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POLICY

Risk Weight for Educational Loans

The Reserve Bank has advised all scheduled commercial banks (excluding RRBs) that henceforth 'educational loans' would be classified as non-consumer credit for the purpose of capital adequacy norms. Accordingly, the risk weight applicable to educational loans would be as follows :

- Under the Basel I framework, the risk weight would be 100 per cent as against the earlier risk weight of 125 per cent.
- Under the Basel II framework, educational loans would be treated as a component of the regulatory retail portfolio as per Reserve Bank's circular of April 27, 2007 attracting a risk weight of 75 per cent as against the earlier risk weight of 125 per cent.

Earlier, educational loans were classified as a part of 'consumer credit' for the purpose of capital adequacy and accordingly attracted a risk weight of 125 per cent.

Additional Interest Subvention to Specified Export Sectors

It has been decided to extend additional interest subvention of 2 per cent (in addition to the 2 per cent already offered earlier) to pre-shipment and post-shipment credit to the following sectors:

- Leather and leather manufactures
- Marine products
- All categories of textiles under the existing scheme including RMG and carpets but excluding man-made fibre
- Handicrafts

Banks would, therefore, now charge interest rates not exceeding the benchmark prime lending rate (BPLR) minus 6.5 per cent on pre-shipment credit up to 180 days and post-shipment credit up to 90 days on the outstanding amount in respect of these sectors. The total subvention would, however, be subject to the condition that the interest rate, after subvention, would not fall below 7 per cent which is the rate applicable to the agriculture sector under priority sector lending.

This dispensation is valid from November 1, 2007 to March 31, 2008.

The terms of credit would be 180 days for pre-shipment and 90 days for post-shipment excepting the carpet sector, for which, the term would be 270 days for pre-shipment and 90 days (like other sectors) for post-shipment.

Earlier, the Reserve Bank had advised scheduled commercial banks in July 2007 and October 2007 regarding provision of interest subvention of 2 percentage points per annum in respect of rupee export credit to specified categories of exporters from April 01, 2007 up to March 31, 2008.

Flow of Credit to Infrastructure Sector

To encourage banks to increase the flow of credit to the infrastructure sector, they have been permitted to invest in unrated bonds of companies engaged in infrastructure activities within the ceiling of 10 per cent for unlisted non-SLR securities.

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NPAs - Obtaining Consent Decree from Court

Reiterating its earlier instructions, the Reserve Bank has advised banks to invariably ensure that once a case is filed before a court/debt recovery tribunal (DRT)/Board for Industrial and Financial Reconstruction (BIFR), any settlement arrived at with the borrower is subject to obtaining a consent decree from the court/DRT/BIFR concerned.

Definition of Infrastructure Lending Expanded

The scope of the definition of 'infrastructure lending' has been expanded to include the credit facilities sanctioned by banks and select all India financial institutions for projects involving laying down and/or maintenance of gas/crude oil/petroleum pipelines. Please see box below for the revised definition of 'infrastructure lending'.

UCBs

Priority Sector Lending Target Revised

The priority sector lending target for UCBs has been revised to 40 per cent of adjusted bank credit (total loan and advances plus investments made by UCBs in non-SLR bonds) OR credit equivalent amount of off balance sheet exposure (OBE), whichever is higher, as on March 31 of the previous year. The revised target would come into effect from April 1, 2008.

The target of priority sector advances was made applicable to UCBs based on the recommendation of the Standing Advisory Committee for UCBs constituted by the Reserve Bank in 1983 under the chairmanship of the then Deputy Governor, Dr. M.V. Hate. The Committee had recommended, *inter alia*, that UCBs should provide 60 per cent of their total advances to priority sectors. This recommendation was later endorsed by the High Power Committee on UCBs, 1999 (Madhav Rao Committee). This Committee had, in its report, suggested that there was no need for reduction in the priority sector targets to 40 per cent, applicable to commercial banks, on account of lower capital to risk weighted assets ratio (CRAR) requirement for non scheduled UCBs and exemptions available to UCBs from income tax.

Since the introduction of priority sector target for UCBs in 1983, the regulatory framework for UCBs has undergone significant changes and it has become more or less comparable with that of commercial banks, specially on CRAR and income recognition, asset classification and provisioning norms. The exemption hitherto enjoyed by UCBs from payment of income tax has also been withdrawn. Further, the justification for a higher target of priority sector advances for UCBs vis a vis commercial banks on the ground of lower statutory preemption of funds by way of CRR and SLR on their NDTL no more holds good in view of the gradual reduction of CRR and SLR requirements for commercial banks over the years.

Gold Loan

UCBs have been permitted to sanction gold loan with bullet repayment option subject to the conditions that -

- (i) The amount of gold loan sanctioned should not exceed Rs 1 lakh at any point of time.
- (ii) The period of loan should not exceed 12 months from the date of sanction.
- (iii) Interest should be charged to the account at monthly rests but would become due for payment along with the principal only at the end of 12 months from the date of sanction.
- (iv) UCBs should prescribe a minimum margin to be maintained in case of such loans and accordingly, fix the loan limit taking into account the market value of the security (gold/gold ornaments), expected price fluctuations, interest that would accrue during the tenure of the loan, etc.
- (v) Such loans would be governed by the extant income recognition, asset classification and provisioning norms which would be applicable once the principal and interest become overdue.
- (vi) The account would also be classified as NPA (sub-standard category) even before the due date of repayment, if the prescribed margin is not maintained.

Infrastructure Lending and List of Items included under Infrastructure Sector

Any credit facility in whatever form extended by lenders (i.e., banks, FIs or NBFCs) to an infrastructure facility as specified below falls within the definition of 'infrastructure lending'. In other words, a credit facility provided to a borrower company engaged in -

- ★ developing, or
- ★ operating and maintaining, or
- ★ developing, operating and maintaining any infrastructure facility that is a project and would also include -
 - (i) a road, including toll road, a bridge or a rail system;
 - (ii) a highway project including other activities being an integral part of the highway project;
 - (iii) a port, airport, inland waterway or inland port;
 - (iv) a water supply project, irrigation project, water treatment system, sanitation and sewerage system or solid waste management system;
 - (v) telecommunication services, whether basic or cellular, including radio paging, domestic satellite service (i.e.,

a satellite owned and operated by an Indian company for providing telecommunication service), network of trunking, broadband network and internet services;

- (vi) an industrial park or special economic zone;
- (vii) generation or generation and distribution of power;
- (viii) transmission or distribution of power by laying a network of new transmission or distribution lines;
- (ix) construction relating to projects involving agro-processing and supply of inputs to agriculture;
- (x) construction for preservation and storage of processed agro-products, perishable goods, such as, fruits, vegetables and flowers including, testing facilities for quality;
- (xi) construction of educational institutions and hospitals;
- (xii) laying down and/or maintenance of gas, crude oil and petroleum pipelines ; and
- (xiii) any other infrastructure facility of similar nature.

It is further clarified that crop loans sanctioned against the collateral security of gold/gold ornaments would continue to be governed by the extant income recognition, asset classification and provisioning norms for such loans.

Banks have been further advised to lay down policies in this regard with the approval of their Board.

RRBs

Funds provided by Sponsor/Commercial Banks

The Reserve Bank has advised that all loans granted by commercial banks/sponsor banks to regional rural banks (RRBs) for on-lending to agriculture and allied activities sector should be classified as indirect finance to agriculture in the books of commercial banks/sponsor banks. Consequently, the amount lent by RRBs out of funds borrowed from commercial banks/sponsor banks, should not be classified by them as part of their priority sector advances. RRBs need not also include such lending as part of their bank credit for the purpose of computing achievement level under priority sector lending.

Application of Capital Adequacy Norms

In order to assess the capital structure of RRBs/state co-operative banks (StCBs)/district central co-operative banks (DCCBs), in the context of financial stability of the whole system, it is proposed that they should disclose the level of CRAR as on March 31, 2008 in their balance sheets.

Accordingly, all RRBs/StCBs/DCCBs have been advised to disclose their CRAR as on March 31, 2008 and thereafter every year as 'Notes on Accounts' to their balance sheets.

Under the proposed CRAR framework, the balance sheet assets and non-funded/off-balance sheet items would be assigned weights and banks would have to compute the ratio of their capital funds to the aggregate of risk weighted assets and other off-balance sheet exposures.

Additionally, these banks should furnish an annual return to the Reserve Bank's/NABARD's regional office, indicating capital funds and risk assets ratio, in the prescribed format. The return should be signed by two officials who are authorised to sign statutory returns submitted to the Reserve Bank.

Appropriation from Reserve Fund

RRBs have been advised to take the Reserve Bank's prior approval before appropriating any sums from the statutory reserve or any other reserves.

RRBs have been further advised that -

- (i) all expenses including provisions and write-offs recognised in a period, whether mandatory or prudential, should be reflected in the profit and loss account for the period as an 'above the line' item (i.e. before arriving at the net profit).
- (ii) wherever draw down from reserves takes place with the Reserve Bank's prior approval, it should be effected only 'below the line' (i.e. after arriving at the profit/loss for the year); and
- (iii) it should also be ensured that suitable disclosures are made of such draw down of reserves in the 'Notes on Accounts' to the Balance Sheet.

It may be recalled that in terms of Section 17(2) read with Section 51 of the Banking Regulation Act, 1949, where a banking company appropriates any sum or sums from the reserve fund, it should, within twenty-one days from the date of such appropriation, report the fact to the Reserve Bank explaining the circumstances relating to such appropriation.

FEMA

SEBI registered FIIs permitted to Short Sell Equity Shares

In consultation with the Government of India and the Securities and Exchange Board of India (SEBI) it has been decided to permit foreign institutional investors (FIIs) registered with SEBI and sub-accounts of FIIs to short sell, lend and borrow equity shares of Indian companies. Short selling, lending and borrowing of equity shares of Indian companies would be subject to the conditions prescribed by the Reserve Bank/SEBI/other regulatory agencies from time to time. The permission is, however, subject to the conditions as follows:

- (i) The FII participation in short selling as well as borrowing/lending of equity shares would be subject to the current foreign direct investment policy and short selling of equity shares by FIIs shall not be permitted for equity shares which are in the Reserve Bank's ban list and/or caution list.
- (ii) Borrowing of equity shares by FIIs should only be for the purpose of delivery into short sale.
- (iii) The margin/collateral should be maintained by FIIs only in the form of cash. No interest should be paid to FIIs on such margin/collateral.

Loans extended by Banks to MFs/Issue of IPCs

Loans extended by MFs

In terms of paragraph 44(2) of the SEBI (Mutual Funds) Regulations, 1996, a mutual fund (MF) shall not borrow except to meet its temporary liquidity needs for the purpose of repurchase,

RBI Launches E-Portal for ICT Based Financial Inclusion

Smt. Usha Thorat, Deputy Governor, Reserve Bank of India, on December 20, 2007 formally launched an e-portal (www.ict.cab.org.in) on information and communication technology (ICT) enabled financial inclusion efforts of banks. The e-portal is developed by the College of Agricultural Banking (CAB), a premier training institution of the Reserve Bank based in Pune. The Reserve Bank has been encouraging banks to harness the power of information and communication technology (ICT) for reaching out to the unbanked population. The e-portal is envisaged to be a platform for sharing of knowledge and experience of banks in this area and, therefore, may have the potential to aid in leapfrogging the extension of formal financial services to the hitherto unserved population.

The e-portal has various useful sections containing policy initiatives by the Government of India and the Reserve Bank, their implementations by banks and other financial institutions, international experiences, a knowledge bank containing relevant articles/research papers, case studies, presentations and video clips, various related upcoming events and news items, ICT solutions and other useful links.

redemption of units or payment of interest or dividend to the unit holders. Further, a MF shall not borrow more than 20 per cent of the net asset of the scheme and for a duration not exceeding six months. The SEBI guidelines imply that MFs should normally meet their repurchase/redemption commitments from their own resources and resort to borrowing only to meet temporary liquidity needs. In view of this, banks have been advised to be judicious in extending finance to MFs and grant loans and advances to MFs only to meet their temporary liquidity needs for the purpose of repurchase/redemption of units within the ceiling of 20 per cent of the net asset of the scheme and for a period not exceeding 6 months. Such finance, if extended to equity-oriented MFs, would form a part of the banks' capital market exposure.

Issue of IPCs

Banks issue irrevocable payment commitments (IPCs) in favour of stock exchanges on behalf of MFs to facilitate transactions done by these clients. As IPCs are in the nature of non-fund based credit facility for purchase of shares they should be treated at par with guarantees issued for the purpose of capital market operations. Such exposure of banks would, therefore, form part of their capital market exposure. Banks are also advised that entities, such as, FIIs are not permitted to avail of fund or non-fund based facilities, such as, IPCs from banks. A transition period of 6 months from the date of these instructions is being provided to enable banks to comply with the above requirements.

RNBCs

Payment of Interest for Delayed Repayment of Deposits

In the interest of depositors, the Reserve Bank has advised residuary non-banking companies (RNBC) that if they fail to repay the deposit along with interest on maturity on the claim made by a depositor, they would be liable to pay interest in the following manner :

- (i) If the RNBC has intimated about the maturity to the depositor at least two months before the date of maturity and has sufficient evidence for the same viz., acknowledgement from the depositor, but the depositor fails to submit his claim on maturity, then interest at the rate as applicable to the deposit from the date of claim till the date of repayment along with the amount due on maturity should be paid.
- (ii) If the RNBC has not intimated about the maturity to the depositor two months before the date of maturity, then, as and when the depositor makes a claim, interest at the rate as applicable to the deposit from the date of maturity till the date of repayment along with the amount due on maturity should be paid.

CUSTOMER SERVICE

Measures taken for Customers Protection

To protect the rights of bank customers, prevent their harassment by banks' agents for realisation of loans, etc.,

steps have been taken by the Government of India/Reserve Bank of India, which *inter-alia*, are as follows -

- The Reserve Bank has issued instructions/guidelines to banks on 'Managing Risks and Code of Conduct in Outsourcing of Financial Services.'
- The Reserve Bank has formulated the "Fair Practices Code for Lenders."
- The Reserve Bank has issued instructions to all commercial banks (excluding RRBs)/NBFCs regarding credit card operations.
- The Code of Banks' Commitments to Customers formulated by the Banking Codes and Standards Board of India (BCSBI) provides, *inter-alia*, that the collection policy of the bank be built on courtesy, fair treatment and persuasion and the bank follows a security repossession policy in consonance with the law.
- The Indian Banks' Association (IBA) has formulated a "Model Code for Collection of Dues and Repossession of Security" as also a "Fair Practice Code for Credit Card Operations" which have been recommended to banks for adoption and implementation.
- In case of violation of the above guidelines, the aggrieved customers can lodge complaints with the Reserve Bank's Customer Service Department, the Banking Division of Department of Financial Services, the Public Grievances Cell of banks concerned, the Banking Ombudsman or the District Consumer Forum. Further, the aggrieved customers can also lodge complaints with the local police.
- The guidelines issued by the Reserve Bank clearly stipulate that banks would be responsible for all acts of omission or commission of their agents. Further, the Reserve Bank reserves the right to impose penalty on a bank for violation of guidelines under the provisions of the Banking Regulation Act, 1949.
- The Reserve Bank takes up complaints with the banks concerned and cautions them to ensure that such incidences do not recur in future. In the Mid-Term Review of the Annual Policy Statement (dated October 30, 2007), the Reserve Bank has observed that in view of the rise in the number of litigations against banks for engaging recovery agents in the recent past, it is felt that the adverse publicity could result in serious reputational risk for the banking sector as a whole. The Reserve Bank has urged banks to follow prescribed specific considerations while engaging recovery agents and has clarified that complaints received regarding abusive practices followed by a bank's recovery agent would invite serious supervisory disapproval. The Reserve Bank would consider imposing a temporary ban (or even a permanent ban in case of persistent abusive practices) for engaging recovery agents on those banks where strictures have been passed/penalties have been imposed by a High Court/Supreme Court against/on its directors/officers with regard to the abusive practices followed by their recovery agents.

Source : Parliament Questions