per cent.

Committee of Capacity Building Requirement

3.71 The Working Group set up under the Chairmanship of Shri Amaresh Kumar, ED, NABARD has given, *inter alia*, the following recommendations on capacity building requirements of RRBs.

i. RRBs should have definite training policy and should treat it as investment on human capital;

ii. A definite budget should be approved by the Board for the purpose every year;

iii. A systematic TNA (Training Need Analysis) be conducted for all the staff;

iv. More on location programmes be organised by RRBs with the help of mobile job trainers;

v. RRBs with more than 100 branches should have their own training centers.

Supervisory and Regulatory Initiatives

i. NABARD had conducted statutory inspection of 61 RRBs during 2009-10;

ii. Regional Seminars on Internal Checks and Control Systems were conducted for the Chiefs of Audit and Inspection Departments of both RRBs and co-operative banks;

iii. At the instance of Financial Intelligence Unit-India (FIU-IND), two meetings of Chairmen of RRBs and three State level meetings of co-operative banks and RRBs were convened to review the status of implementations of Anti-Money Laundering (AML)/ Combating Financing of Terrorism (CFT) guidelines.

iv. Sensitisation workshops were conducted on KYC (Know Your Customer)/AML, CMA (Credit Monitoring Arrangement), Statutory Audit, Frauds, Investments, Internal Checks and Controls, and Corporate Governance for the auditors and other personnel of RRBs and Co-operative Banks.

8. Cooperative Banks

Urban Cooperative Banks (UCBs)

3.72 The major policy initiatives in the UCB sector during the recent years include implementation of the Vision Document 2005, initiatives for financial restructuring and asset liability management. The major policy initiatives in the UCB sector during the year 2009-10 are as under:

New Bank Licenses

3.73 Consequent upon consolidation and improvement in the financial health of the banking sector, it was announced in the Annual

Policy Statement in April 2010 that a Committee would be set up comprising all stakeholders for studying the advisability of granting new licenses to UCBs. Accordingly, an expert committee under the Chairmanship of Shri Y. H. Malegam has been set up. The committee, *inter alia*, will be reviewing the performance of UCBs over the last decade; review the need for organization of new UCBs and the extant regulatory policy on setting up of new UCBs; lay down entry point norms for new UCBs; examine whether the licensing could be restricted only to financially sound and well managed cooperative credit societies through conversion route; and to make recommendations relating to legal and regulatory structure to facilitate growth of sound UCBs.

Area of Operation

3.74 In order to provide avenues for organic growth to sound and well functioning uni-State Tier II UCBs, it was decided to consider requests for expansion of area of operation to the entire state of registration for UCBs conforming to the financial position of a Grade I bank. While considering such requests, RBI will give due consideration to the system of internal control prevailing in the bank and supervisory comfort.

Opening of off-site ATMs

3.75 In the Annual Policy Statement of 2010-11, it was announced that well managed UCBs would be allowed to set up off-site ATMs without seeking approval through Annual Business Plan. While considering such requests, the Reserve Bank would give due consideration to the financial health of the bank in terms of the eligibility criteria laid down.

Maintenance of CSGL Accounts

3.76 The Reserve bank allowed UCBs with a net worth of ₹200 crore and above, and having CRAR of 10 per cent and above, to open and maintain CSGL Accounts.

Credit Information Companies

3.77 As UCBs fall under the category of credit institutions as defined in sub-section (f) of Section 2 of the Credit Information Companies (Regulation) Act, 2005, they were advised to become members of at least one credit information company registered under the Act.

Capital for Market Risk

3.78 The Basel Committee on Banking Supervision (BCBS) had issued an amendment to the Capital Accord in 1996 to incorporate market risks. As an initial step towards prescribing capital requirement for market risks, UCBs were advised to assign an additional risk weight of 2.5 per cent on almost the entire investment portfolio. These additional risk weights are clubbed wtih the risk weights prescribed for credit risk in respect of investment portfolio of UCBs. UCBs were also advised to assign a risk weight of 100 per cent on the open position limits on foreign exchange and gold, and to build up Investment Fluctuation Reserve up to a minimum of 5 per cent of the investment held in Held for Trading and Available for Sale categories in the investment portfolio.

Non-SLR Investments

3.79 Investment by UCBs in unlisted non-SLR securities (subject to the minimum prescribed rating) should not exceed 10 per cent of total non-SLR investments at any time. Since there is a time lag between issuance and listing of securities, investment in non-SLR securities which are proposed to be listed but not listed at the time of subscription are exempted from the 10 per cent limit. Considering that long term bonds issued by companies engaged in infrastructure projects are generally held for a long period and not traded, UCBs investment in non-SLR bonds issued by such companies and having a residual maturity of seven years are allowed to be kept in HTM category.

Resolution of Weak UCBs

3.80 In order to deal with weak UCBs, where proposals for merger were not forthcoming from within the UCB sector, a scheme of transfer of assets and liabilities (including branches) of UCBs to commercial banks, with DICGC support, has been envisaged as an additional option for resolution of weak banks. Accordingly, detailed guidelines were issued by the Reserve Bank on February 24, 2010.

Rural Cooperative Banks (StCBs/DCCBs)

3.81 During the year 2009-10, the following important policy initiatives were taken in respect of State Cooperative Banks (StCBs) and District Central Cooperative Banks (DCCBs) on supervision related matters.

3.82 Prudential norms on Income Recognition, Asset Classification and Provisioning norms were made applicable to the Primary Agricultural Credit Societies (PACS) from the year 2009-10 and detailed guidelines were issued to the Registrar of Cooperative Societies (RCS). Further, following recommendations of the Vaidyanathan Committee for Revival of Short Term Cooperative Credit Structure, guidelines for calculation of Capital to Risk-weighted Assets Ratio for PACS were issued during the year.

3.83 In view of the sizable inflow of funds into the Short Term Cooperative Credit Structure (STCCS) by way of recapitalisation assistance under the Government of India's Revival Package (Vaidyanathan Committee) and under the ADWDR Scheme 2008, banks were cautioned to utilise the funds judiciously;

3.84 Guidelines on 'Fraud Risk Management System' in banks *vis-a-vis* the role of Chief Executive Officers were issued to all co-operative banks;

3.85 Guidance note on Credit Risk Management (CRM), and Business Continuity Planning (BCP) were circulated among StCBs/DCCBs to enable them to gear up their machinery to face the future challenges.

3.86 Consequent to the revised licensing policy announced by the Reserve bank, based on NABARD's recommendation, licenses to 9 StCBs and 132 DCCBs were issued during the last three quarters taking the total number of licensed StCBs and DCCBs to 23 and 207, respectively.

9. Non-Banking Financial Institutions

Regulatory Initiatives for Financial Institutions

3.87 In the wake of recovery in the global as well as Indian economy during 2009-10, the Reserve Bank rolled back the liquidity support measures initiated for AIFIs during 2008-09 for on-lending to HFCs/NBFCs/MFIs and exporters in the following manner: (i) The refinance facilities of ₹7,000 crore, ₹5,000 and ₹4,000 crore for SIDBI, EXIM Bank and NHB, respectively, under the relevant provisions of the Reserve Bank of India Act, 1934 sanctioned in December 2008 were withdrawn with effect from the close of business on March 31, 2010, (ii) The ceiling on aggregate resources raised including funds mobilised under the 'umbrella limit' by SIDBI, NHB and EXIM Bank was raised subject to conditions, with effect from December 8, 2008, for a period of one year. On a review, the relaxation allowed in December 2008 to select AIFIs (SIDBI, NHB and EXIM Bank) in resource raising norms for AIFIs was co-terminated with refinance facility. Accordingly, outstanding borrowings of AIFIs were required to be within the normal prudential limit, *i.e.*, ceiling on aggregate resources at 10 times of NOF and umbrella limit at one time of NOF with effect from March 31, 2010.

3.88 The guidelines regarding lending under consortium arrangements/multiple banking arrangements, provisioning coverage for advances, prudential norms on creation and utilisation of floating provisions, additional disclosures in 'notes to accounts' and prudential norms on income recognition, asset classification and provisioning pertaining to advances – computation of NPA levels and projects under implementation issued to banks were *mutatis mutandis* applied to the select AIFIs with effect from July 1, 2010. Further, the guidelines regarding know your customer (KYC) norms/ anti-money laundering (ALM) standards/ combating of financing of terrorism (CFT) and sale of investments held under Held to Maturity category issued to banks were also made applicable to the select AIFIs.

Participation in Currency Futures

3.89 NBFCs have been permitted to participate in the designated currency futures exchanges recognised by SEBI as clients, subject to Reserve Bank guidelines in the matter, only for the purpose of hedging their underlying forex exposures.

Submission of Statement of Interest Rate Sensitivity [NBS-ALM3]

3.90 NBFCs-ND-SI have been advised to submit the return on Interest Rate Sensitivity (NBS-ALM3) within 20 days of the close of the half year to which it relates.

Interest Rate Futures for NBFCs

3.91 NBFCs have been allowed to participate in the designated interest rate futures exchanges recognised by SEBI, as clients, subject to Reserve Bank/SEBI guidelines in the matter, for the purpose of hedging their underlying exposures.

Fit and Proper Criterion

3.92 Any takeover/acquisition of shares of a deposit taking NBFC or merger/ amalgamation of a deposit taking NBFC with another entity or any merger/amalgamation of an entity with a deposit taking NBFC that would give the acquirer/another entity control of the deposit taking NBFC would require the prior approval of the Reserve Bank. Further, it has also been decided that upon such merger/ amalgamation, the general character of management complies with the 'fit and proper' criteria prescribed by the Reserve Bank.

Acceptance of Deposits by Chit Fund Companies

3.93 Chit funds companies, classified as miscellaneous non-banking companies (MNBCs), can accept deposits from the shareholders but have been prohibited from accepting deposits from public.They have been advised to repay public deposits on maturity.

New category of NBFC-Infrastructure Finance Companies

3.94 Considering the critical role played by companies which are providing credit to the infrastructure sector, it has been decided to introduce a fourth category of NBFCs styled "Infrastructure Finance Companies" (IFCs). Companies that deploy a minimum of 75 per cent of total assets in infrastructure loans, have net owned funds of ₹300 crore or above, have minimum credit rating 'A' or equivalent; and CRAR of 15 percent (with a minimum Tier I capital of 10 percent) would be classified under this category and be allowed to exceed the extant credit concentration norms for lending to single/ group borrower by an additional 5 per cent of owned funds.

Overseas Investment by NBFCs

3.95 Making overseas investments by NBFCs without regulatory clearance from the Department of Non-Banking Supervision of the Reserve Bank, is a violation of FEMA Regulations 2004. Hence, all NBFCs desirous of making any overseas investment must obtain 'No Objection Certificate' (NoC) from the Reserve Bank before making such investment.

Finance for Housing Projects - Information Disclosure

3.96 NBFCs have been advised that while granting finance to housing/development projects, they should specify as a part of the terms and conditions that: (a) the builder/ developer/owner/company would disclose in the Pamphlets/Brochures /advertisements etc., the name(s) of the entity to which the property is mortgaged and that they would provide No Objection Certificate (NOC)/permission of the mortgagee entity for sale of flats/property, if required. (b) Funds should not be released unless the builder/developer/owner/company fulfill the above requirements.

Change in or Take Over of the Management of the Business of the Borrower by Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines, 2010.

3.97 These guidelines are aimed at proper management of the business of the borrower to enable the Securitisation Companies/ Reconstruction Companies (SCs/ RCs) to realise their dues from the borrowers, by effecting change in or takeover of the management of the business of the borrower and related matters.

The Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003 – Amendments

3.98 With a view to bringing transparency and market discipline in the functioning of SC/RCs, additional disclosures related to assets realised during the year, value of financial assets unresolved as at the end of the year, value of security receipts pending for redemption, among others have been prescribed. It is now mandatory for SC/RCs to invest in and continue to hold a minimum of five per cent stake of the outstanding amount of the security receipts issued by them under each scheme and each class till the redemption of all the security receipts issued under a particular scheme.

Loan Facilities to the Physically / Visually Challenged by NBFCs

3.99 NBFCs have been advised that there should be no discrimination in extending products and facilities including loan facilities to the physically/visually challenged applicants on grounds of disability.

Submission of Certificate from Statutory Auditor to the Bank

3.100 Every non-banking financial company has to submit a Certificate from its Statutory Auditor that it is engaged in the business of non-banking financial institution requiring it to hold a Certificate of Registration under Section 45-IA of the RBI Act. The certificate from the Statutory Auditor as at end of the financial year ended March 31 has to be submitted to the Regional Office of the Department of Non-Banking Supervision under whose jurisdiction the non-banking financial company is registered, latest by June 30, every year.

Know Your Customer (KYC) Guidelines / Anti-Money Laundering (AML) Standards

Accounts of Politically Exposed Persons (PEPs)

3.101 Detailed guidelines on Customer Due Diligence (CDD) measures applicable to Politically Exposed Person (PEP) and their family members or close relatives have been issued. In the event of an existing customer or the beneficial owner of an existing account, subsequently becoming a PEP, NBFCs (including RNBCs) should obtain senior management approval to continue the business relationship and subject the account to the CDD measures as applicable to the customers of PEP category including enhanced monitoring on an ongoing basis.

Principal Officer

3.102 NBFCs (including RNBCs) were advised that they should appoint a senior management officer to be designated as Principal Officer and the role and responsibilities of the Principal Officer have been detailed therein. It was advised that the Principal Officer and other appropriate staff should have timely access to customer identification data and other CDD information, transaction records and other relevant information. Further, NBFCs (including RNBCs) should ensure that the Principal Officer is able to act independently and report directly to the senior management or to the Board of Directors.

Prevention of Money laundering Act, 2002-Amendments

3.103 NBFCs (including RNBCs) were advised to maintain for at least ten years from the date of transaction between the NBFC (including RNBC) and the client, all necessary records of transactions according to the Prevention of Money-Laundering (Maintenance of Records of the Nature and Value of Transactions, the Procedure and Manner of Maintaining and Time for Furnishing Information and Verification and Maintenance of Records of the Identity of the Clients of the Banking Companies, Financial Institutions and Intermediaries) Rules, 2005 (PMLA Rules), both domestic or international. However, records pertaining to the identification of the customer and his address (e.g. copies of documents like passports, identity cards, driving licenses, PAN card, utility bills etc.) obtained while opening the account and during the course of business relationship, would continue to be preserved for at least ten years after the business relationship is ended.

Capital Adequacy - Risk weightage on Lending through Collateralized Borrowing and Lending Obligation (CBLO)

3.104 Counterparty credit risk, arising out of exposure of NBFCs to CCIL on account of securities financing transactions (CBLOs) will carry a risk weight of zero, as it is presumed that the CCP's exposures to their counterparties are fully collateralised on a daily basis, thereby providing protection for the CCP's credit risk exposures. The deposits/collaterals kept by NBFCs with CCIL will attract a risk weight of 20 per cent.

Know Your Customer (KYC) Norms/ Anti- Money Laundering (AML) Standards/ Combating of Financing of Terrorism (CFT)

3.105 Financial Action Task Force (FATF) has issued a Statement on October 16, 2009 on risks arising from the deficiencies in AML/CFT regime of Uzbekistan, Iran, Pakistan, Turkmenistan, Sao Tome and Principe on the subject. All NBFCs and RNBCs are accordingly advised to take into account risks arising from the deficiencies in AML/CFT regime of Iran, Uzbekistan, Pakistan, Turkmenistan and Sao Tome and Principe.

Compliance with FDI norms-Half yearly certificate from Statutory Auditors of NBFCs

3.106 NBFCs having FDI whether under automatic route or under approval route are required to submit a certificate from their Statutory Auditors on half yearly basis (half year ending September and March) certifying compliance with the existing terms and conditions of FDI. Such certificate may be submitted not later than one month from the close of the half year to which the certificate pertains, to the Regional Office in whose jurisdiction the head office of the company is registered.

NBFCs-ND-SI issuing guarantees-Applicability of exemption from Concentration norms

3.107 NBFCs-ND-SI also issue guarantees and devolvement of these guarantees might require access to public funds. NBFCs-ND-SI were advised that any systemically important non-deposit taking NBFC not accessing public funds either directly or indirectly or not issuing guarantees to approach the Bank for exemption/ modification in the prescribed ceilings with regard to Concentration of credit / investment norms.

Applicability of NBFCs-ND-SI regulations

3.108 A non-deposit taking NBFC with an asset size of ₹100 is classified as a systemically important entity. NBFCs were, therefore, advised that they may comply with the Reserve Bank's regulations issued to NBFC-ND-SI from time to time, as and when they attain an asset size of ₹100 crore, irrespective of the date on which such size is attained and may continue to comply with the extant directions, even in case of temporary reduction in the size of assets.

Primary Dealers

3.109 During 2009-10, policy initiatives were taken to strengthen the primary dealers (PDs) system. First, standalone PDs were allowed to categorise a portion of their Government Securities (G-Secs) portfolio in the HTM category to the extent of their audited net owned funds (NOF) as at end-March of the preceding financial year. Second, the minimum NOF requirements for PDs has been increased from ₹50 crore to ₹150 crore with effect from April 1, 2010. For PDs who have been permitted to undertake diversified activities, the minimum NOF requirement has been increased from ₹100 crore to ₹250 crore. Third, in conformity with the best practices in disclosure of penalties imposed by the regulator and to maintain transparency, it has been decided that the details of the penalty levied on a PDs shall be placed in the public domain. The penalty is also required to be disclosed in the 'Notes on Accounts' to the balance sheet of the PD. Fourth, concentration of credit/investment norms prescribed in the notification DNBS.193 DG(VL)-2007 dated February 22, 2007 and updated till June 30, 2010 were made applicable to standalone PDs.

10. Financial Markets

3.110 During 2009-10, financial markets functioned in an orderly manner. The money market interest rates generally stayed closer to the lower bound of the liquidity adjustment facility (LAF) rate corridor as the overall liquidity conditions remained in surplus mode. The key drivers of liquidity during the first half of 2009-10 were Central Government balances with the Reserve Bank, open market operations (OMO) and market stabilisation scheme (MSS) unwinding. The large market borrowings by the Government put some upward pressure on yields of government securities during 2009-10. However, this was contained by active liquidity management by the Reserve Bank. Lower credit demand by the private sector also helped in containing the upward pressure on yield. Equity markets generally remained firm during the year with intermittent corrections in line with the global pattern. Resource mobilisation through public issues increased. Housing prices rebounded during 2009-10. According to the Reserve Bank's survey, they surpassed their pre-crisis peak levels in Mumbai. The exchange rate exhibited greater flexibility.

3.111 With the attainment of normalcy in the global financial market, easy domestic liquidity and improvement in the trade credit conditions, some of the earlier measures were either scaled down or rolled back. The facilities of enhanced export refinance credit limit (from 15 per cent to 50 per cent) provided to the commercial banks by the Reserve bank was rolled back to the pre-crisis level on October 27, 2009.

3.112 The definition of the infrastructure sector was expanded by including farm level pre-cooling, for preservation or storage of agricultural and allied produce, marine products and meat. Corporates engaged in the development of integrated township have been permitted to avail ECB under the approval route up to December 31, 2010. A scheme of take-out financing was permitted through ECB under approval route to enhance availability of credit to the infrastructure sectors, such as, sea port and airport, roads including bridges and power sectors for the development of new projects. The scheme of buyback of FCCBs, introduced during the crisis period and initially available up to June 2010, was subsequently extended up to June 2011, under the approval route. Borrowers in the services sectors, *viz*., hotels, hospitals and software were hitherto allowed to avail of ECB up to US$ 100 million per financial year under the automatic route, for foreign currency and/or rupee capital expenditure for permissible end-uses. As a measure of further liberalisation, ECB beyond US$ 100 million has been allowed to borrowers in these specific services sectors under the approval route. However, following improvement in the credit market conditions and narrowing credit spreads in the international markets, the relaxation allowed in the all-in-cost ceilings under the approval route was withdrawn with effect from January 1, 2010.

3.113 The policy initiatives for removal of procedural impediments and anomalies in external transactions have also been strengthened to make capital account liberalisation process more meaningful. Guidelines for the issue of Indian Depository Receipts (IDRs) were operationalised in July, 2009, thereby enabling foreign companies to mobilise funds directly from the Indian capital market. The operationalisation of IDR facilitates residents to make investment in foreign security without any limits and going through currency conversion in India. Foreign Institutional Investors (FIIs) registered with the SEBI and Non-Resident Indians (NRIs) are also allowed to invest, purchase, hold and transfer IDRs.

3.114 FIIs have been permitted to offer domestic Government Securities and foreign sovereign securities with AAA rating, as collateral to the recognised Stock Exchanges in India, in addition to cash, for their transactions in the cash segment of the market. However, cross-margining of Government Securities (placed as margins by the FIIs for their transactions in the cash segment of the market) shall not be allowed between the cash and the derivative segments of the market. The pricing guidelines in respect of issue of shares including preferential allotment and for transfer of equity instruments from a resident to a non-resident and *vice versa* have been revised.

3.115 In deference to the demand of the market participants as also with a view to synchronising the timing of the money, domestic foreign exchange and Government Securities market, with effect from August 2, 2010, market timing for the outright transactions in Government Securities and CBLO markets that settle on T+1 basis shall be between 9.00 hrs and 17.00 hrs from Monday to Friday. The timings for transactions in these markets that settle on T+0 basis and those for Saturdays shall remain unchanged. In order to promote transparency in secondary market transaction for CDs and CP, with effect from July 1, 2010, all Reserve Bank regulated entities were advised to report their OTC transactions in CDs and CP on the FIMMDA platform within 15 minutes of the trade for online dissemination of market information.

3.116 In terms of the earlier regulatory framework, if the SGL transfer form bounces three times in a half year, the account holder is liable to be debarred from using SGL facility for a period of 6 months. The said guidelines were revised and a system of graded monetary penalties subject to a maximum penalty of ₹5 lakh per instance was prescribed in July 2010. Further, as per the Reserve Bank Directions, Non-Convertible Debentures (NCDs) cannot be issued for maturity less than 90 days and cannot have call/put options that are exercisable within 90 days from the date of issue.

3.117 In July 2010, the revised draft guidelines on Over-the-Counter (OTC) Foreign Exchange

Derivatives and Overseas Hedging of Commodity Price Risk and Freight Risk were placed by the Reserve Bank on its web site for public comments.

3.118 As a measure of procedural simplification, an on-line reporting system for Overseas Direct Investment (ODI) by the Indian Parties has been operationalised in a phased manner, with effect from March, 2010. The new system would enable on-line generation of the Unique Identification Number (UIN), acknowledgment of remittance/s and filing of the Annual Performance Reports (APRs) and easy accessibility to data at the AD level for reference purposes.

Exchange Traded Currency Derivatives

3.119 Currency futures in US$-INR were introduced in August 2008. Three more currency pairs, such as, Euro-INR, Japanese Yen-INR and Pound Sterling-INR were introduced during 2009-10 to provide more avenues to hedge the currency exposure of Indian residents. In the interest of financial stability, participation in the currency futures markets is, however, restricted to residents. In order to expand the existing menu of exchange trade hedging tools, recognised stock exchanges have been permitted to introduce plain vanilla currency options on spot USD-INR exchange rate for residents. The currency options market would function subject to directions, guidelines, instructions, and rules issued by the Reserve Bank and the SEBI from time to time.

11. Customer Service in Banks

3.120 During 2009-10, focused attention was paid to customer service in the banking sector by sensitising banks to render an efficient customer service. Reserve Bank has taken a number of steps to disseminate instructions/ guidelines relating to customer service and grievance redressal by banks through the multi-lingual website by placing all customers related notifications and press releases in a specific page titled ‘For Common Person’. Customers of commercial banks can also approach the Reserve Bank with their grievances and queries through ‘Contact Us’ mode of the website. A complaint form for lodging complaints with the Banking Ombudsman has also been made functional.

3.121 With a view to strengthening the Grievance Redressal Mechanism, banks are asked to display names of the concerned nodal officer appointed at their Regional/Zonal Offices along with names of officials who can be contacted for redressal of complaints as per provisions of the Banking Ombudsman Scheme (BOS), 2006. Banks may also display this information on their web-sites as per provisions of BOS.

3.122 A comprehensive Master Circular on Customer Service was issued on July 1, 2010 incorporating various issues, such as, customer service, operations of deposit accounts, levy of service charges, service at counters, disclosure of information, operation of accounts by old and incapacitated persons, facilities to visually impaired persons, guardianship in deposit accounts, remittances, drop box facility, collection of instruments, dishonour of cheques, dealing with complaints, erroneous debits due to wrong/fraudulent transactions, safe deposit lockers, nomination facility, settlement of claims of deceased depositor/missing person, unclaimed deposits and in operative accounts, customer confidentiality obligations, transfer of internal account in branch, switching of bank, coordination of officers of CBDT, implementation of recommendation of Working Groups/Committees, and BCSBI’s code of commitment to customers and instructions issued thereon. In the circular, instructions were issued regarding lodging of ATM-related complaints, display of information regarding Local Level Committees set up under the

National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999 and dealing with incidence of frequent dishonour of cheques of value ₹1 crore and above.

3.123 The Customer Service Department (CSD) has published a FAQ on Housing Loans and Cheque Collection by banks which are placed on the website of the Bank for information to common man. Credit Information Bureau of India Limited (CIBIL) has been advised to revise the format of reporting of data by banks to CIBIL to classify accounts as closed accounts, settled accounts, restructured accounts and written off accounts with dates and with specific flag in status field, separately to better reflect credit history of an individual. Earlier, accounts were, classified as 'written off' even if it was settled with the bank. CIBIL credit report has now been made available to customers against payment of ₹142.

3.124 To avoid internet frauds, banks have been advised to put disclaimer (such as bank does not ask for PIN/password so beware, refrain from doing internet transactions if you are not familiar) on the monitor when customers are carrying out online internet banking transactions.

3.125 The IBA has issued instructions to all banks to provide loan statements on annual basis for all retail loans with details such as particulars of principal, interest and outstanding balance.

Display of information for lodging ATM related Complaints

3.126 The Reserve Bank has advised banks to display prominently at their ATM locations the following information: (a) A notice that complaints should be lodged at branches where customers maintain account to which the ATM card is linked, (b) Telephone numbers of help desk/contact persons of the ATM owning bank to lodge complaint/seek assistance.

3.127 Banks were advised to update customers' records immediately on receipt of intimation of change of address and other details, and also ensure proper coordination with billing department. A Committee on Customer Service in banks under the Chairmanship of Shri M. Damodaran has been constituted to look into banking services rendered to retail and small customers, including pensioners and also to look into the system of grievance redressal mechanism prevalent in banks, its structure and efficacy and suggest measures for expeditious resolution of complaints. Banks have been advised to review customer service/customer care aspects in the bank and submit a detailed memorandum in this regard to the Board of Directors, once every six months and initiate prompt corrective action wherever service quality/skill gaps have been noticed. Further, Banks have been advised not to insist on collateral security for educational loans up to ₹4 lakh.

3.128 Customers are entitled to compensation for delay in collection of cheques or delay in returning documents/securities beyond 15 days of settlement of dues without their demanding the same. Banks are also now committed to explain the provisions of Income Tax Act applicable to interest income and obtain Form 15G/H at the time of opening a term deposit account, wherever applicable; notify the joint holder/s, in addition to the first holder of an account, before classifying an account as dormant/inoperative; not to insist that insurance cover for securities lodged be obtained from a particular provider; disburse any pre-sanctioned credit facilities offered and accepted over telephone, only after obtaining written consent from the customer; introduce a system of checks before referring a loan to a collection agent and dispose customer complaints within 30 days.

Banking Ombudsman Scheme

3.129 Banking Ombudsman (BO) offices receive complaints from general public relating to their grievances against commercial banks, regional rural banks and scheduled primary co-operative banks. Complainants have the facility to send complaints by email, online or by post. These complaints are tracked by BO offices by means of a complaint tracking software. During 2009-10, 79,266 complaints were received by 15 BO offices as against 69,117 complaints received during the previous year.

12. Payment and Settlement Systems

3.130 Recognising the significance of advances in payment and settlement systems for the economy and the financial system, the Reserve Bank works with a clear mission to ensure that all payment and settlement systems operating in the country are "*safe, secure, sound, efficient, accessible and authorised*". Consistent with the above mission, the Reserve Bank took several measures during 2009-10 for improving the efficiency of existing systems as well as promoting the use of new modes/ systems while also striving to put in place a framework for off-site and on-site surveillance of payment systems.

3.131 Under the guidance and directions of the Board for Payment and Settlement Systems (BPSS), policies of the Reserve Bank continued to be transparent and oriented towards promoting orderly development of the payment systems ensuring that the systems functioned in an efficient and secure manner. The policies encouraged participants to shift from paper-based/cash-driven payment systems to safer and faster electronic modes of payments in a non-disruptive manner. The process of issue of authorisation to entities for operating payment systems under the Payment and Settlement Systems Act, 2007, was made rigorous and in alignment with these objectives, ensuring that only entities with sound financial position, adequate expertise, and technology support and good corporate governance are authorised to operate such systems. Thirty seven entities have so far been issued certificate of authorisation to operate various payment and settlement systems in areas of credit-debit card management, ATM networks, cross border money transfer services, and issue of pre-paid payment instruments. The Reserve Bank has prepared a Payment System Vision document covering the period 2009-12.

Paper Based Payment Systems

3.132 Paper based transactions account for 60 per cent of total transactions processed through both MICR and Non-MICR clearing houses. To enhance the safety, security and efficiency of paper based system, the Reserve Bank took steps like (i) discontinued high value clearing in a non-disruptive manner over a period of one year; (ii) extended speed clearing which facilitates local clearing of outstation cheques, to 66 MICR centres; (iii) Initiated steps to roll out Cheque Truncation System (CTS) in Chennai covering all the southern centres after successfully implementing the same in the National Capital Region; (iv) issued a new cheque standard styled CTS-2010 to enhance the integrity of images procured under CTS by mandating minimum security features covering quality of paper, watermark, banks logo in invisible ink, and void pantograph on cheque forms.

Electronic Payment Systems

3.133 The large value electronic payment systems, *viz*., Real Time Gross Settlement System (RTGS) and the Retail Electronic Payment Systems, *viz*., National Electronic Clearing Services (NECS and ECS), National Electronic Fund Transfer (NEFT) and Card Payment Systems are the electronic payment systems available in India. The trend of shift of transactions from paper to electronic mode continued during 2009-10. The share of electronic transactions to total transactions increased from 32.8 per cent to 40 per cent volume-wise and from 83.9 percent to 89 per cent value wise during the year. To encourage the electronic transactions, the waiver of processing charges for ECS/NECS/NEFT/RTGS was further extended up to March 31, 2011.

Real Time Gross Settlement Systems:

3.134 The implementation of RTGS systems by Central Banks throughout the world is driven by the goal to minimize risk in high-value electronic payment settlement systems. In an RTGS system, transactions are settled across accounts held at a Central Bank on a continuous gross basis. Settlement is immediate, final and irrevocable and thus the credit risks due to time lags in settlement are eliminated. India introduced RTGS system in 2004 and since then, each year the volume and value of transactions transacted is increasing in multiples. Reserve Bank in consultation with participants has been continuously striving to bring about improvements. Towards this, following initiatives were taken:

- extended customer and Inter -bank transactions timings for processing RTGS transactions on Saturdays by 30 minutes and is now available from 9.00 hours to 13.30 hours for customer transactions and from 9.00 hours to 15.00 hours for Inter-bank transactions
- permitted SEBI regulated clearing entities viz. Indian Clearing Corporation Limited (ICCL) and National Securities Clearing Corporation Limited (NSCCL) to settle funds legs of OTC trades of the corporate bond transactions in RTGS from December 2009.
- steps initiated for ushering in Next-Gen RTGS keeping in view the increase in the coverage, usage and change in the technology.

Electronic Clearing Service (ECS)/ National Electronic Clearing Service (NECS):

3.135 The ECS facility of multiple credits/ debits against a single debit/credit for bulk payments has been extended to 89 centres. To facilitate the users to submit a single file at a centralized location instead of multiple files at many locations, the *National Electronic Clearing Service* (NECS) was introduced in September 2008. A near two-fold increase in volumes and value of transactions processed through NECS credit was seen during the year which could be attributed to more banks (116), branches (about 48,000) and increased number of companies participating in the system. In July 2010, NECS saw a peak of 8.10 million transactions for ₹152.92 billion against a monthly average of 5.92 million (volume) and ₹65.10 Billion (Value) observed in 2009-10.

3.136 To facilitate State Governments to operate from a single location in the State (the capital city), a concept of *Regional ECS (RECS Credit)* was introduced in Bengaluru in May 2009 and is now extended to Chennai. The State Governments were otherwise using the Local-ECS variant available at different cities / local centres for making repeated payments to persons/entities.

National Electronic Fund Transfer (NEFT) system:

3.137 The centralized version of EFT termed National Electronic Funds Transfer (NEFT) introduced in 2005 enables the funds to be transferred electronically irrespective of location. Viewing the system successfully handling significant volumes the following measures were initiated to strengthen the NEFT system: (i) mandated creation of Customer Facilitation Centre (CFC) at the service centre of the NEFT member bank for prompt resolution of customer complaints. A directory of the CFCs has been placed at the RBI website for the benefit of the public; (ii) return discipline for NEFT transactions tightened by mandating the returns within two hours of completion of a batch against the earlier T+1; (iii) increased the number of settlements from six to eleven on week days and from three to five settlements on Saturdays to achieve a near-real time settlement of transactions; (iv) introduced the system of providing *'Positive Confirmation'* to the remitters of funds through NEFT for a successful credit to beneficiary's account which is a unique initiative.

Credit/Debit Cards and ATMs

3.138 During 2009-10, Reserve Bank mandated the following steps to enhance the quality of customer service in banks and mitigate risks arising out of usage of credit/debit cards over internet: (i) additional authentication on usage of credit cards over internet, based on the information not available on the card; (ii) online alert to be sent to the cardholder for 'card not present' (CNP) transactions of value for ₹5,000 and above; (iii) additional authentication and online alert to be implemented for transactions carried out over telephone (IVRS) from January 2011; (iv) reimbursement to the customers the amount wrongfully debited by banks on account of failed ATM transactions within 12 days and automatically pay compensation of ₹100 per day for delays in such disbursement to them; (v) to place a standardised ATM complaint template at all ATMs and banks' websites; and (vi) permitted banks to allow their customers cash withdrawal up to ₹1,000 per day using debit cards at POS terminals.

Pre-paid Instruments

3.139 Detailed guidelines were issued in April 2009, on the issue and accounting of pre-paid payment instruments. To widen the scope of these guidelines, in August 2009, *non-bank entities* which were not permitted earlier were also permitted to issue mobile based pre-paid payment instruments. The Reserve Bank has accorded approval to 28 banks and authorisation to 16 non-bank entities to issue pre-paid instruments.

3.140 To safeguard interests of customers and to ensure that the payments made by them using Electronic/Online Payment modes are duly accounted for by intermediaries receiving such payments, directions were issued in November 2009. Directions require that the funds received from customers for such transactions need to be maintained in an internal account of a bank and the intermediary should not have access to the same.

Mobile Banking

3.141 The operative guidelines on Mobile Banking issued in October 2008 were reviewed and relaxed in December 2009 by enhancing the limits for mobile banking transactions up to ₹50,000 for both e-commerce and money transfer transactions, and permitting the money transfer facility up to ₹5,000 from a bank account to beneficiaries not having a bank account.

Regulatory/Supervisory Intervention

3.142 The developments in the payment system were continued to be closely monitored to ensure that no person operated a payment system without specific authorisation from the Reserve Bank under the PSS Act, 2007. The Bank intervened in a few such cases and also issued show cause notices to few banks for violation of the Reserve Bank directions on charges for collection of outstation cheques.

Other Developments

3.143 India has been made a member of the Committee of Payment and Settlement System (CPSS) of Bank for International Settlement (BIS). The Reserve Bank also represents on four steering/working groups of CPSS, *viz.*, (i) General

Review of Standards; (ii) Repo Market Infrastructure; (iii) Post trade Services, and (iv) Retail Payment Systems. The Reserve Bank extended assistance to Royal Monetary Authority (RMA) of Bhutan to set up an electronic payment and settlement system infrastructure at Bhutan free of cost under the SAARC Payment Initiatives. In June 2010, the NECS and NEFT systems have been implemented in Bhutan.

13. Technological Developments

3.144 With a view to further leveraging the role of information technology (IT) in enhancing the efficient functioning of the financial system, the Reserve bank undertook important steps covering IT infrastructure and implementation of new applications. A High Level Committee was constituted under the Chairmanship of the Deputy Governor (Dr. K. C. Chakrabarty) and members from IIT, IIM, IDRBT, Banks, and the Reserve Bank to prepare the IT Vision for the Reserve Bank for the period 2011-2017, *inter alia*, to review the functions of Department of Information Technology and suggest measures for way forward.

Green IT and its relevance to Banking Sector

3.145 The term "Green Banking" is becoming popular as more citizens look for ways in which they can help the environment. While, green banking encompasses a wide variety of banking services, many banks are promoting their online banking services as a form of green banking. The environment and the banking industry can both benefit if more bank customers start to use the online banking services that are available. Benefits of online banking include less paperwork and less driving to branch offices by bank customers, which will have a positive impact on the environment. Interestingly, online banking can also increase the efficiency and profitability of a bank. A bank can lower their own costs that result from paper overload and bulk mailing fees if more of their customers use online banking. Green banking also can reduce the expenditure of branch banking (Box III.3).

14. Legal Reforms

3.146 The legislative changes undertaken during 2009-10 are as follows:

The Coinage Bill, 2009

3.147 This Bill (introduced in the Lok Sabha on December 17, 2009) seeks to consolidate laws relating to coinage and Mints into a Single Act while repealing the existing laws, *viz.,* (i) Metal Tokens Act, 1889, (ii) Coinage Act, 1906, (iii) Bronze Coin (Legal Tender) Act, 1918, and (iv) Small Coins (Offences) Act, 1971. The Bill also seeks to prohibit and impose penalty on the melting or destruction of coins, unlawful making, and issue or possession of metal pieces to be used as money.

State Bank of Saurashtra (Repeal) and State Bank of India (Subsidiary Banks) Amendment Bill, 2009

3.148 The Bill seeks to repeal the State Bank of Saurashtra Act, 1950 pursuant to the acquisition of State Bank of Saurashtra by the State Bank of India. It seeks to make certain consequential amendments in the State Bank of India (Subsidiary Banks) Act, 1959 by omitting provisions relating to State Bank of Saurashtra. The Bill has been passed by both the Houses of Parliament and has received the assent of the President.

The Securities and Insurance Laws (Amendment and Validation) Bill, 2010

3.149 This Bill seeks to replace the Securities and Insurance Laws (Amendment and Validation) Ordinance, 2010 which was promulgated by the President of India on June 18, 2010. The Bill seeks to introduce, *inter alia*, Chapter IIIE in the RBI Act to provide for a joint mechanism, consisting of Union Finance

Box III.3: Green IT

Green computing or green IT refers to environmentally sustainable computing or IT which is more environment-friendly. The green computing is also defined as the study and practice of designing, manufacturing, using, and disposing of computers, servers, and associated subsystems - monitors, printers, storage devices, and networking and communications systems - efficiently and effectively with minimal or no impact on the environment. Modern IT system rely upon a complicated mix of people, networks and hardware, as such, a green computing initiative must cover all of these areas as well. The other aspect of Green IT comprises of using the IT services to reduce environmental impact of other industries.

The goals of green computing are to maximise energy efficiency during the product's lifetime, and promote the recyclability or bio-degradability of defunct products and factory waste. The following would be benefits accruing from practicing principles associated with Green IT: (i) reduced energy costs both through lower usage and more efficient operations of equipment, (ii) streamlined IT processes to reduce cost inefficiencies and decrease environmental impact, (iii) enabled a more mobile and agile workforce for flexible and remote working, further reducing carbon emissions from unnecessary travel, (iv) organisations of all sizes can benefit by reducing operation costs and equipment costs.

While ensuring that this can be practiced in all areas of work, the following tips are helpful:

IT services

- Energy efficient data centre and renewable energy sources for data centre power consumption;
- Low energy communication and networking equipments and low energy consuming computing devices;

IT Infrastructure

- Use cloud computing and software-as-a-service solutions (SaaS) instead of running a new application in-house;
- Technologies such as virtual private networks, and collaboration tools help employees work together from different locations;
- Server and storage virtualisation;
- Develop a thin client strategy;

Computers and Desktop Monitors

- Reduce power consumption through effective power management by employing alternative energy sources for computing workstations, servers, networks and data centers;
- Power-down the CPU and all peripherals during extended periods of inactivity and activating standby setting;
- Power-up and power-down energy-intensive peripherals such as laser printers according to need;
- Use liquid-crystal-display (LCD) monitors rather than cathode-ray-tube (CRT) monitors;

Paper

- Reduce paper consumption;
- Use recycled paper or non-wood paper, eliminate paper, printer and packaging waste;
- Re-use papers to make rough notes;

Printer

- Ensure that printer has a standby mode, which should be activated after a short period of inactivity;
- Buy automatic duplex printers, set duplex printing as default or manually feed the paper for printing on both sides;

Go digital

- Transition from paper based to digital processes;
- Use emails with attachments for sending office documents instead of sending hardcopies;

Encourage telecommuting and Collaboration

- Use Web conferencing instead of traveling to meetings;
- Enable staff to telecommute;

Waste Management – Reduce, Reuse, Recycle

- Dispose of e-waste properly;
- Minimise the use of paper and properly recycle waste paper;
- Donate to non-profit organisations;

Minister as its Chairperson, Governor, the Reserve bank of India, Finance Secretary and Chairpersons SEBI, IRDA and PFRDA as its members to resolve any difference of opinion among the regulators. The Bill seeks to slightly modify the Ordinance. In the Bill, the constitution of the Joint Committee has been modified to make the Governor of the Reserve Bank as the Vice Chairperson of the Committee. Further, the difference of opinion which can be referred to the Joint Committee will not include any difference of opinion that may arise between any regulator and the Central Government. The Bill provides for a reference being made to the Joint Committee only by regulators and not by the Central Government. The Bill has been passed by both the Houses of Parliament.

State Bank of India (Amendment) Bill, 2010

3.150 The State Bank of India (Amendment) Bill, 2010 seeks to amend the State Bank of India Act, 1955. The Bill, *inter alia*, provides for: (i) raising the authorised capital of the State Bank of India (SBI) to ₹5,000 crore; (ii) the issued capital of SBI to consist of equity shares or equity and preference shares; (iii) allowing SBI to raise the issued capital by preferential allotment or private placement or public issue or rights issue; (iv) allowing SBI to issue bonus shares to existing equity share holders; (v) reducing the shareholding of the Central Government from fifty five percent to fifty one percent consisting of equity shares of issued capital; (vi) providing nomination facility in respect of shares held by individual or joint shareholder; (vii) restricting the voting rights of preference shareholders only to resolutions affecting their rights and also restricting the preference share holders, other than Central Government, to exercise voting rights in respect of preference shares held by them to a ceiling of ten percent of total voting rights of all preference share holders; (viii) specifying qualifications for directors elected by shareholders of SBI and conferring power upon the Reserve bank to notify the fit and proper criteria for such directors; (ix) empowering the Reserve bank to appoint additional directors as and when considered necessary; (x) conferring upon Central Government the power to supersede the Central Board of SBI in certain cases on the recommendations of the Reserve bank and to appoint an Administrator; (xi) allowing State Bank to hold their Central Board meetings through video-conferencing or other electronic means; (xii) allowing the Central Government to appoint not more than four Managing Directors in consultation with the Reserve Bank; (xiii) abolish the post of Vice-Chairman. The Bill has been passed by both the Houses of Parliament in August, 2010.

15. Conclusions

3.151 The economy has been on a recovery path with the process beginning with second half of 2009-10. The key macroeconomic concern in the second half of 2009-10, however, was the rising inflation, which warranted rebalancing the weights of different objectives pursued through monetary policy.

3.152 The introduction of the base rate system and the concomitant removal of interest rate ceiling on small loans and freeing of rupee export credit interest rate expected to enhance the allocative efficiency of the financial intermediation process by banks, while also promoting financial inclusion. The interest rate deregulation would enable greater flow of credit to agriculture and small businesses. As a regulator, the Reserve Bank emphasises transparency, customer education/awareness and effective grievance redressal systems. The role of Reserve Bank as a regulator and facilitator of payment and settlement systems assumes critical importance, given the pace and complexity of changes as well as the risks involved.

3.153 During 2009-10, the Reserve Bank undertook a number of initiatives in improving IT infrastructure facilities, implementing new applications and initiating steps for further adoption of technology in the financial sector. IT has helped in increasing the speed and efficiency of banking operations by facilitating introduction of innovative products and new delivery channels. Financial inclusion has been emphasised by broadening the scope of BCs. The legal reforms also helped in merger and acquisition as well as amalgamation of banks in the Indian banking system.