CREDIT INFORMATION REVIEW

237
APRIL 1999

CONTENTS

Monetary and Credit Policy :1999-2000

Stance of the Policy

Under normal circumstances – and barring unanticipated developments in domestic or international situation – the overall stance of policy for 1999-2000 will be provision of reasonable liquidity; stable interest rates with policy preference for softening to the extent circumstances permit; active debt-management; orderly development of financial markets; and further steps in financial sector reforms.

Projections for 1999-2000

- M_3 growth to be in the range of 15.5 to 16.0 per cent.
- GDP growth to be in the range of 6 to 7 per cent.
- Aggregate deposits of scheduled commercial banks projected at 16.5 per cent
- Non-food bank credit including investments in commercial paper, shares/debentures/bonds of PSUs and private corporate sector projected to increase by about 18 per cent.

Measures

Forward cover for FIIs: The foreign institutional investors will be able to take forward cover to the extent of 15 per cent of their outstanding investment on March 31,1999 as well as the entire amount – 100 per cent –of any additional investment made after this date. Applications for further additional limits have been exhausted.

In a detailed circular issued subsequently, the Reserve Bank advised authorised dealers to provide forward exchange cover to FIIs to the extent of 15 per cent of their outstanding equity investment as at the close of business of March 31, 1999 converted into dollar terms at the rate of

US$ 1 = Rs.42.43, as well as for the entire amount of any additional investment made after March 31, 1999. Existing forward contracts entered into by FIIs in accordance with earlier instructions may, however, be allowed to continue till maturity even if the amount exceeds 15 per cent of the investment outstanding as on March 31, 1999. The Reserve Bank will consider requests from FIIs for additional limits on a case-by-case basis after the eligible limits have been fully utilised.

Credit facilities for overseas trading Offices: The Reserve Bank would consider requests from export houses/trading houses/star trading houses/super star trading houses for availing of fund based/non-fund based facilities from overseas banks for their trading offices abroad on merits, provided the terms and conditions subject to which such facilities are extended by overseas banks are reasonable. Earlier, authorised dealers could release exchange for establishment of overseas offices by firms/companies in India subject to the condition that the overseas office should not create any financial liabilities, contingent or otherwise, for their Head office in India.

CRR : The Cash Reserve Ratio (CRR) to be maintained by scheduled commercial banks (excluding Regional Rural Banks) will be reduced by one-half of one percentage point from 10.5 per cent to 10.0 per cent effective fortnight beginning May 8, 1999. This reduction in CRR would augment the lendable resources of banks by about Rs. 3,250 crore.

The facility to issue cheques against exchange earners’ foreign currency (EEFC) accounts is being granted with effect from May 1, 1999. (see box)

ILAF : Pending further upgradation in technology and legal/procedural changes to facilitate electronic transfer and settlement, it has now been decided to introduce an Interim Liquidity Adjustment Facility (ILAF) through repos and lending against collateral of Government of India securities.

The general refinance facility was withdrawn with immediate effect. It will be replaced by a collateralised lending facility (CLF) up to 0.25 per cent of the fortnightly average outstanding aggregate deposits in 1997-98 which will be available for two weeks at Bank Rate. An additional collateralised lending facility (ACLF) for an equivalent amount of CLF will also be available at Bank Rate plus 2 per cent. CLF and ACLF availed for periods beyond two weeks will be subject to a penal rate of 2 per cent for an additional two week period. There will be a cooling period of two weeks thereafter. The current restriction on participation in money market (during the period that such facilities are availed of) will be withdrawn in order to facilitate systemic adjustment in liquidity. The existing facility for export refinance will continue. Liquidity support against collateral of government securities, based on bidding commitment and other parameters, will be available to Primary Dealers at Bank Rate and the amounts will remain constant throughout the year.

The ILAF would provide a mechanism by which liquidity would be injected at various interest rates, and absorbed when necessary at the fixed repo rate, so that the volatility in the money market is minimised and the market operates within a reasonable range.

Cheques on EEFC Accounts

Authorised dealers may allow the exchange earners' foreign currency (EEFC) account holders the facility of making payments from such accounts for eligible purposes by issue of cheques to the beneficiaries of the payments. This facility may be introduced with effect from May 1, 1999. For this purpose, authorised dealers may issue separate cheque books to EEFC account holders which should be distinct from the cheques issued on domestic rupee accounts or NRE accounts and should be superscribed with the words "EEFC Account". Authorised dealers may fix their own requirement of minimum balance in the account for being eligible to avail of the cheque facility.

The account holder, within a period of seven days from the date of issue of cheque, should submit an application in form A1/A2 together with the particulars of cheque issued and requisite document to the authroised dealer concerned giving full particulars of payment made by issue of a cheque. The authorised dealer should report the transaction in any appropriate `R' return as and when the cheque is cleared for payment to the beneficiary. While making the payment of cheque authorised dealer should ensure that the transaction in question is permissible under the current exchange control regulations. Any payment made by issue of a cheuqe for a purpose for which use of funds in EEFC account is not permissible should be reported to the Reserve Bank promptly with full details.

Repos : It has been decided to allow UTI, LIC, IDBI and other non-bank participants in the money market to access short term liquidity through repos thereby facilitating their cash management and gradual move out of the call money market. To widen further the number of participants in the repos market through exchange traded repos in debt instruments held in demat form under a tri-party arrangement, with adequate safeguards to manage risks, guidelines are being finalised and will be issued shortly.

MMMFs : It has been decided to permit money market mutual funds (MMMFs) to offer 'cheque writing' facility to their investors.

FRAs : To facilitate hedging of interest rate risks and ensuring orderly development of the derivatives market, guidelines for interest rate swaps and forward rate agreements (FRAs) will be issued.

TBills : It has been decided (a) to obtain minimum bidding commitment from each PD for the auctions of Treasury Bills so that together they absorb 100 per cent of the notified amount, and (b) to offer an enhanced underwriting option to PDs for the entire notified amount in auctions of dated securities.

It is proposed to announce a calendar for issue of Treasury Bills for the entire year and to introduce 182 day Treasury Bill which will be issued every fortnight as part of the calendar. It is also proposed to have the option of issuing new loans on price basis instead of on yield basis as is done currently.

PLR : Banks have been given freedom to operate different PLRs for different maturities provided the transparency and uniformity of treatment originally envisaged continues to be maintained.

Banks have been permitted to offer fixed rate loans subject to conformity to ALM guidelines.

In all such cases of deposit rate being equal to or more than or less than one percentage point below PLR, advances to depositors against fixed deposits can be made by banks without reference to the ceiling of PLR and banks can charge suitable interest rates. This will be applicable both for domestic and NRE deposits.

It has been decided that the Boards of Directors of banks may delegate necessary powers to Asset Liability Management Committee for fixing interest rates on deposits and advances subject to reporting to the Board immediately .

Mark to Market : With effect from the year ending March 31, 2000, banks will have to classify a minimum of 75 per cent of their investments in approved securities as current investments.

Cross-holding : It has been decided that a bank's or a financial institution’s investment in Tier II bonds issued by other banks and financial institutions should be permitted upto 10 per cent of the investing bank's total capital. In a detailed circular issued subsequently, the Reserve Bank further clarified that the total capital for this purpose will be the same as that reckoned for the purpose of capital adequacy. In case any bank has already exceeded this limit of 10 per cent, a reference may be made to RBI indicating the period within which the exposure would be brought within the stipulated limit. It has been reiterated that investments by banks in Tier II bonds of other banks/financial institutions would carry 100 per cent risk weight.

Rescheduled loans : In some cases of rescheduled loans, and where borrowers have started servicing their loans on a regular basis after a short gap, it has been decided that the waiting period of two years may be reduced to one year (or four quarters) if the interest and instalment of loans have been serviced regularly as per the terms of reschedulment. The instructions will be applicable for asset classification with effect from the year ended March 31,1999.

Commercial production : As part of the process of moving away from micro-level regulations, the Reserve Bank has decided that it will now be left to the Board of Directors of each bank to prescribe detailed rules for determining the date of commencement of commercial production of units. The detailed circular on the subject will be issued subsequently.

ALM guidelines : As proposed in the Policy circular, the draft ALM guidelines to financial institutions were issued. The guidelines aim at measurement of liquidity and interest rate risk which could form the basis of evolving an ALM system by the FIs to sensitise the managements of FIs to the need for a formally structured management of the liquidity and interest rate risk of their portfolios and to provide a basis for initiating measures for collection, compilation and analysis of data required for an effective ALM system. The FIs are expected to introduce the

ALM system wthe effect from October 1,1999 on a trial basis and switch over to a regular ALM system from April 1,2000.

Micro-credit : A special cell, manned by a senior officer from the commercial banking sector with practical experience in the field of micro credit is being set up in the Reserve Bank in order to liaise with NABARD and micro-credit institutions for augmenting the flow of credit to micro credit institutions and Self Help Groups. The timeframe for the cell to complete its work will be one year.

While direct loans below certain levels by banks will continue to be subject to the interest rate ceiling as prescribed by the Reserve Bank from time to time, interest rates applicable to loans given by banks to micro-credit organisations or by these organisations to their members/beneficiaries will be left to their discretion.

Interest rates and other terms in respect of Government sponsored programmes, such as IRDP, will, however, remain as they are.

NBFC loans : Incremental credit given to NBFCs by banks for on-lending to small road and water transport operators and to units in tiny sector of industry, over March 31, 1999, will qualify for priority sector status.

Venture capital : In order to encourage the flow of finance for venture capital, the overall ceiling of investment by banks in ordinary shares, convertible debentures of corporates and units of mutual funds, etc., which is currently at 5 per cent of their incremental deposits will stand automatically enhanced to the extent of banks' investments in venture capital. It has also been decided to include investments in venture capital in priority sector lending.

Infrastructure financing : Banks/FIs will be free to sanction term loans for technically feasible, financially viable and bankable projects undertaken by both public and private sector undertakings subject to prescribed criteria.

To ensure timely and adequate availability of credit, banks/FIs are advised to clearly delineate the procedure for approval of loan proposals and institute a suitable monitoring mechanism for reviewing applications pending beyond the specified period. Banks/FIs are urged to ensure close coordination with each other as also other agencies concerned in order to avoid repetitive appraisals and delays, and set up a mechanism for monitoring the project implementation.

SAC : The Government has directed public sector banks to set up Settlement Advisory Committees (SACs) so that chronic cases, specially those relating to the small sector, are settled in a timely and speedy manner. A scheme for Settlement Advisory Committee (SAC) is being finalised by the Reserve Bank.

NBFCs : In respect of new NBFCs, which are incorporated on or after April 20, 1999 and which seek registration with the Reserve Bank, the requirement of minimum net owned fund has been raised to Rs. 2 crore. This stipulation will not apply to NBFCs which are already registered with the Reserve Bank or whose applications are presently under consideration.

National Payments Council : A National Payments Council with a Deputy Governor as the Chairman and representative membership is being constituted. It is planned to have real time gross settlement (RTGS) system in place in the next 15 to18 months.

Review : A review of credit and monetary developments in the first half of the current year will be undertaken in October 1999.

Inter-branch Accounts

Reiterating that large arrears in the reconciliation of inter-branch accounts is a cause for serious concern and banks have been advised from time to time to take necessary action for speedy reconciliation of old outstanding entries, the Reserve Bank has asked banks to segregate, for the year ending March 31, 1999, the debit and credit entries in the inter-branch accounts up to March 31, 1995, remaining unreconciled as on March 31, 1999 and arrive at the net position. In case of a net debit, a provision equivalent to 100 per cent has to be made for the year ending March 31, 1999. While doing so, banks should also take into account the credit balance in the `blocked account'.

Beginning from April 1, 1999 banks should maintain category-wise (head-wise) accounts for various types of transactions put through inter-branch accounts, so that the netting can be done category-wise. As on the balance sheet date, banks should segregate the debit and credit entries remaining unreconciled for more than three years and arrives at the net position category-wise. Thereafter, the net debit under all the categories of inter-branch accounts should be aggregated and a provision equivalent to 100 per cent of the aggregate net debit should be made. The Reserve Bank has asked banks to ensure that while netting, the net debit under one category is not set off against net credit in another category.

Banks have been further advised that they may compile and report details of outstanding entries in inter-branch accounts under various heads in the quarterly statements being submitted to the Reserve Bank.

Filing of suits by banks to recover dues

The Reserve Bank of India has advised that in cases where loss assets are more than two years old on the books of the bank without legal action being initiated, banks should submit a review note to the management committee/board giving specific reason as to why suits have not been filed. Such a review should be placed before the management committee/board every half year with reference to the position as on September 30 and March 31 of each year. A copy of this review should also be sent to the regional office of Department of Banking Supervision under whose jurisdiction a bank's head office falls.

Timely and appropriate legal action for realisation of assets and recovery of dues from the borrowers is absolutely necessary to bring down the level of non-performing assets (NPAs).

The decision to file a suit in respect of a borrowal account is generally taken by banks in accordance with their loan policy and keeping in view the availability/enforceability of charges adequacy of realisable value of the securities to cover the dues, period of limitation, the time taken and cost involved in litigation, etc. The need for prescribing a time frame for starting legal recovery procedure promptly in respect of loss assets which are carried in the books of banks for long periods was recently examined against this background.

Modalities of Financing Infrastructure Projects

Coverage

Infrastructure in a broad sense would include sectors, such as, power, telecommunications, roads, ports, airports, water supply, waterways and urban transport system and sectors with similar characteristics.

Criteria for Financing

Banks/financial institutions (FIs) are free to sanction term loans for technically feasible, financially viable and bankable projects undertaken by both public sector and private sector undertakings while observing all prudential and exposure norms.

Banks have also been asked to ensure that they do not run into liquidity mismatch on account of lending to such projects. In respect of projects undertaken by public sector units, term loans may be sanctioned only for corporate entities (i.e., public sector undertakings registered under Companies Act or a corporation established under the relevant statute). Further, such term loans should not be in lieu of or to substitute budgetary resources envisaged for the project. In relaxation of its earlier instructions, the Reserve Bank has stated that the term loan could, however, supplement the budgetary resources if such supplementing was contemplated in the project design.

Types of Financing by Banks

In order to meet long-term financial requirements of infrastructure projects, banks may, *inter alia*, take recourse to finance through funds raised by way of subordinated debt, entering into take-out financing arrangement with IDFC/other financial institutions or availing of liquidity support from IDFC/other financial institutions, direct financing through rupee term loans, deferred payment guarantees, foreign currency loans, etc, keeping in view the ability to manage asset-liability profile, and investment in infrastructure bonds issued by project promoters/FIs.

In partial modification of its earlier instructions, the Reserve Bank has given to banks, discretion in the matter of issuance of guarantees favouring other lending agencies, in respect of infrastructure projects alone, subject to the following:

(i) a bank would be permitted to issue the guarantee provided it also takes a funding share in the project and that the amount of such guarantees will not exceed twice the funding share assumed by it; and

(ii) the guarantor bank has a satisfactory record in compliance with the prudential regulations such as capital adequacy, credit exposure norms, norms relating to income recognition, asset classification and provisioning, etc.

Appraisal

Banks/FIs have been asked to consider constituting appropriate screening committees/special cells for appraisal of credit proposals and monitoring the progress/performance of infrastructure projects. Often, the size of the funding requirement would necessitate joint financing by banks/FIs or financing by more than one bank under consortium or syndication arrangements. Participating banks/FIs have also been advised that for the purpose of their own assessment. This may refer to the appraisal report prepared by the lead bank/FI or have the project appraised jointly. They should, however, ensure that the appraisal in all cases is completed within a time bound period and repetitive and sequential appraisals by several institutions are avoided.

Administrative Arrangements

The Reserve Bank has also exhorted banks/FIs that timely and adequate availability of credit being the pre-requisite for successful implementation of infrastructure projects, they should clearly delineate the procedure for approval of loan proposals and institute a suitable monitoring mechanism for reviewing applications pending beyond the specified period. Multiplicity of appraisals by every institution involved in financing, leading to delays, has to be avoided and banks should be prepared to broadly accept technical parameters laid down by leading public financial institutions.

Fund remittance for RRBs

The RBI has advised public sector banks to extend facilities for remittance of funds between the head offices of the RRBs and their different branches free of cost irrespective of the fact whether the RRBs are sponsored by them or not. The remittance may be allowed in multiples of Rs. 5000 subject to a minimum of Rs. 5000 at a time.

Edited and published by **Alpana Killawala** for the **Reserve Bank of India**, Press Relations Division, Central Office, Shahid Bhagat Singh Marg, Mumbai 400 001 and printed by her at **Mouj Printing Bureau**, Khatau Wadi, Girgaon, Mumbai 400 004. Annual Subscription : Rs. 12. Subscription to be remitted to the Director, DRRP (Sales Section), DEAP, Reserve Bank of India, Amar Building, Sir P.M. Road, P.B. No. 1036, Mumbai-400 001.