Credit Information Review

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BANKING POLICY

Subordinated Debt for Capital

The Reserve Bank of India has given autonomy to banks, including foreign banks operating in India, to raise rupee subordinated debt as tier II capital, subject to certain terms and conditions. Banks are required to ensure that the terms and conditions mentioned below are strictly adhered to.

Amount

The amount of subordinated debt to be raised may be decided by the Boards of Directors of the banks.

Maturity

Subordinated debt instruments with an initial maturity period of less than five years, or with a remaining maturity of one year should not be included as part of tier-II capital. Further, they should be subjected to progressive discount as they approach maturity at the rates shown below :

Remaining maturity of the instruments	Rate of discount (in per cent)

* less than one year	100
* more than one year and less than two years	80
* more than two years and less than three years	60
* more than three years and less than four years	40
* more than four years and less than five years	20

The bonds should have a minimum maturity of five years. However, if the bonds are issued in the last quarter of the year, i.e., from January to March, they should have a minimum tenure of 63 months.

Rate of Interest

The interest rate should not be more than 200 basis points above the yield on Government of India securities of equal residual maturity at the time of issuing the bonds. The instruments should be 'vanila' with no special features like options, etc.

Other Conditions

The instruments should be fully paid-up, unsecured, subordinated to the claims of other creditors, free of restrictive clauses and should not be redeemable at the initiative of the holder, or without the consent of the Reserve Bank.

Necessary permission from the Reserve Bank should be obtained for issuing the instruments to non-resident Indians/overseas corporate bodies/financial institutional investors.

Banks should comply with the terms and conditions, if any, set by SEBI/other regulatory authorities in regard to issue of the instruments.

Nationalised banks should obtain permission from the Government for issuing the instruments.

In the case of foreign banks rupee subordinated debt should be issued by the head office of the bank, through the Indian branch after obtaining specific approval of the Reserve Bank.

Inclusion in Tier-II Capital

Subordinated debt instruments should be limited to 50 per cent of tier-I capital of the bank. These instruments, together with other components of tier II capital, should not exceeed 100 per cent of tier I capital.

Grant of Advances against Bonds

Banks should not grant advances against the security of their own bonds.

Reserve Requirements

The funds collected by various branches of the bank or other banks for the issue, and held pending finalisation of allotment, should be taken into account for the purpose of calculating reserve requirements.

To the extent the instruments are treated as tier II capital (after discount at the specified rates), they would be exempted from reserve requirements. However, in view of the multiple prescriptions on different categories of liabilities, including prescription of a zero reserve requirement on certain liabilities, as stipulated under the law, effective CRR and SLR maintained by the bank on the total demand and time liabilities, including the total amount raised under subordinated debt, should not be less than 3 per cent and 25 per cent respectively.

Investment
Investments by banks in subordinated debt of other banks should be assigned 100 per cent risk weight for capital adequacy purpose.

For issue of subordinated debt instruments in foreign currency, as well as for borrowing from head office, for inclusion in tier II capital, prior approval of the Reserve Bank of India would be required.

Final Guidelines on ALM System in Banks

The Reserve Bank of India has issued final guidelines on Asset-Liability Management (ALM) Systems for implementation by banks effective from April 1, 1999. The guidelines mainly address liquidity and interest rate risks and have been formulated to serve as a benchmark for banks not having formal ALM systems. Banks which have already adopted more sophisticated systems, have been permitted to continue their existing systems but have been asked to finetune their management information systems (MIS) to be compatible with the ALM system suggested in the guidelines. Other banks have been asked to upgrade their MIS to meet the prescriptions of the new ALM system. Keeping in view, however, the prevailing MIS and the low level of computerisation, banks have been asked to ensure a coverage of at least 60 per cent of their assets and liabilities to start with. Banks have also been asked to set targets in the interim, for covering 100 per cent of their business by April 1, 2000.

The Reserve Bank had, in September 1998, issued broad draft guidelines for asset-liability management systems in banks. The draft guidelines were reviewed by the Reserve Bank in the light of the feedback received from the banks. The final guidelines issued on the basis of this feedback require banks to give adequate attention to putting in place an effective ALM system. Banks have been asked to set up an internal Asset-Liability Committee (ALCO), headed by the CEO/CMD or the ED. The Management Committee or any specific Committee of the Board should oversee the implementation of the system and review its functioning periodically.

The statement of structural liquidity, designed to measure the maturity profile of cash flows should be prepared at quarterly intervals. The intention is to eventually move over to a monitoring system on a fortnightly basis by April 1, 2000. As a prudent measure, banks have been advised to operate within a negative gap of 20 per cent of cash outflows during 1-14 days and 15-28 days time periods. Banks which have structural mismatches and need higher limits, could operate with higher limits with the approval of the board/management committee. Such banks should, however, comply with the prudential limit by April 1, 2000.

The statement of interest rate sensitivity should be prepared at quarterly intervals and moved over to monthly schedule by April 1, 2000. The statement would provide useful feedback on interest rate risk faced by banks. Banks' boards should fix prudent levels of earnings at risk (EAR) or net interest margin (NIM) to minimise the risk profile.

Banks are required to capture the impact of embedded options, exercised by depositors/borrowers to fine-tune ALM practices. Banks should also evolve internal transfer pricing mechanism for supplementing the efficacy of ALM techniques.

The final guidelines are available on the website of the Reserve Bank of India (URL: http://www.rbi.org.in).

Bridge Loans

The Reserve Bank has permitted banks to extend bridge loans against the expected proceeds of non-convertible debentures, external commercial borrowings, global depository receipts and/or funds in the nature of foreign direct investment, in addition to expected equity flows/issues, provided the bank is satisfied that the borrowing company has made firm arrangements for raising the aforesaid resources/funds. The other terms and conditions for providing bridge loans remain unchanged.

The Reserve Bank had, in October 1997, permitted banks to sanction bridge loans to companies for periods not exceeding one year against expected equity flows/issues. Such loans were required to be accomodated within the ceiling of 5 per cent of the incremental deposits of the previous year prescribed for banks' investment in ordinary shares/convertible debentures of corporates, including shares of public sector units, loans sanctioned to corporates for meeting promoters' contribution and in units of mutual funds schemes the corpus of which was not exclusively invested in corporate debt instruments.

BRANCH BANKING

Direct finance for purchase of old house

The Reserve Bank has reviewed its instructions relating to eligibility of direct housing finance for achievement of annual housing finance targets. It has consequently decided to immediately withdraw the stipulation regarding the age of old dwelling units (so far restricted to five years), as lending banks are expected to evolve their own operational guidelines/norms governing housing finance which take into account the technical, commercial and financial feasibilities of the old houses.

Y2K

Supervisory Enforcement

The Reserve Bank of India had advised banks to put into place appropriate time bound stategies to assess, convert, validate and implement fully compliant systems by December 31, 1998. They were also advised to formulate contingency plans to ensure business continuity in the event of

Y2K induced breakdowns, and to forward a copy of the contingency plans approved by their boards of directors, to the Reserve Bank, by March 31, 1999.

From the feedback received from banks, the Reserve Bank has observed that some banks are lagging behind in their compliance efforts. The Reserve Bank has therefore reiterated the importance of tackling the Y2K issue on a war footing, as non-compliance could result in serious systemwide consequences, apart from business continuity problems for banks, and loss to customers. The Reserve Bank has also emphasised the fact that the issue requires the attention and commitment of the top management, and has advised banks to ensure adequate budgets for their Y2K compliance programmes.

The Reserve Bank has decided to enforce a set of measures if in its assessment, the banks' efforts towards Y2K compliance are less than satisfactory. This is to ensure that Y2K issues are adequately addressed to by banks and also to keep up with international supervisory practices. While the specific course of action will be decided by the Reserve Bank, after taking into account the findings of on-site inspection and the information contained in the monthly reports submitted by the banks, the enforcement measures may include one or combinations of the following:

* Issue of supervisory letter of caution.
* Imposition of higher capital risk adequacy ratio (CRAR).
* Imposition of monetary penalties on a graduated scale.
* Restriction on expansionary strategies of banks like opening of new branches, subsidiaries, etc.
* Y2K compliance to be an over-riding criterion while evaluating the performance of the chairman/managing director/chief executive.
* Suspension from participation in call money markets, clearing, securities trading.

EXCHANGE CONTROL

Release of exchange for higher studies abroad

The Reserve Bank has further liberalised regulations relating to release of foreign exchange to students going abroad for studies, as under:

* The entire amount of exchange admissible can now be released in favour of the student concerned. So far exchange towards tuition fees was required to be remitted by means of a draft in the name of the overseas educational institution.
* The entire amount of exchange admissible can be released either in a single annual instalment or in more than one instalment at the option of the applicant.
* In case the letter of confirmed admission from the overseas educational institution does not indicate the exchange requirements, authorised dealers can release exchange up to US $15,000 for the first six months, subject to adjustment, if necessary, while releasing the exchange for subsequent periods, on the basis of documentary evidence produced by the student regarding exchange requirements.
* The amount of scholarship received by the student from the overseas institution may be adjusted against the exchange admissible to him only to the extent desired by the applicant.
* Students going on full sponsorship from close relatives abroad, will be eligible for full

exchange if they desire not to avail of the relatives' hospitality.

* The application form 'TRS' for release of exchange for studies abroad has also been simplified and is made available on the Reserve Bank website (URL: http://www.rbi.org.in).

Export of Software in non-physical form

The Reserve Bank of India, in consultation with the Department of Electronics (DOE), Government of India, has decided that besides computer software in non-physical form (direct data transmission through dedicated earth stations/satellite links), export of video/ TV software and all other types of software products/packages should be declared on the SOFTEX (software export declaration) form. The SOFTEX form (form no.AB) has been revised with effect from February 1, 1999. It is also available on the Reserve Bank website (URL:http://www.rbi.org.in).

Issue/Use of International Credit Cards

The Reserve Bank has revised its instructions regarding the issue/use of International Credit Cards as under:

* Banks and their subsidiaries are free to issue international credit cards without seeking the approval of the Reserve Bank.
* International credit cardholders are free to use the cards for making personal remittances that are permitted under the exchange control regulations, subject to the ceilings, conditions and documents prescribed for the purpose.
* Card holders are required to give an undertaking of compliance with the rules and regulations.
* Persons going abroad on employment and emigration, are not allowed to use the credit cards for drawing exchange. They are required to surrender the cards before going abroad.
* No documents are required if the remittance involved is less than US$250 or its equivalent, and the authorised dealer is satisfied about the bonafides and purpose of the remittance.
* The passport is required to be endorsed for the amount released in foreign currency notes/travellers cheques against international credit cards.
* The cardholder is responsible for getting his passport endorsed, for the use of his credit card for drawing exchange against the basic travel quota entitlement, on his return to India.
* Full fledged money changers are also permitted to release exchange against international credit cards for travel purpose.
* Cardholders are free to make payment in rupees to the issuing bank/subsidiary.
* International credit cards cannot be used for purposes for which release of exchange is not permitted under the exchange control regulations.
* Residents are not allowed EEFC (exchange earners' foreign currency account) facility, for payments received by them, for sale of goods and services in India, against international credit cards.
* The cardholder is required to submit a declaration after having used the card for downloading software/database from the Internet.
* Advance remittance upto US$15,000 for import of software is permitted.
* A single card may be issued, valid in India, Nepal, Bhutan, as well as in other countries, provided the bank has a system to segregate the rupee and forex transactions. However, the card will not be valid for payment in foreign exchange in Nepal and Bhutan.
* Remittances using international credit cards may be made through any authorised dealer.

The restriction on remittances through designated banks is removed.

* Software engineers can be issued international credit cards, on the condition that reimbursement is provided from their foreign currency accounts, or from the exchange earners' foreign currency accounts (EEFC) of their employers.

Export of Flowers for Auction

The Reserve Bank has examined the question of matching of GR forms in case of export of flowers for auctions, where the correct realisable value is not known at the time of export, and realisation is dependant on the result of the auctions held abroad. Authorised dealers have been advised, in such cases to dispose of the GR forms relating to export of flowers for auctions abroad, on the basis of suitable documentary evidence being produced by the exporter indicating the price determined at the auctions.

Form A4

The Reserve Bank has decided that authorised dealers should complete form A4 for all credit transactions of Rs.100,000 and above. For debit transactions, form A-4 should be completed only if the transaction relates to investment in shares/securities/commercial paper of Indian companies, or for purchase of immovable property in India, if the amount involved is Rs.100,000 or more. Authorised dealers are required to submit form A4 to the Reserve Bank for debits and credits to non-resident accounts of all types other than the accounts of non-resident banks, requiring approval of the Reserve Bank or for reporting to the Reserve Bank.

Change of Tenor of Bills

The Reserve Bank has clarified that authorised dealers may also allow change of tenor of export bills drawn on the original buyer/ alternate buyer, provided the revised due date of payment, falls within six months from the date of shipment, and the change of tenor takes place before the original due date of payment of the bill.

In terms of exchange control regulations, prior approval of the Reserve Bank is not necessary, if the goods after shipment, are to be transferred to a party other than the original buyer, provided among other things, the realisation of export proceeds is not delayed beyond six months from the date of shipment.

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