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

Volume IV ◆ Issue 2
August 2007

MONETARY AND CREDIT INFORMATION REVIEW

POLICY

CRR Hiked to 7%

On a review of the liquidity situation, the Reserve Bank increased the cash reserve ratio (CRR) maintained by banks by 50 basis points to 7.00 per cent. The CRR was raised with effect from the fortnight beginning August 4, 2007.

Discounting/Re-discounting of Bills

Reviewing the instructions on discounting/re-discounting of bills, the Reserve Bank has decided that -

(i) In cases where negotiation of bills drawn under letter of credit (LC) is restricted to a particular bank, and the beneficiary of the LC is not a constituent of that bank, the bank concerned may negotiate such an LC, subject to the condition that, the proceeds would be remitted to the regular banker of the beneficiary. The prohibition regarding negotiation of unrestricted LCs of non-constituents would, however, continue to be in force.

(ii) Banks may negotiate bills drawn under LCs, on 'with recourse' or 'without recourse' basis, as per their discretion and based on their perception about the credit worthiness of the LC issuing bank. The restriction on purchase/discount of other bills (bills drawn otherwise than under LC) on 'without recourse' basis would, however, continue to be in force.

In terms of the Reserve Bank's earlier instructions, banks could purchase/discount/negotiate bills under LC only in respect of genuine commercial and trade transactions of their borrower constituents who have been sanctioned regular credit facilities. Banks could not extend fund-based credit facilities (including bills financing) to a non-constituent borrower or a non-constituent member of a consortium/multiple banking arrangement. Further, the practice of drawing bills of exchange with the clause 'without recourse' and issuing letters of credit bearing the legend 'without recourse' should be discouraged because such notations deprive the negotiating bank of the right of recourse it has against the drawer under the Negotiable Instruments Act. Banks should not, therefore, open LCs and purchase/discount/negotiate bills bearing the 'without recourse' clause.

FEMA

ECB Policy Reviewed

The external commercial borrowing (ECB) guidelines were reviewed recently keeping in view the current macroeconomic situation and the experience gained so far by the Reserve Bank in administering the ECB policy. Based on the review, the ECB policy was modified until further review. The modifications which came into effect from August 7, 2007 are:

(i) Henceforth, ECB of more than USD 20 million per borrower company per financial year would be permitted only for foreign currency expenditure for permissible end-uses of the ECB. Accordingly, borrowers raising ECB more than USD 20 million would have to park the ECB proceeds overseas for use as foreign currency expenditures for permissible end-uses and would not remit the funds to India. The modification would be applicable to ECB exceeding USD 20 million per financial year both under the automatic route and under the approval route.

(ii) ECB up to USD 20 million per borrowing company per financial year would be permitted for foreign currency

CONTENTS

expenditures for permissible end-uses under the automatic route and these funds would have to be parked overseas and not be remitted to India. Borrowers proposing to avail ECB up to USD 20 million for rupee expenditure for permissible end-uses would require the Reserve Bank's prior approval under the approval route. Such funds, however, should be parked overseas until actual requirement in India.

(iii) All other aspects of ECB policy, such as, eligible borrower, USD 500 million limit per borrower company per financial year under the automatic route, recognised lender, average maturity period, all-in-cost-ceiling, prepayment, refinancing of existing ECB and reporting arrangements remain unchanged.

(iv) These conditions would not apply to borrowers who have already entered into loan agreement and obtained loan registration number from the Reserve Bank. Borrowers who have taken verifiable and effective steps like, entering into loan agreement to avail of ECB under the previous dispensation, but have not obtained the loan registration number, may apply to the Reserve Bank through their authorised dealer.

RRBs

Housing Loan Ceiling under Priority Sector Enhanced

Regional rural banks (RRBs) have now been allowed to extend, with the approval of their boards, direct finance to the housing sector up to Rs. 20 lakh, irrespective of the area. This has been done to bring RRBs on par with commercial banks. Earlier, RRBs were, with the approval of their boards, permitted to extend direct finance to the housing sector up to Rs.10 lakh in rural and semi-urban areas as part of priority sector lending.

In October 2006, RRBs were advised that the housing loans extended by them should not exceed the limit of 5 % of incremental deposits as at the end of the previous financial year. This limit now stands withdrawn.

Acceptance of FCNR (B) Deposits

With a view to making foreign exchange services available to non-resident Indians (NRIs)/persons of Indian origin (PIOs) on a wider scale, RRBs have been allowed to accept foreign currency non-resident (banks) {FCNR (B)} deposits from NRIs/ PIOs.

The eligibility criteria prescribed for opening/maintaining non-resident ordinary (NRO) and non-resident (external) rupee (NRE) accounts have also been reviewed. The Reserve Bank, in supercession of its earlier instructions, has revised the criteria for opening/maintaining NRO/NRE accounts in rupees and for accepting FCNR (B) deposits by RRBs.

For acceptance of FCNR (B) deposits, RRBs have been advised to adopt the procedure indicated below :

(i) As in the case of authorisation for NRO/NRE accounts, RRBs should approach the Foreign Exchange Department of the Reserve Bank's regional office concerned, for authorisation for acceptance of FCNR (B) deposits.

(ii) Deposits may be accepted in US dollars (USD), pound sterling (GBP), euro, Japanese yen (JPY), Australian dollars (AUD) and Canadian dollars (CAD).

(iii) Since RRBs may not have well-developed treasuries to manage the foreign currency liability or risk, they may enter into suitable tie-up arrangements with their sponsor banks for necessary support and expertise.

(iv) The deposits would be received by credit to the nostro accounts of the sponsoring banks.

(v) While RRBs would issue the FCNR (B) deposit receipt to the depositors, the foreign currency funds received as deposits would be treated as placements/deposits with their sponsor banks. The sponsor banks would be required to manage the foreign currency funds including deployment of FCNR (B) deposit funds.

(vi) RRBs who desire to make use of the foreign currency resources arising out of the FCNR (B) deposits, would be allowed to swap foreign currency funds including accrued interest with the sponsor banks for broad basing their rupee resources provided the entire exchange risk and maturity mismatch risk is managed by the sponsor bank and the RRBs do not carry any foreign currency and maturity mismatch risks in their books.

(vii) The operational and accounting details relating to rate of interest to be offered by the RRBs, accounting treatment of interest accruals on such deposits, payment of maturity proceeds, etc., may be decided by mutual agreement between the RRBs and the sponsoring banks.

UCBs

Amortisation of Goodwill on Merger

In order to smoothen the process of merger in the urban co-operative bank (UCB) sector, the Reserve Bank had in November 2005, permitted acquirer UCBs to amortise the loss taken over from the acquired UCB over a period of not more than five years, including the year of merger. Taking into consideration the underlying provisions of AS-14 of Accounting Standards issued by the Institute of Chartered Accountants of India, the Reserve Bank has reviewed the matter. Acquirer UCBs have now been advised that -

i) Where the consideration, if any, paid for the acquisition/ amalgamation exceeds the book value of the net assets taken over, the excess amount should be treated as goodwill and amortised over a period of five years in equal installments.

ii) Where no consideration is paid but the book value of the assets is less than the book value of liabilities taken over, the excess of the book value of liabilities over the book value of the assets taken over will be considered as goodwill and amortised over a period of five years in equal installments.

iii) Where no consideration is paid, but the book value of the assets taken over is greater than the book value of the liabilities taken over, the excess of the book value of assets over the book value of the liabilities will be considered as 'capital reserve'.

First Quarter Review of Annual Policy: 2007-2008

Dr. Y V Reddy, Governor, Reserve Bank of India presented the First Quarter Review of Annual Statement on Monetary Policy for 2007-08 on July 31, 2007. The highlights are:

Measures

- Bank Rate kept unchanged.
- Reverse Repo Rate and Repo Rate under LAF kept unchanged.
- Withdrawal of the ceiling of Rs. 3,000 crore on daily reverse repo under the liquidity adjustment facility (LAF) with effect from August 6, 2007. The Reserve Bank, however, to retain the discretion to re-impose a ceiling as appropriate.
- The second LAF, conducted between 3.00 p.m. and 3.45 p.m. on a daily basis, withdrawn with effect from August 6, 2007.
- Cash reserve ratio increased by 50 basis points to 7.0 per cent with effect from the fortnight beginning August 4, 2007.

Review of Developments

- GDP growth projection for 2007-08 retained at around 8.5 per cent, barring domestic or external shocks.
- Holding inflation within 5.0 per cent in 2007-08 assumes priority in the policy hierarchy, while reinforcing the medium-term objective to condition policy and perceptions to reduce inflation to 4.0-4.5 per cent on a sustained basis.
- While non-food credit growth has decelerated, the acceleration in money supply and reserve money warrants an appropriate response.
- Recent financial market developments in India and potential uncertainties in global markets warrant a higher priority in the policy hierarchy for managing appropriate liquidity conditions at the current juncture.

Stance

- Monetary policy in India would continue to be vigilant and pro-active in the context of any accentuation of global uncertainties that pose threats to growth and stability in the domestic economy. The domestic outlook continues to be favourable and would dominate the dynamic setting of monetary policy in the period ahead.
- It is important to design monetary policy such that it protects growth by contributing to the maintenance of stability. Accordingly, while the stance of monetary policy would continue to reinforce the emphasis on price stability and well-anchored inflation expectations and thereby sustain the growth momentum, contextually, financial stability may assume greater importance in the months to come.
- Recent developments in financial markets in India and potential uncertainties in global markets warrant a higher priority for managing appropriate liquidity conditions in the policy hierarchy at the current juncture.
- The Reserve Bank will continue with its policy of active demand management of liquidity through appropriate use of the CRR stipulations and open market operations (OMO) including the MSS and LAF, using all the policy instruments at its disposal flexibly, as and when the situation warrants.
- 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 broadly 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, financial stability and the growth momentum.

Overall Assessment

- Domestic economic activity has continued to expand at a strong pace and there are indications that the impulses of growth are getting broad-based. The recent gains in bringing down inflation and in stabilising inflation expectations should support the current expansionary phase of the growth cycle.
- It is, however, necessary to note that demand pressures and cyclical effects persist, mirrored in investment and consumer demand, monetary and banking aggregates, capacity constraints and a widening trade deficit. Financial markets are reflecting the interplay of these factors, although increases in capital inflows and large changes in liquidity conditions are obscuring an accurate assessment of risks, with attendant uncertainty.
- While there is an abatement of inflation in the recent period, upward pressures persist. In this regard, it is essential to carefully monitor developments relating to aggregate supply conditions and the supply response to the impulses of demand in the short-term, while stepping up efforts to expand production capabilities over the medium-term.
- It is also necessary to continuously assess the risks to the inflation outlook emanating from high and volatile international crude prices, the continuing firmness in key food prices and the uncertainties surrounding the evolution of demand-supply gaps, both globally as well as in India.
- Risks from global developments continue to persist, especially in the form of inflationary pressures, re-pricing of risks by financial markets and danger of downturn in some asset classes, with implications for EMEs in general. International food and energy prices are likely to settle at higher levels than before with indications that the sharp acceleration recorded in 2006 will not reverse. In addition, there are risks emanating from the developments in global financial markets.

Licensed to post without prepayment - Licence No. South - 20/2006-08 **Regd. No. MH/MR/South-30/2006-08**
Posted at MUMBAI PATRIKA CHANNEL SORTING OFFICE - GPO on last two working days of every month.

Clarifications on Liberalised Remittance Scheme

As per the Liberalised Remittance Scheme (LRS) announced in February 2004 resident individuals can remit up to USD 100,000 per financial year for any permitted capital and current account transaction. The Reserve Bank has now issued the following clarifications on various operational issues:

- *Provide an illustrative list of capital account transactions permitted under the Scheme.*

Under the Scheme, resident individuals can acquire and hold immovable property or shares or debt instruments or any other assets outside India, without the Reserve Bank's prior approval. Individuals can also open, maintain and hold foreign currency accounts with banks outside India.

- *Can the Scheme be used for purchase of objects of art (paintings etc) either directly or through auction house?*

Remittances under the Scheme can be used for purchasing objects of art subject to the provisions of other applicable laws such as the extant Foreign Trade Policy of the Government of India.

- *Can a customer remit funds for acquisition of employee stock options (ESOPs) under this scheme?*

The Scheme can also be used for remittance of funds for acquisition of ESOPs.

- *Is the scheme in addition to acquisition of ESOPs linked to American Depository Receipt(ADR)/global depository receipt (GDR) (i.e, USD 50,000 for a block of five calendar years)?*

Yes, it is.

- *Is the Scheme in addition to acquisition of qualification shares (i.e, USD 20,000 as 1% of paid up capital of overseas company whichever is lower)?*

Yes, it is.

- *Can a resident individual invest in units of mutual funds, venture funds, unrated debt securities, promissory notes, etc., under this Scheme?*

A resident individual can invest in units of mutual funds, venture funds, unrated debt securities, promissory notes, etc., under this Scheme. Residents can also invest in such securities out of the bank account opened abroad under the Scheme.

- *Can an individual, who has availed of a loan abroad while he was a non-resident, use the remittance facility under the Scheme to repay his loan after returning to India as a resident?*

Yes, he can.

- *Which remittances are not allowed under the Scheme?*

Remittances from India for margins or margin calls to overseas exchanges/overseas counterparty are not allowed under the Scheme. The remittance facility under the Scheme is also not available for the following:

i) Remittance for any purpose specifically prohibited under Schedule I, like purchase of lottery tickets/sweep stakes, proscribed magazines, etc., or any item restricted under Schedule II of Foreign Exchange Management (Current Account Transactions) Rules, 2000.

ii) Remittances made directly or indirectly to Bhutan, Nepal, Mauritius or Pakistan.

iii) Remittances made directly or indirectly to countries identified by the Financial Action Task Force (FATF) as "non co-operative countries and territories" from time to time.

iv) Remittances directly or indirectly to those individuals and entities identified as posing significant risk of committing acts of terrorism as advised separately by the Reserve Bank to the banks.

- *Is this facility in addition to the existing facility detailed in Schedule III of FEMA Rules, 2000?*

Yes, the facility under the Scheme is in addition to those already available for private travel, business travel, studies, medical treatment, etc., as described in Schedule III of Foreign Exchange Management (Current Account Transactions) Rules, 2000. The Scheme can be also be used for these purposes. Gift and donation remittances cannot, however, be made separately and have to be made only under the Scheme. In other words, resident individuals can remit gifts and donations up to USD 100,000 per financial year under the Scheme.

- *Is remittance under the Scheme on gross basis or net basis (net of repatriation from abroad)?*

Remittance under this scheme is on a gross basis.

- *Do resident individuals have to, under this Scheme, repatriate the accrued yield on deposits/investments abroad?*

Currently, the residents are not required to repatriate the funds or income generated out of investments made under the Scheme. The investor can, therefore, retain and reinvest abroad the income earned on investments made under the Scheme.

- *Can minors avail of the remittance facility?*

Yes, minors can also avail the facility.

- *Can remittances under the facility be consolidated in respect of all family members?*

Remittances under the facility can be consolidated in respect of family members subject to the individual family members complying with the terms and conditions of the Scheme.

- *Is the small value remittance of USD 5000 (gifts, donation etc) in addition to LRS of USD 100,000?*

With the larger facility available under the Scheme, the facility of remitting USD 5000 as gift or donation is withdrawn.

- *Is the AD required to check permissibility of remittances based on nature of transaction or allow the same based on remitter's declaration?*

The AD will be guided by the nature of transaction as declared by the remitter and will certify that the remittance is in conformity with the instructions issued by the Reserve Bank.

- *Is it mandatory for resident individuals to have PAN number for sending outward remittances under the Scheme?*

Yes, it is.

- *Can a resident individual request for an outward remittance by way of issuance of a demand draft (either in his own name or in the name of the beneficiary with whom he intends putting through the permissible transactions) at the time of his private visit abroad against self declaration?*

Yes, he can make such a request and such outward remittance in the form of a DD can be effected against a declaration by the resident individual in the format prescribed under the Scheme.

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**