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MONETARY AND CREDIT INFORMATION REVIEW

POLICY

CRR Reduced

The Reserve Bank reduced the cash reserve ratio (CRR) of scheduled commercial banks by 50 basis points from 6.00 per cent to 5.50 per cent of their net demand and time liabilities (NDTL) with effect from the fortnight beginning January 28, 2012.

Appointment of PSBs as Agency Banks of RBI

With a view to enhancing the quality of customer service in government business through more competition, improving customer convenience by increasing the number of customer service outlets and broad basing the revenue collection and payments mechanism of governments, the Reserve Bank has advised that all private sector banks (PSBs) would now be considered eligible to handle any central/state government business (where RBI pays agency commission) at par with public sector banks.

Banks intending to handle government business need to be appointed as agents of the Reserve Bank. For this purpose, for central government/union territory business, the concerned civil/non-civil ministry/department may work out the arrangement with the bank and send the proposal to the Controller General of Accounts (CGA) for examination. The CGA will forward his recommendation on the proposal to the Reserve Bank's Department of Government and Bank Accounts, Central Office, Mumbai (DGBA, CO) and on consideration, the Reserve Bank will formally appoint a bank as an agency bank, on execution of an agreement.

For state government business, the concerned department of the state may work out the arrangement and approach the finance department of the state which will recommend the proposal to the Reserve Bank's Regional Director for the state, who will forward the case with his comments to the DGBA, CO for approval and further action.

For authorisation of fresh/additional business, an agency bank will be required to obtain approval from DGBA, CO, as at present. Once the Reserve Bank authorises a bank for any government business, it's subsequent approval regarding mode (physical or e-Mode) and area of operation is not required. This would be decided by the office of CGA (for central government) or the finance department of the state government.

It is further clarified that a central government ministry/ department (in consultation with CGA) and a state government department (in consultation with the respective AG's Office) may engage any bank for implementation of any of the prefunded schemes without reference to the Reserve Bank, as such schemes do not fall under the purview of government agency business arrangement and hence do not qualify for payment of agency commission by the Reserve Bank.

Grant of Loans/Advances to Relatives of Bank Directors

The Reserve Bank has advised that the restrictions contained in Section 20 of the Banking Regulation Act, 1949 would apply to grant of loans and advances to spouse and minor/dependent children of the directors of banks. Banks may, however, grant loan or advance to or on behalf of spouses of their directors in cases where the spouse has his/her own independent source of income arising out of his/her employment or profession and the facility so granted is based on standard procedures and norms for assessing the creditworthiness of the borrower. Such facility should be extended on commercial terms.

As indicated in the Reserve Bank's circular of March 1, 1996, all credit proposals for Rs. 25 lakhs and above should be sanctioned by the bank's Board of Directors/Management Committee of the Board. Proposals for less than Rs. 25 lakhs may be sanctioned by the appropriate authority in banks in terms of the powers delegated to them.

The above norms relating to grant of loans and advances would be equally applicable to award of contracts.

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Unhedged Foreign Currency Exposure of Corporates

In view of the importance of prudent management of foreign exchange risk, it has been decided that banks, while extending fund based and non-fund based credit facilities to corporates, should rigorously evaluate the risks arising out of unhedged foreign currency exposure of the corporates and price them in the credit risk premium. Further, banks should also consider stipulating a limit on unhedged position of corporates on the basis of bank's Board approved policy.

Banks have also been advised to adhere to the instructions contained in the Reserve Bank's circular of December 8, 2008 on 'Lending under Consortium Arrangement/Multiple Banking Arrangements', to exchange information among themselves in respect of borrowers enjoying credit facilities from more than one bank, which should, inter alia, cover information relating to their derivative transactions and unhedged foreign currency exposures.

Housing Loans

The Reserve Bank has advised banks that for deciding the value of the house property while sanctioning housing loans, they should not include stamp duty, registration and other documentation charges in the cost of the house property. This overstates the realisable value of the property as stamp duty, registration and other documentation charges are not realisable and consequently the margin stipulated gets diluted.

Transactions in Government Securities

It has now been decided to permit repo of G-Sec (on T+0 basis) that have already been contracted for sale (on T+1 basis). Participants, while undertaking such transactions, should ensure that adequate balances are available in their SGL/CSGL accounts to ensure settlement of the transactions on the date of settlement. Any failure in settlement would attract penal provisions as outlined in the Reserve Bank's circular of July 14, 2010.

FEMA

ECBs – Simplification of Procedure

As per the extant external commercial borrowing (ECB) procedures any request for cancellation of loan registration number (LRN) given by the Reserve Bank's Department of Statistics and Information Management (DSIM), or change in permissible end-use for an existing ECB is required to be referred by the AD Category-I bank to the Reserve Bank's Foreign Exchange Department, Central Office, for necessary approval.

With a view to simplifying the existing procedures, designated AD category-I banks have now been delegated powers to approve such requests from ECB borrowers, subject to specified conditions.

Cancellation of LRN

The designated AD Category-I bank may directly approach DSIM for cancellation of LRN for ECBs availed, both under the

RBI Raises Bank Rate as a Technical Adjustment

The Reserve Bank decided to change the Bank Rate by realigning it with the marginal standing facility (MSF) rate, which in turn is linked to the policy repo rate under the liquidity adjustment facility (LAF). Accordingly, the Bank Rate was increased by 350 basis points, i.e., from 6.00 per cent per annum to 9.50 per cent per annum from the close of business on February 13, 2012. This should be viewed and understood as one-time technical adjustment to align the Bank Rate with the MSF rate rather than a change in the monetary policy stance. Henceforth, whenever there is an adjustment of the MSF rate, the Reserve Bank will consider and align the Bank Rate with the revised MSF rate. All penal interest rates on shortfall in reserve requirements, which are specifically linked to the Bank Rate, also stand revised.

Background

Section 49 of the Reserve Bank of India Act, 1934 requires the Reserve Bank to make public (from time to time) the standard rate at which it is prepared to buy or re-discount bills of exchange or other commercial paper eligible for purchase under that Act. Since discounting/rediscounting by the Reserve Bank has remained in disuse, the Bank Rate has not been active.

Being the discount rate, the Bank Rate should technically be higher than the policy repo rate. The Bank Rate has, however, been kept unchanged at 6 per cent since April 2003. This was mainly for the reason that monetary policy signalling was done through modulations in the reverse repo rate and the repo rate under the LAF (till May 3, 2011) and the policy repo rate under the revised operating procedure of monetary policy (from May 3, 2011 onwards). Moreover, under the revised operating procedure, MSF, instituted at 100 basis points above the policy repo rate, has been in operation, which more or less served the purpose of the Bank Rate.

While the policy repo rate and the MSF rate have become operational, the Bank Rate continued to remain at 6 per cent. The Bank Rate acts as the penal rate charged on banks for shortfalls in meeting their reserve requirements (cash reserve ratio and statutory liquidity ratio). The Bank Rate is also used by several other organisations as a reference rate for indexation purposes.

The Reserve Bank consulted various organisations/stakeholders that rely on Bank Rate as a reference rate. Based on the feedback received, it was determined that the Bank Rate should normally stay aligned to the MSF rate.

Penal Interest Rates which are linked to the Bank Rate

Item	Existing Rate	New Rate (Effective close of business on February 13, 2012)
Penal interest rates on shortfalls in reserve requirements (depending on duration of shortfalls).	Bank Rate plus 3.0 percentage points (9.00 per cent) or Bank Rate plus 5.0 percentage points (11.00 per cent).	Bank Rate plus 3.0 percentage points (12.50 per cent) or Bank Rate plus 5.0 percentage points (14.50 per cent).

automatic and approval routes, subject to fulfilment of the conditions as follows:

- no draw down for the said LRN has taken place; and
- the monthly ECB-2 returns till date in respect of the LRN have been submitted to DSIM.

Change in the End-use of ECB Proceeds

Designated AD Category-I banks may approve requests from ECB borrowers for change in end-use in respect of ECBs availed under the automatic route, subject to the conditions as follows:

- the proposed end-use is permissible under the automatic route as per the extant ECB guidelines;
- there is no change in the other terms and conditions of the ECB;
- the ECB is in compliance with the extant guidelines; and
- the monthly ECB-2 returns till date in respect of the LRN have been submitted to DSIM.

AD Category-I banks should continue to monitor the utilisation of end-use proceeds and changes in the end-use should be promptly reported to DSIM, RBI. Change in the end-use of ECBs availed under the approval route should, however, continue to be referred to the Reserve Bank's Foreign Exchange Department, Central Office, as hitherto.

Release of Foreign Exchange for Imports

Based on suggestions received from various stake holders, the limit for foreign exchange remittance towards imports without any documentation formalities, has been raised from USD 500 or its equivalent to USD 5000 or its equivalent from February 21, 2012.

The Reserve Bank has clarified that ADs need not obtain any document, including Form A-1, except a simple letter from the applicant containing basic information viz., the name and the address of the applicant, name and address of the beneficiary, amount to be remitted and the purpose of remittance, provided –

- the exchange being purchased is for a current account transaction and is not included in the Schedules I and II of the Foreign Exchange Management (Current Account Transactions) Rules, 2000 framed by Government of India vide Notification No. G.S.R.381 (E) dated May 3, 2000, as amended from time to time;
- the amount does not exceed USD 5000 or its equivalent; and
- the payment is made by a cheque drawn on the applicant's bank account or by a demand draft.

Advance Payment for Export

With a view to liberalising the procedure regarding receipt of advance payment for export of goods involving shipment (manufacture and ship) beyond one year, it has now been decided to permit AD Category- I banks to allow exporters to receive advance payment for export of goods which would take more than one year to manufacture and ship and where the 'export agreement' provides for shipment of goods extending beyond the period of one year from the date of receipt of advance payment subject to the conditions that -

(i) the AD Category - I bank has done the 'know your customer' (KYC) and due diligence exercise for the overseas buyer;

(ii) compliance with the anti-money laundering standards has been ensured;

(iii) the AD Category-I bank should ensure that export advance received by the exporter is utilised to execute export and not for any other purpose i.e., the transaction is a bona-fide transaction;

(iv) progress payment, if any, should be received directly from the overseas buyer strictly in terms of the contract;

(v) the rate of interest, if any, payable on the advance payment should not exceed London Inter-Bank Offered Rate (LIBOR) + 100 basis points;

(vi) there should be no instance of refund exceeding 10 per cent of the advance payment received in the last three years;

(vii) the documents covering the shipment should be routed through the same authorised dealer bank; and

(viii) if the exporter is unable to make the shipment, partly or fully, no remittance towards refund of unutilised portion of advance payment or towards payment of interest should be made without the Reserve Bank's prior approval.

INFORMATION

Draft Guidelines on Liquidity Risk Management and Basel III Framework on Liquidity Standards

The Reserve Bank released on its website, on February 21, 2012, draft guidelines on liquidity risk management and Basel III framework on liquidity standards for comments and feedback.

To address the deficiencies witnessed in liquidity risk management in the recent crisis and to strengthen liquidity risk management in banks, the Basel Committee on Banking Supervision (BCBS) published "Principles for Sound Liquidity Risk Management and Supervision" in September 2008. This was followed by the publication of "Basel III: International framework for liquidity risk measurement, standards and monitoring" in December 2010 i.e., the Basel III rules text on liquidity prescribing two minimum global regulatory standards viz., liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) for liquidity risk and a set of five monitoring tools.

The Reserve Bank, being a member of the BCBS, is fully committed to the objective of the Basel III reform package and, therefore, intends to implement these proposals for banks operating in India. Accordingly, draft guidelines on liquidity risk management and Basel III framework on liquidity standards have been prepared.

The draft guidelines have been presented in two sections viz., Section I and II. Section I consolidates the various instructions/guidance on liquidity risk management that the Reserve Bank has issued from time to time in the past, and where appropriate, harmonizes and enhances these instructions/guidance in line with the BCBS's Principles for Sound Liquidity Risk Management and Supervision. Section II covers the Basel III guidelines on liquidity risk as will be applicable to Indian banks. Two minimum global regulatory standards viz., LCR and NSFR as set out in the Basel III rules text issued by the BCBS in December 2010 have been prescribed under the guidelines which will become binding from 1 January 2015 and 1 January 2018, respectively. Till then, these guidelines have been issued for compliance on best effort basis. Banks are expected to submit the liquidity returns under the Basel III framework to the Reserve Bank from the month/quarter ending June 2012.

Comments/feedback on the draft guidelines may be forwarded to the Chief General Manager-in-Charge, Department of Banking Operations and Development, Reserve Bank of India, Central Office Building, 12th Floor, S.B. Singh Marg, Mumbai-400001, latest by March 21, 2012.

Posted at MUMBAI PATRIKA CHANNEL SORTING OFFICE - GPO on last two working days of every month. **Regd. No. MH/MR/South-30/2012-14**

Report of the Nair Committee on Priority Sector Lending

The Reserve Bank of India released on its website on February 21, 2012, the Report of the Committee (Chairman: Shri M V Nair, Chairman, Union Bank of India) constituted to re-examine the existing classification and suggest revised guidelines with regard to priority sector lending and related issues.

The Reserve Bank has sought views/comments on the report of the Committee from banks, non-bank financial institutions, other institutions and members of public. Suggestions and comments on the Report may be sent by March 31, 2012 to the Chief General Manager-in-Charge, Reserve Bank of India, Rural Planning & Credit Department, Central Office, 10th floor, Central Office Building, Shahid Bhagat Singh Marg, Mumbai-400001.

The final circular on priority sector lending will be issued after receiving feedback, comments and suggestions on the Report.

Constitution of the Committee

The Reserve Bank had constituted the Committee under the chairmanship of Shri. M. V. Nair on August 25, 2011 pursuant to the announcement made in the Monetary Policy Statement 2011-12. The Committee was to re-examine the existing classification and suggest revised guidelines with regard to priority sector lending and related issues. The Committee had 10 Members from diverse fields and Dr. Deepali Pant Joshi, CGM-in-Charge, Rural Planning and Credit Department, Reserve Bank of India was its Member Secretary. The Committee was given a broad-based terms of reference.

Major Recommendations of the Committee

By adopting a wide and exhaustive consultation process, the Committee identified key issues facing diverse segments and sections of society; examined them thoroughly and made recommendations that would support achieving the objectives of directed lending.

(i) The target of domestic scheduled commercial banks for lending to priority sector may be retained at 40 per cent of adjusted net bank credit (ANBC) or credit equivalent of off-balance sheet exposure (CEOBE), whichever is higher.

(ii) The sector ‘agriculture and allied activities’ may be a composite sector within priority sector, by doing away with distinction between direct and indirect agriculture. The targets for agriculture and allied activities may be 18 per cent of ANBC or CEOBE, whichever is higher.

(iii) A sub target for small and marginal farmers within agriculture and allied activities is recommended, equivalent to 9 per cent of ANBC or CEOBE, whichever is higher to be achieved in stages by 2015-16.

(iv) The medium and small enterprises (MSE) sector may continue to be under priority sector. Within the MSE sector, a sub-target for micro enterprises is recommended equivalent to 7 per cent of ANBC or CEOBE, whichever is higher, to be achieved in stages by 2013-14.

(v) Banks may be encouraged to ensure that the number of outstanding beneficiary accounts under ‘small and marginal farmers’ and micro enterprises’ each register a minimum annual growth rate of 15 per cent.

(vi) The loans to housing and education may continue to be under priority sector. Loans for construction/ purchase of one dwelling unit per individual up to Rs.25 lakh; loans up to Rs.2 lakh in rural and semi urban areas and up to Rs.5 lakh in other centres for repair of damaged dwelling units may be granted under priority sector.

(vii) In order to encourage construction of dwelling units for economically weaker sections and low income groups, housing loans granted to these individuals may be included in weaker sections category.

(viii) All loans to women under priority sector may also be counted under loans to weaker sections.

(ix) Limit under priority sector for loans for studies in India may be increased to Rs. 15 lakh and Rs. 25 lakh in case of studies abroad, from existing limit of Rs 10 lakh and Rs 20 lakh, respectively.

(x) The priority sector target for foreign banks may be increased to 40 per cent of ANBC or CEOBE, whichever is higher with sub-targets of 15 per cent for exports and 15 per cent for MSE sector, within which 7 per cent may be earmarked for micro enterprises.

(xi) The committee recommends allowing non-tradable priority sector lending certificates on pilot basis with domestic scheduled commercial banks, foreign banks and regional rural banks as market players.

(xii) Bank loans to non-bank financial intermediaries for on-lending to specified segments may be allowed to be reckoned for classification under priority sector, up to a maximum of 5 per cent of ANBC or CEOBE, whichever is higher, subject to certain due diligence and documentation standards.

(xiii) The present system of report-based reporting has certain limitations and it may be improved through data-based reporting. There is a need to address the issues in data reporting like pre-defined parameters, reference date, periodicity, unit of reporting, etc.

The recommendations of the Committee are expected to have significant impact in addressing issue of directing lending to those who have lack of access to credit and to those sectors which generate large employment. It is hoped that these recommendations would promote country’s developmental and inclusive goals.

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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