R.No. MAHENG/2004/14130
Regd. No. MH/MR/South-30/2009-11

Monthly Subscription : ₹ 1.

Volume VIII ◆ Issue 1
July 2011

MONETARY AND CREDIT INFORMATION REVIEW

POLICY

Opening Bank Branches in Unbanked Rural Centres

Keeping in view the goal of bringing banking services to identified 72,800 villages with population above 2,000 by March 2012, and thereafter progressively to all villages over a period of time, there is a need for opening more number of brick and mortar branches in rural centres, besides the use of business correspondents.

The Reserve Bank has, therefore, advised banks that while preparing their annual branch expansion plan, they should allocate at least 25 per cent of the total number of branches proposed to be opened during a year, in unbanked rural centres. An unbanked rural centre would mean a rural (Tier 5 and Tier 6) centre that does not have a brick and mortar structure of any scheduled commercial bank for customer based banking transactions.

The Reserve Bank has also advised that it would now be mandatory to open at least one third of the total number of branches proposed to be opened in Tier 3 to Tier 6 centres in underbanked districts of underbanked states. Accordingly, authorisation for branches in Tier 1 and Tier 2 centres will now factor in whether at least 25 per cent of the total number of branches to be opened during a year are proposed to be opened in unbanked rural centres in place of the requirement that at least a third of the branches to be opened in Tier 3 to Tier 6 centres are in underbanked districts of underbanked states.

In view of the continuing need for opening more branches in underbanked districts of underbanked states and to ensure more uniform spatial distribution, banks would be provided incentive for opening such branches. Accordingly, for each branch proposed to be opened in Tier 3 to Tier 6 centres of underbanked districts of underbanked states, excluding the rural branches proposed to be opened in unbanked centres that may be located in underbanked districts of underbanked states, authorisation will be given for opening a branch in a Tier 1 centre. This would be in addition to the authorisation given for branches in Tier 1 and Tier 2 centres based on the considerations mentioned above.

It may be recalled that domestic scheduled commercial banks (excluding regional rural banks) were permitted in December 2009 to open branches in Tier 3 to Tier 6 centres (with population up to 49,999) without the Reserve Bank's prior permission. Prior authorisation from the Reserve Bank was, however, required for opening branches in Tier 1 and Tier 2 centres which was granted based, inter alia, on the (i) number of branches opened in Tier 3 to Tier 6 centres under general permission; (ii) branches proposed to be opened in under-banked districts in under-banked states; and (iii) bank's performance in areas of financial inclusion and customer service. It was observed that on an average, scheduled commercial banks opened about 20 per cent of the total number of new branches in rural centres (Tier 5 and Tier 6) in the last two years.

Banks' Investments in Schemes of MFs

The Reserve Bank has advised banks that their total investment in liquid/short term debt schemes (by whatever name called) of mutual funds (MFs) with weighted average maturity of portfolio of not more than 1 year, would be subject to a prudential cap of 10 per cent of their net worth as on March 31 of the previous year. The weighted average maturity would be calculated as average of the remaining period of maturity of securities weighted by the sums invested.

With a view to ensuring a smooth transition, banks which have already invested in these schemes of MFs in excess of the 10 per cent limit, are allowed to comply with this requirement at the earliest but not later than six months from July 5, 2011.

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Concurrent Audit

With a view to contain frauds, banks have been advised to put in place a system wherein the concurrent audit would look into/report on the following aspects:

(i) Wherever documents of title are submitted as security for loans, there should be a system of verifying the genuineness of these documents, especially for large value loans. In case of loan against security of land, banks may also seek reports from the local revenue authorities regarding the title deeds before sanctioning the loan.

(ii) Wherever a chartered accountant's certificate, property valuation certificate, legal certificate, guarantee/line of credit or any other third party certification is submitted by the borrower, the bank should independently verify the authenticity of such certification by directly communicating with the authority issuing the certificate; indirect confirmation may also be resorted to, ie., indicating to the issuer that in case there is no response by a certain deadline, it would be assumed that the certificate is genuine.

(iii) Banks should ensure aspects, such as, internal discipline, staff rotation, checks and balances, etc.

(iv) In cases where it is established that the certification given by a chartered accountant, lawyer, registered property valuer or such third party is wrong, the Indian Banks' Association (IBA) should put in place a process to issue a 'caution list' regarding the certifier, to all banks.

A study of large value frauds, including frauds under housing loan segment, reported by banks to the Reserve Bank was undertaken to understand the gaps in the control mechanism which contributed to perpetration of those frauds particularly when the branches were also under concurrent audit. It was observed that large number of frauds were perpetrated on account of submission of forged documents by the borrowers which had been certified by professionals, ie., valuers/advocates/chartered accountants.

The reason for failure on the part of concurrent auditors may be attributed to the new/innovative/complex nature of financial products or transactions. Further, banks have assigned audit responsibility to their own staff without ensuring that they are suitably trained to undertake the audit responsibility.

FEMA

Regularisation of Liaison Offices/Branch Offices

Foreign entities which have established liaison offices (LOs) or branch offices (BOs) in India without obtaining the Reserve Bank's permission have been advised to approach it within a period of 90 days from July 15, 2011 for regularisation of such offices in India. Foreign entities who have established LO or BO with permission from the Government of India may also approach the Reserve Bank along with a copy of government's approval to enable the Reserve Bank to allot a unique identification number (UIN).

All such applications/requests should be submitted to the Reserve Bank's Foreign Exchange Department at Mumbai in form FNC and should be routed through the AD Category – I bank where the account of the LO/BO is maintained.

AD Category - I banks have been advised to ensure that their constituents operating LO/BO in India have the Reserve Bank's valid approval and that a copy of the approval is kept on record.

It was observed that certain LOs/BOs established by foreign non-government organisations (NGOs), non-profit organisations, news agencies and other foreign entities are continuing to function in India, without the Reserve Bank's approval, even after the Foreign Exchange Management Act (FEMA), 1999 came into force from June 1, 2000.

Foreign Currency Convertible Bonds

Redemption

Keeping in view the need to provide a window to facilitate refinancing of foreign currency convertible bonds (FCCBs) by Indian companies who may be facing difficulty in meeting redemption obligations, it has been decided to consider applications for refinancing of FCCBs by Indian companies under the automatic route. Accordingly, designated AD Category -I banks may allow Indian companies to refinance the outstanding FCCBs subject to the conditions that -

(i) fresh external commercial borrowings (ECBs)/FCCBs should be raised with the stipulated average maturity period and applicable all-in-cost being as per the extant ECB guidelines;

(ii) the amount of fresh ECB/FCCB should not exceed the outstanding redemption value at maturity of the outstanding FCCBs;

(iii) fresh ECB/FCCB should not be raised six months prior to the maturity date of the outstanding FCCBs;

(iv) the purpose of ECB/FCCB should be clearly mentioned as 'redemption of outstanding FCCBs' in Form 83 while obtaining loan registration number from the Reserve Bank;

(v) the designated AD - Category I bank should monitor the end-use of funds;

(vi) all other aspects of ECB policy under the automatic route, such as, eligible borrower, recognised lender, end-use, prepayment, refinancing of existing ECB and reporting arrangements would remain unchanged;

(vii) ECB/FCCB beyond USD 500 million for the purpose of redemption of the existing FCCB would be considered under the approval route; and

(viii) ECB/FCCB availed of for the purpose of refinancing the existing outstanding FCCB would be reckoned as part of the limit of USD 500 million available under the automatic route as per the extant norms.

Restructuring of FCCBs involving change in the existing conversion price is not permissible. Proposals for restructuring of FCCBs not involving change in conversion price would, however, be considered under the approval route depending on the merits of the proposal.

The policy would be subject to review at an appropriate time depending upon evolving macroeconomic conditions and other relevant factors. This facility has come into force from July 4, 2011.

Buyback/Prepayment

The existing policy on premature buyback of FCCBs has been reviewed and it has been decided to extend the time limit

for such facility and liberalise the procedure. Accordingly, applications for buyback of FCCBs by Indian companies, both under the automatic and approval routes, would be considered as detailed below:

Automatic Route

Designated AD Category - I banks may allow Indian companies to prematurely buyback FCCBs subject to the conditions that –

(i) buyback value of the FCCB should be at a minimum discount of 8 per cent on the book value;

(ii) funds used for the buyback should be out of existing foreign currency funds held either in India (including funds held in the EEFC account) or abroad and/or out of fresh ECB raised in conformity with the current ECB norms; and

(iii) where the fresh ECB is co-terminus with the outstanding maturity of the original FCCB and is for less than three years, the all-in-cost ceiling should not exceed 6 months' Libor plus 200 bps as applicable to short term borrowings. In other cases, the all-in-cost for the relevant maturity of the ECB, as laid down in the Reserve Bank's circular of October 22, 2008 would apply.

Approval Route

Indian companies may be permitted to buyback FCCBs up to USD 100 million of the redemption value per company, out of their internal accruals with the Reserve Bank's prior approval, subject to a :

(i) minimum discount of 10 per cent of book value for redemption value up to USD 50 million;

(ii) minimum discount of 15 per cent of book value for redemption value over USD 50 million and up to USD 75 million; and

(iii) minimum discount of 20 per cent of book value for redemption value of over USD 75 million and up to USD 100 million.

The other terms and conditions as stipulated in the Reserve Bank's circular of December 8, 2008 would continue to be applicable. This facility has come into force from June 30, 2011 and the entire process of buyback should be completed by March 31, 2012.

Issue of Equity Shares under FDI Scheme

The Reserve Bank in consultation with the Government of India, has reviewed the extant guidelines for issue of equity shares/preference shares under the government route of the foreign direct investment (FDI) scheme. It has been decided to permit issue of equity shares/preference shares under the government route of the FDI scheme for the following categories of transactions:

(1) Import of capital goods/machineries/equipments (including second-hand machineries), provided the following conditions are complied with :

(a) the import of capital goods, machineries, etc., made by a resident in India, is in accordance with the Export/Import Policy issued by the Government of India as notified by the Directorate General of Foreign Trade (DGFT) and the regulations issued under the Foreign Exchange Management Act (FEMA), 1999 relating to imports issued by the Reserve Bank;

(b) an independent valuation of the capital goods/ machineries/equipments (including second-hand machineries) is done by a third party entity, preferably by an independent valuer from the country of import and copies of documents/certificates issued by the customs authorities towards assessment of the fair-value of such imports are produced;

(c) the application should clearly indicate the beneficial ownership and identity of the importer company as well as the overseas entity; and

(d) all such conversions of import payables for capital goods into FDI should be completed within 180 days from the date of shipment of goods.

(2) Pre-operative/pre-incorporation expenses (including payment of rent, etc.) provided the following conditions are complied with :

(a) submission of foreign inward remittance certificate (FIRC) for remittance of funds by the overseas promoters for the expenditure incurred;

(b) verification and certification of the pre-incorporation/ pre-operative expenses by the statutory auditor;

(c) payments should be made directly by the foreign investor to the company. Payments made through third parties citing the absence of a bank account or similar such reasons will not be eligible for issuance of shares towards FDI; and

(d) the capitalisation should be completed within the stipulated period of 180 days permitted for retention of advance against equity under the extant FDI policy.

All requests for conversion should be accompanied by a special resolution of the company. Government's approval would be subject to pricing guidelines of the Reserve Bank and appropriate tax clearance.

In terms of Schedule 1 of FEMA notification dated May 3, 2000, an Indian company may, under the automatic route, issue equity shares/preference shares to a person resident outside India, being a provider of technology/technical know-how and against royalty/lumpsum fees due for payment subject to certain conditions like, entry route, sectoral cap, pricing guidelines and compliance with the applicable tax laws.

Hedging Facilities for Non-resident Entities

To facilitate greater use of Indian Rupee in trade transactions, it has been decided to allow non-resident importers and exporters to hedge their currency risk in respect of exports from and imports to India, invoiced in Indian Rupees, with AD category I banks in India. The guidelines issued by the Reserve Bank on July 21, 2011 in this respect have been finalised in consultation with the Foreign Exchange Dealers Association of India (FEDAI) and market participants.

AD Category I banks can opt for either Model I or Model II as given below:

Model I

Non-resident exporter/importer dealing through their overseas bank (including overseas branches of AD banks in India)

- Non-resident exporter/importer approaches his banker overseas with appropriate documents with a request for

Posted at MUMBAI PATRIKA CHANNEL SORTING OFFICE - GPO on last two working days of every month. **Regd. No. MH/MR/South-30/2009-11**

hedging their rupee exposure arising out of a confirmed import or export order invoiced in rupees.

- The overseas bank in turn approaches its correspondent in India (i.e. the AD bank in India) for a price to hedge the exposure of its customer along with documentation furnished by the customer that will enable the AD bank in India to satisfy itself that there is an underlying trade transaction (scanned copies would be acceptable). The following undertakings also need to be taken from the customer: (i) that the same underlying exposure has not been hedged with any other AD Category I bank/s in India; and if the underlying exposure is cancelled, the customer will cancel the hedge contract immediately.
- A certification on the end client KYC may also be taken as a one time document from the overseas bank by the AD bank in India.
- The AD bank in India based on the documents received from the overseas correspondent should satisfy itself about the existence of the underlying trade transaction and offer a forward price (no two-way quotes should be given) to the overseas bank who, in turn, will offer the same to its customer. The AD bank, therefore, will 'not be' dealing directly with the overseas importer/exporter.
- The amount and tenor of the hedge should not exceed that of the underlying transaction and should be in consonance with the extant regulations regarding tenor of payment/ realisation of the proceeds.
- On due date, settlement is to be done through the correspondent bank's 'vostro' or the AD bank's nostro accounts.
- Contracts once cancelled, cannot be rebooked.
- Contracts may, however, be rolled over on or before maturity subject to maturity of the underlying exposure.
- On cancellation of the contracts, gains may be passed on to the customer subject to the customer providing a declaration that he is not going to rebook the contract or that the contract has been cancelled on account of cancellation of the underlying exposure.
- In case the underlying trade transaction is extended, rollover can be permitted once based on the extension of the underlying trade transaction for which suitable documentation is to be provided by the overseas bank and the same procedure followed as in case of the original contract.

Model II

Non-resident exporter/importer dealing directly with AD bank in India

- The overseas exporter/importer approaches the AD bank in India with a request for forward cover in respect of underlying transaction for which he furnishes appropriate documentation (scanned copies would be acceptable), on a pre-deal basis to enable the AD bank in India to satisfy itself that there is an underlying trade transaction, and details of his overseas banker, address etc. The following undertakings also need to be taken from the customer : (i) that the same underlying exposure has not been hedged with any other AD Category I bank/s in India; and (ii) if the underlying exposure is cancelled, the customer will cancel the hedge contract immediately.
- The AD bank may obtain certification of KYC/AML in the prescribed format. In case the AD bank has a presence outside India, the AD may take care of the KYC/AML through its bank's offshore branch.
- AD banks should evolve appropriate arrangements to mitigate credit risk. Credit limits can be granted based on the credit analysis done by self/the overseas branch.
- The amount and tenor of the hedge should not exceed that of the underlying transaction and should be in consonance with the extant regulations regarding tenor of payment/ realisation of the proceeds.
- On due date, settlement is to be done through the correspondent bank's vostro or the AD bank's nostro accounts. AD banks in India may release funds to the beneficiaries only after sighting funds in nostro/vostro accounts.
- Contracts once cancelled, cannot be rebooked.
- Contracts may, however, be rolled over on or before maturity subject to maturity of the underlying exposure.
- On cancellation of the contracts, gains may be passed on to the customer subject to the customer providing a declaration that he is not going to rebook the contract or that the contract has been cancelled on account of cancellation of the underlying exposure.
- In case the underlying trade transaction is extended, rollover can be permitted once based on the extension of the underlying trade transaction for which suitable documentation is to be provided by the overseas bank and the same procedure followed as in case of the original contract.

PAYMENT SYSTEM

Retail Electronic Payment Systems–Processing Charges

The Reserve Bank has advised that clearing houses/ processing centres will now calculate and settle the processing charges payable by originating banks to destination banks (including the service tax applicable thereon), in respect of retail electronic payment products (NEFT, NECS, RECS and ECS). The charges will be calculated and settled by the clearing houses using the multilateral netting method. The service tax will, however, be calculated on gross obligations of the banks. Necessary MIS reports would be provided to banks to enable them to remit the service tax to the government.

Banks managing clearing houses/processing centres should advise the clearing houses/processing centres to put in place necessary systems to undertake this work. The application software is being modified suitably for this purpose. This arrangement will be reviewed after a period of 3 months.

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.
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