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**MONETARY AND CREDIT  
INFORMATION REVIEW**

**Banking Regulation**

**Dealing with Loan Frauds**

The Reserve Bank has formulated a 'Framework for fraud risk management in banks' and advised all scheduled commercial banks (excluding regional rural banks) and all India select financial institutions to make the framework effective from May 7, 2015. The Framework was formulated based on the recommendations of an Internal Working Group (IWG) which looked into the issues relating to prevention, early detection and reporting of frauds in banks keeping in view the growing concern for the rising trend in loan related frauds in the financial sector. The broad guidelines of the Framework include:

*Objective*

In the context of increasing incidence of frauds in general and in loan portfolios in particular, objective of this framework was (i) to direct the focus of banks on the aspects relating to prevention, early detection, prompt reporting to the Reserve Bank (for system level aggregation, monitoring and dissemination) and the investigative agencies (for instituting criminal proceedings against the fraudulent borrowers) and (ii) timely initiation of the staff accountability proceedings (for determining negligence or connivance, if any) while ensuring that the normal conduct of business of the banks and their risk taking ability is not adversely impacted and no new and onerous responsibilities are placed on the banks.

In order to achieve this objective, the framework also seeks to stipulate time lines with the action incumbent on a bank. The time lines/stage wise actions in the loan life-cycle are expected to compress the total time taken by a bank to identify a fraud and aid more effective action by the law enforcement agencies. The early detection of fraud and the necessary corrective action are important to reduce the quantum of loss which the continuance of the fraud may entail. The government is separately looking into the issue of more timely and coordinated action by the law enforcement agencies.

*Early Warning Signals and Red Flagged Accounts*

The concept of a Red Flagged Account (RFA) was introduced in the current framework as an important step in fraud risk control. An RFA is one where suspicion of fraudulent activity is thrown up by the presence of one or more Early Warning Signals (EWS). These signals in a loan account should immediately put the bank on alert regarding weakness or wrong doing which may ultimately turn out to be fraudulent. A bank cannot afford to ignore such EWS but must instead use them as a trigger to launch a detailed investigation into the RFA. The EWS so compiled by a bank would form the basis for

classifying an account as an RFA. The threshold for EWS and RFA is an exposure of ₹500 million or more at the level of a bank irrespective of the lending arrangement (whether solo banking, multiple banking or consortium).

The tracking of EWS in loan accounts should not be seen as an additional task but must be integrated with the credit monitoring process in the bank so that it becomes a continuous activity and also acts as a trigger for any possible credit impairment in the loan accounts, given the interplay between credit risks and fraud risks. The officer responsible for the operations in the account should be sensitised to observe and report any manifestation of the EWS promptly to the Fraud Monitoring Group (FMG) or any other group constituted by the bank for the purpose immediately. To ensure that the exercise remains meaningful, such officers may be held responsible for non-reporting or delays in reporting. A report on the RFA accounts may be put up to the Special Committee of the Board for monitoring and follow-up of Frauds (SCBF) providing, among other things, a synopsis of the remedial action taken together with their current status.

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## Banks to appoint Internal Ombudsman

The Reserve Bank, on May 11, 2015 advised all public sector banks and select private sector and foreign banks to appoint an internal ombudsman. The internal ombudsman would be designated as Chief Customer Service Officer (CCSO). The Reserve Bank has taken this initiative to further boost the quality of customer service and to ensure that there is undivided attention to resolution of customer complaints in banks.

While all public sector banks will have to appoint a Chief Customer Service Officer, the private sector and foreign banks which have been asked to appoint the Chief Customer Service Officers (Internal Ombudsman) are ICICI Bank Ltd., HDFC Bank Ltd., Axis Bank Ltd., Kotak Mahindra Bank Ltd., IndusInd Bank Ltd., Standard Chartered Bank, Citi Bank N.A. and HSBC Ltd. These banks have been selected on the basis of their asset size, business mix, etc.

Among some requirements for internal ombudsman are: The CCSO should not have worked in the bank in which he/she is appointed as CCSO; and the bank's internal ombudsman should be a forum available to bank customers for grievance redressal before they could even approach the Banking Ombudsman.

The Reserve Bank operates the Banking Ombudsman Scheme (BOS), free of cost, so as to make it accessible to all. The Reserve Bank will shortly issue detailed operational guidelines to the banks.

## Dealing with Loan Frauds

*(Continued from page 1)*

### Early Detection and Reporting

The most effective way of preventing frauds in loan accounts is for banks to have a robust appraisal and an effective credit monitoring mechanism during the entire life-cycle of the loan account, namely,

- (i) Pre-sanction stage: Banks may keep the record of pre-sanction checks as part of the sanction documentation;
- (ii) Disbursement stage: Checks by Risk Management Group (RMG) during the disbursement stage may focus on the adherence to the terms and conditions of sanction, rationale for allowing dilution of these terms and conditions, level at which such dilutions were allowed;
- (iii) Annual review: While the continuous monitoring of an account through the tracking of EWS is important, banks also need to be vigilant from the fraud perspective at the time of annual review of accounts. Besides, the RMG should have capability to track market developments relating to the major clients of the bank and provide inputs to the credit officers. This would involve collecting information from the grapevine, following up stock market movements, subscribing to a press clipping service, monitoring databases on a continuous basis and not confining the exercise only to the borrowing entity but to the group as a whole.

Besides, the Framework for fraud risk management in banks also include broad guidelines relating to the (i) Reporting to the Central Repository of Information on Large Credits (CRILC); (ii) Staff Empowerment; (iii) Role of auditors; (iv) Incentive for prompt reporting; (v) Bank as a sole lender; (vi) Lending under consortium or multiple banking arrangements; (vii) Staff accountability; (viii) Filing complaints with law enforcement agencies; (ix) Penal measures for fraudulent borrowers and (x) Central Fraud Registry. (DBS.CO.CFMC. BC.No.007/23.04.001/2014-15 dated May 7, 2015)

## Acquisition of Accommodation on Lease/Rental Basis

The Reserve Bank advised all commercial banks (including regional rural banks) the revised norms and procedures for acquisition of accommodation on lease/rental basis for their use. These will now be determined by the banks themselves. However, banks have to ensure that their branches do not function from premises which are unauthorised as per the prevailing law. Further, banks have been advised that legitimate grievances of owners of property leased to the bank should be examined at appropriately senior level in the bank and expeditious action should be taken to redress such grievances. The Reserve Bank has also decided to do away with the periodic statements on disputed premises which were to be submitted to the Reserve Bank's respective regional office or to the Department of Banking Regulation, Central Office. (DBR. No. BAPD.BC.92 /22.01.003/ 2014-15 dated April 30, 2015)

## Calendar of Reviews

The Reserve Bank advised all public sector banks to suitably determine, with the approval of their boards, the agenda items and the periodicity thereof, keeping in view that there is adequate focus on matters of strategic and financial importance, including the seven broad themes as prescribed by the Committee to Review Governance of Boards of Banks in India (Chairman - Dr. P. J. Nayak), popularly known as Nayak Committee. The Nayak Committee had earlier recommended that discussions in the boards of banks need to be upgraded and greater focus should be on strategic issues.

The Reserve Bank had, in the first bi-monthly monetary policy statement 2015-16, proposed to do away with the 'Calendar of Reviews' and instead, replace it with the seven critical themes prescribed by the Nayak Committee. These are: business strategy, financial reports and their integrity, risk, compliance, customer protection, financial inclusion and human resources. The Reserve Bank has decided to leave it to the banks' boards to determine other list of items to be deliberated and periodicity thereof. (DBR No.BC.93/29.67.001/2014-15 dated May 14, 2015)

## Co-operative Banking

### Reversing Excess Provision

The Reserve Bank has permitted multi-state urban cooperative banks to reverse the excess provision when the sale of financial assets to Securitisation Company (SC)/ Restructuring Company (RC) is for a value higher than the net book value (NBV) of Non Performing Assets (NPAs) to the profit and loss (P& L) account. However, banks can reverse excess provision arising out of sale of NPAs only when the cash received (by way of initial consideration and/or redemption of security receipt /pass through certificates) is higher than the NBV of the NPAs sold to SCs/RCs. Further, the quantum of excess provision reversed to profit and loss account will be limited to the extent of which cash exceeds the NBV of the NPAs sold. The quantum of excess provision reversed to the profit and loss account due to sale of NPAs should be disclosed in the financial statements of the bank under "Notes to Account". (DCBR.BPD.MSCB).Cir No. 1/ 13.05.000/ 2014-15 dated May 14, 2015)

### Opening of Branches/Extension Counters

The Reserve Bank has revised the criteria and the procedure for making application to open branches/extension counters by state co-operative banks (StCBs). The decision has been taken after reviewing the policy for opening of branches/extension counters/ specialised branches within the area of operation of the StCBs.

The revised criteria are: (i) Capital to Risk (Weighted) Assets Ratio (CRAR) not being less than 9 per cent; (ii) No default in maintenance of Cash Reserve Ratio (CRR)/Statutory Liquidity Ratio (SLR) during the preceding financial year; (iii) net Non Performing Assets (NPA) being less than 5 per cent; (iv) A track record of regulatory compliance and no monetary penalty imposed for violation of RBI directives/guidelines during last two financial years.

The Reserve Bank has further advised that StCBs satisfying the above criteria may submit their applications in the prescribed format to the concerned regional office of the Reserve Bank through National Bank for Agriculture and Rural Development (NABARD) for prior approval for opening of branches/specialised branches/extension counters/shifting of branches/upgradation of extension counters into full-fledged branches. (DCBR.CO.RCB.No. BC.34/ 19.51.008/ 2014-15 dated May 7, 2015)

### Implementation of PMJJBY, PMSBY and APY

The Reserve Bank has advised certain primary urban cooperative banks with full Core Banking Solution (CBS) implementation and having capabilities to build necessary modules in the CBS/hand held devices software for banks and Business Correspondents (BCs) for the roll out

### Payment Systems

#### Additional Factor of Authentication for SVCP Transactions

The Reserve Bank, on May 14, 2015, relaxed its requirement of additional factor of authentication (AFA) for Small Value Card Present (SVCP) transactions across all merchant categories. This is in line with the Reserve Bank's approach to enhance customer convenience while ensuring security in card based transactions.

The Reserve Bank advised all scheduled commercial banks including regional rural banks/urban co-operative banks/state co-operative banks/district central co-operative banks/authorised card payment networks, that -

- i. Relaxation for AFA requirement is permitted for transactions for a maximum value of ₹2,000/- per transaction;
- ii. The limit of ₹2000/- per transaction is set across all categories of merchants in the country where such contactless payments are accepted;
- iii. Beyond this transaction limit, the card has to be processed as a contact payment and authentication with PIN (AFA) will be mandatory;
- iv. Even for transaction values below this limit, the customer may choose to make payment as a contact payment, which has to be facilitated by both issuing and acquiring banks. In other words, customers cannot be compelled to do a contactless payment;
- v. Banks are free to facilitate their customers to set lower per-transaction limits. The responsibility for authorising the contactless payment based on such card-based limits will lie with the card issuing banks;
- vi. Suitable velocity checks (i.e., how many such small value transactions will be allowed in a day / week / month) may be put in place by banks as considered appropriate; and
- vii. The contactless cards should necessarily be chip cards adhering to Europay, MasterCard and Visa (EMV) compliant payment standard, so as to be acceptable across the existing card acceptance infrastructure which are EMV compliant based on the earlier mandate in this regard.

of Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY) Scheme, Pradhan Mantri Suraksha Bima Yojana (PMSBY) and participate in Atal Pension Yojana (APY). Such urban co-operative banks (UCBs) are advised to finalise Memorandum of Understandings (MOUs) with Life Insurance Corporation (LIC)/General Insurers' (Public Sector) Association of India (GIPSA) or any other insurance companies of their choice which are willing to offer the product on similar terms with necessary approvals and tie ups with UCBs for this purpose as mentioned in the schemes. For implementation of APY scheme, the UCBs in co-ordination with Pension Fund Regulatory and Development Authority (PFRDA) are advised to introduce the necessary module for this purpose in their CBS package and in the software for the handheld devices of Business Correspondents (BCs) to enable on-line enrolment. The acknowledgement slip may be made into an acknowledgement slip cum registration slip for APY.

UCBs may appoint a Nodal Officer for implementation of the schemes and furnish to regional offices of the Reserve Bank the full details, such as, name of the bank, address, name of the Nodal Officers with details of their telephone numbers, email addresses for onward transmission to Ministry of Finance, Government of India. The details of the schemes are available at [www.jansuraksha.gov.in/www.financialservices.gov.in](http://www.jansuraksha.gov.in/www.financialservices.gov.in) (DCBR.BPD (PCB) Circular No. 8/ 12.05.001/ 2014-15 dated May 5, 2015 and DCBR. BPD (PCB) Cir. No. 9/ 12.05.001/ 2014-15 dated May 21, 2015)

Further, in the interest of customer awareness and protection, the banks are also advised:

- i. to clearly explain to customers the technology, its use, and risks while issuing such contact less cards;
- ii. to create awareness among customers to look for/identify the "contactless" logo on the card (to distinguish them from other cards) as well as the merchant location/POS terminal (to identify that contactless payments are accepted at that location);
- iii. to clearly indicate to the customers that they can use the card in contactless mode (without PIN authentication) for transactions upto ₹2000/- in locations where contactless payments are accepted and to make customers aware that they are free to use the same card as a regular chip card (with PIN authentication) at any location irrespective of transaction value;
- iv. to clearly indicate the maximum liability devolving on the customer, if any, at the time of issuance of such cards along with the responsibility of the customer to report the loss of such cards to the bank; and
- v. to put in place robust mechanism for seamless reporting of lost/stolen cards, which can be accessed through multiple channels (website, phone banking, SMS, IVR etc.).

The Reserve Bank has also indicated that these relaxations shall not apply to—(i) ATM transactions irrespective of transaction value; and (ii) Card Not Present transactions (CNP).

The Reserve Bank had earlier placed in its website ([www.rbi.org.in](http://www.rbi.org.in)) the draft circular on "Relaxation in requirement of Additional Factor of Authentication for small value card present transactions" on March 13, 2015 for public comments till April 4, 2015. This relaxation was considered taking into account the requests received from various segments indicating the need to foster innovative payment products as also enhance the convenience factor in certain types of card uses. (DPSS.CO.PD.No. 2163/ 02.14.003/ 2014-2015 dated May 14, 2015).

## All New Cards to be EMV Chip and Pin based

The Reserve Bank, on May 7, 2015, advised all scheduled commercial banks including RRBs/ co-operative banks / state co-operative banks/ central co-operative banks/ authorised card payment networks that with effect from September 1, 2015, all new cards issued – debit and credit, domestic and international – by banks shall be EMV chip and pin based cards. The migration plan for existing magnetic strip only cards will be framed in consultation with stakeholders and timeline for the same will be advised in due course. (DPSS (CO) PD No.2112/ 02.14.003/ 2014-15 dated May 7, 2015)

## Non-Banking Regulation

### Guidelines on Distribution of MF Products by NBFCs

The Reserve Bank has dispensed with the requirement of prior approval from the Reserve Bank and the minimum eligibility criteria for Non-Banking Financial Companies (NBFCs) to distribute mutual fund products. However, NBFCs, which desire to distribute mutual funds, would be required to adhere to the following stipulations:

#### (i) Operational Aspects

(a) The NBFC should comply with the Securities and Exchange Board of India (SEBI) guidelines / regulations, including its code of conduct, for distribution of mutual fund products;

(b) The NBFC should not adopt any restrictive practice of forcing its customers to go in for a particular mutual fund product sponsored by it. Its customers should be allowed to exercise their own choice;

(c) The participation by the NBFC's customers in mutual fund products should be purely on a voluntary basis and this information should be stated in all publicity material distributed by it in a prominent way. There should be no 'linkage' either direct or indirect between the provisions of financial services offered by the NBFC to its customers and distribution of the mutual fund products;

(d) The NBFC should only act as an agent of its customers, forwarding their applications for purchase/sale of MF units together with the payment instruments, to the Mutual Fund/ the Registrars/ the transfer agents. The purchase of units should be at the customers' risk and without the NBFC guaranteeing any assured return;

(e) The NBFC should neither acquire units of mutual funds from the secondary market for sale to its customers, nor should it buy back units of mutual funds from its customers;

(f) In case the NBFC is holding custody of MF units on behalf of its customers, it should ensure that its own investments and the investments belonging to its customers are kept distinct from each other.

(ii) *Other Aspects*-(a) The NBFC should have put in place a comprehensive board approved policy regarding undertaking mutual funds distribution; (b) the NBFC undertaking this activity should comply with the code of conduct prescribed by SEBI, Know Your Customer (KYC) Guidelines and provisions of prevention of Money Laundering Act and other terms and conditions as may be specified in this regard from time to time. (DNBR. (PD).CC.No.033/03.10.001/2014-15 dated April 30, 2015)

## IDF-NBFCs can invest in Other Sectors

The Reserve Bank has, in consultation with the Government of India, allowed entry of the Infrastructure Debt Fund-Non-Banking Financial Companies (IDF-NBFCs) into sectors even where there is no presence of a Project Authority. The Directions, in this regard, were accordingly amended with respect to investments, risk weights for the purpose of capital adequacy and credit concentration norms. (DNBR (PD) CC.No.035/03.10.001/2014-15 dated May 14, 2015)

## Foreign Exchange Management

### ECB – Mobilisation of INR

The Reserve Bank advised authorised dealer (category-I) banks that recognised non-resident External Commercial Borrowing (ECB) lenders may enter into swap transactions with their overseas bank which shall, in turn, enter into a back-to-back swap transaction with any AD Cat-I bank in India for mobilising INR as per the prescribed procedure. (A. P. (DIR Series) Circular No. 103 dated May 21, 2015)

### RDAs - Trade-related Remittance Limit Trebled

On a review of the permitted transactions under the Rupee Drawing Arrangements (RDAs), the Reserve Bank increased the limit of trade transactions from the existing ₹5,00,000/- (Rupees Five Lakh only) per transaction to ₹15,00,000/- (Rupees Fifteen Lakh only) per transaction, with immediate effect. Further, Authorised Dealer Category - I Banks are permitted to regularise payments exceeding the prescribed limit under RDA subject to conditions prescribed. (A. P. (DIR Series) Circular No. 102 dated May 21, 2015)

### Merchanting Trade to Nepal and Bhutan

The Reserve Bank, in consultation with Government of India, clarified that goods consigned to the importers of Nepal and Bhutan from third countries under merchanting trade from India would qualify as traffic-in-transit, if the goods are otherwise compliant with the provisions of the India-Nepal Treaty of Transit and Indo-Bhutan Treaty of Transit, respectively. (A.P. (DIR Series) Circular No. 97 dated April 30, 2015)

### Declaration of Exports of Goods/Software

The Reserve Bank has dispensed with the requirement of declaring the export of goods/software in the Statutory Declaration Form (SDF) in case of exports taking place through the Electronic Data Interchange (EDI) ports, as the mandatory statutory requirements contained in the SDF have been subsumed in the shipping bill format. (A.P. (DIR Series) Circular No.101 dated May 14, 2015)

### FCNR (B) Scheme- Closure and Remittance

The Reserve Bank has clarified to authorised dealer (category - I) banks that A2 form is to be filed at the time of purchase of foreign exchange using rupee funds and hence is not applicable while remitting Foreign Currency Non Resident (FCNR-B) funds. Further, banks, with the help of technology, will have to devise better alternatives/methods to ensure bonafides of the transaction rather than insisting on physical presence of the account holder, in order to ensure hassle free remittance of funds to the account holder. (A.P. (DIR Series) Circular No. 98 dated May 14, 2015)