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POLICY

First Quarter Review of Monetary Policy for 2011-12

Dr. D. Subbarao, Governor, Reserve Bank of India, in a meeting with chief executives of major commercial banks presented the First Quarter Review of the Monetary Policy for the Year for 2011-12 on July 26, 2011. Highlights:

Projections

- Real GDP growth for 2011-12 retained at 8.0 per cent.
- Baseline projection for wholesale price index (WPI) inflation for March 2012 revised to 7.0 per cent.

Stance

- Maintain an interest rate environment that moderates inflation and anchors inflation expectations.
- Manage the risk of growth falling significantly below trend.
- Manage liquidity to ensure that monetary transmission remains effective, without exerting undue stress on the financial system.

Monetary Measures

- Bank Rate retained at 6.0 per cent.
- Repo rate under the LAF increased by 50 basis points from 7.5 per cent to 8.0 per cent.
- Reverse repo rate under the LAF, automatically adjusted to 7.0 per cent.
- The Marginal Standing Facility (MSF) rate, determined with a spread of 100 basis points above the repo rate, recalibrated at 9.0 per cent.
- Cash reserve ratio (CRR) of scheduled banks retained at 6.0 per cent of their net demand and time liabilities (NDTL).

Expected Outcomes

The monetary policy actions are expected to:

(i) Reinforce the cumulative impact of past actions on demand.

(ii) Maintain the credibility of the commitment of monetary policy to controlling inflation, thereby keeping medium-term inflation expectations anchored.

(iii) Reinforce the point that in the absence of complementary policy responses on both demand and supply sides, stronger monetary policy actions are required.

Standing Liquidity Facilities provided to banks (export credit refinance) and Primary Dealers (PDs) (collateralised liquidity support) from the Reserve Bank increased to the revised repo rate, i.e., at 8.0 per cent.

Timings for Reverse Repo under LAF and MSF revised

The Reverse Repo auctions under Liquidity Adjustment Facility (LAF) and Marginal Standing Facility (MSF) operations are now conducted between 4.30 pm and 5.00 pm on all working days in Mumbai (excluding Saturdays) with effect from August 16, 2011. Repo auctions under LAF will continue to be conducted between 9.30 am and 10.30 am. Earlier, Repo and Reverse Repo auctions under LAF were conducted between 9.30 am and 10.30 am and the MSF was available between 3.30 pm and 4.30 pm on all working days in Mumbai, except Saturdays.

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Prudential Norms for Off-balance Sheet Exposures of Banks

In terms of extant regulations, the overdue receivables representing positive mark to market value of a derivative contract would be treated as a non-performing asset (NPA), if these remain unpaid for 90 days or more. In that case, all other funded facilities granted to the client should also be classified as NPA following the principle of borrower-wise classification as per the existing asset classification norms. As the overdue receivables would represent unrealised income already booked by the bank on accrual basis in the 'Profit and Loss Account', such amount should be reversed after 90 days of overdue period, and held in a 'Suspense Account-Crystalised Receivables' in the same manner as done in the case of overdue advances.

It has been clarified that in cases where the derivative contracts provide for more settlements in future, the MTM value will comprise (a) crystallised receivables and (b) positive or negative MTM in respect of future receivables. If the derivative contract is not terminated on the overdue receivable remaining unpaid for 90 days, in addition to reversing the crystallised receivable from Profit and Loss Account as stipulated above, the positive MTM pertaining to future receivables may also be reversed from Profit and Loss Account to another account styled as '*Suspense Account – Positive MTM*'. The subsequent positive changes in the MTM value may be credited to the 'Suspense Account – Positive MTM', not to P&L Account. The subsequent decline in MTM value may be adjusted against the balance in '*Suspense Account – Positive MTM*'. If the balance in this account is not sufficient, the remaining amount may be debited to the P&L Account. On payment of the overdues in cash, the balance in the '*Suspense Account-Crystalised Receivables*' may be transferred to the 'Profit and Loss Account', to the extent payment is received.

Derivatives Guidelines modified

Comprehensive Guidelines on Derivatives issued by the Reserve Bank in 2007 have been reviewed in the light of experience gained in implementation of the policy. The guidelines with regard to suitability and appropriateness policy for offering of derivative products to users, as outlined in paragraph 8.3 of earlier guidelines, have been modified to additionally include the following:

- In general, market-makers should not undertake derivative transactions with or sell structured products to users that do not have properly documented policies regarding management of risks that include, among other things, guidelines on risk identification, management and control.
- Before offering derivative products to clients, banks should obtain resolution of the board of the corporate authorising the concerned official of the company to undertake derivative transactions on behalf of the company. The board resolution being submitted by the company should:
  - (a) be signed by a person other than the persons authorised to undertake the transactions;
  - (b) be specific and should articulate specific products that can be transacted;
  - (c) also mention the person(s) authorised to sign the International Swaps and Derivatives Association and similar agreements;
  - (d) explicitly mention the limits assigned to a particular person; and
  - (e) specify the names of the people to whom transactions should the bank report. These personnel should be distinct from those authorised to undertake the transactions.

While undertaking derivative transactions with or selling structured derivative products to a user, a market-maker should:

(i) ensure that no bank can be a market maker in a product it cannot price independently. This will also be applicable to deals undertaken on back-to-back basis. Similarly, foreign banks operating in India can be market makers for specific products only if they have the ability to price the products locally in India. The pricing of such products should be locally demonstrable at all times, particularly whenever RBI needs such evidence.

(ii) Banks are required to obtain board resolution from the corporate that states the following:

a) The corporate has in place a Risk Management Policy approved by its board which contains :
   - Guidelines on risk identification, measurement and control
   - Guidelines and procedures to be followed with respect to revaluation and monitoring of positions
   - Names and designation of officials authorised to undertake transactions and limits assigned to them
   - A requirement that the assignment of limits to an official would be specific and in case the limits assigned are not quantified, then the bank should offer derivative products to that client only after getting appropriate documents certifying assignment of specific limits
   - Accounting policy and disclosure norms to be followed in respect of derivative transactions
   - A requirement to disclose the MTM valuations appropriately
   - A requirement to ensure separation of duties between front, middle and back office
   - Mechanism regarding reporting of data to the Board including financial position of transaction.

b) The corporate has laid down clear guidelines for conducting the transactions and institutionalised the arrangements for a periodical review of operations and annual audit of transactions to verify compliance with the regulations.

Market-makers should not undertake derivative transaction with users till they provide a board or equivalent forum resolution stating that they have in place a board approved Risk Management Policy which contains the details mentioned above.

The responsibility of undertaking 'Customer Appropriateness and Suitability' review is on the market-maker. Banks should require its compliance officer to submit a monthly report to the Board of Directors of the bank certifying that all the guidelines including those in respect of this paragraph have been followed for all derivative transactions undertaken by the bank during the period.

If the bank has other derivative exposures on the borrower, the MTMs of other derivative exposures should also be dealt with / accounted for in the manner as described in above para, subsequent to the crystalised/settlement amount in respect of a particular derivative transaction being treated as NPA.

As the legal position regarding bilateral netting is not unambiguously clear, receivables and payables from/to the same counterparty including that relating to a single derivative contract should not be netted.

Similarly, in case of a fund-based credit facility extended to a borrower being classified as NPA, the MTMs of all the derivative exposures should be treated in the manner discussed above.

These instructions will be applicable to both outstanding derivatives contracts and the new derivatives transactions undertaken.

Banks can issue Prepaid Payment Instruments to Corporates

Banks have been permitted to issue prepaid payment instruments to corporates for onward issuance to their employees, subject to certain conditions. These are:

i) Prepaid payment instruments can be issued only to corporate entities listed in any of the stock exchanges in India.

ii) Verification of the identity of the employee would be the responsibility of the concerned corporate. The bank should put in place proper systems to capture and maintain details of the employees to whom the cards are issued by the corporate along with copies of photograph and identity proof of such employees. The corporate is also required to make available details of bank accounts (if any) of the employees to the bank.

iii) Banks may ensure that the list of authorised signatories approved by the board of the corporate entity is taken on record and requests from such authorised persons are only accepted for the purpose of loading/activating the prepaid payment instruments.

iv) These prepaid payment instruments should be loaded/ reloaded only by debit to the bank account, which are subject to full KYC, maintained by the corporate with the same bank.

v) The maximum value outstanding on individual prepaid payment instruments at any point of time should not exceed Rs 50,000/-.

vi) Banks should facilitate transfer of funds from such prepaid payment instruments to a regular bank account of the concerned employee, if requested for.

vii) The banks should be responsible for all customer service aspects related to these instruments.

Implementation of EBT and Its Convergence with FIP

For clearer conceptual understanding and based on detailed consultative meetings and interface with stakeholders, "Operational Guidelines on Implementation of Electronic Benefit Transfer (EBT) and its Convergence with Financial Inclusion Plan (FIP)" have been formulated. The guidelines, among other things, suggest that one–district-many banks-one leader bank model may henceforth be adopted for EBT implementation and provide a model workflow under this scheme of transfer. These guidelines are expected to give a fillip to financial inclusion efforts and lead to a scalable and sustainable financial inclusion model. EBT for servicing low value accounts and extending banking infrastructure to underserved low income areas has been implemented in the states on pilot basis in select districts under the "One District – One Bank" Model. Difficulties have been expressed by stakeholders in up scaling the model. The experience gained so far suggested that the "One District – One Bank" Model has not been able to achieve the objective of financial inclusion. Allocation of villages among banks under the FIP, i.e., roadmap for providing banking services to villages with population above 2000, has generally been on the basis of the Service Area Approach. This has led to a situation in which the designated bank for EBT and FIP in the same village differed.

FEMA

Investment in Units of Domestic Mutual funds

Non-resident investors (other than SEBI registered FIIs and FVCIs) who meet the KYC requirements of SEBI, called 'Qualified Foreign Investors' (QFIs), have been allowed to purchase, on repatriation basis, rupee denominated units of equity schemes of domestic MFs issued by SEBI registered domestic MFs in accordance with the terms and conditions as stipulated by the SEBI and the RBI from time to time in this regard. The QFIs may invest through AD Category - I banks in rupee denominated units of equity schemes of domestic MFs issued by SEBI registered domestic MFs under two routes, namely, Direct Route – SEBI registered Depository Participant (DP) route and Indirect Route - Unit Confirmation Receipt (UCR) route subject to following terms and conditions:

General conditions

i) Investments by the QFIs would be subject to a ceiling of USD 10 billion under both the routes. The total amount invested for the purchase of domestic MFs units by all QFIs and the money lying in the single rupee pool bank accounts of DPs would be added to arrive at the ceiling. SEBI will monitor the ceiling of USD 10 billion on a daily basis.

ii) The investment under both the routes by the QFIs will be in units which are directly issued by domestic MFs and no secondary market purchases would be allowed.

iii) Only QFIs from jurisdictions which are compliant with the FATF standards and are signatories to the IOSCO's Multilateral Memorandum of Understanding will be eligible to invest in domestic MFs under this Scheme.

iv) DPs will ensure KYC of the QFIs as per SEBI norms.

v) Domestic MFs would also undertake KYC of the QFIs.

vi) Units and UCRs issued under this Scheme to QFIs, would be non-tradable and non-transferable.

Direct Route

vii) The DP route will be operated through separate single rupee pool bank account to be maintained by DP with an AD Category I Bank in India. Funds received from QFIs into this account shall be remitted to domestic MF either on the same day of the receipt of the funds from QFIs or by next business day in case money is received after business hours, failing which the funds would be immediately repatriated back to QFI's overseas bank account. The redemption proceeds of the units will also be received from domestic MF into this account and shall be repatriated to the overseas bank account of QFI within two working days of the same having being received in the rupee pool account of the DP. Within these two working days the redemption proceeds can also be utilised for further investment by QFI under this Scheme. The foreign inward remittances in to the single rupee pool bank account of DPs shall be received only in permissible

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currency (i.e., freely convertible currency). Dividend payments on units held by QFIs would have to be directly remitted to the overseas accounts of QFIs by domestic MFs.

viii) QFIs would be allowed to open a single demat account with a DP in India for investment in rupee denominated units of different domestic MFs equity schemes. However, QFIs would not be allowed to open a bank account in India.

Indirect Route

ix) Domestic MFs would be allowed to open foreign currency accounts outside India for the limited purpose of receiving subscriptions from the QFIs as well as for redeeming the UCRs.

x) The UCR will be issued against units of domestic MF equity schemes.

QFIs have also been allowed to invest (under both the routes – Direct and Indirect, subject to the terms and conditions) up to an additional amount of USD 3 billion in units of domestic MF debt schemes which invest in infrastructure debt of minimum residual maturity of 5 years, within the existing ceiling of USD 25 billion for FII investment in corporate bonds issued by infrastructure companies.

Investments by QFIs in units of domestic MFs, as above, shall also comply with the provisions of FEMA.

Branch Banking

Banks need to sign Cheque Return Memo

The Reserve Bank has reiterated that it is necessary to mention the 'Date of Return' in the Cheque Return Memo, in the event of dishonour / return of cheques. In light of the criticality of the document in case of recourse to legal action, it has been indicated that instruments returned unpaid should have a signed / initialed objection slip on which a definite and valid reason for refusing payment must be stated, as prescribed in Rule 6 of the Uniform Regulations and Rules for Bankers' Clearing Houses (URRBCH). The reiteration was necessary in view of instances coming to light in which banks were not signing the Cheque Return Memos stating that they were computer generated and no signature was necessary.

Small Account

'Small Account' means a savings account in a banking company where (i) the aggregate of all credits in a financial year does not exceed rupees one lakh;(ii) the aggregate of all withdrawals and transfers in a month does not exceed rupees ten thousand; and(iii) the balance at any point of time does not exceed rupees fifty thousand.

Officially Valid Documents

The definition of 'officially valid document' has been expanded to include, job card issued by National Rural Employment Guarantee Act (NREGA) duly signed by an officer of the State Government or the letters issued by the Unique Identification Authority of India containing details of name, address and Aadhaar number. Where a bank has relied exclusively on any of these two documents, viz., NREGA job card or Aadhaar letter, as complete KYC document for opening of a bank account, the account so opened will be subjected to all conditions and limitations prescribed for small account.

Additional Authentication for CNP Transactions

The Reserve Bank has made it mandatory for all Card Not Present (CNP) transactions to be brought within the ambit of additional factor of authentication including (i) recurring transactions based on standing instructions given to the merchants by the cardholders indicating the category of utility services and (ii) travel and hotel industry bookings and other mail order / telephone order transactions. Additional factor of authentication in respect of above two items should be put in place from May 01, 2012. It has been mandated that in respect of any case of customer complaint regarding issues arising out of transactions effected without the additional factor of authentication after the stipulated date, the issuer bank shall reimburse the loss to the customer without demur.

Give Option to Customer to select Mode of Payment

The Reserve Bank of India has reiterated that all the participating banks should provide to the customer the option to choose between RTGS / NEFT at the time of initiating funds transfer either at the branch or through internet or any other means. RTGS and NEFT are two important pan-India payment modes for customers, in the wholesale and retail payment systems segments, having distinct objectives and unique features in terms of time criticality of payments, threshold value of transactions, mode of settlement etc. As such, the charges levied for transactions in the two systems are also different.

Procedure for Detection of Counterfeit Banknotes revised

The Reserve Bank, in consultation with Government of India, has modified its procedure for detection of counterfeit banknotes. The procedure has been revised to ensure that all cases of detection of counterfeit notes at the bank branches / treasuries are promptly reported to the police authorities. Accordingly, for cases of detection of counterfeit notes upto four pieces, in a single transaction, a consolidated report as per the prescribed format should be sent to the police authorities at the end of the month. For cases of detection of counterfeit notes of five or more pieces, in a single transaction, FIRs should be lodged with the nodal police station / police authorities. Earlier, FIR was required to be filed in respect of each case of detection of counterfeit note irrespective of the number of pieces.

Issue and Pay DDs for Rs. 50,000 and Above only through Bank Accounts

The Reserve Bank of India has reiterated its stance to banks that all demand drafts, mail transfers, telegraphic transfers and travellers cheques for Rs.50,000 and above should be issued by banks only by debit to the purchaser's account or against cheques or other instruments tendered by the purchaser and not against cash payment. These instructions are also applicable to retail sale of gold/silver/platinum. In the current scenario, where the integrity of the financial system in general and the banking channel in particular is of paramount importance, breach of guidelines and misuse of the banking channel is a matter of serious regulatory concern, the Reserve Bank has stated in its instructions.

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