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POLICY

Draft Guidelines for Licensing of Payments Banks and Small Banks

The Reserve Bank of India released on July 17, 2014, the draft guidelines for "Licensing of Payments Banks" and for "Licensing of Small Banks". The Reserve Bank has sought views/ comments on both the draft guidelines from all interested parties and general public. Suggestions and comments on the draft guidelines may be sent by August 28, 2014 to the Chief General Manager, Reserve Bank of India, Department of Banking Operations and Development, Central Office, 13th floor, Central Office Building, Shahid Bhagat Singh Marg, Mumbai-400001 or can be emailed to cgmicdbodco@rbi.org.in. Final guidelines will be issued and the process of inviting applications for setting up of payments banks and small banks will be initiated after receiving feedback, comments and suggestions on the draft guidelines.

Concept

Both, payments banks and small banks are "niche" or "differentiated" banks, with the common objective of furthering financial inclusion. Small banks will provide a whole suite of basic banking products, such as, deposits and supply of credit, but in a limited area of operation. Payments banks will provide a limited range of products, such as, acceptance of demand deposits and remittances of funds, but will have a widespread network of access points, particularly to remote areas, either through their own branch network or through Business Correspondents (BCs) or through networks provided by others. They will add value by adapting technological solutions to lower costs.

Eligibility

The entities eligible to set up a payments bank include existing non-bank pre-paid instrument issuers (PPIs), non-banking finance companies (NBFCs), corporate BCs, mobile telephone companies, super-market chains, companies, real sector cooperatives, and public sector entities. The entities eligible to set up a small bank include resident individuals with ten years of experience in banking and finance, companies and societies, NBFCs, micro finance institutions (MFIs) and local area banks.

The eligible entities should be "fit and proper" in order to be eligible to promote payments banks and small banks. The Reserve Bank would assess the 'fit and proper' status of the applicants on the basis of their past record of sound credentials and integrity, not; financial soundness and successful track record of at least five years in running their businesses.

The minimum paid up capital requirement of both payments banks and small banks is kept at Rs. 100 crore, of which the promoters' initial minimum contribution will be at least 40 per cent, to be locked in for a period of five years. Shareholding of the promoters should be brought down to 40 per cent within three years, 30 per cent within a period of 10 years, and to 26 per cent within 12 years from the date of commencement of business of the bank.

Taking into account the above, the draft guidelines on payments banks and small banks as differentiated or restricted banks have been prepared. The Reserve Bank is working on the guidelines for continuous authorisation of universal banks and will come out with these separately.

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Flexible Loan Structuring to raise Long Term Bonds

The Reserve Bank of India issued on July 15, 2014, a number of instructions to banks specifying the operational guidelines and incentives in the form of flexibility in loan structuring and refinancing, and also granting exemptions from regulatory pre-emptions, such as, cash reserve ratio (CRR), statutory liquidity ratio (SLR) and priority sector lending (PSL). The objective of these instructions is to mitigate the asset-liability management (ALM) problems faced by banks in extending project loans to infrastructure and core industries sectors, and also to ease the raising of long term resources for project loans to infrastructure and affordable housing sectors. These instructions are contained in:

1. DBOD.BP.BC.No.24/21.04.132/2014-15 dated July 15, 2014; and
2. DBOD.BP.BC.No.25/08.12.014/2014-15 dated July 15, 2014.

The instructions, in the first notification, fleshes out operational guidelines for flexible structuring and refinancing of new project loans to infrastructure and core industries sectors. The instructions, in the second notification, lays down the guidelines for issuance of long term bonds by banks for financing infrastructure project loans and affordable housing, and exemption from regulatory pre-emptions, such as, CRR, SLR and PSL on such bonds. A collateral benefit, if bank bond issuances prove successful, is the development of the domestic corporate bond market.

Framework for dealing with D-SIBs

The Reserve Bank released on July 22, 2014, the Framework for dealing with Domestic Systemically Important Banks (D-SIBs). The Framework discusses the methodology to be adopted by the Reserve Bank for identifying the D-SIBs and additional regulatory/ supervisory policies which D-SIBs would be subjected to.

The assessment methodology adopted by the Reserve Bank is primarily based on the Basel Committee on Banking Supervision (BCBS) methodology for identifying the Global Systemically Important Banks (G-SIBs) with suitable modifications to capture domestic importance of a bank. The indicators which would be used for assessment are: size, interconnectedness, substitutability and complexity. Based on the sample of banks chosen for computation of their systemic importance, a relative composite systemic importance score of the banks will be computed. The Reserve Bank will determine a cut-off score beyond which banks will be considered as D-SIBs. Based on their systemic importance scores in ascending order, banks will be plotted into four different buckets and will be required to have additional Common Equity Tier-I capital requirement ranging from 0.20 per cent to 0.80 per cent of risk weighted assets, depending upon the bucket they are plotted into. Based on the data as on March 31, 2013, it is expected that about 4 to 6 banks may be designated as D-SIBs under various buckets. D-SIBs will also be subjected to differentiated supervisory requirements and higher intensity of supervision based on the risks they pose to the financial system.

The computation of systemic importance scores will be carried out at yearly intervals. The names of the banks classified as D-SIBs will be disclosed in the month of August every year starting from 2015.

Loans against Gold Jewellery for non-agricultural purposes

The Reserve Bank on July 22, 2014, has decided that loans extended against pledge of gold ornaments and jewellery, for other than agricultural purposes, where both interest and principal are due for payment at maturity of the loan will be subject to certain modified conditions.

The Reserve Bank has also clarified that loan-to-value (LTV) of 75 per cent shall be maintained throughout the tenure of the loan for all loans extended against pledge of gold ornaments and jewellery for non-agricultural end uses. The LTV ratio shall be computed against the total outstanding in the account, including accrued interest, and current value of gold jewellery accepted as security/collateral, determined as per the methodology prescribed in the circular dated January 20, 2014.

For the purpose of valuation of gold, banks may use the historical spot gold price data publicly disseminated by a commodity exchange regulated by the Forward Markets Commission on a consistent manner as per their Board approved policy, in addition to the prices disseminated by the India Bullion and Jewellers Association Limited.

This decision was taken after the Reserve Bank received representations from banks requesting to increase the prescribed ceiling and to review other conditions applicable for non-agricultural loans against pledge of gold ornaments and jewellery, where both interest and principal are payable at maturity of the loan, especially in view of introduction of Loan to Value (LTV) ceiling for such loans vide the RBI circular dated January 20, 2014.

IGA with US under FATCA- Registration

The Reserve Bank, on June 27, 2014, advised all scheduled commercial banks (excluding regional rural banks)/local area banks/all India financial institutions to take note of certain instructions with regard to their registration with United States authorities and obtaining a Global Intermediary Identification Number (GIIN) as the Government of India (GoI) and United States of America have reached an agreement in substance on the terms of an Inter-Governmental Agreement (IGA) to implement Foreign Account Tax Compliance Act (FATCA) and India is now treated as having an IGA in effect from April 11, 2014. However, IGA would be signed only after the approval of Cabinet.

The FATCA is a United States federal law that requires United States persons, including individuals who live outside the United States, to report their financial accounts held outside of the United States, and requires foreign financial institutions to report to the Internal Revenue Service (IRS) about their US clients.

Issue of Long Term Bonds by Banks

The Reserve Bank, on July 15, 2014, eased the way for banks to raise long term resources to finance their long term loans to infrastructure as well as affordable housing. It will help promote both growth and stability, as well as improve the supply side. In order to ensure adequate credit flow to infrastructure sector as also towards the affordable housing needs of the country by encouraging banks to optimally utilise the long-term financing avenues already available to them to finance their lending to these sectors, the prudential guidelines on this issue have been reviewed with a view to minimise certain regulatory pre-emptions. The revised instructions are available on RBI website (www.rbi.org.in).

UCBs

Norms for opening of Onsite/Off-site ATMs by UCBs

The Reserve Bank, on July 2, 2014, has permitted Core Banking Solution-enabled urban co-operative banks (UCBs) which satisfy certain criteria, to install onsite/off-site/mobile ATMs as per their need and potential in their area of operation without prior approval of the Reserve Bank, subject to select conditions.

FEMA

Delegation of RDA related work to ROs

The Reserve Bank, on July 18, 2014, delegated the work of granting first time permission to authorised dealer category-I banks (AD Cat-I) for entering into Rupee Drawing Arrangement (RDA) with non-resident exchange house to its Regional Offices. AD Cat-I banks willing to enter into Rupee/Foreign Currency Drawing Arrangement with non-resident exchange house for the first time should, henceforth, submit the application, in the prescribed format, to the respective Regional Office of the Foreign Exchange Department of the Reserve Bank under whose jurisdiction the registered office of the applicant falls. Subsequently, AD Cat-I Banks may enter into RDAs, subject to the prescribed guidelines and inform the concerned Regional Office of the Reserve Bank, immediately.

Further, AD Cat-I Banks should submit the duly approved Annual Review note by 30th June every year, on the Vostro accounts of the Exchange Houses maintained by them under the Rupee/ Foreign Currency Drawing Arrangements (RDAs), duly approved by their Board, to the respective Regional Office of the Foreign Exchange Department of the Reserve Bank under whose jurisdiction the registered office of the applicant falls.

MTSS – Delegation of work to ROs

The Reserve Bank, on July 18, 2014, advised authorised persons, who are Indian Agents under Money Transfer Service Scheme (MTSS) that the work related to authorisation of Indian Agents has been delegated to the Regional Offices of the Reserve Bank. The application for necessary permission to act as an Indian Agent under MTSS should henceforth be made to the respective Regional Office of the Foreign Exchange Department of the Reserve Bank under whose jurisdiction the registered office of the applicant falls.

Issue of Partly Paid Shares and Warrants

On a review of the policy as regards partly paid shares and warrants, the Reserve Bank, on July 14, 2014 decided that the partly paid equity shares and warrants issued by an Indian shall be eligible instruments for the purpose of foreign direct investment (FDI) and foreign portfolio investment (FPI) by Foreign Institutional Investors (FIIs)/Registered Foreign Portfolio Investors(RFPIs) subject to compliance with FDI and FPI schemes. The reporting of receipt of foreign inward remittance towards each upfront /call payment for FDI transaction shall be made in Advance Reporting Form.

LRS for resident individuals-Increase in the limit

The Reserve Bank, on July 17, 2014, has allowed AD Category–I banks to remit up to USD125,000 per financial year, under the Liberalised Remittance Scheme, for any permitted current or capital account transaction or a combination of both. Further, it is clarified that the Scheme can now be used for acquisition of immovable property outside India.

Issue/Transfer of Shares/Convertible Debentures

The Reserve Bank, on July 15, 2014, revised the existing pricing guidelines in respect of transfer/issue of shares and for exit from investment in equity shares with or without optionality clauses of listed/unlisted Indian companies so as to provide greater freedom and flexibility to the parties concerned under the FDI framework. The new pricing guidelines are available on RBI website (www.rbi.org.in).

RPCD

Financial Literacy by FLCs and Rural Bank Branches

The Reserve Bank, on July 7, 2014, has decided to monitor the financial literacy activities by rural bank branches, that are mandated to conduct minimum of one financial literacy camp in a month, on a quarterly basis. Since the literacy camps are being conducted for the last two years, the Reserve Bank decided to measure the extent of financial inclusion achieved through these camps. Accordingly, the Reserve Bank advised all state-level bankers committees (SLBCs) /Union Territory-level bankers committees (UTLBCs) to submit quarterly reports of the financial literacy activities by rural bank branches and financial literacy centres as per the prescribed formats, to the respective regional offices of the Reserve Bank within 20 days after the end of each quarter.

Non-scheduled StCBs to meet SLR by March 2017

On a review, the Reserve Bank, on July 21, 2014, decided to calibrate the transition to the revised dispensation relating to the form and manner of maintenance of Statutory Liquidity Ratio (SLR) assets for Non-scheduled State Co-operative Banks (StCBs) and all Central Co-operative Banks (CCBs). These banks have now been granted time up to March 31, 2017 for complying with the revised norms in a phased manner as below:

Date	Investment in approved securities as percentage of NDTL
March 31, 2015	5 per cent
March 31, 2016	10 per cent
March 31, 2017	Entire SLR as may be prescribed by RBI on that date

Pursuant to the enactment of the Banking Laws (Amendment) Act, 2012, giving powers to the Reserve Bank of India to specify the percentage of Cash reserve Ratio (CRR) for Non-scheduled State Co-operative Banks (StCBs) and all Central Co-operative Banks (CCBs) and the percentage of SLR as well as the form and manner of holding SLR by cooperative banks, it had been decided to increase the CRR for non-scheduled StCBs and all CCBs by 100 basis points from 3.00 per cent to 4.00 per cent of their total net demand and time liabilities, on par with scheduled StCBs, with effect from the fortnight beginning July 12, 2014. It had also been decided to prescribe the form and manner of maintenance of SLR assets for StCBs/CCBs. The revised instructions issued in this regard to StCBs/ CCBs are available on RBI website (www.rbi.org.in).

Reports/Guidelines

Draft Guidelines for setting up of TReDS

The Reserve Bank of India has sought feedback on the draft guidelines for setting up of and operating Trade Receivables Discounting System (TReDS) from the public/stakeholders. Comments may be emailed or sent by post to the Principal Chief General Manager, Department of Payment and Settlement Systems, Reserve Bank of India, Central Office, 14th Floor, Shahid Bhagat Singh Marg, Mumbai - 400001 on or before August 8, 2014. The guidelines are available on RBI website (www.rbi.org.in).

IWG on Implementation of CCCB Framework in India

The Reserve Bank, on July 21, 2014, released the Report of the Internal Working Group (IWG) on Implementation of Counter Cyclical Capital Buffer (CCCB) in India (Chairperson: Shri B. Mahapatra).

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The key recommendations of the IWG are:

- While the credit-to-GDP gap shall be used for empirical analysis to facilitate CCCB decision, it may not be the only reference point in the CCCB framework for banks in India and the credit-to-GDP gap may be used in conjunction with other indicators like Gross Non-Performing Assets (GNPA) growth for CCCB decisions in India.
- The CCCB decision may be pre-announced with a lead time of 4-quarters.
- The lower threshold (L) where the CCCB is activated may be set at 3 percentage points of the credit-to-GDP gap, provided its relationship with GNPA remains significant and the upper threshold (H) where the CCCB is at its maximum may be kept at 15 percentage points of credit-to-GDP gap.
- The CCCB shall increase gradually from 0 to 2.5 per cent of the risk weighted assets (RWA) of the bank but the rate of increase would be different based on the level/position of credit-to-GDP gap between 3 and 15 percentage points. For example, the CCCB requirement shall increase linearly from 0 to 20 basis points when credit-to-GDP gap moves from 3 to 7 percentage points. Similarly, for above 7 and up to 11 percentage points range of credit-to-GDP gap, CCCB requirement shall increase linearly from above 20 to 90 basis points. Finally, for above 11 and up to 15 percentage points range of credit-to-GDP gap, the CCCB requirement shall increase linearly from above 90 to 250 basis points. However, if the credit-to-GDP gap exceeds 15 percentage points, the buffer shall remain at 2.5 per cent of the RWA. If the credit-to-GDP gap is below 3 percentage points then there will not be any CCCB requirement.
- The supplementary indicators shall include incremental C-D ratio for a moving period of three-years (along with its correlation with credit-to-GDP gap and GNPA growth), Industry Outlook (IO) assessment index (along with its correlation with GNPA growth) and interest coverage ratio (along with its correlation with credit-to-GDP gap). In due course, indices like House Price Index / RESIDEX and Credit Condition Survey may also form a part of the supplementary indicators for CCCB decision.
- The Reserve Bank of India may apply discretion in terms of use of indicators while activating or adjusting the buffer.
- The CCCB framework in India may be operated in conjunction with sectoral approach that has been successfully used in India over the period of time.
- The same set of indicators that are used for activating CCCB may be used to arrive at the decision for the release phase of the CCCB. However, instead of hard rule-based approach, flexibility in terms of use of judgement and discretion may be provided to the Reserve Bank of India for operating the release phase of CCCB. Further, the entire CCCB may be released promptly at a single point in time.
- The CCCB may be maintained in the form of Common Equity Tier-I capital only.
- For all banks operating in India, CCCB shall be maintained on solo basis as well as on consolidated basis.
- The indicators and thresholds used for CCCB decisions may be subject to continuous research and empirical testing for their usefulness and new indicators may be explored to support CCCB decisions.

RBI releases June 2014 Financial Stability Report

The Reserve Bank, on June 26, 2014, released the Financial Stability Report (FSR) June 2014, the ninth issue of the half-yearly publication.

The FSR reflects the collective assessment of the Sub-Committee of the Financial Stability and Development Council (FSDC), on risks to financial stability. The Report aims to promote awareness about the vulnerabilities in the financial system, to inform about the resilience of the financial institutions and to encourage debate on issues relating to development and regulation of the financial sector.

The latest issue is being brought out at a time when global financial markets are showing signs of improved stability although growth is still not on strong ground and easy monetary policy continues in many jurisdictions. On the domestic front, the return to political stability has provided impetus to the outlook and the capital markets reflect the expectations on policy measures to address the adverse growth-inflation dynamics and saving-investment balance as also efficient implementation of policies and programmes.

India’s financial system remains stable, though the banking sector is facing some major challenges, mainly relating to public sector banks (PSBs). Although there has been some improvement in the asset quality of scheduled commercial banks (SCBs) since September 2013, the level of gross non-performing advances as percentage of total gross advances (GNPA ratio) of PSBs was significantly higher as compared to the other bank groups. While the ownership pattern and recapitalisation of PSBs are contingent upon government policy and the fiscal situation, there is a case for reviewing the governance structures of PSBs, with a greater emphasis on market discipline.

Macro stress tests show that the system level capital to risk-weighted assets ratio (CRAR) of SCBs remains well above the regulatory minimum even under adverse macroeconomic conditions.

The regulation of securities markets in India is in sync with international developments, although mutual funds and other asset management activities in Indian markets do not carry risks similar to those experienced in other jurisdictions. The lending activity of insurance companies, though relatively small and within the prescribed exposure limits applicable for insurance companies, may need to be streamlined and monitored under a prudential framework comparable to that for banks to eliminate the possibility of regulatory arbitrage. Revised norms for corporate governance as also warehouse and related processes are expected to strengthen the functioning of the commodity derivatives market. In the context of India’s pension sector, inadequate liability computation in case of several defined benefit pension schemes can be a potential source of fiscal stress in years to come.

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