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BANKING POLICY

Recovery of NPAs

The Reserve Bank of India has modified and issued guidelines for recovery of the stock of non-performing assets (NPAs). The revised guidelines provide a simplified, non-discretionary and non-discriminatory mechanism for recovery of the stock of NPAs and will remain operative only up to March 31, 2001. The Reserve Bank has advised that all public sector banks should uniformly implement these guidelines, so as to achieve maximum realisation of dues from the stock of NPAs within the stipulated time. The revised guidelines will cover all sectors including small sector but will not cover cases of wilful default, fraud and malfeasance. The banks should identify such cases and initiate prompt action.

It may be recalled that the Reserve Bank of India had, in May 1999, set out guidelines for constitution of Settlement Advisory Committees (SACs) for compromise settlement of chronic Non-Performing Assets (NPAs) of small sector. A review of compromise settlement of NPAs through SACs revealed that the progress of recovery of NPAs through this mechanism was not encouraging. The recovery position in respect of categories of borrowers other than small sector was also not satisfactory. Banks had represented that on account of relative inflexibility of the parameters given in these May 1999 guidelines, recovery of NPAs did not progress much. It was realised that, while the banks should take effective measures to strengthen the credit appraisal and post-credit monitoring to arrest the incidence of fresh NPAs, a more realistic approach was needed also to reduce the stock of existing and chronic NPAs in all categories.

The modified guidelines distinguish between NPAs up to Rs 5 crore and over Rs 5 crore. The details are:

For NPAs up to Rs. 5 crore

Coverage :

- (a) NPAs in all sectors irrespective of the nature of business, which had become doubtful or loss as on March 31, 1997 with outstanding balance of Rs. 5 crore and below on that date;
- (b) NPAs classified as sub-standard as on March 31, 1997, which have subsequently become doubtful or loss category;
- (c) Cases pending before courts/Debt Recovery Tribunals/Board for Industrial and Financial Reconstruction, subject to the consent decree from the courts/Debt Recovery Tribunals/Board for Industrial and Financial Reconstruction;

Settlement formula:

- (a) *Doubtful or Loss Assets* : In respect of compromise settlement of NPAs classified as doubtful or loss as on March 31, 1997, a minimum of 100 per cent of the outstanding balance in the account as on the date of transfer to the protested bills account or the amount outstanding as on the date on which the account was categorised as doubtful NPA, whichever happened earlier, as the case may be, should be recovered.
- (b) *Sub-standard Assets* : The minimum amount that should be recovered in respect of NPAs classified as sub-standard as on March 31, 1997 which became doubtful or loss subsequently would be 100 per cent of the outstanding balance in the account as on the date of transfer to the protested bills account or the amount as on the date on which the account was categorised as doubtful NPAs, whichever happened earlier, as the case may be, plus interest at existing prime lending rate from April 1, 1997 till the date of final payment.

Payment:

The amount of settlement arrived at in both these above cases, should preferably be paid lump sum. In cases where the borrowers are unable to pay the entire amount in lump sum, at least 25 per cent of the amount of settlement should be paid up front and the balance amount of 75 per cent should be recovered in installments within a period of one year together with interest at the existing prime lending rate from the date of settlement up to the date of final payment.

Sanctioning Authority:

The decision on the compromise settlement and consequent sanction of waiver or remission or write-off should be taken by the competent authority under the delegated powers.

Non-discretionary Treatment:

The banks should follow the guidelines for compromise settlement of all NPAs covered under the revised scheme, without discrimination.

Publicity:

Banks should give notice by August 31, 2000 to the eligible defaulting borrowers to avail of the opportunity for one time settlement of their outstanding dues in terms of these guidelines. Adequate publicity through various means to these guidelines must be ensured.

Reporting:

The concerned authority should submit a monthly report on the progress and details of settlements to the next higher authority and their Central Office. Banks should also submit a report on the

progress in the recovery of NPAs under the revised guidelines every quarter to their Board of Directors. A copy of the quarterly progress report should be sent to the Reserve Bank.

For NPAs over Rs.5 crore:

Chairmen and Managing Directors should personally supervise the NPAs of Rs. 5 crore and above on case to case basis. A list of such NPAs should be prepared. The Chairman and Managing Director should personally review all cases and decide the course of action in terms of rehabilitation / restructuring, one-time settlement or filing of suits, by August 31, 2000. The matter should be placed before the Board of Directors, finalising the course of action by September 30, 2000 in each such case.

The Board of Directors may evolve policy guidelines regarding one time settlement of NPAs over Rs.5 crore covering the computation formula, realisable amount, cut off date and payment conditions with reference to factors of security and disposability, etc., as part of its loan recovery policy including setting up of Settlement Advisory Committee, staff accountability and other relevant aspects and decide individual cases in accordance with such policy. A copy of the policy should be sent to the Reserve Bank.

Wherever a suit is required to be filed against the defaulters, who have not come up for one-time settlement, or where restructuring is not feasible, suits must be filed in all such cases by October 31, 2000. Banks should vigorously and effectively follow up suit filed cases in the courts to enable Debt Recovery Tribunals to decide the cases within six months as laid down in the Debt Recovery Tribunal Act and realise dues at the earliest.

A quarterly report regarding outstanding of above Rs. 5 crore should also be sent to the Reserve Bank.

Deviation

Any deviation from the above settlement guidelines for any borrower should be made only by the Board of Directors.

Donations

The Reserve Bank has reviewed its instructions on donations in the light of representations received from Indian Banks' Association and other banks. As per the revised instructions a profit-making bank can make donations during a financial year aggregating up to one per cent of its published profit for the previous year. The subscriptions/contributions made by banks to professional bodies/institutions, such as, Indian Banks' Association, National Institute of Bank Management, Indian Institute of Bankers, Institute of Banking Personnel Selection and Foreign Exchange Dealers Association of India, during a year would, however, be exempt from the prescribed ceiling of one per cent. Loss making banks can make donations totalling only Rs. 5 lakh in a financial year. The banks should not carry forward unutilised amount of the permissible limit of a year to the next year for the purpose of making donations.

Banks may take their own decision about the purpose of the donations. The Boards of Directors of banks may continue to lay down policy for allowing donations including the purpose for which the donations could be made. The donations should not be linked to deposit mobilisation and should be

fairly well distributed. The banks may continue to submit annual review of donations to their Boards of Directors.

Rajbhasha Policy in Banks

The Reserve Bank has advised the banks to constitute internal standing working groups at their head offices as well as at regional office level to increase the use of Hindi in computers in branches /offices at all levels. Such working groups should consist of specialists in Rajbhasha and information technology as well as practical bankers and the matter should be reviewed in periodical meetings of the Official Language Implementation Committee. The progress should be reported to the Reserve Bank at half yearly intervals.

Lending Gold to Other Banks

In order to provide more deployment avenues within the country and to exploit the synergy between the lending expertise of few banks with the vast branch network of others, the Reserve Bank has allowed lending of gold mobilized under the Gold Deposit Scheme to other authorised dealers, for similar use. Borrowing of gold mobilized under the Gold Deposit Scheme by authorised banks (from other authorised banks) would be treated as inter bank liabilities, and would be exempt from CRR. In view of multiple prescriptions of CRR to be maintained on different categories of liabilities, the effective CRR maintained by the authorised banks on total Net Demand and Time Liabilities (NDTL) including gold borrowings should not be less than 3 per cent. These guidelines have been issued pursuant to the announcement of Monetary and Credit Policy for 2000-2001.

Kisan Credit Card Scheme

The Reserve Bank has advised banks that in order to facilitate wider coverage under the Kisan Credit Card Scheme, banks at their discretion, should consider issue of Kisan Credit Card for credit limits below Rs. 5000. A scheduled bank may, at its discretion, pay interest at a rate based on its perception and other relevant factors on the minimum credit balances in the composite cash credit account of a farmer during the period from 10th to the last day of each calendar month.

Local Area Banks

It has been decided that a family (including close relatives) as part of the promoter group should not be allowed to hold more than 40 per cent of the equity in a local area bank. In other words a family should not hold a majority stake in the equity of a local area bank. This would support the principle of discouraging setting up of family owned banks besides ensuring diversified equity pattern of local area banks.

Entry of Banks into Insurance

The Reserve Bank has invited applications from banks desirous of entering insurance business. It has asked banks to furnish full details in respect of the parameters specified by the Reserve Bank along with the details of equity contribution proposed in the joint venture/strategic investment and the name of the company with whom the bank would have tie-up arrangements in any manner in

the insurance business. The relative board note and resolution approving the bank's proposal together with viability report should also be forwarded to the Reserve Bank.

Subsequent to the recent issue of regulations on registration of Indian insurance companies by The Insurance Regulatory and Development Authority (IRDA), the Government of India issued a notification specifying insurance as a permissible form of business that could be undertaken by banks under Section 6(1)(o) of the Banking Regulation Act, 1949.

Earlier, in April 27, 2000, the Reserve Bank had issued guidelines for banks' entry into insurance business. According to the guidelines, banks having minimum net worth of Rs.500 crore, and satisfying other criteria in regard to capital adequacy, profitability, etc., will be allowed to undertake insurance business through joint venture on risk participation basis. The Reserve Bank will consider bank's equity contribution in the joint venture up to 50 per cent. However, higher equity contribution by a promoter bank may be allowed initially, on a highly selective basis, pending divestment of the equity in excess of 50 per cent within the period prescribed under the amended insurance statutes. Banks which do not satisfy these criteria will be allowed on a 'without risk participation' basis upto 10 per cent of their net worth or Rs.50 crore, whichever is lower, as strategic investors.

The Reserve Bank reiterated that it would not allow banks to undertake insurance business departmentally. Any bank intending to undertake insurance business in the manner set out in the annexure, should obtain prior approval of the Reserve Bank of India before engaging in such business.

Reporting Defaulting Borrowers

The Reserve Bank has advised all banks and financial institutions to take immediate steps to update their records and to report only the names of current directors while furnishing the particulars of defaulting borrowers with outstandings aggregating Rs. one crore and above classified as doubtful and also borrowers against whom suits have been filed. The facts about current directors, wherever possible, should be checked with the Registrar of Companies. They should also furnish information about directors (excluding nominee directors of the government, banks and financial institutions) who were associated with the company at the time the account was classified as defaulter, to put the other banks and financial institutions on guard.

In the case of Government undertakings, it should be ensured that the names of directors are not reported. Instead, a legend "Government of undertaking" should be added. Furthermore, professional directors such as, chartered accountants, unless they have any interest or stake in the company or are otherwise involved in day to day management of the company, should not be equated with the promoter directors or directors who are promoters' family members/relatives or those who are involved with the day-to-day management of the company. Against the name of such professional directors, banks should clearly mention 'professional director'. In cases where the dues have been settled after the close of the half year but before submission of data to the Reserve Bank/consolidation of information by the Reserve Bank details should be expeditiously furnished so that a suitable remark is entered against the name.

These instructions have been issued in view of the representations received from individuals that although they had resigned long back from the directorship of the companies, their names continue to be reported along with the names of the defaulting company in the lists being circulated by the Reserve Bank. Similarly, government officials and representatives of banks/financial institutions, including retired officials, had represented that they were associated with such companies as 'nominee directors' of the government/bank/financial institutions, but their names had been reported along with defaulting companies in the list of defaulters circulated to banks and financial institutions by the Reserve Bank causing damage to their reputation.

RRBs to submit Half-yearly Statements

The Reserve Bank has reviewed the submission of half -yearly statements regarding priority sector lending by the Regional Rural Banks (RRBs). Effective from September 2000, the RRBs should promptly forward these statements after the relevant period, to the concerned regional office of the Reserve Bank instead of Central Office as at present.

Information Center at New Delhi

The New Delhi office of the Reserve Bank of India has operationalised an information center. The center caters to public queries, especially on exchange control matters, through telephone, e-mail and fax. Banks, members of public may approach the center at the Reserve Bank of India, 6, Sansad Marg, New Delhi-110001

Telephone: 011 - 375 2633
Fax: 011 - 3752634
E-mail: Rbndinfo@vsnl.com

EXCHANGE CONTROL

EEFC Account Scheme

On a review of the Exchange Earners Foreign Currency (EEFC) Account Scheme, the Reserve Bank of India, on August 14, 2000 asked authorised dealers to initiate steps to scale down to 50 per cent, the balances held in their customers' EEFC accounts as on August 11, 2000. Authorised dealers were asked to ensure that their constituents convert the excess balances into rupees latest by August 23, 2000.

The Reserve Bank also halved the eligibility levels of maintaining balances in EEFC accounts with effect from August 14, 2000. Accordingly, 100 per cent export oriented unit or a unit in export processing zone or software technology park or electronic hardware technology park may credit up to 35 per cent, and any other person resident in India may credit up to 25 per cent of their eligible inward remittances to the EEFC account.

The Reserve Bank asked authorised dealers not to permit any credit facilities either fund based or non-fund based against the security of balances held in EEFC accounts. Existing facilities may, however, be allowed to continue till the maturity of the existing contract. No extension of time limit should be permitted for repayment of the existing credit facilities.

EEFC accounts can now be maintained only in the form of current or savings account by an individual or in the form of current account by others. The balances in the existing term deposit less forward sales will have to be converted into current/savings deposits on the date of maturity.

Account Scheme was introduced in 1992, which enabled exporters and other exchange earners to retain a portion of their receipts in foreign exchange with an authorised dealer in India. A 100 per cent export oriented unit or a unit in export processing zone and software technology park and electronic hardware technology park were allowed credit up to 70 per cent and any other person resident in India up to 50 per cent of inward remittances to the EEFC account. The EEFC accounts were allowed to be opened, held and maintained in the form of current , savings or term deposit account in cases where the account holder was an individual, and in the form of current or term deposit account in all other cases. Authorised dealers were permitted to grant credit facilities, both fund and non-fund based, against the security of funds held in EEFC accounts.

Safety and Soundness of Banking - Need for Prompt Corrective Action:

The Reserve Bank of India has prepared a discussion paper on Prompt Corrective Action (PCA) to ensure safety and soundness of banks. The discussion paper has been placed on the website www.rbi.org.in for wider discussion, debate and suggestions among banks, financial institutions, market players and academia.

The discussion paper addresses the issue of how to identify problem banks early and how to monitor the behavior of troubled banks in an attempt either to prevent failure or to limit losses. There is a constant search for appropriate supervisory strategies to avoid bank failures as they can have a destabilizing effect on the economy. If a bank is not to be allowed to fail, it is essential that corrective action is taken well in time.

The effort has emanated from one of the Core Principles for Effective Bankers Supervision set out by the Basel Committee on Banking Supervision. The core principle mandates that banking supervisors must have at their disposal adequate supervisory measures, backed by legal sanctions, to bring about timely corrective action when banks fail to meet prudential requirements, such as, minimum capital adequacy ratios or when there are regulatory violations or where their depositors are threatened in any other way. The penal actions range from restricting the current activities of the bank, withholding approval of new activities or acquisitions, restricting or suspending payment to shareholders, restricting asset transfers, restrictions on discretionary powers of managers, directors or controlling owners, arranging a take-over by or merger with healthier institutions. In the extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.

Indian Perspective

The PCA prepared by the Reserve Bank has a broader regime than the one set out by the Basel Committee. It delineates rule-based actions not only for shortfall in capital but also for other indicators of deficiency so that a seamless paradigm for corrective actions can be put in place for major deficiencies in banks' functioning.

Schedule: The schedule of corrective actions has been worked out based on three parameters, i.e., capital to risk weighted assets ratio (CRAR), net non-performing assets (net NPAs) and return on assets (ROA) which represent the three important parameters of capital adequacy, asset quality and profitability.

Trigger Points : Trigger points have been set under the three parameters taking into account the practicability of implementation of certain measures in the Indian context. These are: CRAR less than 9 per cent but equal or more than 6 per cent, CRAR less than 6 per cent but equal or more than 3 per cent and CRAR less than 3 per cent. Two trigger points have been proposed under net NPAs, viz., net NPAs over 10 per cent but less than 15 per cent and net NPAs of 15 per cent and above. The trigger on return on assets has been set at less than 0.25 per cent.

Mandatory Actions: When a bank's performance activates the trigger point, a certain set of mandatory actions will follow. The actions laid down will be directed against those areas of a bank's weakness, such as, inadequacy of capital funds vis-à-vis risk weighted assets, high level of non-performing assets or a low level of operating income. The mandatory actions are in the nature of restriction on expansion of risk-weighted assets, submission and implementation of capital restoration plan, prior approval of the Reserve Bank for opening of new branches and new lines of business, paying off costly deposits and certificate of deposits, pruning of overheads, special drive to reduce the stock of NPAs, review of loan policy, etc.

Discretionary Actions: These action points are proposed to pre-empt any deterioration in the soundness of banks. Any actions, without duly recognising the diverse profile and factors contributing to the problems in banks, however, may not achieve the desired effect. The rationale for classifying the rule based action points into mandatory and discretionary is that some of the actions are essential to restore the financial health of banks, while other actions will be taken at the discretion of the Reserve Bank depending upon the profile of each bank.

GDR/ADR Issues by Banks

The Reserve Bank of India had advised banks to repatriate the entire proceeds of their Global Depository Receipts(GDRs)/American Depository Receipts(ADRs), soon after they complete the issue process. Banks have also been advised to repatriate direct investment made in their issues by non-resident Indians/overseas corporate bodies/foreign banking companies or finance companies including multinational institutions. The advice came in the wake of the fact that banks, which raise capital abroad for improving their capital base, have largely rupee-denominated assets and that most of the risk limits are linked to their capital.

Banks are permitted to raise capital through issue of GDRs or ADRs within the limit prescribed for foreign direct investment by the Government of India for GDR/ADR issues without reference to the end-use criteria with restriction that investment in stock markets and real estate are not permitted.

cheque/DD payable at Mumbai to the Director, DRRP (Sales Section), DEAP, Reserve Bank of India, Amar Building, Sir P.M. Road, P.B. No. 1036, Mumbai - 400 001. Also available on internet at www.cir.rbi.org.in