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POLICY

Guidelines on the Base Rate

The Reserve Bank has directed scheduled commercial banks to switch over to the new system of base rate in place of the existing benchmark prime lending rate (BPLR) system from July 1, 2010. The main highlights of the new base rate system are as follows:

- Base rate shall include all those elements of the lending rates that are common across all categories of borrowers. Banks may choose any benchmark to arrive at the base rate for a specific tenor that may be disclosed transparently. Banks are free to use any methodology provided it is consistent and is made available for supervisory review/scrutiny, as and when required.
- Banks may determine their actual lending rates on loans and advances with reference to the base rate and by including such other customer specific charges as considered appropriate. The actual lending rates charged may be transparent and consistent and be made available for supervisory review/scrutiny, as and when required.
- In order to give banks some time to stabilise the system of base rate calculation, banks are permitted to change the benchmark and methodology any time during the initial six month period i.e. end-December 2010.
- All categories of loans should henceforth be priced only with reference to the base rate. However, the following categories of loans could be priced without reference to the base rate: (a) advances under differential rate of interest scheme (b) loans to banks' own employees (c) loans to banks' depositors against their own deposits.
- The base rate could also serve as the reference benchmark rate for floating rate loan products, apart from external market benchmark rates. The floating interest rate based on external benchmarks should, however, be equal to or above the base rate at the time of sanction or renewal.
- Changes in the base rate shall be applicable in respect of all existing loans linked to the base rate, in a transparent and non-discriminatory manner.
- Since the base rate will be the minimum rate for all loans, banks are not permitted to resort to any lending below the base rate. Accordingly, the current stipulation of BPLR as the ceiling rate for loans up to Rs.2.00 lakh stands withdrawn.
- Banks are required to review the base rate at least once in a quarter with the approval of the board or their asset liability management committees (ALCOs) as per the bank's practice. Since transparency in the pricing of lending products has been a key objective, banks are required to exhibit the information on their base rate at all branches and also on their websites. Changes in the base rate should also be conveyed to the general public from time to time through appropriate channels. Banks are required to provide information on the actual minimum and maximum lending rates to the Reserve Bank on a quarterly basis, as hitherto.
- The base rate system would be applicable for all new loans and for those old loans that come up for renewal. Existing

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loans based on the BPLR system may run till their maturity. In case existing borrowers want to switch to the new system, before expiry of the existing contracts, an option may be given to them, on mutually agreed terms. Banks, however, should not charge any fee for such switch-over.

- The Reserve Bank will separately announce the stipulation for export credit.

It may be recalled that the draft guidelines on the system of base rate were placed on the Reserve Bank's website in February 2010. Taking into consideration feedback/suggestions received, the final guidelines have been issued. It is expected that implementation of the base rate system would enhance transparency in lending rates of banks and would also lead to better assessment of transmission of monetary policy.

Prudential Norms - Projects under Implementation

In terms of the extant prudential norms on income recognition, asset classification and provisioning pertaining to advances (IRAC norms), a grace period of two years for infrastructure projects, and six months for industrial projects, is available for commencement of commercial operations after the original date of completion of the project, for the purpose of retaining the standard asset classification. The Reserve Bank has decided to modify the IRAC norms for project loans in view of several representations received to the effect that there are occasions when the completion of projects is delayed due to reasons beyond the control of the promoters. Some of the main highlights of revised guidelines are as follows:

I. If an infrastructure project loan classified as 'standard asset' is restructured any time during the period up to two years from the original date of commencement of commercial operations (DCCO), it can be retained as a standard asset if the account continues to be serviced as per the restructured terms and the fresh DCCO is fixed within the following limits:

   (a) Infrastructure projects involving court cases- up to another 2 years beyond the existing extended period of 2 years i.e. total extension of 4 years.

   (b) Infrastructure projects delayed for other reasons- up to another 1 year beyond the existing extended period of 2 years i.e. total extension of 3 years.

II. The application for restructuring should be received before the expiry of period of two years from the original DCCO and when the account is still standard.The other conditions applicable would be:

   (a) In cases where there is moratorium for payment of interest, banks should not book income on accrual basis beyond two years from the original DCCO.

   (b) Banks should maintain provisions of 0.40 per cent until two years from the original DCCO and 1.00 per cent during the third and the fourth year after the original DCCO on such accounts as long as these are classified as standard assets.

III. In case of non-infrastructure projects, if the delay in commencement of commercial operations extends beyond the period of six months from the date of completion, banks can prescribe a fresh DCCO, provided the fresh DCCO does not extend beyond a period of twelve months from the original DCCO. The other conditions applicable would be:

   (a) In cases where there is moratorium for payment of interest, banks should not book income on accrual basis beyond six months from the original DCCO.

   (b) Banks should maintain provisions of 0.40 per cent until the first six months from the original DCCO and 1.00 per cent during the next six months on such accounts as long as these are classified as standard assets.

IV. Any change in the repayment schedule of a project loan caused due to an increase in the project outlay on account of increase in scope and size of the project, would not be treated as restructuring if:

   (a) The increase in scope and size of the project takes place before commencement of commercial operations of the existing project.

   (b) The rise in cost excluding any cost-overrun in respect of the original project is 25 per cent or more of the original outlay.

   (c) The bank re-assesses the viability of the project before approving the enhancement of scope and fixing a fresh DCCO.

   (d) On re-rating, (if already rated) the new rating is not below the previous rating by more than one notch.

These guidelines will, however, not be applicable to restructuring of advances classified as commercial real estate exposure, capital market exposure and consumer and personal advances which will continue to be dealt with in terms of the extant provisions in the IRAC norms. 'Project Loan' would mean any term loan which has been extended for the purpose of setting up of an economic venture. Banks must fix a DCCO for all project loans at the time of sanction of the loan/financial closure.

Advances to Micro and Small Enterprises

As per the extant policy, finance granted by banks to micro and small enterprises (MSEs) as defined under the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, is eligible for classification under priority sector. The Reserve Bank has clarified that loans granted by commercial banks to MSEs (manufacturing and services) engaged in exports are also eligible for classification under priority sector, provided such enterprises satisfy the definition of MSE sector as contained in the MSMED Act irrespective of whether the borrowing entity is engaged in exports or otherwise. Some commercial banks had sought clarification in respect of classification of loans granted to MSEs engaged in exports, under priority sector.

Know Your Customer (KYC) guidelines

For the sake of clarity, the Reserve Bank, has laid down criteria for the customer identification procedure in case of accounts of proprietorship concerns. As per the new criteria, apart from following the extant guidelines on customer identification procedure as applicable to the proprietor, banks should call for and verify the following documents before opening of accounts in the name of a proprietary concern:

i) Proof of the name, address and activity of the concern, like registration certificate (in the case of a registered concern), certificate/licence issued by the municipal authorities under the shops and establishment act, sales and income tax returns, central sales tax/value added tax certificate, certificate/registration document issued by sales tax/service tax/professional tax authorities, licence issued by the registering authority like certificate of practice issued by Institute of Chartered Accountants of India, Institute of Cost Accountants of India, Institute of Company Secretaries of India, Indian Medical Council, Food and Drug Control Authorities, etc.

ii) Any two of the above documents would suffice. These documents should be in the name of the proprietary concern.

These guidelines will apply to all new customers, while in case of accounts of existing customers, the banks should complete above formalities in a time bound manner before December 31, 2010.

FEMA

Foreign Institutional Investors

As per the extant norms, foreign institutional investors (FIIs) are permitted to offer cash and foreign sovereign securities with AAA rating as collateral to the recognised stock exchanges in India for their transactions in the derivative segment. As per the extant Securities and Exchange Board of India (SEBI) norms, the FIIs are also required to post collaterals for their transactions in the cash segment of the market. The Reserve Bank has decided, in consultation with the Government of India and the SEBI, to permit the FIIs to offer domestic Government Securities (current limit being USD 5 billion), and foreign sovereign securities with AAA rating, as collateral to the recognised stock exchanges in India, in addition to cash, for their transactions in the cash segment of the market. However, cross-margining of Government Securities (placed as margins by the FIIs for their transactions in the cash segment of the market) shall not be allowed between the cash and the derivative segments of the market. The operational guidelines in this regard will be issued separately by the SEBI. The existing guidelines on collateral for the FIIs transactions in the derivative segment remain unchanged.

Foreign Currency Convertible Bonds (FCCBs)

The Reserve Bank has decided to consider applications for buyback of foreign currency convertible bonds (FCCBs) under the approval route until June 30, 2010, subject to issuers complying with all the terms and conditions of buyback/prepayment of FCCBs. Applications complying with the conditions may be submitted, together with the supporting documents, through the designated authorised dealer category- I (AD Category- I) banks to the Reserve Bank. It may be recalled that Indian companies were allowed to buyback the FCCBs issued by them both under the automatic route and approval route until December 31, 2009 and the buyback scheme was discontinued from January 1, 2010. The present extension under the approval route has been made in view of the representations made by the issuers of FCCBs.

Overseas Investments

As a measure of further liberalisation in overseas investments, the Reserve Bank has decided, in consultation with the Government of India, to allow Indian companies to participate in a consortium with other international operators to construct and maintain submarine cable systems on co-ownership basis under the automatic route. Accordingly, AD Category- I banks may allow remittances by Indian companies for overseas direct investment, after ensuring that the Indian company has obtained necessary licence to establish, install, operate and maintain international long distance services and also by obtaining a certified copy of the board resolution approving such investment. These transactions may be reported by the Indian entities investing in the consortium to the AD Category- I banks and by the AD Category- I banks to the Reserve Bank for allotment of the Unique Identification Number.

Regional Rural Banks

Investment in SLR Securities

The Reserve Bank has extended the exemption granted up to the financial year 2008-09 to the regional rural banks (RRBs) from ‘mark to market’ norms in respect of their investments in SLR securities by one more year i.e. for the financial year 2009-10. Accordingly, RRBs will have the freedom to classify their entire investment portfolio of SLR securities under ‘Held to Maturity’ (HTM) for the financial year 2009-10 with valuation on book value basis and amortisation of premium, if any, over the remaining life of securities.

Cheque Collection Policy

The Reserve Bank has advised RRBs that their cheque collection policy should include instructions on immediate credit for local/outstation cheques in addition to the aspects of time frame for collection of local/outstation instruments and interest payment of delayed collection. It may be recalled that the Reserve Bank had in February 2009 advised RRBs to frame their cheque collection policies as per the time frame prescribed by the National Consumer Disputes Redressal Commission.

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Annual Policy Statement for 2010-11

Dr. D. Subbarao, Governor, Reserve Bank of India, in a meeting with chief executives of major commercial banks presented the Annual Policy Statement for 2010-11 on April 20, 2010. The highlights are:

Projections

- Real GDP growth for 2010-11 placed at 8.0 per cent with an upside bias.
- The baseline projection for Wholesale Price Index (WPI) inflation for March 2011 is placed at 5.5 per cent.
- Money supply (M3) growth for 2010-11 placed at 17.0 per cent.
- Aggregate deposits of scheduled commercial banks projected to grow by 18.0 per cent.
- The growth in non-food credit of scheduled commercial banks is placed at 20.0 per cent.

Challenges

- The immediate challenges facing the economy are (a) uncertainty about the pace and shape of global recovery; (b) increase in global commodity prices could add to inflationary pressure; (c) an unfavourable south-west monsoon could exacerbate food inflation while also imposing fiscal burden and dampening rural consumer and investment demand; (d) large capital inflows pose a challenge for exchange rate and monetary management; (e) the overall size of the government borrowing programme is still very large and can exert pressure on interest rates.

Stance

On the basis of the overall assessment, the stance of monetary policy in 2010-11 will broadly be:

- Anchor inflation expectations, while being prepared to respond appropriately, swiftly and effectively to further build-up of inflationary pressures.
- Actively manage liquidity to ensure that the growth in demand for credit by both the private and public sectors is satisfied in a non-disruptive way.
- Maintain an interest rate regime consistent with price, output and financial stability.

Monetary Measures

- Bank rate retained at 6.0 per cent.
- Repo rate under the Liquidity Adjustment Facility (LAF) increased by 25 basis points from 5.0 per cent to 5.25 per cent with immediate effect.
- Reverse repo rate under the LAF increased by 25 basis points from 3.5 per cent to 3.75 per cent with immediate effect.
- Cash reserve ratio (CRR) of scheduled banks increased by 25 basis points from 5.75 per cent to 6.0 per cent of their net demand and time liabilities (NDTL) effective the fortnight beginning April 24, 2010.

Developmental and Regulatory Policies

- Interest rate futures on 5-year and 2-year notional coupon bearing securities and 91-day treasury bills to be introduced.
- Final guidelines on the issuance of non-convertible debentures (NCDs) of maturity less than one year to be issued by end-June 2010.
- Recognised stock exchanges to introduce plain vanilla currency options on spot US Dollar/Rupee exchange rate for residents.
- Banks to classify their investments in non-SLR bonds issued by companies engaged in infrastructure activities and having a minimum residual maturity of seven years under the held to maturity (HTM) category.
- A reporting platform for all secondary market transactions for certificate of deposits and commercial papers to be created.
- A working group to be constituted to work out the modalities for a single point reporting mechanism for all OTC interest rate and forex derivative transactions.
- Banks to be permitted for engaging any individual, including those operating common service centres (CSCs) as business correspondents.
- A working group to be constituted for better understanding of the grass-root level rural co-operatives for promoting financial inclusion.
- Committee to be set up for studying the advisability of granting new urban co-operative banking licences.
- Well-managed urban co-operative banks (UCBs) to be allowed to set up off-site ATMs without seeking approval through the annual business plans.
- Annuities under build-operate-transfer (BOT) model in respect of road/highway projects and toll collection rights to be treated as tangible security for the purpose of classifying an advance as secured loan.
- A discussion paper on the mode of presence of foreign banks is proposed to be prepared by September 2010.
- A discussion paper on granting new banking licences proposed to be put up for wider comments and feedback by end-July 2010.

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For renewal and change of address please write to the Chief General Manager, Department of Communication, Reserve Bank of India, Central Office Building, 12th floor, Fort, Mumbai - 400 001 without enclosing DD/cheque. MCIR is also available on Internet at www.mcir.rbi.org.in