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Liquidity Adjustment Facility(LAF)

Following the measures announced in the Statement on Monetary and Credit policy for the year 2000-2001, the first stage of the Liquidity Adjustment Facility (LAF) has been implemented from June 5, 2000. Under the scheme, (i) repo auctions (for absorption of liquidity) and (ii) reverse repo auctions (for injection of liquidity) would be conducted on a daily basis (except Saturdays). But for the intervening holidays and Fridays, the repo tenor would be one day. On Fridays, the auctions would be held for three days maturity to cover the following Saturday and Sunday. With the introduction of the Scheme, the existing Fixed Rate Repo would be discontinued. The liquidity support extended to all scheduled commercial banks (excluding RRBs) and Primary Dealers through Additional Collateralised Lending Facility (ACLF) and refinance/reverse repos under Level II, respectively has been withdrawn. Export Refinance and Collateralised Lending Facility (CLF) at Bank Rate would continue as per the existing procedures. Like-wise, Primary Dealers would continue to avail of liquidity support at level I at Bank Rate. The funds from the Facility should be used by the banks for their day-to-day mismatches in liquidity. The Scheme would be reviewed from time to time in consultation with market participants and appropriate changes would be made in the light of experience.

Rate of Interest

Interest rates in respect of both repos and reverse repos would be decided through cut off rates emerging from auctions on uniform price basis conducted by the Reserve Bank of India, at Mumbai. The repo rate in per cent per annum expected by the tenderer would be expressed up to two decimal points rounded off to the nearest 5 basis points. As there would be no adjustment for accrued coupon, the cash flow would depend upon the repo rate emerging on day-to-day basis.

Operations

Bids would be received in tender forms at RBI, Central Office, Mumbai before 11.00 a.m. on week days except Saturdays and the auction results would be displayed by Mumbai Office by 1.00 p.m. The repo would be conducted as Hold in Custody type, with the RBI acting as a custodian for the participants and holding the securities on their behalf in the Repo/Reverse Repo Constituents' Accounts. For this purpose, the participants would have to give an undertaking as given in the respective tender forms authorizing RBI to act on their behalf. RBI, would not, however, be held responsible for any loss, damage or liability on account of acting as the custodian. A Repo Constituents' SGL Account (RC SGL Account) and Reverse Repo Constituents' SGL Account (RRC SGL Account) would be opened and held in the Securities Department in Mumbai Office for this purpose.

Eligibility

All Scheduled Commercial Banks (excluding Regional Rural Banks) and Primary Dealers (PDs) having Current Account and SGL Account with RBI, Mumbai would be eligible to participate in the repo and reverse repo auctions.

Limit

The minimum amount to be tendered under repos and reverse repos would be Rs.10 crore and in multiples of Rs.5 crore.

Eligible Securities

Repos and reverse repos would be undertaken in all transferable dated Government of India Securities and Treasury Bills, except 14 days treasury bills.

Margins

The margins would be uniformly applied in respect of the collateral securities comprising dated securities/treasury bills and the amount of securities offered or tendered on acceptance of a bid for Rs.100 will be Rs.105.00 in terms of face value.

Settlement of Transactions

The settlement of transactions in the auction would take place on the same day.

SLR and Securities held in Repo SGL Account

Securities held by RBI on behalf of banks' Repo Constituents' SGL account and credit balance in the RRC SGL Account would be counted for SLR purpose and a certificate would be issued to banks by RBI on a fortnightly basis. As far as valuation for SLR purpose is concerned extant DBOD instructions would apply.

Tender Forms

Details regarding tender forms for Repo Auction and Reverse Repo Auction along with terms and conditions are available on RBI website <http://www.rbi.org.in>.

Foreign Investments under FEMA

To regulate acquisition and transfer of a foreign security by a person resident in India i.e. investment by Indian entities in overseas joint ventures and wholly owned subsidiaries as also investment by a person resident in India in shares and securities issued outside India, the Foreign Exchange Management Act. (FEMA, 1999) has granted general permission to persons resident in India for purchase and acquisition of securities :

- (a) out of funds held in RFC account;
 - (b) issued as bonus shares on existing holding of foreign currency shares;
 - (c) sale of shares/securities so acquired and out of their foreign currency resources outside India.
- Persons resident in India can now also sell securities so acquired.

Direct Investment Abroad

Any Indian party is now permitted to make investment upto US\$ 50 million. or its equivalent in a block of three financial years, except investment in Nepal and Bhutan; and investment in Indian rupees upto Rs.120 crore in Nepal and Bhutan in a block of three financial years in overseas joint venture (JV)/wholly owned subsidiary (WOS). The ceiling includes contribution to the capital of the overseas JV/WOS, loan granted to the JV/WOS, and 50 per cent of guarantees issued to or on behalf of the JV/WOS. The investment should be in a foreign entity engaged in the same core activity [as defined in clause (d) of Regulation No. 2] carried on by the Indian company. The Indian party should have earned net profit during preceding three accounting years. The Indian party should not have been on the Reserve Bank's caution list or under investigation by the Enforcement Directorate. All transactions relating to a joint venture/wholly owned subsidiary should be routed through a branch of an authorised dealer to be designated by the Indian party. Such an investment may be funded out of balances held in Exchange Earners' Foreign Currency (EEFC) account of Indian party and/or by remittance from India upto the extent of 25 per cent of Indian party's net worth as on the last audited balance sheet and/or utilisation of 50 per cent of proceeds of foreign currency funds raised through ADR/GDR issues.

Where the investment is entirely funded out of balances in EEFC account and/or out of proceeds of ADR/GDR issues the conditions referred above will not apply. An Indian party is permitted to make direct investment without any monetary limit to the extent of 50 per cent of funds raised through ADRs/GDRs. Where the Indian party seeks to make investment in an entity outside India engaged in financial sector it should also fulfil the conditions specified in Regulation No. 7. An Indian party engaged in any of the sectors included in Schedule I to the FEMA Regulations is permitted to acquire shares of a company outside India which is also engaged in the same activity in exchange of ADRs/GDRs issued to the latter for the shares so acquired, provided

- (a) the investment does not exceed US\$ 100 million or its equivalent or

(b) an amount equivalent to 10 (ten) times the export earnings of Indian party during preceding financial year inclusive of any other direct investment made during the same financial year, including investment made under (a) above.

In all other cases of direct investment abroad which are not covered by this general permission, the Reserve Bank's approval would be required.

The Indian party is permitted to capitalise the payments due from the foreign entity towards exports made to it (other than those which have remained outstanding for more than six months) as also fees, royalties or any other payments due from the foreign entity within the ceilings applicable for investment in overseas JVs/WOS.

Authorised dealers have been permitted to remit earnest money deposit or issue a bid bond guarantee on behalf of an Indian party for acquisition of a foreign company through bidding and tender procedure and also allow subsequent remittances subject to the provisions regulating acquisition and transfer of foreign securities.

The Indian party which has made direct investment abroad under these Regulations is under obligation to (a) receive shares certificate or any other document as an evidence of investment, (b) repatriate to India the dues receivable from foreign entity and (c) submit the documents/annual performance report to the Reserve Bank.

Sale of shares of JV/WOS abroad held by an Indian party would require prior approval of the Reserve Bank. The Indian party has, however been permitted to pledge the shares of JV/WOS to an authorised dealer or a financial institution in India for availing of any credit facility for itself or for the JV/WOS abroad.

Other Modes of Investment in Foreign Securities

An Indian company or a body corporate which has obtained necessary approval of Government of India, Ministry of Finance, Department of Economic Affairs has been permitted to issue Foreign Currency Convertible Bonds (FCCBs) to a person resident outside India. Such a company or body corporate is required to submit to the Reserve Bank a report within 30 days form issue of FCCBs.

General permission has been granted to a person resident in India

- (a) to acquire foreign securities as a gift from any person resident outside India;
- (b) to acquire shares under Cashless Employees Option Scheme issued by a company outside India;
- (c) To acquire shares by way of inheritance from a person whether resident in or outside India;
- (d) who is an employee or a director of Indian office or branch of a foreign company or of a subsidiary in India of a foreign company or of an Indian company in which foreign equity is not less than 51 per cent to purchase equity shares offered by the said foreign company under the Employee Stock Option Scheme provided (a) such shares are issued at a concessional price and (b) the amount of consideration for purchase of shares does not exceed US\$ 10,000 or its equivalent in a block of 5 calendar years. Authorised dealers have been permitted to allow remittances for purchase of shares under the scheme by eligible persons. The shares acquired by persons resident in

India in accordance with the provisions of the Act, Rules or Regulations made thereunder are allowed to be pledged for obtaining credit facilities in India from an authorised dealer.

The Reserve Bank would consider applications from residents for acquisition of foreign securities in following cases

- a) acquisition of qualification shares for becoming a director of a company outside India.
- b) purchase of rights shares of a company outside India, provided the consideration therefor does not exceed US\$ 10,000 in a block of five calendar years.
- c) purchase of shares of a JV/WOS abroad by employees/directors of an Indian promoter company in the field of software subject to certain conditions and
- d) purchase of foreign securities under ADR/GDR linked stock option schemes by resident employees of Indian software companies including working directors provided purchase consideration does not exceed US\$ 50,000 or its equivalent in a block of five calendar years.

The Reserve Bank would, on application, permit mutual funds in India to purchase foreign securities subject to such terms and conditions as it may stipulate.

Customer Service

Immediate Credit of Cheques up to Rs 7,500

The Reserve Bank of India has enhanced the amount for immediate credit of outstation and local cheques tendered for collection by bank customers to Rs 7,500 subject to the accounts being conducted satisfactorily. The enhanced limit is effective from June 2, 2000. The earlier limit was Rs 5,000.

Duplicate Demand Draft

Monetary Value

It has been decided that the present monetary value prescribed by the Talwar Committee at Rs.2,500 should be enhanced to Rs.5, 000 for issue of duplicate demand draft (DD) on the basis of adequate indemnity and without obtaining non-payment advice from the drawee branch. The drawee office may merely be cautioned in this regard. If the duplicate draft is to be issued for more than Rs.5,000 non-payment certificate should be called for from drawee office by telex/telegraph at applicant's cost and other formalities completed as per extant procedure.

Fixation of Timeframe

It has been decided that a duplicate demand draft should be issued to the customer within a fortnight from the receipt of such request. For delay in issuing duplicate draft beyond the stipulated period, banks should pay interest at the rate applicable for fixed deposit of corresponding maturity in order to compensate the customer for such delay. As per earlier guidelines issued by the RBI, the banks were advised to ensure that a duplicate demand draft was issued within a maximum period of five days after the completion of all the formalities. The period for issue of duplicate draft has been extended in the light of representation received through Regulations Review Authority that there was considerable delay in issue of non-payment advice by the drawee branch.

Banking Policy

Indirect Finance to Agriculture

Lending by banks to Non Banking Financial Companies (NBFCs) for onlending to agriculture would now be reckoned for the purpose of priority sector lending. A circular to this effect has been issued by the Reserve Bank with a view to providing one more avenue for banks' lending to agriculture and increasing the outreach of banks in rural areas.

Prudential Norms

Securities guaranteed by State Governments

RBI has advised all commercial banks (excluding RRBs) that they should assign risk weight of 100 per cent only on those state government guaranteed securities issued by entities which default in payment of interest and repayment of principal and not on all the securities issued or guaranteed by that state government. Banks should pay due regard to the record of particular state government in honouring their guarantees while processing any further requests for loans to the PSUs in that state on the strength of state government guarantee.

Sick SSI Units under Rehabilitation

It has been decided that no provision need be made for a period of one year from the date of disbursement in respect of additional credit facilities granted to small scale units which are identified as sick and where rehabilitation packages/nursing programmes have been drawn by the banks themselves or under consortium arrangements.

Provision on Standard Assets

The general provision of 0.25 per cent on standard assets should be made on global portfolio basis and not on domestic advances alone. Provisions towards standard assets need not be netted from advances as advised earlier but shown separately as contingent provisions against standard assets, under other liabilities and provisions-others in schedule 5 of the balance sheet. The above contingent provision will not be eligible for inclusion in Tier II capital.

Advances against Book Debts

The commercial banks should also indicate separately in schedule 9 of the balance sheet that item B(i) includes Advances against Book Debts as shown below:

Advances-(schedule 9)

B (i) Secured by tangible assets*

(*includes advances against book debt)

RBI has also clarified that the extra provision needed in the event of a depreciation in the value of the investments should be debited to the Profit and Loss Account and if required, an equivalent amount should be transferred from the 'Investment Fluctuation Reserve Account' to the Profit and Loss Account as a 'below the line' item after determining the profit for the year.

Small Scale Industries

Settlement Advisory Committees (SACs)

RBI has expressed concern at the slow pace of recovery of Non Performing Assets through the Settlement Advisory Committees (SACs). The RBI had, in May 1999, issued indicative parameters to banks for constitution of SACs for considering compromise settlement of chronic NPAs relating to the small sector. The SACs are operative only till September 30, 2000. The RBI has once again impressed upon the chairmen of Public Sector Banks the need to make the Settlement Advisory Committees an effective medium for recovery of chronic dues of the small sector by close monitoring of the functioning of the SACs.

Flow of credit

In terms of notification issued by the Government of India, the ceiling on investment in plant and machinery has been reduced from Rs.3 crore to Rs. 1 crore for small scale/ancillary industrial undertakings and for reckoning of bank advances to SSI units under the priority sector. The Government of India has clarified that the units which have obtained permanent registration earlier, would continue to remain as SSI units .Further, the units which had acquired SSI status based on the order dated December 10, 1997, would continue to retain it and the units which have got provisional registration with state authorities as SSI would also continue to remain as such provided the provisional registration had taken place within the period of limitation of 180 days as specified in the order dated December 10, 1997.

Exemption Limit for Borrowal Accounts

RBI has advised banks that the exemption limit of borrowal accounts for obtention of collateral security has been raised to Rs.5 lakh for the tiny sector. Further, the composite loan limit for providing working capital and term loan through a single window has been raised to Rs.10 lakh in the case of SSI units.

Opening of Specialised Branches

The Reserve Bank has advised banks to accelerate their programme of opening of specialised SSI branches to ensure that SSI clusters within districts are served by at least one specialised SSI branch..In order to improve the quality of banking services ,it has been decided that the specialised SSI branches should also obtain ISO certification.

Regional Rural Banks

Reduction in Single Exposure Limit

With a view to bringing the regional rural banks (RRBs) on par with commercial banks and as a prudential measure aimed at avoidance of concentration of credit risk, it has been decided to refix limits on RRBs' exposure to individual borrowers and on investments from the present level of 25 per cent to 20 per cent of RRBs' owned funds or 20 per cent of the paid up capital of the borrower/investee company, whichever is less, effective from April 1, 2000. RBI has advised RRBs

that wherever the existing level of exposure as on October 31, 1999 is more than 20 per cent of owned funds they should strive to reduce the exposure up to 20 per cent limit within a period of two years. (i.e., by end October 2001). Exposure should include funded and non-funded limits and similar commitments. The investments including investments in bonds of the public sector undertakings and all India financial institutions should satisfy single exposure norm, i.e., the loans granted to a company together with investments made in its shares by RRBs should not exceed 20 per cent of the owned funds of the RRB or 20 per cent of the paid-up share capital of the investee company, whichever is less. For this purpose, the loans granted to a company should be taken together with investments made in its shares /debentures /bonds for ascertaining the single exposure limit.

Computation of Owned Funds

It has also been decided to permit RRBs to take into consideration the additional share capital contributions received from the central government and the sponsor banks (even in cases where State Government's contributions are awaited) for the computation of owned funds on a notional basis, only for the purpose of computing exposure limit for advances/investments.

Miscellaneous

Validity of Section 45 S of the RBI Act

The Supreme Court of India has in a landmark judgement, upheld the constitutional validity of Section 45 S of the Reserve Bank of India Act. Accordingly, Section 45 S is now liable to be enforced notwithstanding any interim order to the contrary, which may have been passed by any high courts. The Supreme Court of India has also ordered that all pending petitions challenging the provisions of Section 45 S before the high courts be disposed of within a period of three months.

Section 45 S of the Reserve Bank of India Act as amended in 1997 clamped a total ban on accepting deposits by individuals and unincorporated associations of individuals engaged in financial activities. This provision was challenged in various high courts with more than 2500 writ petitions filed.

On its judgement Supreme Court has observed that since the deposit acceptance by unincorporated bodies is incapable of being regulated by virtue of the large number of such bodies, the provisions in the nature of the amended Section 45 S are necessary and unincorporated bodies should do their business with their own money or money borrowed from financial institutions or money borrowed from their relatives. Section 45 S now prohibits the conduct of banking business by an unincorporated non-banking entity like a shroff. The provision thus aims at protecting the interest of unwary depositors and borrowers of such non-bank entities.