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# Monetary and Credit Information Review

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## Financial Market Regulation

### Draft Directions on Hedging of Commodity Price Risk and Freight Risk in Overseas Markets

The Reserve Bank, on January 12, 2018, released draft directions on hedging of commodity price risk and freight risk in overseas markets. Comments on the draft directions were invited from banks, market participants and other interested parties by January 31, 2018.

Considering the large number and wide variety of comments received, it has now been decided to place the draft directions in the public domain for seeking comments. The draft directions propose to, inter alia:

(i) Delegate the decision regarding the quantity and tenor to be hedged to the client (subject to the satisfaction of the authorised dealer bank)

(ii) Introduce the facility for hedging of indirect price risk for selected metals.

*Background*

As per the Statement on Developmental and Regulatory Policies dated December 6 , 2017, the report of the Working Group on Hedging of Commodity Price Risk by Residents (Chairman: Shri Chandan Sinha) had been placed in the public domain for feedback and revised directions were to be issued by January 15, 2018. (https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=42848)

## Foreign Exchange Management

### Master Direction – Foreign Investment in India

The Reserve Bank on January 4, 2018, released the master direction on Foreign Investment in India, which lays down the modalities as to how the foreign exchange business has to be conducted by the authorised persons with their customers/constituents with a view to implementing the regulations framed. Instructions issued on Foreign Investment in India and its related aspects under the FEMA have been compiled in this Master Direction. (https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11200)

### Refinancing of External Commercial Borrowings

In order to provide a level playing field, the Reserve Bank in consultation with the Government of India, on January 4, 2018 permitted the overseas branches/subsidiaries of Indian banks to refinance External Commercial Borrowings (ECBs) of highly rated (AAA) corporates as well as Navratna and Maharatna Public Sector Undertakings (PSUs), provided the outstanding maturity of the original borrowing is not reduced and all-in-cost of fresh ECB is lower than the existing ECB. Partial refinance of existing ECBs will also be permitted subject to certain conditions. (https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11198&Mode=0)

### Annual Report of the BO Scheme 2006 released

The Reserve Bank of India on December 19, 2017, released the Annual Report of the Banking Ombudsman Scheme for the year 2016-2017.

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## Currency Management

### RBI reiterates Legal Tender Status of ₹10 Coins of Different Designs

The Reserve Bank on January 17, 2018, clarified that, the coins minted by mints, which are under the Government of India are put into circulation by the Reserve Bank. These coins have distinctive features to reflect various themes of economic, social and cultural values and are introduced from time to time.

As coins have longer life, coins of different designs and shapes circulate in the market at the same time. So far the Reserve Bank has issued ₹10 coins in 14 designs and the public has been informed of their distinctive features through press releases. All these coins are legal tender and can be accepted for transactions.

The Reserve Bank has in the past issued a press release (November 20, 2016) requesting members of the public to continue to accept coins of ₹10 denomination as legal tender in all their transactions without any hesitation.

The Reserve Bank has also advised banks to accept coins for transactions and exchange at all their branches.

*Background*

It has come to the notice of the Reserve Bank that in certain places there is reluctance on part of traders and members of public to accept ₹10 coins due to suspicion about their genuineness. (https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=42887)

### Highlights

- 1,30,987 complaints were received by 20 Offices of the Banking Ombudsman.
- Complaints increased by 27 per cent compared to the previous year.
- Offices of Banking Ombudsman maintained a disposal rate of 92 per cent.
- 31 Awards were issued by the Banking Ombudsman.
- 15 appeals were received by the Appellate Authority against the awards/ decisions of Banking Ombudsman.
- Complaints pertaining to failure to meet commitments, non-observance of fair practices code, Banking Codes and Standards Board of India (BCSBI) Codes taken together constituted the largest category of complaints with 34 per cent of complaints received.
- ATM/Debit card complaints comprised 12.5 per cent of complaints received.
- Credit card complaints comprised 6.4 per cent of complaints received.
- Complaints in the category of pension (6.5 per cent), levy of charges without prior notice (5.6 per cent), deposit accounts (5.5 per cent), loans and advances (4.2 per cent), remittances (2.5 per cent) were other areas of complaints.
- 185 complaints were received by the Offices of Banking Ombudsman through the Government of India (CPGRAMS) portal.
- 616 applications were received under the Right to Information Act.
- Average cost of handling one complaint was ₹3,780.
- Offices of Banking Ombudsman organised awareness campaigns/outreach activities, town hall events, advertisement campaigns to spread awareness about the Scheme primarily covering the rural and semi-urban areas of their respective jurisdictions.

*The Scheme*

The Banking Ombudsman Scheme, 1995 was notified by the Reserve Bank of India on June 14, 1995 under section 35A of the Banking Regulation Act, 1949. The aim and objective of the Scheme is to provide a quick and cost free resolution mechanism for complaints relating to deficiency of banking services of common bank customers, who otherwise find it difficult or cost prohibitive to approach any other redressal fora such as courts. The Scheme is applicable to scheduled commercial banks, scheduled primary urban co-operative banks and the regional rural banks. The Scheme has undergone several revisions since its inception. Presently, the Banking Ombudsman Scheme 2006, as amended up to July 1, 2017, is in operation. There are 20 Banking Ombudsman with specific State-wise jurisdiction covering all the states and union territories. (https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=42609)

## Payment and Settlement Systems

### Rationalisation of MDR for Debit Card Transactions

The Reserve Bank, on December 6, 2017, rationalised the Merchant Discount Rate (MDR) for debit cards based on the following criteria:

a. Categorisation of merchants on the basis of turnover;

b. Adoption of a differentiated MDR for QR-code based transactions; and

c. Specifying a ceiling on the maximum permissible MDR for both 'card present' and 'card not present' transactions.

The decision to rationalise MDR was taken based on consultations with stakeholders on the "Draft Circular - Rationalisation of Merchant Discount Rate (MDR) for Debit Card Transactions", as also taking into account the twin objectives of promoting debit card acceptance by a wider set of merchants, especially small merchants, and ensuring sustainability of the business for the entities involved.

Accordingly, the maximum MDR for debit card transactions is as under:

| Merchant Category | Merchant Discount Rate (MDR) for debit card transactions (as a % of transaction value) | |
|---|---|---|
| | Physical POS infrastructure including online card transactions | QR code-based card acceptance infrastructure |
| Small merchants (with turnover up to ₹20 lakh during the previous financial year) | Not exceeding 0.40 per cent (MDR cap of ₹200 per transaction) | Not exceeding 0.30 per cent (MDR cap of ₹200 per transaction) |
| Other merchants (with turnover above ₹20 lakh during the previous financial year) | Not exceeding 0.90 per cent (MDR cap of ₹1000 per transaction) | Not exceeding 0.80 per cent (MDR cap of ₹1000 per transaction) |

The Reserve Bank further reiterated that the banks and authorised card payment networks need to strictly adhere to the revised directions and ensure that the MDR levied on the merchant should not exceed the cap rates as prescribed above, irrespective of the entity which is deploying the card acceptance infrastructure at the merchant location.

Banks are also advised to ensure that merchants on-boarded by them do not pass on MDR charges to customers while accepting payments through debit cards. These instructions shall be effective from January 1, 2018. (https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11183&Mode=0)

## RBI releases December 2017 Financial Stability Report

The Reserve Bank of India on December 21, 2017 released the Financial Stability Report (FSR) December 2017, a biannual publication and the sixteenth in the series.

The FSR reflects the overall assessment on the stability of India's financial system and its resilience to risks emanating from global and domestic factors. The Report also discusses issues relating to development and regulation of the financial sector.

*Overall assessment of systemic risks*

India's financial system remains stable. Notwithstanding the efforts to normalise monetary policy by the Federal Reserve and the Bank of England, financial conditions in the advanced economies remain accommodative. Commodities space is firming up. Increased geopolitical risks imply likely volatility in commodity prices.

*Global and domestic macro-financial risks*

- The global economy has picked up steam and the growth momentum appears sustainable. In the emerging market context, exports are growing at their fastest clip in six years on the back of a pick-up in global growth.
- In terms of structural change, the information technology-led growth is possibly making the world a lot more unequal.
- Domestic growth rebounded in 2017-18:Q2 after initial hiccups associated with the roll-out of the nationwide goods and services tax (GST) coming on the back of demonetisation.
- The overall investment climate remains challenging though the situation has shown improvement since 2017-18:Q1. The positive signals of improvement - 'the decline in number and cost of stalled projects in 2017-18:Q2', 'the efforts to improve the quality of government expenditure', 'ease of doing business ranking', 'India's sovereign rating upgrade by Moody's' and the 'bank recapitalisation announcement' are expected to provide a significant fillip to investment sentiments in the coming quarters.
- The overhang of liquidity conditions in the wake of demonetisation has led to unprecedented fund flows to both equity and debt mutual funds. Foreign portfolio investment (FPI) flows into the capital market also remained buoyant with a greater preference for debt.

*Financial Institutions: Performance and Risks*

- The overall risks to the banking sector remained elevated due to asset quality concerns. Credit growth of scheduled commercial banks (SCBs) showed an improvement between March and September 2017, while public sector banks (PSBs) continued to lag behind their private sector peers.
- The gross non-performing advances (GNPA) ratio and the stressed advances ratio of the banking sector increased between March 2017 and September 2017.
- Stress test suggests that in the baseline scenario, GNPAs of the banking sector may rise from 10.2 per cent of gross advances in September 2017 to 10.8 per cent in March 2018 and further to 11.1 per cent by September 2018.
- SCBs' return on assets (RoA) remained unchanged at 0.4 per cent between March and September 2017 while PSBs have continued to record negative profitability ratios.
- Overall, capital to risk-weighted assets ratio (CRAR)

improved from 13.6 per cent to 13.9 per cent between March 2017 and September 2017.

- The share of large borrowers both in total SCBs' loans as well as GNPAs declined between March and September 2017.
- GNPAs of the NBFC sector as a percentage of total advances increased between March 2017 and September 2017.
- The network analysis indicates that the degree of interconnectedness in the banking system has decreased gradually since 2012. The joint solvency-liquidity contagion analysis shows that the losses due to default of a bank have declined.

From the perspective of larger financial system, SCBs continued to be the dominant players accounting for nearly 47 per cent of the bilateral exposure followed by asset management companies managing mutual funds (AMC-MFs), non-banking financial companies (NBFCs), insurance companies, housing finance companies (HFCs) and all-India financial institutions (AIFIs).(https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=42642)

## Report on Trend and Progress of Banking in India 2016-17

The Reserve Bank on December 21, 2017 released the statutory Report on Trend and Progress of Banking in India 2016-17. This Report presents the performance and salient policy measures relating to the banking sector during 2016-17. The Report also provides an analysis of the co-operative banks and non-banking financial institutions.

The Report flags the main challenges that will likely shape the outlook for the financial sector in India, which include:

i. Resolution of stressed assets under ongoing refinement of the Insolvency and Bankruptcy Code, 2016;

ii. Strengthening of bank balance sheets for reinvigorating credit growth;

iii. Developing robust accounting standards for banks with the aim of closing gaps in accounting practices;

iv. Promoting differentiated banking and exploring scope for its expansion to wholesale and long-term financing;

v. Promoting digitisation and managing technology-enabled financial services; and

vi. Managing cyber-security risks with the aim of strengthening resilience of the financial system.(https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=42643)

## Mint Street Memo

### Credit Disintermediation from Banks - Has the Corporate Bond Market Come of Age?

The Reserve Bank on January 3, 2018 released Mint Street Memo No.9 on the topic "Credit Disintermediation from Banks - Has the Corporate Bond Market Come of Age?" by R. Ayyappan Nair, M V Moghe and Yaswant Bitra.

The significant increase in inflows into mutual funds and their subsequent deployment is altering the scope of disintermediation in India. The authors looks at this evolving milieu and its implications for bank intermediation in general and credit portfolio of banks in particular. They found that there is, (i) a gradual shift in corporate borrowings from banks to mutual funds as reflected in the contraction in corporate spreads for near-investment grades; and (ii) a significant differential between the risk-free rate and the benchmark lending rate for banks, namely, Marginal Cost of funds based Lending Rate (MCLR), which has given rise to disintermediation of bank credit for quality corporates.

*Introduction*

Historically, the banking sector has played a preeminent role in facilitating flow of resources to the commercial sector in India. However, this is currently under challenge as credit disintermediation, bypassing banking channels, has attained a critical mass. In the year 2011, the share of bank loans in credit to the commercial sector was around 56 per cent and that of non-bank sources of credit (commercial paper, corporate bonds and external commercial borrowings), 44 per cent. By 2017, this has reversed—the banks' share had plummeted to around 38 per cent and that of non-bank sources rose to 62 per cent.

*Disintermediation: Mutual Funds*

The dramatic growth in resources flowing to mutual funds (MFs) suggests that there is a discernible shift in the pattern of deployment of financial savings in India. The flow of liquidity into debt-oriented mutual funds has given rise to a swelling of Money Market Mutual Fund (MMMF) corpus.

*Analysis*

The authors analysed the extent of disintermediation of highly rated corporates that can be accommodated within the corridor. The analysis is done by keeping the tenor of lending constant (1-year) and examining the threshold rating grades above which lending can be accommodated within the corridor; and keeping the rating grade constant and examining the tenor up to which the rating grade can be accommodated.

*Conclusion*

The rise of bank disintermediation in corporate credit does enable our financial system to become robust and more efficient in allocating risks. The unintended consequence of this process could potentially force banks, concerned with the shift in higher-rated borrowers to mutual funds, to either lower their credit standards or to engage in pricing that does not truly reflect their cost of funds. Undertaking necessary structural reforms to restore a healthy banking sector is of paramount importance. At the same time, structural reforms supporting the corporate bond market such as the Insolvency and Bankruptcy Code (IBC) are likely to give a further fillip to non-bank finance for Indian borrowers.(https://www.rbi.org.in/Scripts/MSM_Mintstreetmemos9.aspx)

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