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MONETARY AND CREDIT INFORMATION REVIEW

POLICY

RBI releases Framework for setting up of WOSs by Foreign Banks in India

The Reserve Bank of India, on November 6, 2013 released on its website, the framework for setting up of wholly owned subsidiaries (WOSs) by foreign banks in India.

The policy is guided by two cardinal principles of (i) reciprocity and (ii) single mode of presence. As a locally incorporated bank, the WOSs will be given near national treatment which will enable them to open branches anywhere in the country at par with Indian banks (except in certain sensitive areas where the Reserve Bank's prior approval would be required). They would also be able to participate fully in the development of the Indian financial sector. The policy incentivises the existing foreign bank branches which operate within the framework of India's commitment to the World Trade Organisation (WTO) to convert into WOS due to the attractiveness of near national treatment. Such conversion is also desirable from the financial stability perspective. To provide safeguards against the possibility of the Indian banking system being dominated by foreign banks, the framework has certain measures to contain their expansion if the share of foreign banks exceeds a critical size. Certain measures from corporate governance perspective have also been built in so as to ensure that public interest is safeguarded.

Key features of the Framework

- Banks with complex structures, banks which do not provide adequate disclosure in their home jurisdiction, banks which are not widely held, banks from jurisdictions having legislation giving preferential claim to depositors of home country in winding up proceedings, etc., would be mandated entry into India only in the WOS mode.
- Foreign banks in whose case the above conditions do not apply can opt for a branch or WOS form of presence.
- A foreign bank opting for branch form of presence shall convert into a WOS as and when the above conditions become applicable to it or it becomes systemically important on account of its balance sheet size in India.
- Foreign banks which commenced banking business in India before August 2010 shall have the option to continue their banking business through the branch mode. They will, however, be incentivised to convert into WOS because of the attractiveness of the near national treatment afforded to WOS.
- To prevent domination by foreign banks, restrictions would be placed on further entry of new WOSs of foreign banks/ capital infusion, when the capital and reserves of the WOSs and foreign bank branches in India exceed 20 per cent of the capital and reserves of the banking system.
- The initial minimum paid-up voting equity capital for a WOS shall be Rs. 5 billion for new entrants. Existing branches of foreign banks desiring to convert into WOS shall have a minimum net worth of Rs. 5 billion.
- The parent of the WOS would be required to issue a letter of comfort to the Reserve Bank for meeting the liabilities of the WOS.
- Corporate governance - (i) not less than two-third of the directors should be non-executive directors; (ii) a minimum of one-third of the directors should be independent of the management of the subsidiary in India, its parent or associates; and (iii) not less than fifty per cent of the directors should be Indian nationals/NRIs/PIOs subject to the condition that not less than 1/3rd of the directors are Indian nationals resident in India.

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- The branch expansion guidelines as applicable to domestic scheduled commercial banks would generally be applicable to WOSs of foreign banks except that they will require the Reserve Bank's prior approval for opening branches at certain locations that are sensitive from the perspective of national security.
- Priority sector lending requirement would be 40 per cent for WOS like domestic scheduled commercial banks with adequate transition period for existing foreign bank branches converting into WOS.
- On arm's length basis, WOS would be permitted to use parental guarantee/credit rating only for the purpose of providing custodial services and for their international operations. WOSs should, however, not provide counter guarantee to its parent for such support.
- WOSs may, at their option, dilute their stake to 74 per cent or less in accordance with the existing FDI policy. In the event of dilution, they will have to list themselves.

The issue of permitting WOSs to enter into merger and acquisition transactions with any private sector bank in India subject to the overall investment limit of 74 per cent would be considered after a review is made with regard to the extent of penetration of foreign investment in Indian banks and functioning of foreign banks (branch mode and WOS).

Background

In 2004, the Government of India with a view to liberalising foreign direct investments (FDI) in private sector banks raised the FDI limit to 74 per cent in private sector banks under the automatic route and also permitted foreign banks, regulated by a banking supervisory authority in the home country and meeting the Reserve Bank's licensing criteria to hold 100 per cent paid up capital, to set up a WOS in India.

To operationalise the FDI guidelines, the Reserve Bank released the roadmap for presence of foreign banks in India in consultation with the Government of India on February 28, 2005. The roadmap was divided into two phases – the first phase spanning the period March 2005 to March 2009 and the second phase beginning after a review of experience gained in the first phase.

In the first phase, foreign banks already operating in India were allowed to convert their existing branches to WOS while following the 'one-mode presence' criterion and the WOS was to be treated at par with the existing branches of foreign banks for branch expansion in India. The second phase of the roadmap which was to commence in April 2009 envisaged removal of limitations on the operations of WOS and treating them on par with domestic banks to the extent appropriate. During the first phase no foreign bank came forward to set up or convert their branches into WOS in the absence of adequate incentives.

As a sequel to the roadmap of 2005 and pursuant to the announcements made in the Annual Policy Statement for 2010-11, the Reserve Bank issued a Discussion Paper in January 2011 on the mode of presence of foreign banks in India. The framework for setting up of WOS by foreign banks in India has now been finalised taking into account the feedback received on the Discussion Paper and factoring in the lessons from the crisis which favour a subsidiary mode of presence from financial stability perspective.

Repo/Reverse Repo/MSF Rates

As announced in the Second Quarter Review of Monetary Policy 2013-14, the following rates have changed from October 29, 2013:

Repo Rate

The repo rate under the liquidity adjustment facility (LAF) has been increased by 25 basis points from 7.50 per cent to 7.75 per cent.

Reverse Repo Rate

Consequent to the change in the repo rate, the reverse repo rate under the LAF stands automatically adjusted to 6.75 per cent.

MSF Rate

The marginal standing facility (MSF) rate has been reduced by 25 basis points from 9.00 per cent to 8.75 per cent.

Term Repo under LAF

The quantum of liquidity to be provided through term repos of 7 day and 14 day tenor has been increased from 0.25 per cent to 0.50 per cent of net demand and time liabilities (NDTL) of the banking system from October 29, 2013.

Bank Rate

The Bank Rate has been adjusted by 25 basis points from 9.0 per cent to 8.75 per cent with effect from October 29, 2013.

All penal interest rates on shortfall in reserve requirements, which are specifically linked to the Bank Rate, have also been revised as indicated below:

Item	Existing Rate	Revised Rate
Penal interest rates on shortfalls in reserve requirements (depending on duration of shortfalls).	Bank Rate plus 3.0 percentage points (12.00 per cent) or Bank Rate plus 5.0 percentage points (14.00 per cent).	Bank Rate plus 3.0 percentage points (11.75 per cent) or Bank Rate plus 5.0 percentage points (13.75 per cent).

Standing Liquidity Facilities for Bank/PDs

The standing liquidity facilities provided to banks under export credit refinance (ECR) and to primary dealers (PDs) (collateralised liquidity support) by the Reserve Bank would be available at the revised repo rate, i.e., at 7.75 per cent with effect from October 29, 2013.

BRANCH BANKING

Correspondent Banking Relationship

It has been observed that some commercial banks have arrangements with co-operative banks wherein the latter open current accounts with commercial banks and use the cheque book facility to issue 'at par' cheques to their constituents and walk-in-customers for facilitating their remittances and payments. Since the 'at par' facility offered by commercial banks to co-operative banks is in the nature of correspondent banking arrangements, banks have been advised to monitor and review such arrangements to assess the risks including, credit risk and reputational risk arising therefrom. Banks have also been advised to retain the right to verify the records maintained by the client co-operative banks/societies for compliance with the extant instructions on ‘know your customer’ (KYC) and anti-money laundering (AML) under such arrangements.

Timely Issue of TDS Certificate to Customers

With a view to protecting the interest of depositors and for rendering better customer service, banks have been advised to provide to their customers from whose account income tax has been deducted at source, TDS certificate in Form 16A. Banks have also been advised to put in place systems that will enable them to provide Form 16A to their customers within the time-frame prescribed under the Income Tax Rules.

FEMA

Third Party Payments for Export/Import Transactions

With a view to further liberalising the procedure relating to payments for exports/imports and taking into account evolving international trade practices, it has been decided that -

Export Transactions

Authorised dealer (AD) banks may allow payments for export of goods/software to be received from a third party (a party other than the buyer) subject to the below indicated conditions:

(a) a firm irrevocable order backed by a tripartite agreement should be in place;

(b) third party payment should come from a Financial Action Task Force (FATF) compliant country and through the banking channel only;

(c) the exporter should declare the third party remittance in the export declaration form (EDF);

(d) it would be the responsibility of the exporter to realise and repatriate the export proceeds from such third party named in the EDF;

(e) reporting of outstandings, if any, in the XOS would continue to be shown against the name of the exporter. Instead of the name of the overseas buyer from where the proceeds have to be realised, the name of the declared third party should appear in the XOS; and

(f) in case shipment is made to a country in group II of restricted cover countries, (e.g. Sudan, Somalia, etc.), the payment should be received from an open cover country.

Note: Restricted cover group II country is a country which experiences chronic political and economic problems as well as balance of payment difficulties.

Import Transactions

AD banks are allowed to make payments to a third party for import of goods, subject to the below indicated conditions:

(i) a firm irrevocable purchase order/tripartite agreement should be in place;

(ii) third party payment should be made to a FATF compliant country and through the banking channel only;

(iii) the invoice should contain a narration that the related payment has to be made to the (named) third party;

(iv) bill of entry should mention the name of the shipper as also the narration that the related payment has to be made to the (named) third party;

(v) importer should comply with the related extant instructions relating to imports including those on advance payment being made for import of goods; and

(vi) the amount of an import transaction eligible for third party payment should not exceed USD 100,000. This limit will be revised as and when considered expedient.

UCBs

Classification/Valuation/Provisioning

It has been observed that the recent hardening of long term yields has resulted in banks incurring large mark-to-market (MTM) losses in their investment portfolio. Since these MTM losses are partly resulting from abnormal market conditions and could be recouped going forward, it has been decided to provide the following prudential adjustments -

- As per extant instructions, primary (urban) co-operative banks (UCBs) can shift investments to Held to Maturity (HTM) once a year with their Board of Directors’ approval and such shifting is normally allowed at the beginning of the accounting year. As a one-time measure, it has now been decided to permit UCBs to transfer statutory liquidity ratio (SLR) securities from Available For Sale (AFS)/Held for Trading (HFT) to HTM category up to the limit of 25 per cent of their NDTL. Such transfer of securities from AFS/HFT category to HTM category should be made at the lower of acquisition cost or book value or market value. UCBs have the option of valuing these securities for the purpose of such transfer as at the close of business of July 15, 2013 and depreciation, if any, should be provided for in accordance with the Reserve Bank’s Master Circular on Investments by Primary (Urban) Co-operative Banks dated July 1, 2013. If banks choose to transfer securities as above, the transfers must be done at the earliest but not later than November 15, 2013. This transfer must be out of the outstanding position of AFS/HFT securities as at the close of business of November 1, 2013 up to the limit of 25 per cent of NDTL (i.e. NDTL as on October 4, 2013 applicable for maintenance of SLR for November 1, 2013).
- UCBs are required to periodically value their AFS and HFT portfolio and provide for net depreciation. As a one-time measure, it has been decided to permit UCBs to distribute the net depreciation of the AFS/HFT portfolio on each of the valuation dates in the current financial year in equal instalments during the financial year 2013-14.

Advances Guaranteed by CRGFTLIH

The Ministry of Housing & Urban Poverty Alleviation, Government of India has set up the Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH) vide their notification dated June 21, 2012. The Reserve Bank has advised UCBs to assign risk weight for loans guaranteed by CRGFTLIH as under:

Risk Weight

UCBs may assign ‘zero’ risk-weight to the guaranteed portion of the housing loan extended by them to eligible borrowers. The balance outstanding in excess of the guaranteed portion would attract a risk-weight as appropriate to the counter-party.

Provisioning

In case the advance covered by CRGFTLIH guarantee becomes non-performing, no provision needs to be made towards the guaranteed portion of the housing loan. The amount

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outstanding in excess of the guaranteed portion should be provided for as per the extant guidelines on provisioning for non-performing advances.

Undertaking Activity as PAN Service Agent

It has been decided to permit financially sound and well managed UCBs to act as PAN service agent (PSA) by entering into a tie-up with UTI Infrastructure and Technology Services Ltd., (UTIITSL) with the Reserve Bank's prior approval.

UCBs undertaking PSA activity should, however, exercise due care as violations, such as, delay in forwarding the applications to processing centres of UTIITSL, incomplete applications, insufficient/discrepancy in enclosed documentary proof/applications etc., may result in imposition of penalty by UTIITSL.

In case any UCB has already signed an agreement or has planned to engage in the activity of providing PAN issuance services to its customers by entering into a tie-up with UTIITSL, it may approach the concerned regional office of the Reserve Bank for completing the required formalities/obtaining regulatory approval, subject to fulfilling the prescribed criteria.

NBFCs

Migration of PDC/EMI Cheques to ECS (Debit)

On December 20, 2012 all non-banking financial companies (NBFCs) were advised to ensure replacement of all non-CTS-2010 standard compliant cheques received from their customers for future equated monthly instalment (EMI) payments by March 31, 2013. The Reserve Bank had also advised on July 16, 2013 that cheques not complying with CTS-2010 standard will be cleared at less frequent intervals with effect from January 1, 2014 (thrice a week up to April 30, 2014, twice a week up to October 31, 2014 and weekly once from November 1, 2014 onwards.

With a view to avoid delays in realisation of non-CTS-2010 cheques, all NBFCs have been advised to -

(a) migrate towards accepting only CTS-2010 standard cheques; and

(b) not accept fresh/additional post dated cheques (PDC)/EMI cheques (either in old format or new CTS-2010 format) in locations where the ECS/RECS (Debit) facility is available. The existing PDCs/EMI cheques in such locations may be converted into ECS/RECS (Debit) by obtaining fresh ECS (Debit) mandates. This exercise should be completed not later than December 31, 2013.

Considering the protection available under Section 25 of the Payment and Settlement Systems Act, 2007 which accords the same rights and remedies to the payee (beneficiary) against dishonour of electronic funds transfer instructions under insufficiency of funds as are available under Section 138 of the Negotiable Instruments Act, 1881, NBFCs need not take additional cheques, if any, from customers in addition to ECS (Debit) mandates. Cheques complying with CTS-2010 standard formats should be obtained only in locations, where ECS/RECS facility is not available.

INFORMATION

RBI extends Liquidity Support to MSME Sector

Refinance to SIDBI to ease Liquidity Stress to MSE Sector

In view of the need to ease the liquidity stress to micro and small enterprises (MSE) sector which is employment intensive and contributes significantly to exports, it has been decided to provide refinance of an amount of Rs. 5,000 crore to the Small Industries Development Bank of India (SIDBI) under the provisions of Section 17(4H) of the Reserve Bank of India Act, 1934.

The refinance will be available for direct liquidity support to finance receivables, including export receivable, to MSEs by SIDBI or for liquidity support to MSEs through selected intermediaries, that is, banks, NBFCs and state finance corporations. The refinance will be available against receivables, including export receivables, outstanding as on November 14, 2013 onwards. The facility will be available at the prevailing 14-day term repo rate for a period of 90 days. During this 90-day period, the amount can be flexibly drawn and repaid. At the end of the 90-day period, the drawal can also be rolled over. The refinance facility will be available for a period of one year up to November 13, 2014. The utilisation of funds will be governed by the policy approved by the Board of SIDBI.

Incremental Credit to Medium Enterprises to qualify as Priority Sector

The Medium Sector (as defined vide notification No.S.O.1722(E) dated October 5, 2006 of the Ministry of Small Scale Industries) is also facing liquidity tightness. In order to enhance credit delivery to the medium sector, it has been decided to include, as eligible priority sector lending, incremental credit, including export credit, extended to the medium enterprises by scheduled commercial banks (excluding RRBs) over the outstanding credit as on November 13, 2013. The facility will be available up to March 31, 2014 and will be within the overall target of 40 per cent.

Background

The liquidity support comes in the wake of slowdown in the economy which has resulted in liquidity tightness in a large number of MSEs in the manufacturing and services sector, particularly due to delayed settlement of receivables from large corporate, public sector undertakings and government departments.

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