Credit Information Review

243

October 1999

Monetary Policy

Mid-term Review of Monetary and Credit Policy : 1999-2000

Stance of the policy:

- Credit Policy to support industrial growth with price stability.
- Sufficient liquidity to be made available for growth.

Highlights of measures:

- CRR cut by one percentage point. This will release additional lendable resources of Rs.7,000 crore.
- Incremental CRR of 10 per cent on FCNR(B) deposits withdrawn. This will release lendable resources of Rs.1,060 crore.
- Interest rate surcharge of 30 per cent on import finance withdrawn.
- The minimum interest rate of 20 per cent on overdue export bills withdrawn.
- Emphasis upon simplification of procedures and cutting delays for Non resident investment/Foreign direct investment and improving credit delivery to exporters and other important sectors.
- Further measures to develop money market.
- New measures for deposit insurance and valuation of securities under consideration.
- Special facilities for Y2K preparations.

Dr.Bimal Jalan, Governor, Reserve Bank of India, in a meeting with the Chief Executives of banks presented the Mid-term Review of Monetary and Credit Policy 1999-2000 on October 29, 1999. In his Statement, Governor reviewed the macro-economic conditions and spelt out that the stance of monetary policy for the second half of 1999-2000 would remain broadly the same as in the first half. He also announced a number of policy measures towards improving liquidity and credit delivery and for further development of financial markets.

Measures:

In the light of the macro-economic and monetary policy developments, Governor announced the following changes in the policy :

Cash reserve ratio

(i) The cash reserve ratio (CRR) maintained by the scheduled commercial banks reduced by one percentage point from the present level of 10 per cent to 9 per cent in two instalments, effective the fortnights beginning November 6, 1999 and November 20, 1999 increasing the lendable resources of banks by Rs.7,000 crore.

(ii) The Reserve Bank has introduced a lag of two weeks in the maintenance of stipulated CRR by banks effective from the fortnight beginning November 6, 1999.
(iii) The interest rate surcharge of 30 per cent on import finance, has been withdrawn with immediate effect. This will reduce the financing cost of imports for industrial production and investment.
(iv) The stipulation of a minimum rate of 20 per cent interest on overdue export bills has also been withdrawn.
(v) The minimum maturity for FCNR(B) deposits is being raised to one year from six months. Besides, the requirement by banks to maintain an incremental CRR of 10 per cent on increase in liabilities under FCNR(B) Scheme has been withdrawn, effective from the fortnight beginning November 6, 1999.

Prime lending rates

The Reserve Bank has decided that banks will be given the freedom to charge interest rates without reference to PLR, in respect of the following categories :

- Loans covered by refinancing schemes of term lending institutions.
- Lending to intermediary agencies.
- Discounting of bills.
- Advances/Overdraft against domestic/NRE/FCNR deposits.

Prudential norms:

As further steps in the direction of strengthening prudential norms, the following measures are announced:
(i) In view of the growing share of investments in the assets of banks, the risk weight of 2.5 per cent for the risk arising out of market price variations is being extended to cover all investments including securities outside the SLR. This, however, will take effect from the year ending March 31, 2001.
(ii) With a view to moving closer to the international standard of 15 per cent, it has been decided to lower the exposure ceiling in respect of an individual borrower from the present level of 25 per cent to 20 per cent of the bank's capital funds effective April 1, 2000. Banks are given two year period for adjustment, where the existing level of exposure is more than 20 per cent.

Credit delivery

With a view to providing more flexibility to banks to increase the flow of credit, directly and indirectly through intermediary agencies including Housing and Urban Development Corporation and National Housing Bank, certain changes in the norms for determining the housing finance allocation by banks have been introduced.

Non-banking financial companies

The Reserve Bank has proposed to introduce formats of balance sheet with adequate disclosures as recommended by a Committee constituted by the Bank after getting views of the industry and

Department of Company Affairs, Government of India. The Reserve Bank has also introduced certain measures for the NBFC sector.

Deposit insurance

A Working Group was constituted in the RBI to review the role of deposit insurance in India. The Group has recommended changes in the existing system in regard to coverage, institutions to be brought within the ambits of insurance, regulatory systems, etc.

Year 2000 preparations

The Governor also mentioned that all the 103 commercial banks and their 40 subsidiaries have confirmed Y2K readiness as at the end of August, 1999. The MICR cheque clearance system at the Reserve Bank is being replaced by the state of the art Y2K Compliant Systems in all the metropolitan centres. Besides, all the issue offices of the Reserve Bank and currency chests at commercially important cities have been asked to store adequate quantities of cash in order to meet any sudden increase in demand.

In line with the international practices, all banks shall remain closed for public transactions on January 1, 2000.

To enable the banking system to tide over the century date change liquidity needs, a contingency plan has also been put in place.

Other measures:

The Reserve Bank has also introduced certain measures in money market and in government securities market in its credit policy.

The Governor has also announced provision of following further facilities to non-resident Indians without the need for approval of the Reserve Bank :

(i) Authorised dealers may grant rupee loans and overdrafts in India to NRIs against the security of shares/securities/ debentures or immovable properties held by such persons in India for purposes other than investment.
(ii) General permission to Indian companies for issuing non-convertible debentures by way of public issue to non-resident Indians/overseas corporate bodies on repatriation basis.
(iii) To delegate the powers to authorised dealers to permit portfolio investment by NRIs/PIOs/OCBs in shares/debentures.

Risk Management Systems in Banks

The Reserve Bank of India has issued detailed guidelines for risk management system in banks. The guidelines broadly cover management of credit, market and operational risks. The broad framework for management of liquidity and interest rate risks were covered by the guidelines on Asset-Liability Management (ALM) system, which were issued to banks earlier. The guidelines on

risk management now being issued together with the ALM guidelines are purported to serve as a benchmark to the banks, which are yet to establish an integrated risk management system.

According to the guidelines the management of credit risk should receive the prime attention of the top management. The banks should put in place the loan policy, approved by the board of directors covering the methodologies for measurement, monitoring and control of credit risk. Banks should also evolve comprehensive risk rating system that serves as a single point indicator of diverse risk factors of counterparties in relation to credit and investment decisions. The Reserve Bank guidelines have stated that the activities of asset-liability management committee and credit policy committee for management of credit and market risks need to be integrated.

The guidelines also require banks to evaluate portfolio quality on an on-going basis rather than near about balance sheet date. The proposals for investment should be subjected to the same degree of credit risk analysis as loan proposals. The risk evaluation should also include total exposure, including investments. As regards off-balance sheet exposures, the current and potential credit exposures may be measured on a daily basis. Banks have also been asked to evolve a suitable framework to provide a centralised overview of the aggregate exposure on other banks, endeavour to develop an internal matrix that reckons the counterparty and country risks. To manage liquidity risk, banks have been asked to consider putting in place prudential limits on inter-bank borrowings, especially call fundings, purchased funds, core deposits to core assets, off-balance sheet commitments, swapped funds, etc.

Banks have been asked to evaluate liquidity profile under bank-specific and market crisis scenarios. They have also been asked to prepare contingency plans to measure the ability to withstand sudden adverse swings in liquidity conditions. Banks have been asked to fix a definite timeframe for moving over to value at risk (VaR) and duration approaches for measurement of interest rate risk. The guidelines also mention that it would be desirable to adopt international standards on providing explicit capital cushion for the market risk to which banks are exposed. Banks should also adopt proper systems for measurement, monitoring and control of operational risk that is emerging in the wake of phenomenal increase in the volume of financial transactions. Banks operating in international markets have been asked to develop by March 31, 2001 suitable methodologies for estimating and maintaining economic capital. The other banks have been asked to formulate a medium-term strategy to comply with these requirements.

The guidelines on risk management have placed the primary responsibility of laying down risk parameters and establishing the risk management and control system on the board of directors. They have, however, stated that the implementation of the integrated risk management could be assigned to a risk management committee or a committee of top executives that reports to the board. The risk management guidelines also require banks to constitute a high-level credit policy committee to deal with issues pertaining to credit sanction, disbursement and follow-up procedures and to manage and control credit risk on a whole bank basis. The Reserve Bank has further asked banks to concurrently set up an independent credit risk management department to enforce and monitor compliance of the risk parameters and prudential limits set by the board/credit policy committee.

The Reserve Bank has, however, stated that due to the diversity and varying size of balance sheet items between banks, it may neither be possible nor may it be necessary to adopt uniform risk management system. The design of risk management framework should therefore, be oriented towards the bank's own requirement dictated by the size and complexity of business, risk philosophy, market perception and the existing level of capital. In other words, banks can evolve their own systems compatible with the type and size of operations as well as risk perception. While doing so, banks may critically evaluate their existing risk management system in the light of the guidelines issued by the Reserve Bank and put in place a proper system for covering the existing deficiencies and requisite upgradation.

The Reserve Bank has also asked banks to place the circular together with the guidelines before the board of directors at its next meeting. The bank should identify the gaps in the existing risk management practices and the policies and strategies for complying with the guidelines. The bank should review the board the progress in implementation of the guidelines at half-yearly intervals. The detailed guidelines are available on the RBI website at www.rbi.org.in.

Event Management Centres for Y2K

Time Table for Event Management

- Set up event management centres at their head Offices, Regional Offices and at each of its computerised locations by December 15, 1999.
- Identify core staff who will man these IEMC and EMCs. The contact persons for Y2K already communicated to the Y2K project cell and circulated among banks and FIs, would continue to be the contact points for communication between the CEMC and the IEMC of each bank.
- The EMCs would be manned continuously for 24 hours a day by rotation of earmarked core staff from December 27, 1999 to January 7, 2000 and from February 28, 2000 to March 7, 2000.
- Identify and establish communication channels for information sharing and decision making with the REMC of the Reserve Bank in respect of regional issues.
- The EMCs can be dismantled after the annual closing of accounts on April 1, 2000 if there are no issues outstanding for resolution.

The Reserve Bank of India has advised all commercial banks to set up event management centres at their head offices, regional centres as well as all their computerised branches. The Reserve Bank has conceptualised such event management structures keeping in view the need to provide for greater decentralisation and quicker decision making responses. Accordingly, a central event management centre (CEMC) will be set up at the Central Office of the RBI and regional event management centres (REMC) at each of its Regional Offices. Similarly all banks and financial institutions may set up institutional event management centres (IEMC) at their head offices/principal offices, event management centres (EMC) at regional office and local event management centres (LEMC) at each of its computerised branches. For setting up these centres, the Reserve Bank has also given specific target dates to banks and financial institutions. The Reserve Bank has stated that while banks would be encouraged to identify contact personnel for Year 2000 contact and provide solutions at the local level, as far as possible the local clearing houses could serve as the focal point for such local level contacts and problem resolution exercise.

Recognising that the demand for information before, during and after the century date change will be tremendous, the Reserve Bank has stated that an important consideration while defining links and channels for communication would be the need to predefine the data structures and direction of information flows. This is essential for ensuring that communication channels do not get clogged/ inter-twined due to all participants trying to contact the same source of information at the same time or criss-crossing communication lines. The Reserve Bank has, therefore, asked banks to address issues such as setting up of event management centres, their location, facilities, staffing requirements, security, command/ communication structure and rehearsals (familiarization) and infrastructure arrangements.

Guidelines for Gold Deposit Scheme

The Reserve Bank of India has circulated detailed guidelines for the gold deposit scheme. As per the guidelines, banks authorised by the Reserve Bank to deal in gold and which have the required infrastructure for managing the scheme, expertise/experience in gold business and proper risk management systems may launch the gold deposit scheme. Each bank will, within the framework set out by the Reserve Bank guidelines, devise a scheme in accordance with its own assessment of the market. Banks proposing to introduce a gold deposit scheme will need to take the Reserve Bank approval for introducing the scheme.

According to the broad guidelines issued by the Reserve Bank today, the scheme will be open for investment by resident Indians, Hindu undivided families, trusts and companies. Banks will either issue a passbook or a certificate or bond which will be transferable by endorsement and delivery. Banks will be free to fix their own interest rates on the gold deposit scheme. The scheme will have maturity range from 3 to 7 years with an initial lock-in period to be specified by each bank. Premature payment or encashment will be allowed after the initial lock-in-period at a penalty or cost to be decided by the individual banks.

Gold under the scheme will be accepted in scrap form only. The banks will first subject the tendered gold to preliminary assay by a non-destructive method. After the preliminary assay the depositor will have option to withdraw the tender depending upon the results. The deposit will be repaid in the form of standard gold bar of 0.995 fineness or in rupees equivalent to the price of gold as on the date of maturity at the option of the depositor. The depositor will have to exercise the option at the time of application or once during the tenure of the bond. Nomination facility will be available on these deposits.

Rupee loans will be available against collateral of the gold deposits. The scheme will be open-ended and will be available on tap. To ensure wide reach for the scheme, banks which fulfil these criteria but have limited branch network, may appoint other banks having the necessary infrastructure for collection, storage and transportation of gold as collection agents only.

For the purpose of operation of the scheme, the Reserve Bank/Government have also given certain facilities to the banks. These include exemption from customs duty for export/import of gold scrap/refined gold, payment of foreign exchange for refining and such other charges, exemption from cash reserve ratio on the liabilities under the scheme and to hedge the price risk arising out of gold price movement

It may be recalled that with a view to mobilising a portion of the privately held stock of gold in the country and putting it to productive use, the Finance Minister had announced the introduction of a gold deposit scheme in the budget for 1999-2000. The Scheme seeks to provide depositors the opportunity to earn interest on their idle gold holdings along with the benefits of safety and security of holding gold without any cost. The Government of India has since issued various enabling notifications.

Exchange Control

Issue of Rights/Bonus Shares to Non-Residents

The Reserve Bank of India has now granted general permission to (a) Indian companies to issue rights/bonus shares to non-residents and to send such shares out of India and (b) to non-residents to acquire such shares, subject to certain conditions.

It may be noted, that issue of rights/bonus shares resulting into increase in the percentage of foreign equity as also issue of shares by companies whose original projects cost was more than Rs 600 crores shall continue to require prior approval by Government of India, as per the existing procedure.

Acquisition/Purchase of Shares from other Non-Residents

The Reserve Bank of India has now granted general permission to
(a) (I) non-residents to acquire shares of companies incorporated in India from other non-residents (other than Non-Resident Indians and Overseas corporate bodies) by way of sale/transfer provided the transferor/seller had acquired the shares under general/ special permission of Reserve Bank.
(ii) non-resident Indians and persons of indian origin and OCBs to acquire shares of companies incorporated in India from other non-resident Indians. Persons of Indian Origin or OCBs by way of sale/transfer provided the transferor had acquired the shares under general or special permission of Reserve Bank:
on certain conditions.

The Reserve Bank of India does not permit transfer of shares from NRIs/PIOs/OCBs to other foreign nationals/companies incorporated outside India. In such cases, the transferee may approach the Secretariat for Industrial Assistance (SIA), Ministry of Industry, Government of India, New Delhi for necessary permission. Subsequently, an application in Form FNC-7 along with SIA's permission may be made to Reserve Bank of India, Exchange Control Department (Foreign Investment Division), Central Office, Mumbai for necessary permission under Foreign Exchange Regulation Act, 1973.

Sale/Transfer of Nominal Number of Shares

The Reserve Bank of India has now granted general permission to a person resident outside India or a company incorporated outside India to acquire shares from the shareholders who had acquired

such shares as signatories to the Memorandum and Articles of Association provided (I) the Indian company is permitted to become a 100% owned subsidiary, (ii) the total number of shares so acquired does not exceed 500 and (iii) the face value of the shares to be transferred is less than 0.1% (one tenth of one per cent) of the paid-up capital of the Indian company. The Company whose shares are so released and/or a depository have also been granted permission to enter an address outside India in their books in respect of such shares.

Edited and published by Alpana Killawala for the Reserve Bank of India, Press Relations Division, Central Office, Shahid Bhagat Singh Marg, Mumbai 400 001 and printed by her at Mouj Printing Bureau, Khatau Wadi, Girgaon, Mumbai 400 004. Annual Subscription : Rs. 12. Subscription to be remitted to the Director, DRRP (Sales Section), DEAP, Reserve Bank of India, Amar Building, Sir P.M. Road, P.B. No. 1036, Mumbai - 400 001. Also available on RBI website at www.rbi.org.in