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MONETARY AND CREDIT INFORMATION REVIEW

BANKING POLICY

Greater Transparency in Processing Loan Applications

With a view to achieving greater transparency in loan processing, the Reserve Bank has advised all scheduled commercial banks and all India financial institutions (FIs) that loan application forms in respect of all categories of loans, irrespective of the amount of loan sought by the borrower, should be comprehensive and should include information about the fees/charges, if any, payable for processing, the amount of such fees refundable if the application is not accepted, pre-payment options and any other matter which affects the interest of the borrower. This would enable the borrower to make a meaningful comparison with that of other banks and take an informed decision. Banks/FIs have been advised to work out a transparent policy in this regard with their board's approval.

Further, in respect of all categories of loans, including credit card applications, irrespective of any threshold limits, if the loan application has been rejected, banks/FIs should convey in writing the main reason/reasons which, in their opinion led to the rejection.

Banks/FIs have been advised to make necessary modifications in the Fair Practices Code by April 30, 2007 with their board's approval. The modified Fair Practices Code should be placed on their website and given wide publicity.

Prudential Limits for Inter-Bank Liabilities

In order to reduce the extent of banks' concentration on the liability side, the Reserve Bank has prescribed measures as follows:

(a) The inter-bank liability (IBL) of a bank should not exceed 200 per cent of its networth as on March 31 of the previous year. Individual banks may, however, with the approval of their board of directors, fix a lower limit for their inter-bank liabilities, keeping in view their business model.

(b) Banks whose capital to risk weighted assets ratio (CRAR) is at least 25 per cent more than the minimum CRAR (9 per cent) i.e. 11.25 per cent as on March 31 of the previous year, are allowed to have a higher limit of up to 300 per cent of the net worth for IBL.

(c) These limits would include only fund based IBL within India (including inter-bank liabilities in foreign currency to banks operating within India). In other words, the IBL outside India are excluded.

(d) The above limits would not include collateralised borrowings under collateralised borrowing and lending operations (CBLO) and refinance from National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI) etc.

(e) The existing limit on the call money borrowings prescribed by the Reserve Bank would operate as a sub-limit within the above limits.

(f) Banks having high concentration of wholesale deposits should be aware of the potential risk associated with such deposits and should frame suitable policies to contain the liquidity risk arising out of excessive dependence on such deposits.

These guidelines are applicable from April 1, 2007. Banks which are not in a position to comply with these requirements from April 1, 2007, should, however, furnish a plan to the Reserve Bank for approval indicating the date by which they would be able to comply with the requirements.

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Banks not to Grant Loans for Acquiring KVPs

The Reserve Bank has advised banks not to sanction loans for acquiring/investing in small savings instruments including Kisan Vikas Patras (KVPs).

The Reserve Bank had come across certain instances where banks had sanctioned loans to individuals, mostly high networth individuals, for acquisition of KVPs. The high networth individuals were first required to bring in 10 per cent of the total face value of the proposed investment in the KVPs as margin and the remaining 90 per cent of the investment was treated as loan and funded by the bank for acquisition of the KVPs. Once the KVPs were acquired in the borrower's name, they were thereafter pledged to the bank.

Agency Commission - PPF/SCSS

It has been decided in consultation with the Government of India and a few select banks to follow only one channel of payment of remuneration to banks for handling transactions under the Public Provident Fund Scheme, 1968 (PPF) and the Senior Citizens Savings Scheme 2004 (SCSS). The Reserve Bank will pay agency commission on these transactions as below:

Type of Transaction	Rate *(in Rs)*
Receipts	Rs.45 per transaction
Payments	9 paise per Rs.100 turnover

These rates are applicable from July 1, 2005 for PPF transactions and from April 1, 2006 for SCSS transactions. With this revision of rates, the Government of India will discontinue payment of remuneration for managing PPF and SCSS.

There will not be any change in the existing arrangement for payment of commission paid at source to small savings agents for mobilising deposits under the two schemes and the government will continue to reimburse the commission.

Service Charges for Non-chest Branches Increased

The Reserve Bank has permitted currency chest holding banks to enhance the 'service charges' from Re.1 per note packet of 100 pieces to Rs.2 per packet to be levied on cash deposited by the non-chest bank branches with effect from April 01, 2007. The constituent banks should be advised well in advance regarding the enhancement in the service charge.

The exemption granted to co-operative banks and regional rural banks on their cash deposits for the purpose of transfer of funds under the Reserve Bank of India's Remittance Facility Scheme would, however, continue.

CRR Exempt Categories of DTL

★ Liabilities to the banking system in India as computed under Clause (d) of the Explanation to Section 42(1) of the RBI Act, 1934;

★ Credit balances in ACU (US$) Accounts;

★ Transactions in collaterialised borrowing and lending obligation (CBLO) with Clearing Corporation of India (CCIL); and

★ Demand and time liabilities (DTL) in respect of their offshore banking units (OBUs).

The exemptions are subject to banks maintaining statutory minimum CRR of 3 per cent of their total DTL.

Maintenance of CRR

The Reserve Bank of India (Amendment) Act, 2006 was enacted in June 2006. Consequent to the enactment, the Reserve Bank, on June 22, 2006 decided to -

(i) continue the status quo on the rate of cash reserve ratio (CRR) to be maintained by scheduled banks and the existing exemptions (please see box on this page);

(ii) remove the statutory minimum CRR maintenance requirement of 3 per cent; and

(iii) not pay any interest on the eligible CRR balances maintained by scheduled banks with effect from the fortnight beginning June 24, 2006.

The Extraordinary Gazette notification No.S.O.21(E) dated January 9, 2007 notified January 9, 2007 as the date on which all the provisions, except Section 3, of the Reserve Bank of India (Amendment) Act, 2006 would come into force.

Section 3 the Reserve Bank of India (Amendment) Act, 2006 provided for the removal of:

- the ceiling and floor on the CRR to be prescribed by the Reserve Bank having regard to the need for securing monetary stability in the country; and
- the provisions for interest payment on eligible CRR balances [i.e., the amount of reserves between the statutory minimum CRR and the CRR prescribed by the Reserve Bank.

Since Section 3 has not been notified so far, in consultation with the Government, it has been decided:

(i) that the minimum CRR level of 3.0 per cent and the maximum CRR level of 20 per cent of total of banks' demand and time liabilities remain as per the existing provisions of Section 42(1) of the Reserve Bank of India Act, 1934;

(ii) to exempt those banks from payment of penal interest that have breached the statutory minimum CRR level of 3.0 per cent between June 22, 2006 and March 2, 2007 on account of CRR exemptions reckoned for computation of demand and time liabilities for CRR; and

(iii) to pay interest on eligible CRR balance during the interregnum as follows:

Rate of Interest *(in per cent)*	For the Period
3.5	June 24 to December 8, 2006
2.0	December 9, 2006 to February 16, 2007
1.0	February 17, 2007 until further notice

INFORMATION

Interest Payment on CRR Balances

Current Position

The Reserve Bank has been paying interest on eligible CRR balances since 1973. Eligible balances were defined as the difference between the amount required to be maintained and the statutory minimum of 3.0 per cent CRR on net demand and time liabilities (NDTL). On the eve of the amendment, that is, till June 22, 2006, the prescribed CRR was 5.0 per cent of NDTL. Banks thus received interest at the rate of 3.5 per cent on eligible balances which worked out as 5.0 per cent of NDTL less 3.0 per cent of NDTL, the latter being the statutory minimum CRR. No interest has been payable on the statutory minimum requirement of 3.0 per cent and on excess CRR balances maintained with the Reserve Bank. Furthermore, several exemptions from the CRR were allowed to banks, such as, inter-bank liabilities up to 14 days, collateralised borrowing and lending obligations (CBLO), Asian Clearing Union (ACU) transactions and offshore banking units (OBUs), subject to the maintenance of the minimum statutory requirement of 3.0 per cent. Inter-bank liabilities of 15 days to one year maturity were totally exempt from the calculation of NDTL. Given these exemptions the effective interest rate on eligible CRR balances worked out to 1.4 per cent.

Background

In terms of Section 42(1) of the RBI Act, the Reserve Bank can prescribe CRR for scheduled banks between 3 per cent and 20 per cent of total of their demand and time liabilities. During the 1970s, the CRR was actively employed as an instrument of monetary policy to contain inflationary pressures emanating from international oil price shocks. While the level of the CRR was moderate, it steadily rose from 5.0 per cent in 1973 to 6.0 per cent by 1980. The Reserve Bank started paying interest on eligible CRR balances since 1973 to compensate for the erosion in the profitability of banks. Initially the rate of interest was 4.75 per cent per annum which gradually increased to 7.0 per cent by the end of the 1970s.

During the 1980s, monetisation of the fiscal deficit progressively became a dominant influence on the conduct of monetary policy, which had to contend with the secondary rounds of monetary expansion entailed by primary budget financing. Consequently, the CRR evolved as one of the principal instruments of monetary policy and the level of the CRR rose progressively to 15.0 per cent by 1992. Besides, an additional CRR of 10.0 per cent was prescribed on incremental NDTL (related to a base date) starting from 1983 up to 1992. Over the same period, the rate of interest payable on eligible CRR balances had to be gradually increased form 8.0 per cent to 10.0 per cent per annum.

At this juncture, the CRR was increasingly viewed as a punitive tax on the banking system, adversely impacting the profitability of banks on account of fiscal profligacy. In this context, the Committee on the Financial System, 1991 (Chairman : Shri M. Narasimham) observed :

'As regards the cash reserve ratio, the Reserve Bank should have the flexibility to operate this instrument to serve its monetary policy objectives. The Committee believes that given the Government's resolve to reduce the fiscal deficit, the occasion for the use of cash reserve ratio to control the secondary expansion of credit should also be less. The Committee accordingly proposes that the Reserve Bank consider progressively reducing the cash reserve ratio from its present high level. With the deregulation of interest rates there would be more scope for the use of open market operations by the Reserve Bank with correspondingly less emphasis on variations in the cash reserve ratio. The Committee proposes that the interest rate paid to banks on their SLR investments and on CRR in respect of impounded deposits above the basic minimum should be increased'.

In the ensuing period, the level of the CRR was gradually, albeit flexibly, reduced to the current level of 5.0 per cent. The additional CRR was also discontinued in 1993. Interest was paid on eligible cash balances at 10.5 per cent per annum under a two-tier formula under which CRR on incremental NDTL earned a lower rate which was lowered from 8.0 per cent per annum in 1990 to 3.0 per cent in 1992 and was finally abolished in the same year. With payment of zero interest on incremental CRR and the final abolition of CRR on incremental NDTL, the effective rate of interest on the eligible CRR balances worked out to 3.5 per cent. Accordingly, as a measure of rationalisation, the interest rate on CRR balances was set at 4.0 per cent. This had the effect of improving the return on eligible CRR balances since the revised rate was made applicable to the entire balances.

Another round of rationalisation occurred in 2001 following the re-activation of the Bank Rate as a medium-term signaling rate for monetary policy. The Statement on Monetary and Credit Policy for 2001-02 by former Governor, Dr. Bimal Jalan, aligned the interest rate on eligible CRR balances with the Bank Rate in two stages and announced that the medium-term objective would be to reduce the CRR to its statutory minimum.

The Internal Group on Liquidity Adjustment Facility recommended in December 2003 that *"with substantial scaling down of CRR coupled with marked decline in overall interest rate structure in the economy and increasing liquidity needs of participants in the wake of higher inter-linkages among different segments of the market, the degree to which CRR had been impacting banks as an implicit taxation earlier is considerably less in recent period. Accordingly, the remuneration of eligible cash balances at the Bank Rate is no longer justifiable and the remuneration of CRR, if any, be de-linked from the Bank Rate and placed at a lower rate than the repo rate"*. Accordingly, the interest paid on the eligible CRR balances was brought down to 3.5 per cent from September 2004 and eliminated from June 24, 2006.

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FOREX

Liberalisation of Export and Import Procedures

In order to facilitate external trade and provide greater flexibility to the authorised dealer category - I (AD Category - I) banks, certain relaxations have been made in the areas of exports and imports and foreign currency accounts. The relaxations are :

EXPORTS

Extension of Time for Realisation of Export Proceeds

AD Category-I banks may now extend the period of realisation of export proceeds, beyond six months from the date of export, up to a period of six months, at a time, irrespective of the invoice value of the export, provided -

(a) The export transactions covered by the invoices are not under investigation by the Enforcement Directorate/Central Bureau of Investigation or other investigating agencies;

(b) The AD Category-I bank is satisfied that the exporter has not been able to realise the export proceeds for reasons beyond his control;

(c) The exporter submits a declaration that the export proceeds would be realised during the extended period; and

(d) While considering extension beyond one year from the date of export, the total outstanding of the exporter does not exceed USD one million or 10 per cent of the average export realisations during the preceding three financial years, whichever is higher.

The date up to which the extension has been granted should be indicated in the 'Remarks' column of the XOS statement.

In cases where the exporter has filed suits abroad against the buyer, extension may be granted irrespective of the amount involved/outstanding. Cases which do not fall under the above category would require the Reserve Bank's prior approval.

Earlier, AD Category - I banks could extend the period of realisation of export proceeds in certain cases beyond six months, up to a period of three months at a time, where the invoice value of the export did not exceed USD one million or its equivalent.

Write-off of Unrealised Export Bills

Status holder exporters can now write-off outstanding export dues to the extent of (i) 5 per cent of their average annual realisation during the preceding three financial years or (ii) 10 per cent of the export proceeds due during the financial year, whichever is higher.

On-site Software Contracts - Repatriation of Funds

Overseas offices/branches of software exporter companies/ firms now need not repatriate to India 30 per cent of the contract value of each on-site contract. The companies should, however, repatriate the profits of the on-site contract after the completion of the contract.

Earlier, software exporter companies/firms were obliged to repatriate to India 100 per cent of the contract value of each off-site contract and at least 30 per cent of the contract value of each on-site contract.

Reduction in Invoice Value

AD Category - I banks can now allow reduction in the invoice value up to 25 per cent of the invoice. In cases where goods have been shipped and are to be transferred to a buyer other than the original buyer in the event of default by the latter, the Reserve Bank's prior approval is not required if the reduction in value, if any, involved does not exceed 25 per cent and the realisation of export proceeds is not delayed beyond a period of six months from the date of export.

IMPORTS

Import Bills – Credit Report on the Overseas Supplier

AD Category - I banks now need not obtain credit report on the overseas supplier from his banker/reputed credit agency before processing import bills received directly from the overseas supplier, provided (i) the invoice value does not exceed USD 100,000, and (ii) the bonafides of the transaction and track record of the importer are satisfactory.

GENERAL

Time Base for Trade Related Transactions

Henceforth, 'financial year' (April to March) should be reckoned as the time base for all trade related transactions. To mitigate the mismatch in the time period due to change of time base from calendar/previous year to financial year, AD Category – I banks may, up to March 31, 2007 only**,** reckon the time base which is beneficial to their constituent/s.

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