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MONETARY AND CREDIT INFORMATION REVIEW

POLICY

Banks' Investments in Venture Capital Funds

The Reserve Bank has revised the prudential framework governing banks' exposure to venture capital funds (VCFs). All scheduled commercial banks (excluding RRBs) have been advised to comply with the prudential requirements relating to financing of VCFs as indicated below :

Prudential Exposure Limits

(i) All exposures to VCFs (both registered and unregistered) will be deemed to be on par with equity and hence will be reckoned for compliance with the capital market exposure ceilings (ceiling for direct investment in equity and equity linked instruments as well as ceiling for overall capital market exposure).

(ii) Banks will not hold more than 30 per cent of the paid up capital of the investee company or 30 per cent of their own paid up share capital and reserves, whichever is lower.

(iii) Investments in VCFs in the form of equity/units etc., will also be subjected to the limits stipulated in the Reserve Bank's Master Circular on Para Banking Activities of July 1, 2005 in terms of which, the investment by a bank in a subsidiary company, financial services company, financial institution, stock and other exchanges should not exceed 10 per cent of the bank's paid-up capital and reserves and investments in all such companies, financial institutions, stock and other exchanges put together should not exceed 20 per cent of the bank's paid-up capital and reserves.

Valuation/Classification

(i) The quoted equity shares/bonds/units of VCFs in the bank's portfolio should be held under 'available for sale' (AFS) category and marked to market preferably on a daily basis, but at least on a weekly basis in line with valuation norms for other equity shares as per existing instructions.

(ii) Henceforth, banks' investments in unquoted shares/bonds/units of VCFs will be classified under held to maturity (HTM) category for the initial period of three years and will be valued at cost during this period. For investments made before issuance of these guidelines, the classification would be done as per the existing norms.

(iii) For this purpose, the period of three years will be reckoned separately for each disbursement made by the bank to VCF as and when the committed capital is called up. To ensure conformity with the existing norms for transferring securities from HTM category, transfer of all securities which have completed three years as mentioned above will be effected at the beginning of the next accounting year in one lot to coincide with the annual transfer of investments from HTM category.

(iv) After three years, the unquoted units/shares/bonds should be transferred to AFS category and valued as under:

Units

In the case of investments in the form of units, the valuation will be done at the net asset value (NAV) shown by the VCF in its financial statements. Depreciation, if any, on the units based

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on NAV has to be provided at the time of shifting the investments to AFS category from HTM category as also on subsequent valuations which should be done at quarterly or more frequent intervals based on the financial statements received from the VCF. At least once in a year, the units should be valued based on the audited results. If the audited balance sheet/financial statements showing NAV figures are not available continuously for more than 18 months as on the date of valuation, the investments should be valued at Rupee 1.00 per VCF.

Equity

In the case of investments in the form of shares, the valuation can be done at the required frequency based on the break-up value (without considering 'revaluation reserves', if any) which is to be ascertained from the company's (VCF's) latest balance sheet (which should not be more than 18 months prior to the date of valuation). Depreciation, if any, on the shares has to be provided at the time of shifting the investments to AFS category as also on subsequent valuations which should be done at quarterly or more frequent intervals. If the latest balance sheet available is more than 18 months old, the shares should be valued at Rupee 1.00 per company.

Bonds

Investments in bonds of VCFs, if any, should be valued as per prudential norms for classification, valuation and operation of investment portfolio issued by the Reserve Bank from time to time.

Risk Weight/Capital Charge for Market Risk

Shares/Units

Investments in shares/units of VCFs should be assigned 150 per cent risk weight for measuring the credit risk during the first three years when these are held under HTM category. When these are held under or transferred to AFS, the capital charge for specific risk component of the market risk should be fixed at 13.5 per cent to reflect the risk weight of 150 per cent. The charge for general market risk component should be at 9 per cent as in the case of other equities.

Bonds

Investments in bonds of VCFs will attract risk weight of 150 per cent for measuring the credit risk during the first three years when these are held under HTM category. When the bonds are held under or transferred to AFS category, these would attract specific risk capital charge of 13.5 per cent. The charge for general market risk should be computed as in the case of investment in any other kind of bonds as per existing guidelines.

VCFs other than Investments

Exposures to VCFs other than investments should also be assigned a risk weight of 150 per cent.

Exemption

Investments in unlisted and unrated bonds of VCFs will be exempted from the extant guidelines relating to non-SLR securities, in terms of which, a bank's investment in unlisted non-SLR securities should not exceed 10 per cent of its total investment in non-SLR securities as on March 31, of the previous year; and banks must not invest in unrated non-SLR securities.

Approval for Strategic Investments

Banks should obtain the Reserve Bank's prior approval for making strategic investment in VCFs i.e., investments equivalent to more than 10 per cent of the equity/unit capital of a VCF.

Internet Banking

On a review of the guidelines on Internet Banking in India, the Reserve Bank has decided to permit banks to offer Internet based foreign exchange services for permitted underlying transactions, in addition to the local currency products already allowed to be offered on Internet based platforms. Such permission is subject to the terms and conditions as follows :

(i) Banks would remain responsible for secrecy, confidentiality and integrity of data.

(ii) The data relating to Indian operations should be kept segregated.

(iii) The data should be made available to the Reserve Bank for inspection/ audit as and when called for.

(iv) The service should allow only reporting and initiation of foreign exchange related transactions, with the actual trade transactions being permitted only after verification of physical documents.

(v) Banks should comply with FEMA regulations relating to cross-border transactions.

In all other matters relating to Internet banking services, banks may continue to be guided by the instructions contained in the Reserve Bank's circular of June 14, 2001.

Appropriation from Reserve Fund

In order to ensure that banks' recourse to drawing down the 'statutory reserve' is done prudently and is not in violation of any of the regulatory prescriptions, they have been advised in their own interest to take the Reserve Bank's prior approval before any appropriation is made from the statutory reserve or any other reserves.

Banks have been further advised that -

(i) all expenses including provisions and write-offs recognised in a period, whether mandatory or prudential, should be reflected in the profit and loss account for the period as an 'above the line' item (i.e., before arriving at the net profit);

(ii) wherever draw down from reserves takes place with the Reserve Bank's prior approval, it should be effected only 'below the line' (i.e., after arriving at the profit/loss for the year); and

(iii) it should be ensured that suitable disclosures are made of such draw down of reserves in the 'Notes on Accounts' to the balance sheet.

It may be recalled that in terms of section 17 (1) and 11 (1)(b) (ii) of the Banking Regulation Act, 1949 banks are required to transfer, out of the balance of profit as disclosed in the profit and loss account, a sum equivalent to not less than 20 per cent of such profit to 'Reserve Fund'. This provision is a minimum requirement. Considering the imperative need for augmenting the reserves, all scheduled commercial banks operating in India (including foreign banks) were advised in September 2000 to transfer not less than 25 per cent of the 'net profit' (before appropriations) to the Reserve Fund with effect from the year ending March 31, 2001.

In terms of Sec 17(2), where a banking company appropriates any sum or sums from the reserve fund or the share premium account, it should, within twenty-one days from the date of such appropriation, report the fact to the Reserve Bank explaining the circumstances relating to such appropriation.

Banks' Exposure to Entities setting up SEZs

The Reserve Bank has advised all commercial banks (excluding regional rural banks) that their exposure to entities setting up special economic zones (SEZs) or acquiring units in SEZs which includes real estate, would be treated as exposure to commercial real estate sector with immediate effect. Banks would have to make provisions as also assign appropriate risk weights for such exposures as per the existing guidelines.

BRANCH BANKING

Borrowal Accounts affected by Natural Calamities

The Reserve Bank has clarified to all scheduled commercial banks that its instructions on moratorium, maximum repayment period, additional collateral for restructured loans and asset classification in respect of fresh finance will be applicable to all restructured borrowal accounts affected by natural calamities, including accounts of industries, trade and agriculture.

Further, asset classification of the restructured accounts as on the date of the natural calamity would continue if the restructuring is completed within a period of three months from the date of the natural calamity. The restructured accounts would be governed by the guidelines contained in the Reserve Bank's master circular of July 1, 2006. The guidelines applicable to 'sub-standard' accounts will apply, *mutatis mutandis*, to doubtful accounts.

FOREX

Purchase of Immovable Property by NRIs/PIOs

The Reserve Bank has clarified that the payment made by non-resident Indians (NRIs)/persons of Indian origin (PIOs) for purchasing immovable property in India other than agricultural property, plantation or a farm house, should be made out of -

(i) funds received in India through normal banking channels by way of inward remittance from any place outside India, or

(ii) funds held in any non-resident account maintained in accordance with the provisions of the Foreign Exchange Management Act, 1999 and the regulations made by the Reserve Bank.

Accordingly, such payment cannot be made either by traveller's cheque or by foreign currency notes or by any other modes besides those specified above.

ODI by Regulated Entities in the Financial Sector

The Reserve Bank has advised that now regulated entities in financial sector in India investing overseas in **any** activity will also have to comply with the conditions stipulated in Regulation 7 of FEMA notification of July 7, 2004. The conditions are indicated below :

The Indian party -

(i) should have earned net profit during the preceding three financial years from the financial services activities;

(ii) is registered with the regulatory authority in India for conducting the financial services activities;

(iii) has obtained approval from the concerned regulatory authorities both in India and abroad for venturing into such financial sector activity; and

(iv) has fulfilled the prudential norms relating to capital adequacy as prescribed by the concerned regulatory authority in India.

Earlier, entities engaged in financial services activities in India making investment in non-financial services activities overseas were not required to comply with the above conditions.

It is also clarified that trading in commodities exchanges overseas and setting up joint ventures (JV)/wholly owned subsidiaries (WOS) for trading in overseas commodities exchanges would be reckoned as financial services activity and would require clearance from the Forward Markets Commission (FMC). The FMC has recently put in place guidelines for allowing FMC registered members of commodity exchanges to undertake commodity related activities abroad. Indian entities desirous of setting up JV/WOS overseas for trading in overseas commodities exchanges may, therefore, approach the FMC for regulatory clearance.

Unregulated Indian entities engaged in financial services activities in India may invest in non-financial sector activities overseas subject to Regulation 6 of FEMA notification of July 7, 2004.

NBFCs

NBFI Business - Submission of Auditor's Certificate

In order to ensure that only those non-banking financial companies (NBFCs) which are actually engaged in the business of non-banking financial financial institution (NBFI) hold certificate of registration (CoR) from the Reserve Bank, all NBFCs, including residuary non-banking companies (RNBCs) have been advised to submit a certificate from their statutory auditors every year stating that they are engaged in the business of NBFI requiring them to hold CoR under Section 45-IA of the RBI Act, 1934. The statutory auditor's certificate should be submitted to the regional office of the Department of Non-Banking Supervision under whose jurisdiction the NBFC is registered, latest by June 30, every year with reference to the position of the company as on March 31 of that year. The first such certificate should relate to the financial year ending March 31, 2006.

In terms of Section 45-IA of the RBI Act, 1934 it is mandatory for a company to obtain CoR from the Reserve Bank before commencing or to carry on business of NBFI. It had been observed that there are NBFCs which are no longer engaged in the business of NBFI but still continue to hold the CoR even though they are not required/eligible to hold the CoR granted by the Reserve Bank.

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CUSTOMER SERVICE

Branch Details in Pass Books/Statement of Accounts

In order to improve the quality of service available to customers in branches, banks have been advised to ensure that the full address/telephone number of the branch is invariably mentioned in the pass books/statement of accounts issued to account holders.

Payment of Interest/Principal of Relief/Savings Bonds

With a view to further improving customer service to outstation investors of relief/savings bonds, it has been decided that in cases where the payment of principal/interest on relief/savings bonds is to be made payable at a centre other than the one at which the investment is held, banks should either issue a demand draft, free of cost, or an 'at par' cheque payable at all their branches.

RBI's Instructions on Customer Service

Commencing from the May 2006 issue, the Monetary and Credit Information Review has been covering the Reserve Bank's instructions useful to common bank customers. Some more instructions on customer service are reproduced below :

Operation of Accounts by Old/Incapacitated Persons

Pursuant to the difficulties faced by old/sick/incapacitated bank customers while operating their bank accounts, the Reserve Bank had, in consultation with the Indian Banks' Association issued instructions in the matter to banks in October 1998. The instructions are :

Types of sick/old/incapacitated account holders

Sick/old/incapacitated bank account holders fall into the following categories :

(a) An account holder who is too ill to sign a cheque/cannot be physically present in the bank to withdraw money from his bank account but can put his/her thumb impression on the cheque/withdrawal form.

(b) An account holder who is not only unable to be physically present in the bank but is also not able to put his/her thumb impression on the cheque/withdrawal form due to certain physical defect/incapacity.

Operational Procedure

With a view to enable the old/sick account holders to operate their bank accounts, banks should follow the procedure as indicated below -

- Wherever thumb or toe impression of the sick/old/incapacitated account holder is obtained, it should be identified by two independent witnesses known to the bank, one of them being a reasonable bank official.
- Where the customer cannot even put his/her thumb impression and also would not be able to be physically present in the bank, a mark should be obtained on the cheque/withdrawal form which should be identified by two independent witnesses, one of them being a responsible bank official.
- The customer should also be asked to indicate to the bank as to who would withdraw the amount from the bank on the basis of the cheque/withdrawal form and that person should be identified by two independent witnesses. The person who would be actually drawing the money from the bank should be asked to furnish his signature to the bank.

Cheque Drop Box Facility/Cheque Books

The Reserve Bank had in April 2004, advised all scheduled commercial banks to implement the recommendations of the Committee on Procedures and Performance Audit on Public Services (Chairman : Shri S.S.Tarapore) relating to cheque drop box facility, issue of cheque books and statement of accounts/pass books. The instructions are :

Cheque Drop Box Facility

Customers should be given the facility to either drop cheques in a box or tender them at the regular collection counters. Cheques tendered over the counter, should invariably be acknowledged.

Cheque Books

Banks should ensure that when so requested, cheque books are delivered over the counter to depositors or their authorised representative. The Committee had observed that some banks do not allow depositors to collect their cheque book at the branch and insist on despatching the cheque book by courier to the depositor. Further, the depositor is forced to sign a declaration that despatch of the cheque book through courier is at the depositor's risk and consequence and that he shall not hold the bank liable in any manner whatsoever, for such despatch. Banks are advised that such a procedure is an unfair practice and they should refrain from obtaining such undertakings from depositors.

Statement of Accounts/Pass Books

With a view to avoiding inconvenience to depositors, banks are advised to avoid inscrutable entries in passbooks/statements of account, such as, "By Clearing" or "By Cheque". Banks should ensure that brief, intelligible particulars are invariably entered in passbooks/statements of account. Banks should also adhere to the prescription of sending statement of accounts at monthly intervals.

The Committee had noted that in the case of electronic clearing system (ECS) and electronic funds transfer (EFT) banks invariably do not provide any details in passbooks/statements even though brief particulars of the remittance is provided to the receiving bank. In some cases computerised entries use sophisticated codes which cannot be deciphered.

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