# Credit Information Review

## Contents

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## Guidelines

### Investment in non-SLR Securities

To contain the risk arising out of non-SLR (statutory liquidity requirement) investment portfolio of banks and financial institutions (FIs) in particular, through private placement route, the Reserve Bank had circulated draft operating guidelines on management of non-SLR investment portfolio for obtaining banks' views/comments. On the basis of the feedback received from banks, Fzixed Income Money Market and Derivatives Association of India (FIMMDA) and the Indian Banks' Association (IBA), the Reserve Bank has finalised the guidelines, which come into force with immediate effect. The guidelines are :

### Coverage

The guidelines cover banks' investments in non-SLR securities issued by corporates, banks, FIs and state and central government sponsored institutions, special purpose vehicles (SPVs), etc. The guidelines, however, are not applicable to investments in securities issued directly by the central and state governments, which are not reckoned for SLR and investments in equity shares. The guidelines apply to investments both in the primary as well as the secondary market.

### Regulatory requirements

Banks should not invest in non-SLR securities of original maturity of less than one-year, other than commercial paper and certificates of deposits which are covered under the Reserve Bank's guidelines.

Banks should undertake due diligence regarding their investments in non-SLR securities. The Reserve Bank's regulations preclude banks from extending credit facilities for certain purposes. Banks should ensure that such activities are not financed by funds raised through non-SLR securities.

### Listing/rating

- Banks should not invest in unrated non-SLR securities.

- According to the Securities and Exchange Board of India (SEBI)'s stipulations, any listed company making issue of debt securities on a private placement basis and listed on a stock exchange, has to make full disclosures (initial and continuing) in the manner prescribed in Schedule II of the Companies Act 1956, SEBI (Disclosure and Investor Protection) Guidelines, 2000 and the Listing Agreement with the exchanges. Furthermore, the debt securities should carry a credit rating of not less than investment grade from a credit rating agency registered with SEBI. Accordingly, while making fresh investments in non-SLR debt securities, banks should ensure that such investments are made only in listed debt securities of companies which comply with SEBI's requirements.

### Prudential limits

Bank's investments in unlisted non-SLR securities should not exceed 10 per cent of its total investment in non-SLR securities as on March 31, of the previous year.

Bank's investments in unlisted non-SLR securities may exceed the limit of 10 per cent, by an additional 10 per cent, provided the investment is made in securities issued by SPVs for mortgage backed securities (MBS), securitisation papers issued for infrastructure projects and bonds/debentures/security receipts/pass through certificates issued by securitisation companies and reconstruction companies set up under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and registered with the Reserve Bank.

Banks which have exposure to investments in unlisted non-SLR securities in excess of the prudential limit as on March 31, 2003 should not make any fresh investment in such securities till they comply with the prudential limit.

### Internal assessment

Since non-SLR securities are mostly in the form of credit substitutes, banks were advised in June 2001 to (i) subject all their investment proposals relating to non-SLR securities to credit appraisal on par with their credit proposals, irrespective of the fact that the proposed investments may be in rated securities, (ii) make their own internal credit analysis and rating even in respect of rated issues and that they should not entirely rely on the ratings of external agencies, and (iii) strengthen their internal rating systems which should also include building up of a system of regular (quarterly or half-yearly) tracking of the financial position of the issuer with a view to ensuring continuous monitoring of the rating migration of the issuers/issues.

**Role of Boards**

Banks should ensure that their investment policies duly approved by the board of directors are formulated after taking into account all the relevant issues specified in these guidelines. Banks should put in place proper risk management systems for capturing and analysing the risk in non-SLR investment and taking remedial measures in time. Banks should also put in place appropriate systems to ensure that investment in privately placed instruments is made in accordance with the systems and procedures prescribed under their investment policy.

Banks' Boards should review at quarterly intervals the following :

- Total business (investment and divestment) during the reporting period.
- Compliance with the prudential limits prescribed by the Board for non-SLR investment.
- Compliance with the Reserve Bank's prudential guidelines on non-SLR securities.
- Rating migration of the issuers/issues held in the bank's books and consequent diminution in the portfolio quality.
- Extent of non-performing investments in the non-SLR category.

**Disclosures**

Investing banks should file with the Credit Information Bureau (India) Ltd. (CIBIL) a copy of all offer documents in order to help in the creation of a central database on private placement of debt. Investing banks should also report to CIBIL, any default relating to interest/instalment regarding any privately placed debt, along with a copy of the offer document.

Banks should disclose the details of the issuer composition of non-SLR investments and the non-performing non-SLR investments in the 'Notes on Accounts' of the balance sheet from the year ending March 31, 2004.

**Trading/settlement**

As per SEBI guidelines, all trades with the exception of spot transactions in a listed debt security, should be executed only on the trading platform of a stock exchange. Banks should comply with these guidelines of SEBI. Banks should also ensure that all spot transactions in listed and unlisted debt securities are reported on the negotiated dealing system (NDS) and settled through the Clearing Corporation of India (CCIL) from a date to be notified by the Reserve Bank.

## Definitions

With a view to imparting clarity and to ensure that there is no divergence in the implementation of the guidelines, some of the terms used in the guidelines are defined below.

- A security would be treated as rated if it is subjected to a detailed rating by an external rating agency in India which is registered with SEBI and is carrying a current or valid rating. The rating relied upon would be deemed to be current or valid if –

  (i) the credit rating letter relied upon is not more than one month old on the date of opening of the issue, and

  (ii) the rating rationale from the rating agency is not more than one year old on the date of opening of the issue, and

  (iii) the rating letter and the rating rationale are a part of the offer document.

  (iv) In the case of secondary market acquisition, the credit rating of the issue should be in force and confirmed from the monthly bulletin published by the respective rating agency.

- Securities which do not have a current or valid rating by an external rating agency would be deemed as unrated securities.

- The investment grade ratings awarded by each of the external rating agencies operating in India would be identified by IBA/ FIMMDA. These would also be reviewed by IBA/ FIMMDA at least once a year.

- A 'listed' security is a security which is listed in a stock exchange. If not so, it is an 'unlisted' security.

- A non-performing investment (NPI), similar to a non-performing advance (NPA), is one where –

  (i) Interest/instalment (including maturity proceeds) is due and remains unpaid for more than 180 days. The delinquency period would become 90 days from March 31, 2004.

  (ii) The above would apply mutatis-mutandis to preference shares where the fixed dividend is not paid.

  (iii) In the case of equity shares, if the investment in the shares of any company is valued at Re.1 per company due to non-availability of the latest balance sheet, those equity shares would also be reckoned as NPI.

  (iv) If any credit facility availed by the issuer is NPA in the books of the bank, investment in any of the securities issued by the same issuer would also be treated as NPI.

## Banking

### RIDF Interest Rates Revised

Keeping in view the declining interest rates scenario and the need to further rationalise the interest rate structure under the rural infrastructure development fund (RIDF), it has been decided, with the approval of the Government of India, to restructure the lending and deposit rates in respect of the undisbursed amounts of RIDF-IV to IX with effect from November 1, 2003. The revised rates are:

| **RIDF** | **Interest rates on deposits payable to banks** | | **Interest rates on loans payable by state Governments** | |
|---|---|---|---|---|
| | Existing | Revised | Existing | Revised |
| IV to VII | 8 per cent | 6 per cent | 9 per cent | 7 per cent |
| VIII | Linked to shortfall, varying between 8 to 5 per cent | Varies between the Bank Rate and Bank Rate minus 3 percentage points depending upon the extent of deficit in Lending to agriculture (currently varies between 6 per cent and 3 per cent | 8.5 per cent | Bank rate + 0.5 Percentage Point (currently 6.5 per cent) |
| IX | Linked to shortfall Varying between Bank Rate + 1.5 per cent to Bank Rate - 1.5 per cent | Same as above | Bank Rate + 2 per cent | Same as above |

In the case of RIDF-VIII and IX, therefore, the rates of interest on deposits will continue to be linked to the shortfall in lending to agriculture and will be as follows :

| **Shortfall in lending to agriculture in terms of percentage to net bank credit** | **Rate of interest on the entire deposit to be made in RIDF VIII and RIDF-IX (Per cent per annum)** |
|---|---|
| Less than 2 percentage points | Bank Rate (6 at present) |
| 2 and above, but less than 5 percentage points | Bank Rate minus 1 |
| 5 and above, but less than 9 percentage points | Bank Rate minus 2 |
| 9 percentage points and above | Bank Rate minus 3 |

It may be recalled that the RIDF was established with the National Bank for Agriculture and Rural Development (NABARD) in terms of the Union Finance Minister's Budget speech for the year 1995-96 for assisting state governments and state owned corporations in quick completion of on-going projects relating to minor and medium irrigation, soil conservation, watershed management and other forms of rural infrastructure. Domestic scheduled commercial banks, both in the public and private sector, are required to contribute to the RIDF on the basis of their shortfall in lending to priority sector/ agriculture.

### Remittance of Profit by Foreign Banks

The Reserve Bank has advised foreign banks operating in India that they may remit net profits/surplus (net of tax) earned in a quarter year in the normal course of business arising out of their Indian operations on a quarterly basis to their head offices. They may remit the profit without the Reserve Bank's prior approval provided their accounts are audited on a quarterly basis and appropriate transfer to statutory reserves are made as per the provisions of Section 11(2)(b)(ii) of the Banking Regulation Act, 1949 and other relevant provisions of the Banking Regulation Act, 1949 and directions issued by the Reserve Bank in this regard are complied with. In the event of excess remittance, the head office of the foreign bank should immediately make good the shortfall.

Full details of the quarterly remittance should be submitted to the Chief General Manager-in-Charge, Department of Banking Supervision, Reserve Bank of India, Central Office, Centre 1, World Trade Centre, Cuffe Parade, Colaba, Mumbai 400 005 and to the Chief General Manager-in-Charge, Exchange Control Department, Reserve Bank of India, Central Office, Central Office Building, Fort, Mumbai 400 001.

## Clearing Difference Entries

The Reserve Bank has advised all scheduled commercial banks that netting off of old and small value clearing difference entries at the branches, transfer of entries to head office, netting off at the head office and writing off/transfer at the head office should be subjected to a one hundred per cent audit by at least two of the following audits, viz., concurrent audit, internal audit and statutory audit.

## Standing Facilities Rationalised

To phase out sector-specific standing facilities as also to rationalise the rates at which liquidity is injected into the system, it has been decided to make available the "normal" and "back-stop" portions of standing facilities in a ratio of one-third to two-thirds (33:67) from the fortnight beginning December 27, 2003.

Banks are eligible for standing facility (export credit eligible for refinance) and primary dealers are eligible for collateralised liquidity support from the Reserve Bank subject to certain limits. These limits are split into a "normal" facility and a "back-stop" facility. Earlier, the apportionment between "normal" and "back-stop" facilities was one-half each.

## Freedom for Retail Loan Interest

Banks have now been given the freedom to determine interest rates on loans and advances (i) for purchase of consumer durables (ii) to individuals against shares and debentures/bonds and (iii) other non-priority sector personal loans regardless of the size of the loans. Banks should, however, have a transparent and objective policy approved by their Boards in this regard.

Earlier, banks were advised not to charge interest rates below prime lending rate (PLR) on such advances, regardless of the size of the loan.

## Priority Sector Lending

### Interest on Shortfall

The Reserve Bank has advised all foreign banks operating in India that with effect from November 3, 2003, the interest rate on deposits placed by them with the Small Industries Development Bank of India (SIDBI) to make good the shortfall in achieving the priority sector lending target, would be at the Bank Rate.

Earlier, the rate of interest on such deposits placed by foreign banks with SIDBI was 6.75 per cent.

### Education Loan

To provide financial support to deserving/meritorious students for pursuing higher education in India and abroad, the Reserve Bank had advised banks to formulate an education loan scheme based on the guidelines forwarded to them in April 2001.

To encourage banks to lend more to the poor and needy students, it has been decided that education loans up to the ceilings of Rs. 7.50 lakh for studies in India and Rs. 15 lakh for studies abroad would be reckoned under priority sector advances.

*SSI*

With a view to further enhancing credit flow to the small scale industries (SSIs) sector, it has been decided that all new loans granted by banks to non-banking finance companies (NBFCs) for on-lending to the SSI sector would be reckoned as priority sector lending.

### Collateral free loans

To further improve the flow of credit to SSIs, it has been decided that banks may, on the basis of good track record and financial position of the SSI units, increase the limit of dispensation of collateral for loans, from the existing level of Rs. 15 lakh to Rs. 25 lakh (with the appropriate authority's approval).

### Stockinvest Scheme Withdrawn

The Reserve Bank has withdrawn the stockinvest scheme with immediate effect. It was observed that the use of stockinvests as a mode of payment for application for allotment of shares/ debentures in the primary market has declined substantially. Moreover, several measures have been taken by the Securities and Exchange Board of India (SEBI) for bringing down the allotment period under primary issues. This has considerably reduced hardships caused to the investors on account of delay in the allotment process.

## Forex

### Opening of Project Office in India and Remittance of Assets

To liberalise and simplify the procedures for establishment of project offices, the Reserve Bank has granted general permission to foreign entities for setting up a project office in India subject to the conditions that

(a) a contract to execute a project in India has been secured from an Indian company; and
(b) the project is funded by inward remittance from abroad; or
(c) the project is funded by a bilateral or multilateral international finance agency; or
(d) the project has been cleared by an appropriate authority; or
(e) a company or entity in India awarding the contract has been granted term loan by a public financial institution or a bank in India for the project.

The foreign company should furnish a report to the concerned regional office of the Reserve Bank under whose jurisdiction the project office is set up. The report should contain the following details :

(i) Name and address of the foreign company.
(ii) Reference number and date of letter awarding the contract.
(iii) Particulars of the authority awarding the project/contract.
(iv) Total amount of contract.
(v) Address and tenure of project office.
(vi) Nature of project undertaken.

The project office has to approach the regional office of the Reserve Bank for granting permission for opening a foreign currency account, if required. Applications for opening foreign currency accounts should be accompanied with the following details :

- The reasons for opening a foreign currency account.
- The excerpts of contract of the concerned project office to ascertain whether it provides for payment/ receipt of funds in foreign currency.
- The total amount involved.

General permission has also been granted to foreign entities to remit the surplus on winding up/completion of projects through authorised dealers (ADs). ADs have been advised to allow such remittances on receipt of requests from their respective constituents. In case of request by a project office for intermittent remittance of temporary surplus, ADs may approach the concerned regional office of the Reserve Bank for necessary approval.

## Ucbs

### Demat Account for PSU Bonds

The Reserve Bank has advised all UCBs that in addition to their subsidiary general ledger (SGL)/constituent subsidiary general ledger (CSGL) account, they may open a dematerialised (demat) account with a bank depository participant of National Securities Depository Limited (NSDL)/Central Depository Services Limited (CDSL) or with Stock Holding Corporation of India Ltd. (SHCIL) for holding private sector undertaking (PSU) securities.

SGL/CSGL account enables participants to hold only those securities that the Reserve Bank has issued on behalf of the Government of India/state governments. Securities issued by public sector enterprises, both at the central level and the state level, do not come under the Reserve Bank's purview. Hence, PSU securities cannot be held by banks in demat form in the gilt accounts maintained with the Reserve Bank. In view of this, UCBs have been advised to open an additional demat account.

## Dummy Cheques

The Reserve Bank has advised all urban co-operative banks (UCBs) to caution their dealing staff not to accept dummy cheques/ payment instruments and not to present them in the mechanised clearing system.

It is observed that dummy cheques issued by some commercial banks as business promotional material had been misused by some co-operative banks by presenting them in clearing and thereby making false claim on the drawee banks. The presenting banks did not notice the word "Dummy" printed on the instruments. As such, cheques, look-alike payment instruments were encoded manually for the amount field by oversight. As the rest of the magnetic ink character recognition (MICR) band is not encoded in MICR ink, all such dummy cheques were rejected by the system. If such cheques are encoded by the presenting bank on their back side, through oversight, the drawee bank's account would be debited.

## Mid-term Review of the Monetary and Credit Policy for 2003-04 Presented on November 3, 2003 - Highlights Domestic Developments

- GDP growth in 2003-04 placed at 6.5-7.0 per cent, with an upward bias, compared to 6.0 per cent projected in April.
- Inflation projected for policy purposes at 4.0-4.5 per cent, with a possible downward bias, as compared with earlier projection of 5.0-5.5 per cent.
- Money Supply ($M_3$) growth within the projected level as envisaged in April.
- Noticeable reduction in banks' lending rates except for corporates and housing segment yet to take place.
- Orderly conditions witnessed in the forex market.
- Rupee appreciated against US dollar but depreciated against Euro, Pound sterling and Japanese yen.
- Foreign exchange reserves up by US $ 17.2 billion since end-March to US $ 92.6 billion by

end-October 2003, and are at comfortable level.

- Exchange rate management, as in the past, based on flexibility, without a fixed or pre-announced target, but with ability to intervene.

- RIBs of US $ 5.5 billion redeemed without any adverse impact on financial market and reserves.

- In the first half, in US dollar terms, exports are up by 10 per cent and import growth is high at 21.4 per cent reflecting a pick up in economic activity, as evident from higher capital goods imports.

**Overall Assessment**

- Gains from lower inflationary expectations in the recent years need to be consolidated and reinforced.

**Stance**

- Expectations of higher GDP growth, benign inflation outlook, subdued growth in money supply and stronger capital flows prompt continuation with the overall stance of monetary policy announced in April 2003.

- The stance of monetary policy continues to be provision of adequate liquidity to meet credit growth and support investment demand with a vigil on the price level with preference for soft and flexible interest rate environment.

- Continuance of measures with an accent on implementation with the objective of facilitating ease of transactions by the common persons.

- Support economic growth consistent with stability by strengthening of institutional capacity through a consultative process in the medium-term.

**Measures**

- Bank Rate kept unchanged at 6 per cent.

- CRR kept unchanged at 4.5 per cent.

- IBA to advise banks on benchmark PLR.

- Measures to improve credit delivery to agriculture and small scale sectors.

- Simplification of procedures and complete flexibility in micro-finance structure proposed to boost credit flow.

- Banks to ensure hedging of foreign currency loans to corporates above US $ 10 million except for exporters and for forex expenditures.

- Flexibility to exporters in realisation of export proceeds and write off of overdues, up to 10 per cent of their export proceeds in a calendar year.

- Road map for financial institutions to adopt 90 days norm for recognition of loan impairment.

- RTGS system scheduled for introduction in January 2004.

- Select private banks authorised to conduct government business for public convenience.

- Payment of tax refunds through electronic clearing services (ECS).

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