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MONETARY AND CREDIT INFORMATION REVIEW

POLICY

Exchange-traded Interest Rate Futures

It has been decided to permit trading of interest rate futures on 91- Day treasury bills issued by Government of India.

Features of 91-Day T-Bill Futures

The 91-Day T-Bill futures shall have features as follows:

- The contract shall be on 91-day treasury bills issued by the Government of India.
- The contract shall be cash settled in Indian Rupees.
- The final settlement price of the contract shall be based on the weighted average price/yield obtained in the weekly auction of the 91-day treasury bills on the date of expiry of the contract.

Methodology for Computing the Weighted Average Discount Yield

It was decided by the RBI-SEBI Standing Technical Committee on Currency and Interest Rate Futures that the methodology of computation and dissemination of the weighted average discount yield would be publicly disclosed by the Reserve Bank.

Accordingly, for the purpose of final settlement of 91-day T-bill futures, SEBI recognised stock exchanges may use the weighted average price obtained from the weekly auction of 91-day treasury bills on the day of expiry of the contract (notified by the Reserve Bank in its press release announcing the auction results of the day) for arriving at the weighted average discount yield. The formula for arriving at the weighted average discount yield shall be:

$$WAY = \frac{100 - WAP}{100} X \frac{360}{90}$$

WAY = weighted average discount yield

WAP = weighted average price obtained from the weekly auction of 91-day treasury bills on the day of expiry of the contract (notified by the RBI in its press release announcing the auction results of the day).

Mid-Quarter Review of Monetary Policy 2010-11

The Reserve Bank released the Mid-Quarter Review of the Monetary Policy 2010-11 on March 17, 2011. In the Review, the Reserve Bank expressed concern on the emerging inflation scenario. The statement indicated that -

'After a slight moderation in January, headline WPI inflation reversed in February 2011 accompanied by a sharp increase in non-food manufactured products inflation.

As expected, the food article prices have declined substantially since January 2011. However, the prices of protein sources such as milk and 'eggs, meat and fish' continued to remain high reflecting structural demand-supply imbalances. A number of measures contained in the Budget for 2011-12 to improve the agricultural supply response in the medium-term will aid in redressing these imbalances. Fuel prices remain high, reflecting the global trend, with potential for further rise. Significantly, non-food manufactured products inflation, an indicator of demand side pressure, rose sharply from 4.8 per cent in January to 6.1 per cent in February and continues to stay well above its medium-term trend. The acceleration was spread across manufacturing activities, indicating that producers are able to pass on higher input prices to consumers.

In its Third Quarter Review, the Reserve Bank had projected year-on-year WPI inflation for March 2011 at 7 per cent. However, further upside risks have stemmed from high international crude prices, their impact on freely priced petroleum products, the increase in administered coal prices and pick-up in non-food manufactured product prices. The March 2011 WPI inflation is now estimated to be higher - around 8 per cent.'

In the light of this, the repo rate and the reverse repo rate under the liquidity adjustment facility (LAF) have been increased from March 17, 2011 as indicated below :

Repo Rate : by 25 basis points from 6.50 per cent to 6.75 per cent.

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Reverse Repo Rate : by 25 basis points from 5.50 per cent to 5.75 per cent.

Expected Outcomes

The policy action in this Review is expected to:

- continue to rein in demand-side inflationary pressures while minimising risks to growth; and
- manage inflationary expectations and contain the spillover of food and commodity prices into more generalised inflation.

Standing Liquidity Facilities for Banks/PDs

The standing liquidity facilities provided to banks (export credit refinance) and primary dealers (PDs) (collateralised liquidity support) from the Reserve Bank would be available at the revised repo rate, i.e., at 6.75 per cent from March 17, 2011.

Implementation of Compensation Guidelines deferred

The Reserve Bank has deferred the implementation of the guidelines on compensation for whole time directors/chief executive officers/risk takers and control function staff of private sector banks and foreign banks operating in India to 2012-13. This was done to give banks sufficient time to formulate their policies. The guidelines were slated for implementation for 2011-2012. The Reserve Bank has advised banks to refer, in the meantime, to the Basel Committee on Banking Supervision (BCBS) consultative document on Methodologies for Risk and Performance Alignment of Remuneration and start preparatory work. The document was issued in October 2010. The Reserve Bank has also stated that it would issue the final guidelines on compensation after the publication of the final paper by the BCBS.

It may be recalled that the Reserve Bank had, in July 2010, placed on its website draft guidelines on compensation for whole time directors/chief executive officers/risk takers and control function staff of private sector banks and foreign banks operating in India. A large number of comments/suggestions have been received on the draft guidelines. These are being examined. Meanwhile, the BCBS, in October 2010, brought out a consultative paper titled 'Range of Methodologies for Risk and Performance Alignment of Remuneration' for public comments.

BRANCH BANKING

Banks advised to exchange Coins of 25 paise and below

The Reserve Bank has instructed banks maintaining small coin depots to arrange for exchange of coins of denomination of 25 paise and below for their face value at their branches. Members of public can exchange small denomination coins at any branch of these banks. Exchange facility is also available at all Issue Offices of the Reserve Bank. The coins will be exchanged at the branches of these banks/offices of the Reserve Bank till the close of business on June 30, 2011.

Advances to MSE Sector

As per the Reserve Bank's extant guidelines to banks, 60 per cent of medium and small enterprise (MSE) advances should be directed towards micro enterprises. Banks have been advised that the allocation of 60 per cent of MSE advances to micro enterprises is to be achieved in stages viz., 50 per cent in the year 2010-11, 55 per cent in the year 2011-12 and 60 per cent in 2012-13.

Coins of denomination of 25 paise and below will not be accepted for exchange at the bank branches from July 1, 2011 onwards.

It may be recalled that in exercise of powers conferred by Section15A of the Coinage Act, 1906 (3 of 1906), the Government of India has decided to withdraw coins of denomination of 25 paise and below from circulation from June 30, 2011. From this date, these coins shall cease to be legal tender for payment as well as on account.

INFORMATION

WG on Operating Procedure of Monetary Policy - Report

The Reserve Bank has, on March 15, 2011, placed on its website www.rbi.org.in the Report of the Working Group on Operating Procedure of Monetary Policy (Chairman: Shri Deepak Mohanty). The key recommendations of the Working Group are:

- The liquidity adjustment facility (LAF) with some modifications should be the key element in the operating framework of the Reserve Bank.
- The modified LAF should operate in a deficit liquidity mode and the liquidity level should be contained around (+)/(-) one per cent of net demand and time liabilities (NDTL) of banks for optimal monetary transmission.
- The repo rate should be the single policy rate to unambiguously signal the stance of monetary policy to achieve macroeconomic objectives of growth with price stability. It will operate within a corridor set by the Bank Rate and the reverse repo rate. As the repo rate changes, the Bank Rate and the reverse repo rate should change automatically.
- The Reserve Bank at its discretion could conduct simultaneous auctions for longer period if the liquidity situation so warrants. Such auctions should, however, be at variable prices as they will be purely for liquidity management rather than for signalling the policy rate.
- The Bank Rate should be reactivated as a discount rate as envisaged in the Reserve Bank of India Act, 1934. It will be the rate at which the Reserve Bank will provide liquidity under a new collateralised Exceptional Standing Facility (ESF) up to one per cent of NDTL of banks to be carved out of the required statutory liquidity ratio (SLR) portfolio. The Bank Rate will constitute the upper bound of the corridor.
- The reverse repo rate will have a negative spread on the repo rate and it will be the rate at which the Reserve Bank will absorb liquidity under the LAF. The reverse repo rate will constitute the lower bound of the corridor.
- The optimal width of the policy corridor should be fixed at 150 basis points and should not be changed in the normal circumstance. The corridor should be asymmetric with the spread between the policy repo rate and reverse repo rate be twice as much as the spread between the repo rate and the Bank Rate. With a corridor of 150 basis points, the Bank Rate should be fixed at repo rate plus 50 basis points and the reverse repo rate at repo rate minus 100 basis points.
- The weighted average overnight call money rate should be the operating target of the Reserve Bank. The operating objective should be to contain this rate around the repo rate within the corridor.

- The Reserve Bank should conduct second LAF (SLAF) on a regular basis.
- Persistent liquidity in excess of (+) / (-) one per cent of the NDTL should be managed through other instruments.
- Banks should be incentivised to progressively mark-to-market their SLR portfolio to improve the effectiveness of open market operations (OMO) as an instrument of liquidity management. The Working Group recognises that in due course, the accounting standard would get aligned with the international financial reporting standards (IFRS).
- To improve liquidity management, a scheme of auctioning of government surplus cash balance at the discretion of the Reserve Bank be put in place in consultation with the government.
- Collateral pool for reverse repo operation under the LAF could be extended to include oil bonds.
- The methodology for the Reserve Bank's internal liquidity forecast should be strengthened. Information on government cash balances should be put in public domain with minimum time lag for better liquidity assessment by market participants.
- The minimum level of reserves to be maintained on any day by banks with the Reserve Bank during a fortnight should be raised from the present level of 70 per cent to 80 per cent of the required cash reserve ratio (CRR).
- The T+0 transactions for short-term money market segments (collateralised borrowing and lending obligations (CBLO) and market repo) should be extended up to the cut-off timing (i.e., 4.30 pm) for customers in real time gross settlement (RTGS) so that the banking system could square off their CRR position efficiently.

Background

The Working Group on Operating Procedure of Monetary Policy was constituted on October 1, 2010 in pursuance of the First Quarter Review of Monetary Policy for 2010-11 announced on July 27, 2010. Members of the Working Group were drawn from financial markets, academia and the Reserve Bank. The Working Group was assigned the following terms of reference:

(i) to survey the operating procedures of major central banks;

(ii) to review the current operating procedure of monetary policy in India, in particular, the LAF;

(iii) to examine the operation of the LAF with regard to:

  (a) the width of the corridor

  (b) the frequency and timing of auctions

  (c) the maturity period of repo and reverse repo operations;

(iv) to assess the role of the Bank Rate;

(v) to examine the role of standing facilities, such as, the export credit refinance; and

(vi) to suggest changes to the current operating procedure of monetary policy in India in the light of international practices and domestic experience, with particular reference to:

  (a) whether there should be a corridor at all

  (b) if so, whether its width should be fixed or variable under specified conditions

  (c) if so, what instruments/mechanisms may be necessary to enable the corridor to function efficiently.

Working Group set up to examine NBFC Sector Issues

The Reserve Bank has constituted a Working Group under the Chairmanship of Smt. Usha Thorat, Director, Centre for Advanced Financial Research and Learning (CAFRAL) to examine a range of emerging issues pertaining to regulation of the NBFC (non-banking financial companies) sector.

The NBFC sector in India has undergone a significant transformation in the past few years and has come to be recognised as a systemically important element of the financial system. The recent global financial crisis has also highlighted the regulatory imperatives concerning the non-banking financial sector and the risks arising from regulatory gaps, arbitrage and systemic inter-connectedness. A need was, therefore, felt to reflect on the broad principles that underpin the regulatory architecture for NBFCs keeping in view the economic role and heterogeneity of this sector and the recent international experience.

Other members of the Group are Shri Sanjay Labroo, Director, Central Board, Reserve Bank of India, Shri Rajiv Lall, Managing Director and Chief Executive Officer, Infrastructure Development Finance Corporation, Shri Bharat Doshi, Executive Director and Group Chief Financial Officer, Mahindra & Mahindra and Shri Pratip Kar, Director, Globsyn Business School, Kolkata. Ms. Uma Subramaniam, Chief General Manager-in-Charge, Department of Non-Banking Supervision will be the Member-Secretary.

While examining a range of emerging issues pertaining to the regulation of the sector, the Working Group will focus on the definition and classification of NBFCs, addressing regulatory gaps and regulatory arbitrage, maintaining standards of governance in the sector and appropriate approach to NBFC supervision. The scope of examination will, however, be within the current legislative framework.

Unclaimed Deposits/Inoperative Accounts

In view of the increase in the amount of unclaimed deposits with banks year after year and the inherent risk associated with such deposits, the Reserve Bank has advised banks to play a more pro-active role in finding the whereabouts of the account holders whose accounts have become inoperative. Reviewing the instructions in this regard, the Reserve Bank has advised banks to follow the instructions detailed below while dealing with inoperative accounts:

- Banks should make an annual review of accounts in which there are no operations (i.e., no credit or debit other than crediting of periodic interest or debiting of service charges) for more than one year. Banks may approach the customers and inform them in writing that there has been no operation in their account and ascertain the reasons for the same. In case non-operation in the account is due to the customer shifting from the locality, he/she may be asked to provide the details of the new bank account to which the balance in the existing account could be transferred.
- If letters sent to the customers' address are returned undelivered, enquiries may be made to find out the whereabouts of the customers or their legal heirs in case they are deceased.

Unclaimed Deposits

Unclaimed deposits lying in non-operational accounts of scheduled commercial banks as on December 31, 2010 are:

No. of Accounts	Amount of Unclaimed Deposits
1,03,45,857	₹ 1,723.24 crore

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- In case the whereabouts of the customers are not traceable, banks should consider contacting the persons who had introduced the account holder. They could also consider contacting the employer/or any other person whose details are available with them. They could also consider contacting the account holder telephonically in case his telephone number/cell number has been furnished to the bank. In case of non-resident accounts, banks may also contact the account holders through e-mail and obtain confirmation of their account details.
- Savings as well as current account should be treated as inoperative/dormant if there are no transactions in the account for over two years.
- In case the account holder gives reasons for not operating the account, banks should continue classifying the account as an operative account for one more year within which period the account holder may be requested to operate the account during the extended period. If, however, the account holder still does not operate the account during the extended period, banks should classify the account as inoperative after the expiry of the extended period.
- For the purpose of classifying an account as 'inoperative', both the type of transactions i.e., debit as well as credit transactions induced at the instance of customers as well as third party should be considered. The service charges levied/interest credited by the bank should, however, not be considered.
- There may be instances where the customer has given a mandate for crediting the interest on fixed deposit account to the savings bank account and there are no other operations in the savings bank account. This should be treated as a customer induced transaction. As long as the interest on the fixed deposit account is credited to the savings bank account, the account should be treated as operative account. The savings bank account can be treated as inoperative only after two years from the date of the last credit entry of interest on the fixed deposit account.

The amount of unclaimed deposits lies with the respective banks and is utilised by them for their general business like any other deposits. The government has conceived a proposal, in consultation with the Reserve Bank, involving an amendment of the Banking Regulation Act, 1949, thereby providing that the deposit accounts which have not been operated upon for a period of ten years or any amount remaining unclaimed with any bank for more than ten years will be credited, within three months from the expiry of the period of ten years, to a fund called "Depositor Education and Awareness Fund" to be utilised for promotion of depositors' interest and for such other purposes as may be specified by the Reserve Bank from time to time.

Source: Parliament Questions

Mobile Banking Service

Recognising the importance of mobile phones as a medium for providing banking services, the Reserve Bank issued operating guidelines to banks for mobile banking transactions on October 8, 2008, which were reviewed and further relaxed on December 24, 2009. The Reserve Bank has authorised 46 banks to offer mobile banking services to their customers and 33 banks have commenced mobile banking.

Further, in September 2010, the Reserve Bank has extended the list of entities permitted to function as business correspondents (BCs) for banks, permitting banks to engage companies registered under the Indian Companies Act, 1956 with large and wide-spread retail outlets (excluding NBFCs) as BCs. This recent relaxation enables mobile operators to also become BCs of banks. The Indian Banks' Association (IBA) has informed that the Indian mobile service provider Vodafone Essar will become a BC for ICICI Bank Limited, while Bharti Airtel has announced a joint venture with the State Bank of India. Union Bank of India has partnered with Nokia and Obopay to launch a mobile payment service called 'Union Bank Money' available to consumers across India.

The services which are being offered by banks under their mobile banking services are : (i) alert services; (i) service requests (cheque book, statement request); (iii) account enquiry; (iv) intra-bank funds transfer; (v) inter-bank funds transfer - inter-bank mobile payment service by the National Payments Corporation of India (NPCI); and (vi) value added services, such as, bill pay, ticketing, etc.

The Reserve Bank has also permitted scheduled commercial banks to operationalise mobile branches in Tier 3 to Tier 6 centres and in rural, semi urban and urban centres in the North Eastern States and Sikkim, subject to reporting. The mobile branch guidelines envisage the extension of banking facilities through a well protected van. The mobile unit would visit the places proposed to be served by it on specific days/ hours so that its services could be utilised by the customers. Some banks like Allahabad Bank, UCO Bank, Corporation Bank, have launched the mobile van bank services.

Source: Parliament Questions

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