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MONETARY AND CREDIT INFORMATION REVIEW

Fourth Bi-monthly Monetary Policy Statement, 2016-17

Resolution of the Monetary Policy Committee

The Monetary Policy Committee (MPC), Reserve Bank of India met on October 3 and 4, 2016 and announced its resolution on October 4, 2016. On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) on October 4, 2016, decided to:

- reduce the policy repo rate under the liquidity adjustment facility (LAF) by 25 basis points from 6.5 per cent to 6.25 per cent with immediate effect;
- consequently, the reverse repo rate under the LAF stands adjusted to 5.75 per cent;
- marginal standing facility (MSF) rate and the Bank Rate to 6.75 per cent.

The decision of the MPC is consistent with an accommodative stance of monetary policy in consonance with the objective of achieving consumer price index (CPI) inflation at 5 per cent by Q4 of 2016-17 and the medium-term target of 4 per cent within a band of +/- 2 per cent, while supporting growth.

The next meeting of the MPC is scheduled on December 6 and 7, 2016 and its resolution will be announced on December 7, 2016.

Statement on Developmental and Regulatory Policies

This Statement, announced on October 4, 2016, reviews the progress of various developmental and regulatory policy measures announced by the Reserve Bank in recent policy statements and sets out new measures to be taken for further strengthening the banking structure; broadening and deepening financial markets; extending the reach of financial services to all; and extending the reach of financial services by enhancing the efficacy of the payment and settlement systems and improving currency management. Some of the important policy measures include:

- Selectively extend elements of the Basel III capital framework to the four AIFIs, viz., Export Import (EXIM) Bank, National Housing Bank (NHB), National Bank for Agriculture and Rural Development (NABARD) and Small Industries Development Bank of India (SIDBI), with effect from April 1, 2018;
- Draft Guidelines on Interest Rate Risk in the Banking Book to be issued by end-November 2016;
- Scheme for Sustainable Structuring of Stressed Assets put in place to provide flexibility in restructuring, to involve material write-down of debt and/or making large provisions, under a credible framework;
- Draft Operating Guidelines for Small Finance Banks and Payment Banks were discussed with the applicants who had received the in-principle approvals, based on which operating guidelines have been finalised;
- Custodian banks of Foreign Portfolio Investors (FPIs) to be responsible for monitoring all derivative transactions of an FPI;
- Overseas parent or its central treasury allowed to hedge the currency risk arising out of genuine current account exposures of the Indian subsidiary in order to better manage the latter's currency risk;
- Final guidelines on Introduction of Interest Rate Options to be issued shortly;
- Start-ups to be allowed to raise External Commercial Borrowings (ECBs) up to USD 3 million or equivalent per financial year either in INR or in any convertible foreign currency or a combination of both;
- With a view to improving the effectiveness of monitoring the import payments, a single centralised system in the form of Import Data Processing and Monitoring System (IDPMS) to be implemented soon;
- An Acceptance Development Fund (ADF) to be set up in order to encourage wider adoption of electronic payments and to ensure planned expansion of card acceptance infrastructure in the country;
- Guidelines for issuance and operation of Pre-paid Payment Instruments (PPI) to be reviewed in view of significant developments in the payments space using newer technologies, products and players;
- A high level inter-agency committee to be set up by end-October 2016 to review the entire gamut of security of treasure in transit in order to beef up security of remittance of currency notes/coins.

(https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=38225)

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Banking Regulation

Operating Guidelines for Small Finance Banks and Payment Banks

The Reserve Bank on October 6, 2016, issued 'Operational Guidelines for Small Finance Banks' and 'Operational Guidelines for Payment Banks' considering the differentiated nature of business and financial inclusion focus of these banks. These Operating Guidelines are supplementary to the 'Guidelines for Licensing of Small Finance Banks', issued on November 27, 2014 and are effective from October 6, 2016. The Operating Guidelines are as under:

Prudential Regulation

The prudential regulatory framework for the small finance banks (SFBs) and payment banks (PBs) will largely be drawn from the Basel standards. However, given the financial inclusion focus of these banks, it will be suitably calibrated.

Capital Adequacy Framework

The Capital Adequacy Framework (CAR) requirements for both SFBs and PBs are:-

Minimum Capital Requirement	15 per cent
Common Equity Tier 1	6 per cent
Additional Tier I	1.5 per cent
Minimum Tier I capital	7.5 per cent
Tier 2 capital	7.5 per cent
Capital Conservation Buffer	Not Applicable
Counter-cyclical capital buffer	Not applicable
Pre-specified Trigger for conversion of AT1	CET1 at 6 per cent up to March 31, 2019, and 7per cent thereafter

Small Finance Banks

Leverage Ratio

Leverage Ratio for SFBs	4.5 per cent	Calculated as percentage of Tier I capital to Total Exposure

Liquidity Coverage Ratio and Net Stable Funding Ratio

Liquidity Coverage Ratio (LCR), as applicable to scheduled commercial banks, will be applicable to small finance banks. The transition period for the SFBs for achieving the prescribed level of LCR would be as follows:

	Till Dec. 31, 2017	By Jan 1, 2018	By Jan 1, 2019	By Jan 1, 2020	By Jan 1, 2021
Min LCR	60 per cent	70 per cent	80 per cent	90 per cent	100 per cent

Net Stable Funding Ratio (NSFR) will be applicable to small finance banks on par with scheduled commercial banks as and when finalised.

Capital Measurement Approaches

Credit Risk	Basel II Standardised Approach for credit risk. In this connection, it is clarified that the use of external rating based risk weight for rated exposure and regulatory retail approach for small retail loans is permitted.

Inter-bank Borrowings

SFBs will be allowed exemption from the existing regulatory ceiling on inter-bank borrowings till the existing loans mature or up to three years, whichever is earlier. Afterwards, it will be on par with scheduled commercial banks. In this context, it is clarified that the borrowings made by the SFB after the commencement of operations will be subject to inter-bank borrowing limits. This exemption is only applicable to the legacy borrowings that are migrated to the opening balance sheet of the SFB on the day of commencement of operations.

The extant provisions with regard to (i)Investment Classification and Valuation Norms; (ii) Restrictions on loans and advances (including lending to Non – Banking Financial Companies (NBFCs)) including regulatory limits;(iii) Income recognition, asset classification and provisioning norms on advances including that for restructuring of credit facilities;(iv) the risks and risk management techniques as applicable to scheduled commercial banks;(v) Cash Reserve Ratio, Statutory Liquidity Ratio, disclosures and statutory/regulatory reports; as applicable to commercial banks, shall be applicable to SFBs as well.

Apart from the instructions on credit risk transfer and portfolio sales/purchases, para-banking activities, and control regulations; constitution and functioning of board of directors; constitution and functioning of committees of the board, management level committees, remuneration policies; banking operations, that covers branch authorisation policy; regulation of business correspondents; bank charges, lockers, nominations, facilities to disabled persons, etc.; Marginal Cost of Funds based Lending Rate (MCLR), other related regulations on interest rates and fair practice code for lenders and financial inclusion and development; bank deposits that covers KYC Requirements, foreign exchange business, other banking services like currency distribution (covering detection of forged and counterfeit notes, currency chest facilities, facilities for exchange of notes); customer education and protection; credit information reporting and iImplementation of Ind AS.

Payment Banks

Large exposures limits (for investments in deposits of SCBs)

The exposure in this regard to an individual scheduled commercial bank shall not be more than five per cent of the total outside liabilities of the PB.

Capital Measurement Approaches

Basel II standardised approach for credit risk is permitted.

Inter-bank Borrowings

PBs will be permitted to participate in the call money and Centralised Borrowing and Lending Obligation (CBLO) market as both borrowers and lenders. These borrowings would, however, be subject to the limit on call money borrowings as applicable to scheduled commercial banks.

The Operating Guidelines for PBs also include instructions regarding (i) investment classification and valuation norms;(ii)restrictions on loans and advances (including lending to NBFCs) including regulatory limits;(iii) para-banking activities;(iv)product approval;(v) risk management;(vi) internal controls, audit and compliance;(vi) CRR, SLR, disclosures and statutory/regulatory reports;(vii)ownership and control regulations;(viii) corporate governance;(ix)constitution and functioning of board of directors;(x)constitution and functioning of committees of the board, management level committees, remuneration policies;(xi)banking operations that covers -authorisation of access points; regulation of business correspondents; bank charges, lockers, nominations, facilities to disabled persons, etc.; bank deposits; KYC requirements; foreign exchange business; other banking services; currency distribution (covering detection of forged and counterfeit notes, currency chest facilities, facilities for exchange of notes), outsourcing of operations, internet banking and mobile banking, customer education and protection and implementation of Ind AS.

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Risk Weights for Exposures to HFCs

The Reserve Bank on October 20, 2016 has advised all scheduled commercial banks that exposures to all Housing Finance Companies (HFCs) would be risk weighted as per the ratings assigned by the rating agencies registered with the Securities and Exchange Board of India (SEBI) and accredited by the Reserve Bank of India. The advice was issued after examining the matter of risk weights prescribed in respect of banks' exposures to HFCs as it was observed that there was a lack of uniformity among banks in the application of risk weights on their exposures to HFC.

(https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10655&Mode=0)

Publishing of Photographs of Wilful Defaulters

The Reserve Bank on September 29, 2016 has advised all scheduled commercial banks and all India financial institutions that:

- A lending institution can consider publication of the photographs of only those borrowers, including proprietors/ partners /directors / guarantors of borrower firms/ companies, who have been declared as wilful defaulters.
- The lending institutions shall formulate a policy with the approval of their Board of Directors which clearly sets out the criteria based on which the decision to publish the photographs of a person will be taken by them so that the approach is neither discriminatory nor inconsistent.
- The lending institutions shall not publish photographs of any other defaulting borrowers.

These guidelines have been issued to prevent the publishing of photographs of defaulting borrower/ guarantor in an indiscriminate manner in newspapers.

(https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10619&Mode=0)

Financial Market Regulation

FPIs can trade G - secs in Secondary Markets

The Reserve Bank on October 20, 2016 has allowed Foreign Portfolio Investors (FPIs) to trade Government securities in the secondary market through the primary members of Negotiated Dealing System – Order Matching (NDS-OM) including the web-module. The primary members of NDS-OM shall be responsible for settlement of the trades, which will be on T+1 basis. This facility will become available with effect from December 1, 2016. FPIs are currently permitted to transact in Over-The-Counter (OTC) market for Government securities with T+2 settlement.

(https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10646&Mode=0)

NDS-OM Web Module – Access to Gilt Account Holders

The Reserve Bank on October 20, 2016 has advised all Subsidiary General Ledger (SGL)/ Constituent Subsidiary General Ledger (CSGL) account holders that the Primary Members (PM) have to mandatorily offer the web-based Negotiated Dealing System – Order Matching (NDS-OM) module to their constituent gilt account holders (GAH) (excluding individuals) for online trading in Government securities in the secondary market. Constituents not desirous of availing this facility may do so by opting out in writing. On the other hand, individual GAHs desirous of the NDS-OM web facility may be provided the web access based only on specific requests.

The access to the Web module of NDS-OM by the GAHs shall be subject to controls by the concerned Primary Member as the Primary Member would continue to be responsible for settlement of trades in respect of its GAHs as is the case at present. All trades executed by the GAHs on NDS-OM Web module shall be subject to the Constituent Subsidiary General Ledger (CSGL) guidelines, rules, regulations, notifications and/or any other instructions issued by the Reserve Bank from time to time.

(https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10647&Mode=0)

Internal Debt Management

SGBs can be accepted as Collateral

The Reserve Bank on October 20, 2016 has issued certain clarifications with regard to the Sovereign Gold Bond Scheme as under:

- The Sovereign Gold Bonds (SGB) are government securities. As the holder of an SGB can therefore create a pledge, hypothecation or lien against the security, the SGBs may be used as collateral security for any loan.
- Banks and other eligible holders can acquire more than 500 gms of SGBs in a fiscal year, through transfers etc., including transfers arising out of recovery proceedings.

The clarifications were issued after the Reserve Bank received queries from banks and others about the feasibility of lending against the bonds and whether the restrictions on subscription to the bonds which is 500 gm per person per fiscal year, would extend to acquisitions through transfers.

(https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10656&Mode=0)

Payment and Settlement Systems

Framework for Monetary Penalty under PSS

The Reserve Bank on October 20, 2016 has decided to put in place a framework for imposition of penalty/fine under the Payment and Settlement Systems Act, 2007 (PSS Act) and compounding of contraventions/offences under the Act. The details of the framework include – (i) Nature of Offences, (ii)Compounding,(iii)Operational procedure to be followed, (iv)Amount of Penalty/fine,(v)Disclosure,and (vi)Method of payment of penalty/fine,(vii)Non-payment of penalty/fine.

(https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10657&Mode=0)

Financial Inclusion and Development

'Doubling Farmers' Income by 2022' - Measures

The Reserve Bank on September 29, 2016 advised State Level Banker's Committee (SLBC) convener banks/ lead banks about the steps to be taken in relation to the Lead Bank Scheme. Lead banks are accordingly advised to ensure the following:

a) Work closely with National Bank for Agriculture and Rural Development (NABARD) in preparation of Potential Linked Plans (PLPs) and Annual Credit Plans keeping the strategy of doubling farmers' income by 2022 in consideration.

b) Include 'Doubling of Farmer's Income by 2022' as a regular agenda under Lead Bank Scheme in various forums such as SLBC, District Consultative Committee(DCC), District Level Review Committee(DLRC) and Block Level Banker's Committee(BLBC).

c) For the purpose of monitoring and reviewing the progress, Lead banks may use the benchmarks as may be provided by NABARD.

d) Map the overall strategy to the agriculture/agro-ancillary lending plan of their bank.

The strategy to achieve the goal of doubling farmers' income by 2022, inter-alia, include,

- Focus on irrigation with large budgets with the aim of "per drop, more crop";
- Provision of quality seeds and nutrients based on soil health of each field;
- Investments in warehousing and cold chains to prevent post-harvest crop losses;
- Promotion of value addition through food processing;
- Creation of a national farm market, removing distortions and develop infrastructure such as, e-platform across 585 stations;
- Strengthening of crop insurance scheme to mitigate risks at affordable cost;
- Promotion of ancillary activities like poultry, bee-keeping and fisheries.

Background

The Government of India in the Union Budget 2016-17 had announced its resolve to double the income of farmers by 2022. Several steps have been taken towards attaining this objective including setting up of an inter-ministerial committee for preparation of a blue print for the same. This agenda has also been reiterated by the government in several forums and has acquired primacy from the point of view of rural and agricultural development.

(https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10614&Mode=0)

Foreign Exchange Management

Limit for Investment by FPIs in G - secs enhanced

The Reserve Bank on September 30, 2016 has advised to increase the limits for investment by Foreign Portfolio Investors (FPI) in Central Government Securities for the next half year in two tranches, each of ₹100 billion from October 3, 2016 and January 2, 2017 respectively.

As in the previous half-year, the limits for State Development Loans (SDLs) are proposed to be increased in two tranches, each of ₹35 billion, from October 3, 2016 and January 2, 2017 respectively.

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Import Data Processing and Monitoring System

The Reserve Bank on October 6, 2016 advised all category-I authorised dealer (AD) banks that Import Data Processing and Monitoring System (IDPMS) will go live with effect from October 10, 2016, used for reporting and monitoring of the import transactions.

Customs department has modified the Bill of Entry (BoE) format to display the AD Code of bank with effect from April 1, 2016 and Special Economic Zones (SEZ) from June 1, 2016 respectively. Primary import transaction data (from Customs/SEZ) with effect from the specified dates will be made available to respective AD banks in the IDPMS database for further processing. Beginning from October 10, 2016 all transactions will flow to IDPMS on daily basis for AD banks, to log all subsequent activities and monitor the import transactions.

The operational directions/guidelines are as under:

- AD banks are required to create Outward Remittance Message (ORM) for all such outward remittance/s for import payments on behalf of their importer customer for which the prescribed documents for evidence of import have not been submitted.
- Creation of ORM for all outstanding outward remittance/s for import payments needs to be completed on or before October 31, 2016.

(https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10633&Mode=0)

Review of Sectoral Caps and Simplification of FDI Policy

The Reserve Bank on October 20, 2016 in consultation with the Central Government has reviewed the extant Foreign Direct Investment (FDI) Policy on various sectors and has made certain amendments in the Consolidated FDI Policy.

(https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10648&Mode=0)

Investment by a Foreign Venture Capital Investor

In order to further liberalise and rationalise the investment regime for Foreign Venture Capital Investor (FVCI) and to give a fillip to foreign investment in the start-ups, the Reserve Bank in consultation with the Government of India on October 20, 2016 reviewed the extant regulatory provisions and accordingly amendments have been carried out.

Any FVCI which has obtained registration under the Securities and Exchange Board of India (SEBI) (FVCI) Regulations, 2000, will not require any approval from Reserve Bank of India and can invest in:

- Equity or equity linked instrument or debt instrument issued by an Indian company whose shares are not listed on a recognised stock exchange at the time of issue of the said securities/instruments and engaged in select sectors;
- Equity or equity linked instrument or debt instrument issued by an Indian 'start-up' irrespective of the sector in which the start-up is engaged. A startup will mean an entity (private limited company or a registered partnership firm or a limited liability partnership) incorporated or registered in India not prior to five years, with an annual turnover not exceeding INR 25 crores in any preceding financial year, working towards innovation, development, deployment or commercialisation of new products, processes or services driven by technology or intellectual property and satisfying certain conditions given in the Regulations;
- Units of a Venture Capital Fund (VCF) or of a Category I Alternative Investment Fund (Cat-I AIF) or units of a Scheme or of a fund set up by a VCF or by a Cat-I AIF subject to certain condition.

(https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10649&Mode=0)

Foreign Investment in Other Financial Services

On a review, in consultation with the Government of India, the Reserve Bank on October 20, 2016 has advised to allow foreign investment up to 100 per cent under the automatic route in 'Other Financial Services'. Other Financial Services will include activities which are regulated by any financial sector regulator such as Reserve Bank of India, Securities and Exchange Board of India, Insurance Regulatory and Development Authority, Pension Fund Regulatory and Development Authority, National Housing Bank or any other financial sector regulator as may be notified by the Government of India in this regard. Such foreign investment shall be subject to conditionalities, including minimum capitalisation norms, as specified by the concerned Regulator/ Government Agency.

Other salient features of the revised regulatory framework are as under:-

a) In financial services activities which are not regulated or partly regulated by any financial sector regulator or where there is lack of clarity regarding regulatory oversight, foreign investment will be allowed up to 100 per cent under the Government approval route.

b) Foreign investment in an activity which is specifically regulated by an Act, will be restricted to foreign investment levels/limits, if any, specified in that Act.

c) Downstream investment by any entity engaged in 'Other Financial Services" will be subject to extant sectoral regulations and provisions of Principal Regulations.

(https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10650&Mode=0)

Extension of Matured and Unpaid ECBs

The Reserve Bank on October 20, 2016 has decided to simplify the process of dealing with matured but unpaid External Commercial Borrowings (ECB).

To simplify the procedure relating to ECB, it has been decided to delegate the powers to designated Authorised Dealer (AD) Category-I banks to approve requests from borrowers for extension of matured but unpaid ECB, subject to certain conditions. Further, powers are also delegated to designated AD Category – I bank to approve cases of conversion of matured but unpaid ECB into equity while ensuring that conversion is within the terms.

It should also be noted that if the ECB borrower concerned has availed credit facilities from the Indian banking system including overseas branches/subsidiaries, any extension of tenure / conversion of unpaid ECBs into equity (whether matured or not) shall be subject to applicable prudential guidelines issued by the Department of Banking Regulation of the Reserve Bank, including guidelines on restructuring. Further, such conversion into equity shall also be subject to consent of other lenders, if any, to the same borrower or at least information regarding conversions shall be exchanged with other lenders of the borrower. All other aspects of the ECB policy shall remain unchanged.

(https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10652&Mode=0)

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