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MONETARY AND CREDIT INFORMATION REVIEW

POLICY

Guidelines on Fair Practices Code for NBFCs

The Reserve Bank has issued broad guidelines on fair practices to be adopted by all non-banking financial companies (NBFCs) {including residuary non-banking companies (RNBCs)}. NBFCs have been advised to frame a fair practices code based on these guidelines and get it approved by their boards of directors. The NBFCs should publish and disseminate the fair practices code on their website, if any, for the information of the public. The broad guidelines are indicated below :

Loan Applications

- Loan application forms should include necessary information which affects the interest of the borrower, so that a meaningful comparison with the terms and conditions offered by other NBFCs can be made and informed decision can be taken by the borrower. The loan application form should indicate the documents required to be submitted with the application.
- NBFCs should devise a system of giving acknowledgement for receipt of all loan applications. Preferably, the time frame within which loan applications would be disposed off should also be indicated in the acknowledgement.
- NBFCs should convey in writing to the borrower by means of a sanction letter or otherwise, the amount of loan sanctioned along with the terms and conditions, including annualised rate of interest and the method of application. The acceptance of the terms and conditions by the borrower should be kept on record.

Disbursement of Loans

- NBFCs should give notice to the borrower of any change in the terms and conditions including disbursement schedule, interest rates, service charges, prepayment charges, etc. NBFCs should also ensure that changes in

interest rates and charges are effected only prospectively. A suitable condition in this regard should be incorporated in the loan agreement.

- Decision to recall/accelerate payment or performance under the agreement should be in consonance with the loan agreement.
- NBFCs should release all securities on repayment of all dues or on realisation of the outstanding amount of loan subject to any legitimate right or lien for any other claim NBFCs may have against the borrower. If such right of set off is to be exercised, the borrower should be given due notice with full particulars about the remaining claims and the conditions under which the NBFC is entitled to retain the securities till the relevant claim is settled/paid.

General

- NBFCs should refrain from interference in the affairs of the borrower except for the purposes provided in the terms and conditions of the loan agreement (unless new

CONTENTS

PAGE

POLICY

Guidelines on Fair Practices Code for NBFCs	1
Operational Guidelines for Bank-PDs	2
PM's 15 Point Programme for Minorities	3

UCBs

Individual Housing Loan Ceiling Enhanced	3
--	---

CUSTOMER SERVICE

Passbooks for Savings Bank Account Holders	3
--	---

INFORMATION

Amendment to the Banking Companies (Acquisition & Transfer of Undertaking) Act, 1970/1980	4
---	---

information, not earlier disclosed by the borrower, has come to the notice of the lender).

- If a borrower requests for transfer of borrowal account, the consent or otherwise i.e., objection of the NBFC, if any, should be conveyed within 21 days from the date of receipt of the request. Such transfer should be as per transparent contractual terms in consonance with law.
- As regards recovery of loans, NBFCs should not resort to undue harassment, such as, persistently bothering the borrowers at odd hours, use of muscle power, etc.

The NBFCs' board of directors should also lay down the appropriate grievance redressal mechanism within the organization to resolve disputes arising in this regard. Such a mechanism should ensure that all disputes arising out of the decisions of the lending institutions' functionaries are heard and disposed off at least at the next higher level. The board of directors should also provide for a periodical review of the compliance of the Fair Practices Code and the functioning of the grievances redressal mechanism at various levels of the management. A consolidated report of such reviews should be submitted to the board at regular intervals, as prescribed by it.

NBFCs should put in place the Fair Practices Code with the approval of their boards within one month from the issue of these guidelines. NBFCs would have the freedom of drafting the Fair Practices Code, enhancing the scope of the guidelines but in no way sacrificing the spirit underlying the guidelines.

Operational Guidelines for Bank-PDs

The Reserve Bank has issued additional guidelines to be followed by banks undertaking primary dealer (PD) business. The additional guidelines are indicated below :

Application

Banks eligible to apply for primary dealership for undertaking PD business, should approach the Reserve Bank's Department of Banking Operations & Development (DBOD) at Mumbai. On obtaining an in-principle approval from DBOD, banks may then apply to the Reserve Bank's Internal Debt Management Department at Mumbai for an authorisation for undertaking PD business departmentally.

Banks willing to undertake PD business by merging/taking over PD business from their partly/wholly owned subsidiary, or foreign banks operating in India willing to undertake PD business departmentally by merging the PD business being undertaken by group companies, will be subject to the terms and conditions, as applicable, of the undertaking given by such subsidiary/ group company till a fresh undertaking is executed by the bank.

Banks authorised to undertake PD business will be required to have a standing arrangement with the Reserve Bank based on the execution of an undertaking and the authorisation letter issued by the Reserve Bank each year (July-June).

Applicability of Guidelines

- The operational guidelines contained in the Reserve Bank's Master Circular of July 18, 2006 and other guidelines issued to PDs from time to time would also be applicable to bank-PDs.

- Bank-PDs' role and obligations in terms of supporting the primary market auctions for issue of government dated securities/treasury bills, underwriting of dated government securities, market-making in government securities and secondary market turnover of government securities will be guided by the instructions contained in the Reserve Bank's Master Circular of July 18, 2006 issued to PDs.
- Bank-PDs are expected to join the Primary Dealers' Association of India (PDAI) and the Fixed Income Money Market and Derivatives Association (FIMMDA) and abide by the code of conduct framed by them and such other actions initiated by them in the interests of the securities markets.
- The requirement of ensuring minimum investment in government securities and treasury bills on a daily basis based on net call/Reserve Bank borrowing and net owned funds will not be applicable to bank-PDs.
- As banks have access to the call money market, refinance facility and the liquidity adjustment facility of the Reserve Bank, bank-PDs will not have separate access to these facilities and liquidity support as available to the standalone PDs.
- For the purpose of "when-issued trades" bank-PDs will be treated as primary dealers.
- As regards borrowing in call/notice/term money market, inter-corporate deposits, FCNR (B) loans/external commercial borrowings and other sources of funds, bank-PDs shall be guided by the extant guidelines applicable to banks.
- Banks should suitably amend their investment policy to include PD activities also. Within the overall framework of the investment policy, the PD business undertaken by the bank will be limited to dealing, underwriting and market-making in government securities. Investments in corporate/public sector undertaking/financial institution bonds, commercial papers, certificate of deposits, debt mutual funds and other fixed income securities will not be deemed to be a part of PD business.
- The guidelines on classification, valuation and operation of investment portfolio as applicable to banks in regard to "held for trading" portfolio will also apply to the portfolio of government dated securities and treasury bills earmarked for PD business.
- Government dated securities and treasury bills under PD business will count for statutory liquidity ratio (SLR).
- As regards business through brokers, ready forward transactions, interest rate derivatives (OTC & exchange traded derivatives), investment in non-government securities, issue of subordinated debt instruments, declaration of dividends, capital adequacy and risk management, bank-PDs shall be guided by the extant guidelines applicable to banks.

Maintenance of Books/Accounts

- Banks should maintain separate books of accounts for transactions relating to PD business (distinct from normal banking business) with necessary audit trails.

- They should ensure that at any point of time there is a minimum balance of Rs.100 crore of government securities earmarked for PD business.
- Bank-PDs should subject the transactions by the PD department to concurrent audit. An auditors' certificate for having maintained the minimum stipulated balance of Rs. 100 crore of government securities in the PD-book on an ongoing basis and having adhered to the guidelines/instructions issued by the Reserve Bank should be forwarded to the Reserve Bank's Internal Debt Management Department on a quarterly basis.

Capital Adequacy and Risk Management

The capital adequacy requirement and risk management guidelines will be as per the extant guidelines applicable to banks. For the purpose of assessing the bank's capital adequacy requirement and coverage under risk management framework, banks should also take into account the PD activity. Banks undertaking PD activity may put in place adequate risk management systems to measure and provide for the risks emanating from the PD activity.

Supervision

Off-site supervision

Banks authorised to undertake PD business are required to submit prescribed periodical returns to the Reserve Bank promptly.

On-site inspection

The Reserve Bank will have the right to inspect the books, records, documents and accounts of banks. Bank-PDs are required to make available all such documents, records, etc. to the Reserve Bank's inspectors and render all necessary assistance.

The Reserve Bank reserves its right to amend or modify these guidelines from time to time, as may be considered necessary.

Besides these guidelines, bank-PDs are also required to comply with the instructions/guidelines contained in the Reserve Bank's circulars of February 27, 2006 and August 9, 2006.

PM's 15 Point Programme for Minorities

The Government of India have recently finalised a new 'Prime Minister's 15 Point Programme for the Welfare of Minorities'. An important objective of the Programme is to ensure that an appropriate percentage of the priority sector lending is targeted for the minority communities and that the benefits of the various government sponsored schemes reach the under-privileged, which includes the disadvantaged sections of the minority communities. Accordingly, the Reserve Bank has advised all scheduled commercial banks to ensure that within the overall target for priority sector lending and the sub-target of 10 per cent for the weaker sections, the minority communities also receive an equitable portion of the credit. Lead banks should keep this requirement in view while preparing district credit plans.

UCBs have also been advised to ensure that within the overall target for priority sector lending and the sub-target of 25 per cent for the weaker sections, the minority communities also receive an equitable portion of the credit.

UCBs

Individual Housing Loan Ceiling Enhanced

The Reserve Bank has decided to allow primary (urban) co-operative banks (UCBs) to extend individual housing loan up to Rs. 25 lakh per beneficiary of a dwelling unit. Housing finance to borrowers availing loans above Rs. 15 lakh will not, however, be treated as priority sector lending.

Banks may, subject to the prudential exposure ceiling and with their board's approval, extend direct housing finance repayable within a maximum period of 15 years. The earlier stipulation that the amount of installment and interest should not exceed 30 per cent of the borrower's income has now been dispensed with.

CUSTOMER SERVICE

Passbooks for Savings Bank Account Holders

The Reserve Bank has exhorted banks to invariably offer pass book facility to all their savings bank account holders (individuals). In case a bank is offering the facility of sending statement of account and a customer chooses to get statement of account, the bank must issue the statement of accounts on monthly basis. Further, banks have also been advised not to charge cost of providing such pass book or statements to the customer.

The Reserve Bank had been receiving representations from customers, including senior citizens' associations, that many banks have unilaterally discontinued issuing pass books to savings bank account holders (individuals) causing much inconvenience to the account holders. It was also brought to the notice of the Reserve Bank that banks are issuing statement of account to savings bank account holders at quarterly intervals instead of at monthly intervals.

The Reserve Bank has further reiterated that a passbook, besides being handy and compact, is a ready reckoner of transactions and is, therefore, far more convenient to the small customer than a statement of account. Use of statements has some inherent difficulties viz., (a) they need to be filed regularly; (b) the opening balance needs to be tallied with the closing balance of the last statement; (c) loss of statements in postal transit is common and obtaining duplicate statements involves expense and inconvenience; (d) ATM slips during the interregnum between two statements do not provide a satisfactory solution as full record of transactions is not available; and (e) there are a large number of small customers who do not have access to computers/internet. As such, non-issuance of pass-books to such small customers would indirectly lead to their financial exclusion.

INFORMATION**Amendment to the Banking Companies (Acquisition & Transfer of Undertaking) Act, 1970/1980**

The Bill for amending the Banking Companies (Acquisition & Transfer of Undertaking) Act, 1970/1980 was passed by the Parliament and came into effect from September 25, 2006. The following paragraphs describe, in simple terms, the changes brought about in the Act by this amendment.

Composition of Banks' Boards

- The number of whole-time directors increased from two to four to have more functional directors in view of expansion of activities of nationalised banks.
- The director to be nominated by the Reserve Bank will be a person possessing necessary experience and expertise in regulation or supervision of commercial banks instead of an officer of the Reserve Bank.
- Removal of nominee directors from the Securities and Exchange Board of India, the National Bank for Agriculture and Rural Development and Public Financial Institutions.
- Nomination of one to three shareholder directors on the Board on the basis of percentage of shareholding instead of one to six directors as per existing provision so as to provide for a more equitable representation on the basis of percentage of ownership. As a result, there will be a maximum of three elected directors in nationalised banks.
- Elected directors will be persons having fit and proper status as per the criteria notified by the Reserve Bank from time to time.

Additional Directors

The Reserve Bank is empowered to appoint one or more additional directors, if found necessary, in the interest of banking policy/public interest/interest of the bank or the depositors.

Capital

- Nationalised banks will be able to raise capital by preferential allotment or private placement or public issue in accordance with the procedure as may be specified by regulation with the previous approval of the central government and after consultation with the Reserve Bank.
- Nationalised banks will be able to issue preference shares in accordance with the guidelines framed by the Reserve Bank.
- The central government will hold at all times not less than 51 per cent of the paid-up capital consisting of equity shares.

- The voting rights of preference shares of nationalised banks are restricted only to resolutions directly affecting their rights and also restrict the preference shareholder to exercise voting rights in respect of preference shares held by him to a ceiling of 1 per cent of total voting rights of all the shareholders holding preference share capital only.

Balance Sheet to be approved

The shareholders are empowered to discuss, adopt and approve the Directors' report, the annual accounts and the balance sheet at the annual general meeting

Transfer of Unclaimed Dividends

Nationalised banks will be required to transfer the dividends unclaimed for more than seven years to Investor Education and Protection Fund established under section 205c of the Companies Act, 1956.

Supersession of the Board

- The central government is empowered to supersede the Board of Directors. This can be done on the recommendation of the Reserve Bank.
- Supersession is to be made only –
 - (a) in public interest, or
 - (b) for preventing the affairs of the bank being conducted in a manner detrimental to the interest of the depositors or the bank, or
 - (c) for securing the proper management of the nationalised bank.
- The central government will appoint an Administrator and a Committee of three or more members having experience in law, finance, banking, economics or accountancy in consultation with Reserve Bank to assist him in the discharge of his duties.
- Supersession will be for a period not exceeding 6 months which may be extended up to a maximum of one year.

Non-official Directors

The State Bank of India Act, 1955, State Bank of India (Subsidiary Banks) Act, 1959, the DICGC Act, 1961, the Exim Bank Act, 1981 and the NHB Act, 1987 provide that the part-time directors shall hold office for a period of three years or until a successor is appointed subject to a maximum period of six years. Since a large number of part-time non-official directors in banks and financial institutions continue to hold office even after expiry of their term as their successor is not appointed in time, amendments are made in these acts so that such non-official directors will vacate their office whether their successor is appointed or not. This is in lines of the provisions for part-time non-official directors in nationalised banks. For the workmen and officer directors, the existing provisions will continue.