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**MONETARY AND CREDIT  
INFORMATION REVIEW**

**POLICY**

**Guidelines on Outsourcing of Financial Services by Banks**

In view of the extensive use of outsourcing by banks, the Reserve Bank had issued draft guidelines in December 2005 for laying down a framework for managing the attendant risks in outsourcing. On the basis of the suggestions received from all concerned, the draft guidelines have been suitably modified. The Reserve Bank has advised all scheduled commercial banks desiring to outsource a financial services activity, to put in place necessary safeguards for addressing the risks inherent in such outsourcing as detailed in the below guidelines -

**Activities that can be Outsourced**

Typically outsourced financial services include application processing (loan origination, credit card), document processing, marketing and research, supervision of loans, data processing and back office related activities, etc. In regard to outsourced services relating to credit cards, the Reserve Bank's detailed instructions contained in its circular of November 2005 would be applicable.

**Activities not permitted to be Outsourced**

Banks should not outsource core management functions including internal audit, compliance and decision-making functions like determining compliance with 'know your customer' norms for opening deposit accounts, according sanction for loans (including retail loans) and management of investment portfolio.

**Outsourcing Policy**

A bank intending to outsource any of its financial activities should put in place a comprehensive outsourcing policy, approved by its board. The policy should incorporate, *inter alia*, criteria for selection of such activities as well as service providers, parameters for defining material outsourcing, delegation of authority depending on risks and materiality and systems to monitor and review the operations of these activities.

**Bank's Role**

- Banks would be responsible for the actions of their service provider including direct sales agents (DSAs)/direct

marketing agents (DMAs)/recovery agents and confidentiality of the information pertaining to the customers that is available with the service provider. Banks should retain ultimate control of the outsourced activity.

- Banks, when performing due diligence in relation to outsourcing, should consider all relevant laws, regulations, guidelines and conditions of approval, licensing or registration.
- Outsourcing arrangements should not affect the rights of a customer against the bank, including the ability of the customer to obtain redress as applicable under relevant laws.
- Outsourcing, whether the service provider is located in India or abroad should not impede or interfere with the ability of the bank to effectively oversee and manage its activities nor should it impede the Reserve Bank in carrying out its supervisory functions and objectives.
- The service provider if it is not a subsidiary of the bank, should not be owned or controlled by any director or officer/employee of the bank or their relatives.

**Senior Management's Responsibility**

The bank's senior management would be responsible for-

- Evaluating the risks and materiality of all existing and prospective outsourcing based on the framework approved by the board.

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- Developing and implementing sound and prudent outsourcing policies and procedures commensurate with the nature, scope and complexity of the outsourcing.
- Reviewing periodically the effectiveness of policies and procedures.
- Communicating information pertaining to material outsourcing risks to the Board in a timely manner.
- Ensuring that contingency plans based on realistic and probable disruptive scenarios are in place and tested.
- Ensuring that there is independent review and audit for compliance with set policies.
- Undertaking periodic review of outsourcing arrangements to identify new material outsourcing risks as they arise.

### Evaluating the Service Provider

In considering or renewing an outsourcing arrangement, due diligence should be performed to assess the capability of the service provider to comply with the obligations in the outsourcing agreement. Due diligence should involve an evaluation of all available information about the service provider, including but not limited to -

- Past experience and competence to implement and support the proposed activity over the contracted period.
- Financial soundness and ability to service commitments even under adverse conditions.
- Business reputation and culture, compliance, complaints and outstanding/potential litigation.
- Security and internal control, audit coverage, reporting and monitoring environment and business continuity management.
- External factors like political, economic, social and legal environment of the jurisdiction in which the service provider operates and other events that may impact performance of service.
- Due diligence by service provider of its employees.

### Outsourcing Agreement

The terms and conditions governing the contract between the bank and the service provider should be carefully defined in written agreements and vetted by bank's legal counsel on their legal effect and enforceability. The contract should -

- clearly define what activities are going to be outsourced including appropriate service and performance standards;
- enable the bank to have access to all books, records and information relevant to the outsourced activity available with the service provider;
- provide for continuous monitoring and assessment by the bank of the service provider so that any necessary corrective measure can be taken immediately;
- include a termination clause and minimum periods to execute a termination provision, if deemed necessary;
- provide for controls to ensure customer data confidentiality and service provider's liability in case of breach of security and leakage of confidential customer related information;
- contain contingency plans to ensure business continuity;

- provide for the prior approval/consent of the bank for the use of subcontractors by the service provider for all or part of an outsourced activity;
- provide the bank with the right to conduct audits on the service provider whether by its internal or external auditors or by agents appointed to act on its behalf and to obtain copies of any audit or review reports and findings made on the service provider in conjunction with the services performed for the bank;
- include clauses to allow the Reserve Bank or persons authorised by it to access the bank's documents, records of transactions and other necessary information given to, stored or processed by the service provider within a reasonable time;
- include a clause to recognise the Reserve Bank's right to inspect the books and accounts of the service provider of a bank by one or more of its officers or employees or other persons;
- in cases where the controlling/head offices of foreign banks operating in India outsource the activities relating to their Indian operations, the agreement should include clauses to allow the Reserve Bank or persons authorized by it to access the bank's documents, records of transactions and other necessary information given or stored or processed by the service provider within a reasonable time. Such agreements should also include clauses to recognise the Reserve Bank's right to inspect the books and accounts of the service provider by one or more of its officers or employees or other persons;
- provide that confidentiality of customers' information should be maintained even after the contract expires or gets terminated; and
- provide for the preservation of documents and data by the service provider in accordance with the legal/regulatory obligation of the bank.

### Responsibilities of DSAs/DMAs/Recovery Agents

Banks could use the code of conduct for DSAs formulated by the Indian Banks' Association (IBA) in formulating their own codes for DSAs/DMAs/recovery agents. Banks should ensure that the DSAs/DMAs/recovery agents are properly trained to handle with care and sensitivity, their responsibilities, particularly aspects like soliciting customers, hours of calling, privacy of customer information and conveying the correct terms and conditions of the products on offer.

Recovery agents should adhere to the Reserve Bank's instructions on Fair Practices Code for Lending as also their own code for collection of dues. The recovery agents should refrain from action that could damage the integrity and reputation of the bank and should observe strict customer confidentiality.

Banks and their agents should not resort to intimidation or harassment of any kind, either verbal or physical, against any person in their debt collection efforts, including acts intended to humiliate publicly or intrude the privacy of the debtors' family members, referees and friends, making threatening and anonymous calls or making false and misleading representations.

### Business Continuity/Disaster Recovery Plan

- Banks should ensure that their service providers develop and establish a robust framework for documenting, maintaining and testing business continuity and recovery procedures.
- In establishing a viable contingency plan, banks should consider the availability of alternate service providers or the possibility of bringing the outsourced activity back in-house in an emergency and the costs, time and resources that would be involved.

### Grievance Redressal

- (i) Banks should constitute a grievance redressal machinery within the bank and give wide publicity about it through electronic and print media. The name and contact number of the bank's designated grievance redressal officer should be made known and widely publicised. It should be clearly indicated that bank's grievance redressal machinery will also deal with the services provided by the outsourced agency.
- (ii) Generally, a time limit of 30 days should be given to customers for preferring their complaints/grievances. If a complainant does not get a satisfactory response from the bank within 60 days from the date of his lodging the complaint, he will have the option to approach the office of the concerned Banking Ombudsman for redressal of his grievance/s.

These guidelines are not applicable to technology related issues and activities not related to banking services like usage of courier, catering of staff, housekeeping and janitorial services, security of the premises, movement and archiving of records, etc.

Audit-related assignments to chartered accountant firms will continue to be governed by the instructions/policy laid down by the Reserve Bank's Department of Banking Supervision.

Banks which desire to outsource financial services would not require the Reserve Bank's prior approval whether the service provider is located in India or outside India.

### Delhi High Court Directions on Housing Loans

Pursuant to the directions given by the Hon'ble High Court of Delhi during the hearing of a Writ Petition, the Monitoring Committee constituted by the Delhi High Court regarding unauthorised construction, misuse of properties and encroachment on public land, has advised banks/financial Institutions (FIs) to comply with certain instructions while sanctioning housing loans. The instructions are :

#### Building Construction

- i) In cases where the applicant owns a plot/land and approaches a bank/FI for a credit facility to construct a house, banks/FIs should obtain a copy of the sanctioned building plan by the competent authority, in the name of the person applying for such credit facility, before sanctioning the home loan.
- ii) Banks should obtain an affidavit-cum-undertaking from the person applying for housing loan stating that, he will not

violate the sanctioned plan, construction would be strictly as per the sanctioned plan and it would be the sole responsibility of the executant to obtain a completion certificate within 3 months of completion of the construction, failing which the bank would have the power and the authority to recall the entire loan with interest, costs and other usual bank charges.

- iii) An architect appointed by the bank should also certify at various stages that the construction of the building is strictly as per the sanctioned plan. The architect should also certify at a particular point of time that the completion certificate of the building issued by the competent authority has been obtained.

#### Purchase of Constructed/Built up Property

- i) In cases where an applicant approaches a bank/FI for a credit facility to purchase a built up house/flat, it would be mandatory for him to declare by way of an affidavit-cum-undertaking that the built up property has been constructed as per the sanctioned plan and/or building bye-laws and as far as possible has a completion certificate also.
- ii) An architect appointed by the bank must also certify before disbursement of the housing loan that the built up property is strictly as per the sanctioned plan and/or building bye-laws.

Further, banks/FIs have been advised not to give loans in respect of those properties which fall in the category of unauthorised colonies unless and until they have been regularised and the development and other charges have been paid. Loans should also not be given in respect of properties meant for residential use but which the applicant intends to use for commercial purposes and declares so while applying for loan.

### FEMA

#### Bank Guarantee on behalf of Service Importers

With a view to further liberalise the procedure for import of services, AD Category-I banks have now been permitted to issue guarantee on behalf of their customers importing services, provided :

- the guarantee amount does not exceed USD 100,000;
- the bonafides of the transaction are found to be satisfactory;
- the documentary evidence for import of services is submitted in normal course; and
- the guarantee is to secure a direct contractual liability arising out of a contract between a resident and a non-resident.

#### Ceiling on Overseas Investment by Mutual Funds Enhanced

With a view to providing greater opportunity to invest overseas, the aggregate ceiling on overseas investments by mutual funds, registered with the Securities and Exchange Board of India (SEBI), has been increased from USD 2 billion to USD 3 billion with immediate effect. All other terms and conditions and operational guidelines as issued by SEBI would remain unchanged.

## Mid-term Review of Annual Policy for 2006-07 : Highlights

*In a meeting with chief executives of major commercial banks on October 31, 2006, Dr. Y. Venugopal Reddy, Governor, presented the Mid-term Review of the Annual Policy for the Year 2006-07. The highlights are :*

### Stance

Barring the emergence of any adverse and unexpected developments in various sectors of the economy and keeping in view the current assessment of the economy including the outlook for inflation, the overall stance of the monetary policy in the period ahead will be :

- To ensure a monetary and interest rate environment that supports export and investment demand in the economy so as to enable continuation of the growth momentum while reinforcing price stability with a view to anchoring inflation expectations.
- To maintain the emphasis on macroeconomic and, in particular, financial stability.
- To consider promptly all possible measures as appropriate to the evolving global and domestic situation.

### Monetary Measures

- Repo rate increased to 7.25 per cent from 7.0 per cent.
- The flexibility to conduct overnight repo or longer term repo including the right to accept or reject tender(s) under the LAF, wholly or partially retained.
- Reverse repo rate, bank rate and CRR kept unchanged.
- 'When issued' trading to be extended to fresh issues of central government securities.
- Scheduled commercial banks and primary dealers to be allowed to cover their short positions in central government securities within an extended period of five trading days.
- Resident individuals would be free to remit up to US \$ 50,000 per financial year as against the earlier limit of US \$ 25,000.
- Foreign exchange earners may retain up to 100 per cent of their foreign exchange earnings in their exchange earners' foreign currency accounts.
- Authorised dealer (AD) banks permitted to borrow funds from their overseas branches and correspondent banks (including borrowing for export credit, external commercial borrowings (ECBs) and overdrafts from their head office/nostro account) up to a limit of 50 per cent of their unimpaired Tier I capital or US \$ 10 million, whichever is higher.
- Borrowers eligible for accessing ECBs can avail of an additional US \$ 250 million with average maturity of more than 10 years under the approval route.
- Prepayment of ECB up to US \$ 300 million without the Reserve Bank's prior approval.
- AD banks permitted to allow remittances on behalf of their customers up to 15 per cent of the average annual sales/

income or turnover during the last two financial years or up to 25 per cent of their net worth, whichever is higher, for initial expenses, and remittances up to 10 per cent of the average annual sales/income or turnover during the last two financial years for recurring expenses. They may also permit remittances for acquisition of immovable property for the overseas office, within these limits.

- The existing limit of US \$ 2 billion on investments in government securities by foreign institutional investors (FIIs) to be enhanced in phases to US \$ 3.2 billion by March 31, 2007.
- The extant ceiling of overseas investment by mutual funds of US \$ 2 billion enhanced to US \$ 3 billion.
- Importers to be permitted to book forward contracts for their customs duty component of imports.
- FIIs to be allowed to rebook a part of the cancelled forward contracts.
- Forward contracts booked by exporters and importers in excess of 50 per cent of the eligible limit to be on deliverable basis and cannot be cancelled.
- AD banks to be permitted to issue guarantees/letters of credit for import of services up to US \$ 100,000 for securing a direct contractual liability arising out of a contract between a resident and a non-resident.
- Lock-in period for sale proceeds of immovable property credited to the NRO account eliminated, provided the amount being remitted in any financial year does not exceed US \$ one million.
- Banks, with approval of their boards, may formulate a transparent policy for providing one time settlement facility to those farmers whose accounts have been rescheduled/restructured due to natural calamities as also those who have defaulted on account of circumstances beyond their control.
- For opening small accounts, banks need to seek only a photograph of the account holder and self-certification of address.
- Indian banks having presence outside India and foreign banks to migrate to the Basel II framework effective March 31, 2008 and other scheduled commercial banks to migrate in alignment but not later than March 31, 2009.
- Prudential limit on credit and non-credit facilities to Indian joint ventures/wholly owned subsidiaries abroad enhanced to 20 per cent of unimpaired capital funds.
- Financially sound urban co-operative banks (UCBs) registered in states that have signed MoU with the Reserve Bank and those registered under the Multi-State Co-operative Societies Act, 2002 allowed to convert existing extension counters into full-fledged branches.
- Non-banking financial companies (NBFCs) to be allowed to issue co-branded credit cards with banks without risk sharing and to market and distribute mutual fund products.