CREDIT INFORMATION REVIEW

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BRANCH BANKING

Educational Loan Scheme

The Indian Banks' Association (IBA) has prepared a model educational loan scheme for adoption by all banks. The model scheme is based on the recommendations of a study group constituted by the IBA under the chairmanship of Shri R.J.Kamath, to examine the role of commercial banks in facilitating pursuit of higher education by poor and meritorious students. The Government of India has decided to accept the model scheme for implementation, with certain modifications. The details of the modified scheme are:

Objective

Providing financial support on reasonable terms from the banking system to deserving / meritorious students for pursuing their higher education in India and abroad.

Applicability

The scheme could be adopted by all scheduled commercial banks. It provides broad guidelines to the banks for operationalising the educational loan scheme and the implementing bank will have the discretion to make changes suiting to the convenience of the students / parents to make it more customer friendly.

Eligible Courses

The courses eligible under the scheme for pursuing studies in India are:

- School education including plus 2 stage
- Graduation courses, such as, Bachelor of Arts, Bachelor of Commerce and Bachelor of Science, etc.,
- Post Graduation courses, such as, Master's degree and Doctor of Philosophy
- Professional courses, such as, Engineering, Medical, Agriculture, Veterinary, Law, Dental, Management, Computer, etc.
- Computer certificate courses of reputed institutes accredited to the Department of Electronics or institutes affiliated to universities.
- Courses like ICWA, CA, CFA etc.
- Courses conducted by IIM, IIT, IISc, XLRI, NIFT etc.
- Courses offered in India by reputed foreign universities.
- Evening courses of approved institutes.
- Other courses leading to diploma / degree etc. conducted by colleges / universities approved by UGC / Government / AICTE / AIBMS / ICMR etc.
- Courses offered by national institutes and other reputed private institutions. Banks may have the system of appraising other institution courses depending on future prospects/ recognition by user institutions.

The courses eligible under the scheme for pursuing studies abroad are:

Graduation	:	For job oriented professional / technical courses offered by reputed universities.
Post graduation	:	Courses like MCA, MBA, MS, etc. Courses conducted by CIMA- London, CPA in USA etc.

Student Eligibility

- Should be an Indian national and Should have secured admission to professional / technical courses through entrance test / selection process.
- Should have secured admission to foreign university / institutions.

Expenses for Loan

- Fee payable to college / school / hostel
- Examination / library / laboratory fee
- Purchase of books / equipments / instruments / uniforms
- Caution deposit / building fund / refundable deposit supported by Institution bills / receipts
- Travel expenses / passage money for studies abroad
- Purchase of computers essential for completion of the course
- Any other expense required to complete the course - like study tours, project work, thesis, etc.

Quantum of Finance

Need based finance subject to repaying capacity of the parents / students with margin and the following ceilings.

Studies in India : Maximum Rs.7.50 lakh
Studies abroad : Maximum Rs.15 lakh

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Margin

Upto Rs.4 lakh : No margin

For loans of higher amounts

Studies in India : 5 per cent

Studies abroad : 15 per cent

Scholarship / assistantship, if any, to be included in margin.

Margin may be brought-in on year-to-year basis as and when disbursements are made on a pro-rata basis.

Security

Upto Rs.4 lakh : No security to be insisted.

Above Rs.4 lakh : Collateral security of suitable value or co-obligation of parents / guardians / third party alongwith the assignment of future income of the student for payment of instalments be obtained.

The document of security should be executed by both student and his / her parent / guardian.

The security can be in the form of land / building / Government securities/ public sector bonds/ units of Unit Trust of India, National Savings Certificates, Kisan Vikas Patra, policy of Life Insurance Corporation, gold, shares / debentures, bank deposit in the name of student / parent / guardian or any other third party with suitable margin.

Wherever the land/ building is already mortgaged, the unencumbered portion can be taken as security on second charge basis provided it covers the required loan amount.

In case the loan is given for purchase of computer, the computer to be hypothecated to the bank.

Powers to support highly meritorious / deserving students without security should be delegated to a fairly higher level authority.

Rate of Interest

Upto Rs.4 lakh : Prime lending rate

Above Rs.4 lakh : Prime lending rate + 1 per cent

Simple interest to be debited quarterly / half yearly on simple basis during the repayment holiday / moratorium period.

Penal interest at the rate of 2 per cent be charged for loans above Rs.2 lakh for the overdue amount and overdue period.

Sanction / Disbursement

The loan be sanctioned as per delegation of powers preferably by the branch nearest to the place of domicile.

No application for educational loan received should be rejected without the concurrence of the next higher authority.

The loan to be disbursed in stages as per the requirement / demand directly to the institutions / vendors of books/ equipments / instruments to the extent possible.

Repayments

Holiday / Moratorium : Course period + 1 year or 6 months after getting job, whichever is earlier.

The loan to be repaid in 5-7 years after commencement of repayment. If the student is not able to complete the course within the scheduled time extension of time for completion of course may be permitted for a maximum period of 2 years. If the student is not able to complete the course for reasons beyond his control, sanctioning authority may at his discretion consider such extensions as may be deemed necessary to complete the course.

The accrued interest during the repayment holiday period should be added to the principal and repayment in equated monthly instalments (EMI) fixed.

Interest concession of 1-2 per cent may be provided for loanees if the interest is serviced during the study period when repayment holiday is specified for interest / repayment under the scheme.

Follow up

Banks should obtain the progress report at regular intervals from college / university authorities.

Processing Charges

No processing / up-front charges may be collected on educational loans.

Capability Certificate

Banks can also issue the capability certificate for students going abroad for higher studies. For this financial and other supporting documents may be obtained from applicant, if required.

Other Conditions

No due certificate need not be insisted upon as a pre-condition for considering educational loan. However, banks may obtain a declaration / an affidavit confirming that no loans are availed from other banks.

Loan applications have to be disposed of within a period of 15 days to 1 month, but not exceeding the time norms stipulated for disposing of loan applications under priority sector lending.

In order to bring flexibility in terms like eligibility, margin, security norms, banks may consider relaxation in the norms on a case to case basis delegating the powers to a fairly higher level authority.

The Reserve Bank has clarified that this scheme is separate and in addition to and not in supersession of the education loan scheme evolved by it under the Supreme Court orders operationalised with effect from August 1, 2000. (*Please see Credit Information Review : 241 of August 1999.*)

Credit Card Business of Banks

The Reserve Bank of India had undertaken a special study on credit card business of certain banks covering aspects relating to the systems and controls on issue of credit cards and recovery of dues. The study report was circulated to banks for their comments and suggestions. Based on the response received from banks, it has been decided that banks should adopt the following additional safeguards to ensure that their credit card operations are run on sound, prudent and profitable lines.

Recovery of Overdues

Credit card debt is an unsecured line of credit. Repayment of credit card dues depends primarily upon the repaying capacity of the cardholders. The highly competitive environment in credit card business has provided customers with opportunity to hold more than one credit card from different banks with the intention to pay only minimum monthly payments on outstanding balances. As a result, the card holders are often overextended and unable to repay the dues in full. Credit card operations entail credit risk in the overall credit portfolio of banks. Relaxed underwriting standards, aggressive solicitation programmes, inadequate account management increase credit risk and may lead to over-dues and non-performing assets in the credit card portfolios of banks. It is therefore imperative that banks take immediate steps to reduce the incidence of default in this business and closely monitor the recovery of credit card outstandings. Banks may formulate specific action plans to this effect with the approval of their Board of Directors. Banks are advised to observe the code of ethics formulated by the Indian Banks' Association while engaging recovery agents for collection of credit card over-dues.

Sharing of Information

Credit Information Bureaus are now being set up to provide a mechanism for mitigating credit risk by enhancing the quality of credit decisions and help in curbing the growth of fresh non-performing assets. Banks are advised to become members of one or more Credit Information Bureaus in order to maintain the selectivity of customers in their credit card business and take advantage of the existing negative file projects to guard against defaults in this business.

Fraud Control

The common methods of fraudulent usage of credit cards are:

(i) Fraud at application stage
(ii) Misuse of lost / stolen cards and cards not received by genuine applicants
(iii) Counterfeit and altered cards
(iv) Merchants acting in collusion with card holder

Banks are advised to set up internal control systems to combat frauds committed through these or other methods. Fraud prevention committees / task forces are in existence which formulate laws to prevent frauds and take proactive fraud control and enforcement measures. Banks are advised to actively participate in such fraud prevention committees / task forces.

Processing

In order to provide efficient back office solution to the cards management process and in the areas of accounts receivables, billing, settlement and other related services it is necessary that banks have in place a proper processing solution. Banks are advised to make use of developments in this area to ensure better operating controls.

Fees/charges

Banks charge fees for services in respect of credit card operations. These include membership / entrance fees, renewal / annual fees, service charges on revolving credit facility and penal charges for overdue payments. Disputes often occur between card issuing banks and cardholders regarding the basic level of penal charges. Banks are advised to clearly spell out fees / charges to the cardholder at the time of their applying for credit card, if not done so far. Banks, in particular, should bring to the notice of the cardholder, the rates of interest to be charged in case of delays and default in payments, besides the membership / renewal fees.

Internet Banking Guildlines

The Reserve Bank of India accepted the recommenda-tions of the 'Working Group on Internet Banking' which was set up to examine different aspects of Internet Banking (I-banking). Accordingly, the Reserve Bank has issued guidelines to all scheduled commercial banks for implementation of the recommendations. Banks are also advised that they may be guided by the original report, for a detailed guidance on different issues.

The Group had focussed on three major areas of I-banking, i.e, (i) technology and security issues, (ii) legal issues and (iii) regulatory and supervisory issues. The guidelines pertaining to regulatory and supervisory issues are:

Regulatory Framework

The Group recommended that the existing regulatory framework over banks would also be extended to internet banking. In this regard, it is advised that:

(i) Only such banks which are licensed and supervised in India and have a physical presence in India will be permitted to offer Internet banking products to residents of India. Thus, both banks and virtual banks incorporated outside the country and having no physical presence in India will not, for the present, be permitted to offer Internet banking services to Indian residents.
(ii) The products should be restricted to account holders only and should not be offered in other jurisdictions.
(iii) The services should only include local currency products.
(iv) The 'in-out' scenario where customers in cross border jurisdictions are offered banking services by Indian banks (or branches of foreign banks in India) and the 'out-in' scenario where Indian residents are offered banking services by banks operating in cross-border jurisdictions are generally not permitted and this approach will apply to Internet banking also. The existing exceptions for limited purposes under FEMA, i.e., where resident Indians have been permitted to continue to maintain their accounts with overseas banks etc., will, however, be permitted.
(v) Overseas branches of Indian banks will be permitted to offer Internet banking services to their overseas customers subject to their satisfying, in addition to the host supervisor, the home supervisor.

Instructions

Given this regulatory approach, banks have been advised to follow the following instructions:

(a) All banks, those propose to offer transactional services on the Internet should obtain prior approval from the Reserve Bank. Bank's application for such permission should indicate its business plan, analysis of cost and benefit, operational arrangements like technology adopted, business partners, third party service providers and systems and control procedures the bank proposes to adopt for managing risks. The bank should also submit a security policy covering recommendations of the working group on Internet Banking and a certificate from an independent auditor that the minimum requirements prescribed have been met. After the initial approval the banks will be obliged to inform RBI any material changes in the services / products offered by them.
(b) Banks will report to RBI every breach or failure of security systems and procedure and the latter, at its discretion, may decide to commission special audit / inspection of such banks.
(c) The earlier guidelines issued by RBI on 'Risks and Controls in Computers and Telecommunications' in February 1998 will equally apply to Internet banking. The RBI as supervisor will cover the entire risks associated with electronic banking as a part of its regular inspections of banks.
(d) The banks should develop outsourcing guidelines to manage risks arising out of third party service providers, such as, disruption in service, defective services and personnel of service providers gaining intimate knowledge of banks' systems and misutilizing the same, etc., effectively.
(e) With the increasing popularity of e-commerce, it has become necessary to set up 'Inter-bank Payment Gateways' for settlement of such transactions. The protocol for transactions between the customer, the

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bank and the portal and the framework for setting up of payment gateways as recommended by the Group should be adopted.

(f) Only institutions, which are members of the cheque clearing system in the country will be permitted to participate in Inter-bank payment gateways for Internet payment. Each gateway must nominate a bank as the clearing bank to settle all transactions. Payments effected using credit cards, payments arising out of cross border e-commerce transactions and all intra-bank payments (i.e., transactions involving only one bank) should be excluded for settlement through an inter-bank payment gateway.

(g) Inter-bank payment gateways must have capabilities for both net and gross settlement. All settlement should be intra-day and as far as possible, in real time.

(h) Connectivity between the gateway and the computer system of the member bank should be achieved using a leased line network (not through Internet) with appropriate data encryption standard. All transactions must be authenticated. Once, the regulatory framework is in place, the transactions should be digitally certified by any licensed certifying agency. SSL / 128 bit encryption must be used as minimum level of security. Reserve Bank may get the security of the entire infrastructure both at the payment gateway's end and the participating institutions' end certified prior to making the facility available for customers use.

(i) Bilateral contracts between the payee and payee's bank, the participating banks and service provider and the banks themselves will form the legal basis for such transactions. The rights and obligations of each party must be clearly defined and should be valid in a court of law.

(j) Banks must make mandatory disclosures of risks, responsibilities and liabilities of the customers in doing business through Internet through a disclosure template. The banks should also provide their latest published financial results over the net.

(k) Hyperlinks from banks' websites, often raise the issue of reputational risk. Such links should not mislead the customers into believing that banks sponsor any particular product or any business unrelated to banking. Hyperlinks from a banks' websites should be confined to only those portals with which they have a payment arrangement or sites of their subsidiaries or principals. Hyperlinks to banks' websites from other portals are normally meant for passing on information relating to purchases made by banks' customers in the portal. Banks must follow the minimum recommended security precautions while dealing with request received from other websites, relating to customers' purchases.

Review

All banks offering internet banking have also been advised to make a review of their systems in the light of the Groups recommendations and report to Reserve Bank the types of services offered, extent of their compliance with the recommendations, deviations and their proposal indicating a time frame for compliance. The first such report must reach the Reserve Bank by July 13,2001. Banks not offering any kind of I-banking may submit a 'nil' report.

Banks which are already offering any kind of transactional service are advised to report, in addition to those mentioned in paragraph above, their business models with projections of cost / benefits, etc., and seek post-facto approval of the Reserve Bank.

Filing of Suits

It has, been decided that banks and financial institutions (FIs) should examine all cases of wilful defaults of Rs.1crore and above and file suits in such cases, if not already done. Banks and financial institutions should also examine in such cases of wilful defaults, whether there are instances of cheating / fraud by the defaulting borrowers and if so, they should also file criminal cases against those borrowers. In other cases involving amounts below Rs.1 crore, banks and financial institutions should take appropriate action, including legal action, against the defaulting borrowers.

This decision has been taken in view of the fact that, a review of the information on wilful defaults submitted to the Reserve Bank revealed that there are quite a few cases where the amount outstanding is substantial but the banks and FIs have not initiated any legal action. As these, cases of wilful defaults have an element of fraud and cheating and, therefore, should be viewed differently.

Implementation of Nayak Committee Recommendations

The Reserve Bank had carried out a study to assess the progress made by the specialised small scale industries (SSI) bank branches of the public sector banks in implementing the recommendations of Nayak Committee as also their performance in extending credit to SSI sector.

The study observed that banks had made satisfactory progress in computation of working capital on the basis of projected annual turnover method, extension of adequate finance to SSI sector, adhering to the prescribed schedule for disposal of loan applications, introduction of simplified application forms maintenance of application register in a comprehensive manner, delegation of adequate discretionary powers to the branch managers, etc. The position regarding advances to tiny and cottage industries has also improved.

Banks have been advised to initiate corrective steps in the following areas for further improvement:

(i) Delegation of adequate discretionary powers to branch officials for sanction of credit facilities.
(ii) Issuing acknowledgement for the loan proposals received.
(iii) Providing technical expertise in the branches.
(iv) Insistence of compulsory deposit as a quid pro quo was in practice in a few branches.
(v) Providing of credit to the tiny sector.
(vi) Maintenance of a comprehensive register for loan applications.
(vii) Referring proposals liable for rejection/curtailment in the amount of finance to the next higher authority.

In view of this, banks should initiate corrective steps to improve the situation in the above areas.

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