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MONETARY AND CREDIT INFORMATION REVIEW

POLICY

Agricultural Debt Waiver and Debt Relief Scheme, 2008 – Prudential Norms

Pursuant to the Hon'ble Finance Minister announcing a debt waiver and debt relief scheme for farmers in his Budget Speech for 2008-09, the Reserve Bank had issued instructions to banks on May 23, 2008 for implementation of the scheme. The Reserve Bank has now issued guidelines to banks regarding income recognition, asset classification and provisioning, and capital adequacy as applicable to the loans covered by the Agricultural Debt Waiver and Debt Relief Scheme, 2008 scheme. The guidelines are -

Accounts subjected to Debt Waiver

As regards small and marginal farmers eligible for debt waiver, the amount eligible for waiver, pending receipt from the Government of India, should be transferred to a separate account named "Amount receivable from Government of India under Agricultural Debt Waiver Scheme 2008". The balance in this account should reflect in Schedule 9 (Advances) of the balance sheet.

The balance in this account should be treated as a "performing" asset, provided adequate provision is made for the loss in Present Value (PV) terms, computed under the assumption that such payments would be received from the Government of India in the following installments:

a) 32 per cent of the total amount due by September 30, 2008,

b) 19 per cent by July 31, 2009,

c) 39 per cent by July 2010, and

d) the remaining 10 per cent by July 2011.

The provision required under the current norms for standard assets, need not, however, be provided for in respect of the balance in this account.

The discount rate for arriving at the loss in PV terms should be taken as 9.56 per cent, being the yield to maturity on 364-day Government of India treasury bill, prevailing as on the date of this circular (July 30, 2008).

The prudential provisions held in respect of the NPA accounts for which the debt waiver has been granted may be reckoned for meeting the provisions required on PV basis.

In case, however, the amount of prudential provision held is more than the amount of provision required on PV basis, such excess provision should be reversed in a phased manner. This phased reversal may be effected in the proportion of 32 per cent, 19 per cent, 39 per cent, and 10 per cent during the years ended March 2009, 2010, 2011 and 2012, respectively, only after the installments due from the Government, for the relative years, have been received.

On receipt of the final instalment from the Government, the provision made for loss in PV terms should be transferred to the General Reserves, below the line.

In case the claim of a farmer is specifically rejected at any stage, the asset classification of the account should be determined with reference to the original date of NPA (as if the account had not been treated as performing in the interregnum based on the transfer of the loan balance to the aforesaid account) and suitable provision should be made. The provision made on PV basis may also be reckoned against the NPA-provisions required, consequent upon the account being treated as NPA due to the rejection of the claim.

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Accounts subjected to Debt Relief

Under the scheme, 'other' farmers, will be given a rebate of 25 per cent of the "eligible amount", by the Government by credit to his account, provided the farmer pays the balance 75 per cent of the 'eligible amount". The Scheme provides for payment of share of 75 per cent by such farmers in three instalments and the first two instalments should be for an amount not less than one-third of the farmer's share. The last dates of payment of the three instalments would be September 30, 2008; March 31, 2009 and June 30, 2009, respectively.

Asset Classification

Where the farmers covered under the Debt Relief Scheme have given the undertaking, agreeing to pay their share under the OTS, their relevant accounts should be treated by banks as "standard" / "performing" provided –

(a) adequate provision has been made for the loss in PV terms for all the receivables due from the borrowers as well as the Government; and

(b) such farmers pay their share of the settlement within one month of the due dates.

Provisioning

Standard Assets: The accounts subject to debt relief would stand classified as standard assets after receipt of the aforesaid undertaking from the borrowers. Accordingly, such accounts would also attract the prudential provisioning as applicable to standard assets.

PV Basis : For computing the amount of loss in PV terms under the Scheme, the cash flows receivable from the farmers, as per the repayment schedule, as well as from the government should be discounted to the present value. It may be assumed in this context that the Government's contribution would be received by June 30, 2010. The discount rate to be applied for the purpose should be the interest rate at which the loan was granted including the element of interest subsidy, if any, available from the Government.

The prudential provisions held in respect of the NPA accounts, for which the debt waiver has been granted, should be reckoned for meeting the provisions required on PV basis as well as for the standard assets (pursuant to classification of these loans as standard) and shortfall, if any, should be provided for. Thus, the total provisions held would comprise the provisions required on PV basis, provision for standard assets and excess prudential provisions, if any, towards NPA.

Provisioning in case of down-gradation of Accounts: The accounts subject to Debt Relief Scheme would be classified as standard/performing assets only if the farmers pay their share of the settlement within one month of the pre-specified due dates. In case, however, payments are delayed by the farmers beyond one month of the respective due dates, the outstanding amount in the relevant accounts of such farmers should be treated as NPA. The asset classification of such accounts should be determined with reference to the original date of NPA, (as if the account had not been treated as performing in the interregnum based on the aforesaid undertaking). On such down-gradation of the accounts, additional provisions as per the extant prudential norms should also be made.

For meeting this additional provisioning requirement, the excess prudential provisions, if any, held; the amount of provisions held for standard assets together with the provision made on PV basis, all in respect of such downgraded account, could be reckoned.

Reversal of Excess Prudential Provisions : In case the amount of the prudential NPA-provisions held are larger than the aggregate of the provision required on PV basis and for the standard assets (pursuant to classification of these loans as standard), such excess prudential provision should not be reversed but be continued to be held till the earlier of the two events, viz., : (a) till the entire outstanding of the borrower stands repaid – at which point, the entire amount could be reversed to the P/L account; or (b) when the amount of such excess provision exceeds the amount outstanding on account of the repayments by the borrower – at which point, the amount of provision in excess of the outstanding amount could be reversed to the P/L account.

Reversal of Provisions made on PV Basis: The provision made on PV basis represents a permanent loss to the bank on account of delayed receipt of cash flows and hence, should not be reversed to the P/L Account. The amount of such provision should, therefore, be carried till the account is finally settled and after receipt of the Government's contribution under the Scheme, the amount should be reversed to the General Reserves, below the line.

Grant of Fresh Loans

A small/marginal farmer and "other farmers" would become eligible for fresh agricultural loans/short-term production loans and investment loans, upon the eligible amount being waived, in terms of Reserve Bank's circular of May 23, 2008. The fresh loan should be treated as "performing asset", regardless of the asset classification of the loan subjected to debt waiver/debt relief and its subsequent asset classification should be governed by the extant IRAC norms.

Capital Adequacy

The amount outstanding in the account styled as "Amount receivable from Government of India under Agricultural Debt Waiver Scheme 2008" should be treated as a claim on the Government of India and would attract zero risk weight for the purpose of capital adequacy norms. The amount outstanding in the accounts covered by the Debt Relief Scheme should, however, be treated as a claim on the borrowers and risk weighted as per the extant norms. This treatment would apply under the Basel I as well as Basel II frameworks.

CRR increased

The Reserve Bank increased the cash reserve ratio (CRR) for scheduled banks by 25 basis points to 9.00 per cent of their net demand and time liabilities from the fortnight beginning August 30, 2008.

Rupee Export Credit Interest Rates

The Reserve Bank has advised that interest rates subvention scheme on export credit would be brought to a close from September 30, 2008. Banks have been advised to bring this to the notice of their exporter clients covered under the scheme so that they get adequate time to make necessary adjustments.

Savings Bonds - Collateral Facility

The Government of India has decided to allow for pledge/ hypothecation/lien of 7% Savings Bonds 2002, 6.5% Savings Bonds 2003 (non-taxable) and 8% Savings (taxable) Bonds 2003 as collateral for obtaining loans from scheduled banks. Accordingly, holders of these bonds would be entitled to create pledge or hypothecation or lien in favour of scheduled banks in accordance with section 28 of the Government Securities Act, 2006 (the G S Act) and regulations 21 and 22 of the Government Securities Regulations, 2007 (the G S Regulations).

It is further advised that, the collateral facility is available only for loans extended to holders of the bonds and not in respect of loans extended to third parties.

It may be recalled that earlier, these savings bonds were not eligible as collateral for loans from banks, financial institutions and non-banking financial companies.

Number of Returns to be submitted by Banks reduced

The Reserve Bank has implemented Online Returns Filing System (ORFS) for submission of certain important returns by commercial banks to the Reserve Bank. As part of the online submission of returns, the Reserve Bank will, in due course, adopt the international standards for data sharing among business entities through eXtensible Business Reporting Language (XBRL). The Reserve Bank is moving towards the XBRL standards under a high level Steering Committee chaired by the Deputy Governor, Shri V. Leeladhar.

As part of the XBRL implementation, the Reserve Bank had initiated an exercise of rationalisation of returns. The number of returns to be submitted by scheduled commercial banks (excluding RRBs) has now been reduced to 223 from 291. The Reserve Bank has placed on its website, the list of returns to be submitted as also the list of returns not to be submitted by banks.

FEMA

Direct Dispatch of Shipping Documents

With a view to further liberalising the facilities available to exporters and to simplify the procedure, AD Category - I banks have been allowed to regularise cases of dispatch of shipping documents by exporters directly to the consignee or his agent resident in the country of the final destination of goods, up to USD 1 million or its equivalent, per export shipment, subject to conditions as follows:

* The export proceeds have been realised in full.
* The exporter is a regular customer of the AD Category - I bank for a period of at least six months.
* The exporter's account with the AD Category – I bank is fully compliant with Reserve Bank's extant KYC / AML guidelines.
* The AD Category – I bank is satisfied about the bonafides of the transaction.

In case of doubt, the AD Category – I bank may consider filing suspicious transaction report (STR) with FIU_IND (Financial Intelligence Unit in India).

Advance Remittance for Import of Goods

With a view to simplifying the procedure for import of goods into India, AD Category – I banks have been advised that, in cases where the importer (other than a public sector company or a Department/Undertaking of the Government of India/state government) is unable to obtain bank guarantee from overseas suppliers and the AD Category – I bank is satisfied about the track record and bonafides of the importer, the requirement of bank guarantee/standby letter of credit may not be insisted upon for advance remittance up to the limit of USD 5,000,000 or its equivalent. Earlier, this limit was up to USD 1,000,000 or its equivalent.

All payments towards advance remittance for imports would be subject to the following conditions:

a) The importer is a customer of the AD Category – I bank.

b) The customer's account is fully compliant with the Reserve Bank's extant know your customer (KYC)/ anti-money laundering (AML) guidelines. KYC and due diligence exercise should be done for the Indian importer entity as well the overseas manufacturer/supplier.

c) The AD Category - I banks should undertake the transactions based on their commercial judgment and after being satisfied about the bonafides of the transactions.

d) Advance payments should be made strictly as per the terms of the sale contract and should be made directly to the account of the manufacturer/supplier concerned.

e) Physical import of goods into India should be made within six months (three years in case of capital goods) from the date of remittance and the importer should give an undertaking to furnish documentary evidence of import, within fifteen days from the close of the relevant period.

f) AD Category – I banks should follow up submission of documentary evidence for import into India.

g) In the event of non-import of goods, AD Category – I banks should ensure that the amount of advance remittance is repatriated to India or is utilised for any other purposes for which release of exchange is permissible.

Project Offices - Foreign Currency Accounts in India

Foreign companies have been permitted to open an additional foreign currency account for each project office (established under the Reserve Bank's general/specific approval) subject to the same terms and conditions as applicable to the existing foreign currency account. Both the foreign currency accounts should, however, be maintained with the same AD Category – I bank.

Earlier, foreign companies having project offices in India were permitted to open only one foreign currency account for each project. With a view to avoiding currency exposures, many foreign companies had been approaching the Reserve Bank for permission to open more than one foreign currency account, usually in their home currency and another in US Dollar.

Exchange Earner's Foreign Currency Account

The Reserve Bank has advised that from November 1, 2008, all exchange earners' foreign currency (EEFC) accounts would be only in the form of non-interest bearing current accounts.

It may be recalled that in October 2007, all exporters, as a temporary measure, were permitted to earn interest on EEFC accounts to the extent of outstanding balances of USD 1 million per exporter. The permission was valid up to October 31, 2008 and was subject to review. The measure has since been reviewed in consultation with the Government of India and the facility would be withdrawn from November 01, 2008.

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First Quarter Review of Annual Statement on Monetary Policy : 2008-09

Dr Y.V.Reddy, Governor, Reserve Bank of India, presented the First Quarter Review of the Annual Statement on Monetary Policy for the Year 2008-09 on July 29, 2008. The highlights are:

Monetary Measures

- Bank rate kept unchanged at 6.0 per cent.
- Reverse repo rate under LAF kept unchanged at 6.00 per cent.
- The fixed repo rate under the LAF increased by 50 basis points from 8.5 per cent to 9.00 per cent with immediate effect.
- Cash reserve ratio increased by 25 basis points to 9.0 per cent with effect from the fortnight beginning August 30, 2008.

Stance

- GDP growth projection for 2008-09 revised from the range of 8.0-8.5 per cent to around 8.0 per cent, barring domestic or external shocks.
- The policy endeavour would be to bring down inflation from the current level of about 11.0-12.0 per cent to a level close to 7.0 per cent by March 31, 2009.
- It is necessary to moderate monetary expansion and plan for a rate of money supply growth in the range of around 17.0 per cent in 2008-09 in consonance with the outlook on growth and inflation so as to ensure macroeconomic and financial stability in the period ahead.
- Consistent with the projection of money supply, the growth in aggregate deposits in 2008-09 is now placed at around 17.5 per cent or around Rs.6,00,000 crore.
- The growth of non-food credit including investments in bonds/debentures/shares of public sector undertakings and private corporate sector and CP is placed at around 20.0 per cent in 2008-09.
- Barring the emergence of any adverse and unexpected developments in various sectors of the economy, assuming that capital flows are effectively managed, and keeping in view the current assessment of the economy including the outlook for growth and inflation, the overall stance of monetary policy in 2008-09 will broadly continue to be:
  - o To ensure a monetary and interest rate environment that accords high priority to price stability, well-anchored inflation expectations and orderly conditions in financial markets while being conducive to continuation of the growth momentum.
  - o To respond swiftly on a continuing basis to the evolving constellation of adverse international developments and to the domestic situation impinging on inflation expectations, financial stability and growth momentum, with both conventional and unconventional measures, as appropriate.
  - o To emphasise credit quality as well as credit delivery, in particular, for employment-intensive sectors, while pursuing financial inclusion.

Overall Assessment

- Domestically, aggregate demand pressures appear to be strongly in evidence, exacerbated by the slack in supply response.
- The upsurge in inflation during the current financial year reflects a combination of forces at work: the pass-through of international crude prices to domestic administered prices effected on June 5, 2008; inflationary pressures in addition to crude oil prices; and movements in international prices of key commodities indicating elevated upside pressures for domestic prices of a number of commodities with implications for the evolving scenario.
- There are some signs of moderation in key monetary and banking aggregates in response to monetary measures, which have withdrawn liquidity from the system and tightened interest rates across the term structure.
- The rates of money supply and deposit growth have started to moderate in consonance since June, edging towards the trajectory set for 2008-09.
- The balancing of monetary and liquidity conditions has not, however, impacted the demand for bank credit which has accelerated on a year-on-year basis.
- The deepening financial turbulence in major financial centres has worsened the macroeconomic outlook further by erosion of consumer and business sentiment and tightening of financing conditions with indications that a generalised credit squeeze may take hold.
- The impact of the slowdown in developed economies on EMEs cannot but be adverse, but it has so far been limited by the strength of domestic demand, particularly investment, and consumption spending has remained stable.
- The slowing of import demand from developed economies could, however, pose a risk to the growth outlook for these economies.
- Inflation has emerged as the biggest risk to the global outlook, having risen to very high levels across the world, levels that have not been generally seen for a couple of decades.
- In the overall assessment, several risks looming over the global economy at the time of the Annual Policy Statement of April 2008 have either materialised or intensified with implications for every national economy, including India, warranting heightened vigilance and stress testing of the preparedness to deal with these developments.

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