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MONETARY AND CREDIT INFORMATION REVIEW

POLICY

'Fit and Proper' Criteria for Elected Directors on Banks' Boards

The Reserve Bank has laid down specific 'fit and proper' criteria to be fulfilled by persons being elected as directors on the boards of nationalised banks/associate banks of the State Bank of India. The authority, manner/procedure and criteria for deciding the 'fit and proper' status etc., are -

Nomination

All nationalised banks/associate banks of State Bank of India are required to constitute a "nomination committee" consisting of a minimum of three directors (all independent/non-executive directors) from amongst the board of directors. The board of directors should also nominate one among them as the Chairman of the nomination committee. The quorum required is three, including the Chairman. In case of absence of any member already nominated, the board of directors may nominate any other independent director in his place for the ensuing meeting. At the time of constituting the nomination committee the board should decide on its tenure.

Procedure

The nomination committee should undertake a process of due diligence to determine the 'fit and proper' status of existing elected directors/the person to be elected as director. For this purpose, banks should obtain necessary information and declaration from the existing elected directors/persons who file their nominations for election. The nomination committee should meet before the last date of acceptance of nominations and decide whether or not the person's candidature should be accepted based on the criteria laid down. The committee's discussions should be properly recorded as formal minutes of the meeting and voting, if done, should also be noted in case of both existing and proposed directors. Based on the information provided in the signed declaration, the nomination committee should decide on the acceptance, or otherwise, of the candidate. The nomination committee may make references, where considered necessary, to the appropriate authority/persons to ensure compliance with the requirements.

Criteria

The nomination committee should determine the 'fit and proper' status of the existing elected directors/proposed candidates based on the broad criteria indicated below :

- Educational qualification
- Experience and field of expertise
- Track record and integrity

(This list is only illustrative and not exhaustive).

The nomination committee should see whether non-adherence to any of the above criteria would hamper the existing elected director/proposed candidate from discharging his duties as a director on the bank's board. Further, adverse notice by any authority/regulatory agency, insolvency or default of any loan from any bank or financial institution would make the candidate unfit and improper to be a director on a bank's board.

Other Matters

The board should ensure, in public interest, that the elected directors execute, as on March 31 every year, the deed of covenants as recommended by the Dr Ganguly Group.

All the elected directors must mandatorily furnish a simple declaration as on March 31 every year that the information already provided by them has not undergone any change. If

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there is any change in the information provided, the directors should immediately furnish the requisite details. If there are any significant changes, the nomination committee should undertake the due diligence exercise afresh and examine the 'fit and proper' status of the director.

Nationalised banks/associate banks of the State Bank of India have been advised to complete the process of determining the 'fit and proper' status in respect of existing elected directors on their boards at the earliest.

CRR Hiked

On a review of the current liquidity situation, the cash reserve ratio (CRR) of scheduled banks has been raised by 50 basis points to 7.50 per cent of their demand and time liabilities with effect from the fortnight beginning November 10, 2007.

Deposit Schemes with Lock-in Period

Reiterating its earlier instructions on interest paid on deposits, the Reserve Bank has advised banks not to discriminate between one deposit and another, accepted on the same date and for the same maturity, whether such deposits are accepted at the same office or at different offices of the bank. Fixed deposit schemes specifically for resident Indian senior citizens offering higher and fixed rates of interest as compared to normal deposits of any size, and single term deposits of Rs.15 lakh and above on which varying rates of interest is permitted on the basis of size of the deposits are, however, outside the purview of these instructions.

The Reserve Bank has further advised banks that have floated special deposit schemes with lock-in periods and other features, to immediately discontinue the schemes and report compliance to the Reserve Bank.

It has been brought to the notice of the Reserve Bank that some banks are offering special term deposit products to customers in addition to regular term deposits, ranging from 300 days to five years, with the following features:

- Lock-in periods ranging from 6 to 12 months.
- During the lock-in period, premature withdrawal is not permitted. In case of premature withdrawal during the lock-in period, no interest is paid.
- Rates of interest offered on these deposits are not in tune with the rates of interest on normal deposits.
- Part pre-payment is allowed by some banks, subject to certain conditions.

RBI opens Sub-office at Ranchi

The Reserve Bank's Sub-office at Ranchi started functioning from November 15, 2007. The Sub-office, which was inaugurated by Hon'ble Chief Minister of Jharkhand, Shri Madhu Koda, has the Rural Planning and Credit Department and Financial Inclusion Cell and will cover the State of Jharkhand.

The address and contact details of the sub-office are - R.R.D.A. Building, Pragati Sadan (4th Floor), Kutchery Road, Ranchi – 834001. Tel. No: 0651-2210509. Fax.No: 0651-2210511

Project Finance Portfolio of Banks

At the time of financing projects, banks generally adopt one of the following methodologies for determining the level of promoters' equity :

(i) Promoters bring their entire contribution upfront before the bank starts disbursing its commitment.

(ii) Promoters bring certain percentage of their equity (40 per cent – 50 per cent) upfront and the balance is brought in stages.

(iii) Promoters agree, *ab initio*, that they would bring in equity funds proportionately as the banks finance the debt portion.

It is observed that the last method has greater equity-funding risk. To contain this risk, the Reserve Bank has advised banks to have a clear policy regarding the debt equity ratio (DER) and to ensure that the infusion of equity/fund by promoters should be such that the stipulated level of DER is maintained at all times. Further, banks should adopt funding sequences so that the possibility of equity funding by banks is obviated.

Additional Options to Banks for raising Capital

With a view to providing a wider choice of instruments to Indian banks for raising Tier I and Upper Tier II capital, banks are now allowed to issue the following types of preference shares in Indian Rupees, subject to extant legal provisions.

Tier I Capital

Perpetual non-cumulative preference shares

Upper Tier II capital

(i) Perpetual cumulative preference shares

(ii) Redeemable non-cumulative preference shares

(iii) Redeemable cumulative preference shares

The perpetual non-cumulative preference shares would be treated on par with equity and hence, the coupon payable on these instruments would be treated as dividend (an appropriation of profit and loss account). All other types of preference shares mentioned above would be treated as liabilities and the coupon payable thereon would be treated as interest (charged to profit and loss account).

The addition of these instruments is expected to significantly enhance the range of eligible instruments available to banks for capital adequacy purposes. Hence, it is not considered necessary to allow banks to issue preference shares in foreign currency in overseas markets at this stage.

FEMA

Commodity Hedging

It has been decided to permit domestic oil marketing and refining companies to hedge their commodity price risk to the extent of 50 per cent of their inventory based on the volumes in the quarter preceding the previous quarter. The hedging may be undertaken through AD Category – I banks which have been authorised by the Reserve Bank. The hedges may be undertaken using over-the-counter (OTC)/exchange traded derivatives overseas with the tenor restricted to a maximum of one-year forward. The instructions in this regard are –

- AD Category – I banks should ensure that the entities hedging their exposures have board approved policies which define the overall framework within which the derivatives activities should be undertaken and the risks contained.
- AD Category-I banks should approve this facility only after ensuring that the board's approval has been obtained for the specific activity (i.e. hedging of inventories) and also for dealing in OTC markets.
- The board approval must include explicitly, the mark-to-market policy, counterparties permitted for OTC derivatives, etc.
- The entities must put up the list of OTC transactions to the board on a half yearly basis, which must be evidenced by the AD before permitting continuation of hedging facilities under this scheme.
- AD Category – I banks should also carry out due diligence regarding "user appropriateness" and "suitability" of the hedging activity of the customer.

Further, AD Category – I banks should continue to forward to the Reserve Bank, for approval, applications from customers to undertake hedge transactions not covered under the delegated authority.

Limit for Direct Receipt of Import Bills/Documents Enhanced

As a sector specific measure, the limit for direct receipt of import bills/documents has been enhanced from USD 100,000 to USD 300,000 in the case of import of rough diamonds. Accordingly, AD Category - I banks may now allow remittance for imports up to USD 300,000 where the importer of rough diamonds has received the import bills/ documents directly from the overseas supplier and the documentary evidence for the import is submitted by the importer at the time of remittance. AD Category - I banks may undertake such transactions subject to the conditions that -

(i) The import is subject to the prevailing Foreign Trade Policy.

(ii) The transactions are based on their commercial judgment and they are satisfied about the bonafides of the transactions.

(iii) Due diligence and 'know your customer' (KYC) exercise has been done and the financial standing/status and track record of the importer customer is satisfactory. Before extending the facility, banks should also obtain a report on each individual overseas supplier from the overseas banker or reputed credit agency overseas.

Internet based Platforms for dealing in Rupee Vostro Accounts

The Reserve Bank has advised scheduled commercial banks that they may permit internet based operations on rupee vostro accounts maintained by exchange houses or banks outside India with them, provided they ensure that the software prevent any unauthorised operation. The internet based operations on vostro accounts are permitted provided banks -

(i) remain responsible for secrecy, confidentiality and integrity of data;

(ii) strictly comply with FEMA rules/regulations issued in connection with operations/maintenance of vostro accounts in India; and

(iii) strictly adhere to KYC and anti-money laundering (AML) standards and procedures relating to correspondent banking/exchange houses.

CUSTOMER SERVICE

Appointed Guardians can operate Bank Accounts of Disabled

Banks have been advised that legal guardians appointed by the district court under the Mental Health Act, 1987 or by the local level committees set up under the National Trust for the Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999 can open and operate the bank accounts of persons with disability covered under the Act.

Banks have been advised to ensure that their branches give proper guidance to the parents/relatives of the disabled persons so that they do not face any difficulties in this regard.

RBI launches Financial Education Site

To commemorate Children's day, the Reserve Bank of India launched a financial education site on November 14, 2007. Mainly aimed at teaching basics of banking, finance and central banking to children in different age groups, the site will soon also have information useful to other target groups, such as, women, rural and urban poor, defence personnel and senior citizens.

To explain complexities of banking, finance and central banking in a simple and interesting way, the Reserve Bank has used comic books format for children. It has created two special characters for this purpose – 'Raju' who learns all about banking and 'Money Kumar' who explains subjects dealt with by the Reserve Bank of India, such as, monetary policy, bank regulations and currency notes. Two comic books are already available on this site – 'Raju and the Money Tree' explains basic banking and 'Money Kumar and Monetary Policy!' explains the role and relevance of the Reserve Bank's monetary policy for the common person.

The site has films on security features of currency notes of different denominations and an educative film to persuade citizens to not to staple notes. Interestingly, the site also has a games section. This section aims at educating children through entertainment. The games currently on display have been especially designed to familiarise school children with India's various currency notes.

The site will soon be available in Hindi as well as in 11 regional languages.

The site can be accessed at www.rbi.org.in/financialeducation or from the quick link provided on the home page of the main RBI website at www.rbi.org.in

Comments and feedback for improvements in the website can be sent by email to helpprd@rbi.org.in.

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Mid-term Review of Annual Policy Statement for 2007- 08 : Highlights

In a meeting with chief executives of major commercial banks on October 30, 2007, Dr. Y. Venugopal Reddy, Governor, Reserve Bank of India, presented the Mid-term Review of the Annual Policy Statement for the Year 2007-08. The highlights are :

Stance

- Real GDP growth in 2007-08 placed at 8.5 per cent for policy purposes, as set out in the Annual Policy Statement of April 2007 and reiterated in the First Quarter Review.
- Policy endeavour would be to contain inflation close to 5.0 per cent in 2007-08 and the resolve, going forward, would be to condition expectations in the range of 4.0-4.5 per cent so that an inflation rate of 3.0 per cent becomes a medium-term objective.
- Moderating the expansionary effects of net capital flows is warranted so that money supply is not persistently out of alignment with the indicative projections.
- The Reserve Bank would continue with its policy of active demand management of liquidity through appropriate use of the CRR stipulations and open market operations (OMO) including the MSS and the LAF, using all the policy instruments at its disposal flexibly, as and when the situation warrants.
- Barring the emergence of any adverse and unexpected developments in various sectors of the economy and keeping in view the current assessment of the economy including the outlook for inflation, the overall stance of monetary policy in the period ahead would broadly continue to be:
  - To reinforce the emphasis on price stability and well-anchored inflation expectations while ensuring a monetary and interest rate environment that supports export and investment demand in the economy so as to enable continuation of the growth momentum.
  - To re-emphasise credit quality and orderly conditions in financial markets for securing macroeconomic and, in particular, financial stability while simultaneously pursuing greater credit penetration and financial inclusion.
  - To respond swiftly with all possible measures as appropriate to the evolving global and domestic situation impinging on inflation expectations, financial stability and the growth momentum.
  - To be in readiness to take recourse to all possible options for maintaining stability and the growth momentum in the economy in view of the unusual heightened global uncertainties, and the unconventional policy responses to the developments in financial markets.

Monetary Measures

- Bank rate, repo rate and reverse repo rate kept unchanged.
- The flexibility to conduct overnight repo or longer term repo including the right to accept or reject tender(s) under the LAF, wholly or partially retained.
- CRR increased by 50 basis points to 7.5 per cent from the fortnight beginning November 10, 2007.

Developmental and Regulatory Policies

- Covering of ‘short-sale’ and ‘when issued’ transactions to be permitted outside the negotiated dealing system – order matching (NDS-OM) system.
- Systemically important non-deposit taking non-banking financial companies (NBFC-ND-SI) to be considered as ‘qualified entities’ for accessing NDS-OM using the constituents’ subsidiary general ledger (CSGL) route.
- Reinstatement of the eligible limits under the past performance route for hedging facility to be permitted.
- Oil companies to be permitted to hedge foreign exchange exposures by using overseas over-the-counter (OTC)/ exchange traded derivatives up to a maximum of one year forward.
- Importers and exporters having foreign currency exposures to be allowed to write covered call and put options in both foreign currency/rupee and cross currency and receive premia.
- Authorised dealers (ADs) to be permitted to run cross currency options books subject to the Reserve Bank’s approval.
- ADs to be permitted to offer American options as well.
- Working Group to be constituted for preparing a road-map for migration to core banking solutions (CBS) by regional rural banks (RRBs).
- RRBs and state/central cooperative banks to disclose their capital-to-risk weighted assets ratio (CRAR) as on March 31, 2008 in their balance sheets.
- High Level Committee to be constituted to review the Lead Bank Scheme.
- Financial assistance to RRBs for implementing information and communication technology (ICT) based solutions.
- Working group to be constituted to lay down the road-map for cross -border supervision and supervisory cooperation with overseas regulators, consistent with the framework envisaged in the Basel Committee on Banking Supervision (BCBS).
- Besides general market risk, specific risk, especially the credit risk arising out of deficient documentation or settlement risk to be covered under the supervisory process.
- Action plan to be drawn up for implementation of National Electronic Clearing Service (NECS) with centralised clearing and settlement at Mumbai.

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