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POLICY

RBI grants "in-principle" approval for banking licences

The Reserve Bank of India has on April 2, 2014, granted "in-principle" approval to two applicants, namely, IDFC Limited and Bandhan Financial Services Private Limited, to set up banks under the Guidelines on Licensing of New Banks in the Private Sector. The Guidelines were issued on February 22, 2013. These two applicants were also recommended as suitable for grant of "in-principle" approval by the High Level Advisory Committee (HLAC) set up by the Reserve Bank. The HLAC had recommended that in the case of Department of Posts which has applied for licence, it would be desirable for the Reserve Bank to consider the application separately in consultation with the Government of India. The Reserve Bank has accepted the recommendation of the HLAC.

The "in-principle" approval granted will be valid for a period of 18 months during which the applicants have to comply with the requirements under the Guidelines and fulfil the other conditions as may be stipulated by the Reserve Bank. On being satisfied that the applicants have complied with the requisite conditions laid down by the Reserve Bank as part of "in-principle" approval, they would be considered for grant of a licence for commencement of banking business under Section 22(1) of the Banking Regulation Act, 1949. The applicants would be able to do banking business after a regular licence is issued to them.

The Reserve Bank's approach in this round of bank licences could well be categorised as conservative. At a time when there is public concern about governance, and when it comes to licences for entities that are intimately trusted by the Indian public, this may well be the most appropriate stance. Going forward, the Reserve Bank intends to use the learning from this licensing exercise to revise the Guidelines appropriately and move to give licences more regularly, that is, virtually "on tap". It will also frame categories of differentiated bank licences, building on its prior discussion paper, and this will allow a wider pool of entrants into banking. The Reserve Bank believes that some of those entities who did not qualify in this round for a full-fledged banking licence could well apply in future rounds or could apply for differentiated licences under the proposed framework.

Registration of NOFHCs

The Reserve Bank, on April 7, 2014, has decided to create a separate category of non-banking finance companies (NBFCs), namely, Non-Operative Financial Holding Company (NOFHC). While the NOFHC will be registered as a non-deposit taking non-banking financial company (NBFC) with the Department of Non-Banking Supervision (DNBS) of the Reserve Bank, the regulatory and supervisory framework of NOFHC including prudential norms and submission of returns will be governed by the instructions issued by Department of Banking Operations and Development (DBOD) from time to time.

The Reserve Bank in its 'Guidelines for Licensing of New Banks in the Private Sector' dated February 22, 2013 issued by DBOD, had stated that promoter/promoter groups would be permitted to set up a new bank only through a wholly-owned Non-Operative Financial Holding Company (NOFHC) which will hold the bank as well as all other financial services companies regulated by the Reserve Bank or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.

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Guidelines on Gold Metal Loans

The Reserve Bank has commuicated that stand-by letter of credit (LC)/bank guarantee (BG) issuing bank and the gold metal loan (GML) providing banks should keep certain additional guidelines in view to mitigate the risk of frauds/misuse of the scheme by the GML borrowers. These guidelines were issued on April 2, 2014 by the Department of Banking Operations and Development (DBOD) of the Reserve Bank after observing certain instances in which lack of proper monitoring mechanism and not ensuring end use of GML had resulted in frauds/ misuse related to GML by unscrupulous jewellers.

Implementation of Basel III Capital Regulations in India

The Reserve Bank, on March 27, 2014, extended the transitional period for full implementation of Basel III Capital Regulations in India upto March 31, 2019. Earlier deadline was March 31, 2018. This will also align full implementation of Basel III in India closer to the internationally agreed date of January 1, 2019. The decision was taken as there were industry-wide concerns about the potential stresses on the asset quality and consequential impact on the performance/profitability of the banks, which would have necessitated some lead time for banks to raise capital within the internationally agreed timeline for full implementation of the Basel III Capital Regulations.

The Reserve Bank also advised banks to keep in view the potential impact of the changing macro-economic conditions and the outcomes of periodic stress tests on the adequacy and composition of regulatory capital while undertaking their capital planning exercise. Boards of banks should, therefore, actively engage themselves in the capital planning process and oversee its implementation.

Policy for Banks' Properties at Overseas Centres

The Reserve Bank, on April 9, 2014, advised all Indian banks to ensure that they comply with all the applicable laws of the host country/city or locality while undertaking transactions in the nature of sale and purchase of property and acquiring/ letting out property on lease/rental basis at overseas centres. Banks should also ensure that all future transactions relating to purchase/sale of real estate as well as acquiring/letting out property on lease/rental basis at overseas centres are undertaken in accordance with the Board approved policy.

Differential Rate of Interest for MSEs

The Reserve Bank, on April 15, 2014, advised the banks to take into account the incentives available to Micro and Small Enterprises (MSE) borrowers in the form of the credit guarantee cover of the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) and the zero risk weight for capital adequacy purpose for the portion of the loan guaranteed by the CGTMSE and provide differential interest rate while pricing their loans for such MSE borrowers, than the other borrowers. However, banks should note that such differential rate of interest is not below the base rate of the bank.

Further, banks have been advised to review their loan policy governing extension of credit facilities to the MSE sector, with a view to using Board approved credit scoring models in their evaluation of the loan proposals of MSE borrowers.

Exposure Norms for Standalone PDs

With a view to promoting central clearing of standardised over the counter (OTC) derivative products through a central counter party (CCP), as an interim measure, a standalone primary dealer's (PD) clearing exposure to a qualifying CCP (QCCP) will be kept outside of the exposure ceiling of 25 per cent of its net owned funds applicable to a single borrower/counterparty. The Reserve Bank would consider revised framework on PDs' exposure to QCCP depending on international consensus in this regard. These guidelines, issued by the Reserve Bank on March 27, 2014, shall supersede all existing instructions issued to standalone PDs in this regard and shall be effective from April 1, 2014.

Guidelines on Capital Charge for Credit Risk revised

The Reserve Bank has issued revised guidelines on capital charge for credit risk of standalone primary dealers' exposure to interest rate derivative contracts, repo/reverse repo transactions and central counterparties. The revised guidelines have come into effect from April 1, 2014.

REPORT

Financial Benchmarks-Governance Framework

The Reserve Bank has accepted the recommendations of the Committee on Financial Benchmarks (Chairman: Shri P. Vijaya Bhaskar, Executive Director) on measures/principles to be adopted in respect of major Indian Rupee interest rate and Foreign exchange benchmarks to strengthen their quality, setting methodology and the governance framework. The Reserve Bank has set in motion the process to implement the recommendations of the Committee in consultation with the Fixed Income Money Market and Derivatives Association of India (FIMMDA) and Foreign Exchange Dealers' Association of India (FEDAI).

The Reserve Bank has since advised FIMMDA and FEDAI to act as the Administrator of the Indian Rupee interest rate and Foreign exchange benchmarks respectively and to take necessary steps to implement the recommendations of the Committee. In order to overcome the possible conflicts of interest in the benchmark setting process arising out of the current governance structure of the FIMMDA and FEDAI, an independent body, either separately or jointly, may be formed by the FIMMDA and FEDAI for administration of the benchmarks. In case of benchmarks determined based on polled submissions, the FIMMDA and FEDAI may select the Benchmark Submitters on the basis of their standing, market-share in the benchmark/instrument linked to the benchmark and representative character and may put in place a Code of Conduct specifying various provisions including hierarchy of data inputs for submissions as recommended by the Committee. The Benchmark Submitters thus selected by the respective Administrator, have to necessarily participate in the polling process and comply with the various provisions specified in the Code of Conduct. The Benchmark Submitters may extend necessary support and cooperation to the respective Benchmark Administrator in strengthening the benchmark determination process. In order to strengthen the governance framework for benchmark submission, the Benchmark Submitters are advised to implement certain measures.

First Bi-monthly Monetary Policy Statement 2014-15

Dr. Raghuram G. Rajan, Governor, announced the First Bi-monthly Monetary Policy Statement, 2014-15 on April 1, 2014. 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 liability (NDTL); and
- increase the liquidity provided under 7-day and 14-day term repos from 0.5 per cent of NDTL of the banking system to 0.75 per cent, and decrease the liquidity provided under overnight repos under the LAF from 0.5 per cent of bank-wise NDTL to 0.25 per cent with immediate effect.

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

The other highlights of the policy are:

Liquidity Management

In pursuance of the Dr. Urjit Patel Committee's recommendation to de-emphasise overnight "guaranteed-access" windows for liquidity management and progressively conduct liquidity management through term repos, the Reserve Bank has decided to further reduce access to overnight repos under the liquidity adjustment facility (LAF) while compensating fully with a commensurate expansion of the market's access to term repos from the Reserve Bank. The primary objective is to improve the transmission of policy impulses across the interest rate spectrum.

Developmental and Regulatory Policies

The Reserve Bank has further taken some new measures based on the five-pillar framework, set out to guide its developmental and regulatory policies. Some of these measures are:

Markets

- To expand investor demand for Inflation Indexed Bonds, design changes improving their attractiveness to the general public are being worked out.
- In order to expand the market for corporate bonds, banks will be allowed to offer partial credit enhancements to them.
- The feasibility of limited re-repo/re-hypothecation of "repoed" government securities is being explored.

As regards *Foreign Investors*, the Reserve Bank has decided to-(i) Work out modalities allowing Foreign Portfolio Investors (FPIs) to hedge their currency risks through exchange traded currency futures; (ii) Allow FPIs to hedge their coupon receipts falling due during next 12 months; (iii) Simplify Know your customer (KYC) norms for FPIs; and (iv) Permit FPI investments in G-Secs, only in dated securities of maturity one year and above, and allow existing investment in T-bills to taper off on maturity/sale.

On Inclusion and Customer Protection, the Reserve Bank has decided to consider enlarging the Banking Correspondent (BC) base through the inclusion of new entities, as well as a relaxation of existing distance restrictions

A number of *Measures to protect Consumers* are being envisaged. For example, banks should not levy penal charges for non-maintenance of minimum balance in ordinary savings bank account and inoperative accounts, but instead curtail the services accorded those accounts until the balance is restored.

To tackle *Distress in the System*, the comprehensive framework to help banks reduce their non-performing assets (NPAs) even while putting distressed projects back on track will be effective from April 1, 2014. The Reserve Bank will monitor progress and make any needed adjustments to ensure it operates smoothly.

FEMA

Foreign Portfolio Investment Scheme

The Reserve Bank, on March 25, 2014, has put in place a framework for investments under a new scheme called 'Foreign Portfolio Investment' scheme. The portfolio investor registered in accordance with SEBI guidelines shall be called 'Registered Foreign Portfolio Investor (RFPI)'. The existing portfolio investor class, namely, Foreign Institutional Investor (FII) and Qualified Foreign Investor (QFI) registered with SEBI shall be subsumed under RFPI.

Any foreign institutional investor who holds a valid certificate of registration from SEBI shall be deemed to be a registered foreign portfolio investor (RFPI) till the expiry of the block of three years for which fees have been paid as per the Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995. A QFI may continue to buy, sell or otherwise deal in securities subject to the SEBI (FPI) Regulations, 2014 for a period of one year from the date of commencement of these regulations, or until he obtains a certificate of registration as foreign portfolio investor, whichever is earlier. However, all investments made by that FII/QFI in accordance with the regulations prior to registration as RFPI shall continue to be valid and taken into account for computation of aggregate limit.

Harmonisation of KYC norms for FPIs

The Reserve Bank, on April 3, 2014, decided to simplify the know your customer (KYC) norms for opening bank accounts by Foreign Portfolio Investors (FPIs) apropos the first Bi-Monthly Monetary Policy Statement, 2014-15, announced on April 1, 2014.

The Reserve Bank has advised banks to rely on the KYC verification done by the third party (i.e., the Custodian/Securities and Exchange Board of India (SEBI) regulated intermediary) for FPIs who have been duly registered in accordance with SEBI guidelines and have undergone the required KYC due diligence/ verification prescribed by SEBI through a custodian/intermediary regulated by SEBI, for opening a bank account for the purpose of investment under Portfolio Investment Scheme (PIS).

SEBI has further been requested to advise custodians/ intermediaries regulated by them to share the relevant KYC documents with the banks concerned based on written authorisation from the FPIs. While opening bank accounts for FPIs in terms of the simplified procedure, banks may bear in mind that they are ultimately responsible for the customer's due diligence done by the third party (i.e., the custodian/regulated intermediary) and may need to take enhanced due diligence measures, as applicable, if required. Further, banks are required to obtain undertaking from FPIs or a global custodian acting on behalf of the FPI to the effect that as and when required, the exempted documents will be submitted.

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To facilitate secondary market transactions, the Reserve Bank has further advised the banks to share the KYC documents received from the FPI or certified copies received from a custodian/regulated intermediary with other banks/regulated market intermediaries based on written authorisation from the FPI.

Foreign Investment in India in G-secs

All eligible investors including Registered Foreign Portfolio Investors (RFPIs) will now be permitted to invest only in Government dated securities having residual maturity of one year and above, within the total foreign investment limit of US$ 30 billion. The existing foreign investments in treasury bills (T-bills) and Government dated securities (G-secs)of less than one year residual maturity will be allowed to taper off on maturity/sale. The rationale behind the Reserve Bank's decision is to encourage longer term flows.

Booking of Forward Contracts liberalised

Apropos the announcement of the first Bi-Monthly Monetary Policy Statement, 2014-15, all resident individuals, firms and companies, who have actual or anticipated foreign exchange exposures, are now allowed to book foreign exchange forward contracts up to US$ 250,000 on the basis of a simple declaration without any requirement of further documentation.

Hedging of Currency Risk

As per the existing guidelines relating to hedging of currency risk of probable exposures based on past performance by residents,

- Exporters are allowed to hedge currency risk on the basis of a declaration of an exposure up to an eligible limit computed as the average of the previous three financial years' (April to March) actual export turnover or the previous year's actual export turnover, whichever is higher.
- Importers are allowed to hedge up to an eligible limit computed as 25 percent of the average of the previous three financial years' actual import turnover or the previous year's actual import turnover, whichever is higher.

To provide greater operational flexibility, the Reserve Bank, on March 27, 2014, advised that in the event of cancellation of contracts booked upto 75 percent of the eligible limit as allowed to the exporters/importers for hedging, the exporter/importer shall have to bear the loss or gain as the case may be. While in the event of cancellation of contracts booked in excess of 75 percent of the eligible limit, the exporter/importer shall have to bear the loss but will not be entitled to receive the gain.

Compounding of Contraventions under FEMA

The Reserve Bank, on April 4, 2014, has decided to delegate powers to compound select contraventions to its Regional Offices. These contraventions can be compounded by all Regional Offices (except Kochi and Panaji) without any limit on the amount of contravention. Kochi and Panaji Regional offices can compound these contraventions for amount of contravention below Rupees one crore (Rs.1,00,00,000/-). The contraventions above Rupees one crore (Rs.1,00,00,000/-) under the jurisdiction of Panaji and Kochi Regional Offices and all other contraventions of FEMA will continue to be compounded at Cell for Effective Implementation of FEMA (CEFA), Mumbai, as earlier.

Reporting of OTC Interest Rate Derivatives

The reporting arrangement in which banks and primary dealers report the client level Rupee Interest Rate Swap (IRS)/ Forward Rate Agreement (FRA) transactions to the Financial Markets Department on a weekly basis in the specified format in physical form/through e-mail and on the Banks' Online Returns Filing System (ORFS), has been dispensed with from the week ending April 4, 2014. The Reserve Bank, on March 25, 2014, advised banks and primary dealers to continue reporting the transactions to the Clearing Corporation of India (CCIL)'s reporting platform.

Advance Remittance for Import of Rough Diamonds

With a view to liberalising the procedure for facilitating the import of rough diamonds, the Reserve Bank, on April 1, 2014, permitted Authorised Dealer (AD) category-I banks to take decision on overseas mining companies to whom an importer (other than a Public Sector Company (PSC) or a Department/ Undertaking of the Government of India/State Government) can make advance payments, without any limit/bank guarantee/ stand-by letter of Credit. However, while allowing the advance remittance without bank guarantee for import of rough diamonds, the AD Category–I banks must ensure to fulfil certain conditions.

ECB for Civil Aviation

The Reserve Bank, on March 26, 2014, advised all authorised dealers (ADs) that the scheme for raising external commercial borrowings (ECB) by airline companies for working capital as a permissible end-use, under the approval route, will continue till March 31, 2015 instead of December 31, 2013.

UCBs

Balance Sheet of Banks - Disclosure of Information

The Reserve Bank, on March 25, 2014, advised all urban co-operative banks (UCBs) including tier I UCBs, to disclose certain information as 'Notes on Accounts' to their Balance Sheet prepared in terms of Section 29 of the Banking Regulation Act,1949 (as applicable to Co-operative Societies) effective from the year ending March 31, 2014.

Guidelines on Sale of Financial Assets to SC/RC

The Reserve Bank, on March 28, 2014, permitted urban cooperative banks registered under the Multi-State Co-operative Societies Act, 2002 to invest in security receipts issued by Securitisation Company/Reconstruction Company (SC/RC) in respect of financial assets sold by them to the SC/RC. However, UCBs must ensure that there is no order issued by a Court of competent jurisdiction restricting them from entering into such transactions.

The Reserve Bank further advised UCBs to place before their respective bank's Board the set of guidelines to be followed by Multi-State Co-operative Banks on sale of Financial Assets to SC/RC, formulated by the Reserve Bank and take appropriate steps for their implementation.

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