Box II.10: Credit Derivatives

The credit derivatives belong to the class of credit risk transfer instruments which enable transfer of credit risk from one party to another. The credit default swap (CDS) is the cornerstone of the credit derivatives market. The vast majority of credit derivatives take the form of the *credit default swap* (CDS), which is a contractual agreement to transfer the default risk of one or more *reference entities* from one party to the other. One party, the protection buyer, pays a periodic fee to the other party, the protection seller, during the term of the CDS. If the reference entity defaults, declares bankruptcy, or another specified *credit event* occurs, the protection seller is obligated to compensate the protection buyer for the loss by means of a specified *settlement* procedure. The reference entity is not a party to the contract, and it is not necessary for the buyer or seller to obtain the reference entity's consent to enter into a CDS.

Credit Derivatives Market

In the global OTC market, the notional amount outstanding against the CDS increased from US$ 13,908 billion in December 2005 to US$ 28,828 billion in December 2006 (BIS, May 2007).

A CDS may specify that on occurrence of a credit event the protection buyer shall deliver the reference obligation to the protection seller, in return for which the protection seller shall pay the face value of the delivered asset to the protection buyer. This type of settlement is known as *physical settlement.* This settlement takes place in a CDS where the protection is bought on a specific reference obligation. It is also possible that the CDS contract may specify a number of alternative obligations of the reference entity that the protection buyer can deliver to the protection seller. These are known as *deliverable obligations* and this may apply in a CDS contract where the protection is bought on the reference entity instead of a specific obligation of the reference entity. Where more than one deliverable obligation is specified, the protection buyer will deliver the cheapest of the list of deliverable obligations. This is referred to as the *cheapest to deliver* contract. This type of settlement is also known as *payment of par value*.

A CDS may specify that on occurrence of a credit event the protection seller shall pay difference between the nominal value of the reference obligation and its market value at the time of credit event. This type of settlement is known as cash settlement or payment of par less recovery. A calculation agent plays an important role in the process of settlement.

CDS Mechanics

Product Variations in CDS

- For the simplest form of CDS, the single name CDS, the reference entity is an individual,corporation or government.
- A CDS with more than one (usually, between three and ten) reference entity is known as a *basket CDS*. In the most common form of basket CDS, *the first to default CDS*, the protection seller compensates the buyer for losses associated with the first entity in the basket to default, after which the swap terminates and provides no further protection.
- CDS referencing more than ten entities are sometimes referred to as portfolio products. Such products are generally used in connection with synthetic securitisations, in which a CDS transfers credit risk of loans or bonds to collateralised debt obligation (CDO) note holders in lieu of a true sale of the assets as in a cash securitisation.
- A major source of credit derivatives growth since 2004 has been index CDS, in which the reference entity is an index of as many as 125 corporate entities. An index CDS offers protection on all entities in the index, and each entity has an equal share of the notional amount. The two main indices are the CDX index, consisting of 125 North American investment grade firms, and the iTraxx index, consisting of 125 euro zone-based firms, mainly investment grade.
- Recent innovations in CDS have extended the protection to reference obligations instead of entities. CDS on asset-backed securities (ABS), for example, provides protection against credit events related to securitised assets, usually securitised home equity lines of credit. In addition, CDS can specify CDO notes as reference obligations.

Credit events

With regard to credit events, the confirmation of a CDS deal specifies a standard set of events that must occur before the protection seller compensates the buyer for losses; the parties to the deal decide which of those events to include and which to exclude. First, the most commonly included credit event is failure to pay. Second, bankruptcy is a credit event for corporate reference entities, but not for sovereign entities. Third, restructuring, which refers to actions such as coupon reduction or maturity extension undertaken in lieu of default, is generally included as a credit event for corporate entities. Restructuring is sometimes referred to as a 'soft' credit event because, in contrast to failure to pay or bankruptcy, it is not always clear what constitutes a restructuring that should trigger compensation. Fourth, repudiation or moratorium provides for compensation after specified actions of a government reference entity and is generally relevant only to emerging market reference entities. Finally, obligation acceleration and obligation default, which refer to technical defaults such as violation of a bond covenant, are rarely used.

derivative transaction from the regulatory perspective. The emphasis is on the proper risk management framework and appropriate corporate governance practices. The focus is also on 'suitability' and 'appropriateness' of derivative products being offered by market-makers to customers (users) as also 'customer appropriateness'. The guidelines also cover extant instructions relating to rupee interest rate derivatives. It was indicated that the guidelines relating to forex derivatives would be issued separately.

Income Recognition, Asset Classification and Provisioning

2.97 During 2006-07, prudential norms relating to provisioning were further refined with a view to bringing them on par with the international best standards. In the light of high credit growth and with a view to ensuring credit quality and improving the stability of the financial system, the provisioning norms were streamlined and the guidelines for floating provisions were reviewed.

Projects Involving Time Overrun

2.98 Infrastructure projects require heavy fund outlays with long gestation periods due to many inherent factors such as statutory/regulatory clearances, land acquisition, resettlement/ rehabilitation of the displaced people, among others. All these factors, which are beyond the control of the promoters, may lead to delay in project implementation and involve restructuring/ reschedulement by banks. In terms of extant instructions in respect of the projects to be financed by banks, the date of completion of the project should be clearly spelt out at the time of financial closure of the project. In case the date of commencement of commercial production extends beyond a period of six months after the date of completion of the project, as originally envisaged, the account should be treated as sub-standard asset. It was decided to partially modify the asset classification norms for infrastructure projects alone, involving time overrun. Accordingly, banks were advised on April 12, 2007 that the asset be treated as sub-standard only if the date of commencement of commercial production extended beyond a period of one year (as against six months earlier) after the date of completion of the project, as originally envisaged. The revised instructions came into force with effect from March 31, 2007.

Provisions against Standard Asset

2.99 The continued high credit growth in the real estate sector, personal loans, credit card receivables, and loans and advances qualifying as capital market exposure and a higher default rate with regard to personal loans and credit card receivables, emerged as a matter of concern during the year. In May 2006, the general provisioning requirement for banks (excluding RRBs) on standard advances in respect of specific sectors, *i.e.,* personal loans, loans and advances qualifying as capital market exposures, residential housing loans beyond Rs.20 lakh and commercial real estate loans was increased to 1.0 per cent from 0.40 per cent. Banks were further advised on January 31, 2007 to increase the provisioning requirement, with immediate effect, in respect of standard assets in the following categories of loans and advances from the earlier level of one per cent to two per cent: (i) personal loans (including credit card receivables); (ii) loans and advances qualifying as capital market exposure; and (iii) real estate loans (excluding residential housing loans). Further, the provisioning requirements for loans and advances in the standard asset category to systemically important non-deposit accepting (NBFC-ND-SI) was revised from 0.40 per cent to 2.00 per cent. In order to ensure continued and adequate availability of credit to the highly productive sectors of the economy, the provisioning requirement for all other loans and advances, which are standard assets has been kept unchanged, *viz.*, (i) direct advances to the agricultural and SME sectors at 0.25 per cent; and (ii) all other loans and advances at 0.4 per cent. As hitherto, these provisions would be eligible for inclusion in Tier II capital for capital adequacy purposes to the permitted extent.

Prudential Norms on Creation and Utilisation of Floating Provisions

2.100 Considering that higher loan loss provisioning improves the overall financial strength of banks and the stability of the financial sector, banks were urged to voluntarily set apart floating provisions, *i.e.,* provisions which are not made in respect of specific non-performing assets or are made in excess of regulatory requirement for provisions for standard assets. As some banks were found using floating provisions to set-off provisions required to be made as per the extant prudential guidelines with a view to smoothening their profits, the extant guidelines were reviewed. Revised instructions on utilisation, creation, accounting and disclosures of floating provisions were issued on June 22, 2006.

2.101 Banks were advised that the floating provisions should not be used for making specific provisions in respect of non-performing assets or for making regulatory provisions for standard assets. The floating provisions can be used only for contingencies under extraordinary circumstances for

making specific provisions in impaired accounts after obtaining board's approval and with prior permission of the Reserve Bank. The banks' boards of directors should lay down approved policy regarding the level to which the floating provisions can be created. A bank may voluntarily make specific provisions for advances at rates which are higher than the rates prescribed under existing regulations provided such higher rates are approved by the board of directors, and consistently adopted from year to year. Such additional provisions are not to be considered as floating provisions.

2.102 Floating provisions cannot be reversed by credit to the profit and loss account. They can only be utilised for making specific provisions in extraordinary circumstances as alluded to earlier. Until such utilisation, these provisions can be netted off from gross NPAs to arrive at disclosure of net NPAs. Alternatively, they can be treated as part of Tier II capital within the overall ceiling of 1.25 per cent of total risk-weighted assets.

2.103 In order to enable banks' boards to evolve suitable policies in the context of following floating provisions, it was clarified on March 13, 2007 that extraordinary circumstances refer to losses which do not arise in the normal course of business, and are exceptional and non-recurring in nature. These extraordinary circumstances could broadly fall under three categories, *viz.*, general, market and credit. Under general category, there can be situations where bank is put unexpectedly to loss due to events such as civil unrest or collapse of currency in a country. Natural calamities and pandemics may also be included in the general category. Market category would include events such as general meltdown in the markets, which affects the entire financial system. Among the credit category, only exceptional credit losses would be considered as an extraordinary circumstance.

Valuation of Properties - Empanelment of Valuers

2.104 Different banks follow different policies for valuation of properties and appointment of valuers for the purpose. The issue of correct and realistic valuation of fixed assets owned by banks and that accepted by them as collateral for a sizable portion of their advances portfolio assumes significance in view of their implications for correct measurement of capital adequacy position of banks. Recognising the need for putting in place a system/procedure for realistic valuation of fixed assets and also for empanelment of valuers for the purpose, banks were advised on January 4, 2007 that (i) they should have a board approved policy in place for valuation of properties including collaterals accepted for their exposures; (ii) valuation should be done by professionally qualified independent valuers, *i.e.,* 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; (iv) banks should have a procedure for empanelment of professional valuers and maintain a register of 'approved list of valuers'; (v) banks may prescribe a minimum qualification for empanelment of valuers taking into account the qualifications prescribed under Section 34AB (Rule 8A) of the Wealth Tax Act, 1957; and (vi) banks may also be guided by the relevant accounting standard (AS) issued by the Institute of Chartered Accountants of India (ICAI).

2.105 In addition to the above, banks may also keep the following aspects in view while formulating policy for revaluation of their own properties. One, 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. In view of this, 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, the frequency of revaluation, depreciation policy for such assets and policy for sale of such revalued assets. 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. Two, 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 are required to adhere to these principles scrupulously while changing the frequency of revaluation/method of depreciation for a particular class of asset and should make proper disclosures in this regard.

NPA Management by Banks

2.106 Keeping in view the fact that the chances as well as the extent of recovery of NPAs reduce overtime, the Reserve Bank took several measures in recent years to expedite recovery of NPAs by banks by strengthening the various channels of NPA recovery such as debt recovery tribunals (DRTs), *Lok Adalats,* corporate debt restructuring (CDR) mechanism and the SARFAESI Act, 2002.

2.107 In order to review and align the existing guidelines on restructuring of advances (other than under CDR mechanism and SME debt restructuring mechanism) on the lines of provisions under the revised CDR mechanism, a Working Group comprising members from commercial banks, Indian Banks' Association (IBA) and the Reserve Bank was constituted. The Working Group suggested adoption of the regulatory framework prescribed under CDR mechanism to other categories of advances (those extended to non-CDR/non-SME borrowers) with suitable modifications. On the basis of the recommendations made by the Working Group and the feedback received, the draft prudential guidelines on restructuring/rescheduling were issued in June 2007.

2.108 With a view to providing an additional option and developing a healthy secondary market for NPAs, guidelines on sale/purchase of NPAs were issued in July 2005 covering the procedure for purchase/sale of non-performing assets (NPAs) by banks, including valuation and pricing aspects; and prudential norms relating to asset classification, provisioning, accounting of recoveries, capital adequacy, exposure norms, and disclosure requirements. The guidelines were partially modified in May 2007, whereby it was stipulated that at least 10 per cent of the estimated cash flows should be realised in the first year and at least 5 per cent in each half year thereafter, subject to full recovery within three years.

2.109 Consequent upon the enactment of the Credit Information Companies (Regulation) Act, 2005, the Reserve Bank constituted a Working Group (Chairman: Shri Prashant Saran) to frame draft rules and regulations for implementation of the Act. The draft rules and regulations were prepared and placed on the Reserve Bank's website for wider dissemination and comments. On the basis of the responses received, the draft rules and regulations were prepared and notified in December 2006 in consultation with the Government of India (Box II.11).

Corporate Governance

2.110 Corporate governance has assumed crucial significance for ensuring the stability and soundness of the financial system in recent years. In order to protect the interests of depositors and integrity of the financial system, it is necessary that owners and managers of banks are persons of sound integrity. Keeping these considerations in view, the Government of India at Reserve Bank's initiative, carried out amendments to the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980 and the State Bank of India (Subsidiary Banks) Act, 1959 to include new sections providing for applicability of 'fit and proper' criteria to elected directors on the boards of public sector banks. The process of preparing necessary guidelines in this regard is underway.

2.111 Two new sections Section 9 (3AA) and (3AB) were included in the Banking Companies (Acquisition & Transfer of Undertakings) Act, 1970/1980 (as amended in 2006) effectively introducing the applicability of 'fit and proper' criteria to the elected directors on the boards of nationalised banks. In terms of the provisions of the above sections a notification and a circular dated November 1, 2007 introducing 'fit and proper' criteria for elected directors on the boards of nationalised banks were issued. Similarly, Sections 25(2) and (3) were included in State Bank of India (Subsidiary Banks) Act, 1959 (as amended in 2007) introducing the applicability of 'fit and proper' criteria to the elected directors on the boards of Subsidiary Banks of State Bank of India. The process of issuing necessary guidelines in respect of subsidiary banks of State Bank of India is underway.

Know Your Customer Guidelines and Anti-Money Laundering Standards

2.112 Guidelines on know your customer (KYC) and anti-money laundering (AML) standards were issued by the Reserve Bank in November 2004. The provisions of the Prevention of Money Laundering Act (PMLA), 2002 came into effect from July 1, 2005. In terms of the Rules, the Financial Intelligence Unit – India (FIU-IND) was set up to collect, compile, collate and analyse the cash and suspicious transactions reported by banks and financial institutions. Reporting

Box II.11: Credit Information Companies (Regulation) Act, 2005 — Rules and Regulations

The Credit Information Companies (Regulation) Act, 2005 was passed in Parliament in May 2005. The rules and regulations for the implementation of the Act were notified on December 14, 2006. The Act was enacted with a view to strengthening the legal mechanism and enabling the credit information companies to collect, process and share credit information on the borrowers of banks and financial institutions. The Act also covers, *inter alia*, responsibilities of credit information companies, rights and obligations of the member credit institutions and safeguarding of privacy rights. The salient features of Credit Information Companies Rules and Regulations are set out below:

I. Salient features of Credit Information Companies Rules

(i) A credit information company whose application for certificate of registration has been rejected or whose certificate of registration has been cancelled, can approach the appellate authority designated by the Central Government for the purpose.

(ii) Every credit institution and the credit information company should formulate appropriate policy and procedure, duly approved by its board of directors, specifying therein the steps and security safeguards with regard to (a) collecting, processing and collating of data relating to the borrower; (b) steps for security and protection of data and the credit information maintained at their end; (c) appropriate and necessary steps for maintaining an accurate, complete and updated data; and (d) transmitting data through secure medium. Further, the credit institution or the credit information company should ensure that the credit information is accurate and complete with reference to the date on which such information is furnished or disclosed to the credit information company or the specified user as the case may be.

(iii) In order to prevent unauthorised access, every credit information company, credit institution and specified user should adopt policy and procedures to:

- (a) secure confidentiality of data;
- (b) allow access to only to authorised managers or employees on a need to know basis;
- (c) ensure control access to the data at terminals, network by means of physical barriers including biometric access control and logical barriers by way of passwords;
- (d) ensure that the passwords are changed regularly and frequently;
- (e) ensure that the best practices in relation to deletion and disposal of data especially the disposal of records or discs off-site or by external contractors are followed;
- (f) ensure protection against unauthorized modification or deletion of data;
- (g) ensure maintenance of log of all accesses to data, all unsuccessful attempts and all incidents involving a proven or suspected breach of security
- (h) protection against pilferage of information while passing through the public and private networks.

II. Salient features of Credit Information Companies Regulations

(i) The Regulations indicate which companies can obtain credit information as specified users (insurance company, cellular/ phone company, credit rating agency, stock broker, trading member, SEBI, IRDA, among others) in addition to those provided under section 2(l) of the Act.

(ii) Every application by a company for grant of certificate of registration for continuing/commencing business of credit information should be made in 'Form A' to the Reserve Bank. On carrying out scrutiny of the application, the Reserve Bank may grant 'in-principle approval' to such applicant company and provide time to the company, not exceeding three months, for fulfilling the conditions included therein and may grant the certificate of registration to the company thereafter.

(iii) The regulations provide for the form of business in which credit information companies can engage (providing Data Management Services to members, collection/dissemination of information on investments made by members in securities, fraud, money laundering *etc.*) in addition to those provided under section 14(l) of the Act.

(iv) The privacy principles formulated to guide the credit Information companies, credit institutions and specified users include the following:

- (a) Care in collection of credit information: The credit information shall be properly and accurately recorded, collected and processed and shall be protected against loss, unauthorised access, use, modification or disclosure.
- (b) Access to and modification of credit information: Every credit information company upon request from a person shall disclose to him, his own credit information report, subject to satisfactory identification. Further, every credit information company, credit institution and specified user shall take prompt action in relation to updating of credit information with proper coordination amongst them within prescribed time limit.
- (c) Data use limitation: Obligation to disclose by the specified user to a borrower or client as the case may be within thirty days in case credit is denied to him.
- (d) Length of preservation of credit information: Credit information shall be preserved for a minimum period of seven years.

(v) Regulations provide for the principles and procedures relating to personal credit information in respect of manner and purpose of collection of personal data, solicitation of personal data, accountability in transferring data to third party, redressal of grievances of individuals and length and preservation of personal data, among others.

(vi) Maximum fee leviable by a credit information company is as under:

- Rs.15 lakh – Membership fee for credit institution and credit information company;
- Rs.50,000 and Rs.15 lakh – annual fee for credit institution and credit information company, respectively.
- Rs.100 for proving an individual his own credit report
- Rs.500 and Rs.5,000 for providing credit report on individual and non-individuals, respectively to specified users.

formats for suspicious transactions and currency transactions were finalised in consultation with the FIU-IND and, accordingly, banks were advised to report cash and suspicious transactions as prescribed under the PMLA, 2002 to FIU-IND. The KYC/AML/combating of financing of terrorism (CFT) regime put in place by the Reserve Bank is consistent with the international best practices and recommendations of the Financial Action Task Force (FATF). The country as a whole and financial sector, in particular, were evaluated by the Asia Pacific Group on Money Laundering (APGML) in 2005 and India has now secured the status of 'Observer' in the FATF.

2.113 Banks use wire transfers as an expeditious method for transferring funds between bank accounts. Wire transfers include transactions occurring within the national boundaries of a country or from one country to another. As wire transfers do not involve actual movement of currency, they are considered as a rapid and secure method for transferring value from one location to another. In this regard, Guidelines on KYC/AML/CFT were issued to banks on April 13, 2007 on the lines of FATF Special Recommendation (SR) VII, which aims at preventing terrorists and other criminals from misusing wire transfers for movement of their funds across boarders. The salient features of a wire transfer transaction include: (a) all cross-border wire transfers must be accompanied by accurate and meaningful originator information; (b) information accompanying cross-border wire transfers must contain the name and address of the originator and where an account exists, the number of that account in the absence of an account, a unique reference number, as prevalent in the country concerned, must be included; (c) where several individual transfers from a single originator are bundled in a batch file for transmission to beneficiaries in another country, they may be exempted from, including full originator information, provided they include the originator's account number or unique reference number as at (b) above; (d) information accompanying all domestic wire transfers of Rs.50,000 and above must include complete originator information, *i.e.,* name, address and account number, unless full originator information can be made available to the beneficiary bank by other means; (e) if a bank has reason to believe that a customer is intentionally structuring wire transfers to below Rs. 50,000/- to several beneficiaries in order to avoid reporting or monitoring, the bank must insist on complete customer identification before effecting the transfer; and (f) when a credit or debit card is used to effect money transfer, necessary information as (d) above is required to be included in the message. Further, the record of originator information accompanying a wire transfer should be kept for ten years, as required under PMLA, 2002. In case, any overseas ordering bank fails to furnish information on the remitter, the receiving bank should restrict or even terminate its business relationship with the ordering bank.

2.114 These instructions are also applicable to domestic wire transfer transactions. An amendment to the PMLA Rules was also notified by the Government on May 24, 2007, which has broadened the definition of suspicious transaction by including suspicion on account of probable terrorist financing as one of the grounds for making an suspicion transaction report (STR) by banks to FIU-IND.

Committee on Financial Sector Assessment

2.115 Building up a resilient and well-regulated financial system is widely acknowledged as *a sine qua non* for macroeconomic and financial stability. It has, therefore, been the endeavour of regulatory authorities in India to develop a safe, sound and efficient financial system in line with the best standards prevailing internationally, suitably adapted to the domestic conditions. Besides voluntarily participating as one of the earliest member countries in the Financial Sector Assessment Programme (FSAP) of the World Bank and the International Monetary Fund (IMF) in 2001, India also undertook a self-assessment of all the areas of international financial standards and codes by the Committee on International Financial Standards and Codes (Chairman: Dr. Y.V. Reddy). Drawing upon the experience gained during the 2001 FSAP and recognising the relevance and usefulness of the analytical details contained in the Handbook on Financial Sector Assessment jointly brought out by the World Bank and the IMF, in September 2005, the Government of India, in consultation with the Reserve Bank of India, decided to undertake a comprehensive self-assessment of the financial sector. Accordingly, in September 2006, a Committee on Financial Sector Assessment (CFSA) was constituted (Chairman: Dr. Rakesh Mohan; Co-Chairman: Dr. D. Subbarao) (Box II.12).

Box II.12: Committee on Financial Sector Assessment

A Committee on Financial Sector Assessment (CFSA) was constituted by the Government of India in September 2006 (Chairman: Dr. Rakesh Mohan; Co-Chairman: Dr. D. Subbarao) with the following terms of reference:

- To identify the appropriate areas, techniques and methodologies in the Handbook on Financial Sector Assessment brought out by the IMF/World Bank and also in any other pertinent documents for financial sector assessment relevant in the current and evolving context of the Indian financial sector;
- To apply relevant methodologies and techniques adapted to the Indian system and attempt a comprehensive and objective assessment of the Indian financial sector, including its development, efficiency, competitiveness and prudential aspects;
- To analyse specific development and stability issues as relevant to India;
- To make available its report(s) through Reserve Bank of India/Government of India websites.

The central plank of the assessment is based on three mutually reinforcing pillars, *viz.*, (i) financial stability assessment and stress testing; (ii) legal, infrastructural and market development issues; and (iii) assessment of the status and progress in implementation of international financial standards and codes. To assist in the process of assessment, the CFSA has constituted four Advisory Panels for the assessment of (i) Financial Stability and Stress Testing; (ii) Financial Regulation and Supervision; (ii) Institutions and Market Structure; and (iv) Transparency Standards. The Advisory Panels will prepare separate reports covering each of the above aspects. The Advisory Panels comprise of non-official experts with domain knowledge in respective areas and officials with similar expertise represented as special invitees. The panels would have the option of co-opting as special invitees any other experts as they deem fit.

The Advisory Panel on Financial Stability and Stress Testing (Chairman: Shri M.B.N. Rao) would conduct macro-prudential surveillance (including system-level stress testing) to assess the soundness and stability of the financial system and suggest measures for strengthening the financial structure and system and its development in a medium-term perspective.

The other three panels would (i) identify and consider the relevant standards and codes as currently prescribed and applicable to different areas; (ii) evaluate their implementation in the Indian context; (iii) identify gaps in adherence to respective standards; and (iv) suggest possible roadmaps towards compliance in a medium-term perspective. The Advisory Panel on Financial Regulation and Supervision (Chairman: Shri M.S. Verma) would consider the relevant standards and codes applicable for financial regulation and supervision pertaining to the banking sector, financial markets and insurance. The Advisory Panel on Institutions and Market Structure (Chairman: Shri C.M. Vasudev) would consider the relevant standards and codes applicable to bankruptcy laws, accounting and auditing, payment and settlement systems and corporate governance policies. The Advisory Panel on Transparency Standards (Chairman: Shri Nitin Desai) would consider the relevant standards and codes applicable for transparency in monetary, financial, fiscal and data dissemination policies.

To provide the Panels with technical notes and background material, the CFSA has set up Technical Groups consisting of officials representing mainly regulatory agencies and the Government in all the above subject areas which have progressed with technical work and assisting Advisory Panels in respective areas.

With a view to enhancing credibility of self assessment, the assessment of the Advisory Panels are proposed to be peer received by international experts. The views of the peer reviews would be taken on board while finalising Advisory Panels Reports.

The CFSA would publish Advisory Panel reports and also its own report. Based on an objective analysis of the present strengths and weaknesses of the financial sector and the status with regard to standards, the CFSA is expected to lay down a roadmap for further reforms in a medium-term perspective. The CFSA is expected to complete the assessment by March 2008.

6. Supervision and Supervisory Policy

2.116 The Reserve Bank has been paying special attention to supervisory aspects within the financial sector with a view to improving efficiency and soundness of the regulated entities and stability of the markets. The Board for Financial Supervision (BFS) was constituted on November 16, 1994 to pay undivided attention to supervision. During July 2006-June 2007, the BFS held twelve meetings. The BFS not only suggested the course of action to be pursued in respect of institution-specific supervisory concerns, but also provided guidance on several regulatory and supervisory policy matters. A detailed account of the working of the BFS during 2006-07 is set out at Annex II-1.

Significant Changes in the Monitoring Mechanism of Financial Conglomerates

2.117 The supervisory processes for the financial conglomerates (FC) the world over are in evolving stage. A beginning was made in India when a FC monitoring framework was put in place following the acceptance of the report of an Inter-regulatory Working Group (Convenor: Smt. Shyamala Gopinath) on monitoring of systemically important financial intermediaries (SIFI - more commonly known as FCs) in June 2004. Based on the experience gained, several initiatives have been taken in consultation with other regulators to strengthen the FC monitoring framework. In this regard, two major initiatives were taken during 2006-07. One, the criteria for identification

of FCs were revised. Many of the identified FCs not only had very few entities within their fold, but also had limited operations beyond one market segment. There were fewer intra-group transactions in these conglomerates. Merger of housing finance arm and primary dealer subsidiary in some of the conglomerates had further reduced the number of entities in the group. It was, therefore, felt that it was not necessary to subject such systemically less important groups to focussed FC monitoring. The criteria for identification of FCs were, thus, revisited in order to focus on major financial groups which are of supervisory interest. As per the revised criteria, a FC is defined as a cluster of companies belonging to a Group[3] which has significant presence in at least two financial market segments. Banking, insurance, mutual fund and NBFC (deposit taking and non-deposit taking) are considered as financial market segments. Two, FC returns were revised in order to appropriately focus on the supervisory issues. Receipt and analysis of quarterly FC return is an important plank of the FC monitoring system. The FC return, while focusing on intra-group transactions and exposures, elicited information on financial parameters, exposures to various markets, cross-linkages, and commonality of back-office arrangements. The format of the quarterly FC return was amended to include information on gross/net NPA and provisions held for the impaired assets, bad debt, fraud in any group entity, 'holding out' operations undertaken by the group, other assets and change in accounting policies, among others. While the FC monitoring framework looks at the specified financial intermediaries (SFIs), *i.e.,* entities which are regulated by the Reserve Bank, Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority (IRDA) or National Housing Bank (NHB), the format of the returns has been suitably modified to capture intra-group transactions and exposures involving regulated and unregulated entities of the group in order to have a better appreciation of systemic risk emanating from the group as a whole.

Compliance Function in Banks

2.118 As compliance function is an integral part of governance along with the internal control and risk management process, guidelines on compliance function of banks were issued on April 20, 2007 (Box II.13)

Preventive Measures Taken by the Reserve Bank against Frauds

2.119 For centralised monitoring of frauds detected in regulated entities of the Reserve Bank, *viz.*, commercial banks, urban co-operative banks, financial institutions and non-banking financial companies, a Fraud Monitoring Cell (FrMC) under the administrative control of the Department of Banking Supervision was set up in June 2004. All commercial banks file fraud reports on-line through Fraud Monitoring and Reporting System (FRMS) to FrMC. The Reserve Bank monitors the progress in criminal cases filed by the banks, recovery of the dues, examination of staff accountability and rectification of deficiencies in the system and controls in banks in order to reduce the incidence of frauds, through quarterly statements submitted by banks.

2.120 The *modus operandi* in credit card frauds included cloning, and obtaining credit cards from banks based on fake documents. In view of the reported incidents of attempts made by some persons to use plastic cards other than credit/ debit cards at ATMs to effect withdrawal of cash, guidelines were issued to banks for focussed customer education and operational/security measures to be taken by them so as to avoid recurrence of such frauds. Detailed instructions were issued to banks in February 2006 to help prevent *phishing*[4] attacks by certain persons/ entities. Cloning mostly through skimming

[3] Group: An arrangement involving two or more entities related to each other through any of the following relationships: Subsidiary - parent (defined in terms of AS 21), joint venture (defined in terms of AS 23), associate (defined in terms of AS 27), promoter-promotee, a related party (defined in terms of AS 18), common brand name, and investment in equity shares 20 per cent and above. group entity: any entity involved in the above arrangement.

[4] Phishing involves hijacking of brand names of banks, e-retailers and credit card companies wherein an e-mail is sent to a user, falsely claiming to be an established legitimate enterprise in an attempt to scam the user into surrendering private information that is used for identity theft. The e-mail directs the user to visit a website where he is asked to update personal information such as passwords and credit card, social security and bank account numbers. The website, however, is fake and set up only to steal the user's information. The information, thus, obtained is used to commit frauds.

Box II.13: Compliance Function in Banks

Compliance function in banks is perceived as one of the key elements in their corporate governance structure. Based on the recommendations of the Ghosh Committee, banks in India have already put in place compliance processes. However, the processes and the organisational structures have not kept pace with the increased complexities and sophistication in the banking business. In a large number of banks, the compliance function is yet to reckon the 'compliance risk' and the reputational risk arising out of compliance failures causing huge economic costs. The need for the management of the compliance risk by banks as one of the key facets of integrated risk management or enterprise-wide risk management framework at banks was recognised. Accordingly, the Annual Policy Statement for the year 2006-07 stressed the need for strong compliance standards in banks. A Working Group set up by the Reserve Bank with participation from the banking industry to review the present system of compliance machinery in banks recommended a number of measures for strengthening the compliance function. Based on the recommendations, guidelines on compliance function of the banks were issued on April 20, 2007. The guidelines sought to introduce certain principles, standards and procedures relating to compliance function consistent with the high level paper on 'Compliance and the Compliance Function in Banks' issued by the Basel Committee of Banking Supervision as also the operating environment in India. The guidelines articulate the Reserve Bank's view that the compliance function is an integral part of governance, along with the internal control and risk management process. The guidelines are also intended to guide the bank-led financial conglomerates in managing their 'group-wide compliance risk'. The salient features of the guidelines are as under:

- Each bank will put in place a formal compliance function and designate a compliance officer for its bank. It will be the responsibility of the bank's compliance officer to assist the top management in managing effectively the compliance risks faced by the bank.
- A robust compliance system in a bank should include a well documented compliance policy, outlining the philosophy of the bank, role and set up of the compliance department, composition of its staff and their specific responsibilities. The policy should be reviewed annually by the bank's board.
- Depending on its branch network, size and complexity of the business operations, sophistication of products and services offered, every bank should decide on the organisational structure and composition of its compliance unit. The structure may, however, be laid down within the overall framework of these guidelines and should avoid all potential conflicts of interest.
- The compliance department at the Head Office should play the central role in the area of identifying the level of compliance risk in each business line, products and process and issue instructions to operational functionaries and formulate proposals to mitigate such risk. It should periodically circulate the instances of compliance failures among staff along with the preventive instructions.
- The responsibilities of the compliance function should be carried out under a compliance programme that sets out its planned activities. The compliance programme should be risk-based and subject to oversight by the head of compliance to ensure appropriate coverage across businesses and co-ordination among risk management functions. The compliance function should advise and assist the senior management on compliance laws, rules and standards. It should also put up to the senior management information on developments by establishing written guidance to staff on the appropriate implementation of compliance laws, rules and standards through policies and procedures and other documents such as compliance manuals, internal codes of conduct and practice guidelines.
- Banks may choose to carry on business in various jurisdictions for a variety of legitimate reasons. In such cases, it should be ensured that they comply with the applicable laws and regulations in all such jurisdictions and that the organisation and structure of the compliance function and its responsibilities are consistent with local legal and regulatory requirements. It is for local businesses to ensure that compliance responsibilities specific to each jurisdiction are carried out by individuals with the appropriate local knowledge and expertise, with oversight from the head of compliance in co-operation with the bank's other risk management functions.

involved transferring data from a genuine credit card to the magnetic stripe of a counterfeit credit card using certain skimming devices. In June 2006, the Reserve Bank issued guidelines to commercial banks listing out various measures that could be initiated by them to combat skimming.

2.121 The Reserve Bank, in May 2006, circulated to banks some of the best practices which could be adopted in order to reduce the incidence of frauds in areas of housing loans. The *modus operandi* adopted by the fraudulent borrowers involved availing multiple finance by submission of fake documents of properties, fake salary slips and income tax certificates. Several instances have also come to the notice of the Reserve Bank wherein builders used gullible borrowers to avail of loans and then diverted the proceeds. Further, funds were also siphoned off through fictitious accounts opened in the name of builders.

2.122 Certain instances of fraudulent transfer of funds from non-resident accounts through fake e-mails and fax messages were reported by banks. The Reserve Bank, in November 2006, alerted banks to be cautious while remitting funds from the accounts of non-residents based on requests

received through e-mail/fax messages. They were asked to put in place appropriate systems to verify the authenticity of the messages thoroughly before effecting remittance.

2.123 A number of cases of frauds in the area of financing against warehouse receipts were reported to the Reserve Bank during the year. In such cases, warehouses issued warehouse receipts (WR) representing values much higher than the actual stocks to the borrowers who availed of higher finances against the stock of commodities. The fraud was perpetrated mainly due to the lack of adequate supervision/control over the pledged stock. With a view to alerting all the banks on such financing, guidelines on *modus operandi* were issued by the Reserve Bank in February 2007.

7. Financial Markets

2.124 The Reserve Bank initiated several important measures during 2006-07 to widen and deepen the various segments of the financial market under its jurisdiction. The institutional framework for financial markets was further strengthened in terms of processes, while allowing greater flexibility to market participants to carry out their transactions.

Developments in the Money Market

2.125 In pursuance of the announcement made in the Annual Policy Statement of April 2005, a screen-based negotiated quote-driven system for dealings in call/notice and term money market (NDS-CALL) was developed by the Clearing Corporation of India Ltd. (CCIL), which was launched on September 18, 2006 with participation by market constituents on a voluntary basis. Apart from helping in improving the ease of transactions, the system has brought about greater transparency and efficient price discovery. There has been a growing preference for the NDS-CALL screen, which currrently accounts for around 75 per cent of total call money volumes.

2.126 The Reserve Bank issued comprehensive guidelines in respect of interest rate derivatives in April 2007. In respect of over-the counter (OTC) derivative transactions, it became necessary to have a mechanism for transparent capture and dissemination of trade information as well as an efficient post-trade processing infrastructure to address some of the attendant risks. To begin with, the CCIL was advised to start a trade reporting platform for rupee interest rate swaps (IRS). This reporting module was launched on August 31, 2007.

2.127 Recognising the need for a robust interest rate futures market as an effective instrument for management of interest rate risk and in pursuance of the recommendation of the Reserve Bank's Technical Advisory Committee on Money, Foreign Exchange and Government Securities Markets, a Working Group on Interest Rate Futures (Chairman: Shri V.K. Sharma) was set up by the Reserve Bank on August 9, 2007 which would review the experience gained so far with interest rate futures with particular reference to product design issues and make recommendations for activating the instrument. The Group would also revisit the recommendations of the earlier Committees in this area and examine regulatory requirements as well as the scope and extent of participation of non-residents while making its own recommendations. The report would be placed on the Reserve Bank's website within three months (by December 31, 2007) after further discussions with the TAC on Money, Foreign Exchange and Government Securities Markets.

Developments in the Government Securities Market

2.128 The provision of the Fiscal Responsibility and Budget Management Act, 2003 prohibiting the Reserve Bank from participating in the primary issuances of Government securities came into effect on April 1, 2006. In order to meet the requirements of the new environment, a number of initiatives were taken during 2006-07 with the objective of further deepening and widening the Government securities market. These measures included extending short selling in Central Government securities to five days, introduction of 'when issued' market, permitting diversification of primary dealer (PD) business, introduction of a revised scheme of underwriting commitment and liquidity support to primary dealers, and extension of the Negotiated Dealing System - Order Matching (NDS-OM) module to new participants.

2.129 In order to further strengthen the debt management framework, the guidelines on 'when issued' (WI) trading in 'reissued' Central Government dated securities were prescribed in May 2006 and trading in this segment commenced from August 2006. At present, the 'WI' trading can

be undertaken in Central Government dated securities, both reissued and newly issued securities, on a selective basis. The 'WI' trading is permitted only on the NDS-OM to all NDS members, subject to the open position limits. However, short positions in 'WI' market can be run only by PDs.

2.130 With a view to enabling the market participants to a take two-way view on interest rate expectations and better manage their interest rate risk, the internal Technical Group on Central Government Securities set up by the Reserve Bank had recommended the introduction of short selling in Central Government securities in a phased manner. In the first phase, banks/PDs were permitted intra-day short selling from February 28, 2006. Subsequently, on January 31, 2007, the participants were permitted to keep their short positions open up to five trading days, including the day of trading. With a view to enabling participants to run short positions across settlement cycles, banks/PDs were permitted to use the securities acquired under reverse repo (other than LAF) to meet the delivery obligation of the short sale transaction.

2.131 Pursuant to the recommendations of the Working Group on Screen Based Trading in Government Securities (Chairman: Dr. R. H. Patil) and with a view to providing the Government securities market participants with an advanced and efficient trading platform, the NDS-OM platform was operationalised on August 1, 2005. The system, which initially accommodated trading only in Central and State Government dated securities, was upgraded on July 31, 2006 to handle trading of Treasury Bills. Membership to the NDS-OM, which was initially only for the Reserve Bank regulated NDS members (banks and PDs), was subsequently expanded to include insurance companies, mutual funds and select large provident funds. Furthermore, to encourage retail trading, a separate module on NDS-OM was operationalised to enable trading in odd lots (of sizes less than a standard lot of Rs.5 crore).

2.132 In order to widen the reach of NDS-OM, on May 25, 2007, the access was extended to qualified entities maintaining gilt accounts with NDS members. Qualified entities cover all entities required by law or by regulation to invest in Government securities such as deposit taking NBFCs, provident funds, pension funds, mutual funds, insurance companies, co-operative banks, regional rural banks and trusts. These entities could place orders on NDS-OM through direct NDS-OM members, *viz.*, banks and PDs using the constituents' subsidiary general ledger (CSGL) route. Such trades are settled through the CSGL account and current account of the NDS-OM member. Though the system permits putting through CSGL trades on behalf of all gilt account holders, it is the responsibility of the respective custodians (CSGL account holders) to exercise caution and not to permit any trade on account of entities that were not 'qualified'. They should evolve a mechanism to ensure that the gilt account holder satisfies the eligibility criteria before allowing orders to be placed on the NDS-OM. In the Mid-Term Review of the Annual Policy Statement for 2007-08, it was proposed to include systemically important non-deposit taking NBFCs (NBFC-ND-SI) as qualified entities.

2.133 Pursuant to the recommendations of the Internal Technical Group on Central Government Securities and with a view to consolidating Central Government securities to impart liquidity to the Government Securities market, a scheme of active consolidation was finalised and approved by the Central Government. Under this scheme, securities to be bought back were identified by the liaison group formed for the purpose. In the Union Budget 2007-08, the Central Government provided Rs.2,500 crore towards the premium payment under the scheme. The actual exercise of buying back of securities is expected to be conducted during 2007-08.

2.134 During 2006-07, several instructions/ guidelines having a bearing on the operations of the PDs were also issued. These included entrusting the PDs with the responsibility to underwrite the entire issue and broad-basing and diversification of the PD activity.

Developments in the Foreign Exchange Market

2.135 Against the backdrop of current realities and with a view to suggesting future roadmap for capital account convertibility, the Reserve Bank, in consultation with the Government of India, constituted the Committee on Fuller Capital Account Convertibility (FCAC) (Chairman: Shri S. S. Tarapore), which submitted its report in July 2006. Apart from making several recommendations on the development of financial markets, the Committee recommended that an Internal Task Force should be constituted to re-

examine the extant regulations under the Foreign Exchange Management Act (FEMA) and make recommendations to remove the operational impediments in the path of liberalisation already in place. Accordingly, an internal Task Force was constituted and it completed the assigned task in January 2007. Certain recommendations of the Task Force were implemented in the Annual Policy Statement for the year 2007-08 announced on April 24, 2007.

2.136 With a view to simplifying the procedures and providing greater flexibility in foreign exchange transactions, the ceiling for remittances for resident individual under the Liberalised Remittance Scheme for Resident Individuals was enhanced in two stages: from US $ 25,000 (per calendar year) to US $ 50,000 in December 2006 (per financial year) and further to US $ 1,00,000 (per financial year) in May 2007, with some conditions. A uniform period of six months has been allowed for surrender of received/unspent/ unused foreign exchange from the date of receipt/ purchase/acquisition/date of return of the traveller, as the case may be.

2.137 In April 2007, resident individuals were permitted to manage/hedge their foreign exchange exposures, including anticipated exposures by booking forward contracts without production of underlying documents up to an annual limit of US $ 1,00,000 which can be freely cancelled and rebooked.

2.138 The requirement of issue of encashment certificate on security paper if the amount of foreign currency encashed exceeds Rs.15,000 in value has been dispensed with and instead AD category-I banks[5], when requested by the customer, can now issue encashment certificate, duly signed by authorised officials, on their letter head (with their logo printed on it), irrespective of the amount.

2.139 Non-Resident Indians (NRIs) and Persons of Indian Origin (PIO) are permitted to remit up to US $ 1 million per financial year for any bonafide purpose out of the balances in their Non-Resident Ordinary (NRO) accounts. The balance in the NRO accounts could also include the sale proceeds of immovable property acquired by the non-resident out of her/his resources in India, or sale proceeds of property received by way of inheritance or gift. With a view to providing greater flexibility, the lock-in period of 10 years for remittance of sale proceeds of immovable property was dispensed with, from November 2006. Taking into account the sizeable increase in non resident deposits in 2006-07 and reports of large growth in advances being granted against such deposits, and in order to avoid upward pressure on asset prices in sensitive sectors, banks were prohibited from granting fresh loans in excess of Rs. 20 lakh against the NR(E)RA and FCNR(B) deposits, either to depositors or to third parties, effective January 31, 2007. Banks were also advised not to undertake artificial slicing of the loan amount to circumvent the ceiling.

2.140 In order to provide corporates with greater flexibility in their external transactions, certain measures were undertaken. These included, *inter alia,* permitting AD category-I banks to reimburse pre-incorporation expenses incurred in India up to certain limits; permitting AD category-I banks to make remittances on account of donations by corporates for specified purposes, subject to certain limits from April 2007 and raising the limit for remittance for consultancy service procured from outside by Indian companies executing infrastructure projects from US $ 1 million per project to US $ 10 million per project with effect from April 2007.

2.141 Facilities available to exporters/importers were liberalised/simplified further. These, *inter alia*, included (i) allowing all categories of foreign exchange earners to credit up to 100 per cent (50 per cent earlier) of their foreign exchange earnings to their exchange earner's foreign currency (EEFC) account from November 2006; (ii) allowing (in January 2007) project/service exporters to deploy their temporary cash surpluses, generated outside India, in specified instruments/products outside India; and (iii) dispensing with the requirement of repatriation of 30 per cent of the contract value in respect of on-site contracts by software exporter company/firm with effect February 2007. AD Category –I banks were also granted some facilities which, *inter alia*, included (a) extension of time to realise export proceeds beyond the prescribed period of six months from February 2007; and

[5] Banks currently authorised to deal in foreign exchange (namely, scheduled commercial banks, State cooperative banks, and urban co-operative banks) are categorized as AD category I banks. They are authorised to deal in all current and capital account transactions, according to the directions issued by the Reserve Bank from time to time.

(b) permitting these banks to issue guarantee on behalf of their customers, subject to guidelines from November 2006.

2.142 Furthermore, with a view to providing greater flexibility to corporates in regard to their overseas investment, a number of measures were undertaken, which, *inter alia,* included enhancing the overseas investment limit (total financial commitments) for Indian companies; (ii) enhancement of limit for portfolio investment abroad by listed Indian companies in listed overseas companies; and (iii) liberalisation of the limits of remittances for initial/recurring expenses incurred abroad.

2.143 In order to facilitate dynamic hedging of foreign exchange exposures and keeping in view the size of the market in India and the large positions held by FIIs, it was decided to allow rebooking of cancelled contracts in a gradual and phased manner. Accordingly, in February 2007, AD category–I banks were permitted to allow FIIs to cancel and rebook forward contracts up to a limit of two per cent of the market value of their entire investment in equity and/or debt in India. The limit for calculating the eligibility for rebooking is based on the market value of the portfolio at the beginning of the financial year. The outstanding contracts must be duly supported by underlying exposure at all times. The AD bank has to ensure that the total outstanding forward contracts do not exceed the market value of portfolio.

2.144 The Annual Policy Statement of April 2007 proposed to set up a Working Group on Currency Futures to study the international experience and suggest a suitable framework to operationalise the proposal within the existing legal and regulatory framework. Accordingly, an Internal Working Group on Currency Futures (Chairman: Shri Salim Gangadharan) was set up which studied, *inter alia,* the experiences of some emerging market economies where currency futures exchanges have been functioning within an environment of capital controls. The Group considered the views of a wide cross section of stakeholders, including banks, industry associations, domestic and international exchanges, and had extensive and detailed consultations with market participants in the TAC on Money, Foreign Exchange and Government Securities Markets. The Group explored various options for the proposed currency futures exchange, particularly on aspects like participation, clearing and settlement, market intermediaries, margins, contract design and surveillance mechanism. The draft report of the Group was placed on the Reserve Bank's website for comments on November 16, 2007.

8. Customer Service in Banks

2.145 The Reserve Bank initiated several measures during 2006-07 to protect customers' rights, enhance the quality of customer service and strengthen the grievance redressal mechanism in the Reserve Bank as well as in banks. A new department for customer service, 'Customer Service Department', was constituted in the Reserve Bank which became operational on July 1, 2006 mainly to (i) oversee the customer service aspects relating to grievance redressal by banks; (ii) administer the Banking Ombudsman (BO) Scheme; and (iii) liaise with the Banking Codes and Standards Board of India (BCSBI). The department also oversees the level of customer service in the Reserve Bank offices. The data regarding the complaints received at the Reserve Bank offices are collated and analysed at Central Office level on a monthly basis and reviewed by the Local Board on a quarterly basis.

2.146 The 'Code of Bank's Commitment to Customers' was released on July 1, 2006 which signifies the first formal collaborative effort by the Reserve Bank, banks and the BCSBI to provide a framework for a minimum standard of fair practices on various banking transactions for individual customers. Out of 84 scheduled commercial banks, 70 banks are committed to follow the code as members of the BCSBI.

2.147 In order to facilitate easy comparison of service charges of various banks by their customers, banks were advised on July 20, 2006 to place service charges and fees on the homepage of their website at a prominent place under the title of 'service charges and fees'. A weblink to the websites of the banks was provided on the Reserve Bank's website. Banks were also advised that a complaint form, along with the name of the nodal officer for complaint redressal, may be provided on the homepage itself to facilitate complaint submission by the customers.

Reasonableness of Service Charges

2.148 The Working Group set up to formulate a scheme for ensuring a reasonableness of bank charges submitted its Report in August 2006. The

Report examined various issues such as basic banking/financial services to be rendered to individual customers, the methodology adopted by banks for fixing the charges and the reasonableness of such charges. The Working Group identified twenty seven basic banking services relating to deposit accounts, loan accounts, remittance facilities and cheque collection and defined low value transactions for cheque collection and remittance up to Rs.10,000 in each case and up to $500 for foreign exchange transactions. The Working Group indicated broad principles of reasonableness based on (i) lower rates for individuals as compared to non-individual entities; (ii) lower rates for special categories of individuals such as senior citizens, rural customers and pensioners; (iii) charges that are just and supported by reason; and (iv) levy of service charges *ad valorem* only to cover incremental cost, subject to a cap. For basic services rendered to special category of individuals, the Working Group recommended that banks should levy charges on more liberal terms than the terms on which the charges are levied to other individuals.

2.149 The Working Group also recommended that the individual customers be provided upfront and in a timely manner, the complete information on the charges as well as the proposed changes in charges applicable to all basic services. The recommendations of the Working Group have been accepted by the Reserve Bank with certain modifications. Based on the recommendations of the Working Group, the Reserve Bank issued a circular to all scheduled commercial banks on February 2, 2007.

Complaints about Excessive Interest Charged by Banks

2.150 The Reserve Bank and the Banking Ombudsman offices have been receiving several complaints regarding levying of excessive interest rates and charges on certain loans and advances. The issue was examined and banks were advised on May 7, 2007 that though interest rates have been deregulated, rates of interest beyond a certain level may be seen to be usurious, and can neither be sustainable, nor be conforming to normal banking practice. Boards of banks were, therefore, advised to lay down appropriate internal principles and procedures so that usurious interest, including processing and other charges, are not levied by them on loans and advances. In laying down principles and procedures in respect of small value loans, particularly, personal loans and such other loans of similar nature, banks were advised to take into account, *inter alia*, the following broad guidelines: (i) the total cost to the borrower, including interest and all other charges levied on a loan, should be justifiable 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; and (ii) an appropriate ceiling may be fixed on the interest, including processing and other charges that could be levied on such loans, which may be suitably publicised.

Analysis and Disclosure of Complaints

2.151 Based on the recommendation of the Committee on Procedures and Performance Audit of Public Services (CPPAPS) (Chairman: Shri S.S. Tarapore) and for enhancing the effectiveness of the grievance redressal mechanism, banks were advised, on February 22, 2007, to place a statement of complaints before their boards/Customer Service Committees along with an analysis of the complaints received. Banks have also been advised to place the detailed statement of complaints and their analysis on their websites for information of the general public at the end of each financial year. The complaints should be analysed to identify customer service areas in which the complaints are frequently received, frequent sources of complaint, and to identify systemic deficiencies, for initiating appropriate action to make the grievance redressal mechanism more effective.

2.152 Further, banks were also advised to disclose brief details relating to customer complaints such as number of complaints received, number of complaints redressed and number of pending complaints alongwith their financial results. Similarly, banks were also required to disclose brief details relating to 'awards' passed by the Banking Ombudsmen such as number of awards passed, number of awards implemented/remaining unimplemented alongwith their financial results.

2.153 With a view to ensuring better governance standards and probity/transparency in the conduct of affairs of public institutions, the Government had, on April 21, 2004, authorised the Central Vigilance Commission (CVC) as the 'designated agency' to receive written complaints or disclosure of any allegation of corruption or of misuse of office, and recommend appropriate action. The jurisdiction of the CVC is restricted to employees

of the Government or of any corporation established by it or under any Central Act, Government companies, societies or local authorities owned or controlled by the Government, and hence covers only public sector banks. As private sector banks and foreign banks are outside the purview of the CVC, the Reserve Bank introduced a similar scheme called 'Protected Disclosures Scheme for Private Sector and Foreign Banks' on April 18, 2007. The complaints under the scheme cover areas such as corruption, misuse of office, criminal offences, suspected/actual fraud, failure to comply with existing rules and regulations, and acts resulting in financial loss/operational risk, loss of reputation, and acts detrimental to depositors' interest/public interest. Under the scheme, employees of the bank concerned (private sector banks and foreign banks operating in India), customers, stakeholders, NGOs and members of public can lodge complaints (Box II.14).

Right to Privacy of Members of the Public

2.154 Instructions were issued to all card-issuing banks regarding maintenance of 'Do Not Call Registry' with a view to protecting the right to privacy of the members of the public. Keeping in view the continuous complaints from credit card subscribers and the observations of the High Court of Delhi in the context of a public interest litigation (PIL) in this regard, the Telecom Regulatory Authority of India (TRAI) has framed the Unsolicited Commercial Communications (UCC) Regulations, 2007. Based on these regulations as also the guidelines for telemarketers issued by the Department of Telecommunications (DoT), Government of India, the Reserve Bank advised banks on July 3, 2007 on the modalities to be followed in the case of unsolicited commercial communications. The guidelines prescribed the criteria for engaging telemarketers. Banks were advised (i) not to engage telemarketers [direct selling agents (DSAs)/direct marketing agents (DMAs)], who do not have a valid registration certificate from the Department of Telecommunications (DoT), Government of India, as telemarketers; (ii) to furnish a list of telemarketers (DSAs/DMAs) engaged by them alongwith the registered telephone numbers being used by them for making telemarketing calls to IBA to forward the same to TRAI; and (iii) to ensure that all telemarketers

Box II.14: Introduction of Protected Disclosures Scheme for Private Sector Banks and Foreign Banks

Disclosure of information in the public interest by the employees of an organisation is increasingly gaining acceptance by public bodies for ensuring better governance standards and probity/transparency in the conduct of affairs of public institutions. In this context, the Government of India had passed a resolution on April 21, 2004 authorising the Central Vigilance Commission (CVC) as the 'Designated Agency' to receive written complaints or disclosure on any allegation of corruption or of misuse of office and recommend appropriate action. The jurisdiction of the CVC in this regard is restricted to employees of the Central Government or of any corporation established by it or under any Central Act, Government companies, societies or local authorities owned or controlled by the Central Government. The jurisdiction of the CVC in this regard is restricted to employees of the Central. Thus, the Government of India scheme covers the public sector banks and the Reserve Bank (since it is an entity established under the Central statute).

As a proactive measure for strengthening financial stability and with a view to enhancing public confidence in the robustness of the financial sector, the Reserve Bank, in April 2007, introduced a similar scheme called 'protected disclosures scheme for private sector banks and foreign banks'. The salient features of the scheme are as under:

(i) As public sector banks are covered under the scheme of Government of India, this scheme would cover all private sector banks and foreign banks operating in India.

(ii) The complaints under the scheme would cover the areas such as corruption, misuse of office, criminal offences, suspected/actual fraud, failure to comply with existing rules and regulations such as Reserve Bank of India Act, 1934, Banking Regulation Act 1949, and acts resulting in financial loss/operational risk, loss of reputation, detrimental to depositors' interest/ public interest.

(iii) Under the scheme, employees of the bank concerned, customers, stake holders, NGOs and members of public can lodge complaints.

(iv) Anonymous/pseudonymous complaints will not be covered under the scheme and such complaints will not be entertained.

(v) The Reserve Bank will be the nodal agency to receive complaints under the Scheme. The Reserve Bank would keep the identity of the complainant secret, except in cases where complaint turns out to be vexatious or frivolous and action has to be initiated against the complainant as mentioned in point (vi) below.

(vi) The institution against which complaint has been made can take action against complainants in cases where motivated/vexatious complaints are made under the scheme, after being advised by the Reserve Bank. An opportunity of hearing will, however, be given by the concerned bank to the complainant before taking such action. Final action taken by the Reserve Bank on the complaint will be intimated to the complainant.

(DSAs/DMAs) already engaged by them register themselves with DoT as telemarketers. As IBA will be the co-ordinating agency at the industry level to ensure compliance with the requirements of TRAI regulations, banks were advised to actively co-operate with the IBA in this regard. Subsequently, based on a clarification received from TRAI, banks were advised by the Reserve Bank that in addition to DSAs/DMAs, banks/their call centres, who make solicitation calls, are also required to be registered as telemarketers with the DoT. Banks were advised that banks / their call centres, while registering themselves as telemarketers, will be required to give the details of the telephone numbers used for telemarketing.

Guidelines on Fair Practices Code for Lenders - Reasons for Rejection of Loans

2.155 In terms of guidelines issued by the Reserve Bank on May 5, 2003 on 'Fair Practices Code for Lenders', banks/FIs were required to ensure that loan application forms in respect of priority sector advances up to Rs. 2 lakh contain comprehensive information about the fees/charges and any other matter which affects the interests of the borrower. The guidelines also required banks/FIs to convey in writing the main reason/ reasons for rejection of loan applications in the case of small borrowers seeking loans up to Rs. 2 lakh. The guidelines were revised on March 6, 2007 and banks/FIs were advised to ensure that all loan applications in respect of all categories of loans, irrespective of the amount of loan sought by the borrower, contain comprehensive information about fees/charges. The revised guidelines also required banks/FIs to convey in writing the main reasons for rejection of the loan application in the case of all categories of loans, irrespective of any threshold limits, including credit card applications (Box II.15).

Doorstep Banking

2.156 In order to ensure transparency in respect of rights and obligations of customers, to bring about uniformity in approach and clearly delineate the risks involved, it was decided to lay down general principles and broad parameters to be followed by banks for offering doorstep services to their customers. Accordingly, guidelines were issued in February 2007 to banks permitting them to prepare a scheme for offering doorstep banking services to their customers with the approval of their boards. Under the scheme, banks were permitted to offer doorstep services such as pick up of cash/instruments, delivery of cash against cheques received at the counter and delivery of demand drafts to corporates/Government departments/PSUs and pick up of cash/ instruments and delivery of demand drafts to individual customers. In May 2007, banks were also permitted to offer delivery of cash to individuals. Further, the delivery of cash/draft to individuals/ corporates/Government departments/ PSUs was permitted against requests received through any secure convenient channels, subject to the banks adopting technology and security standards and procedures laid down by the Reserve Bank. The Reserve Bank directed all SCBs and RRBs on May 24, 2007 to comply with the amended Banking Ombudsman Scheme, 2006 while offering doorstep banking products.

Housing Loans: Fairness and Transparency

2.157 It had come to the notice of the Reserve Bank that some banks, while lending for housing, were not fully transparent in indicating the circumstances and factors governing the benchmark in respect of floating rates as well as with regard to reset clauses. Banks were, therefore, urged to review all practices which are less than fair or transparent. They were also urged to afford an opportunity to borrowers to obtain fair and transparent terms consistent with the legal requirements and fair practices.

Pension Payment Services

2.158 The Reserve Bank continued with its initiatives to improve services provided by agency banks to pensioners under various schemes announced by the Government of India. Under the 'Scheme for Payment of Pension for Central Government Civil Pensioners through Authorised Banks', a pensioner receives pension through her/ his savings/current account operated individually by her/him. Since June 2006, the Central Pension Accounting Office of the Government of India has allowed crediting of the pension amount to a joint account operated by pensioner with her/his spouse where family pension has been authorised. The Reserve Bank has issued suitable instructions to agency banks in this regard.

Other Banking Services

2.159 Banks (excluding RRBs) were advised on March 30, 2007 to ensure that cheques/drafts

Box II.15: Credit Cards with Special Reference to Consumer Protection

Based on the recommendations of the Working Group on Regulatory Mechanism for Cards set up by the Reserve Bank, comprehensive guidelines on credit card operations of banks were framed in November 2005 for implementation by the credit card issuing banks. These guidelines were updated in July 2007 and *inter alia*, cover areas like transparency in interest rates and other charges, wrongful billing, use of direct marketing agents (DMAs)/direct selling agents (DSAs) and other agents, protection of customer rights, redressal of grievances *etc*. Banks were advised that credit card dues are in the nature of non-priority sector personal loans and as such banks are free to determine the rate of interest on credit card dues without reference to their BPLR and regardless of the size.

Customer's rights in relation to credit card operations primarily relate to personal privacy, customer confidentiality and fair practices in debt collection. The areas of consumer protection taken care of in the guidelines are as under:

(i) Banks should be transparent in fixing their interest rate/service charge on credit card dues and include the above in the 'Welcome Kit' and the monthly statements.

(ii) Banks should have a well documented policy and a Fair Practices Code for credit card operations and should adopt the Fair Practices Code for credit card operations of banks released by the Indian Banks' Association.

(iii) The card issuing bank should ensure that wrong bills are not raised and issued to customers. In case, a customer protests any bill, the bank should provide explanation and, if necessary, documentary evidence to the customer within a maximum period of sixty days. The credit card issuing bank may consider providing bills and statements of accounts online, with suitable security built for that purpose.

(iv) While outsourcing the various credit card operations banks have to take care that the quality of the customer service and the bank's ability to manage credit, liquidity and operational risks is not compromised. In the choice of the service provider, banks have to be guided by the need to ensure confidentiality of the customer's records, respect customer privacy, and adhere to fair practices in debt collection.

(v) The Code of Conduct for Direct Sales Agents (DSAs) formulated by the Indian Banks' Association could be used by banks in formulating their own codes for the purpose. The bank should ensure that the DSAs engaged by them for marketing their credit card products scrupulously adhere to the bank's own Code of Conduct for credit card operations which should be displayed on the bank's website and be available easily to any credit card holder.

(vi) Unsolicited cards should not be issued and unsolicited loans or other credit facility should not be offered.

(vii) The card issuing bank should not unilaterally upgrade credit cards and enhance credit limits. Prior consent of the cardholder should invariably be taken whenever there are any change/s in terms and conditions.

(viii) The card issuing bank should not reveal any information relating to customers to any other person/organisation without obtaining their specific consent. In case of providing information relating to credit history/repayment record of the card holder to a credit information company (specifically authorised by the Reserve Bank), the bank may explicitly bring to the notice of the customer that such information is being provided in terms of the Credit Information Companies (Regulation) Act, 2005. A similar prior notice may be given to the cardholder before reporting default status to the Credit Information Bureau of India Ltd. (CIBIL) or any other credit information Company authorised by the Reserve Bank.

(ix) In the matter of recovery of dues, banks should ensure that they, as also their agents, adhere to the extant instructions on Fair Practice Code for lenders issued by the Reserve Bank as also IBA's Code for Collection of dues and repossession of security. In case banks have their own code for collection of dues it should, at the minimum, incorporate all the terms of IBA's Code. In particular, in regard to appointment of third party agencies for debt collection, it is essential that such agents refrain from action that could damage the integrity and reputation of the bank and that they observe strict customer confidentiality.

(x) Banks/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 credit card holders' family members, referees and friends, making threatening and anonymous calls or making false and misleading representations.

(xi) Generally, a time limit of sixty days may be given to the customers for preferring their complaints/grievances. The card issuing bank should constitute grievance redressal machinery within the bank. The name and contact number of designated grievance redressal officer of the bank should be mentioned on the credit card bills/displayed on the website. The bank should have a system of acknowledging customers' complaints for follow up such as complaint number/docket number even if the complaints are received on phone.

(xii) Option to approach of the Office of the Banking Ombudsman for redressal of grievances relating to Credit Cards has also been provided in the guidelines.

(xiii) The Reserve Bank reserves the right to impose penalty on banks under the provisions of the Banking Regulation Act, 1949 for violation of any of the credit card guidelines.

issued by clients containing fractions of a rupee are not rejected or dishonoured by them.

2.160 Banks were advised on April 5, 2007 to generally insist that the person opening a deposit account makes a nomination. In case the person opening an account declines to fill in nomination the bank should explain the advantages of nomination facility. If the person opening the account still does not want to nominate, the bank should ask him to give a specific letter to the effect that he does not want to make a nomination. In case the person opening the account declines to give such a letter, the bank should record the fact on the account opening form and proceed with the opening of the account, if otherwise found eligible. Under no circumstances, a bank should refuse to open an account solely on the ground that the person opening the account has refused to nominate. Similar guidelines were issued to RRBs on April 13, 2007.

2.161 Based on the recommendations of the Committee on Procedures and Performance Audit on Public Services (CPPAPS) for easy operation of lockers, the Reserve Bank reviewed all the guidelines issued on various issues relating to safe deposit lockers/safe custody articles and revised guidelines were issued on April 17, 2007. The guidelines contain instruction relating to (i) allotment of lockers; (ii) security aspects relating to locker; (iii) access to the safe deposit lockers/return of safe custody articles to survivor(s)/ nominees/legal heirs; and (iv) customer guidance and publicity.

2.162 Banks were advised on April 25, 2007 to ensure that none of their bank branches/staff refuses to accept lower denomination notes and/ or coins. Banks were asked to issue strict instructions to all branches that the staff concerned should in no case refuse to accept small denomination notes and coins tendered at the counters. It should also be ensured that all the staff members are made fully conversant with the instructions in this regard and also comply strictly with the same. Stern action would have to be taken in the event of refusal/ non-compliance by any staff member.

2.163 Bank were advised on May 3, 2007 that they need not obtain prior approval of the Reserve Bank for taking up corporate agency business for distribution of insurance products without risk participation. However, a report is required to be sent to the concerned Regional Office of the Reserve Bank within 15 days of commencement of the insurance agency business.

9. Payment and Settlement Systems

2.164 Smooth functioning of the payment and settlement systems is a pre-requisite for stability of the financial system. Payment and settlement systems are also important from the point of view of transmission channels for monetary policy. Any malfunctioning of the system could seriously impair the flow of goods and services and financial assets in the economy. This could have serious implications for financial stability and the transmission mechanism of monetary policy.

2.165 The Board for regulation and supervision of Payment and Settlement Systems (BPSS), the apex body for giving policy direction in the area of payment and settlement systems, has been meeting regularly. The BPSS held four meetings (September 25, 2006, December 21, 2006, April 10, 2007 and June 14, 2007) during 2006-07. The main thrust of the BPSS was on electronification of the payment systems by way of encouragement and information dissemination. Publishing of the frequently asked questions (FAQs) on Real Time Gross Settlement (RTGS), National Electronic Funds Transfer (NEFT) and Electronic Clearing Service (ECS) - credit and debit, was a step in the direction of creating awareness among the public at large. Names of branches, which are offering the various payment services operated by the Reserve Bank, were placed in public domain. The charges levied by banks for the electronic payment services being offered are also being published and updated as and when any change is reported by the banks. This has given the customers the option to choose banks, based on services offered and charges levied.

2.166 The Reserve Bank has taken a keen interest in developing robust payment and settlement systems, both retail and large value. The Reserve Bank has also taken a number of measures for improving efficiency of both large value and retail payments systems. The expansion of NEFT and RTGS to cover more centres/branches for retail and large value systems, respectively, has been a step in this direction. Simultaneously, the clearing houses were urged to implement ECS which is used for bulk payments/receipts. The broad structure and features of the retail and large value payment systems as evolved over the years and the oversight of the payment systems are detailed in this Section.

Retail Payment Systems

2.167 The retail payment systems comprise paper-based clearing and electronic clearing systems, *viz.*, national electronic funds transfer, electronic clearing service, card payments, e-payment, internet and mobile payments. Technological developments have facilitated innovations in the payment mechanism such as e-purse (Box II.16).

Paper-based Clearing - Extension of MICR and Implementation of Magnetic Media Based Clearing System (MMBCS)

2.168 The paper-based cheque is still the predominant mode of payment. The volume of transactions settled through this mode makes it imperative that the system operates smoothly. The standardisation of cheque in MICR format has been achieved. However, at quite a large number of clearing houses, the processing was manual. Thus, on completing the setting up of MICR Cheque Processing Centres (CPCs) at the 59 identified centres, the need was felt to computerise the settlement operations at the clearing houses where the setting up of a MICR CPC was not a viable option due to lower volumes. A plan was drawn for computerisation of the clearing operations using the Magnetic Media Based Clearing System (MMBCS).

2.169 The MMBCS provides for clearing and settlement based on the MICR code information. The system has been in operation for more than 15 years. It covers presentation clearing, return clearing, high value/high value return clearings and inter-bank clearing, but does not cover inter-city clearing. The system was initially implemented at the four MICR CPCs operated by the Reserve Bank. The same was subsequently implemented at all the clearing houses managed by the Reserve Bank. The member banks present their claims in the form of an electronic file which gets processed on the computer. As a result, the settlement figures are arrived at within 15 minutes compared to 3 or 4 hours under the manual system. In Phase I (clearing house with more than 25 banks), 41 clearing house were identified and computerised. During Phase II (clearing houses with 15 or more member banks), 180 clearing houses were identified for computerisation. Of these, 176 clearing houses were computerised. In addition, another 313 clearing houses were also computerised even though they had less than 15 member banks. Thus, the total number of clearing houses computerized stood at 530 at end-September 2007. Computerisation of the clearing houses has helped in reducing time and errors in the processing of cheques. New clearing houses are operationalised only with MMBCS.

2.170 The cheque truncation system (CTS) was also taken up to improve efficiency of the paper-based payment system. On operationalisation of the CTS, the paper instruments would not travel beyond the presenting bank. Banks would take a business decision at the point of truncating the cheque – branch level or service branch or gateway

Box II.16: E-purse Related Initiatives

The 'survey of developments in electronic money and internet and mobile payments' published in March 2004 by the Committee on Payment and Settlement Systems (CPSS), Bank for International Settlements (BIS) defines electronic money as, 'monetary value as represented by a claim on the issuer which is: (i) stored on an electronic device; (ii) issued on receipt of funds of an amount not less in value than the monetary value issued; and (iii) accepted as means of payment by undertakings other than the issuer'. This definition includes both prepaid cards (sometimes called electronic purse) and prepaid software products that use computer networks (sometimes called digital cash). An electronic purse or e-purse is a stored value or prepaid product in which a record of the funds or value is stored on an electronic device which is in the consumer's possession and is available to the consumer for multipurpose use. The loading of value onto the device is akin to the withdrawal of cash from an ATM. Most of the e-purses relate to use of reloadable cards. The money is loaded on cards by transfer of balances from bank accounts through ATMs or in some cases through the telephone or internet, on receipt of equivalent monetary value. These can be used for making payment for purchases which are generally of low value.

In India, quite a few banks have started issuing prepaid cards. Now a number of non-banks in collaboration with banks/without collaboration of banks are issuing both, limited or multipurpose prepaid cards. Broad categories under which cards have been issued by banks in India are-co-branded pre-paid travel card/foreign travel cards, co-branded pre-paid annuity cards, co-branded pre-paid payroll cards, *etc.* These cards, apart from being used at ATMs, can also be used at point of sale (POS) terminals for making payments. The payment could also be made for transactions done on internet. Slowly, but steadily, usage of these mode of payment is on an increase. Recognising the satential and associate advantages of e-purse, various issues associated with these types of payments are being examined by the Reserve Bank.

level. A pilot project for cheque truncation has been set up to cover the National Capital Region of Delhi. Smaller banks, which may find it unviable to set up this infrastructure, could come together and utilise the services of service bureaus set up for providing this service. A few large banks would set up service bureaus for smaller banks for this purpose.

Electronic Clearing Service

2.171 Electronic clearing service (ECS) is a retail payment system that can be used to make bulk payments/receipts of a similar nature, especially where each individual payment is of a repetitive nature and of relatively small amount. It has two variants - one for direct credit and the other for direct debit. Under ECS (credit) one entity/company makes payments from its bank account to a number of recipients by direct credit to their bank accounts. The direct credit facility enables companies and Government departments to make large volumes of payments such as salary and pension. With the ECS (debit), the organisations such as utility companies (electricity and telecom) and insurance companies collect their bills, insurance *premia* and equated monthly instalment payments of loans directly from the bank account of their customers. ECS is now available at all bank branches at 67 centres.

2.172 In order to broad-base the facilities of electronic funds transfer to centers where the Reserve Bank does not have its offices and to implement public key infrastructure (PKI) - based security system, a variant of the EFT called the national electronic fund transfer (NEFT) system was introduced in November 2005. The NEFT system has become a critical payment system for retail electronic payments after the RTGS was made a system for large value payments. The settlement of NEFT takes place on a 'net' basis; there are 6 settlements on week days (9.30 a.m., 10.30 a.m., 12.00 noon, 1.00 p.m., 3.00 p.m. and 4.00 p.m.) and 3 settlements (9.30 a.m., 10.30 a.m. and 12.00 noon) on Saturdays. The increase in the number of settlements of the NEFT system, which is a deferred net settlement, has made it close to a real time system. There are now 74 banks offering the facility at over 30,000 branches. The Reserve Bank joined NEFT in May 2007. However, the Reserve Bank participates only as a remitting bank.

2.173 Agency banks were advised on April 30, 2007 to provide an enabling environment and facilities to the customers for making Government transactions electronically by providing ECS/ EFT facilities.

Card-based Payment System

2.174 Credit and debit cards have been in use in the country for many years now. However, the card-based usage has picked up only during the last five years. Payment by cards is now becoming a much preferred mode for making retail payments in the country.

e-payment: Internet and Mobile Payment

2.175 The rapid growth of e-commerce and the use of the internet have led to the development of new payment mechanisms capable of exploiting the internet's unique potential for speed and convenience. Similarly, the broader usage of mobile phones has encouraged banks and non-banks to develop new payment services for their customers. Internet payments and mobile payments are defined by the channel through which the payment instruction is entered into the payment system.

National Financial Switch

2.176 National financial switch (NFS) was established by the Institute for Development and Research in Banking Technology (IDRBT) to facilitate apex level connectivity among all banks' ATM switches. This will facilitate ATM connectivity among banks across the country. The CCIL has been designated as the settlement agency for all transactions routed through the NFS. The net settlement obligations of individual members are sent to CCIL by IDRBT. This file is submitted to the Reserve Bank by CCIL for settlement. The settlement in this segment takes place on an 'all-or-none' basis.

Large Value Payment Systems

2.177 The large value payment systems comprise the RTGS, Government securities clearing and forex clearing. The RTGS was operationalised in March 2004. At present, 100 participants (banks, primary dealers and the Reserve Bank) are members of the RTGS system. The RTGS system facilitates customer transactions, apart from inter-bank funds transfer.

2.178 From January 2007, the system has been made a purely high value system and transactions above Rs.1 lakh only can now be put through this system. Integration of the RTGS with the integrated accounting system (IAS) and centralised funds management system (CFMS) has facilitated better funds management by banks and seamless transfer of funds across their accounts with the Reserve Bank. Integration of the RTGS-IAS with the securities settlement system (SSS) has facilitated automatic intra-day liquidity (IDL) availability based on the eligibility conditions.

2.179 The RTGS has the facility of multilateral net settlement batch (MNSB) mode of settlement, which has been implemented for the settlements at Mumbai covering cheque clearing settlements (including high value clearing), ECS and EFT/NEFT. The CCIL settlement is also being done in RTGS. The reach and utilisation of the RTGS is on the rise. At present, 32,768 branches are providing this facility to their customers.

2.180 The Clearing Corporation of India Limited is the central counterparty (CCP) for Government securities clearing as also the forex clearing. The settlement of all secondary market outright sales and repo transactions in Government securities is carried out through the CCIL. All OTC trades in this segment, which are reported on the Reserve Bank's NDS platform and trades which are contracted on the online anonymous trading platform NDS–OM, are accepted by the CCIL for settlement, after the necessary validations. These trades are settled on a DvP III basis, *i.e.*, the funds leg as well as the securities leg is settled on a net basis. The CCIL acts as the CCP for all the transactions and guarantees both the securities and the funds leg of the transactions. The CCIL guarantees settlement of trades on the settlement date by acting as a central counterparty to every trade through the process of novation.

2.181 The Reserve Bank has implemented the CFMS which enables banks to transfer funds across their accounts with the various offices of the Reserve Bank. At present, the system of funds transfer is available at eleven centres – Ahmedabad, Bangalore, Chandigarh, Chennai, Guwahati, Hyderabad, Kolkata, Mumbai, Nagpur, New Delhi and Patna.

Oversight of the Payment Systems

2.182 Existence of a sound legal framework is the basis for smooth functioning of the payment and settlement systems. Currently, there is no exclusive legislation in India which vests the Reserve Bank with formal oversight authority over the payment and settlement systems in the country. The Reserve Bank is discharging this role by deriving powers from the existing statutes such as the Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949.

2.183 The Payment and Settlement Systems Bill has been cleared by the Cabinet. Once the Bill is enacted as an Act, the Reserve Bank would be empowered to regulate and supervise all payment and settlement systems in the country. The Act will also provide legal recognition to multilateral netting and settlement finality, which are the basic tenets of the deferred net settlement (DNS) systems – the mode of settlement of all payment systems in the country, except the RTGS system.

2.184 In order to ensure that operations in the systems do not pose any payment and settlement risk, the Reserve Bank has, in a limited way, started formalising its oversight function. To begin with, the Reserve Bank has prepared the minimum standards of operational efficiency for MICR cheque processing centres (CPCs). The MICR CPCs have to submit a quarterly self-assessment report (SAR) on compliance to these standards. The standards relate to encoding of instruments, time schedule, regulated entry into CPC, maintenance of machines, operational procedures, monitoring of reject rates, speed and accuracy of on-line reject repair (OLRR), checking of settlement reports for supervisory signals, return clearing discipline to be adhered to, enabling banks to download reports/data, on-line reconciliation, customer service, and business continuity planning. The quarterly SARs submitted are analysed and discrepancies observed are informed to the bank managing the clearing house and the compliance monitored. Visits to the clearing house are also undertaken to have on-the spot information.

2.185 The Reserve Bank has also brought out the first report on the oversight of payment systems, which details the compliance of systemically important payment systems (SIPS) to the international standards.

10. Technological and Other Developments

2.186 Technology has been playing an increasingly important role in the banking sector. Recognising the role of technology in reducing the

transaction cost and delivering the financial services in an efficient way, the Reserve Bank has been encouraging the use of technology in the banking sector. A holistic approach has been adopted for designing and development of modern, robust, efficient and secure payment system with minimal settlement risks. However, the use of technology has also posed certain challenges, especially relating to security of IT based products/services.

2.187 Information technology (IT) has emerged as a key business facilitator for developing new products and services both by the Reserve Bank and commercial banks. IT has helped in handling large transactional volumes and in meeting the changing customer expectations, apart from providing almost real time information processing for both the managements of banks and the customers.

2.188 The year 2006-07 witnessed the commencement of consolidation of IT based efforts by the financial sector in general and by the commercial banks in particular. The major developments during the year included the setting up of the data centres, migration towards centralised systems and large scale implementation of core banking systems across bank branches.

2.189 Banks in India have started to reap the benefits of introduction of IT which commenced in a small way more than a decade ago. After migrating to the use of stand-alone systems, the older banks in the country started the migration towards core banking systems (CBS). While new private sector banks had commenced operations with a complete IT based backbone (this was one of the pre-requisites insisted upon by the Reserve Bank), public sector banks and old private sector banks which were dependent on manual systems for their operations, had to pass through various stages in their metamorphosis to CBS. Although this resulted in a relative late implementation of the CBS, the banks have benefitted from the application of latest available technology.

2.190 CBS has opened up new vistas for banks to offer a variety of facilities to their customers. Facilities such as 'anywhere and anytime banking' got a fillip due to a centralised information pool available with banks. Constituents are now treated as customers of the bank as a whole instead of being attached to a particular branch alone. In addition, newer delivery channels based on technology have also gained ground. Some of these include internet banking, mobile banking, ATMs and shared ATM networks for availing of banking services on a much broader scale than ever before.

2.191 While new products and services using IT have revolutionised the availability of banking services, these also pose many challenges to be overcome. Apart from staff education and re-orientation, customer awareness and changes in work processes at the banks' own end, security, which is at the base of all IT based initiatives, is a factor which has gained great importance. In order to ensure that the basic requirements of security are taken care of from an IT perspective, banks are being encouraged to not only ensure that the common minimum requirements indicated by the Reserve Bank are complied with, but additional safeguards are also provided for. Commonly accepted international standards for security in IT are at the base of such requirements, which are also subject to regular, periodical review and upgradation, apart from being put through the rigours of information systems audit by the internal auditors/inspectors of the bank and by external/statutory auditors of the banks concerned.

2.192 With large scale dependence on IT for day-to-day operations, the need to ensure uninterrupted availability of such systems attains significance. To this end, business continuity and disaster recovery management are ascribed due importance by the Reserve Bank not only for its own systems but for the systems implemented in the commercial banks as well To this end, the Reserve Bank performs regular, periodical disaster recovery (DR) drills of critical systems hosted by the Reserve Bank where all member banks also participate. This exercise reinforces the DR preparedness of the entire system in respect of critical and systemically important payment system applications. In addition, individual banks are also exhorted to conduct their own DR exercises to ensure that their systems stand the test of any unforeseen contingency.

Technology in Banks and the Role of the Reserve Bank

2.193 To enable banks to plan their IT road maps and ensure best results, the Reserve Bank had published the Financial Sector (FST) Vision in 2005. This document was reviewed in the context of IT developments and the draft document for the medium-term has been placed for public

comments before it is finalised. The Mission Statement as 'IT for Efficiency and Excellence' and the corporate objective of 'enabling financial sector to leverage on IT for better customer service, improved housekeeping and overall systemic efficiency' continue to be the guiding principles of the FST Vision.

Technology-Based Services by the Reserve Bank for Banks

2.194 The Reserve Bank continued to function as a business facilitator for deployment of new products and services by banks. The systems provided by the Reserve Bank included the negotiated dealing system (NDS) for Government securities, the real time gross settlement system and the centralised funds management system, [apart from the structured financial messaging system (SFMS) over the Indian Financial Network (INFINET)] and the national electronic funds transfer system.

2.195 Improvements in the software architecture of the NDS have resulted in better throughput and reduced processing times for banks, which are members of the system. Initiatives aimed at hiving off some of the front-end related functions to the CCIL are also underway. The RTGS has stabilised and the usage of the facility for transfer of funds, especially for large values and for systemically important purposes, has been on the rise. More than 35,000 branches of banks now offer RTGS-based funds transfers for their customers.

2.196 The secured website of the Reserve Bank, provides electronic information for authorised users, *viz.*, the Government and the commercial banks. This facility, which can be accessed through the internet continued to be used on a large scale. During the year, the transmission of clearing data – both for cheque clearing and for electronic clearing services – was done in many centres through the secured website. In addition, collation of inputs from currency chests as part of the integrated currency chest operations and management system (ICCOMS) was done using the secured website. The secured internet website has been linked to the online return filing system (ORFS) using an extensible business reporting language (XBRL) structure to facilitate a single-stop reporting by banks to the Reserve Bank.

Technological Developments in Banks

2.197 Multi-application smart cards, which are heralding a new vista in banking, have made their presence felt as part of initiatives aimed at financial inclusion in parts of the North-East and the Southern regions (Box II.17).

Box II.17: Multi-Application Smart Cards and their Potential in Banking

A smart card is a card which is similar to a credit/debit ATM card. The distinguishing feature lines in the presence of a chip in the card which can store information. Unlike in the case of magnetic-stripe based cards, the stored information in the chip could either be permanent in nature, or may be subject to change. For instance, the passwords can be changed at any frequency by the cardholder. Because of its additional feature, smart cards find usage not only for financial transaction processing but in a number of other areas as well.

One of the greatest advantages of the smart card technology is its ability to consolidate multiple applications in a single, dynamic card. These cards simplify life for end-users, often replacing up to three other cards for payment and other transactions. Thus, there can be a single card which can function as an identity card, as a driving licence, as a health card and also for other funds related purposes. Because these cards deliver such highly personalised applications, their perceived value among end-users is much higher and helps to build stronger than average customer loyalty.

With Indian banking having embraced IT in a large way, the potential for usage of multi-application smart cards is high. Smart-card-based electronic purse systems, in which value is stored on the card chip and not in an externally recorded account so that machines accepting the card need no network connectivity. Thus, the multi-application cards are beneficial for issuers as well, especially because they provide the prospect to create unique marketing opportunities. They are particularly suitable for financial inclusion in remote parts of the country. For the banks interested in introducing smart cards, another quantifiable benefit is the ability to forecast a reduction in fraud.

Multi-application smart cards also pose several challenges. Managing multiple smart card applications along with their associated scripts, data streams and cryptographic keys is more complex than issuing single-function cards. Open standards and interoperability become more critical. Life cycle management is also much more elaborate, especially post-issuance upgrades to applications. In these environments, establishing a proven, integrated smart card infrastructure will likely mean the difference between ongoing success and failure to capitalise on the most lucrative opportunities. To address these issues, the Reserve Bank has supported pilot projects which would outline the major problems which are likely to be faced and the measures to overcome them, based on which acceptable and implementable standards will emerge.

Box II.18: IT Governance

Information Technology Governance (IT governance) or Information and Communication Technology (ICT governance) is a subset discipline of corporate governance focused on information technology (IT) systems and their performance and risk management. The rising interest in IT governance is partly due to compliance initiatives such as the Sarbanes-Oxley Act and Basel II, as well as the acknowledgement that IT projects can easily get out of control and profoundly affect the performance of an organisation. This is more relevant for the financial sector, including the banking sector, where the lack of IT governance may even lead to catastrophic consequences. IT governance is ideally a sub-set of the broader level of corporate governance.

A recurring theme of IT governance discussions is that the IT capability can no longer be a black box. Owing to limited technical experience and IT complexity, key decisions in the traditional handling of IT management by board level executives are deferred to IT professionals. IT governance implies a system in which all stakeholders, including the board, internal customers and related areas such as finance, provide the necessary input into the decision-making process. This prevents a single stakeholder, typically IT, being blamed for poor decisions. It also prevents users from later complaining that the system does not behave or perform as expected.

IT governance follows many models. While there exist many supporting mechanisms developed to guide the implementation of IT governance, some of the more common ones are:

- The IT Infrastructure Library (ITIL), which is a detailed framework with hands-on information on how to achieve a successful governance of IT.
- Control Objectives for Information and related Technology (COBIT) which is an approach to standardise good information technology security and control practices. This is done by providing tools to assess and measure the performance of 34 IT processes of an organisation. The ITGI (IT Governance Institute) is responsible for COBIT
- The ISO/IEC 27001 (ISO 27001) is a set of best practices for organisations to follow to implement and maintain a security program. It started as the British Standard 7799 (BS7799), which was published in the United Kingdom and became a well known standard in the industry that was used to provide guidance to organisations in the practice of information security.
- The Information Security Management Maturity Model ISM3, which is a process based ISM maturity model for security.
- AS8015-2005- an Australian Standard for Corporate Governance of Information and Communication Technology.
- CMM - The Capability Maturity Model which lays focus on software engineering.
- The Balanced Scorecard (BSC) which is a method to assess an organisation's performance in many different areas.
- Six Sigma which aims to focus on quality assurance.

IT governance is, however, characterised by a few incumbent challenges as well. The manifestation of IT governance objectives through detailed process controls (for instance, in the context of project management) is a frequently controversial matter in large scale IT management. Further, difficulties in achieving a balance between financial transparency and cost-effective data capture in IT financial management (*i.e.*, to enable chargeback) is a topic for which clear conclusions have not yet been arrived at.

Developments in the INFINET

2.198 The Indian Financial Network (INFINET) continued to be the most preferred communication channel for transmission of electronic information by banks for the systemically important inter-bank payment systems of the Reserve Bank. Taking into account the developments in networking technology, the INFINET is being migrated to a multi-protocol layer switching (MPLS) technology which offers economies of scale, apart from the ease of operation.

IT Governance

2.199 The smooth operation of all IT-based products requires good IT governance (Box II.18).

11. Legal Reforms

2.200 During the year, several major amendments were made to the banking related statutes. In addition, some new bills were tabled for enactment.

Banking Companies (Acquisition and Transfer of Undertakings) and Financial Institutions Laws (Amendment) Act, 2006

2.201 The Banking Companies (Acquisition and Transfer of Undertakings) and Financial Institutions Laws (Amendment) Act, 2006, which amended the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and the Banking Companies (Acquisition and Transfer of

Undertakings) Act, 1980, was passed by the Parliament and came into force with effect from October 16, 2006. The amended Act, *inter alia*, provides for the following changes in the composition of the board : (i) the number of whole-time directors increased from two to four to have more functional directors in view of expansion of activities of the nationalised banks; (ii) the director to be nominated by the Government of India on the reconmmendations of the Reserve Bank will be a person possessing necessary experience and expertise in regulation or supervision of commercial banks, instead of nominating an officer of the Reserve Bank; (iii) removal of the provision for nominee directors from amongst the officials of SEBI/NABARD/PFIs; (iv) nomination of up to three shareholder directors on the board on the basis of percentage of shareholding instead of one to six directors as per the existing provision so as to provide for a more equitable representation on the basis of percentage of ownership (as a result, there will be a maximum of three elected directors in nationalised banks); and (v) elected directors will be persons having 'fit and proper' status as per the criteria notified by the Reserve Bank from time to time; and (vi) the Reserve Bank is empowered to appoint one or more additional directors, if found necessary, in the interest of banking policy/public interest/interest of the bank or the depositors.

2.202 Nationalised banks will be able to raise capital by preferential allotment or private placement or public issue in accordance with the procedure as may be specified by regulation with the prior approval of the Central Government and after consultation with the Reserve Bank. Nationalised banks will also be able to issue preference shares in accordance with the guidelines framed by the Reserve Bank. The Central Government will hold at all times not less than 51 per cent of the paid-up capital consisting of equity shares. Moreover, the voting rights of preference shares of the nationalised banks will be restricted only to resolutions directly affecting their rights. The amendment also restricts the shareholders' voting rights in respect of preference shares held by them to a ceiling of one per cent of total voting rights of all the shareholders holding preference share capital only.

2.203 The amendment has empowered shareholders to discuss, adopt and approve the directors' report, the annual accounts and the balance sheet at the annual general meeting. Nationalised banks are enabled to transfer the unclaimed dividends for more than seven years to Investor Education and Protection Fund established under section 205C of the Companies Act, 1956.

2.204 The Central Government is now empowered to supersede the board of directors on the recommendation of the Reserve Bank in public interest, or for preventing the affairs of the bank being conducted in a manner detrimental to the depositors or bank's interest, or for securing proper management of nationalised banks. Supersession can be for a period not exceeding 6 months which may be extended up to a maximum of one year. The Central Government can appoint an administrator and a committee of three or more members having experience in law, finance, banking, economics or accountancy in consultation with the Reserve Bank to assist it in the discharge of its duties.

The State Bank of India (Subsidiary Banks Laws) Amendment Act, 2007

2.205 The State Bank of Saurashtra Act, 1950, the State Bank of Hyderabad Act, 1956 and the State Bank of India (Subsidiary Banks) Act, 1959 were amended with a view to (i) remove the difficulties faced by the shareholders of the subsidiary banks of State Bank of India; (ii) facilitate increase in the capital of the subsidiary banks; and (iii) enable subsidiary banks to raise resources from the market. The Act of 2007, which came into force with effect from July 9, 2007 amended the said three Acts, *inter alia,* to: (i) increase the authorised capital of subsidiary banks to Rupees five hundred crore and divide the authorised capital into shares of one hundred rupees each or of such denomination as may be decided by the subsidiary banks, with the approval of State Bank of India (SBI); (ii) allow the subsidiary banks to issue share certificates of such denomination as may be prescribed by regulations made by SBI with the approval of the Reserve Bank to the existing shareholders; (iii) allow the subsidiary banks to raise issued capital through preferential allotment or private placement or public issue in accordance with the procedure as may be specified by regulations made by SBI with the approval of the Reserve Bank and to issue preference shares in accordance with the guidelines framed by the Reserve Bank;

(iv) allow reduction of the SBI's shareholding in the subsidiary banks from 55 per cent to 51 per cent; (v) remove the restriction on individual shareholdings in excess of two hundred shares and increase the percentage of voting rights of shareholders (other than the SBI) from one per cent to 10 per cent of the issued capital of the subsidiary bank concerned; (vi) enable the Reserve Bank to nominate one director, possessing necessary expertise and experience in the matters relating to regulation or supervision of commercial banks, and to make provisions for nomination of additional director by the Reserve Bank as and when considered necessary, in the interest of banking policy and depositors' interest; (vii) increase the number of elected directors representing shareholders of subsidiary bank limited to a maximum of three, subject to different percentage of public ownership; (viii) specify the qualification regarding eligibility criteria including 'fit and proper' criteria for elected directors of subsidiary bank and to confer power upon the Reserve Bank to remove elected directors who are not 'fit and proper' and also to allow the board of directors of a subsidiary bank to co-opt any other person who is 'fit and proper' in his place; (ix) confer power upon the Reserve Bank to supersede the boards of directors of subsidiary banks in public interest or depositor's interest, or for securing proper management of the subsidiary banks on the recommendation of SBI and to appoint an administrator and a committee to assist the administrator; (x) enable the board of a subsidiary bank to frame regulation after consultation with State Bank of India and with the previous approval of the Reserve Bank; (xi) enable the banks to hold board meeting through video-conferencing or such other electronic means; and (xii) entitle the share holders present in the annual general meeting to adopt the balance sheet.

The Banking Regulation (Amendment) Ordinance, 2007

2.206 The Government of India promulgated the Banking Regulation (Amendment) Ordinance, 2007 in January 2007 which provides for: (i) amendment to section 24 of the Banking Regulation Act, 1949 to enable the Reserve Bank to specify the statutory liquidity ratio without any floor and the assets which will be maintained in such form and manner by the scheduled banks and (ii) amendment to section 53 of the Banking Regulation Act, 1949 to provide that requirement of laying the draft notification before both Houses of Parliament shall apply in cases of exemptions being granted to institutions/ banks/branches located in special economic zones (SEZs).

2.207 The Ordinance was repealed by the Banking Regulation (Amendment) Act, 2007 which came into effect on January 23, 2007 and was notified on March 28, 2007.

Bills Tabled in the Parliament

2.208 The Banking Regulation (Amendment) Bill, 2005 introduced in the Lok Sabha on May 13, 2005, seeks to amend some of the provisions of the Banking Regulation Act, 1949 with a view to strengthening the regulatory powers of the Reserve Bank. The Bill includes provisions for: (i) removing the restriction on voting rights and introducing the requirement of prior approval of the Reserve Bank for acquisition of shares or voting rights above the specified limit (empowering the Reserve Bank to satisfy itself that the applicant is a 'fit and proper person' to acquire shares or voting rights, and to impose such further conditions that the Bank may deem fit to impose); (ii) amending Section 12 of the Act to enable banking companies to issue preference shares subject to regulatory guidelines framed by the Reserve Bank; (iii) empowering the Reserve Bank to direct a banking company to disclose in its financial statement, or furnish to the Reserve Bank separately, such statements and information relating to the business of any associate enterprise as the Reserve Bank considers necessary, and also to cause an inspection to be made of any associate enterprise; (iv) empowering the Reserve Bank to supersede the board of directors of a banking company and appoint an administrator; (v) amending Section 56 of the Act to remove he provision facilitating primary credit societies to carry on the business of banking without obtaining a license from the Reserve Bank; and (vi) empowering the Reserve Bank to order special audit of a co-operative bank in public interest or in the interest of the co-operative bank or its depositors. The Standing Committee on Finance of the Parliament has submitted its report on the Bill.

2.209 The Payments and Settlements Bill, 2006 was introduced in the Lok Sabha on July 25, 2006. The Bill seeks to designate the Reserve Bank as the authority to regulate payment and settlement systems. The Bill contains provisions

for: (i) compulsory requirement of an authorisation by the Reserve Bank to operate payment systems; (ii) empowering the Reserve Bank to regulate and supervise the payment systems by determining standards, calling for information, returns, documents etc.; (iii) empowering the Reserve Bank to audit and inspect by entering the premises where payment systems are being operated; (iv) empowering the Reserve Bank to issue directions; and (v) overriding other laws and providing for settlement and netting to be final and irrevocable at the determination of the amount of money, securities or foreign exchange payable by participants. The Bill was referred to the Standing Committee on Finance for its consideration and the Report of the Committee was presented to the Lok Sabha in May 2007.

2.210 The State Bank of India (Amendment) Bill, 2006 containing amendments to the State Bank of India Act, 1955 was introduced in the Lok Sabha in December 2006. The proposed Bill seeks to provide for enhancement of the capital of State Bank of India by issue of preference shares, and to enable it to raise resources from the market by public issue or preferential allotment or private placement. The Bill also aims at providing flexibility in the management of the bank. The Bill, *inter alia*, provides for: (i) increase in the authorised capital of State Bank of India to rupees five thousand crore divided into shares of ten rupees each or of such denomination as may be decided by the Central Board with the approval of the Reserve Bank; (ii) increase or reduction in the authorised capital by the Central Government in consultation with the Reserve Bank; (iii) increase in the issued capital of State Bank of India by preferential allotment of share or private placement or public issue in accordance with the procedure as may be prescribed by regulations with the previous approval of the Reserve Bank and the Central Government and the issue of preference shares in accordance with guidelines framed by the Reserve Bank; (iv) issue of bonus shares by State Bank of India to the existing equity shareholders; (v) reduction of the Reserve Bank's shareholding from 55 per cent to 51 per cent consisting of equity shares of the issued capital; (vi) the State Bank to accept share monies in installments, make calls, and forfeit unpaid shares and their reissue; (vii) nomination facility in respect of shares held by individual/joint shareholders; (viii) the Central Government to appoint not more than four managing directors in consultation with the Reserve Bank and to abolish the post of 'vice-chairman'; and (ix) power for the Central Government to supersede the Central Board in certain cases on the recommendations of the Reserve Bank and to appoint an administrator for the period during which the central board stands superseded.