

# MONETARY AND CREDIT INFORMATION REVIEW

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## Important Banking and Financial Developments in 2005

### January

- Banks advised to formulate suitable loan policies to finance second hand assets, both directly and through non-banking finance companies (NBFCs).
- Guidelines issued to urban co-operative banks (UCBs) to delink the requirement of invocation of state government guarantee for asset classification and provisioning.
- Risk weight on housing loan exposure of UCBs increased from 50 per cent to 75 per cent and from 100 per cent to 125 per cent in the case of consumer credit including personal loans and credit card exposure.

### February

- Draft prudential guidelines on capital adequacy released for implementation of Basel II norms by banks. In order to maintain consistency and harmony with international standards, banks advised to adopt Standardised Approach for credit risk and Basic Indicator Approach for operational risk with effect from March 31, 2007.
- Comprehensive guidelines issued on ownership and governance in private sector banks encompassing minimum capital requirement, diversified ownership, procedures for acquisition and transfer of shares, 'fit and proper' criteria for directors and important shareholders.
- Roadmap for presence of foreign banks in India laid out in two phases. In the first phase (March 2005 to March 2009) foreign banks wishing to establish presence in India for the first time, to either operate through branch presence or set up a 100 per cent wholly owned subsidiary (WOS), following the one-mode presence criterion.
- NBFCs accepting/holding public deposits advised to ensure that at all times full cover is available for public deposits accepted by them.
- Comprehensive guidelines on 'know your customer' (KYC) norms and anti-money laundering measures issued to NBFCs, state co-operative banks (StCBs) and district central co-operative banks (DCCBs). They were advised to frame their KYC policies incorporating four key elements, viz., (i) customer acceptance policy; (ii) customer identification procedures; (iii) monitoring of transactions; and (iv) risk management.

- Minimum net worth for undertaking insurance agency business by UCBs and scheduled/licensed StCBs/DCCBs reduced to Rs.50 crore from Rs.100 crore.

### **March**

- The Reserve Bank constituted a Board for Regulation and Supervision of Payment and Settlement Systems as a Committee of the Central Board.
- Banks advised to disclose a minimum framework on their risk exposure in derivatives portfolio with effect from March 31, 2005.
- Detailed guidelines issued to UCBs regarding classification and valuation of investment portfolio for provisioning requirements.
- Prudential norms in respect of income recognition, asset classification, provisioning and other related matters for UCBs revised.
- UCBs advised to exercise caution in outsourcing their IT systems and to ensure that risks in this regard are minimised.
- Banks authorised to deal in foreign exchange permitted to allow a resident power of attorney holder to remit funds out of the balances in NRE/FCNR(B) account through normal banking channels, to a non-resident account holder provided, specific powers for the purpose have been given.

### **April**

- Comprehensive draft guidelines issued on securitisation of standard assets.
- Lending and deposit interest rates in respect of amounts disbursed on or before October 31, 2003 out of Rural Infrastructure Development Fund (RIDF) IV to VII, restructured.
- Banks advised to pay *suo moto* compensation for delayed credit under electronic clearing service (ECS)/electronic funds transfer (EFT)/special electronic funds transfer (SEFT).
- Banks advised to put in place a Business Continuity Plan including a robust information risk management system within a fixed time frame.
- Banks advised to convert the existing *ad hoc* Committees on Procedures and Performance Audit of Public Services (CPPAPS) into a Standing Committee on Customer Service.
- Banks permitted to shift their rural branches within the block/ service area without obtaining the Reserve Bank's prior approval, subject to their complying with certain conditions.
- The fixed reverse repo rate under the liquidity adjustment facility (LAF) of the Reserve Bank increased by 25 basis points to 5.0 per cent effective April 29, 2005. The fixed repo rate under the LAF left unchanged at 6.0 per cent.

- Effective from April 16, 2005, all scheduled banks which are members of negotiated dealing system (NDS) and acting as issuing and paying agents for commercial paper (CP) issuance, advised to report details of CP issue on NDS platform within two days from the date of completion of the issue.
- UCBs advised to reduce their prudential exposure limits on advances to 15 per cent and 40 per cent of the 'capital funds' in the case of a single borrower and a group of borrowers, respectively. The definitions of capital funds and exposure also modified for this purpose. UCBs advised to bring down the outstanding or their sanctioned exposure limit exceeding the revised limit within a maximum period of 2 years, i.e., by March 31, 2007.
- UCBs advised to explore the option of merger/ amalgamation, wherever necessary, for revitalising and rehabilitating weak scheduled UCBs.
- Guidelines on merger and amalgamation between private sector banks and NBFCs issued. The guidelines cover the process of merger, determination of swap ratios, disclosures, norms for buying/selling of shares by promoters before and during the process of merger and the Board's involvement in the merger process.
- Banks allowed to formulate schemes for providing services at the premises of a customer within the framework of Section 23 of the Banking Regulation Act, 1949 and submit to the Reserve Bank for approval.
- Ceilings on donations/contributions for public/charitable purposes out of profits of UCBs announced.
- The rate of interest to be charged on group loans under swarnjayanti gram swarozgar yojana linked to per capita size of the loan.
- Financial institutions not accepting public deposits but having asset size of Rs. 500 crore and above to be subjected to limited off-site supervision by the Reserve Bank.
- Minimum maturity period of certificates of deposit (CDs) reduced from 15 days to 7 days.
- Limit on loans to farmers through the produce marketing scheme increased from Rs. 5 lakh to Rs. 10 lakh under priority sector lending.

## **May**

- General permission granted to banks to declare dividends, subject to the fulfillment of certain conditions, including observance of minimum CRAR and NPA ratio, subject to a ceiling of dividend payout ratio of 40 per cent.
- StCBs, DCCBs and regional rural banks (RRBs) permitted to undertake insurance agency business on referral basis.

- The eligibility to participate in repo market extended to non-scheduled urban co-operative banks and listed companies, having a gilt account with a scheduled commercial bank subject certain conditions.
- Vision Document on Payment and Settlement Systems 2005-08 released.

## **June**

- Banks allowed to extend financial assistance to Indian companies for acquisition of equity in overseas joint ventures/wholly owned subsidiaries or in other overseas companies, new or existing, as strategic investment in terms of a Board approved policy, duly incorporated in the loan policy of the bank.
- Instructions issued to banks, in supersession of all earlier instructions on settlement of claims in respect of deceased depositors, covering aspects relating to (i) access to balance in deposit account; (ii) premature termination of term deposit accounts; (iii) treatment of flows in the name of the deceased depositor; (iv) access to safe deposit lockers/safe custody articles; and (v) time limit for settlement of claims.
- Private and public sector banks need not obtain the Reserve Bank's approval for permitting any of their whole-time officers or employees (other than chairmen/CEOs) to become director or a part-time employee of any other company.
- Banks advised to have a Board mandated policy in respect of their real estate exposure covering exposure limits, collaterals to be considered, margins to be kept, sanctioning authority/level and sector to be financed.
- Processing charges waived for all electronic products for transactions under EFT, SEFT and ECS facility involving Rs.2 crore and above up to March 31, 2006. This to be in addition to the waiver on transactions involving less than Rs.2 crore.

## **July**

- Guidelines issued on sale/purchase of NPAs, including valuation and pricing aspects along with prudential and disclosure norms.
- Prior approval of the Reserve Bank not required for offering internet banking services, subject to fulfillment of certain conditions.
- The risk weight for credit risk on capital market and commercial real estate exposures increased from 100 per cent to 125 per cent.
- Single branch UCBs and those having multiple branches within a single district having deposits up to Rs. 100 crore, permitted to classify NPAs based on 180 days delinquency instead of the earlier 90 days norm till March 31, 2007.

- Commercial banks delegated the authority to grant permission to companies listed on a recognised stock exchange to hedge the price risk in respect of any commodity (except gold, silver, petroleum and petroleum products) in the international commodity exchanges/markets.
- Guidelines issued for relief measures by banks in areas affected by unprecedented rains and floods in Maharashtra. Banks advised to consider granting consumption loans to affected persons up to Rs.5,000 without any collateral and Rs.10,000 at the discretion of the branch manager, depending on the repaying capacity of the borrower.
- Authorised dealers (ADs) given the freedom not to follow up submission of evidence of import involving amount of USD 1,00,000 or less provided they are satisfied about the genuineness of the transaction and the *bona fides* of the remitter.
- Foreign direct investment (FDI) up to 100 per cent permitted under the automatic route in petroleum product marketing, oil exploration in both small and medium sized fields and petroleum product pipelines. In air transport services (domestic airlines) sector, FDI up to 100 per cent permitted under the automatic route by NRIs and up to 49 per cent by others.
- Investments made by banks in venture capital on or after July 1, 2005 not to be eligible for classification under priority sector lending. Investments already made up to June 30, 2005 not to be eligible for classification under priority sector from April 1, 2006.

## **August**

- In view of the natural calamity in Maharashtra and the need to provide immediate succour, banks instructed to observe minimum formalities for enabling affected persons to open bank account quickly.
- Banks advised to formulate a detailed mid-term corporate plan for branch expansion for a three year period with their Board's approval. The plan should cover all categories of branches/offices having customer contact, including specialised branches, extension counters and number of ATMs. The plan to be formulated on district-wise basis, giving number of branches proposed to be opened in metropolitan/urban/semi-urban/rural areas. The proposal for branch expansion to be submitted on an annual basis by December every year.
- StCBs and DCCBs permitted to invest their genuine surplus funds in non-SLR securities without taking the Reserve Bank's prior approval.
- KYC procedure for opening accounts simplified further for those persons who intend to keep balances not exceeding Rs.50,000 in all their accounts taken together and the total credit in all the accounts taken together is not expected to exceed rupees Rs.1,00,000 in a year. Banks advised to open accounts with introduction from another account holder (holding

account for at least six months) who has been subjected to full KYC procedure or any other evidence so as to identify the customer and his address to the bank's satisfaction.

- Pursuant to the announcement made by the Union Finance Minister for stepping up credit to small and medium enterprises (SMEs), public sector banks advised to take measures to improve flow of credit to the sector.

### **September**

- Guidelines on a one time settlement scheme for SMEs for recovery of NPAs below Rs.10 crore announced.
- Banks nominated to import gold, allowed to extend gold (metal) loans to domestic jewellery manufacturers who need not be exporters of jewellery.
- The policy for authorisation of bank branches in India liberalised and rationalised with a framework for a new branch authorisation policy consistent with the medium-term corporate strategy of banks and public interest. While considering applications for opening branches weightage to be given to the nature and scope of banking facilities provided by banks to common persons, particularly in underbanked areas, actual credit flow to the priority sector, pricing of products and overall efforts for promoting financial inclusion, including introduction of appropriate new products and the enhanced use of technology for delivery of banking services.
- Banks advised to implement a debt restructuring mechanism for units in the SME sector. Detailed guidelines laid down relating to eligibility and viability criteria, prudential norms for restructured accounts, treatment of additional finance, asset classification and repeated restructuring.
- Licensed and/or scheduled StCBs permitted to undertake, without risk participation, co-branded domestic credit card business with tie-up arrangement with one of the scheduled commercial banks, already having arrangement for issue of credit cards, subject to their fulfilling certain conditions.

### **October**

- The Reserve Bank issued the revised Guidance Note on Management of Operational Risk. Banks advised to use the Guidance Note for upgrading their risk management system.
- Banks advised to liberally extend the relief package to the state of Jammu and Kashmir and other parts of north India hit by earthquake. Banks also advised to provide financial assistance for the purpose of repairs/reconstruction of dwelling units damaged on account of the earthquake.

- Banks advised to provide details of ECS credits to their customers in their pass book/account statement. A similar approach also to be adopted for capturing the sender/ remittance details for other electronic payment products such as EFT, SEFT, RTGS.
- Reverse repo rate and repo rate under the LAF of the Reserve Bank increased by 25 basis points each to 5.25 per cent and 6.25, respectively from October 26, 2005 .
- NBFCs advised to ensure full compliance with KYC guidelines in respect of deposits collected by persons authorised by them, including brokers/agents etc, to collect deposits on their behalf.
- UCBs carrying accumulated losses in their balance sheet would not be eligible to make donations.
- Guidelines issued to NBFCs (including RNBCs) on classification of frauds, approach towards monitoring of frauds and reporting requirements.

## **November**

- The Reserve Bank issued guidelines on credit cards for immediate implementation by credit card issuing banks and NBFCs. Banks/NBFCs directed to have a well documented policy and a Fair Practices Code for credit card operations and to widely disseminate its contents, including through their websites, latest by November 30, 2005.
- Revised guidelines on corporate debt restructuring issued. The coverage of the scheme extended to include entities with outstanding exposure of Rs. 10 crore or more.
- The general provisioning requirement for 'standard advances', with the exception of banks' direct advances to agricultural and SME sectors, increased from the present level of 0.25 per cent to 0.40 per cent.
- Banks advised to introduce a basic banking 'no frills' account which could either be with 'nil' or very low minimum balances/charges. The nature and number of transactions in such accounts could be restricted but should be made known to customers in advance in a transparent manner.
- Persons/entities eligible under the FDI route, other than foreign institutional investors (FIIs), permitted to invest in the equity capital of asset reconstruction companies (ARCs) registered with the Reserve Bank.
- General permission granted to FIIs registered with the Securities and Exchange Board of India (SEBI) to invest in security receipts issued by ARCs registered with the Reserve Bank.

- The national electronic funds transfer (NEFT) went live from November 21, 2005 with one settlement at 12 Noon every day.
- To smoothen the process of merger in the UCB sector, the acquirer UCB permitted to amortise the loss taken over from the acquired UCB over a period of not more than five years, including the year of merger.

### **December**

- All authorised money changers (AMCs) advised to formulate suitable policies and procedures for prevention of money laundering. The anti-money laundering measures so formulated should include (i) KYC norms; (ii) recognition, handling and disclosure of suspicious transactions; (iii) appointment of money laundering reporting officer; (iv) staff training; (v) maintenance of records; and (vi) audit of transactions.
- The Reserve Bank announced draft guidelines on outsourcing to provide direction and guidance to banks to adopt sound and responsive risk management practices for effective oversight, due diligence and management of risks arising from outsourcing activities. The Reserve Bank's prior approval not required for outsourcing services except when the service provider is located outside India or when the outsourcing is in relation to doorstep banking.
- Banks advised to formulate their own policy relating to donations given by them to various entities, with their Board's approval. Profit making banks permitted to make donations during a financial year aggregating up to one per cent of their published profit for the previous year.
- NBFCs (including RNBCs) with public deposits/deposits of Rs 50 crore and above advised to stipulate rotation of partners of audit firms appointed for auditing the company. The partner/s of the chartered accountant firm conducting the audit to be rotated every three years so that same partner does not conduct audit of the company continuously for more than a period of three years. The partner so rotated would, however, be eligible for conducting the audit of the NBFC/RNBC after an interval of three years.

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