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MONETARY AND CREDIT INFORMATION REVIEW

POLICY

Roadmap for Banking Reforms

The Reserve Bank released on February 28, 2005, the roadmap for presence of foreign banks in India and guidelines on ownership and governance in private sector banks.

Guidelines on Ownership and Governance in Private Banks

- The broad principles underlying the comprehensive policy framework relating to ownership and governance in Indian private sector banks would have to ensure that -
 - (i) The ultimate ownership and control of private sector banks is well diversified to minimise the risk of misuse or imprudent use of leveraged funds.
 - (ii) Important shareholders (i.e., with shareholding of 5 per cent and above) are 'fit and proper', as per the Reserve Bank's guidelines on acknowledgement for allotment and transfer of shares dated February 3, 2004.
 - (iii) The directors and the chief executive officer who manage the affairs of the bank are 'fit and proper' as indicated in the Reserve Bank's circular dated June 25, 2004 and should observe sound corporate governance principles.
 - (iv) Private sector banks have minimum capital/net worth for optimal operations and systemic stability.
 - (v) The policy and the processes are transparent and fair.
- Private sector banks would be required to maintain a net worth of Rs. 300 crore at all times.
- Shareholding or control, directly or indirectly, in any bank in excess of 10 per cent of the paid-up capital of the private sector bank by any single entity or group of related entities would require the Reserve Bank's prior approval.
- Banks (including foreign banks having branch presence in India)/financial institutions would not be allowed to acquire any fresh stake in a bank's equity, if by such acquisition, their total holding in the investee bank exceeds 5 per cent of the equity capital of the bank.
- Large industrial houses would be allowed to acquire, by way of strategic investment, shares not exceeding 10 per cent of the paid-up capital of the bank subject to the Reserve Bank's prior approval.

- The Reserve Bank may permit a higher level of shareholding on a case by case basis for restructuring of problem/weak banks or in the interest of consolidation in the banking sector.
- Private sector banks would be required to ensure that the directors on their boards representing specific sectors are indeed representatives of those sectors in a demonstrable fashion, that they do not belong to the same family and they satisfy the 'fit and proper' criteria for directors of banks as indicated in the Reserve Bank's circular of June 25, 2004.
- In any of the banks, if the shareholding exceeds the prescribed limit or if the net worth is below Rs. 300 crore, a time-bound programme to reduce the stake or to augment the capital, should be submitted to the Reserve Bank.

CONTENTS

	Page
POLICY	
Roadmap for Banking Reforms	1
Ownership Guidelines for Private Banks	1
Road Map for Foreign Banks	2
Setting up of WOS	2
Prudential Norms for State Government guaranteed Advances	3
UCBs	
Higher Risk Weight on Housing and Consumer Loans	3
NBFCs	
Full Cover for Public Deposits	3
RBI	
Board for Regulation and Supervision of Payment and Settlement Systems set up	3
FOREX	
Operations in NRE/FCNR (B) Accounts by Resident Power of Attorney Holders	4
INFORMATION	
Customer Complaints relating to Credit Cards	4
Non-Performing Assets of Financial Institutions	4

- Aggregate foreign investment in private banks from all sources (FDI, FII, NRI) cannot exceed 74 per cent of the paid-up capital of a bank with the following limits in each category :
 - (a) If FDI (other than by foreign banks or foreign bank group) in private banks exceeds 5 per cent either individually or as a group, the entity acquiring such stake, would have to meet the 'fit and proper' criteria indicated in the share transfer guidelines of February 2, 2004 and should get the Reserve Bank's acknowledgement for transfer of the shares.
 - (b) Currently, the limit for individual FII investment in a bank is 10 per cent. The aggregate limit for all FII investments, is restricted to 24 per cent which can be raised to 49 per cent with the approval of the board/shareholders. This dispensation would continue.
 - (c) The current aggregate limit for all NRI investments is 24 per cent, with individual NRI limit of 5 per cent, subject to the approval of the board/shareholders.

Road Map for Presence of Foreign Banks in India

In the roadmap for presence of foreign banks in India, the Reserve Bank has prescribed gradual enhancement of the presence of foreign banks in India in two phases - Phase I spanning from March 2005 to March 2009 and Phase II beyond March 2009.

Phase I

- Foreign banks entering India for the first time would be permitted to operate either through a branch presence or by setting up a wholly owned subsidiary (WOS), but they must only follow the one-mode presence.
- Foreign banks already operating in India would also have the option to convert their existing branches into WOS or to continue to operate only through branch presence.
- If a foreign bank already having presence in India makes an acquisition, then it would have to conform to the 'one form of presence' requirement within a period of six months after the acquisition.

Guidelines for setting up of WOS/Conversion of Existing Branches

I. Setting up of WOS by Foreign Banks

Eligibility

Foreign banks that are subject to adequate prudential supervision in their home country including compliance with Basel standards and in whose case the home country regulator has approved the setting up of a WOS in India, would be eligible.

Other factors, such as, financial soundness, ownership pattern, rating by international rating agencies, international presence, international and home country ranking of the foreign bank and economic and political relations between India and the country of incorporation of the foreign bank, would also be considered.

Capital

WOS should have a minimum start-up capital of Rs. 3 billion and would be required to maintain a capital adequacy ratio of 10 per cent on a continuous basis, from the time of commencement of its operations.

The parent foreign bank would continue to hold 100 per cent equity in the Indian subsidiary for a minimum prescribed period of operation.

Corporate Governance

The composition of the board of directors should be as follows :

- Minimum 50 per cent of the directors should be Indian nationals resident in India.
- Minimum 50 per cent of the directors should be non-executive directors.
- Minimum one-third of the directors should be totally independent of the management of the subsidiary in India, its parent or associates.
- The directors should conform to the 'fit and proper' criteria as laid down in the Reserve Bank's guidelines of June 25, 2004.

Other Requirements

The WOS would be -

- subject to the licensing requirements and conditions, broadly consistent with those for new private sector banks;
- treated on par with the existing branches of foreign banks for branch expansion. The Reserve Bank may also prescribe market access and national treatment limitation consistent with the World Trade Organisation (WTO) principles; and
- governed by the provisions of the Companies Act, 1956, Banking Regulation Act, 1949, Reserve Bank of India Act, 1934, other relevant statutes and the directives, prudential regulations and other guidelines/instructions issued by the Reserve Bank and other regulators from time to time.

While considering an application made by any foreign bank to acquire stake in any private sector bank identified by the Reserve Bank for restructuring, the above-mentioned eligibility criteria as well as their track record in restructuring banks would be considered by the Reserve Bank.

II. Conversion of Existing Branches into a WOS

All the requirements prescribed above for setting up a WOS would be applicable to existing foreign bank branches converting into a WOS. They would also have to satisfy additional requirements as follows -

- The minimum net worth of the WOS on conversion should not be less than Rs. 3 billion and the WOS would be required to maintain a minimum capital adequacy ratio of 10 per cent of the risk weighted assets on a continuous basis. While reckoning the minimum net worth, the local available capital including remittable surplus retained in India, as assessed by the Reserve Bank, would qualify.
- Existing branches of a foreign bank would be permitted to convert into a WOS depending upon the manner in which the affairs of the branches of the bank are conducted, compliance with the statutory and other prudential requirements and the over all supervisory comfort of the Reserve Bank.

- Operations of WOS would have market access and national treatment limitation consistent with WTO principles.
- Foreign banks would be allowed to open more than the existing WTO commitment of 12 branches in a year.
- Foreign banks would be permitted to acquire a controlling stake in a phased manner, but only in those private sector banks which are identified by the Reserve Bank for restructuring.
- Where such acquisition is by a foreign bank already having presence in India, a time bound plan covering a period not exceeding six months to conform to the 'one form of presence' concept would have to be submitted by the foreign bank along with the application for acquisition.
- The Reserve Bank would consider proposals made only by globally and locally reputed foreign banks and only if such a step is in the long term interest of all the stakeholders in the investee bank.

Phase II

- Limitations on the operations of WOS of foreign banks would be removed and they would be treated on par with domestic banks. This would be done after reviewing the experience in Phase I and after due consultation with all the stakeholders in the banking sector.
- On completion of a minimum prescribed period of operation, foreign banks would be allowed to list and dilute their stake in WOS through initial public offer or sell it in such a way that at least 26 per cent of the paid-up capital of the subsidiary is held by resident Indians at all times.
- Foreign banks may be permitted to enter into merger and acquisition transactions with any private sector bank in India subject to the overall investment limit of 74 per cent.

Prudential Norms for State Government guaranteed Advances

The Reserve Bank has reviewed the prudential norms pertaining to state government guaranteed exposures, i.e., advances and investments and decided to de-link the requirement of invocation of state government guarantee for asset classification and provisioning. These exposures would now be subjected to the same norms as applicable to exposures not guaranteed by the state governments. With a view to enabling banks to have a smooth transition in the matter, the revised prudential norms in respect of state government guaranteed exposures, i.e., both advances and investments would, however, be implemented in a phased manner as under :

- With effect from the year ending March 31, 2006, state government guaranteed advances and investments in state government guaranteed securities would attract asset classification and provisioning norms, if interest and/or principal or any other amount due to the bank remains overdue for more than 180 days.
- With effect from the year ending March 31, 2007, state government guaranteed advances and investments in state government guaranteed securities would attract asset classification and provisioning norms, if interest and/or instalment of principal or any other amount due to the bank remains overdue for more than 90 days.

UCBs

Higher Risk Weight on Housing and Consumer Loans

The Reserve Bank has increased the risk weight, for capital adequacy purposes, on housing loans extended by primary urban co-operative banks (UCBs) to individuals which are fully secured by mortgage of residential properties, to 75 per cent from 50 per cent at present. In all other cases it will be 100 per cent. The risk weight on consumer credit, including personal loans, has been increased from 100 per cent to 125 per cent. As the capital to risk-weighted assets ratio (CRAR) is to be maintained on an on-going basis, the new risk weights, would be applicable on all outstanding exposures.

NBFCs

Full Cover for Public Deposits

The Reserve Bank has advised non-banking financial companies (NBFCs) to ensure that at all times there is full cover available for public deposits accepted by them. While calculating this cover, the value of all debentures (secured and unsecured) and outside liabilities other than the aggregate liabilities to depositors may be deducted from the total assets. Further, the assets should be evaluated at their book value or realisable/market value whichever is lower for this purpose. It would be incumbent upon the NBFC concerned to inform the regional office of the Reserve Bank in case the asset cover calculated as above falls short of the liability on account of public deposits. Further, all NBFCs accepting/holding public deposits should create a floating charge on the statutory liquid assets invested in terms of Section 45-IB of the Reserve Bank of India Act, 1934, in favour of their depositors. Such charge should be duly registered in accordance with the requirements of the Companies Act, 1956.

RBI

Board for Regulation and Supervision of Payment and Settlement Systems set up

The Reserve Bank has on March 10, 2005 constituted a Board for Regulation and Supervision of Payment and Settlement Systems (BPSS) as a Committee of its Central Board, as per the Reserve Bank of India (Board for Regulation and Supervision of Payments and Settlement Systems) Regulations 2005 which were notified in the Gazette of India dated February 18, 2005. The BPSS will have a tenure of two years.

The BPSS will prescribe policies relating to the regulation and supervision of all types of payment and settlement systems, set standards for existing and future systems, authorise the payment and settlement systems, determine criteria for membership to these systems, including continuation, termination and rejection of membership.

In order to assist BPSS in performing its functions, the Reserve Bank has constituted a new department, viz., the Department of Payment and Settlement Systems which has started functioning from March 7, 2005.

FOREX

Operations in NRE/FCNR (B) Accounts by Resident Power of Attorney Holders

Pursuant to the observations/recommendations made by the Committee on Procedures and Performance Audit on Public Services (Chairman : Shri S.S. Tarapore) it has been decided that banks authorised to deal in foreign exchange may permit a resident power of attorney holder to remit, through normal banking channels, funds out of the balances in non-resident external (NRE/foreign currency non-resident (bank) {FCNR (B)}) accounts to the non-resident account holder provided specific powers for the purpose have been given. The remittances under power of attorney are, however, permitted only to the non-resident account holder.

Earlier in May 2000, residents holding power of attorney of non-resident account holders, were permitted to operate NRE accounts provided, such operations were restricted to withdrawals for local payments.

complaints and constitute proper grievance redressal cells to mitigate the hardships caused to their credit card customers. Banks were also advised to issue appropriate code of conduct to the direct selling agents (DSAs) marketing their credit card products and cautioned to take pre-emptive steps to prevent avoidable litigations.

The banks assured the Reserve Bank that they had systems in place to check the level of service rendered by DSAs and also had mechanism for redressal of customer grievances. They, however, pointed out that it was difficult to prevent sale of databases in the absence of any strict privacy laws in the country which in turn made it difficult to control unsolicited calls.

To mitigate customer hardships in this area, the Reserve Bank had recently set up a Working Group for evolving a regulatory mechanism for credit cards. The Working Group would, among other things, suggest the type of regulatory measures which are required for plastic cards so as to encourage their growth in a safe, secure and efficient manner; to recommend measures to be introduced to ensure that the rules, regulations, standards and practices of the card issuers are in alignment with the best customer practices; to draw a road map of setting up a grievance redressal mechanism for the card user and to educate the customers about their rights and duties. The Reserve Bank has also requested members of the public to send their suggestions on these areas to cardsgroupdit@rbi.org.in

The Reserve Bank had, of late, been receiving a large number of complaints from various organisations, associations, media and members of the public against credit card issuing banks. The complaints centred around harassment of customers, receiving unsolicited cards, wrongful activation of cards, lack of transparency in levying service charges/other charges and absence of an effective grievance redressal machinery.

INFORMATION

Customer Complaints relating to Credit Cards

A meeting of major credit card issuing banks was convened by the Reserve Bank to discuss issues relating to the credit card operations of banks. In response to the decisions taken in the meeting, it was decided that the Indian Banks' Association (IBA) along with some large credit card issuing banks would evolve a Fair Practices Code for credit card issuers, to be voluntarily adopted by the banks issuing credit cards.

During the course of the meeting, the Reserve Bank reiterated to the banks issuing credit cards, to be more receptive to customer

Non-Performing Assets of Financial Institutions*

(Rs. in crore)

Name of the Institution	2001-02		2002-03		2003-04	
	Gross NPA	Net NPA	Gross NPA	Net NPA	Gross NPA	Net NPA
IFCI LTD.	6574	3898	8382	4560	9998	3864
IIBI	1121	609	1718	915	1722	800
IDBI	7932	3873	8751	7517	10292	8693
Exim Bank	986	448	784	184	729	129
NABARD	0.93	1.61	0.80			
NHB	NIL	NIL	NIL	NIL	NIL	NIL
IDFC	NIL	NIL	NIL	NIL	30	NIL
SIDBI		382.17		472.70		225.82

* The August 2004 issue of the Monetary and Credit Information Review carried a list of non-performing assets (NPAs) of public sector banks and the September 2004 issue carried a similar list of private sector banks.

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