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MONETARY AND CREDIT INFORMATION REVIEW

UCBs

Supervisory Action Framework

With the introduction of a revised supervisory rating model for urban co-operative banks (UCBs) based on CAMELS pattern from March 31, 2009, in place of the Grading System, the framework of supervisory action has been realigned. The revised supervisory action framework (SAF) envisages, in the initial stage of deterioration in the financial position, self corrective action by the UCB's management and supervisory action by the Reserve Bank in case the financial position of the bank does not improve.

Self Corrective Action

If the capital to risk-weighted assets ratio (CRAR) falls below 9 per cent or there is deterioration in asset quality or decline in profits, liquidity constraints etc., the bank's management should identify the cause of deterioration and take necessary corrective actions, on their own, with a view to improving the bank's financial position. Such corrective action should be prompt as any delay could be detrimental to the interest of the bank's depositors and other stake holders. The corrective action should include –

- Measures for augmenting capital.
- Close monitoring of non-performing assets (NPAs) and their recovery, especially the large NPAs.
- Improving profitability by curtailing expenses.
- Mobilising low cost deposits.

UCBs should also prepare a time bound specific action plan for bringing about necessary improvement in their functioning. In every meeting of the Board of Directors, the progress in implementation of the action plan should be monitored.

Supervisory Action by the Reserve Bank

If necessary steps are not taken by UCBs to improve their financials or the steps taken do not result in the required improvement in their financial position, the Reserve Bank will step in and initiate supervisory actions as it deems necessary. The supervisory actions which would be taken by the Reserve Bank would be in two stages.

First Stage - The Reserve Bank would commence active monitoring of the UCB's performance when one or more of the following circumstances exist:

(i) Capital adequacy is less than 6 per cent.

(ii) Losses are incurred for two consecutive years.

(iii) Gross NPAs exceed 10 per cent of the advances.

(iv) Concentration of deposits i.e., top 20 deposits/depositors exceed 30 per cent of total deposits.

(v) Credit-deposit ratio exceeds 70 per cent.

Monitoring would be done by directing the UCBs to submit to the Reserve Bank's Regional Office, an action plan for improving their performance in the specific areas where there is deterioration or cause for concern, (CRAR, profitability, gross NPA, CD ratio, concentration of deposits, as the case may be) and returns, pertaining to the specified weak area, at quarterly/half-yearly intervals.

Second Stage - The supervisory action would be in the form of pre-emptive action aimed at arresting further deterioration in the UCB's financial position. The extent and nature of supervisory action would depend on the level of capital adequacy and the extent of erosion in deposits, if any, in the bank. The supervisory action would increase in terms of

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severity as the financials deteriorate and could include restriction on pre-mature withdrawal of deposits, freezing the level of advances/deposits, prohibiting acceptance of deposits, issue of show cause for cancellation of banking licence, etc.

If the CRAR of a UCB falls below 4 per cent, but its net worth continues to be positive, the bank will not be permitted to increase its aggregate advances beyond the level of advances as on a specified date.

If the financials of a UCB further deteriorate resulting in the net worth turning negative, then the Reserve Bank would initiate further action depending on the extent of deposit erosion.

Deposit Erosion

(i) In case of deposit erosion up to 10 per cent - the bank will be advised to explore options for merger with another bank. The bank will not be permitted to increase its aggregate deposits beyond the level of deposits as on a specified date. The bank will also be prohibited from premature payment of all term deposits.

(ii) In case of deposit erosion beyond 10 per cent and up to 25 per cent - when all options for revival of the bank are exhausted, it will be prohibited from accepting fresh deposits and repaying existing deposits. Renewal of deposits will, however, be permitted.

(iii) Deposit erosion in excess of 25 per cent - a show cause notice will be issued for cancellation of the bank's licence.

On certain occasions, notwithstanding the financial position of the bank, issue of Directions, including all inclusive Directions under Section 35A of the Banking Regulation Act, 1949 (AACS) would be considered if there are exceptional circumstances viz., run on a bank, reports of severe liquidity crunch, complaints of non-payment or preferential payment of matured deposits, market information regarding dissension in management, etc.

UCBs have been further advised that the supervisory action framework does not preclude the Reserve Bank from taking any action as it deems necessary, including cancelling the licence of a bank, at any stage of the SAF.

Convergence of Indian Accounting Standards with IFRS

The Core Group constituted by the Ministry of Corporate Affairs, Government of India had approved in March 2010, a road map for convergence of Indian Accounting Standards (IAS) with International Financial Reporting Standards (IFRS). In the Annual Policy Statement 2010-2011 of the Reserve Bank issued on April 20, 2010, it was stated that UCBs having net worth in excess of Rs. 300 crore would, in the preparation of their accounts, converge with IFRS in tandem with the time schedule given for scheduled commercial banks and accordingly convert their opening balance sheet as on April 1, 2013 in compliance with IFRS converged IAS. UCBs having net worth in excess of Rs. 200 crore but not exceeding Rs. 300 crore would convert their opening balance sheet as on April 1, 2014 in compliance with IFRS converged IAS.

UCBs having net worth in excess of Rs. 200 crore have been advised to take necessary steps to ensure that they are in readiness to adopt the IFRS converged IAS from April 1, 2013 or April 1, 2014 as the case may be.

POLICY

Rates of Interest - RIDF and other Funds

Consequent upon the revision of Bank Rate from 6 per cent to 9.5 per cent from the close of business on February 13, 2012, the Reserve Bank has reviewed the interest rates applicable to rural infrastructure development fund (RIDF) and other similar funds with Small Industries Development Bank of India (SIDBI) and National Housing Bank (NHB) and it has been decided to -

(a) keep the interest rates payable to banks on deposits kept with NABARD/SIDBI/NHB due to shortfall in their prescribed priority sector obligations and on loans disbursed by NABARD from RIDF up to March 31, 2012 unchanged and linked to pre-revised Bank Rate as under:

Deposit Rates	
Shortfall in agriculture lending target for domestic commercial banks and higher of shortfall in overall priority sector lending target or aggregate shortfall in sub-targets of MSE and exports for foreign banks	**Existing Rate prior to revision of Bank Rate**
Less than 2 percentage points	Pre-revised Bank Rate (6.0 per cent)
2 and above, but less than 5 percentage points	Pre-revised Bank Rate minus 1 percentage point (5.0 per cent)
5 and above, but less than 9 percentage points	Pre-revised Bank Rate minus 2 percentage points (4.0 per cent)
9 percentage points and above	Pre-revised Bank Rate minus 3 percentage points (3.0 per cent)
Lending Rates	
Loans disbursed from RIDF up to March 31, 2012	Pre-revised Bank Rate plus 0.5 percentage points (6.5 per cent)

(b) revise the interest rates payable to banks on deposits placed with NABARD/SIDBI/NHB and loans disbursed by NABARD from RIDF on or after April 1, 2012, linked to the Bank Rate as under:

Deposit Rates	
Shortfall in agriculture lending target for domestic commercial banks and higher of shortfall in overall priority sector lending target or aggregate shortfall in sub-targets of MSE and exports for foreign banks	**Revised Rates**
Less than 2 percentage points	Bank Rate (9.5 per cent) minus 2 percentage points
2 and above, but less than 5 percentage points	Bank Rate (9.5 per cent) minus 3 percentage points
5 and above, but less than 9 percentage points	Bank Rate (9.5 per cent) minus 4 percentage points
9 percentage points and above	Bank Rate (9.5 per cent) minus 5 percentage points
Lending Rates	
Loans disbursed from RIDF on or after April 1, 2012	Bank Rate (9.5 per cent) minus 1.5 percentage points

CRR Reduced

The average cash reserve ratio (CRR) required to be maintained by every scheduled commercial bank has been reduced by 75 basis points from 5.50 per cent to 4.75 per cent of its net demand and time liabilities (NDTL) from the fortnight beginning March 10, 2012.

Financial Inclusion - Use of Business Correspondents

The Reserve Bank had, in September 2010, advised that while a business correspondent (BC) can be a BC for more than one bank, at the point of customer interface, a retail outlet or a sub-agent of a BC shall represent and provide banking services of only one bank. It was also stated that the terms and conditions governing the contract between the bank and the BC should be carefully defined in written agreements and subjected to thorough legal vetting. Banks would be fully responsible for the actions of the BCs and their retail outlets/ sub agents.

The Reserve Bank has now permitted interoperability at the retail outlets or sub-agents of BCs (i.e., at the point of customer interface), provided the technology available with the bank, which has appointed the BC, supports interoperability, subject to the following conditions:

(a) the transactions and authentications at such retail outlets or sub-agents of BCs are carried out on-line;

(b) the transactions are carried out on core banking solution (CBS) platform; and

(c) banks follow the standard operating procedures to be advised by the Indian Banks' Association (IBA).The BC or its retail outlet or sub-agent at the point of customer interface would, however, continue to represent the bank, which has appointed the BC.

NBFCs

Non- Reckoning FDs with Banks as Financial Assets

It has come to the notice of the Reserve Bank that some non-banking financial companies (NBFCs) obtain registration from the Reserve Bank, park their funds in fixed deposits with commercial banks but do not commence non-banking financial institution (NBFI) activities for several years thereafter. The auditors of such companies have also certified that the companies are conducting NBFI activities.

The Reserve Bank has clarified that a certificate of registration (CoR) is issued for the specific purpose of conducting NBFI activities. Investments in fixed deposits cannot be treated as financial assets and receipt of interest income on fixed deposits with banks cannot be treated as income from financial assets as these are not covered under the activities mentioned in the definition of "financial Institution" in Section 45I(c) of the RBI Act 1934. Besides, bank deposits constitute near money and can be used only for temporary parking of idle funds, and/or in the above cases, till commencement of NBFI business.

An NBFC which is in receipt of a CoR from the Reserve Bank must necessarily commence NBFC business within six months of obtaining the CoR. If the business of NBFC is not commenced by the company within the period of six months from the date of issue of CoR, the CoR stands withdrawn automatically. Further, there can be no change in ownership of the NBFC prior to commencement of business and regularisation of its CoR.

Lending Against Security of Gold Jewellery

The Reserve Bank has advised all NBFCs to -

(i) maintain a loan-to-value(LTV) ratio not exceeding 60 per cent for loans granted against the collateral of gold jewellery; and

(ii) disclose in their balance sheet the percentage of such loans to their total assets.

NBFCs primarily engaged in lending against gold jewellery (such loans comprising 50 per cent or more of their financial assets) have been advised to maintain a minimum Tier I capital of 12 per cent by April 1, 2014. NBFCs have also been advised not to grant any advance against bullion/primary gold and gold coins.

Provisioning Norms - Extension of Time

Taking into account the difficulties faced by micro finance institutions (MFI) sector and the representation received by the Reserve Bank from them, it has been decided to defer the implementation of asset classification and provisioning norms for non-banking financial company-micro finance institutions (NBFC-MFIs) to April 1, 2013. NBFC-MFIs are, however, required to comply with the other regulations laid down in the Reserve Bank's circular of December 2, 2011.

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It may be recalled that a new category of NBFCs namely, NBFC-MFIs was introduced in December 2011 and they were advised to adhere to the guidelines on asset classification and provisioning norms from April 1, 2012.

FEMA

Credit to NRE Accounts

AD Category-I banks have been advised to allow repayment of loans taken by individual residents in India from their close relatives outside India, by credit to the non-resident (external) rupee (NRE)/foreign currency non-resident (bank) [FCNR(B)] account of the lender concerned subject to the conditions that -

- the loan to the resident individual was extended by way of inward remittance in foreign exchange through normal banking channels or by debit to the NRE/ FCNR(B) account of the lender; and
- the lender is eligible to open NRE/FCNR(B) account within the meaning of the Foreign Exchange Management (Deposit) Regulations, 2000. Such credit would be treated as an eligible credit to the NRE/ FCNR(B) account.

FII/NRI Limits for Investments under PIS

Registered foreign institutional investors (FII) and non-resident Indians (NRIs) are allowed to purchase/sell shares and convertible debentures of an Indian company (through registered brokers) on recognised stock exchanges in India subject to, *inter-alia,* an aggregate investment limit of 24 per cent and 10 per cent, respectively, of the paid up equity capital or value of each series of convertible debentures of the Indian company.

The Reserve Bank has clarified that the Indian company raising the aggregate FII investment limit of 24 per cent to the sectoral cap/statutory limit, as applicable to the respective Indian company or raising the aggregate NRI investment limit of 10 per cent to 24 per cent, should immediately intimate the Reserve Bank of the same, along with a certificate from the company secretary stating that all the relevant provisions of the extant Foreign Exchange Management Act, 1999 regulations and the Foreign Direct Policy, as amended from time to time, have been complied with.

The Reserve Bank monitors the ceilings on FII/NRI/PIO investments in Indian companies on a daily basis. For effective monitoring of foreign investment ceiling limits, the Reserve Bank has fixed cut-off points that are two percentage points lower than the actual ceilings. Once the aggregate net purchases of equity shares of a company by FIIs/NRIs/PIOs reaches the cut-off point of 2 per cent below the overall limit, the Reserve Bank cautions all the designated bank branches not to purchase any more equity shares of the respective company on behalf of any FII/NRI/PIO without the Reserve Bank's prior approval. The link offices are then required to intimate the Reserve Bank about the total number and value of equity shares/convertible debentures of the company proposed to be bought on behalf of their FII/NRI/PIO clients. On receiving such proposals, the Reserve Bank gives clearances on a first-come-first served basis till such investments in companies reach the respective limits (such as, 10/24/30/40/49 per cent limit or the sectoral caps/statutory ceilings), as applicable. On reaching the aggregate ceiling limit, the Reserve Bank advises all designated bank branches to stop purchases on behalf of their FII/NRI/PIO clients. The Reserve Bank also informs the general public about the 'caution' and the 'stop purchase' in these companies through a press release and the updated list is placed on its website (www.rbi.org.in).

Liberalised Remittance Scheme for Resident Individuals

The Reserve Bank has clarified that –

- The Liberalised Remittance Scheme for Resident Individuals is available to all resident individuals including minors. In case the remitter is a minor, the LRS declaration form should be countersigned by the minor's natural guardian.
- Remittances under the facility can be consolidated in respect of family members subject to individual family members complying with the terms and conditions of the scheme.
- Remittances under the scheme can be used for purchasing objects of art subject to the provisions of other applicable laws, such as, the extant Foreign Trade Policy of the Government of India.

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