

### Financial Sector : Important Developments in 2002

#### January

- The Reserve Bank of India advised public sector banks to formulate a policy for one time settlement of dues pertaining to loans outstanding up to Rs. 25,000.
- Boards of banks advised to formulate detailed guidelines for lending for margin trading.
- Authorised dealers (ADs) and full fledged money changers (FFMCs) 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.
- Pursuant to Euro bank notes and coins being put into circulation in the 12 member countries of the European Union, the Reserve Bank advised ADs and FFMCs to display Euro exchange rates for currency notes and travellers' cheques.
- Permission given to Overseas Corporate Bodies (OCBs) to invest under the portfolio investment scheme withdrawn.
- Banks/financial institutions (FIs) advised to exercise due caution while taking any investment decisions to subscribe to debentures, bonds, shares, etc., and refer to the defaulters' list to ensure that investments are not made in companies/entities which are defaulters to banks/FIs.

#### February

- Based on the recommendations of the Working Group on Rehabilitation of Sick Small Scale Industries, the Reserve Bank revised its guidelines for rehabilitation of sick and potentially viable SSI units.
- Consolidated guidelines issued on foreign direct investments (FDI) in the banking sector. FDI from all sources in private banks permitted under the automatic route up to 49 per cent.
- The Reserve Bank advised all scheduled commercial banks not to display products and services of manufacturers, dealers and vendors on their automated teller machines (ATMs).
- The Reserve Bank operationalised the guidelines for the limited two-way fungibility of American Depository Receipts/Global Depository Receipts (ADRs/GDRs) as approved by the Government of India.

#### March

- The Reserve Bank modified its instructions relating to criteria for financing, inter-institutional guarantees and group exposure limit for infrastructure projects.
- The Reserve Bank advised all commercial banks [excluding regional rural banks (RRBs) and local area banks (LABs)] to charge interest on loans/advances at monthly rests from April 1, 2002. The banks were later in July, given the option to do this from April or July 2002 or by April 2003 (see July).

- The Reserve Bank announced a special one time settlement scheme for small and marginal farmers to cover loans up to Rs. 50,000 principal amount (excluding any interest element) which have become NPAs as on March 31, 1998.
- Minimum lending rate of urban co-operative banks (UCBs) reduced by one percentage point from 13 per cent to 12 per cent.
- The Reserve Bank issued guidelines for pricing of shares by private sector banks. All private sector banks - listed or unlisted -could issue bonus and rights issues without the Reserve Bank's prior approval. Bonus issue is delinked from rights issue. Initial public offerings and preferential shares, however, still need the Reserve Bank's approval.
- Indian corporates with proven track record permitted to contribute funds from their foreign exchange earnings for setting up chairs in educational institutions outside India.
- An Indian company or a body corporate, created by an Act of Parliament permitted to issue foreign currency convertible bonds not exceeding USD 50 million in any one financial year to a person resident outside India under the automatic route without approval from the Government or the Reserve Bank.

#### April

- With a view to providing full convertibility of deposit schemes for non-resident Indians (NRIs) and rationalising the existing nonresident deposit schemes, the Reserve Bank discontinued the non-resident (non-repatriable) rupee (NRNR) account and the non-resident special rupee (NRSR) account schemes from April 1, 2002.
- In order to make the interest rate on export credit more competitive, the ceiling rate on foreign currency loans for exports by banks reduced to LIBOR plus 0.75 per cent from the earlier ceiling rate of LIBOR plus 1.00 per cent.
- Banks permitted to issue smart cards to select customers with good financial standing subject to their ensuring the implementation of 'Know Your Customer' concept.

#### May

- With a view to encouraging holding of government securities in dematerialised form, the Reserve Bank advised commercial banks, co-operative banks, LABs, RRBs, primary dealers, financial institutions and non-banking financial companies to take certain measures to reduce the scope for trading in physical form.
- ADs permitted to crystallise their foreign exchange liability arising out of guarantees provided for external commercial borrowings (ECBs) raised by corporates in India, into rupees.
- ADs advised to allow repatriation of current income like rent, dividend, pension, interest, etc., of NRIs, who do not maintain a non-resident (ordinary) (NRO) account in India. Such remittance to be permitted provided a chartered accountant certifies that the amount proposed to be remitted is eligible for remittance and that applicable taxes have been paid/provided for.
- With a view to providing greater flexibility to banks in funds management, the Reserve Bank enhanced the ceiling of banks' investment in overseas money market instruments and/or debt instruments from fifteen per cent to twenty-five per cent of their unimpaired Tier I capital or US \$ 10 million, whichever was higher.

- With a view to moving closer to international best practices in regard to provisioning norms, the Reserve Bank decided that with effect from March 31, 2005, an asset would be classified as doubtful if it remained in sub-standard category for 12 months.
- Banks advised to compute investment fluctuation reserve with reference to investment in two categories, viz., “held for trading” and “available for sale” and not include investments under ‘held to maturity’.
- Satellite dealers scheme discontinued from May 31, 2002.

## June

- Cash Reserve Ratio (CRR) to be maintained by banks reduced by 50 basis points from 5.5 per cent to 5.0 per cent from the fortnight beginning June 1, 2002.
- The Reserve Bank advised all commercial banks to provide full particulars of each transaction while updating passbooks of customers maintaining savings/current accounts with them, irrespective of whether the withdrawal is effected by issue of cheques by the customer and presented through Bankers’ Clearing Houses or entries have emanated from usage of electronic clearing service.
- In order to further improve the flow of credit to SSIs, all scheduled commercial banks (including RRBs and LABs) were advised that they may, on the basis of good track record and financial position of the units, increase the limit of dispensation of collateral requirement for loans from Rs. 5 lakh to Rs. 15 lakh.

## July

- Banks advised to adopt and implement the recommendations of the Consultative Group of Directors of Banks and Financial Institutions (Dr. A.S.Ganguly Committee) set up to review the supervisory role of boards.
- In order to increase the investor base, the minimum size of certificates of deposit (CDs) to a single investor reduced from Rs. 5 lakh to Rs. 1 lakh and in multiples of Rs. 1 lakh thereafter.
- As a prudential measure, all RRBs advised to maintain their entire statutory liquidity ratio (SLR) in government and other approved securities.
- With a view to ensuring that minority communities secure, in a fair and adequate measure, the benefits flowing from various development schemes, all UCBs advised to initiate steps to enhance/augment flow of credit under priority sector to artisans, craftsmen, vegetable vendors, cart pullers, cobblers, etc.
- Banks given the option to compound interest at monthly rests effective either from April 1, 2002 or July 1, 2002 or April 1, 2003. Earlier, in April, banks were advised to charge interest on advances at monthly rests from April 1, 2002.

## August

- The Reserve Bank formulated a special relief package for the economic rehabilitation of Gujarat riot-affected people, which banks were advised to implement immediately.
- All primary (urban) co-operative banks (PCBs) advised to maintain a strict vigil in opening and operations of deposit accounts and to take stringent action against all officials/ employees who violate the Reserve Bank’s instructions in this regard and/or facilitate suspicious transactions.
- The Reserve Bank introduced an automatic route for prepayment of ECBs on an

experimental basis. The automatic route for prepayment of ECBs without the Reserve Bank's prior permission will be available up to March 31, 2003.

- Individual professionals allowed to keep up to 100 per cent of their foreign exchange earnings from consultancy and other services rendered to persons or bodies outside India, in their exchange earners' foreign currency (EEFC) account.
- As part of 'Know Your Customer' principle, the Reserve Bank consolidated its earlier guidelines relating to identification of depositors and advised banks to put in place systems and procedures to help control financial frauds, identify money laundering and suspicious activities and for scrutiny/monitoring of large value cash transactions.

### **Monetary and Credit Policy for the year 2002-03**

- Growth rate in 2002-03 projected at 6.0 to 6.5 per cent. Inflation to remain low.
- Monetary conditions and liquidity position highly comfortable.
- RBI to provide adequate liquidity to meet credit growth and support investment demand.
- Soft interest rate regime to continue and greater flexibility to interest rate structure in the medium-term.
- Further cut in CRR by 50 basis points.
- Bank Rate may be cut by up to 50 basis points depending on monetary developments - No timing fixed yet.
- No change in interest rate on savings account.
- Interest rate on export credit in foreign currency lowered.
- Abolition of minimum lending rate for co-operative banks.
- Banks to declare maximum and minimum lending rates.
- Banks to provide information on deposit rates on various maturities and effective annualised return to depositors.
- Facilities for small scale industries liberalised.
- Further measures to improve credit delivery mechanism to priority sector.
- Measures to improve flow of credit to housing sector.
- Further measures to develop government securities market.
- Access to call money market to be regulated.
- CDs to be issued in demat form.
- More prudential measures to bring financial stability.
- Measures to improve technology - EFT facilities to be expanded.
- Real Time Gross Settlement System to be ready for testing in a year's time.
- Submission of returns by NBFCs - RBI to penalise delays.

### **September**

- All scheduled commercial banks advised to classify advances for financing agriclincs and agribusiness centres as 'direct finance under agriculture'.
- Ceiling on bank advances under priority sector to retail traders raised from Rs. 5 lakh to Rs. 10 lakh.
- Ceiling on advances to professional and self-employed persons raised from Rs. 5 lakh to Rs. 10 lakh, of which, not more than Rs. 2 lakh to be for working capital.
- Ceiling of Rs. 15 lakh, with a sub-ceiling of Rs. 3 lakh for working capital requirements,

fixed for advances granted to professionally qualified medical practitioners setting up practice in semi-urban and rural areas.

- Banks advised to refrain from offering low/zero per cent interest rates on consumer durable advances to borrowers through adjustment of discount available from manufacturers/dealers of consumer goods. Banks also advised to refrain from linking their names in any form/manner with any incentive-based advertisements which lack clarity about interest rate.
- RRBs and sponsor banks of RRBs advised that from March 31, 2005, an asset would be classified as doubtful if it remained in sub-standard category for 12 months instead of 18 months as at present. RRBs permitted to phase the consequent additional provisioning over a four year period, with a maximum of 20 per cent each year.
- ADs permitted to release foreign exchange up to USD 50,000 for medical treatment outside India, without insisting on any estimate from a doctor or hospital, on the basis of a declaration of requirement given by the applicant, provided the payment for purchase of such foreign exchange is made by cheque or by debit to the applicant's account.
- EEFC scheme rationalised to have only two categories of EEFC account holders - one, those who can retain up to 100 per cent of their receipt in foreign exchange and others who can retain up to 50 per cent of their receipts in foreign exchange. The rationalisation, thus was also towards giving boost to export oriented units (EOUs).
- ADs permitted to release foreign exchange remittance up to USD 500 on the basis of a simple letter from resident individuals. The letter should contain basic information, viz., name and address of the applicant, name and address of the beneficiary, amount to be remitted and the purpose of remittance.
- Taking into account changes in the external financial markets and requirements of corporates, the automatic route for prepayment of ECBs further liberalised. Applicants permitted to raise ECB from any internationally recognised source, such as, banks, export credit agencies, suppliers of equipment, foreign collaborators, foreign equity holders, international capital markets, etc.
- PCBs (other than scheduled urban co-operative banks) desirous of setting up branch-automated teller machines (ATMs) advised to seek permission from the Reserve Bank's concerned regional office.
- With a view to further improving flow of credit to the housing sector, UCBs extending housing loans to individuals against the mortgage of residential housing properties, permitted to assign risk weight of 50 per cent on such loans instead of the earlier 100 per cent.

### **Mid-term Review of Monetary and Credit Policy for 2002-03**

- RBI pegs GDP growth at 5.0 to 5.5 per cent despite drought conditions.
- Bank Rate reduced by 0.25 percentage point.
- CRR reduced by 0.25 percentage point.
- Substantial increase in flow of bank credit to industries. Upturn in industrial production and buoyancy in exports to sustain growth

- Money supply ( $M_3$ ) contained within the projected trajectory of 14 per cent
- Decline in reserve money despite large increase in foreign exchange reserves and significant primary support to government borrowing programme.
- Bulk of the government borrowing programme completed at lower interest cost and with longer maturity.
- Inflation to remain benign around 4 per cent despite drought and pressures on oil prices.
- Sharp reduction in interest rates on various types of government and corporate papers.
- Reduction in effective lending rates of banks.
- Reserves build up at a low effective cost without adding to external debt. The increase in reserves reflects higher remittances, quicker repatriation of export proceeds and non-debt inflows.
- RBI to continue the monetary policy stance for 2002-03 announced in April 2002 for the remaining half of the year.
- Monetary and prudential measures towards flexibility.

### October

- At the behest of Board for Financial Supervision, the Reserve Bank conducted a study on non-performing assets (NPAs) by scanning relevant information/data obtained from a select group of banks. Based on the study, the Reserve Bank suggested a framework of recommendations for preventing slippage of NPAs from sub-standard to doubtful/loss category. Banks were advised to place the guidelines before their board of directors and to work out their strategic response in keeping with the broad thrust of the guidelines.
- All foreign banks operating in India advised to invariably inform the Reserve Bank well in advance of their intention of closing any of their branches including those in metropolitan areas. They were advised to furnish a detailed plan of closure to ensure that their customers' interests and convenience are addressed adequately.
- UCBs advised not to act as agents/sub-agents of money transfer service schemes. UCBs already acting as agents/sub-agents of such schemes advised to withdraw/disengage themselves from such activities.
- ADs permitted to grant foreign currency loans in India against the security of funds held in foreign currency non-resident (banks) {FCNR(B)} deposit accounts to the account holders subject to certain conditions.
- Limit of advances granted to dealers in drip irrigation/sprinkler irrigation system/agricultural machinery located in rural/semi-urban areas, increased from Rs. 10 lakh to Rs. 20 lakh under priority sector lending for agriculture.
- Individual credit limit to artisans, village and cottage industries increased from Rs. 25,000 to Rs. 50,000.
- Limit of housing loans for repairing damaged houses increased from Rs. 50,000 to Rs. 1 lakh in rural and semi-urban areas and to Rs. 2 lakh in urban areas.
- Credit limit to small business increased from Rs. 10 lakh to Rs. 20 lakh without any ceiling for working capital. Banks given freedom to fix individual limits for working capital depending upon the requirements of different activities.
- UCBs advised not to pay any additional interest on savings bank accounts over and above



what is paid by commercial banks and not to pay interest on current accounts.

- UCBs advised that their fresh investments in permitted instruments, such as, PSU bonds, bonds/equity of specified all India financial institutions, infrastructure bonds issued by financial institutions and units of UTI, should be only in dematerialised form. UCBs also advised to convert all their existing investments in these instruments into dematerialised form latest by December 31, 2002.
- The Reserve Bank developed a rating model for UCBs based on CAMEL factors with a view to summarising the performance of UCBs and assessing the aggregate strength and soundness of the urban banking system. The Reserve Bank to rate scheduled UCBs from the inspection cycle beginning March 2003.
- ADs advised to permit exporters to repay packing credit advances, whether availed of in rupee or in foreign currency, from balances in their EEFC account to the extent exports have actually taken place.
- NBFCs advised to necessarily hold their investments in government securities only in dematerialised form, either in constituent's subsidiary general ledger accounts with a scheduled commercial bank/Stock Holding Corporation of India Ltd., or with a depository.
- The Reserve Bank began disseminating the data on trades on government securities and other data captured by the negotiated dealing system through its website on real time basis.
- The level of minimum daily CRR to be maintained by banks raised to 80 per cent from the earlier level of 50 per cent with effect from the fortnight beginning November 16, 2002.. Banks advised to maintain the minimum level of 80 per cent on all the days of the fortnight including the reporting Friday.
- ADs permitted to issue International Credit Cards (ICCs) to NRIs/ PIOs, without the Reserve Bank's prior approval, subject to the condition that charges on the use of ICCs should be settled by the concerned NRIs/PIOs, only out of inward remittances or balances held in their non-resident external (NRE) accounts/ foreign currency non-resident (FCNR) accounts.
- The Reserve Bank formulated a scheme for setting up of offshore banking units (OBUs) in special economic zones (SEZs) by banks. These units would be virtually foreign branches of Indian banks but located in India. These OBUs, *inter alia*, would be exempt from CRR, SLR and give access to SEZ units and SEZ developers to international finances at international rates.
- Banks advised not to effect recovery of crop loans including interest during the current financial year in the states affected by the failure of the South-West monsoon.
- Banks advised that CDs may be issued as a coupon-bearing instrument. In order to give additional choice to both investors and issuers, the Reserve Bank has decided that banks may issue CDs on floating rate basis provided the methodology of computing the floating rate is objective, transparent and market-based.
- The Reserve Bank issued a Memorandum of Instructions to FFMCs and restricted money changers containing procedural instructions for adherence while undertaking money changing transactions.
- ADs have been advised to allow advance remittances for import of goods up to USD 100,000 without the Reserve Bank's prior approval.

**November**

- As a precursor to full convertibility of the rupee, persons resident in India allowed to open, hold and maintain with an AD in India a foreign currency account known as Resident Foreign Currency Domestic Account. Foreign exchange in the form of currency notes, bank notes and travellers cheques can be kept in this account by residents.
- Limit of foreign exchange available to residents in one calendar year for one or more private visits abroad (except Nepal and Bhutan) enhanced from USD 5,000 to USD 10,000 or its equivalent.
- ADs permitted to allow remittance of foreign exchange for miscellaneous purposes, such as, cost of Euro Rail passes/ tickets, overseas hotel reservations, etc., for Indian travellers, consolidated tour arrangements for foreign tourists visiting neighbouring countries, advertisements in television media abroad, subscription to overseas TV media companies, bids in foreign currency for projects to be executed in India, sale proceeds of overseas telephone cards, supply of goods by a 100 per cent EOU/EPZ unit to another such unit against payment in foreign exchange, payment of fees to embassy affiliated educational institutions.

### December

- The Reserve Bank allowed banks to offer foreign currency-rupee swaps to customers without any limit and exporters/importers to book forward contracts upto USD 100 million without documentary evidence as also freely rebook cancelled contracts. The Reserve Bank has also granted general permission to banks to offer hedging facility to foreign direct investments. Moreover, banks will be able to freely invest in overseas money and debt market instruments. Foreign banks will not be required to spread their requirement of hedging their Tier I capital over six months.
- The Reserve Bank issued draft directions/guidelines for securitisation/reconstruction companies. The Government of India promulgated The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance, 2002 which came into effect from June 21, 2002.
- The Reserve Bank issued draft guidelines on Fair Practices Code for observance by banks and FIs.
- NRIs/Persons of Indian Origin (PIOs) permitted to settle the dues of their international credit cards out of funds held in their NRO account.

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