CREDIT INFORMATION REVIEW

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BANKING OPERATIONS

OTS for Loans up to Rs. 25,000

The Reserve Bank has advised the boards of public sector banks to formulate a policy for one time settlement (OTS) for recovery of dues pertaining to loans outstanding up to Rs. 25,000. The policy is to be formulated keeping the following parameters in view:

(i) Coverage

(a) The scheme should cover all loan accounts with outstanding balance of up to Rs. 25,000 principal amount (excluding interest) which have become non-performing assets (NPAs) as on March 31, 1998.

(b) The guidelines will also cover suit-filed and decreed debts. After the settlement is reached, the banks may take appropriate steps for closure of cases in respective courts.

(c) The scheme will not, however, cover cases of fraud, malfeasance and wilful defaults.

(d) The guidelines will be operative up to June 30, 2002.

(ii) Settlement Formula – Amount and Cut-off Date

The amount that should be recovered as settlement amount under these guidelines would be the balance outstanding towards principal in the loan account as on March 31, 1998. Any interest which is included in the outstanding amount as on March 31, 1998 or accrued on the balance outstanding after March 31, 1998 will be waived.

(iii) Payment

The amount of settlement arrived at as above, should normally be paid in one lump sum. In deserving cases, banks may consider recovering the settlement amount in instalments with down payment of at least 25% to be received at the time of settlement. The balance amount should be recovered within one year from the date of settlement.

(iv) Sanctioning Authority

The decision on the compromise settlement would be vested with the branch manager. In case the loan had been sanctioned by the branch manager himself, the decision on compromise settlement for such cases, should be taken by the next higher authority.

(v) Non-discriminatory Treatment

Banks should follow the above guidelines for compromise settlement of NPAs, without discrimination.

(vi) Formulation of Policy

The board of directors of banks should frame the policy on compromise settlement of NPAs covered under the guidelines. Banks can also devise their own accounting procedure for treatment of the outstanding amount subject to the one-time settlement.

(vii) Publicity

Banks should give adequate publicity to the scheme to enable all the eligible defaulting borrowers to avail of the opportunity of one time settlement of their outstanding dues.

(viii) Review by the Board

A monthly report on the progress and details of settlements made should be submitted by the concerned authority to the next higher authority and the head office. The compromise settlements reached should be reviewed by the board at monthly intervals.

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Limits on Credit Exposure

It has been decided that infusion of capital either through domestic issue or overseas float, after the published balance sheet date would be taken into account for determining exposure ceiling. Banks will have to furnish a certificate to the Reserve Bank on completion of the augmentation of capital before reckoning the additions.

It was mentioned earlier that capital funds for determining exposure ceiling would comprise paid-up capital and free reserves as per the published accounts as on March 31, of the previous year. In terms of the Reserve Bank's circular on exposure norms issued earlier, the concept of capital funds has been broadened to comprise the total capital as defined under capital adequacy standards (Tier 1 and Tier 2 capital), effective from March 31, 2002.

The Reserve Bank had been receiving representations from banks that the reckoning of capital funds as at the end of the previous year deprive them of the benefit of capital/long-term resources raised after the date of balance sheet for determining the exposure ceiling.

Banks were earlier advised that other accretion to capital funds by way of quarterly profits, etc., would not be eligible to be reckoned for determining exposure ceiling. Banks should also ensure that they do not take exposures in excess of the ceiling prescribed in anticipation of infusion of capital on a future date.

Bank Financing for Margin Trading

It has been decided to continue the scheme of extending finance by banks to stockbrokers for margin trading until further notice. It has been further decided that the board of each bank should formulate detailed guidelines for lending for margin trading, subject to the following parameters:

(i) The finance extended for margin trading should be within the overall ceiling of 5% prescribed for exposure to capital market.

(ii) A minimum margin of 40 % should be maintained on the funds lent for margin trading.

(iii) The shares purchased with margin trading should be in dematerialised mode, under pledge to the lending bank. The bank should put in place an appropriate system for monitoring and maintaining the margin of 40% on a regular basis.

(iv) The bank's board should prescribe necessary safeguards to ensure that no "nexus" develops between inter-connected stock broking entities/stockbrokers and the bank in respect of margin trading. Margin trading should be spread out by a bank among a reasonable number of stockbrokers and stock broking entities.

The audit committee of the board should periodically monitor the bank's exposure by way of financing for margin trading and ensure that the guidelines formulated by the bank's board, subject to the above parameters, are complied with. Banks should disclose the total finance extended for margin trading in the "Notes on Account" to their balance sheets.

A copy of the policy on financing of margin trading approved by the bank's board may be forwarded to the Reserve Bank in due course.

The earlier guidelines issued by the Reserve Bank on September 22, 2001 will remain in operation until fresh guidelines are issued by the bank's board.

Earlier, banks were permitted, on an experimental basis, to extend finance to stockbrokers for margin trading within the overall ceiling of 5% prescribed for exposure of banks to capital market, for a period of 60 days (i.e., up to November 22, 2001). The guidelines were reviewed by the Reserve Bank in consultation with major commercial banks.

Banks' Investments in US-64

It has been decided to allow banks, which desire to do so, to shift the investment in the units of UTI's US 64 scheme to 'held to maturity' (HTM) category at book value. This shift would be allowed as a one time measure and would be subject to following conditions:

(a) Banks will be required to amortise the premium over the face value over a period up to May 31, 2003.

(b) Banks will not be allowed, for any reason, to shift these units out of the HTM category, either in part or full.

The decision was taken in view of the Government of India's decision that US 64 units can be redeemed on May 31, 2003 either at Rs.10.00 or at net asset value (NAV) as on that date, whichever is higher.

Investments by Banks/FIs

Banks/financial institutions (FIs) have been advised to exercise due caution while taking any investment decision to subscribe to debentures, bonds, shares, etc., and refer to the 'Defaulters Lists' to ensure that investments are not made in companies/entities who are defaulters to banks and FIs.

Earlier, banks and notified FIs were required to report to the Reserve Bank, at prescribed periodicity, the particulars of borrowers with outstanding aggregating Rs. one crore and above (both funded and non- funded) classified as doubtful or loss and borrowers against whom suits had been filed. Banks and FIs were also required to report cases of wilful default of Rs.25 lakh and above on a quarterly basis.

It was observed that some of the banks/FIs had not exercised due precaution by referring to the defaulters list while investing in bonds, debentures, etc., of companies.

Guidelines on Investment Fluctuation Reserves

The Reserve Bank has issued certain guidelines to banks on building up of Investment Fluctuation Reserve. These include:

(i) Banks should transfer maximum amount of the gains realised on sale of investment in securities to the Investment Fluctuation Reserve Account (IFR).

(ii) The objective should be to achieve IFR of a minimum of 5 per cent of the portfolio, by transferring the gains realised on sale of investment, within a period of 5 years. Banks are, however, free to build up higher percentage of IFR of upto 10 per cent of the portfolio depending on the size and composition of their portfolio, with the concurrence of their board of directors.

(iii) Banks should ensure that the unrealised gains on valuation of the investment portfolio are not taken to the income account or to the IFR.

(iv) Individual scrips held under the *Available for Sale* category should be marked to market at least at quarterly intervals.

(v) The Investment Fluctuation Reserve, consisting of realised gains from sale of investments, would be eligible for inclusion in Tier 2 capital as before.

(vi) Banks are advised to assess the impact of changes in interest rates on their investment portfolio. Banks may also initiate appropriate steps for moving over to *Value at Risk and Duration methods* for measurement of interest rate risk.

(vii) Banks would be permitted to transfer balances from IFR to Profit and Loss Account to meet the depreciation requirement on investment as a 'below the line' item, as before.

Foreign Exchange

Money Changing Facilities Liberalised

Under a new scheme announced by the Reserve Bank, authorised dealers (ADs) and full fledged money changers (FFMCs) have been permitted to freely enter into agency/ franchising agreements with entities for the purpose of carrying on the business of conversion of foreign currency notes, coins or travellers' cheques into rupees. ADs and FFMCs desirous of entering into such business arrangements would only be required to obtain a one-time approval from the Reserve Bank. The details of the new scheme are :

Objective : The objective of the scheme is to provide easier conversion facilities to travellers and tourists, including non-resident Indians (NRIs), by enlarging the network of money changing facilities in the country. It is expected that the new facility will enable banks and full fledged money changers to provide such facilities at all tourist centres and major cities for extended hours and on holidays.

Earlier, the conversion of foreign currency notes, coins or travellers' cheques into Indian rupees was done through banks designated as ADs as also through two other channels viz., FFMCs and restricted money changers (RMCs). While FFMCs were allowed to, both, buy and sell foreign exchange against Indian rupees, the RMCs could only buy foreign exchange against Indian rupees. ADs, FFMCs and RMCs were required to get authorisation from the Reserve Bank to undertake the money changing business.

Proposed Scheme : Under the new scheme, in addition to the existing facilities, the Reserve Bank would freely permit ADs and FFMCs to enter into agency/franchising agreements at their option with entities for the purpose of carrying on restricted money changing business i.e., conversion of foreign currency notes, coins or travellers' cheques into rupees.

Franchisee : A franchisee can be any entity who has a place of business and whose bonafides are acceptable to the AD/FFMC. These franchisees would undertake only restricted money changing business.

Agency/Franchise Agreement : ADs/FFMCS are free to decide on the tenor of the arrangement as also the commission or fee through mutual agreement with the franchisee.The agency/ franchise agreement to be entered into by them should, however, include the following salient features :

a) The franchisee should display the exchange rates. Exchange rate of foreign currency into rupees should be the same or close to the daily exchange rate charged by the AD/FFMC at its branches.

b) The franchisee should surrender the collections to the franchiser or other authorised persons, as may be agreed upon, within 7 days.

c) The franchisee should maintain proper record of transactions.

d) ADs/FFMCs should carry out on-site inspection of the premises and records of the franchisee at least once a year.

Procedure for Application : The franchiser i.e., an AD or an FFMC should apply to the Reserve Bank in the prescribed format for putting in place arrangements under this scheme. The application should be accompanied by a declaration that while selecting the franchisees, due diligence has been carried out and that such entities have undertaken to comply with all the provisions of the franchising agreement/prevailing Reserve Bank regulations regarding money changing. Approvals would be issued by the Reserve Bank on a one time basis. Thereafter, as and when new agency/franchise agreements are entered into, these would have to be reported to the Reserve Bank on a post-facto basis along with the declaration.

Existing RMCs : Existing RMCs who are licensed by the Reserve Bank are free to undertake money changing under this scheme as a franchisee of an AD/FFMC on surrendering the existing Reserve Bank licence. Those who do not opt for operation under this scheme may continue to undertake existing money changing business until further notice.

Selection of Centres and Training : Franchisers are free to select centres for operationalising the scheme. Franchisers should impart training to the agents/franchisees regarding operations and maintenance of records. The Reserve Bank would also be willing to provide the required support for organising such training, subject to mutual convenience.

Reporting and Inspection : Franchisers should prescribe a simple format in which franchisees would report transactions to them on a regular basis, preferably at monthly intervals. Further, a system of annual inspection of the books of franchisees should be put in place to ensure that the money changing business is being carried out by the franchisees in conformity with the terms of agreement/ prevailing Reserve Bank guidelines and that necessary records are being maintained.

No PIS for OCBs

It has been decided that Overseas Corporate Bodies (IOCBs) will not be permitted to invest under the portfolio investment Scheme (PIS) in India. The OCBs that have already made investments under the portfolio investment scheme, may however, continue to hold the shares/convertible debentures till such time, these are sold on the stock exchange.

The link offices of the ADs will continue to report the sale transactions undertaken by the OCBs on daily basis as before. It was further clarified that OCBs will continue to enjoy the facilities of opening and maintaining non-resident accounts as before. OCBs would also continue to be eligible for making direct investment (FDI), as per the Reserve Bank's guidelines.

ADs are aware that in terms of Schedule 3 to Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000, NRIs and

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OCBs are eligible to purchase/sell, through a designated branch of an AD, shares and convertible debentures of Indian Companies on a stock exchange in India, under the PIS.

Passport Endorsement

With a view to further simplifying the procedure, it has been decided that ADs need not endorse on passport the exchange released to persons travelling abroad for tourism. Accordingly, on the basis of a declaration given by the traveller regarding the amount of foreign exchange availed of during a calendar year, ADs may release exchange for travel for tourism and private purposes. Travellers can, however, seek endorsement on their passports, of foreign exchange released, at their option if they consider it necessary for their record.

Acquisition of Shares under ESOP

ADs are permitted to allow remittance of foreign exchange by employees of wholly owned subsidiaries or branch offices of the foreign company or a company in which the shareholding of a foreign company is not less than 51 per cent, for purchase of shares of the foreign company offered under employees stock option scheme (ESOP). Such remittances are permitted provided the ESOPs are offered at a concession and subject to the ceiling prescribed.

It was clarified that such remittances for acquisition of shares under ESOP would be permitted irrespective of whether the concession was being borne by the foreign company, its wholly owned subsidiary or office in India or a company in which foreign share holding was not less than 51 per cent.

Conversion to Euro

On January 1, 2002 Euro bank notes and coins were put into circulation in the 12 member countries of the European Union and the 12 legacy currencies ceased to be legal tender as per the time schedule set by the member countries.

ADs and FFMCs have been advised by the Reserve Bank to display Euro exchange rates for travellers' cheques immediately and for currency notes from January 1, 2002 at their foreign exchange dealing branches, especially those located at airports and tourist centres. The Reserve Bank has also advised ADs and FFMCs that on introduction of Euro banknotes and coins, they may exchange legacy currencies held by residents to the Euro.

Presently, a person resident in India is permitted to retain foreign currency notes, bank notes and foreign currency travellers' cheques not exceeding US$ 2000 or its equivalent, in aggregate. Residents holding balances of any of the 12 legacy currencies may, accordingly, convert these balances to the Euro till January 31, 2002.

More information on the Euro is available on the European Central Bank web site which can also be accessed through the 'Other Links' section on the Reserve Bank website www.rbi.org.in

Export Credit to Processors/Exporters/ Agri-Export Zones

The Government of India has proposed that Agri Export Oriented units (processing) would be set up in Agri Export Zones and to promote such units, production and processing have to be integrated. The producer has to enter into contract farming with the farmers around the unit and has to ensure supply of quality seeds, pesticides, micro-nutrients and other material to the group of farmers from whom the exporter would be purchasing their products as raw-material for production of the final products for export. The Government has, therefore, suggested that such export processing units may be provided packing credit under the extant guidelines for the purpose of procuring and supplying inputs to the farmers so that quality inputs are available to them which in turn will ensure that only good quality crops are raised. The exporters will be able to purchase/import such inputs in bulk which will have the advantages of economies of scale.

The Reserve Bank has advised that banks may treat the inputs supplied to farmers by exporters as raw material for export and consider sanctioning the lines of credit/export credit to processors/exporters to cover the cost of such inputs required by farmers to cultivate such crops to promote export of agri products. The processor units would be able to effect bulk purchases of the inputs and supply the same to the farmers as per a pre-determined arrangement.

Banks will have to ensure that the exporters have made the required arrangements with the farmers and overseas buyers in respect of crops to be purchased and products to be exported respectively. Financing banks will also appraise the projects in agri export zones and ensure that the tie-up arrangements are feasible and projects would take off within a reasonable period of time.

Further, banks will have to monitor the end-use of funds, viz., distribution of the inputs by the exporters to the farmers for raising the crops as per arrangements made by the exporter/ main processor units.

Banks will have to ensure that the final products are exported by the processors/exporters as per the terms and conditions of the sanction in order to liquidate the pre-shipment credit as per extant instructions.

Forward Contracts

ADs have been allowed to book forward contracts to exporters and importers without the production of documents evidencing exposure to foreign exchange risk provided, at any point of time, such contracts outstanding do not exceed 25 per cent of the eligible limit worked out on the basis of the average of the previous three years export/import turnover, subject to a cap of US $ 50 million. This liberalised facility would be available until further notice.

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