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POLICY

RBI announces revised Liquidity Management Framework

In line with the Third Bi-Monthly Monetary Policy Statement, 2014-15 issued on August 5, 2014, the Reserve Bank has reviewed the existing liquidity arrangements. With a view to ensuring flexibility and transparency in liquidity management operations, a revised framework for liquidity management is being put in place with effect from September 5, 2014 (Friday). The details of the revised liquidity management framework for instruments like Overnight Fixed Rate Repos (at repo rate); Variable Rate 14 Day Term Repo Auctions; Overnight Variable Rate Repo Auction; Overnight Fixed Rate Reverse Repo; Overnight Variable Rate Reverse Repo Auctions; Overnight Marginal Standing Facility; and Export Credit Refinance, are available on the RBI website (www.rbi.org.in) under press releases section.

In addition to the revised framework, the Reserve Bank may announce special variable rate short term repo/reverse repo auctions at short notice to take care of fast-changing liquidity conditions at any time during the day. Further, apart from addressing day-to-day liquidity requirements arising out of frictional factors, the Reserve Bank will also manage liquidity movements of a more durable nature through open market operations (including those conducted on the NDS-OM platform) and forex operations.

Under the existing arrangements, day-to-day liquidity requirements are met through variable rate 14-day/7-day repo auctions equivalent to 0.75 per cent of net demand and time liabilities (NDTL) of the banking system, supplemented by daily overnight fixed rate (at the repo rate) repos equivalent to 0.25 per cent of bank-wise NDTL and export credit refinance (at the repo rate) of 32 per cent of bank-wise outstanding eligible export credit bills (about 0.4 per cent of NDTL). In addition, the Reserve Bank conducts special repos of varying maturities in order to manage transient liquidity pressures emanating from unanticipated frictional factors.

The Reserve Bank will review the operation of the Revised Liquidity Management Framework on an ongoing basis and bring about further refinements as considered necessary.

Refinancing of Project Loans

The Reserve Bank, on August 7, 2014, permitted banks to refinance existing project loans, by way of full or partial take-out financing, even without a pre-determined agreement with other banks/financial institutions, and fix a longer repayment period. Further, this would not be considered as restructuring in the books of the existing as well as taking over lenders, if the following conditions are satisfied:

(i) The aggregate exposure of all institutional lenders to such project should be minimum ₹1,000 crore;

(ii) The project should have started commercial operation after achieving Date of Commencement of Commercial Operation (DCCO);

(iii) The repayment period should be fixed by taking into account the life cycle of and cash flows from the project, and, Boards of the existing and new banks should be satisfied with the viability of the project. Further, the total repayment period should not exceed 85 percent of the initial economic life of the project/concession period in the case of Public-Private Partnership (PPP) projects;

(iv) Such loans should be ‘standard’ in the books of the existing banks at the time of the refinancing;

(v) In case of partial take-out, a significant amount of the loan (a minimum 25 percent of the outstanding loan by value) should be taken over by a new set of lenders from the existing financing banks/financial institutions; and

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(vi) The promoters should bring in additional equity, if required, so as to reduce the debt to make the current debt-equity ratio and Debt Service Coverage Ratio (DSCR) of the project loan acceptable to the banks.

The above facility will be available only once during the life of the existing project loans. The instructions regarding refinancing of existing project loans were revised following the feedback received from banks that shows that the stipulation of substantial take-over of loans i.e., more than 50 percent of the outstanding loan by value from the existing financing banks/ financial institutions is generally difficult to achieve, since a significant number of banks are already part of the consortium/ multiple banking arrangement of such project loans.

Additional Disclosures by RRBs in Notes to Accounts

The Reserve Bank had on April 1, 2014, proposed to prescribe certain additional disclosure requirements as per the recommendations of the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households to encourage banks to actively manage their exposures to various sectors, including priority sector.

The Reserve Bank, on July 28, 2014, advised all regional rural banks to disclose sector-wise advances in the 'Notes to Accounts' to the financial statements as per the prescribed format given, from the financial year 2014-15 onwards. The additional disclosure would include information on:

- Concentration of Deposits, Advances, Exposures and Non-performing Assets (NPAs)
- Sector-wise NPAs
- Movement of NPAs

Third Bi-Monthly Monetary Policy Statement, 2014-15

Dr. Raghuram G. Rajan, Governor, announced the Third Bi-Monthly Monetary Policy Statement, 2014-15 on August 5, 2014 in Mumbai. On the basis of an assessment of the current and evolving macroeconomic situation, the Reserve Bank decided to:

- keep the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 8.0 per cent;
- keep the cash reserve ratio (CRR) of scheduled banks unchanged at 4.0 per cent of net demand and time liabilities (NDTL);
- reduce the statutory liquidity ratio (SLR) of scheduled commercial banks by 50 basis points from 22.5 per cent to 22.0 per cent of their NDTL with effect from the fortnight beginning August 9, 2014; and
- continue to provide liquidity under overnight repos at 0.25 per cent of bank-wise NDTL and liquidity under 7-day and 14-day term repos of up to 0.75 per cent of NDTL of the banking system.

Consequently, the reverse repo rate under the LAF will remain unchanged at 7.0 per cent, and the marginal standing facility (MSF) rate and the Bank Rate at 9.0 per cent.

Assessment

Since the second bi-monthly monetary policy statement of June 2014, global economic activity has been picking up at a modest space from a sharp slowdown in Q1. Investor risk appetite has buoyed financial markets, partly drawing strength from assurances of continuing monetary policy support in industrial countries. Portfolio flows to emerging market economies (EMEs) have risen strongly.

Restructuring of SJSRY as NULM

The Reserve Bank, on August 14, 2014, advised all scheduled commercial banks (including regional rural banks) to note that the Government of India, Ministry of Housing and Urban Poverty Alleviation (MoHUPA), has launched the National Urban Livelihoods Mission (NULM). NULM was launched after restructuring the existing Swarna Jayanti Shahari Rozgar Yojana (SJSRY). The Self Employment Programme (SEP) component of NULM will focus on providing financial assistance through a provision of interest subsidy on loans to support establishment of individual and group enterprises and self-help groups (SHGs) of urban poor.

Futhermore, the existing provision of capital subsidy for USEP (Urban Self Employment Programme) and UWSP (Urban Women Self-Help Programme) components of SJSRY has been replaced by interest subsidy for loans to individual enterprise (SEP- I), group enterprise (SEP- G) and self help groups (SHGs).

The operational guidelines of the Self Employment Programme (SEP) component of NULM, are available on the RBI website (www.rbi.org.in) as annex with the RBI notification dated August 14, 2014.

Payment and Settlement Systems

Security and Risk Mitigation for CNP Transactions

The Reserve Bank, on August 22, 2014, advised scheduled commercial banks including RRBs/urban co-operative banks/state co-operative banks/district central co-operative banks/authorised card payment networks to immediately stop entities from evading the mandatory additional authentication process, where payments are made by customers for a service via 'Card Not Present' (CNP) transactions as adopting such practices would lead to willful non-adherence and violation of extant instructions of the directives issued under the Payment and Settlement Systems Act 2007 besides the requirements under the Foreign Exchange Management Act, 1999.

The Reserve Bank has advised that where cards issued by banks in India are used for making card not present payments towards purchase of goods and services provided within the country, the acquisition of such transactions has to be through a bank in India and the transaction should necessarily settle only in Indian currency, in adherence to extant instructions on security of card payments.

The Reserve Bank has observed that certain entities are evading the mandate of additional authentication/validation by following business/payment models which are resulting in foreign exchange outflow. The Reserve Bank has clarified that the linkage to an overseas website/payment gateway can not be done via CNP transaction.

RBI rationalises Number of Free Transactions on ATMs

The Reserve Bank, on August 14, 2014, advised the banks to reduce the number of mandated free transactions for savings bank account holders at other bank ATMs from five to three per month. This will apply for transactions done at ATMs located in six metro centres, namely, Mumbai, New Delhi, Chennai, Kolkata, Bengaluru and Hyderabad which are well-served in terms of payment infrastructure. This reduction will, however, not apply to customers having no-frills/small/Basic Savings Bank Deposit Account (BSBDA) type of accounts as well as for transactions done by savings bank account holders at ATMs situated outside these six metro centres. Banks are also free to offer free transactions above this mandated limit.

Further, taking into account the scope for cross-subsidisation and with a view to ensuring more transparency in the pricing of these transactions, the Reserve Bank advised the banks to provide their savings bank account holders with at least five free transactions per month at their own ATMs. Beyond this, banks may decide to levy transaction charges (not exceeding ₹20/- plus applicable taxes per transaction) which are decided in a transparent manner.

Given that different banks may adopt different pro-customer policies with respect to ATM usage, and with a view to minimising customer grievances, the Reserve Bank further advised the banks to put in place a mechanism to make customers aware of the location-status of the ATM (metro/non-metro) and also the fact that the transaction may attract charges. Banks have been asked to put in place mechanisms to advise/alert customers regarding the number of free transactions availed during the month by him/her.

RBI releases NG-RTGS Character Set

The Reserve Bank, on August 21, 2014, defined and issued a list of special characters that are allowed and a list of characters that are not allowed in RTGS (real time gross settlement) messages. This is in order to have uniformity in usage of special characters by Indian banking industry for seamless processing of RTGS messages.

All RTGS member participants are advised to strictly follow these lists for usage of special characters while transmitting RTGS messages.

The Next Generation Real Time Gross Settlement (NG-RTGS) System has several advanced features, such as, liquidity management facility, extensible markup language (XML) based messaging system conforming to ISO 20022 and real time information and transaction monitoring and control systems.

Earlier on March 7, 2013, the Reserve Bank had placed the ISO 20022 standard message formats - and revised frequently asked questions (FAQs) for Next Generation Real Time Gross Settlement System (NG-RTGS) for wider dissemination, on its website (www.rbi.org.in).

FEMA

Issue of Prepaid Forex Cards

The Reserve Bank on July 25, 2014, clarified that prepaid foreign currency cards are a form of foreign currency, similar to foreign currency notes or travellers cheques. As such, the authorised dealers/full-fledged money changers (FFMCs) selling pre-paid foreign currency cards for travel purposes are required to comply with the same rigorous standards of due diligence and know your customer (KYC) as they would in case they were selling foreign currency notes/travellers cheques to their customers.

The clarification was issued after the Reserve Bank gathered that some authorised dealers/full-fledged money changers may neither be exercising due diligence nor adhering to KYC norms while selling prepaid foreign currency cards (issued by a few select banks) to their customers.

NBFCs

Lending against Shares

The Reserve Bank, on August 21, 2014, advised all non-banking finance companies (NBFCs) with asset size of ₹100 crore and above (excluding the primary dealers) to maintain a Loan-To-Value (LTV) ratio of 50 percent in case of loans where shares are taken as collateral. As per the guidelines issued to NBFCs on lending against shares, NBFCs can only offer loans against a security of 'Group 1' shares (as specified by SEBI), where the loan is more than ₹5 lakh.

Further, all NBFCs with asset size of ₹100 crore and above, shall report on-line to stock exchanges, information on the shares pledged in their favour, by borrowers for availing loans. The Reserve Bank also advised these NBFCs to approach the exchanges for creation of user IDs. The web links for the respective exchanges are - BSE : http://nbfc.bseindia.com; NSE: https://www.connect2nse.com/LISTING.

Appointment of Select NBFCs as Sub-agents under MTSS

To broaden the network of sub-agents under the Money Transfer Service Schemes (MTSS), the Reserve Bank, on August 12, 2014, permitted non-deposit accepting non-banking finance companies (NBFCs) with asset size of ₹100 crore and above, to act as sub-agents under MTSS subject to the following conditions:

- There is no co-mingling of the Indian agent's funds with that of the NBFC's funds.
- The Indian agent should maintain with a designated bank, a security deposit in favour of the NBFC sub-agent. The amount of the security deposit to be maintained may be mutually decided between the Agent and the sub-agent. It should be ensured that the payouts of NBFC sub-agents pending reimbursement by the agents should not, at any point of time, be higher than the security deposits.
- No NBFC, acting as sub-agent, should appoint any other entity as its sub-agent.

The NBFCs desirous to act as sub-agents under the MTSS, will, however, need to seek prior approval from the Reserve Bank, for which they need to forward their applications to the concerned regional offices of the Reserve Bank.

Interest Rate Futures

The Reserve Bank, on August 12, 2014, permitted all non-deposit accepting non-banking finance companies (NBFCs) with asset size of ₹1000 crore and above, to participate in the interest rate futures market permitted on recognised stock exchanges as trading members, subject to RBI/SEBI guidelines. It may be noted that in terms of RBI circular issued by Internal Debt Management Department (IDMD) dated December 5, 2013 on 'Exchange-Traded Interest Rate Futures', the position limits for the various categories of participants in the Interest Rate Futures market shall be subject to the guidelines issued by the Securities and Exchange Board of India.

Allotment of UCIC for NBFC Customers in India

The Reserve Bank, on August 1, 2014, advised all non-banking finance companies (NBFCs) on the extension of the time for completing the process of allotting Unique Customer Identification Code (UCIC) to all their existing customers up to December 31, 2014. Earlier, on May 3, 2013, the Reserve

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Bank had advised all NBFCs to initiate steps for allotting UCIC to all their customers while entering into any new relationships for individual customers to begin with, and to existing individual customers by end-June 2013.

Modification of Guidelines on MGCs

The Reserve Bank, on August 8, 2014, made certain modifications to the “Guidelines on Registration and Operations of Mortgage Guarantee Companies (MGCs)”, in the wake of representations received from the industry and keeping in view the long – term beneficial impact of development of the Mortgage Guarantee industry. The modifications are:

Capital Adequacy

While calculating the capital adequacy of the MGC, the mortgage guarantees provided by the MGCs may be treated as contingent liabilities and the credit conversion factor applicable to these contingent liabilities will be fifty percent as against the present applicable credit conversion factor of hundred percent.

Contingency Reserve

- The extant guidelines provide for a lower appropriation to contingency reserves if provision made towards losses exceed 35 per cent of the premium or fee earned during a financial year. It does not specify the exact level of contingency reserves to be created. It is now clarified that in such a case, the contingency reserves could go to a minimum of 24 percent of the premium or fee earned, such that the aggregate of provisions made towards losses and contingency reserves is at least 60 per cent of the premium or fee earned during a financial year.
- As per the extant instructions, a MGC can utilise the contingency reserves only with the prior approval of the Reserve Bank. The instruction is now modified to the extent that contingency reserve can be used without the prior approval of the Reserve Bank for the purpose of meeting and making good the losses suffered by the mortgage guarantee holders. Such a measure can be initiated only after exhausting all other avenues and options to recoup the losses.

Classification on Investments

The Reserve Bank has now decided that investments made towards Government securities, quoted or otherwise, government guaranteed securities and bonds not exceeding the MGC’s capital may be treated as “Held To Maturity (HTM)” for the purpose of valuation and accounted for accordingly. Investment classified under HTM need not be marked to market and will be carried at acquisition cost, unless it is more than the face value, in which case the premium should be amortised over the period remaining to maturity. The book value of the security should continue to be reduced to the extent of the amount amortised during the relevant accounting period. However, if any security out of this HTM category is traded before maturity, the entire lot will be treated as securities held for trade and will have to be marked to market.

Provision for Loss on invoked Guarantees

In case the provisions already held for loss on invoked guarantees are in excess of the contract wise aggregate of ‘amount of invocation’ (after adjusting the realisable value of the assets held by the company in respect of each housing loan), the excess may be reversed; as against the extant instruction which states that the excess cannot be reversed. However, the reversal can be done only after full recovery/closure of the invoked guarantee amount or after the account becomes standard.

Reports/Working Groups

RBI’s Annual Report for 2013-14

The Reserve Bank on August 21, 2014, released its Annual Report for 2013-14, a statutory Report of its Central Board of Directors. The Annual Report covers (i) the assessment of the macroeconomic performance during 2013-14 and the prospects for 2014-15 along with some challenges for the Indian Economy in the short and medium term; (ii) review of the economy; (iii) the working and operations of the Reserve Bank, especially in the area of monetary policy operations; credit delivery and financial inclusion; development and regulation of financial markets; regulation, supervision and financial stability; public debt management; currency management; payment and settlement systems and information technology; and governance, human resources development and organisational management; and (iv) its financial accounts for the year 2013-14.

RBI’s Agenda for 2014-15

The Report also provides for the first time a chapter on the Reserve Bank’s vision and agenda for 2014-15. The Reserve Bank intends to further improve the financial sector through a series of initiatives that rest on five pillars: (i) strengthening the monetary policy framework; (ii) increasing diversity and competition in banking industry while improving governance in existing banks; (iii) broadening the choice of financial instruments, and deepening and enhancing liquidity in financial markets; (iv) improving access to finance; and (v) reinforcing the financial system’s ability to cope with stress. Its work agenda includes working with the government to strengthen the monetary policy framework. To strengthen the banking structure, the Reserve Bank will put in place a system for licensing differentiated banks and move towards on-tap licensing of universal banks. Several complementary steps, like refining priority sector guidelines and know your customer (KYC) norms are also under consideration. The Reserve Bank will continue its efforts to broaden and deepen financial markets through an array of initiatives. Besides, ongoing efforts will reinforce the regulatory and supervisory regimes, with a view to reducing distress in financial and non-financial firms.

Working Group on Taxation for Financial Instruments

With a view to promoting private financial savings, the Reserve Bank has constituted a Working Group (Convenor-Smt. Balbir Kaur, Adviser, Department of Economic and Policy Research, Reserve Bank of India) on August 20, 2014 to study various issues relating to taxation of financial instruments in India and suggest rationalisation. The terms of reference of the Working Group are:

- To review the current tax structure as applicable to various financial instruments issued in the Indian financial system;
- To identify possible ‘tax arbitrage’ among financial instruments under the extant tax structure; and
- To suggest rationalisation of tax treatment across financial instruments to promote financial savings and for minimising distortions, taking into account the recommendations of earlier Committees in this regard and the draft Direct Taxes Code.

The Working Group may consult with experts and market participants as considered necessary. The Working Group is expected to submit its report within three months of its first meeting.

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