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POLICY

Guidelines on Management of Intra-Group Transactions and Exposures

The Reserve Bank, on February 11, 2014, issued guidelines on Intra-Group Transactions and Exposures (ITEs) for banks. The guidelines are exclusively meant for banks' transactions and exposures to entities belonging to the bank's own group (group entities). The guidelines contain quantitative limits on financial ITEs and prudential measures for the non-financial ITEs to ensure that banks engage in ITEs in a safe and sound manner in order to contain concentration and contagion risks arising out of ITEs. These measures are aimed at ensuring that banks, at all times, maintain arm's length relationship in dealings with their own group entities, meet minimum requirements with respect to group risk management and group-wide oversight, and adhere to prudential limits on intra-group exposures.

The guidelines will become effective from October 1, 2014. Banks should accordingly submit data on intra-group exposures to the Reserve Bank (Department of Banking Supervision, Central Office), from the quarter ending December 31, 2014.

In case a bank's current intra-group exposure is more than the limits stipulated in the guidelines, it should bring down the exposure within the limits at the earliest but not later than March 31, 2016. The exposure beyond permissible limits subsequent to March 31, 2016, if any, would be deducted from Common Equity Tier 1 capital of the bank.

The Reserve Bank may review the guidelines as and when guidance on ITEs is issued by the Basel Committee on Banking Supervision.

FEMA

Import of Gold/Gold Dore - Clarifications

The Reserve Bank has issued the following clarifications on Advance Authorisation (AA)/Duty Free Import Authorisation (DFIA) which come into force with immediate effect:

a) In case of AA/DFIA issued before August 14, 2013, the condition of sequencing imports prior to exports shall not be insisted upon even in case of entities/units in the Special Economic Zone and Export Oriented Units, Premier and Star Trading Houses.

b) The imports made as part of the AA/DFIA scheme will be outside the purview of the 20:80 scheme. Such Imports will be accounted for separately and will not entitle the Nominated Agency/ Banks/Entities for any further import.

c) The Nominated Banks/Agencies/Entities may make available gold to the exporters (other than AA/DFIA holders) operating under the Replenishment Scheme. They can resort to import of gold for the purpose, if considered necessary. However, such import will be accounted for separately and will not entitle them for any further import.

d) Import of gold in the third lot onwards will be lesser of the two:

   i. Five times the export for which proof has been submitted; or

   ii. Quantity of gold permitted to a Nominated Agency in the first or second lot.

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Further with reference to import of Gold Dore, the Reserve Bank has clarified that:

i) The refiners can import Gold Dore of 15% of their licence for each of the first two months.

ii) In case, the quantity has already been identified by Director General of Foreign Trade (DGFT) for first two lots, import of such quantity will be in compliance with the guidelines issued on December 31, 2013 in this regard.

iii) DGFT, through a notification, may include new refiners, and fix licence quantity for them.

Limits for G-sec Investments for SEBI-registered Long Term Investors doubled

The existing sub-limit of USD 5 billion available to Long term investors registered with SEBI - Sovereign Wealth Funds (SWFs), Multilateral Agencies, Pension/Insurance/Endowment Funds and Foreign Central Banks - for investment in Government dated securities has been enhanced to USD 10 billion. This would, however, be within the total limit of USD 30 billion available to them for foreign investments in Government securities. The limit so far was USD 5 billion. The decision, which has taken effect immediately, has been taken to enhance the limit on a review in consultation with Government of India.

Limits for Investment in Corporate Debt reduced

Foreign Institutional Investors, Qualified Financial Institutions and long term investors registered with SEBI, such as, Sovereign Wealth Funds (SWFs), Multilateral Agencies, Pension/Insurance/Endowment Funds, Foreign Central Banks, can now invest only upto USD 2 billion in commercial paper. The sub-limit has been reduced from USD 3.5 billion with immediate effect.

Applicable Interest on FCNR(B)/NRE Deposits from March 1

It has been decided that interest rate ceilings on Foreign Currency Non-Resident (B) deposits for maturity period of one year to less than three years and three to five years, respectively will continue till February 28, 2014. They will revert to the ceiling prior to August 14, 2013, as under:

Maturity Period	Existing	From March 1, 2014
1 year to less than 3 years	LIBOR/Swap plus 200 basis points	No change
3-5 years	LIBOR/Swap plus 400 basis points	LIBOR/SWAP plus 300 basis points

All other instructions in this regard, as amended from time to time, will remain unchanged.

It has been also been decided that the freedom to offer interest rates on incremental deposits with maturity of 3 years and above without any ceiling be extended till February 28, 2014. With effect from March 1, 2014, the interest rate ceiling will also revert to the position prior to August 14, 2013. That is, banks cannot offer higher interest rates on NRE deposits than what they offer on comparable domestic rupee deposits. All other instructions in this regard, as amended from time to time, will remain unchanged.

FCNR(B)/NRE Deposits and Exemptions from CRR/SLR

It has been decided that the exemption granted on incremental Foreign Currency Non-Resident (B)/Non Resident (External) deposits from maintenance of Cash Reserve Ratio (CRR)/Statutory Liquidity Ratio (SLR) will be withdrawn with effect from reporting fortnight beginning March 8, 2014. From this date, only the eligible amount of incremental FCNR(B) and NRE deposits of maturities of three years and above from the base date of July 26, 2013, and outstanding as on March 7, 2014, would qualify for CRR/SLR exemption till their maturities/pre-mature withdrawals.

Further, for computation of priority sector lending targets, advances extended in India against the incremental FCNR(B)/NRE deposits qualifying for exemption from CRR/SLR requirements, will be eligible for exclusion from Adjusted Net Bank Credit (ANBC) till their repayment.

NBFCs

RBI eases Pricing of Credit Directions for NBFC-MFIs

It has been decided that the interest rates charged by an NBFC-MFI to its borrowers will be the lower of the following:

(i) The cost of funds plus margin, or

(ii) The average base rate of the five largest commercial banks by assets multiplied by 2.75.

The average of the base rates of the five largest commercial banks shall be advised by the Reserve Bank on the last working day of the previous quarter, which shall determine interest rates for the ensuing quarter.

The above instructions will come into effect from the quarter beginning April 01, 2014. The Reserve Bank will announce the applicable average base rate on March 31, 2014 and every quarter end thereafter.

OTHER

Withdrawal of Old Series of Banknotes issued prior to 2005

The Reserve Bank of India has clarified that the rationale behind its move to withdraw banknotes printed prior to 2005 is to remove these banknotes from the market because they have fewer security features compared to banknotes printed after 2005. It is standard international practice to withdraw old series notes.

The Reserve Bank has already been withdrawing these bank notes from the market in a routine manner through banks. In Reserve Bank's view, the volume of the banknotes printed prior to 2005 today, still in circulation, is not significant enough to impact the general public in a large way.

However, it has advised members of public to start exchanging these notes at bank branches at their convenience. Further, even July 1, 2014 onwards, members of public can exchange any number of these old series notes from the bank branches where they have their accounts.

The Reserve Bank has assured that it would continue to monitor and review the process of withdrawal of old series notes so that the public is not inconvenienced in any manner.

Regardless of the above, the Reserve Bank has reiterated that the notes printed prior to 2005 would continue to be legal tender.

REPORTS

Expert Committee to Revise and Strengthen the Monetary Policy Framework

The Expert Committee to Revise and Strengthen the Monetary Policy Framework submitted its report to the Governor on January 21, 2014. The Expert Committee was appointed on September 12, 2013 by Dr. Raghuram G Rajan. The main objective of the Committee was to recommend what needs to be done to revise and strengthen the current monetary policy framework with a view to, inter alia, making it transparent and predictable.

Highlights of Recommendations

(1) Inflation should be the nominal anchor for the monetary policy framework. This nominal anchor should be set by the Reserve Bank as its predominant objective of monetary policy in its policy statements.

(2) The Reserve Bank should adopt the new CPI (combined) as the measure of the nominal anchor for policy communication. The nominal anchor should be defined in terms of headline CPI inflation, which closely reflects the cost of living and influences inflation expectations relative to other available metrics.

(3) The nominal anchor or the target for inflation should be set at 4 per cent with a band of +/- 2 per cent around it (a) in view of the vulnerability of the Indian economy to supply/external shocks and the relatively large weight of food in the CPI; and (b) the need to avoid a deflation bias in the conduct of monetary policy.

(4) In view of the elevated level of current CPI inflation and hardened inflation expectations, supply constraints and weak output performance, the transition path to the target zone should be graduated to bringing down inflation from the current level of 10 per cent to 8 per cent over a period not exceeding the next 12 months and to 6 per cent over a period not exceeding the next 24 month period before formally adopting the recommended target of 4 per cent inflation with a band of +/- 2 per cent. The Committee is also of the view that this transition path should be clearly communicated to the public.

Third Quarter Monetary Policy Review

The Reserve Bank of India announced the Third Quarter Review of the Monetary Policy Statement 2013-14 on January 28, 2014.

On the basis of an assessment of the current and evolving macroeconomic situation, the following policy actions were taken:

- policy repo rate under the liquidity adjustment facility (LAF) increased by 25 basis points - from 7.75 per cent to 8.00 per cent; and
- cash reserve ratio (CRR) of scheduled banks kept unchanged at 4.0 per cent of net demand and time liability (NDTL).

Consequently, the reverse repo rate under the LAF stands at 7.0 per cent, and the marginal standing facility (MSF) rate as well as the Bank Rate at 9.0 per cent.

(5) Since food and fuel account for more than 57 per cent of the CPI on which the direct influence of monetary policy is limited, the commitment to the nominal anchor would need to be demonstrated by timely monetary policy response to risks from second round effects and inflation expectations in response to shocks to food and fuel.

(6) Monetary policy decision-making should be vested in a monetary policy committee (MPC).

(7) As an overarching prerequisite, the operating framework has to subserve stance and objectives of monetary policy. Accordingly, it must be redesigned around the central premise of a policy rule.

(8) A phased refinement of the operating framework is necessary to make it consistent with the conduct of monetary policy geared towards the establishment and achievement of the nominal anchor.

(9) To support the operating framework, the Committee recommends that some new instruments be added to the toolkit of monetary policy.

Committee on Financial Benchmarks

The Reserve Bank of India released the Report of the Committee on Financial Benchmarks on February 7, 2014. The Reserve Bank had announced the constitution of the Committee on Financial Benchmarks (Chairman: 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. The Draft Report of the Committee was placed on Reserve Bank website on January 3, 2014 for public comments. The Committee has finalised its report after taking into account the feedback received from market participants and other stakeholders.

Highlights of Recommendations

- FIMMDA and FEDAI may be designated as administrators for all the Rupee interest rate and foreign exchange benchmarks respectively, with primary responsibility for the entire benchmark setting process;
- The benchmark calculation may be based on observable transactions, wherever available, as first layer of inputs subject to appropriate threshold criteria. The executable bids and offers, wherever available, subject to appropriate threshold and polled submissions may be used as second and third layer of inputs respectively in terms of hierarchy of inputs;
- The Benchmark Administrator may publicly disclose individual submissions after a suitable lag;
- The Administrators may periodically review each benchmark and undertake necessary changes;
- New benchmarks may be registered with the concerned Administrator before being introduced in the market;
- Credible contingency provision may be put in place and there should be written policies and procedure to handle possible cessation of a benchmark;
- Overnight MIBID-MIBOR setting may be shifted from existing polling method to volume weighted average of trades executed between 9 AM to 10 AM on NDS-CALL operated by CCIL;
- FIMMDA may coordinate the transition of legacy contracts referenced to NSE MIBID-MIBOR through multilateral and bilateral amendment agreement, as appropriate;

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- Construction of the G-sec yield curve may use volume weighted average rate of the trades executed over longer time window in place of last traded yields;
- Transaction data may be used for calculation of INBMK, T-Bill, CP, and CD Curves as the first layer of data inputs;
- The threshold trades/bids and offers specified for setting of G-sec yield curve, spread for FRBs, prices of SDL and corporate bonds may be subjected to periodic resetting at a well-defined time intervals, for keeping them at reasonably higher level taking into account the overall liquidity and developments in the respective market segments. In the absence of required trading volume in SDL, the spread discovered in the last two SDL auctions, subject to appropriate qualifying criteria, may be used in place of existing fixed 25bps spread;
- The Reserve Bank may continue with the existing system of fixation of Reference Rates, keeping in view the recent international moves where the official sector is assuming greater role in fixation of financial benchmarks and also the fact that several central banks in developed as well as emerging economies publish such reference rates;
- Reserve Bank reference rates may be based on volume weighted average of actual transactions executed during a sufficiently longer time window in place of existing polling method;
- The benchmark/benchmark tenors that are not used in the interbank/PD transactions may be phased-out subject to FIMMDA ascertaining the extent of outstanding client transactions referenced to those benchmarks/benchmark tenors (MIFOR- 1-month, 2-month and 1-year; MITOR, INBMK–all tenors except 1-year) and facilitate suitable transition arrangements, if required;
- FEDAI may stop publishing spot fixings, if it is not used for any meaningful purpose by corporates and other clients;
- Banks may strive to develop the USD/INR basis swaps and USD/INR forwards (beyond 1 year) so as to obviate the need to use MIFOR;
- MIOIS and MIOCS may be uniformly used for valuation of outstanding OIS and MIFOR swap trades respectively.

Technical Committee on Mobile Banking

The Reserve Bank of India released, for public comments, the “Report of the Technical Committee on Mobile Banking” on February 7, 2014.

The Reserve Bank of India had, in October 2013, constituted a Technical Committee on Mobile Banking under the chairmanship of Shri B. Sambamurthy, Director, Institute for Development and Research in Banking Technology, to examine the options/alternatives including the feasibility of using encrypted SMS based funds transfer using an application that can run on any type of handset for expansion of mobile banking in the country.

The Committee, cognisant of the fact that the country has a subscriber base of 870 million, around 450 million bank accounts but only 22 million active mobile banking customers, has attempted to identify the challenges faced by banks in filling this gap. Mobile banking transaction is considered economical and has capability of last mile delivery.

The Committee has identified the challenges faced by the banks in providing mobile banking to customers in general (customer enrolment and technical issues) and further highlighted the challenges faced in providing SMS/Unstructured Supplementary Service Data (USSD)/application based mobile banking and recommended solutions for the same. The major challenges identified are registration, M-PIN generation, concerns related to security, bank staff training and customer education.

The report emphasises the need for a standardised and simplified procedure for registration/authentication of customers for mobile banking services, a cohesive awareness programme to be put in place, adoption of common application platform (with necessary level of security through encryption) across all banks. The issuance of necessary guidelines by the Telecom Regulatory Authority (TRAI) of India which has prescribed the optimum service parameters as also ceiling on transactional cost for extension of the USSD services by telecom operators to the banks and their agents has been highlighted and the Committee recommends that the implementation of the TRAI regulations must be expedited by all the stakeholders.

Technical Committee on Enabling PKI in Payment System

The Reserve Bank of India released, for public comments, the Report of the Technical Committee on Enabling Public Key Infrastructure (PKI) in Payment System Applications on February 7, 2014.

The Reserve Bank of India had, in September 2013, constituted a group to prepare an approach paper for enabling PKI for Payment Systems in India comprising members from banks (State Bank of India and ICICI bank), Institute for Development and Research in Banking Technology-Certifying Authority (IDRBT-CA), Controller of Certifying Authority (CCA), New Delhi and Reserve Bank of India [(Department of Technology (DIT), Department of Payment and Settlement Systems (DPSS), Department of Government and Bank Accounts (DGBA) - Core Banking Solution (CBS) and Chief Information Security Officer (CISO)].

Cognisant of the fact that non-PKI enabled payment systems, such as, clearing (MICR/Non MICR), electronic credit system, credit card and debit cards contributed 75 per cent in volume terms but only 6.3 per cent in value terms in the year 2012-13, the Group has suggested that in order to ensure a safe, secure payment system in the country and to ensure legal compliance, digital technology, such as, PKI may be used.

The report also highlights, among other things, security features in existing payment system applications and feasibility in implementing PKI in all payments system applications. The Group has also recommended that banks may carry out in phases PKI implementation for authentication and transaction verification.

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