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# MONETARY AND CREDIT INFORMATION REVIEW

**POLICY**

## Maintenance of SLR

The Banking Regulation (Amendment) Act, 2007 replacing the Banking Regulation (Amendment) Ordinance, 2007 has come into effect from January 23, 2007. Consequent upon amendment to Section 24 of the Banking Regulation Act, 1949 the Reserve Bank has advised all scheduled commercial banks to continue to maintain in India assets, the value of which shall not, at the close of business on any day, be less than 25 per cent of the total net demand and time liabilities in India as on the last Friday of the second preceding fortnight, valued in accordance with the method of valuation specified by the Reserve Bank from time to time. These assets are -

(a) Cash, or

(b) Gold valued at a price not exceeding the current market price, or

(c) Unencumbered investment in the following instruments which would be referred to as statutory liquidity ratio (SLR) securities :

   (i) Dated securities;

   (ii) All treasury bills already issued, and to be issued in future, by the Government of India;

   (iii) Dated securities to be issued in future by the Government of India under the market borrowing programme and under the market stabilisation scheme with SLR status incorporated in the relevant notification;

   (iv) State development loans to be issued in future by the state governments under their market borrowing programme, with SLR status incorporated in the relevant notification; and

   (v) Any other instrument as notified in future by the Reserve Bank for SLR status.

*Explanation*: 'unencumbered investment' of a banking company would include its investment in the aforesaid securities lodged with another institution for an advance or any other credit arrangement to the extent to which such securities have not been drawn against or availed of.

In computing the amount for the above purpose, the following would be deemed to be cash maintained in India:

- The deposit required under sub-section (2) of Section 11 of the Banking Regulation Act, 1949 to be made with the Reserve Bank by a banking company incorporated outside India.
- Any balances maintained by a scheduled bank with the Reserve Bank in excess of the balance required to be maintained by it under Section 42 of the Reserve Bank of India Act, 1934 (2 of 1934).
- Net balances in current accounts with other scheduled commercial banks in India.

### Bank Finance to Factoring Companies

Reviewing the guidelines on financing of factoring companies, the Reserve Bank has advised banks that they may extend financial assistance to support the factoring business of factoring companies provided -

a) The factoring companies carry out all the components of a standard factoring activity, viz., financing of receivables, sale-ledger management and collection of receivables.

b) The factoring companies derive at least 80 per cent of their income from factoring activity.

c) The receivables purchased/financed, irrespective of whether on 'with recourse' or 'without recourse' basis, form at least 80 per cent of the assets of the factoring company.

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d) The assets/income referred to above would not include the assets/income relating to any bill discounting facility extended by the factoring company.

e) The financial assistance extended by the factoring companies is secured by hypothecation or assignment of receivables in their favour.

## Guidelines for Relief Measures to Poultry Industry

In view of instances of outbreak of Avian Influenza (bird flu) in some areas of the country and the subsequent loss of income suffered by poultry units due to culling of birds as well as steep fall in the demand for poultry products and their prices, the Reserve Bank has announced some relief measures to the poultry industry. Banks have been advised to consider extending the following facilities to poultry units financed by them:

(i) Principal and interest due on working capital loans as also installments and interest on term loans which have fallen due for payment on/after the onset of bird flu, i.e. December 31, 2007 and remaining unpaid amount may be converted into term loans. The converted loans may be recovered in installments based on projected future inflows over a period of up to three years with an initial moratorium of up to one year (the first year of repayment may be fixed after the expiry of moratorium period).

(ii) The remaining portion of term loans may be rescheduled similarly with a moratorium period up to one year depending upon the cash flow generating capacity of the unit.

(iii) The reschedulement/conversion may be completed on or before April 30, 2008.

(iv) The rescheduled/converted loans may be treated as current dues.

(v) After conversion as above, the borrower would be eligible for fresh need based finance.

(vi) These relief measures may be extended to all accounts of poultry industry, which were classified as standard accounts as on December 31, 2007.

For state/district co-operative banks and regional rural banks, NABARD will issue circular on similar lines.

## KYC Norms – AML Guidelines for CFT

Clarifying its earlier instructions of November 2004 on the nature and type of documents/information that may be relied upon for customer identification under the ‘know your customer’ (KYC) procedure, the Reserve Bank has advised banks that, permanent correct address means the address at which a person usually resides and can be taken as the address as mentioned in a utility bill or any other document accepted by the bank for verification of the address of the customer. It has been observed that some close relatives, e.g. wife, son, daughter and parents etc., who live with their husband, father/mother and son, as the case may be, are finding it difficult to open account in some banks as the utility bills required for address verification are not in their name. It is further advised that in such cases, banks may obtain an identity document and a utility bill of the relative with whom the prospective customer is living along with a declaration from the relative that the said person (prospective customer) wanting to open an account is a relative and is staying with him/her. Banks may use any supplementary evidence such as a letter received through post for further verification of the address. While issuing operational instructions to their branches in this regard, banks have been advised to keep in mind the spirit of the instructions issued by the Reserve Bank and avoid undue hardships to individuals who are, otherwise, classified as low risk customers.

Earlier in 2004, banks were advised to put in place a system of periodical review of risk categorisation of accounts and the need for applying enhanced due diligence measures in case of higher risk perception on a customer. Banks have been further advised that such review of risk categorisation of customers should be carried out at a periodicity of not less than once in six months. Banks should also introduce a system of periodical updation of customer identification data (including photograph/s) after the account is opened. The periodicity of such updation should not be less than once in five years in case of low risk category customers and not less than once in two years in case of high and medium risk categories.

Banks were also earlier advised that KYC/anti-money laundering guidelines (AML) guidelines issued by the Reserve Bank also apply to their branches and majority owned subsidiaries located outside India, especially, in countries which do not or insufficiently apply the FATF (Financial Action Task Force) Recommendations, to the extent local laws permit. It is clarified that in case there is a variance in KYC/AML standards prescribed by the Reserve Bank and the host country regulators, branches/overseas subsidiaries of banks are required to adopt the more stringent regulation of the two.

### Combating Financing of Terrorism (CFT)

Banks have been advised to develop suitable mechanism through appropriate policy framework for enhanced monitoring of accounts suspected of having terrorist links and swift identification of the transactions and making suitable reports to the Financial Intelligence Unit – India (FIU-IND) on a priority basis.

As and when list of individuals and entities, approved by the Security Council Committee established pursuant to various United Nations’ Security Council Resolutions (UNSCRs) are received from the Government of India, the Reserve Bank circulates these to all banks and financial institutions (FIs). Banks/FIs should ensure to update the consolidated list of individuals and entities circulated by the Reserve Bank. The updated list of such individuals/entities can be also be accessed in the United Nations website at http://www.un.org/sc/committees/1267/consolist.shtml. Banks have been advised to ensure, before opening any new account that the name/s of the proposed customer does not appear in the list. Further, banks should scan all existing accounts to ensure that no account is held by or linked to any of the entities or individuals included in the list. Full details of accounts bearing resemblance with any of the individuals/entities in the list should immediately be intimated to the Reserve Bank and the FIU-IND.

Banks should also put in place adequate screening mechanism as an integral part of their recruitment/hiring process of personnel.

The Reserve Bank has further advised that these guidelines have been issued under Section 35A of the Banking Regulation Act, 1949 and any contravention thereof would attract penalties under the relevant provisions of the Act.

# Microfinance and Financial Inclusion

Financial inclusion (FI) is delivery of banking services at an affordable cost to the vast sections of disadvantaged and low-income groups. Unrestrained access to public goods and services is the sine qua non of an open and efficient society. As banking services are in the nature of public service, provision of banking and payment services to the entire population without discrimination should be the prime objective of the public policy.

The spread of banking facilities has been uneven in the country, throwing up challenges for achieving financial inclusion. Going by the available data on the number of savings accounts and even assuming that one person has only one account, on an all India basis only 59 per cent of adult population in the country has bank accounts. The unbanked population is higher in the North Eastern and Eastern Regions as compared to other regions.

Further, the extent of credit inclusion is even lower at 14 per cent of adult population. The financially excluded sections largely comprise marginal farmers, landless labourers, oral lessees, self employed and unorganised sector enterprises, urban slum dwellers, migrants, ethnic minorities and socially excluded groups, senior citizens and women.

## Approach to Financial Inclusion

- Aim at 'connecting' people with the banking system and not just credit dispensation.
- Aim at giving people access to the payments system.
- Use multiple channels such as civil service organisations, NGOs, post offices, farmers' clubs, panchayats, MFIs (other than NBFCs), etc. as Business Facilitators/ Correspondents to expand the outreach of banks.
- Adopt a decentralised approach, which is state /region specific, and has close involvement and cooperation between the respective State Governments and banks.
- Make use of ICT using bio-metric smart cards and mobile hand held electronic devices for receipts and disbursement of cash by agents of banks, such as business facilitators/correspondents.

A few of the measures taken are:

## No-Frills Accounts and General Purpose Credit Cards

(i) Banks were advised to make available a basic banking 'no-frills' account with low or nil minimum balances as well as charges.

(ii) Banks are required to make available all printed material used by retail customers in the concerned regional language.

(iii) In order to ensure that persons belonging to low income group, both in urban and rural areas do not encounter difficulties in opening bank accounts, the know your customer (KYC) procedure for opening accounts has been simplified for those accounts with balances not exceeding Rs.50,000/- and credits thereto not exceeding Rs.1,00,000/- in a year. The simplified procedure allows introduction by a customer on whom full KYC drill has been observed.

(iv) Banks have been asked to consider introduction of a General Purpose Credit Card (GCC) facility up to Rs. 25,000/- at their rural and semi-urban branches. Interest rate on the facility is completely deregulated. Fifty per cent of the GCC loans can be treated as part of the banks' priority sector lending.

## Adoption of Districts for 100% Financial Inclusion

(i) The State Level Bankers Committee (SLBC) is required to identify one district for 100 % financial inclusion. Surveys are then conducted to identify households without bank account. Responsibility is given to the banks in the area for ensuring that all those who wanted to have a bank account are provided with one.

(ii) Recognising the need for providing social security to vulnerable groups, in some cases banks have provided, in association with insurance companies, innovative insurance policies at affordable cost.

(iii) So far, SLBCs have reported having achieved 100 per cent financial inclusion in 49 districts in 14 states. The outcome of the efforts made is reflected in opening of 12.6 million 'no frills' bank accounts opened as on December 31, 2007.

(iv) In certain less developed States, such as in North Eastern Region, Bihar, Chhatisgarh and Uttarakhand, Working Groups appointed by the Reserve Bank have made specific recommendations for financial inclusion, strengthening financial institutions and improving currency and payments systems.

## Use of Intermediaries as agents in Microfinance

(i) The Reserve Bank permitted banks to utilise the services of non-governmental organizations (NGOs), micro-finance institutions (other than Non-Banking Financial Companies) and other civil society organisations as intermediaries in providing financial and banking services through the use of business facilitator and business correspondent (BC) models, thus addressing the last mile problem.

(ii) Banks are also entering into agreements with Indian Postal authorities for using the enormous network of post offices as business correspondents.

## Use of ICT Solutions for Enhancing Outreach of Banks

(i) The Reserve Bank has been encouraging use of ICT solutions by banks for enhancing their outreach with the help of their Business Correspondents (BCs). The BCs carry hand-held devices, which are essentially smart card readers. The information captured is transmitted to a central server where the accounts are maintained.

(ii) Mobile phones have also been developed to serve as card readers. Account-holders are issued smart cards, which have their photographs and finger impressions. Certain banks have been using this technology in Andhra Pradesh, Karnataka and Maharashtra.

## Financial Literacy and Credit Counselling

(i) A multilingual website in 13 Indian languages on all matters concerning banking and the common person has been launched by the Reserve Bank on 18 June 2007. Comic-type books introducing banking to schoolchildren have already been put on the website. Similar books will be prepared for different target groups such as rural households, urban poor, defence personnel, women and small entrepreneurs.

(ii) Each SLBC convenor has been asked to set up a credit-counselling centre in one district as a pilot, and extend it to all other districts in due course.

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# Third Quarter Review of Annual Policy Statement : 2007- 08

Dr. Y Venugopal Reddy, Governor, Reserve Bank of India presented the Third Quarter Review of the Annual Statement on Monetary Policy for the Year 2007-08 on January 29, 2008. The highlights are:

## Monetary Measures

- Bank Rate kept unchanged at 6.0 per cent.
- Reverse repo rate and repo rate under the LAF kept unchanged at 6.0 per cent and 7.75 per cent, respectively.
- The flexibility to conduct overnight or longer term repo including the right to accept or reject tenders under the liquidity adjustment facility (LAF), wholly or partially, retained.
- CRR kept unchanged at 7.5 per cent.

## Stance

- Overall real GDP growth projection for 2007-08 at around 8.5 per cent is retained.
- The policy endeavour would be to contain inflation close to 5.0 per cent in 2007-08 while conditioning expectations in the range of 4.0-4.5 per cent.
- While non-food credit has decelerated, growth in money supply and aggregate deposits of scheduled commercial banks continue to expand well above indicative projections.
- High growth in reserve money is driven by large accretion to RBI's net foreign exchange assets.
- Liquidity management will assume priority in the conduct of monetary policy through appropriate and timely action.
- 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 growth and inflation, the overall stance of monetary policy in the period ahead will broadly continue to be:
  - ☐ To reinforce the emphasis on price stability and well-anchored inflation expectations while ensuring a monetary and interest rate environment conducive to continuation of the growth momentum and orderly conditions in financial markets.
  - ☐ To emphasise credit quality as well as credit delivery, in particular, for employment-intensive sectors, while pursuing financial inclusion.
  - ☐ To monitor the evolving heightened global uncertainties and domestic situation impinging on inflation expectations, financial stability and growth momentum in order to respond swiftly with both conventional and unconventional measures, as appropriate.

## Overall Assessment

- Real GDP originating in agriculture and allied activities has accelerated in the first half of 2007-08 in comparison with April-September 2006 and subsequent developments seem to confirm the positive outlook for agriculture.
- Assuming that there are no exogenous shocks, either global or domestic, the prospects for the industrial sector over the rest of 2007-08 remain reasonably positive.
- While the prospects for services continue to be favourable, uncertainties surrounding the evolution of global developments could affect the outlook.
- Domestic activity continues to be investment driven, supported by external demand. Building up of supply capacities, both new and existing, is strongly underway as reflected in the sustained demand for domestic and imported capital goods.
- Domestic monetary and liquidity conditions continue to be more expansionary than before and are likely to be amplified by global factors.
- There was a large increase in the total overhang of liquidity over the third quarter of 2007-08, reflecting the sizeable expansion in primary liquidity generated by the large accretions to the Reserve Bank's net foreign assets.
- In the foreign exchange market, large inflows have imposed persistent upward pressures on the exchange rate of the rupee.
- There has been some improvement in the finances of the Central Government as the gross fiscal deficit has declined indicating that adherence to the Fiscal Responsibility and Budget Management (FRBM) rules in the current financial year is on track.
- Consensus forecasts indicate a slowing of the global economy in 2007 and 2008 with the US subprime crisis, food and crude prices posing the gravest risks. While the dangers of global recession are relatively subdued at the current juncture and consensus expectations seem to support a soft landing, the upside pressures on inflation have become more potent and real than before.
- Headline inflation has trended up in the US, the euro area, Japan and China. Overall, inflationary pressures have firmed up with implications for the outlook for 2008.
- Developments in global financial markets present several issues that need to be monitored carefully in the context of the implications for EMEs. First, corporate credit spreads and those on mortgage-backed securities have widened since early October as concerns relating to the possibility of prolonged disruption to credit intermediation have deepened. Second, the impact of the recent financial market turmoil has been sizeable on banks, particularly internationally active banks on both sides of the Atlantic. Third, the responses of central banks to recent events have demonstrated that ensuring financial stability can, under certain circumstances, assume overriding importance relative to other more explicitly pursued goals.

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