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POLICY

Dishonour of Cheques

Pursuant to the recommendations of the Joint Parliamentary Committee into the Stock Market Scam, the Reserve Bank has reviewed the extant instructions relating to return of all dishonoured cheques. The additional procedure to be followed by banks in respect of all dishonoured cheques are detailed below -

Return/despatch

- (i) The paying bank should return dishonoured cheques presented through clearing houses strictly as per the return discipline prescribed for respective clearing house in the Uniform Regulations and Rules for Bankers' Clearing Houses. The collecting bank on receipt of a dishonoured cheque should immediately despatch it to the payee/holder.
- (ii) Cheques presented directly to the paying bank for settlement of transaction by way of transfer between two accounts with that bank, if dishonoured, should be immediately returned to payees/holders.
- (iii) Cheques dishonoured for want of funds in respect of all accounts should be returned along with a memo indicating the reason for dishonour as "insufficient funds."

Information

- (i) Data regarding each dishonoured cheque, for an amount of Rs.one crore and above should be a part of banks' management information system (MIS) on constituents. Branches should report such data to their controlling office/head office.

- (ii) Banks should separately consolidate data regarding cheques drawn in favour of stock exchanges and dishonoured, irrespective of the value of such cheques, as a part of their MIS on broker entities. Banks should report such data to their head offices/central offices.

Frequent dishonour

- (i) With a view to enforcing financial discipline among customers banks should introduce a condition for operation of accounts with cheque facility that, no fresh cheque book would be issued if a cheque valuing rupees one crore and above drawn on a particular account of the drawer is dishonoured on four occasions during a financial year for want of sufficient funds in the account. Banks may even consider closing a current account at its discretion. In respect of advances accounts such as cash credit account, overdraft account, the need for continuance or otherwise of these credit facilities and the cheque facility should be reviewed by an appropriate authority higher than the sanctioning authority.
- (ii) While issuing new cheque books banks may issue a letter advising the constituents of the condition that the cheque book facility would be withdrawn if cheques valuing rupees one crore and above are dishonoured on four occasions during a financial year due to insufficient funds.
- (iii) If a cheque is dishonoured for a third time on a particular account of the drawer during a financial year, banks should issue a cautionary advice to the concerned constituent that if a cheque issued on the same account is dishonoured on fourth occasion during the financial year, then the cheque facility would be stopped. A bank may issue a similar cautionary advice if it intends to close an account.

General

- (i) Banks should extend full co-operation to a complainant (payee/ holder of a dishonoured cheque) for adducing evidence to prove dishonour of cheque in any proceeding relating to dishonoured cheque before a court, consumer forum or any other competent authority. Banks should furnish him/her with documentary proof of dishonour of cheques.
- (ii) Banks should place before their audit/management committee every quarter, consolidated data regarding dishonoured cheques for an amount of rupees one crore and above including those relating to settlement transactions of stock exchanges. Such data should be placed before their audit/management committee commencing from the first quarter of 2003-04, i.e., quarter ending June 2003.

Banks may also adopt with the approval of their respective boards, appropriate procedure for dealing with dishonoured cheques with inherent preventive measures and checks to prevent any scope for collusion of the staff of the bank or any other person, with the drawer of the cheque for causing delay in or withholding communication of the fact of dishonour of the cheque to the payee/ holder or the return of such dishonoured cheque to him. Banks should lay down internal

guidelines for their officers and staff to follow and ensure that the guidelines are strictly adhered to.

Treatment of Premium on Buyback of G-Secs

It may be recalled that the Government of India had offered to buyback illiquid securities from banks on a voluntary basis in its budget for 2003-2004. It was also indicated that banks that declare the premium received under the buyback scheme as business income, for income tax purposes, would be allowed additional deduction to the extent such income is used for provisioning of their non-performing assets (NPAs). The buyback auction was conducted on July 19, 2003.

With a view to enabling banks which might have included the securities proposed to be bought back by the Government in 'held to maturity' (HTM) category and to enable them to take benefit of the structure of tax incentives for the premium received under the buyback scheme, banks were exempt from the requirement of appropriating the profit on sale of securities from HTM category to 'capital reserve account', as a one time measure. The exemption, however, would be applicable only in respect of securities sold to the Government of India under the debt buyback programme.

Earlier, in October 2000, banks were advised that profit on sale of investments in HTM category should be first taken to the profit and loss account and thereafter be appropriated to the capital reserve account.

Netting off of Old and Small Value Entries

The Reserve Bank has, while reviewing the position of progress made by scheduled commercial banks in reducing the outstanding entries in their clearing adjustment account, observed that entries of smaller values form a significant portion of the old outstanding clearing differences and pose practical difficulties in the reconciliation. As such, it has been decided, as a one time measure, to allow banks to net off the entries representing clearing differences receivable against entries representing clearing differences payable up to Rs. 500 which are outstanding for more than three years. This decision is in the light of suggestions received from banks and with a view to reducing the level of long pending outstanding entries in the clearing adjustment account of banks.

Procedure for netting off entries

- (a) Banks should net off all entries representing clearing differences 'receivable' against entries representing clearing differences 'payable', of amounts less than Rs. 500 each, which are outstanding in the clearing adjustment accounts for more than three years as on March 31, 2003, i.e., all outstanding entries of less than Rs. 500 each in the clearing adjustment account (receivables against payables) originated on or before March 31, 2000 and outstanding as on March 31, 2003. Earlier, banks were advised to transfer all old clearing differences (both payable and receivable) prior to April 1, 1994 to a blocked account. The entries in these blocked accounts may also be reckoned for the purpose of netting off.

- (b) Since the entries would be outstanding in the branch books, the service branches/nodal branches may net off the outstanding entries in the clearing differences account and thereafter transfer the net position to their head office along with the full details of the entries representing clearing differences payable as also the entries representing clearing differences receivable.
- (c) At the head office, the bank may aggregate the net positions reported by the branches and arrive at the net aggregate position of clearing differences. If the aggregate net is in debit, the same may be written off by debit to the profit and loss account. If the aggregate net is a credit, the same may be transferred to a separate blocked account and shown under 'other liabilities and provisions - others' in the balance sheet (schedule 5 of the balance sheet). The balance in the blocked account will be reckoned for the purpose of maintenance of CRR/SLR.
- (d) Banks should ensure that the above exercise does not result in any portion of the clearing difference entries being parked in the inter-branch accounts.
- (e) Banks should maintain a record of the clearing difference entries transferred to head office at the branches/head office for verification by internal inspection/auditors/Reserve Bank inspection. The netting off at the branches, the transfer of entries by the branches to the head office, the netting off at the head office and the writing off/transfer at the head office should be subjected to a 100 per cent audit by the internal auditors, the concurrent auditors and the statutory auditors.

It has also been observed that the clearing adjustment account of banks include entries pertaining to inter-branch clearing differences in addition to the inter-bank clearing differences. Separation of instruments, viz., cheques, demand drafts, etc., pertaining to inter-branch transactions from inter-bank clearing is expected to reduce the clearing differences considerably. Hence, banks are advised to route their inter-branch clearing instruments through an in-house clearing mechanism and not route it along with inter-bank clearing instruments.

The Reserve Bank had been advising all scheduled commercial banks from time to time to take corrective action for early adjustment of the pending entries in the clearing adjustment accounts. Though banks have made progress in reducing the number of entries outstanding in the clearing adjustment account, the level of outstanding entries still continues to be high. Since this is a fraud prone area, it is imperative for banks to adjust the old pending entries in the clearing adjustment accounts.

The Reserve Bank has asked the scheduled commercial banks to place these guidelines before their board of directors.

EXCHANGE CONTROL

Foreign Currency - Rupee Options

As a part of developing the derivative market in India and adding to the spectrum of hedge products available to residents and nonresidents for hedging currency exposures, the Reserve Bank has permitted foreign currency – rupee options from July 7, 2003. Accordingly, authorised dealers (ADs) are permitted to offer foreign currency rupee options on the following terms and conditions :

- ADs offering the product should have a minimum credit to risk asset ratio (CRAR) of 9 per cent. The product may be offered on a back-to-back basis.
- ADs would be allowed to run an option book after obtaining a one-time approval from the Reserve Bank provided they fulfill the following criteria :
 - (i) Continuous profitability for at least three years.
 - (ii) Minimum CRAR of 9 per cent.
 - (iii) Net NPAs at reasonable levels (not more than 5 per cent of net advances).
 - (iv) Minimum net worth not less than Rs. 200 crore.
 - (v) Adequate internal control, risk monitoring/ management systems, marks to market mechanism.
- Initially, ADs may offer only plain vanilla European options.
- Customers can purchase call or put options. Customers can also enter into packaged products involving cost reduction structures provided the structure does not increase the underlying risk and does not involve customers receiving premium. Customers are not permitted to write options.
- ADs should obtain an undertaking from customers interested in using the product that they have clearly understood the nature of the product and its inherent risks.
- ADs may quote the option premium in rupees or as a percentage of the rupee/foreign currency notional.
- Option contracts may be settled on maturity either by delivery on spot basis or by net cash settlement in rupees on spot basis as specified in the contract. In case of unwinding of a transaction prior to maturity, the contract may be cash settled based on the market value of an identical offsetting option.
- All the conditions applicable for booking, rolling over and cancellation of forward contracts would be applicable to option contracts also. The limit available for booking of forward contracts on past performance basis, i.e., contracts outstanding not to exceed 25 per cent of the average of the previous three years' import/export turnover within a cap of USD 100 million would be inclusive of option transactions. Higher limits would be permitted on a case-by-case basis on application to the Reserve Bank as in the case of forward contracts.
- Only one hedge transaction can be booked against a particular exposure/part thereof for a given time period.
- Option contracts cannot be used to hedge contingent or derived exposures (except exposures arising out of submission of tender bids in foreign exchange).

Users

- Customers who have genuine foreign currency exposures (as indicated in FEMA Notification of May 3, 2000, as amended from time to time), are eligible to enter into option contracts.

- ADs may use the product for the purpose of hedging trading books and balance sheet exposures.

Risk Management/Regulatory Issues

- ADs desirous of running an option book and acting as market makers should apply to the Chief General Manager, Reserve Bank of India, Exchange Control Department, Forex Markets Division, Central Office, Fort, Mumbai-400001 with a copy of the approval of the competent authority and a copy of the detailed memorandum. The Reserve Bank should also be informed if an AD desires to use the product on a back-to-back basis.
- Market makers would be allowed to hedge the 'Delta' of their option portfolio by accessing the spot markets. Other 'Greeks' may be hedged by entering into option transactions in the inter-bank market. The 'Delta' of the option contract would form part of the overnight open position. As regards inclusion of option contracts for the purpose of 'AGL', the "delta equivalent" as at the end of each maturity should be taken into account. . The residual maturity (life) of each outstanding option contract can be taken as the basis for the purpose of grouping under various maturity buckets
- For the present, ADs should manage the option portfolio within the risk management limits already approved by the Reserve Bank.
- ADs running an option book are permitted to initiate plain vanilla cross currency option positions to cover risks arising out of market making in foreign currency-rupee options.
- Banks should put in place necessary systems for marking to market the portfolio on a daily basis. The Foreign Exchange Dealers Association of India (FEDAI) daily will publish a matrix of polled implied volatility estimates, which market participants can use for marking to market their portfolio.

Reporting

ADs should report to the Reserve Bank the transactions undertaken on a weekly basis.

Accounting

The accounting framework for option contracts would be as per FEDAI Circular of May 29,2003.

Documentation

Market participants may follow only International Swap Dealers Association (ISDA) documentation.

Capital Requirements

Capital requirements would be as per the guidelines issued by the Reserve Bank's Department of Banking Operations and Development from time to time.

Other Requirements

Banks should train their staff adequately and put in place necessary risk management systems before they undertake option transactions. They should also take steps to familiarise their constituents with the product.

The need for continuance of the product would be reviewed after six months based on market development.

Liberalisation of Current Account Transactions

As a step towards further liberalisation, it has been decided to raise the present limits for release of foreign exchange as detailed below :

Purpose	Existing limit (in USD)	Proposed limit (in USD)
Employment abroad	5,000	100,000
Emigration	5,000	100,000
Maintenance of close relatives abroad	5,000	100,000
Education abroad	30,000	100,000
Medical Treatment	50,000	100,000
Consultancy Services	100,000	one million per project

Accordingly, ADs have been advised to allow remittances for amounts up to the revised limits for each category, without insisting on any supporting documents except in the case of consultancy services where the applicant would have to submit documents to the satisfaction of the AD. Such amounts may be released on the basis of self declaration by the applicant, incorporating the basic details of the transaction and submission of application in Form A2. ADs should also ensure that the applicant pays for the foreign exchange purchased by a cheque or demand draft or by debit to his/her account.

BRANCH BANKING

Credit to SCs/STs

The Reserve Bank has advised all scheduled commercial banks to take corrective measures for certain operational deficiencies noticed at branch level, relating to flow of credit to scheduled castes (SCs) and scheduled tribes (STs). The deficiencies noticed were:

- Some banks have not yet set up special cells for monitoring the flow of credit to SC/ST beneficiaries.
- Some convenor banks do not invite the representatives of National Commission for SCs/STs for state level bankers' committee (SLBC) meetings.
- Application receipts/disposal registers, complaint registers, etc., are not maintained in the desired order.
- Relevant documents and passbooks are maintained in Hindi and English instead of the local language.

- Some branch managers reject loan applications of SC borrowers at their level instead of at a next higher level.
- Some branches do not intimate reasons for rejection of the application.
- Though income is generated, it is not utilised for repayment of loans, leading to poor recovery of loans.
- Instances of branches in the state of West Bengal releasing loan component after keeping subsidy in fixed deposit accounts till the full repayment of bank dues, were observed. This leads to under financing to SCs/STs and thereby hampering asset creation/income generation.
- Few instances of bank branches insisting on collateral security while sanctioning loans to SCs/STs under government sponsored poverty alleviation/self-employment schemes were also noticed.
- Bank branches in West Bengal do not circulate circulars issued by the Reserve Bank/NABARD among the staff concerned for noting the contents. As a result, the staff is not aware of the instructions and no proper follow up is done.
- Banks are required to contact SC/ST borrowers, hold meetings/workshops exclusively for them. It has been noticed, however, that since many branches are suffering from acute shortage of staff/have no field staff, they are not in a position to contact SC/ST borrowers/hold meetings.

The Reserve Bank had undertaken a sample study through its 16 regional offices to review the flow of credit to SCs and STs. The study covered 53 groups, 1683 beneficiaries in 57 districts and 154 branches throughout the country covering three half years' period ending September 2001, March 2002 and September 2002

Ceiling on Interest Rate on NRE Deposits

In order to provide consistency in the interest rates offered to non-resident Indians, it has been decided that, until further notice, the interest rates on fresh repatriable non-resident (external) rupee (NRE) deposits for one to three years should not exceed 250 basis points above the LIBOR/SWAP rates for the US dollar of corresponding maturity. The rates will be applicable to NRE deposits contracted effective July 17, 2003. For purposes of operational convenience, the interest rates could be rounded off to the nearest decimal point. For example, a computed interest rate of 3.67 per cent could become 3.7 per cent and 3.64 per cent could become 3.6 per cent.

The maturity period of repatriable NRE deposits would continue to be one to three years and the interest rate as determined above for three year deposits would be applicable in case the maturity period exceeds three years. The changes in interest rates will also apply to repatriable NRE deposits renewed after their present maturity period.

At present, banks can offer foreign currency non-resident {FCNR(B)} deposits in foreign currency and NRE deposits in domestic currency to non-resident Indians. NRE deposits are now fully repatriable. The interest rates on FCNR(B) deposits are subject to a ceiling of LIBOR/SWAP rates for the corresponding maturities minus 25 basis points, and generally to conform to global interest rates in foreign currency deposits in US dollar, pound sterling, euro, etc., whereas interest rates offered by banks on NRE deposits are more or less on par with interest rates on domestic rupee deposits.

UCBs

G-Secs to settle through CCIL

The Reserve Bank has advised all primary (urban) cooperative banks (UCBs) which are not a member of the negotiated dealing system (NDS) - Clearing Corporation of India Ltd. (CCIL) system, to undertake their transactions in government securities through gilt account/demat account maintained with an NDS member.

The Reserve Bank has extended to all market participants the facility of settlement in government securities transactions over NDS - CCIL System besides settlement under the delivery versus payment (DvP) system. All government securities transactions (both outright and repo) are being settled compulsorily only through CCIL from April 1, 2003. Any government securities transactions settled by banks outside the NDS-CCIL system since that date are not entertained by the Reserve Bank.

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