

CREDIT INFORMATION REVIEW

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POLICY

Strengthening of Prudential Norms

The Reserve Bank of India has issued detailed guidelines on policy changes effected in the mid term review of the Monetary and Credit policy for 1998-99 announced on October 30.

Guidelines are :

Capital Adequacy

In line with the international best practices, the minimum capital to risk asset ratio (CRAR) for banks has been enhanced, from the existing 8 per cent to 9 per cent, with effect from the year ending March 31, 2000.

Risk Weights on securities :

a) *Government and other approved securities :*

Investments in Government and other approved securities have been assigned a risk weight of 2.5 per cent for market risk, with effect from the year ending March 31, 2000. The balance of 2.5 per cent to reach the norm of 5 per cent, as recommended by the Narasimham Committee, will be announced at a later date.

(b) *Government guaranteed securities :*

A risk weight of 20 per cent on investments in the Government guaranteed securities of government undertakings which do not form part of the approved market borrowing programme has been introduced from the financial year 2000-2001. To provide sufficient time to comply with this provision, banks are permitted to account for the risk weight on the outstanding stock of such securities in the portfolio of banks as on March 31, 2000, in two phases of 10 per cent each in 2001-2002 and 2002-2003.

(c) *Bonds/debentures of PFIs :*

The risk weights on investments in bonds/debentures of Public Financial Institutions (PFIs), have been given uniform risk weight of 20 per cent with immediate effect.

Risk weights for CRAR

Nature of Asset	Risk-weight (%)	
	Existing	Revised
Investments in Government securities	0	2.5
Investments in other approved securities guaranteed by central/state government	0	2.5
Investments in other securities where payment of interest and repayment of principal are guaranteed by the central government	0	2.5

Investments in other securities where payment of interest and re-payment of principal are guaranteed by state governments. (In case of a default in interest/ principal by state government, banks should assign 100 per cent risk weight on investments in securities of the concerned state government.)	0	2.5
Investments in other approved securities where payment of interest and re-payment of principal are not guaranteed by central/ state government.	0	20
Investments in government guaranteed securities of government undertaking which do not form part of the approved market borrowing programme.	0	20
Balances in current account with other banks.	20	20
Claims on banks and all PFIs (see box)	20	20
Investments in bonds issued by other banks/PFIs.(see box)	100	20
Investments in securities which are guaranteed by banks or PFIs (see box) as to payment of interest and repayment of principal.	100	20
Investments in subordinated debt in the form of Tier II capital bonds issued by other banks/PFIs	100	100
All other investments	100	100

Government guaranteed advances :

On advances in which the guarantee has been invoked, and the concerned state government has remained in default as on March 31, 2000, a risk weight of 20 per cent should be assigned. On state governments which continue to be in default in respect of such invoked guarantees, even after March 31, 2001, a risk weight of 100 per cent should be assigned.

Foreign exchange/gold open positions :

Foreign exchange open position limit should carry 100 per cent risk weight with effect from March 31, 1999. Open position limit in gold, should also carry 100 per cent risk weight, with effect from March 31, 1999. Risk weights, both in respect of foreign exchange and gold open position limits, should be added to the other risk weighted assets for calculation of CRAR.

Asset classification and Provisioning Norms :

(a) *Reduction in the timeframe for sub-standard assets :*

With a view to moving closer to international practices in regard to provisioning norms, it has been decided that an asset should be classified as doubtful, if it has remained in the sub-standard category for 18 months instead of 24 months, as at present, by March 31, 2001. Banks are permitted to achieve these norms for additional provisioning, in phases, as under :

As on March 31, 2001: Provisioning of not less than 50 per cent, on the assets which have become doubtful on account of the new norm.

As on March 31, 2002: Balance of the provisions not made during the previous year, in addition to the provisions needed, as on March 31, 2002.

(b) *Government Guaranteed Advances :*

In order to strengthen the banks' efforts to recover expeditiously, dues on state government guaranteed advances, to discourage the practice of delaying payment on invoked guarantees, and as a prudent measure, provisioning norms in respect of advances guaranteed by state governments have been introduced. Banks will now have to make provision in cases where guarantees have been invoked, and have remained in default for more than two quarters. This measure would be effective in respect of advances sanctioned against state government guarantees with effect from April 1, 2000. As regards provisioning requirements for advances guaranteed by state governments which stand invoked as on March 31, 2000, necessary provisions will have to be made during the financial years ending March 31, 2000 to March 31, 2003 with a minimum of 25 per cent each year.

Provision on standard assets : To start with, banks should make a general provision on standard assets of a minimum of 0.25 per cent from the year ending March 31, 2000.

Exposure Norm : For the purpose of calculation of exposure norm, investments made by banks in bonds and debentures of corporates, which are guaranteed by a PFI, will be treated as an exposure by the bank on the PFI, and not on the corporate as is the practice at present. Guarantee issued by the PFI to the bonds of corporates, will be treated as an exposure by the PFI to the corporates, to the extent of 50 per cent being a non-fund facility, whereas the exposure of the bank on the PFI guaranteeing the corporate bond, will be 100 per cent. The PFI before guaranteeing the bonds/debentures should, however, take into account the overall exposure of the guaranteed unit to the financial system.

Other Measures

Banks and financial institutions should adhere to the prudential norms on asset classification, provisioning, etc., and avoid the practice of "evergreening".

Banks should take effective steps for reduction of NPAs and also put in place risk management systems and practices to prevent re-emergence of fresh NPAs.

Public sector banks are encouraged to raise their Tier II capital. Government guarantee to these instruments does not seem appropriate.

Banks have already been advised to put in place a formal Asset-Liability Management (ALM) system with effect from April 1, 1999. Instructions on further disclosures will be issued in due course.

Banks are advised to strictly comply with instructions which are already in place.

Arrangements should be put in place for regular updating of operational manuals. Compliance has to be reported to the Reserve Bank by April 30, 1999.

While the system of reporting and checking, by the back offices, of trading transactions is already in place, banks are required to monitor this vigorously to strengthen their internal control systems. Detailed guidelines on risk management systems will be issued to further strengthen the internal control systems.

Banks should ensure a loan review mechanism for larger advances soon after sanction, and continuously monitor the weaknesses developing in the accounts, for initiating corrective measures in time.

More focus needs to be given to training needs in arrears, such as credit management, treasury management, derivative products, asset liability management, system and risks management, payment and settlement systems and information technology.

List of All-India financial institutions whose bonds/debentures would qualify for 20 per cent risk weight for capital adequacy ratio.

1. Industrial Credit and Investment Corporation of India Ltd.,
2. Industrial Finance Corporation of India Ltd.
3. Industrial Development Bank of India.
4. Industrial Investment Bank of India Ltd.
5. Tourism Finance Corporation of India Ltd.
6. Risk Capital and Technology Finance Corporation Ltd.
7. Technology Development and Information Company of India Ltd.
8. Power Finance Corporation Ltd.
9. National Housing Bank.
10. Small Industries Development Bank of India.
11. Rural Electrification Corporation Ltd.
12. Indian Railways Finance Corporation Ltd.
13. National Bank for Agriculture and Rural Development.
14. Export Import Bank of India.
15. Infrastructure Development Finance Co.Ltd.

Acquisition of property

The Reserve Bank of India has delegated powers relating to acquisition and hiring of property to the banks. In a circular issued to all commercial banks, the Reserve Bank has stated that the norms and procedures laid down by the RBI for acquisition of accommodation on lease/rental basis by commercial banks for their use (for office and for residence of staff) have been in operation for a number of years. These have enabled banks to focus on evolving a proper system for examining proposals for securing premises and making a realistic assessment of the attendant terms and conditions. The procedures which have now stabilised were reviewed by a group constituted by the Government of India.(see box)

On a review, it has been decided that the norms and procedures to be followed, should be left to the discretion of the banks. Accordingly, powers relating to hiring of premises, rentals, deposit, loans to the premises owners, etc., have been delegated to the banks.

The Reserve Bank has advised banks as under :

(i) Boards of directors of the banks should lay down policy and formulate detailed operational guidelines covering all areas, in respect of acquiring premises on lease/rental basis for their use including delegation of powers at various levels. The guidelines should prescribe norms separately in respect of metropolitan, urban, semi-urban and rural areas. The guidelines should

ensure that the contractual obligations are complied with, and the decisions taken for hiring/de-hiring of premises are non-discriminatory. While delegating powers, banks may ensure that decisions for surrender or shifting of premises, other than at rural centres are taken at central office level by a committee of senior executives.

(ii) The banks' boards may also determine the rate of interest at quarterly rests on premises loans. For this purpose, the boards should lay down a separate policy in respect of loans granted to landlords, who provide them premises on lease/rental basis.

The Reserve Bank has also advised banks to evolve a suitable machinery to ensure that genuine grievances of the landlords are dealt with expeditiously.

Further, negotiated contracts in respect of rentals (including taxes, etc., and deposits of Rs.25 lakh and above for premises taken by banks on lease/rental basis, will continue to be reported to the Central Bureau of Investigation as per extant Government instructions.

GROUP TO REVIEW POLICY ON HIRING/DE-HIRING OF BANK PREMISES

A Group to review the policy on hiring/de-hiring of bank premises was constituted by the Government with the following:

Shri D.R.S.Chaudhary, Joint Secretary, Banking Division	...	Chairman
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Shri D.T.Pai, Executive Director, Union Bank of India	...	Member
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Smt.Shyamala Gopinath, Chief General Manager Reserve Bank of India.	...	Member
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The Group looked into all guidelines issued by the Reserve Bank relating to hiring of premises, advances to landlords, rental deposits and allied matters. It took note of the common complaints/grievances generally received from landlords in the matter of rentals and surrender of premises. The Group also met the Secretary, Indian Banks' Association and officials of a few public sector banks and a new private sector bank.

The Group observed that the genesis of the Reserve Bank's intervention in the area of hiring of premises and issuing guidelines, was to avoid unhealthy competition among banks, while conducting negotiations, for acquisition of premises on lease/rental basis for their use and to bring about greater uniformity in the terms offered. The guidelines issued by the Reserve Bank are applicable to public and private sector commercial banks. This was supplemented by the Indian Banks' Association bringing out a check-list on hiring and leasing of premises.

The guidelines issued by the Reserve Bank, cover, advances to landlords, rental ceilings, taxes and service charges, period of lease, interest free deposit, reporting of transactions to CBI and surrender/shifting of premises. The Group further observed that the Reserve Bank guidelines served a useful purpose particularly at the time when the banks were opening a large number of branches every year, in accordance with the branch licensing policy. These guidelines helped in bringing about uniformity in terms of sanction, reducing costs, resisting unreasonable demands made by landlords and undesirable practices. In fact public sector banks, during the interaction the Group had with them, were found to be in favour of continuation of some of the guidelines,

particularly those relating to the period of lease, advance rent being limited to six months' rent, quantum of loan and recovery within the lease period.

The Group was however, of the view that the situation has now changed. Banks have themselves streamlined procedures. They are also experiencing operational difficulties in adhering to the limits prescribed by the Reserve Bank in regard to loans and rental ceilings in the changing scenario, resulting in increasing references to the management committee. The deviations do not involve any major decision making and only result in increasing the burden on the management committee and also in delaying the decision making.

RECOMMENDATIONS

The Group took stock of all relevant factors including the Reserve Bank's present policy to move away from micro management and give full freedom to the banks to decide on operational issues. In the view of the Group hiring/de-hiring of premises is purely a managerial function best left to the boards of the banks. It recommended that :

- (a) Boards of banks should lay down their own policy in this regard with detailed operational guidelines. The Group has made detailed recommendations in the areas covered by guidelines issued by the Reserve Bank, in its report.
- (b) Any deviation from the norms laid down by the board should be approved by the management committee.
- (c) It will be advisable if all proposals on hiring of premises are examined by an internal committee of the bank's executives and their recommendations are submitted to the delegated authority.

It has also to be recognised that banks being commercial organisations have to take commercial aspects into account while deciding increases in rents or surrender of premises. Keeping in view the sensitivities involved in these matters, the Group recommended that surrender of premises in urban/metropolitan areas should invariably be examined by the internal committee of executives who would send their recommendations to the management committee.

The Group also made observations on the areas covering normal grievances of landlords. In order to ensure that requests from landlords are dealt with expeditiously, keeping in view all relevant factors, banks should evolve suitable machinery for dealing with genuine grievances. The Group also noted, that as per existing instructions public sector banks are required to report to the Central Bureau of Investigations (CBI) all negotiated contracts relating to premises, involving amounts of Rs.25 lakh and above. The Group recommended withdrawal of these instructions, as CBI itself gets information on such matters as and when the situation so warrants.

Bank Account by Old/Sick/Incapacitated Customers

The Reserve Bank of India has prescribed a procedure which banks can follow to enable old/sick/incapacitated account holders to operate their bank accounts. In a recent circular the Reserve Bank has identified two categories of sick/old/incapacitated customers. One, who is too ill to sign a cheque/cannot be physically present in the bank to withdraw money from the bank account but can put his/her thumb impression on the cheque/withdrawal form; and the other who is not only unable to be physically present in the bank but is also unable to put his/her thumb impression on the cheque/withdrawal form due to certain physical defect/incapacity.

The Reserve Bank has, in such cases, asked the banks to get the thumb/toe impression of the sick/old/incapacitated account holders identified by two independent witnesses known to the bank, one of the witnesses being a responsible bank official.

The Reserve Bank has further stated that in case the customer cannot put his/her thumb impression and is also unable to be physically present in the bank, the bank should obtain a mark on the cheque/withdrawal form. This mark should be identified by two independent witnesses, one of whom should be a responsible bank official. Further, the customer may be asked to indicate to the bank as to who would withdraw the amount from the bank. This person should also be identified by two independent witnesses. The person who would actually be drawing the money from the bank should be asked to furnish his signature to the bank.

The question of extending a suitable facility to old/sick/incapacitated bank customers for operation of their bank accounts had been engaging the attention of the Reserve Bank for quite some time. In consultation with the Indian Banks' Association, the Reserve Bank has decided to offer the above facility to old/sick/incapacitated persons who are not willing to open joint accounts. Similar facility is already available to pension account holders.

BROKEN PERIOD INTEREST ON GOVERNMENT SECURITIES

To bring about uniformity in the accounting treatment of broken period interest on government securities paid at the time of acquisition and also to comply with the accounting standards prescribed by the Institute of Chartered Accountants of India, the Reserve Bank has decided that banks should not capitalise the broken period interest paid to the seller as part of the cost but should treat it as an item of expenditure under profit and loss account as per Accounting Standard 13.

Some banks capitalise the broken period interest (interest accrued on the securities purchased upto the time of acquisition) included in the cost price, on the ground that such accrued interest paid to the seller at the time of purchase is not recognised as a revenue expenditure for tax purposes.

The above decision does not take into account the taxation implications and hence banks will have to comply with the requirements of income tax.

REDISCOUNTING OF TRANSPORT BILLS

The Reserve Bank has allowed banks to rediscount bills discounted by non-banking financial companies (NBFCs) arising from sale of commercial vehicles including light commercial vehicles. Banks should, however, ensure that such rediscounting is subject to normal lending safeguards. This measure will enable NBFCs to have recourse to further finance through the rediscounting of bills.

In a circular issued to all scheduled commercial banks, the Reserve Bank has stated that the NBFCs are playing an important role in meeting the financial needs of the transport sector particularly the commercial vehicles segment, including trucks, cars, three wheelers and other light commercial vehicles. The ability of NBFCs to meet these requirements, however, was constrained because of non-availability of rediscounting facilities from banks.

Earlier, the Reserve Bank had allowed bank credit to eligible NBFCs for on lending to small road and water transport operators for financing of trucks to be treated as priority sector lending.

EXCHANGE CONTROL

FOREIGN DIRECT INVESTMENT

To monitor and compile inflow data, the Reserve Bank has made it mandatory for Indian companies to report the receipt of foreign remittances. This requirement is in addition to the

submission of the prescribed documents within 30 days from the date of issue of shares. Indian companies receiving funds from their foreign investors in accordance with the general permission, should immediately report in writing regarding investment received, to the regional office of the Reserve Bank having jurisdiction over the company. Such report should be within the period of 30 days from the date of receipt of remittance and contain :

- (i) Name of the foreign investor,
- (ii) Country of residence or incorporation of the foreign investor,
- (iii) Date of receipt of remittance and its rupee equivalent
- (iv) Name and address of the authorised dealer in India through whom the remittance is received, and
- (v) In case the funds are received based on Secretariat for Industrial Approval (SIA)/Foreign Investment Promotion Board (FIPB) approval, the number and date of such approval.

Reporting

To simplify the procedures for foreign direct investment, the Reserve Bank of India had already granted general permission to Indian companies under the Foreign Exchange Regulation Act, (FERA) and dispensed with the need for its prior approval either for receipt of funds or for issue of shares under automatic route of the Reserve Bank/Government (SIA/FIPB). Earlier, the Reserve Bank had granted permission for issue of equity shares to foreign investors under the automatic route of Reserve Bank of India as also to non-resident Indians (NRIs)/overseas corporate bodies (OCBs) under 100 per cent scheme. Similar general permission was granted to issue shares/securities to foreign investors in accordance with the approval of the SIA/FIPB. The Reserve Bank has, however, been experiencing difficulties in capturing inflow figures in time. This is particularly due to the fact that the Indian entities receiving remittances from abroad sometimes issue shares after a time gap or fail to report the position in time.

Liberalisation

Under this arrangement, the Indian companies issuing shares in accordance with the general permission are required to file certain documents (including foreign inward remittance certificate (FIRC) in support of receipt of funds) with the concerned regional office of the Reserve Bank within 30 days from the date of issue of shares.

As a measure of further liberalisation, the general permission granted for issue of equity shares is extended to :

- (i) issue of preference shares to foreign investors under the automatic route of the Reserve Bank as also for NRIs/OCBs under 100 per cent scheme and to.
- (i) issue of equity up to 100 per cent in respect of companies engaged in generation and transmission of electric energy through hydrothermal power plants.

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