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MONETARY AND CREDIT  
INFORMATION REVIEW

**POLICY**

**Repo/Reverse Repo Rates increased**

The Reserve Bank of India increased the repo rate and the reverse repo rate under the liquidity adjustment facility (LAF) on an assessment of the current macroeconomic situation, as below –

*Repo Rate* - increased by 25 basis points from 5.25 per cent to 5.50 per cent.

*Reverse Repo Rate* - increased by 25 basis points from 3.75 per cent to 4.00 per cent.

The new rates are effective from July 2, 2010.

**Standing Liquidity Facilities for Banks and PDs**

The standing liquidity facilities provided to banks (export credit refinance) and primary dealers (PDs) (collateralized liquidity support) from the Reserve Bank would be available at the revised repo rate, *i.e.*, at 5.50 per cent from July 3, 2010.

**Additional Liquidity Support under LAF extended**

The additional liquidity support to scheduled commercial banks under the Liquidity Adjustment Facility (LAF) has been extended up to July 16, 2010. For any shortfall in maintenance of statutory liquidity ratio (SLR) arising out of avilment of this facility, banks should seek waiver of penal interest purely as an *ad hoc* measure to the extent of up to 0.5 per cent of their net demand and time liabilities (NDTL). The Reserve Bank had extended the second liquidity adjustment facility (SLAF) on a daily basis till July 30, 2010.

**Rupee Export Credit Interest Rates**

With the introduction of the Base Rate System, the interest rate applicable to all tenors of rupee export credit advances from July 1, 2010 will be at or above the Base Rate for all fresh/renewed advances. Banks have been advised to reduce the interest rates chargeable to exporters under these sectors by the amount of subvention under the scheme, subject to a floor rate of 7 per cent.

Exporters in certain sectors, namely, handicrafts, carpets, handlooms and small and medium enterprises (SMEs) are eligible for subvention under the Scheme. If, as a consequence, the interest rate charged to exporters goes below the Base Rate, such lending will not be construed to be violative of the Base Rate guidelines.

**Bank credit to MSMEs**

Pursuant to the recommendations of the Prime Minister's Task Force on Micro, Small and Medium Enterprises (MSMEs) (Chairman: Shri T K A Nair) constituted by the Government of India, the Reserve Bank has asked banks:

- (i) to achieve a 20 per cent year-on-year growth in credit to micro and small enterprises to ensure enhanced credit flow;
- (ii) the allocation of 60 per cent of the MSE advances to the micro enterprises is to be achieved in three stages namely, 50 per cent in 2010-11, 55 per cent in 2011-12 and 60 per cent in 2012-13; and
- (iii) to achieve a 10 per cent annual growth in number of micro enterprise accounts.

Banks have been further advised to open more MSE focussed branch offices at different MSE clusters which can also act as counselling centres for MSEs. Each lead bank of a district should adopt at least one MSE cluster.

**Penalty for bouncing of SGL Forms**

The Reserve Bank has advised that if the subsidiary general ledger (SGL) transfer form bounces and the account holder concerned fails to offer satisfactory explanation for such bouncing, the account holder would be liable to pay penalties as under:

- (i) Graded monetary penalties subject to a maximum penalty of Rs.5 lakh per instance;

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Applicable to	Monetary Penalty (in per cent)	Illustration (penal amount on Rs.5 crore default)
First three defaults in a financial year (April to March)	0.10 (10 paise per Rs.100 FV)	Rs.50,000/-
Next three defaults in the same financial year	0.25 (25 paise per Rs.100 FV)	Rs.1,25,000/-
Next three defaults in the same financial year	0.50 (50 paise per Rs.100 FV)	Rs.2,50,000/-

(ii) On the tenth default in a financial year, the entities would for the remaining portion of the financial year be debarred from using the SGL account for undertaking short sales in government securities even to the extent permissible under the Reserve Bank's circular dated January 31, 2007 as amended from time to time. Upon being satisfied that the account holder has effected improvements in its internal control systems, the Reserve Bank may grant specific approval to the account holder to undertake short sales in the next financial year by using the SGL account facility.

(iii) The monetary penalty should be paid by the account holder concerned by cheque or through electronic mode favouring the Reserve Bank, within five working days of receiving the Reserve Bank's order intimating imposition of the penalty.

For the purpose of these instructions, 'SGL bouncing' shall mean failure of settlement of a government securities transaction on account of insufficiency of funds in the current account of the buyer or insufficiency of securities in the SGL/CSGL account of the seller, maintained with the Reserve Bank.

The defaulting member should make appropriate disclosure, on the number of instances of default as well as the quantum of penalty paid to the Reserve Bank during the financial year, under the "Notes to Account" in its balance sheet.

For violation of the terms and conditions of the opening and maintenance of SGL/CSGL accounts or breach of its operational guidelines, the Reserve Bank reserves the right to take any action including, temporary or permanent debarment of the SGL account holder, in accordance with the powers conferred under the Act as it may deem fit.

### Issuance of Non-Convertible Debentures

The Reserve Bank has issued directions to agencies dealing in securities and money market instruments, on the issuance of non-convertible debentures (NCDs) of original or initial maturity up to one year. The extracts from directions which will come into effect from August 2, 2010 are:

#### Definition

For the purposes of these Directions -

Non-Convertible Debenture means a debt instrument issued by a corporate (including NBFCs) with original or initial maturity up to one year and issued by way of private placement. Corporate means a company as defined in the Companies Act, 1956 (including NBFCs) and a corporation established by an act of any Legislature.

#### Eligibility

A corporate would be eligible to issue NCDs if it fulfills the following criteria:

- the corporate has a tangible net worth of not less than Rs.4 crore as per the latest audited balance sheet;
- the corporate has been sanctioned working capital limit or term loan by bank/s or all-India financial institution/s; and
- the borrowal account of the corporate is classified as a standard asset by the financing bank/s or institution/s.

#### Rating

- An eligible corporate intending to issue NCDs should obtain credit rating for issuance of the NCDs from one of the rating agencies.
- The minimum credit rating should be P-2 of CRISIL or such equivalent rating by other agencies.
- At the time of issuance of NCDs, the corporate should ensure that the rating so obtained is current and has not fallen due for review.

#### Maturity

- NCDs should not be issued for maturities of less than 90 days from the date of issue.
- The exercise date of option (put/call), if any, attached to the NCDs should not fall within the period of 90 days from the date of issue.
- The tenor of the NCDs should not exceed the validity period of the credit rating of the instrument.

#### Denomination

NCDs may be issued in denominations with a minimum of Rs.5 lakh (face value) and in multiples of Rs.1 lakh.

#### Limits/Amount of Issue

- The aggregate amount of NCDs issued by a corporate should be within such limit as may be approved by the corporate's board of directors or the quantum indicated by the credit rating agency for the rating granted, whichever is lower.
- The total amount of NCDs proposed to be issued should be completed within a period of two weeks from the date on which the corporate opens the issue for subscription.

#### Procedure

- The corporate should disclose to the prospective investors, its financial position as per the standard market practice.
- The auditors of the corporate should certify to the investors that all the eligibility conditions set forth in these directions for the issue of NCDs are met by the corporate.
- The corporate should comply with the requirements of all the provisions of the Companies Act, 1956 and the Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008, or any other law, that may be applicable.
- The debenture certificate should be issued within the period prescribed in the Companies Act, 1956 or any other law as in force at the time of issuance.
- NCDs may be issued at face value carrying a coupon rate or at a discount to face value as zero coupon instruments as determined by the corporate.

### Debenture Trustee

Every corporate issuing NCDs should appoint a Debenture Trustee (DT) for each issuance of the NCDs.

Any entity that is registered as a DT with SEBI under SEBI (Debenture Trustees) Regulations, 1993, would be eligible to act as DT for issue of the NCDs only subject to compliance with the requirement of these Directions.

The DT should submit to the Reserve Bank such information as required by it from time to time.

### Investment in NCD

- NCDs may be issued to and held by individuals, banks, primary dealers (PDs), other corporate bodies including, insurance companies and mutual funds registered or incorporated in India and unincorporated bodies, nonresident Indians (NRIs) and foreign institutional investors (FIIs).
- Investments in NCDs by banks/PDs would be subject to the approval of the respective regulators.
- Investments by FIIs would be within such limits as may be set forth in this regard from time to time by SEBI.

### Preference for Dematerialisation

While option is available to both issuers and subscribers to issue/hold NCDs in dematerialised or physical form, they are encouraged to issue/ hold NCDs in dematerialised form. Banks, FIs and PDs are, however, required to make fresh investments in NCDs only in dematerialised form.

### Roles/Responsibilities

The directions also describe the role and responsibilities of corporates, DTs and credit rating agencies.

### Disclosure and Penalties

Issuers of NCDs of maturity up to one year should follow the Disclosure Document brought out by the Fixed Income Money Market and Derivatives Association of India (FIMMDA), in consultation with the Reserve Bank as amended from time to time.

The Reserve Bank has further advised that the violation of these directions would attract penalties, which would include debarring of the entity from the NCD market.

### Credit Card Operations

The Reserve Bank has advised all banks to strictly adhere to the guidelines contained in its Master Circular on Credit Card Operations dated July 1, 2010, both in letter and in spirit, failing which the Reserve Bank would be constrained to initiate suitable penal action, including levy of monetary penalties, under the relevant statutory provisions.

The advice came in the wake of continued receipt of numerous complaints from credit card holders regarding the credit card operations of banks, despite the issue of comprehensive instructions on credit cards to banks.

## FEMA

### Compounding of Contraventions under FEMA, 1999

With the objective of rationalising and streamlining the compounding process and to enhance transparency and effect smooth implementation, the procedure for compounding of contravention/s under FEMA has been updated.

#### Application

As per sub-rule (3) of Rule 4 of the Rules, the compounding process would be subject to the direction, control and supervision of the Governor of the Reserve Bank.

An application for compounding of a contravention under FEMA, 1999 should be submitted to the Reserve Bank on being advised of a contravention under FEMA, 1999 either through a memorandum or *suo moto* being made or becoming aware of the contravention.

On receipt of the application for compounding, the proceedings would be initiated in accordance with the Foreign Exchange (Compounding Proceedings) Rules, 2000 and the compounding order would be issued by the Compounding Authority within 180 days from the date of receipt of the application for compounding.

On receipt of the application for compounding, the Reserve Bank would examine the application based on the documents and submissions made in the application in terms of sub rule (1) of Rule 4 of the Foreign Exchange (Compounding Proceedings) Rules, 2000 and assess whether the contravention is quantifiable and, if so, the amount of contravention.

The Reserve Bank would examine the nature of contravention keeping in view, *inter alia*, the following indicative points:

- whether the contravention is technical and/or minor in nature and needs only an administrative cautionary advice;
- whether the contravention is serious and warrants compounding of the contravention; and
- whether the contravention, *prima facie*, involves money-laundering, national and security concerns involving serious infringements of the regulatory framework.

If, before disposal of the compounding application by issue of a compounding order the Reserve Bank finds that there is sufficient cause for further investigation, it may recommend the matter to the Directorate of Enforcement (DoE) for further investigation and necessary action under FEMA, 1999 by them or to the Anti Money Laundering Authority instituted under the Prevention of Money Laundering Act, 2002 or to any other agencies, as deemed fit. Since the compounding application has to be disposed of within 180 days, the application would be disposed of by returning the application to the applicant in view of such investigation required to be conducted.

The Compounding Authority (CA) at the Reserve Bank may call for any additional information, record or any other document relevant to the compounding proceedings. Where additional information/document is called for, such additional information/document should be submitted within the period as may be specified by the Compounding Authority. In case the contravener fails to submit the additional information/documents called for within the specified period, the application for compounding will be liable for rejection.

The CA at the Reserve Bank would consider the application and would pass an order of compounding after affording the contravener an opportunity of being heard as

expeditiously as possible but not later than 180 days from the date of receipt of the completed application.

The Compounding Order would specify the provisions of the FEMA, 1999 or any rule, regulation, notification, direction or order issued in exercise of the powers under FEMA, 1999 in respect of which contravention has taken place along with details of the alleged contravention.

### Scope/Manner of Compounding

The CA on the basis of the application together with the documents submitted and the submissions made during the personal hearing would form an opinion on the nature of the contravention.

The application for compounding would be processed further and disposed of on merits upon consideration of the records and submissions and at the absolute discretion of the CA. The factors which may be taken into consideration for the purpose of passing compounding order and adjudging the quantum of sum on payment of which contravention would be compounded are-

- (i) the amount of gain of unfair advantage, wherever quantifiable, made as a result of the contravention;
- (ii) the amount of loss caused to any authority/agency/exchequer as a result of the contravention;
- (iii) economic benefits accruing to the contravener from delayed compliance or compliance avoided;
- (iv) the repetitive nature of the contravention, the track record and/or history of non-compliance of the contravener;
- (v) contravener's conduct in undertaking the transaction and in disclosure of full facts in the application and submissions made during the personal hearing; and
- (vi) any other factor as considered relevant and appropriate.

### Issue of Order

The applicant/contravener would be given an opportunity for personal hearing for further submission of documents in person in support of the application within a specified period. If the contravener or its authorised representative fails to appear in person or make any submissions before the CA for personal hearing, the CA would proceed with the processing of the compounding application on the basis of available information and documents submitted along with the application for compounding.

The CA would pass a compounding order on the basis of the averments made in the application as well as other documents and submissions made in this context by the contravener during the personal hearings.

One copy of the compounding order issued would be supplied to the applicant (the contravener) and also to the Adjudicating Authority, where the compounding of any contravention is made after making of a complaint under subsection (3) of section 16 of the FEMA, as the case may be.

### Payment

The sum for which the contravention is compounded as specified in the order of compounding of contravention should be paid by way of a demand draft in favour of the "Reserve Bank of India" within 15 days from the date of the order. The

demand draft has to be deposited in the manner as directed in the compounding order.

The provisions of the Rules do not confer any right to the contravener, after a compounding order is passed, to seek to withdraw the order or to hold that the compounding order is void or request review of the order passed by the Compounding Authority.

In case of failure to pay the sum compounded within the time specified in the compounding order and the Foreign Exchange (Compounding Proceedings) Rules, 2000, it would be deemed in terms of Rule 10 of the Rules that the contravener had never made an application for compounding of any contravention under these Rules.

For contraventions of the FEMA, 1999 (as defined in section 13 of FEMA, 1999), which are not compounded by the Compounding Authority, other relevant provisions of FEMA, 1999 dealing with contraventions would apply accordingly.

On realisation of the sum for which contravention is compounded, the Reserve Bank would issue a certificate subject to the specified conditions, if any, in the order.

### Prerequisite for Compounding Process

A contravention committed by any person within a period of three years from the date on which a similar contravention committed by him was compounded under the Compounding Rules, such contraventions would not be compounded and relevant provisions of the FEMA, 1999 would apply. Any second or subsequent contravention committed after the expiry of a period of three years from the date on which the contravention was previously compounded would be deemed to be a first contravention.

Contraventions relating to any transaction where proper approvals or permission from the Government or any statutory authority concerned, as the case may be, have not been obtained, such contraventions would not be compounded unless the required approvals are obtained from the concerned authorities.

Cases of contravention, such as, those having a money laundering angle, national security concerns and/or involving serious infringements of the regulatory framework or where the contravener fails to pay the sum for which contravention was compounded within the specified period in terms of the compounding order, would be referred to the Directorate of Enforcement (DoE) for further investigation and necessary action under FEMA, 1999 or to the authority instituted for implementation of the Prevention of Money Laundering Act 2002, or to any other agencies, for necessary action as deemed fit.

The Reserve Bank generally advises the persons concerned of their choice and option to make an application for compounding as and when the contraventions come to its notice. The facts constituting such contraventions would be brought to the notice of the DoE for further necessary action in case no application for compounding is made within the time indicated by the Reserve Bank.

The provisions of section 15 of FEMA, 1999 empower the Reserve Bank to compound any contravention as defined under section 13 of the FEMA, except the contraventions under section 3 (a) of FEMA, on an application made by the person committing such contravention.