R.No. MAHENG/2004/14130
Regd. No. MH/MR/South-30/2006-08

Volume III ◆ Issue 11
May 2007

MONETARY AND CREDIT INFORMATION REVIEW

POLICY

Interest Subvention Scheme for Short-Term Crop Loans to Continue

Pursuant to the announcement made by the Hon'ble Finance Minister in his Budget Speech, the government will provide interest subvention of 2 per cent per annum to public sector banks for short-term production credit up to Rs. 3 lakh provided to farmers. The amount of subvention would be calculated on the amount of crop loan disbursed from the date of disbursement/drawal up to the date of payment or up to the date beyond which the outstanding loan becomes overdue i.e., March 31, 2008 for kharif and June 30, 2008 for rabi respectively, whichever is earlier. The subvention would be available to public sector banks on the condition that they make available short-term credit at ground level at 7 per cent per annum.

Accordingly, the Reserve Bank has advised banks to:

- ✶ immediately submit their estimates of short-term production credit to farmers up to Rs. 3 lakh for kharif and rabi 2007-08 (separately) to enable it to provide the government with an estimate of the likely amount of subvention. The estimates should be realistic in nature;
- ✶ submit their claims on a half-yearly basis as at September 30, 2007 and March 31, 2008 within one month from the end of the respective half years; and
- ✶ submit a statutory auditor's certificate along with the claim for the half-year ending March 31, 2008, certifying that the claims for subvention (amounts claimed for each of the half-years to be specified) for the entire year ended March 31, 2008 are true and correct. Final settlement of the claims would be only on receipt of this certificate.

Excessive Interest Charged by Banks

Reiterating the earlier instructions contained in its Master Circular of July 1, 2006, the Reserve Bank has advised banks to have an objective and transparent policy approved by their boards for fixing interest rates on loans and advances. In the case of short-term advances granted to small and marginal farmers, banks have been advised to ensure that interest applied does not exceed the principal amount. The Reserve Bank has further advised banks' boards to lay down appropriate internal principles and procedures so that usurious interest, including processing and other charges, are not levied on loans and advances. In laying down such principles and procedures for small value loans, particularly personal loans and such other loans of similar nature, banks should take into account, inter-alia, broad guidelines indicated below :

- An appropriate prior approval process should be prescribed for sanctioning such loans, which should take into account, among others, the cash flows of the prospective borrower.
- Interest rates charged by banks, inter-alia, should incorporate reasonable risk premium having regard to the internal rating of the borrower. Further, considering the risk, the presence or absence of security and the value thereof, should be taken into account.
- The total cost to the borrower, including interest and all other charges levied on a loan, should be justifiable

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having regard to the total cost incurred by the bank in extending the loan, which is sought to be defrayed and the extent of return that could be reasonably expected from the transaction.

- An appropriate ceiling should be fixed on the interest, including processing and other charges that could be levied on such loans, and it should be suitably publicised.

Risk Weight on Residential Housing Loans Reduced

The risk weight for housing loans up to Rs. 20 lakh to individuals, against the mortgage of residential housing properties, has been reduced from 75 per cent to 50 per cent. Similarly, the risk weight for banks' investments in mortgage backed securities, issued by housing finance companies regulated by the National Housing Bank, has also been reduced from 75 per cent to 50 per cent.

SCSS, 2004 - Interest Rate after Expiry of Depositor

The Government of India, Ministry of Finance has clarified that in cases under the Senior Citizens' Savings Scheme (SCSS), 2004 where the depositor has expired before the maturity of the deposit and the nominee/legal heir approaches the banker for closure of the deposit account, the nominee/legal heir in such cases, would be entitled to interest at the savings bank rate for the period commencing from the date of death of the depositor to the date of closure of the account.

UCBs

Undertaking Insurance Business - UCBs

Urban co-operative banks (UCBs) registered in states that have entered into memorandum of understanding (MoU) with the Reserve Bank or are registered under the Multi State Co-operative Societies Act, 2002 have now been permitted to undertake insurance agency business as corporate agents without risk participation. Such UCBs can undertake insurance agency business provided -

- they have a minimum networth of Rs 10 crore; and
- they have not been classified as a Grade III or IV bank.

There is no change in the existing norms for UCBs registered in states which have not signed MoUs with the Reserve Bank.

FEMA

Interest Rates

NRE Deposits

The interest rates on new non-resident (external) rupee (NRE) term deposits with maturity from one to three years should not exceed the LIBOR/SWAP rates, as on the last working day of the previous month, for US dollar of corresponding maturities (as against the earlier rate of LIBOR/SWAP rates plus 50 basis points). These interest rates would be applicable even if the maturity period exceeds three years. The revised interest rate would also apply to NRE deposits renewed after their present maturity.

FCNR(B) Deposits

Interest rate should be paid within the ceiling rate of LIBOR/SWAP rates for the respective currency/corresponding maturities minus 75 basis points (as against the earlier rate of LIBOR/SWAP rates minus 25 basis points) on foreign currency (non-resident) (banks) [FCNR (B)] deposits of all maturities contracted effective from the close of business in India as on April 24, 2007. Interest should be paid within the ceiling of SWAP rates for the respective currency/maturity minus 75 basis points on floating rate deposits with the interest reset period of six months.

Remittance towards Donation by Corporates

AD Category-I banks are now permitted to make remittances abroad on account of donations by Indian corporates for specified purposes as under:

- Creation of chairs in reputed educational institutes.
- Donations to funds (not being an investment fund) promoted by educational institutes.
- Donation to a technical institution or body or association in the field of activity of the donor company.

Such remittances would be subject to a limit of one per cent of the foreign exchange earnings during the previous three financial years or USD 5 million, whichever is less. Applications for remittances for purposes other than those specified above should be forwarded to the Chief General Manager, Reserve Bank of India, Central Office, Foreign Exchange Department, Foreign Investments Division, Central Office Building, Mumbai-400 001, together with (a) details of their foreign exchange earnings during the last 3 years, (b) brief background of the company's activities, (c) purpose of the donation and (d) likely benefits to the corporate.

The existing facility for remittance up to USD 5000 per remitter/per donor per financial year towards donations by Indian corporates would continue as earlier.

Infrastructure Consultancy - Remittance Limit Raised

The limit for remittance for consultancy service procured from outside India by Indian companies executing infrastructure projects has been raised from USD 1 million per project to USD 10 million per project. For this purpose, infrastructure sector is defined as (i) power, (ii) telecommunication, (iii) railways, (iv) road including bridges, (v) sea port and airport, (vi) industrial parks, and (vii) urban infrastructure (water supply, sanitation and sewage projects). Accordingly, AD Category - I banks may allow remittances on behalf of Indian companies in such cases up to USD 10 million per project after verifying the bonafides of the transaction.

In all other cases, the existing limit of USD 1 million, per project, for any consultancy service procured from outside India, would continue.

Foreign Currency Accounts-Ship-Manning/Crew-Management

AD Category – I banks have been permitted to allow ship-manning/crew managing agencies in India to open and maintain non-interest bearing foreign currency accounts in India for undertaking transactions in the ordinary course of their business. Such permission is subject to the conditions as follows :

a) Credits to such accounts are made by way of inward remittances through normal banking channels from the overseas principal.

b) Debits are towards various expenses relating to management of the ships/crew, incurred during the ordinary course of business.

c) No credit facility (fund based or non-fund based) should be granted against security of funds held in the account.

d) The bank should meet the prescribed reserve requirements in respect of such accounts.

e) No exchange earners' foreign currency (EEFC) facility should be allowed in respect of the remittances received in the account.

f) The account should be maintained only during the validity period of the agreement.

Credit to Step-down Subsidiaries of Indian Corporates

Banks in India have been permitted to extend funded and/or non-funded credit facilities to wholly owned step-down subsidiaries of subsidiaries of Indian companies (where the holding by the Indian company is more than 51 per cent) abroad.

Before granting the facility, banks should ensure that :

- The set up of the step down subsidiary should be such that banks can effectively monitor end-use of the facilities granted by them.
- Proper systems for management of credit and interest rate risks arising out of such cross border lending are in place.
- Section 25 of the Banking Regulation Act, 1949 is complied with.
- The resource base for such lending is funds held in foreign currency accounts, such as, FCNR(B), exchange earners' foreign currency (EEFC), resident foreign currency (RFC) etc., in respect of which banks have to manage exchange risk.
- Maturity mismatches arising out of such transactions are within the overall gap limits approved by the Reserve Bank.
- All existing safeguards and prudential guidelines relating to capital adequacy, exposure norms etc., applicable to domestic funded/non-funded exposures are adhered to.
- Grant of such facilities is based on proper appraisal and commercial viability of the project and the countries where the step-down subsidiary is located.
- There is no restriction in the countries where the step-down subsidiaries are located in regard to (a) companies obtaining foreign currency loans and on repatriation or repayment thereof; and (b) non-resident banks to have a legal charge on securities/assets in these countries as well as right of disposal, in case of need.

Liberalised Remittance Scheme - Limit Enhanced

The remittance limit under the liberalised remittance scheme for resident individuals has been enhanced from USD 50,000 to USD 100,000 per financial year (April-March). Accordingly, AD Category – I banks may now allow remittance up to USD 100,000, per financial year, for any permitted current or capital account transactions or a combination of both.

It is clarified that, transactions which are otherwise not permissible under the Foreign Exchange Management Act (FEMA) and those in the nature of remittance for margins or margin calls to overseas exchanges/overseas counterparty are not allowed under the Scheme.

AD Category – I banks are further advised that they should not extend any kind of credit facilities to resident individuals for remittances under the Scheme.

ECBs - End-use and All-in-Cost Ceilings - Revised

Based on a review undertaken of the external commercial borrowing (ECB) guidelines, the ECB policy has been modified as indicated below:

End-use

Utilisation of ECB proceeds is not permissible in real estate, without any exemption. As per the earlier ECB policy, the term 'real estate' excluded 'development of integrated township'. This exemption accorded to 'development of integrated township' as a permissible end-use of ECB has now been withdrawn.

All-in-cost Ceilings

With the sovereign credit ratings of India enhanced to investment grade, the all-in-cost ceilings for ECBs have been modified as follows:

Average Maturity Period	All-in-Cost Ceilings over 6 Months LIBOR*	
	Existing	*Revised*
Three years and up to five years	200 basis points	150 basis points
More than five years	350 basis points	250 basis points

** for the respective currency of borrowing or applicable benchmark.*

These changes would apply to ECBs both under the automatic route as well as approval route with immediate effect

NBFCs

Interest Rate Ceiling on NBFC Deposits Enhanced

In view of the prevailing interest rates in the entire financial system, the maximum interest rate payable on public deposits by non-banking financial companies (NBFCs) (other than residuary non-banking financial companies (RNBCs) has been revised from 11.0 per cent to 12.5 per cent per annum on and from April 24, 2007. This is the maximum permissible rate NBFCs can pay on their public deposits and they may offer lower rates. The revised interest rate would be applicable to fresh public deposits and renewals of matured public deposits.

The enhanced interest rate ceiling of 12.5 per cent per annum is also applicable to deposits accepted/renewed by miscellaneous non-banking companies (chit fund companies).

Other conditions relating to the rests at which interest should be compounded, rate of brokerage, etc., remain unchanged.

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Annual Policy Statement for the Year 2007-08

Dr. Y. V. Reddy, Governer, in a meeting with chief executives of major commercial banks presented the Annual Policy Statement for the year 2007-08 on April 24, 2007. The highlights are :

Stance

- GDP growth for 2007-08 projected at around 8.5 per cent.
- Inflation to be contained close to 5.0 per cent during 2007-08. Going forward, the resolve is to condition policy and perceptions for inflation in the range of 4.0-4.5 per cent over the medium term.
- M3 expansion to be contained at around 17.0 - 17.5 per cent during 2007-08.
- Deposits projected to increase by around Rs.4,90,000 crore during 2007-08.
- Adjusted non-food credit projected to increase by around 24.0-25.0 per cent during 2007-08, implying a graduated deceleration from the average of 29.8 per cent over 2004-07.
- Greater emphasis on price stability and well-anchored inflation expectations while ensuring a monetary and interest rate environment that supports growth momentum.
- Appropriate liquidity to be maintained to meet legitimate credit requirements, consistent with price and financial stability.
- 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 monetary policy in the period ahead will continue to be :
  * to reinforce the emphasis on price stability and well-anchored inflation expectations while ensuring a monetary and interest rate environment that supports export and investment demand in the economy so as to enable continuation of the growth momentum.
  * to re-emphasise credit quality and orderly conditions in financial markets for securing macroeconomic and, in particular, financial stability while simultaneously pursuing greater credit penetration and financial inclusion.
  * to respond swiftly with all possible measures as appropriate to the evolving global and domestic situation impinging on inflation expectations and the growth momentum.

Monetary Measures

- Bank rate kept unchanged at 6.0 per cent.
- Reverse repo rate and repo rate kept unchanged at 6.00 per cent and 7.75 per cent, respectively.
- Scheduled banks required to maintain CRR of 6.5 per cent with effect from the fortnight beginning April 28, 2007.
- Ceiling interest rate on FCNR (B) deposits reduced by 50 basis points to LIBOR minus 75 basis points.
- Ceiling interest rate on NR(E)RA deposits reduced by 50 basis points to LIBOR/SWAP rates.

Developmental and Regulatory Policies

- Average cut-off yield on 182-day treasury bills to be used as a benchmark rate for floating rate bonds.
- Working Group to be set up to go into all the relevant issues and suggest measures to facilitate the development of interest rate futures market.
- Overseas investment limit (total financial commitments) for Indian companies enhanced to 300 per cent of their net worth.
- Listed Indian companies limit for portfolio investment abroad in listed overseas companies enhanced to 35 per cent of net worth.
- Aggregate ceiling on overseas investment by mutual funds enhanced to US $ 4 billion.
- Prepayment of external commercial borrowings (ECBs) without the Reseve Bank's prior approval increased to US $ 400 million.
- Present limit for individuals for any permitted current or capital account transaction increased from US $ 50,000 to US $ 100,000 per financial year in the liberalised remittance scheme.
- A Working Group on Currency Futures to be set up to suggest a suitable framework to operationalise the proposal in line with the current legal and regulatory framework.
- Risk weight on loans up to Rs.1 lakh against gold and silver ornaments for all categories of banks reduced to 50 per cent.
- Introduction of a credit guarantee scheme for distressed farmers.
- Indian banks permitted to extend credit and non-credit facilities to step-down subsidiaries within the existing prudential limits and some additional safeguards.
- Banks and primary dealers permitted to begin transactions in single-entity credit default swaps.
- Risk weight on residential housing loans to individuals for loans up to Rs.20 lakh reduced to 50 per cent as a temporary measure.
- Existing relaxed prudential norms applicable to Tier I and Tier II urban cooperative banks extended by one year.
- Ceiling rate of interest payable by NBFCs (other than RNBCs) on deposits raised by 150 basis points.

Edited and published by **Alpana Killawala** for the **Reserve Bank of India,** Press Relations Division, Central Office, Shahid Bhagat Singh Marg, Mumbai - 400 001 and printed by her at **Onlooker Press,** 16, Sassoon Dock, Colaba, Mumbai - 400 005. **For renewal and change of address please write to the Chief General Manager, Press Relations Division, Reserve Bank of India, Central Office Building, 12th floor, Fort, Mumbai - 400 001 without enclosing DD/cheque. MCIR is also available on Internet at www.mcir.rbi.org.in**