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MONETARY AND CREDIT INFORMATION REVIEW

POLICY

Banks' Investments in Subsidiaries/Other Companies

The Reserve Bank has laid down prudential guidelines for banks' investments in companies which are not subsidiaries and are not 'financial services companies'. The guidelines which were announced on December 12, 2011 are-

(i) Equity investment by a bank in companies engaged in non financial services activities would be subject to a limit of 10 per cent of the investee company's paid up share capital or 10 per cent of the bank's paid up share capital and reserves, whichever is less. For the purpose of this limit, equity investments held under 'held for trading' category would also be reckoned. Investments within the above mentioned limits, irrespective of whether they are in the 'held for trading' category or otherwise, would not require the Reserve Bank's prior approval.

(ii) Equity investments in any non-financial services company held by (a) a bank; (b) entities which are bank's subsidiaries, associates or joint ventures or entities directly or indirectly controlled by the bank; and (c) mutual funds managed by asset management companies (AMCs) controlled by the bank should in the aggregate not exceed 20 per cent of the investee company's paid up share capital.

(iii) A bank's request for making investments in excess of 10 per cent of such investee company's paid up share capital, but not exceeding 30 per cent, would be considered by the Reserve Bank if the investee company is engaged in non-financial activities which are permitted to banks in terms of Section 6(1) of the B. R. Act. It is reiterated that banks are permitted to set up subsidiaries for undertaking activities which are conducive to the spread of banking in India or useful or necessary in public interest.

(iv) A bank's equity investments in subsidiaries and other entities that are engaged in financial services activities together with equity investments in entities engaged in non financial services activities should not exceed 20 per cent of the bank's paid-up share capital and reserves. The cap of 20 per cent would not apply for investments classified under 'held for trading' category and which are not held beyond 90 days.

(v) Equity holding by a bank in excess of 10 per cent of non financial services investee company's paid up capital, would be permissible without the Reserve Bank's prior approval (subject to the statutory limit of 30 per cent in terms of Section 19 (2) of the B.R. Act) if the additional acquisition is through restructuring/corporate debt restructuring (CDR), or acquired by the bank to protect its interest on loans/investments made in a company. The equity investment in excess of 10 per cent of investee company's paid up share capital in such cases would be exempted from the 20 per cent limit referred to above. Banks will, however, have to submit to the Reserve Bank a time bound action plan for disposal of such shares within a specified period.

Banks have been advised to strictly observe these guidelines while investing in companies undertaking non-financial services activities. Wherever their investments do not conform to the above indicated policy parameters, banks should ensure that (a) the investments are brought down to the prescribed limits and/or control or the exercise of significant influence is given up as the case may be or (b) seek the Reserve Bank's approval.

Interest Rates on NRE Deposits/NRO Accounts Deregulated

With a view to providing greater flexibility to banks in mobilising non-resident deposits and also in view of the prevailing market conditions, the interest rates on non-resident (external) rupee (NRE) deposits and ordinary non-resident (NRO) accounts have been deregulated from December 16, 2011. Accordingly, banks are now free to determine their interest rates on both savings deposits and term deposits of maturity of one year and above under NRE deposit accounts and savings deposits under NRO accounts. The interest rates

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offered by banks on NRE and NRO deposits, however, cannot be higher than those offered by them on comparable domestic rupee deposits.

Banks should obtain the prior approval of their Board/ asset liability management committee (if powers are delegated by the board) while fixing interest rates on such deposits. At any point of time, individual banks should offer uniform rates at all their branches.The revised deposit rates will apply only to fresh deposits and on renewal of maturing deposits.

Banks' Investments in Financial Entities

The Reserve Bank has advised that banks' investments in paid up equity of financial entities, even if they are exempted from 'capital market exposure' (CME) norms, would henceforth be assigned a risk weight of 125 per cent or risk weight warranted by external rating (or lack of it) of the counterparty, whichever is higher.

Accordingly, banks' capital market investments in banking book, including those exempted from CME norms, would attract risk weight of 125 per cent (i.e. 11.25 per cent of capital charge on gross equity position) or as per the risk weight warranted by external rating (or lack of it) of the counterparty, whichever is higher. If such investments are in trading book, they would, however, attract capital charge of 20.25 per cent or higher [i.e. capital charge towards specific risk at 11.25 per cent or as per the risk weight warranted by external rating (or lack of it) of the counterparty, whichever is higher and general market risk at 9 per cent of gross equity position].

These instructions are applicable from January 1, 2012.

Marginal Standing Facility - Scheme

Banks have been permitted to avail of funds from the Reserve Bank on overnight basis, under marginal standing facility (MSF), against their excess statutory liquidity ratio (SLR) holdings. Additionally, they can also avail of funds, on overnight basis below the stipulated SLR, up to one per cent of their respective net demand and time liabilities (NDTL) outstanding at the end of the second preceding fortnight. If banks' SLR holdings fall below the statutory requirement, they will not have the obligation to seek a specific waiver for default in SLR compliance arising out of use of this facility.

Dairy Credit to be treated as Indirect Agri Finance

As credit under the dairy segment (including procurement, storage, processing, collection, transportation, etc.) primarily benefits small/marginal farmers and tiny units, it has been decided that bank credit to all activities which contribute to the development of dairy business would be treated as indirect finance to agriculture under priority sector. Banks have, however, been advised to exercise due care to ensure that the ultimate beneficiaries are farmers engaged in dairy farming, who will benefit from such investment

Compensation to Relief/Savings Bonds Investors

The Reserve Bank has advised that as the interest rate on savings bank deposits has since been deregulated, banks should compensate the investors in Relief/Savings Bonds for the financial loss incurred at by them due to late receipt/delayed credit of interest warrants/maturity value of investments, etc., at their own savings bank deposit rate for respective amounts (i.e., up to ₹ 1 lakh and over ₹ 1 lakh) without any discrimination.

PAYMENT SYSTEM

NEFT - Penal Interest for Delayed Credit/Refunds

The Reserve Bank has reiterated that banks should strictly adhere to the extant instructions of paying penal interest at the stipulated rate to the customers suo-moto, without waiting for a claim from the customers (under the extant guidelines, banks are required to pay penal interest at the current RBI LAF Repo Rate plus two per cent for the period of delay/till the date of refund, as the case may be, to the affected customers. Banks have been advised to place before their Board, in its next meeting, data regarding the amount of penalty paid along with an explanatory note and the action proposed to be taken to minimise such incidents. A copy of the Board note along with the Board's resolution on this issue should be furnished to the Reserve Bank immediately after the meeting of the Board.

Further, under the NEFT Procedural Guidelines, banks are required to establish dedicated customer facilitation centres (CFCs) to handle customer queries/complaints regarding NEFT transactions. Banks are advised to keep the contact details of their CFCs available on their websites updated at all times and also advise changes, if any, immediately to the National Clearing Cell, Nariman Point, RBI for updating the central directory placed on the Reserve Bank's website. Banks should also ensure that calls made/e-mails sent to CFCs are promptly attended to and sufficient resources are dedicated for the same.

Mobile Banking Transactions in India

The Reserve Bank has advised that for mobile banking transactions, the cap of Rs. 50,000 per customer per day for both funds transfer and transactions involving purchase of goods/services has now been removed. Banks should, however, place per transaction limits based on their own risk perception with their Board's approval.

FEMA

Risk Management and Inter Bank Dealings

Keeping in view the developments in the foreign exchange market, the following measures have been implemented from December 15, 2011 until further review -

(i) The facility of cancelling and rebooking forward contracts, involving the Rupee as one of the currencies, booked by residents to hedge current account transactions, regardless of the tenor, and to hedge capital account transactions, falling due within one year, has now been withdrawn. Forward contracts booked by residents irrespective of the type and tenor of the underlying exposure, once cancelled, cannot be rebooked.

(ii) For importers, the past performance facility, stands reduced to 25 per cent of the average of the previous three financial years' (April to March) actual import/export turnover or the previous year's actual import/export turnover, whichever is higher. In case of importers who have already utilised in excess of the revised/reduced limit, no further bookings would be allowed under this facility. All forward contracts booked under this facility by both exporters and importers hence, forth would be on fully deliverable basis. In case of cancellations, exchange gain, if any, should not be passed on to the customer by ADs.

(iii) All cash/tom/spot transactions by ADs on behalf of clients would be undertaken for actual remittances/delivery only and cannot be cancelled/cash settled.

(iv) Forward contracts booked by foreign institutional investors (FIIs), once cancelled, cannot be rebooked. The forward contracts may, however, be rolled over on or before maturity.

(v) Net overnight open position limit (NOOPL) of ADs has been reduced across the board. Revised limits in respect of individual banks are being advised to the ADs separately. The Intra-day open position/daylight limit of ADs should not exceed the existing NOOPL approved by the Reserve Bank.

External Commercial Borrowings

MFIs allowed to raise ECBs

Considering the specific needs of the micro finance sector, the existing external commercial borrowings (ECB) policy has been reviewed in consultation with the Government of India and it has been decided to permit micro finance institutions (MFIs) to raise ECB up to USD 10 million or equivalent during a financial year for permitted end-uses, under the automatic route. The detailed guidelines are -

Eligible Borrower

The following MFIs engaged in micro finance activities would be considered as eligible borrowers to avail of ECBs:

- MFIs registered under the Societies Registration Act, 1860;
- MFIs registered under Indian Trust Act, 1882;
- MFIs registered either under the conventional state-level cooperative acts, the national level multi-state cooperative legislation or under the new state-level mutually aided cooperative acts (MACS Act) and not being a co-operative bank;
- Non-banking financial companies (NBFCs) categorised as 'non-banking financial company-micro finance institutions' (NBFC-MFIs) and complying with the norms prescribed in the Reserve Bank's circular dated December 2, 2011; and
- Companies registered under Section 25 of the Companies Act, 1956 and involved in micro finance activity.

Borrowing Relationship/Fit and Proper Status

MFIs registered as societies, trusts and co-operatives and engaged in micro finance -

- should have a satisfactory borrowing relationship for at least 3 years with a scheduled commercial bank authorised to deal in foreign exchange; and
- would require a certificate of due diligence on `fit and proper' status of the Board/Management Committee of the borrowing entity from the designated authorised dealer (AD) bank.

Recognised Lenders

ECB funds should be routed through normal banking channels. NBFC-MFIs can avail of ECBs from multilateral institutions, such as, IFC, ADB etc./regional financial institutions/ international banks/foreign equity holders and overseas organisations.

Companies registered under Section 25 of the Companies Act and engaged in micro finance can avail of ECBs from international banks, multilateral financial institutions, export credit agencies, foreign equity holders, overseas organisations and individuals.

Other MFIs can avail of ECBs from international banks, multilateral financial institutions, export credit agencies, overseas organisations and individuals.

Overseas organisations and individuals complying with following safeguards may lend ECB.

- Overseas organisations planning to extend ECB would have to furnish a certificate of due diligence from an overseas bank which in turn is subject to regulation of host-country regulator and adheres to Financial Action Task Force (FATF) guidelines to the designated AD. The certificate of due diligence should comprise that (i) the lender maintains an account with the bank for at least a period of two years; (ii) the lending entity is organised as per the local law and held in good esteem by the business/local community; and (iii) there is no criminal action pending against it.
- Individual lender has to obtain a certificate of due diligence from an overseas bank indicating that the lender maintains an account with the bank for at least a period of two years. Other evidence/documents, such as, audited statement of account and income tax return which the overseas lender may furnish, need to be certified and forwarded by the overseas bank. Individual lenders from countries wherein banks are not required to adhere to know your customer (KYC) guidelines are not permitted to extend ECB.

Permitted End-use

Designated ADs must ensure that the ECB proceeds are utilised for lending to self-help groups or for micro-credit or for bonafide micro finance activity including capacity building.

Amount of ECB

With a view to ensuring minimisation of systemic risk, the maximum amount of foreign currency borrowings of a borrower is capped at USD 10 million during a financial year.

It has also been decided that non-government organisations (NGOs) engaged in micro finance activities can avail of ECB up to USD 10 million or equivalent per financial year under the automatic route as against the earlier limit of USD 5 million or equivalent per financial year.

Other ECB Parameters

Average Maturity under the Automatic Route

The ECB limit for eligible borrowers under the automatic route was enhanced on September 23, 2011 to USD 750 million or equivalent per financial year per borrower for permissible end-uses under the automatic route. Consequent to the enhancement in limits, the revised average maturity guidelines under the automatic route are:

a) ECB up to USD 20 million or equivalent in a financial year with minimum average maturity of three years; and

b) ECB above USD 20 million and up to USD 750 million or equivalent with minimum average maturity of five years.

Accordingly, the requirement of average maturity period, prepayment and call/put options specified in the Reserve Bank's circular dated December 4, 2006 (for additional amount of USD 250 million) has been dispensed with.

It is also clarified that eligible borrowers under the automatic route can raise foreign currency convertible bonds (FCCBs) up to USD 750 million or equivalent per financial year for permissible end-uses. Similarly, corporates in specified service sectors, viz., hotel, hospital and software, can raise FCCBs up to USD 200 million or equivalent for permissible end-uses during a financial year subject to the condition that the proceeds of the ECB should not be used for acquisition of land.

INFORMATION

Compensation to Whole Time Directors/CEOs

The Reserve Bank had placed on its website in July 2010, for public comments, draft guidelines on compensation of whole time directors/chief executive officers/other risk takers and control function staff of private sector and local area banks and foreign banks operating in India. A large number of comments/suggestions were received on the draft guidelines and it was proposed in the Second Quarter Review of Monetary Policy for 2010-11 to issue final guidelines by end-December 2010. Meanwhile, in October 2010, the Basel Committee on Banking Supervision (BCBS) brought out a consultative paper titled Range of Methodologies for Risk and Performance Alignment of Remuneration, for public comments. The implementation of the Reserve Bank's guidelines on compensation policy was, therefore, deferred till 2012-13 and banks were advised through a press release on February 23, 2011 to refer to the BCBS consultative paper and begin preparatory work.

The BCBS has since published in May 2011 the final report on Range of Methodologies for Risk and Performance Alignment of Remuneration.

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In July 2011, the BCBS in consultation with the Financial Stability Board (FSB) has also published Pillar 3 disclosure requirements for remuneration.

Taking into account the stipulations in these documents and the comments received on the draft guidelines, the Reserve Bank has finalised the compensation guidelines for implementation by private sector and foreign banks from the financial year 2012-13. The guidelines were placed on the Reserve Bank's website on January 13, 2012. These guidelines supersede the Reserve Bank's earlier guidelines relating to compensation.

As hitherto, private sector and foreign banks operating in India would be required to obtain regulatory approval for grant of remuneration to whole time directors/chief executive officers. The approval process will involve, inter alia, an assessment whether the compensation policies and practices are in accordance with the FSB Principles.

Draft Guidelines on Basel III Capital Regulations

The Reserve Bank, on December 30, 2011 released on its website, draft guidelines outlining proposed implementation of Basel III capital regulation in India. These guidelines are in response to the comprehensive reform package entitled "Basel III: A global regulatory framework for more resilient banks and banking systems" of the Basel Committee on Banking Supervision (BCBS) issued in December 2010. The major highlights of the draft guidelines are:

Minimum Capital Requirements

- Common equity tier 1 (CET1) capital must be at least 5.5 per cent of risk-weighted assets (RWAs);
- Tier 1 capital must be at least 7 per cent of RWAs; and
- Total capital must be at least 9 per cent of RWAs.

Capital Conservation Buffer

Capital conservation buffer in the form of common equity of 2.5 per cent of RWAs.

Transitional Arrangements

- It is proposed that the implementation period of minimum capital requirements and deductions from common equity will begin from January 1, 2013 and be fully implemented as on March 31, 2017.
- Capital conservation buffer requirement is proposed to be implemented between March 31, 2014 and March 31, 2017.
- The above indicated implementation schedule will be finalised taking into account the feedback received on these guidelines.
- Instruments which no longer qualify as regulatory capital instruments will be phased out during the period from January 1, 2013 to March 31, 2022.

Enhancing Risk Coverage

For OTC derivatives, in addition to the capital charge for counterparty default risk under Current Exposure Method, banks will be required to compute an additional credit value adjustments (CVA) risk capital charge.

Leverage Ratio

The parallel run for the leverage ratio will be from January 1, 2013 to January 1, 2017, during which banks would be expected to strive to operate at a minimum Tier 1 leverage ratio of 5 per cent. The leverage ratio requirement will be finalised taking into account the final proposal of the Basel Committee.

Third Quarter Review of Monetary Policy 2011-12

Dr. D. Subbarao, Governor, Reserve Bank of India, in a meeting with chief executives of major commercial banks presented the Third Quarter Review of Monetary Policy for the Year 2011-12 on January 24, 2012. Highlights:

Projections

- Baseline projection of GDP growth for 2011-12 revised downwards from 7.6 per cent to 7.0 per cent.
- Baseline projection for WPI inflation for March 2012 retained at 7 per cent.
- M_3 growth projection for 2011-12 retained at 15.5 per cent.
- Non-food credit growth scaled down to 16.0 per cent.

Stance

- Maintain an interest rate environment to contain inflation and anchor inflation expectations.
- Manage liquidity to ensure that it remains in moderate deficit, consistent with effective monetary transmission.
- Respond to increasing downside risks to growth.

Monetary Measures

- Bank Rate retained at 6.0 per cent.
- Cash reserve ratio (CRR) of scheduled banks reduced by 50 basis points from 6.0 per cent to 5.5 per cent of their NDTL effective the fortnight beginning January 28, 2012.
- Repo rate under the liquidity adjustment facility (LAF) retained at 8.5 per cent.
- Reverse repo rate under the LAF, determined with a spread of 100 basis points below the repo rate, retained at 7.5 per cent.
- Marginal standing facility (MSF) rate, determined with a spread of 100 basis points above the repo rate, retained at 9.5 per cent.

Expected Outcomes

The policy actions and the guidance are expected to:

- Ease liquidity conditions.
- Mitigate downside risks to growth.
- Continue to anchor medium-term inflation expectations on the basis of a credible commitment to low and stable inflation.

Edited and published by **Alpana Killawala** for the **Reserve Bank of India,** Department of Communication, Central Office, Shahid Bhagat Singh Marg, Mumbai - 400 001 and printed by her at **Onlooker Press,** 16, Sassoon Dock, Colaba, Mumbai - 400 005.
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