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MONETARY AND CREDIT INFORMATION REVIEW

POLICY

Banks' Exposure to Capital Markets

The Reserve Bank has revised the guidelines on banks' exposure to capital markets. The modified guidelines, which will come into effect from April 1, 2007, are -

Components

Banks' capital market exposures would include both their direct exposures and indirect exposures. Aggregate exposure (both fund and non-fund based) of banks to capital markets in all forms would include -

i) direct investment in equity shares, convertible bonds, convertible debentures and units of equity-oriented mutual funds, the corpus of which, is not exclusively invested in corporate debt;

ii) advances against shares/bonds/debentures or other securities or on clean basis to individuals for investment in shares (including initial public offerings {IPOs}/ employees' stock option plans {ESOPs}), convertible bonds, convertible debentures and units of equity-oriented mutual funds;

iii) advances for any other purposes where shares or convertible bonds or convertible debentures or units of equity oriented mutual funds are taken as primary security;

iv) advances for any other purposes to the extent secured by the collateral security of shares or convertible bonds or convertible debentures or units of equity oriented mutual funds i.e., where the primary security other than shares/ convertible bonds/convertible debentures/units of equity oriented mutual funds does not fully cover the advances;

v) secured and unsecured advances to stockbrokers and guarantees issued on behalf of stockbrokers and market makers;

vi) loans sanctioned to corporates against the security of shares/bonds/debentures or other securities or on clean basis for meeting promoter's contribution to the equity of new companies in anticipation of raising resources;

vii) bridge loans to companies against expected equity flows/ issues;

viii) underwriting commitments taken up by banks in respect of primary issue of shares or convertible bonds or convertible debentures or units of equity oriented mutual funds;

ix) financing to stockbrokers for margin trading; and

x) all exposures to venture capital funds (VCFs) (both registered and unregistered).

Exposure Limits

Solo Basis

The aggregate exposure of a bank to the capital markets in all forms (both fund based and non-fund based) should not exceed 40 per cent of its net worth as on March 31 of the previous year. Within this overall ceiling, the bank's direct investment in shares, convertible bonds/debentures, units of equity-oriented mutual funds and all exposures to VCFs (both registered and unregistered) should not exceed 20 per cent of its net worth.

Consolidated Basis

The aggregate exposure of a consolidated bank to capital markets (both fund based and non-fund based) should not exceed 40 per cent of its consolidated net worth as on March 31 of the previous year. Within this overall ceiling, the aggregate direct exposure by way of the consolidated bank's investment in shares, convertible bonds/debentures, units of equity-oriented mutual funds and all exposures to VCFs (both registered and unregistered) should not exceed 20 per cent of its consolidated net worth.

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Excluded Items

The items to be excluded from the aggregate exposure ceiling of 40 per cent of networth and direct investment exposure ceiling of 20 per cent of networth (wherever applicable) are -

i) Banks' investments in own subsidiaries, joint ventures, sponsored regional rural banks (RRBs) and investments in shares and convertible debentures, convertible bonds issued by institutions forming crucial financial infrastructure, such as, National Securities Depository Ltd. (NSDL), Central Depository Services (India) Ltd. (CDSL), National Securities Clearing Corporation Ltd. (NSCCL), National Stock Exchange (NSE), Clearing Corporation of India Ltd., (CCIL), Credit Information Bureau of India Ltd. (CIBIL), Multi Commodity Exchange Ltd. (MCX), National Commodity and Derivatives Exchange Ltd. (NCDEX), National Multi-Commodity Exchange of India Ltd. (NMCEIL), National Collateral Management Services Ltd. (NCMSL) and other all india financial institutions. After listing, the exposures in excess of the original investment (i.e., prior to listing) would form part of the capital market exposure;

ii) Tier I and tier II debt instruments issued by other banks;

iii) Investment in certificates of deposit (CDs) of other banks;

iv) Preference shares;

v) Non-convertible debentures and non-convertible bonds;

vi) Units of mutual funds under schemes where the corpus is invested exclusively in debt instruments;

vii) Shares acquired by banks as a result of conversion of debt/overdue interest into equity under corporate debt restructuring (CDR) mechanism; and

viii) Term loans sanctioned to Indian promoters for acquisition of equity in overseas joint ventures/wholly owned subsidiaries under the refinance scheme of the Export Import Bank of India.

Computation

For computing the exposure to the capital markets, loans/ advances sanctioned and guarantees issued for capital market operations should be reckoned with reference to sanctioned limits or outstanding, whichever is higher. In the case of fully drawn term loans where there is no scope for re-drawal of any portion of the sanctioned limit, banks may, however, reckon the outstanding as the exposure. Further, banks' direct investment in shares, convertible bonds, convertible debentures and units of equity oriented mutual funds would be calculated at their cost price.

Loans/Advances against Shares

To Individuals

Loans against security of shares, convertible bonds, convertible debentures and units of equity oriented mutual funds to individuals from the banking system should not exceed the limit of Rs.10 lakh per individual if the securities are held in physical form and Rs. 20 lakh per individual if the securities are held in demat form. Loans/advances to any individual from the banking system against security of shares, convertible bonds, convertible debentures, units of equity oriented mutual funds and public sector undertaking (PSU) bonds should not exceed the limit of Rs.10 lakh for subscribing to IPOs. Banks may extend finance to employees for purchasing shares of their own companies under ESOP to the extent of 90 per cent of the purchase price of the shares or Rs. 20 lakh, whichever is lower. These instructions would, however, not be applicable to banks extending financial assistance to their own employees for acquisition of shares under ESOPs/IPOs. Banks should, therefore, not extend advances including to their employees/ employee trusts set up by them for the purpose of purchasing their (banks') own shares under ESOP/IPO or from the secondary market. This prohibition will apply irrespective of whether the advances are unsecured or secured.

Banks should obtain a declaration from the borrower indicating the details of loans/advances availed against shares and other securities specified above, from any other bank/s in order to ensure compliance with the ceilings prescribed for the purpose.

To Stockbrokers and Market Makers

Banks are free to provide credit facilities to stockbrokers and market makers on the basis of their commercial judgment, within the policy framework approved by their boards. In order to avoid any nexus emerging between inter-connected stock broking entities and banks, the board of each bank should fix within the overall ceiling of 40 per cent of its net worth as on March 31 of the previous year, a sub-ceiling for total advances to –

(a) all the stockbrokers and market makers (both fund based and non-fund based, i.e. , guarantees); and

(b) any single stock broking entity, including its associates/ inter-connected companies.

Further, banks should not extend credit facilities directly or indirectly to stockbrokers for arbitrage operations in stock exchanges.

Advances against Shares held Jointly

While granting advances against shares held in joint names to joint holders or third party beneficiaries, banks should be circumspect and ensure that the objective of the regulation is not defeated by granting advances to other joint holders or third party beneficiaries to circumvent the limits placed on loans/ advances against shares and other securities specified above.

Margin on Advances

A uniform margin of 50 per cent should be applied on all advances/financing of IPOs/issue of guarantees for capital market operations. A minimum cash margin of 25 per cent (within the margin of 50 per cent) should be maintained for guarantees issued by banks for capital market operations.

Investments in VCFs

Banks' exposures to VCFs (both registered and unregistered) would be deemed to be on par with equity and hence would be reckoned for compliance with the capital market exposure ceilings (both direct and indirect).

Empanelment of Valuers for Valuation of Properties

The Reserve Bank has advised banks that while formulating a policy on valuation of properties and appointment of valuers, they may be guided by the aspects indicated below:

Valuation of Properties

i) Banks should have a board approved policy in place for valuation of properties including collaterals accepted for their exposures.

ii) The valuation should be done by professionally qualified independent valuers. The valuer should not have a direct or indirect interest.

iii) Banks should obtain minimum two independent valuation reports for properties valued at Rs.50 crore or above.

Revaluation of Bank's Own Properties

While formulating a policy for revaluation of their own properties, banks may keep the following aspects in view in addition to those indicated above:

i) As the extant guidelines on capital adequacy permit banks to include revaluation reserves at a discount of 55 per cent as a part of tier II capital, it is necessary that revaluation reserves represent true appreciation in the market value of the properties and banks have in place a comprehensive policy for revaluation of fixed assets owned by them. Such a policy should *inter alia* cover procedure for identification of assets for revaluation, maintenance of separate set of records for such assets, frequency of revaluation, depreciation policy, policy for sale of such revalued assets, etc. The policy should also cover the disclosure required to be made in the 'notes on account' regarding the details of revaluation, such as, the original cost of the fixed assets subject to revaluation and accounting treatment for appreciation/depreciation, etc.

ii) As the revaluation should reflect the change in the fair value of the fixed asset, the frequency of revaluation should be determined based on the observed volatility in the prices of the assets in the past. Further, any change in the method of depreciation should reflect the change in the expected pattern of consumption of the future economic benefits of the assets. Banks should adhere to these principles meticulously while changing the frequency of revaluation/method of depreciation for a particular class of asset and should make proper disclosures in this regard.

Empanelment of Independent Valuers

i) Banks should have a procedure for empanelment of professional valuers and maintain a register of 'approved list of valuers'.

ii) Banks should prescribe a minimum qualification for empanelment of valuers. While prescribing the qualification, banks should take into consideration the qualifications prescribed under Section 34AB (Rule 8A) of the Wealth Tax Act, 1957. Different qualifications may be prescribed for different classes of assets (e.g. land and building, plant and machinery, agricultural land, etc.).

Banks have also been advised to be guided by the relevant Accounting Standard issued by the Institute of Chartered Accountants of India.

NBFCs

NBFCs - Co-branded Credit Cards/MF Product Distribution

In order to strengthen the non-banking financial companies (NBFC) sector by allowing diversification of their area of business, it has been decided to allow NBFCs, selectively, to issue co-branded credit cards with scheduled commercial banks as well as to market and distribute mutual fund (MF) products as agents of mutual funds. NBFCs are permitted to undertake these activities without risk sharing, with the Reserve Bank's prior approval, for an initial period of two years and a review thereafter. NBFCs fulfilling the following minimum requirements are eligible to apply:

- Minimum net owned fund of Rs.100 crore.
- The company should have made net profit as per last two years audited balance sheet.
- The percentage of net non-performing assets (NPAs) to net advances as per the last audited balance sheet should not be more than 3 per cent.
- Non-deposit-taking NBFCs (NBFCs-ND) should have capital to risk weighted assets ratio (CRAR) of 10 per cent and deposit-taking NBFCs (NBFCs-D) should have CRAR of 12 per cent or 15 per cent, as applicable to the company.

NBFCs would also be required to adhere to additional stipulations as follows :

Operational Aspects

Issue of Co-branded Credit Cards

a) The NBFC's role under the tie-up arrangement should be limited only to marketing and distribution of co-branded credit cards. The co-branded credit card issuing bank would be subject to all the instructions/guidelines issued by its concerned regulatory authority.

b) The co-branded credit card issuing bank would be solely responsible for fulfillment of 'know your customer' (KYC) requirements in respect of all co-branded cards issued under the tie-up arrangement.

c) Risks, if any, involved in the co-branded credit cards business should not get transferred to the NBFC's business.

d) The co-branded credit card account should be maintained by the customer with the bank and all the payments by the co-branded card holders should be in the name of the bank; account, if any, maintained by the user with the NBFC should not be debited for settlement of dues arising out of the co-branded credit card.

e) NBFCs entering into tie-up should ensure confidentiality of the customer's accounts. The NBFC should not reveal any information relating to customers obtained at the time of opening the account and should also not permit the co-branded credit card issuing bank to access any details of customers' accounts that may violate NBFCs ' secrecy obligations.

f) The card issuing bank should put in place a suitable mechanism for the redressal of customer grievances. Customer complaints arising out of deficiency in the credit card service would be the bank's responsibility.

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g) Legal risk, if any, arising out of court cases, damages, etc., should be borne by the issuing bank.

Distribution of Mutual Fund Products

a) NBFCs should comply with the Securities and Exchange Board of India (SEBI) guidelines/regulations, including their code of conduct, for distribution of mutual fund products.

b) NBFCs should not adopt any restrictive practice of forcing their customers to go in for a particular MF product sponsored by it. The customers should be allowed to exercise their own choice.

c) The participation of a company's customer in mutual fund products is purely on a voluntary basis and this information should be stated in all publicity material distributed by the company in a prominent way. There should be no 'linkage' either direct or indirect between the provision of financial services offered by the company to its customers and distribution of the MF products.

d) NBFCs should only act as agents of their customers, forwarding the investors' applications for purchase/sale of MF units together with the payment instruments to the MF/ registrars/transfer agents. The purchase of units should be at the customers' risk without the company guaranteeing any assured return.

e) The company should neither acquire units of MFs from the secondary market for sale to customers, nor should it buy back units of MFs from their customers.

f) In case an NBFC is holding custody of MF units on behalf of its customers, it should ensure that it's own investments and the investments belonging to it's customers are kept distinct from each other.

g) The risks, if any, involved in mutual fund agency business should not get transferred to the NBFC's business.

Other Aspects

NBFCs should –

- Put in place guidelines on fair practices code.
- Adhere to KYC guidelines and the provisions of prevention of Money Laundering Act.
- Comply with Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 and/or Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998, any other instructions and provisions of RBI Act, 1934 to the extent applicable to the NBFC concerned.
- Comply with other terms and conditions as the Reserve Bank may specify in this behalf from time to time.

NBFCs have been further advised that the permission to undertake these activities is liable to be withdrawn with a notice period of 3 months in the event of any undesirable/unhealthy operations coming to the notice of the Reserve Bank.

FOREX

Liberalisations in Project and Service Exports

With a view to simplifying the procedures and providing greater flexibility to project exporters and exporters of services in conducting their overseas transactions, the guidelines in this regard have been modified. The revised guidelines are -

Inter-Project Transfer of Machinery

On completion of turnkey/construction contracts abroad, in case the equipment, machinery, etc., is used for another overseas project, now it is not necessary to recover the market value (not less than book value) from the transferee project. Further, exporters can use the machinery/equipment for performing any other contract secured by them in any country subject to the satisfaction of the sponsoring authorised dealer category - I bank(s)/Exim Bank/ working group.

Inter-Project Transfer of Funds

Henceforth, AD Category - I bank(s)/Exim Bank/working group can permit exporters to open, maintain and operate one or more foreign currency account/s in a currency/currencies of their choice with inter-project transferability of funds in any currency or country.

Deployment of Temporary Cash Surpluses

Project/service exporters now need not approach the Reserve Bank for overseas deployment of their temporary cash surpluses. They can now deploy their temporary cash surpluses, generated outside India, in the instruments/products indicated below :

(a) Investments in short-term paper abroad including treasury bills and other monetary instruments with a maturity or remaining maturity of one year or less, the rating of which, should be at least A-1/AAA by Standard & Poor or P-1/Aaa by Moody's or F1/AAA by Fitch IBCA etc.

(b) Deposits with branches/subsidiaries outside India of an AD category - I bank in India.

FDI in Infrastructure Companies in Securities Markets

It has been decided in consultation with the Government of India to allow foreign investment in infrastructure companies in securities markets, namely, stock exchanges, depositories and clearing corporations, in compliance with SEBI regulations and subject to the conditions as follows :

(i) Foreign investment up to 49 per cent will be allowed in these companies with a separate foreign direct investment (FDI) cap of 26 per cent and foreign institutional investment (FII) cap of 23 per cent;

(ii) FDI will be allowed with the specific approval of the Foreign Investment Promotion Board (FIPB); and

(iii) FII will be allowed only through purchases in the secondary market.

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