



Volume VII ♦ Issue 4
October 2010

MONETARY AND CREDIT
INFORMATION REVIEW

POLICY

Guidelines for Engaging Business Correspondents

A discussion paper on engagement of 'for profit' companies as business correspondents (BCs) was placed on the Reserve Bank's website on August 2, 2010 to seek the views/comments of banks, non-banking financial institutions, 'for-profit' companies, regulators, academicians, non-government organisations (NGOs) and the public at large. Taking into consideration, all factors and including the feedback received, scheduled commercial banks, including regional rural banks (RRBs) and local area banks (LABs) have now been permitted to engage companies registered under the Indian Companies Act, 1956, excluding non-banking financial companies (NBFCs), as BCs in addition to the individuals/entities permitted earlier, subject to compliance with the guidelines.

Banks may formulate a policy with their Board of Directors' approval for engaging BCs. Due diligence should be carried out on the individuals/entities to be engaged as BCs prior to their engagement. The due diligence exercise should, *inter alia*, cover aspects such as (i) reputation/market standing; (ii) financial soundness; (iii) management and corporate governance; (iv) cash handling ability; and (v) ability to implement technology solutions in rendering financial services.

The revised guidelines in this regard are -

Eligibility

Individuals/entities who may be engaged as BCs are -

- Retired bank employees/teachers/government employees and ex-servicemen, individual owners of kirana/medical/fair price shops, individual public call office (PCO) operators, agents of small savings schemes of Government of India/insurance companies, individuals who own petrol pumps, authorised functionaries of well run self help groups (SHGs) which are linked to banks, any other individual including those operating common service centres (CSCs);
- NGOs/micro finance institutions (MFIs) set up under Societies/Trust Acts and Section 25 companies;
- Cooperative societies registered under Mutually Aided Cooperative Societies Acts/Cooperative Societies Acts of States/Multi State Cooperative Societies Act;

- Post offices; and
- Companies registered under the Indian Companies Act, 1956 with large and widespread retail outlets, excluding NBFCs.

BC Model

While a BC could 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. 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. While drawing up agreements, banks should strictly adhere to the instructions contained in the guidelines on managing risks and code of conduct in outsourcing of financial services by banks, issued by the Reserve Bank on November 3, 2006. Banks will be fully responsible for the actions of the BCs and their retail outlets/sub agents.

Activities

The scope of activities of BCs may include (i) identification of borrowers; (ii) collection and preliminary processing of loan applications including verification of primary information/data; (iii) creating awareness about savings and other products and education and advice on managing money and debt counselling; (iv) processing and submission of applications to banks; (v) promoting, nurturing

CONTENTS

PAGE

POLICY

Guidelines for Engaging Business Correspondents	1
Prudential Guidelines on Restructuring of Advances	3
Collection of Third Party Account Payee Cheques	3
Issue of Irrevocable Payment Commitments	3
Investment in Zero Coupon Bonds	4

PAYMENT SYSTEM

Inward Transactions to be Processed Solely on A/c Number	4
--	---

CO-OPERATIVE BANKING

Participation in Exchange Traded Currency Option Market	4
---	---

and monitoring SHGs/joint liability groups/credit groups/others; (vi) post-sanction monitoring; (vii) follow-up for recovery, (viii) disbursement of small value credit, (ix) recovery of principal/collection of interest; (x) collection of small value deposits; (xi) sale of micro insurance/mutual fund products/pension products/other third party products; and (xii) receipt and delivery of small value remittances/other payment instruments.

The activities to be undertaken by the BCs would be within the normal course of the bank's banking business, but conducted through the BCs at places other than the bank premises/ATMs.

KYC

Know your customer (KYC) and anti-money laundering (AML) procedures, as laid down in the Reserve Bank's Master Circular dated July 1, 2010 and subsequent circulars on the subject must be adhered to. The banks may, if necessary, use the services of the BC for preliminary work relating to account opening formalities. Ensuring compliance with KYC and AML norms under the BC model would, however, be the responsibility of banks.

Confidentiality

Banks should ensure that the confidentiality of customer information in the custody/possession of the BC is protected and preserved.

IT Standards

Banks should ensure that the equipment and technology used by the BC are of high standards.

Distance Criterion

With a view to ensuring adequate supervision over the operations and activities of the retail outlet/sub-agent of BCs by banks, every retail outlet/sub-agent of BC is required to be attached to and be under the oversight of a specific bank branch designated as the base branch. The distance between the place of business of a retail outlet/sub-agent of BC and the base branch should ordinarily not exceed 30 kms in rural, semi-urban and urban areas and 5 kms in metropolitan centres. The district consultative committee (DCC)/state level bankers committee (SLBC) could consider and approve relaxation in distance criterion on merits in respect of under-banked areas etc.

Commission/Fee

Banks may pay reasonable commission/fee to the BC, the rate and quantum of which may be reviewed periodically. The agreement with the BCs should specifically prohibit them from charging any fee from the customers for services rendered by them on behalf of the bank. Commission structure or incentive mechanism should be devised in such a manner that a mere increase in the number of clients or the transaction volumes do not drive the commission. The remuneration should combine fixed and variable parts dependent, *inter-alia*, on some indication or measure of customer satisfaction. Some part of the variable remuneration could be deferred or clawed back in case of deficiency of service.

Banks (and not BCs) are permitted to collect reasonable service charges from the customers in a transparent manner.

Transactions put through BC

Banks should adopt technology-based solutions for managing the risk, besides increasing the outreach in a cost effective manner. Transactions should normally be put through ICT devices (handheld device/mobile phone) that are seamlessly integrated into the core banking solution (CBS) of the bank. The transactions should be accounted for on a real time basis and the customers should receive immediate verification of their transactions through visuals (screen based) or other means (debit or credit slip).

The arrangements with the BC shall specify:

- (i) suitable limits on cash holding by intermediaries as also limits on individual customer payments and receipts;
- (ii) cash collected from the customer should be acknowledged by issuing a receipt on behalf of the bank;
- (iii) that all off-line transactions are accounted for and reflected in the books of the bank by the end of the day; and
- (iv) all agreements/contracts with the customer shall clearly specify that the bank is responsible to the customer for acts of omission and commission of the BC.

Internal Control/Monitoring

Banks should carry out a detailed review of the performance of various BCs engaged by them at least once in a year and should monitor the activities of BCs through their controlling offices and also through various fora under the lead bank scheme. The internal control mechanism in the bank should include visits to BCs and interface with customers at periodical intervals.

Consumer Protection

Banks should take all measures to protect the interests of the customers. Some safeguards include :

- The retail outlet/sub-agent of the BC should be personally introduced to the members of public by the bank officials in the presence of village elders and government functionaries in a public meeting to avoid misrepresentation/impersonation.
- The products and processes should be approved by the banks and the company should not introduce any product/process without the approval of the bank concerned.
- Each retail outlet/sub-agent may be required to post a signage indicating their status as service provider for the bank as also disclose the name of the BC, the telephone number of the base branch/controlling office of the bank and the Banking Ombudsman and the fees for all services available at the outlet.
- Financial services offered by the retail outlets/sub-agents of the BC should not be tied to the sale of any product of such company.
- The charges for offering various services should be indicated in a brochure and made available at the retail outlets/with the sub-agents.
- Banks should develop suitable training modules in the local language(s) in order to provide proper attitudinal orientation and skills to the BCs/sub-agents.

- As a measure of social audit, there could be periodic block level meetings where members of public are invited along with the BCs operating in the area as also the linked branch managers to express their difficulties and to obtain feedback. The lead district manager of the lead bank could attend such meetings in the district to get a direct feedback and provide such feedback to the controlling offices.
- Banks should have necessary business continuity plan (BCP) in place to ensure uninterrupted service in case the agency arrangement with the company/sub-agent is terminated.
- In case a company is engaged as BC by more than one bank, it should be ensured that the customer database and account details are kept separate and there is no co-mingling of data.

Grievance Redressal

Banks should constitute a grievance redressal machinery for redressing complaints about services rendered by the BCs and give wide publicity about its existence through electronic and print media. The name and contact number of the designated grievance redressal officer of the bank should be widely publicised. The designated officer should ensure that genuine grievances of customers are redressed promptly. The grievance redressal procedure of the bank and the time frame fixed for responding to complaints should be placed on the bank's website. If a complainant does not get satisfactory response from the bank within 60 days from the date of his lodging the complaint, he will have the option to approach the office of the Banking Ombudsman concerned for redressal of his grievance/s.

Prudential Guidelines on Restructuring of Advances

The Reserve Bank has advised banks and select all-india financial institutions (AIFIs) that -

- (i) The promoter's sacrifice and additional funds required to be brought in by the promoters should be brought in upfront. If, however, banks are convinced that the promoters face genuine difficulty in bringing their share of the sacrifice immediately and need some extension of time to fulfil their commitments, the promoters could be allowed to bring in 50 per cent of their sacrifice, i.e. 50 per cent of 15 per cent, upfront and the balance within a period of one year.
- (ii) In case the promoters fail to bring in their balance share of sacrifice within the extended time limit of one year, the asset classification benefits derived by banks will cease to accrue and banks will have to revert to classifying such accounts as per the asset classification norms specified in the Reserve Bank's Master Circular on 'Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances' of July 1, 2010.

The contribution by the promoter need not necessarily be brought in cash and can be brought in the form of de-rating of equity, conversion of unsecured loan brought by the promoter into equity and interest free loans.

Collection of Third Party Account Payee Cheques

With a view to mitigate the difficulties faced by the members of co-operative credit societies in collection of account payee cheques, the Reserve Bank has clarified that collecting

banks may collect account payee cheques drawn for an amount not exceeding Rs.50,000 to the account of their customers who are co-operative credit societies, if the payees of such cheques are the constituents of such co-operative credit societies. While collecting such cheques, banks should have a clear representation in writing from the co-operative credit societies concerned that, upon realisation, the proceeds of the cheques will be credited only to the account of the member of the co-operative credit society who is the payee named in the cheque. This shall, however, be subject to the fulfillment of the requirements of the provisions of the Negotiable Instruments Act, 1881, including Section 131 thereof.

The collecting bank should carry out proper due diligence of such co-operative credit societies and ensure that the KYC documents of the customers are preserved in the society's records and are available to the bank for scrutiny.

In the event of a claim by the true owner of the cheque, banks will have to establish that they acted in good faith and without negligence while collecting the cheque in question.

Issue of Irrevocable Payment Commitments

With a view to put in place an adequate risk mitigation mechanism to protect banks from the adverse movements in the equity prices and the possibility of default by domestic/foreign funds (MFs)/(FIIs), while at the same time ensuring that there is no undue disruption in the functioning of the capital market in the country, the Reserve Bank has advised that -

- From November 1, 2010 -
 - (a) only those custodian banks who have a clause in the agreement with their clients that gives them an inalienable right over the securities to be received as payout in any settlement, would be permitted to issue irrevocable payment commitments (IPCs); and
 - (b) the maximum risk to the custodian banks issuing IPCs would be reckoned at 50 per cent on the assumption of downward price movement of the equities bought by FIIs/MFs on the two successive days from the trade date (T) i.e., on T+1 and T+2, of 20 per cent each with an additional margin of 10 per cent for further downward movement.
- The potential risk on T+1 would be reckoned at 50 per cent of the settlement amount and this amount would be reckoned as CME at the end of T+1 if margin payment/early pay in does not come in.
- In case there is early pay in, on T+1 there will be no exposure.
- In case margin is paid in cash on T+1, the CME would be reckoned at 50 per cent of settlement price minus the margin paid.
- In case margin is paid on T+1 by way of permitted securities to FIIs/MFs, the CME would be reckoned at 50 per cent of settlement price minus the margin paid plus haircut prescribed by the Exchange on the securities tendered towards margin payment.

The IPC will be treated as a financial guarantee and capital will have to be maintained against it.

These arrangements will continue till October 31, 2011 and would be reviewed with a view to modify it further for reducing the risk to the custodian banks issuing IPCs.

Investment in Zero Coupon Bonds

The Reserve Bank has advised banks that they should -

- not invest in zero coupon bonds (ZCBs) unless the issuer builds up sinking fund for all accrued interest and keeps it invested in liquid investments/securities (government bonds), and
- put in place conservative limits for their investments in ZCBs.

PAYMENT SYSTEM

Inward Transactions to be Processed Solely on A/c Number

With a view to further streamlining the transactions routed through the various electronic products, such as, real time gross settlement (RTGS), national electronic funds transfer (NEFT), national electronic credit service (NECS) and electronic clearing service (ECS) and to avoid delays in affording credit to accounts, the Reserve Bank has advised all member banks participating in RTGS/NEFT/NECS/ECS that -

- Responsibility to provide correct inputs in the payment instructions, particularly the beneficiary account number information, rests with the remitter/originator. While the beneficiary's name should be compulsorily mentioned in the instruction request, and carried as part of the funds transfer message, reliance will be only on the account number for the purpose of affording credit. This is applicable both for transaction requests emanating at branches and those originated through the online/internet delivery channel. The name field in the message formats will, however, be a parameter to be used by the destination bank based on risk perception and/or use for post-credit checking or otherwise.
- Originating banks should put in place an appropriate maker-checker system to ensure that the account number information furnished by their customers is correct and free from errors. This may entail advising customers enjoying online/internet banking facilities to input the account number information more than once (with the first time feed being masked as in case of change of password requirements) or such other prescriptions. Customers submitting funds transfer requests at branches may be required to write down the account number information twice in the application form.
- For transactions requested at branches, the originating bank should put in place a maker-checker process with one employee expected to input the transaction and the other checking the input.

- Banks should put suitable disclaimers on the funds transfer screens in the online/internet banking platform and funds transfer request forms advising customers that credit will be effected based solely on the beneficiary account number information and the beneficiary name particulars will not be used.
- Destination banks may afford credit to the beneficiary's account based on the account number furnished by the remitter/originating bank in the message/data file. The beneficiary's name details may be used for verification based on risk perception, value of transfer, nature of transaction, post-credit checking, etc.
- Member banks should take necessary steps to create awareness amongst their customers about the need to provide correct account number information while making payments through RTGS/NEFT/NECS/ECS credit.
- The system of providing mobile/e-mail alerts to customers for debit/credit to their accounts will be another way of ensuring that the debits/credits are genuine and put through/expected by them, and preferably, should be extended to all customers for all funds transfer transactions irrespective of value.
- Notwithstanding the above, in cases where it is found that credit has been afforded to a wrong account, banks need to establish a robust, transparent and quick grievance redressal mechanism to reverse such credits and set right the mistake and/or return the transaction to the originating bank. This needs to function efficiently and pro-actively till such time customers are comfortable with the new arrangements.

These modifications are equally applicable to ECS debit transactions to be used by destination banks for debiting their customer accounts based on details furnished by the user institutions/sponsor banks.

Banks have been advised to put in place appropriate systems and procedures to ensure compliance with these prescriptions.

CO-OPERATIVE BANKING

Participation in Exchange Traded Currency Option Market

AD Category – I urban co-operative banks (UCBs) fulfilling the norms for AD – I license have been allowed to participate in the exchange traded currency option market of a designated exchange recognised by the Securities and Exchange Board of India (SEBI), only as clients. Participation will be allowed only for hedging underlying forex exposure arising from customer transactions.

UCBs which are authorised to undertake forex business as AD category – I and desirous of participating in the exchange traded currency option market may approach the Reserve Bank's Urban Banks Department for specific approval.