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MONETARY AND CREDIT INFORMATION REVIEW

POLICY

RBI relaxes Norms for Lending against Gold Jewellery for NBFCs

The Reserve Bank had, on September 16, 2013 issued instructions to NBFCs for lending against gold jewellery (referred to as 'the circular'). The Reserve Bank, in January 2014, revised its instructions partially in the wake of the Reserve Bank receiving certain representations from NBFCs. According to the revised instructions:

i) Loan-To-Value (LTV) Ratio

In view of the moderation in the growth of gold loan portfolios of NBFCs in the recent past, and also taking into consideration the experience so far, it has been decided to raise the Loan-to-Value (LTV) ratio to up to 75 per cent for loans against the collateral of gold jewellery from the present limit of 60 per cent with immediate effect.

The Reserve Bank further clarified that the value of the jewellery for the purpose of determining the maximum permissible loan amount will be only the intrinsic value of the gold content and no other cost elements should be added to it. The intrinsic value will continue to be arrived at as detailed in 'the circular'. It was understood that some NBFCs were adding making charges, etc., to the value of the gold jewellery determined in terms of paragraph 2(iii) of 'the circular'.

ii) Standardisation of Value of Gold in arriving at LTV Ratio

The Reserve Bank has clarified that the need to give a certificate on the purity of gold cannot be dispensed with. The certified purity should be applied for determining the maximum permissible loan and the reserve price for auction. The NBFCs can, however, include suitable caveats to protect themselves against disputes on redemption.

As per para 2 (iii) of 'the circular', NBFCs were required to give in writing to the borrower the purity (in terms of carats) and weight of gold. NBFCs had raised apprehensions on certifying the purity of the gold jewellery accepted as collateral on grounds that under the current practices it was possible only to arrive at the proximate purity of the gold and that such a certification could lead to dispute with the borrowers.

iii) Verification of the Ownership of Gold

In view of the fact that it may not be possible for borrowers to produce receipts establishing ownership, especially when the jewellery has been inherited, the Reserve Bank clarified that the ownership verification need not necessarily be through original receipts for the jewellery pledged but a suitable document may

be prepared to explain how the ownership was determined, particularly in each and every case where the gold jewellery pledged by a borrower at any one time or cumulatively on loan outstanding is more than 20 grams. The Reserve Bank has also directed NBFCs to have an explicit policy in this regard in their overall loan policy.

In terms of para 2 (iv) of 'the circular', NBFCs were required to keep a record of verification of ownership of the jewellery where the gold jewellery pledged by a borrower at any one time

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or cumulatively on loan outstanding is more than 20 grams. Also, NBFCs were required to lay down the method of establishing ownership in its overall loan policy approved by its Board.

iv) Auction Process and Procedures

In terms of para 2 v of 'the circular', NBFCs were directed to conduct the auction in the same town or taluk in which the branch that had extended the loan is located. Representations have been received seeking permission to conduct auction in the district rather than the taluk. The Reserve Bank has not found it feasible to accept this request and as such the current instructions remain unchanged.

v) Other Instructions

In terms of para 2 vi (ii) of 'the circular', NBFCs were directed to disburse high value loans of ₹ one lakh and above, only through cheque. NBFCs had represented that payment by issue of cheques would lead to delay in the borrower getting access to the funds and the delays could be accentuated where disbursements happen during weekends. It is observed that a majority of the loans in the portfolio of NBFCs is below ₹ one lakh. It has, therefore, been decided to retain the current instructions in this regard.

Risk Weights and Provisioning For guaranteed Low Income Housing Loans

For loans guaranteed by Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH):

- i) Risk weight: NBFC-MFIs may assign zero risk weight for the guaranteed portion. The balance outstanding in excess of the guaranteed portion would attract a risk-weight as per extant guidelines.
- ii) Provisioning: In case the advance covered by CRGFTLIH guarantee becomes non-performing, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for as per the extant guidelines on provisioning for non-performing advances.

The CRGFTLIH has been set up by the Ministry of Housing & Urban Poverty Alleviation, Government of India for the purpose of providing guarantee in respect of low income housing loans.

Implementing Capital Regulations for OTC Derivatives and CCPs

It has been decided to implement the credit valuation adjustment (CVA) risk capital charge on Over-the-Counter (OTC) derivatives from April 1, 2014, instead of January 1, 2014. The guidelines on capital requirements for banks' exposures to central counterparties (CCPs) will become effective from January 1, 2014.

Prudential Norms for Credit Card Accounts

In order to bring in consistency and to induce transparency, the Reserve Bank has advised that a credit card account will be treated as non-performing asset if the minimum amount due, as mentioned in the statement, is not paid fully within 90 days from the next statement date. The gap between two statements should not be more than a month. Banks should follow this uniform method of determining over-due status for credit card accounts while reporting to credit information companies and for the purpose of levying of penal charges, namely, late payment charges, if any.

Incremental Provisioning and Capital for Unhedged Foreign Currency Exposures

The Reserve Bank has introduced incremental provisioning and capital requirements for bank exposures to entities with unhedged foreign currency exposures. The guidelines have been framed keeping in view the domestic borrowers' vulnerability to the foreign currency exposure. The framework also considers currency induced credit risk for exposures of overseas branches and foreign subsidiaries.

Likely Loss/EBID (%)	Incremental Provisioning Requirement on the total credit exposures over and above extant standard asset provisioning	Incremental Capital Requirement
Upto 15 per cent	0	0
More than 15 per cent and upto 30 per cent	20bps	0
More than 30 per cent and upto 50 per cent	40bps	0
More than 50 per cent and upto 75 per cent	60bps	0
More than 75 per cent	80 bps	25 per cent increase in the risk weight

The framework may be implemented from April 1, 2014.

Background

Unhedged foreign currency exposures of the entities are an area of concern not only for individual entity but also to the entire financial system; entities which do not hedge their foreign currency exposures can incur significant losses due to exchange rate movements. These losses may reduce their capacity to service the loans taken from the banking system and affect the health of the banking system. The Reserve Bank has issued various guidelines advising banks to closely monitor the unhedged foreign currency exposures of their borrowing clients and also factor this risk into the pricing. However, the extent of unhedged foreign currency exposures of the entities continues to be significant and this can increase the probability of default in times of high currency volatility.

FEMA

ODI – Rollover of Guarantees

It has been decided that in the case of Foreign Direct Investment (ODI) not to treat/reckon the renewal/rollover of an existing/original guarantee, which is part of the total financial commitment of the Indian party in terms of Regulation 6 of the Notification No. FEMA.120/RB-2004 dated July 7, 2004, as a fresh financial commitment, provided that:

- a. The existing/original guarantee was issued in terms of the then extant/prevaling FEMA guidelines.
- b. There is no change in the end use of the guarantee, i.e., the facilities availed by the JV/WOS/Step Down Subsidiary;
- c. There is no change in any of the terms & conditions, including the amount of the guarantee except the validity period;

- d. The reporting of the rolled over guarantee would be done as a fresh financial commitment in Part II of Form ODI, as hitherto; and
- e. If the Indian party is under investigation by any investigation/enforcement agency or regulatory body, the concerned agency/body shall be kept informed about the same.

In case, however, the above conditions are not met, the Indian party shall obtain prior approval of the Reserve Bank for rollover/renewal of the existing guarantee through the designated AD bank.

Issue of Non Convertible/ Redeemable Bonus Preference Shares or Debentures - Clarifications

It has been decided that an Indian company may issue non-convertible/redeemable preference shares or debentures to non-resident shareholders, including the depositories that act as trustees for the ADR/GDR holders, by way of distribution as bonus from its general reserves under a Scheme of Arrangement approved by a Court in India under the provisions of the Companies Act, as applicable, subject to no-objection from the Income Tax Authorities. This has been done with a view to rationalising and simplifying the procedures for issue of non-convertible/redeemable bonus preference shares or debentures to non-resident shareholders from the general reserve under a Scheme of Arrangement by a Court, under the provisions of the Companies Act, as applicable.

This general permission to Indian companies is, however, only for issue of non-convertible/redeemable preference shares or debentures to non-resident shareholders by way of distribution as bonus from the general reserves. The issue of preference shares (excluding non-convertible/redeemable preference shares) and convertible debentures (excluding optionally convertible/partially convertible debentures) under the FDI scheme would continue to be subject to A.P. (DIR Series) Circular Nos.73 and 74 dated June 8, 2007 as hitherto.

MRO to be part of Airport Infrastructure for ECBs

On a review, it has been decided that, for the purpose of External Commercial Borrowings (ECB), 'Maintenance, Repairs and Overhaul' (MRO) will also be treated as a part of airport infrastructure. Accordingly, MRO, as distinct from the related services which are other than infrastructure, will be considered as part of the sub-sector of airport in the Transport Sector of infrastructure. All other aspects of ECB policy shall remain unchanged.

Import of Gold by Nominated Entities

In consultation with the Government of India, it has been decided to issue the following clarifications on import of gold by nominated banks/agencies/entities:

- a. Refineries are allowed to import dore up to 15% of their gross average viable quantity based on their licence entitlement in the first two months for making this available to the exporters on First in First out (FIFO) basis. Subsequent to this, the quantum of gold dore to be imported should be determined lot-wise on the basis of export performance.
- b. Before the next import, not more than 80% shall be allowed to be sold domestically.

- c. The dore so imported shall be refined and shall be released based on FIFO basis following 20:80 principle. This would be monitored by CBEC as earlier.
- d. The imports, thereafter, shall be allowed only up to 5 times the quantum for which proof of export has been submitted. This shall be on accrual basis.

The instructions have come into effect immediately.

Residents can on-lend Rupees borrowed from Resident Outside India

A person resident in India who had borrowed in Rupees from a person resident outside India was restricted under current FEMA regulations from using such borrowed funds for any investment, whether by way of capital or otherwise, in any company or partnership firm or proprietorship concern or any entity, whether incorporated or not, or for relending.

On a review, such resident entities / companies in India, authorised by the Government of India, to issue tax-free, secured, redeemable, non-convertible bonds in Rupees to persons resident outside India have been permitted to use such borrowed funds for:

- (a) on lending / re-lending to the infrastructure sector; and
- (b) keeping in fixed deposits with banks in India pending utilization by them for permissible end-uses.

Revised Guidelines for Merchanting Trade Transactions

The Reserve Bank of India has revised guidelines on Merchanting Trade Transactions. The earlier guidelines on the subject were issued in 2003. Merchanting or Intermediary Trade involves purchase of goods by Indian residents from non-residents and then reselling them to another non-resident directly without the goods touching the Indian ports. Although the merchanting trade transactions do not contribute to the exports from India, they result in net foreign exchange inflows. The Technical Committee on Services / Facilities to exporters (Chairman: Shri G. Padmanabhan) in its report (May 2013) recommended that the procedure be simplified.

Under the revised guidelines, total period of merchanting trade has been extended from six months to nine months and short term financing for both export and import leg has been enabled. Half yearly reporting of outstanding merchanting trade by AD Banks has also been prescribed to ensure better monitoring.

Mid-Quarter Monetary Policy Review: December 2013

The Reserve Bank of India announced the Mid-Quarter Review of the Monetary Policy Statement 2013-14 on December 18, 2013. On the basis of an assessment of the current and evolving macroeconomic situation, it has been decided to:

- keep the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 7.75 per cent; and
- keep the cash reserve ratio (CRR) of scheduled banks unchanged at 4.0 per cent of net demand and time liability (NDTL).

Consequently, the reverse repo rate under the LAF will remain unchanged at 6.75 per cent, and the marginal standing facility (MSF) rate and the Bank Rate at 8.75 per cent.

Reports

Committee on Comprehensive Financial Services for Small Business and Low Income Households

The Reserve Bank of India released on its website for public comments, the Report of the Committee on Comprehensive Financial Services for Small Business and Low Income Households. The Reserve Bank of India had, in September 2013, set up a Committee on Comprehensive Financial Services for Small Business and Low Income Households, under the Chairmanship of Dr. Nachiket Mor, Member on the Reserve Bank's Central Board of Directors.

Vision

The Committee, while laying down its vision statement for financial inclusion and deepening, has suggested providing a universal bank account to all Indians above the age of eighteen years and has recommended a Vertically Differentiated Banking System with Payments Banks for Deposits & Payments and Wholesale Banks for credit outreach with relaxed entry point norms of ₹ 50 crore.

Priority Sector Lending

On priority sector, the Committee has recommended Adjusted Priority Sector Lending Target of 50 per cent against the current requirement of 40 per cent with sectoral and regional weightages based on the level of difficulty in lending. The Committee has also recommended risks and liquidity transfers through markets. In view of the fact that banks may choose to focus their priority sector strategies on different customer segments and asset classes, the Committee has recommended that the regulator provide specific guidance on differential provisioning norms at the level of each asset class. A bank's overall Non Performing Assets Coverage Ratio would therefore be a function of its overall portfolio asset mix.

Definition of NBFCs

On definition of Non-Banking Finance Companies (NBFCs), the Committee has recommended only two categories - one for core investment companies and another category for all other NBFCs. The Committee has advocated regulatory convergence between banks and NBFCs based on the principle of neutrality with regard to classification of non-performing assets and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 eligibility.

State Level Regulators

The Committee has suggested that a State Finance Regulatory Commission (SFRC) be created into which all the existing State Government-level regulators could be merged and functions like the regulation of Non-Government Organisations-Micro Finance Institutions (NGO-MFIs) and local Money Services Business could be added on. The Committee has desired that the Reserve Bank should issue regulations on suitability, applicable specifically for individuals and small businesses, to all regulated entities within its purview so that the violation of such regulations would result in penal action for the institution as contemplated

under the relevant statutes through a variety of measures, including fines, cease-and-desist orders, and modification and cancellation of licences.

Committee on Financial Benchmarks

The Reserve Bank of India has placed on its website, the 'Draft Report of the Committee on Financial Benchmarks' for public comments. The Reserve Bank had announced the constitution of the Committee on Financial Benchmarks under Chairmanship of Shri P. Vijaya Bhaskar, Executive Director on June 28, 2013 with a mandate to study various issues relating to financial benchmarks in India and to submit the Report by December 31, 2013.

In the aftermath of the revelations regarding manipulations of several key global benchmark rates, viz. LIBOR, EURIBOR, TIBOR, etc., several international standard setting bodies, national regulators, and self-regulatory market bodies have reviewed the benchmark setting processes and came out with wide ranging reform measures and governing principles for enhancing the robustness and reliability of the financial benchmarks. The IOSCO has released its final report on Principles for Financial Benchmarks in July 2013. The FSB, working under the mandate of G-20, has endorsed the IOSCO's Principles. The Benchmark Administrators are required to disclose their compliance with the IOSCO Principles by July 2014.

The Report of the Committee provides a brief overview of the measures recommended by various international bodies/committees and the reforms already undertaken/underway in key benchmarks in various jurisdictions. Building on the cross-country experiences, the Report provides an in-depth analysis of the existing benchmark setting methodology and governance framework of the major Indian Rupee interest rate benchmarks and foreign exchange benchmarks. While the existing system was found generally satisfactory, the Report recommends several measures/principles to be followed to strengthen the benchmark quality, setting methodology and governance framework of the Benchmark Administrators, Calculation Agents and Submitters. In line with the international move towards greater regulatory oversight of the benchmark setting process, the Report reviews the existing regulatory powers of RBI over the financial benchmarks and recommends suitable amendments of the RBI Act, as a long term measure, to explicitly empower RBI to determine policy with regard to benchmarks used in Money, G-sec, Credit and Foreign Exchange markets in India and to issue binding directions to all the agencies involved in the benchmark setting. Pending the amendments, the Report recommends appropriate regulatory and supervisory framework to be put in place by RBI for the above financial benchmarks under its existing statutory powers.