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MONETARY AND CREDIT INFORMATION REVIEW

POLICY

Cash Withdrawal at Point-of-Sale

As a further step towards enhancing customer convenience in using plastic money, the Reserve Bank has now permitted cash withdrawals at point-of-sale (POS) terminals. To start with, this facility would be available for all debit cards issued in India, up to Rs.1000 per day. This facility would, however, be subject to the conditions as indicated below:

- The facility is available only against debit cards issued in India.
- The maximum amount that can be withdrawn at POS terminals is fixed at Rs.1000 per day.
- The facility may be made available at any merchant establishment designated by a bank after due diligence is carried out.
- The facility is available irrespective of whether the card holder makes a purchase or not.
- In case the facility is being availed of along with the purchase of merchandise, the receipt generated should separately indicate the amount of cash withdrawn.
- Banks offering this facility should put in place a proper customer redressal mechanism. Complaints in this regard would fall within the ambit of the Banking Ombudsman Scheme.

Banks desirous of offering this facility should obtain the approval of their board of directors. The note put up to the board should incorporate the product profile, risk perceived by the bank and the risk mitigation measures. Banks should also seek one time permission from the Reserve Bank's Department of Banking Operations and Development under Section 23 of the Banking Regulation Act, 1949. (A copy of the note put up to the board/board's approval should be enclosed to the application).

Ready Forward Contracts

The Reserve Bank has permitted unlisted companies who have been issued special securities by the Government of India and have gilt accounts with scheduled commercial banks to enter into ready forward contracts, subject to certain conditions and restrictions.

Accordingly, the categories of entities eligible to enter into ready forward contracts (market repos and not repos with the Reserve Bank under the liquidity adjustment facility) in the government securities are:

(a) persons or entities maintaining a subsidiary general ledger (SGL) account with the Reserve Bank, Mumbai, and

(b) entities which do not maintain SGL accounts with the Reserve Bank but maintain gilt accounts (i.e., gilt account holders) with a bank or any other entity (i.e., the custodian) permitted by the Reserve Bank to maintain constituent subsidiary general ledger account (CSGL account) with its Public Debt Office, Mumbai. These entities are:

   (i) any scheduled bank;
   (ii) any primary dealer authorised by the Reserve Bank;
   (iii) any non-banking financial company registered with the Reserve Bank (other than government companies as defined in section 617 of the Companies Act, 1956);
   (iv) any mutual fund registered with the Securities and Exchange Board of India;
   (v) any housing finance company registered with the National Housing Bank;
   (vi) any insurance company registered with the Insurance Regulatory and Development Authority;
   (vii) any non-scheduled urban co-operative bank;
   (viii) any listed company having a gilt account with a scheduled commercial bank; and
   (ix) any unlisted company which has been issued special securities by the Government of India and having gilt account with a scheduled commercial bank.

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For entering into ready forward contracts, the additional restrictions which would be applicable to the eligible unlisted companies are:

(a) The eligible unlisted companies can enter into ready forward transactions as the borrower of funds in the first leg of the repo contract only against the collateral of the special securities issued to them by the Government of India; and

(b) The counterparty to the eligible unlisted companies for repo transactions should be either a bank or a primary dealer maintaining SGL account with the Reserve Bank.

Time Schedule for Advanced Approaches of Basel II Framework

Having regard to the necessary up-gradation of risk management framework as also capital efficiency likely to accrue to banks due to adoption of the advanced approaches envisaged under the Basel II framework and the emerging international trend in this regard, the Reserve Bank has laid down a timeframe for implementation of the advanced approaches in India. This would enable banks to plan and prepare for their migration to the advanced approaches for credit risk and operational risk, as also for the internal models approach for market risk. The time schedule is:

Sr. No.	Approach	Earliest date for applying to RBI	Likely date of approval by RBI
1.	Internal Models Approach for market risk	April 1, 2010	March 31, 2011
2.	Standardised Approach for operational risk	April 1, 2010	September 30, 2010
3.	Advanced Measurement Approach for operational risk	April 1, 2012	March 31, 2014
4.	Internal Ratings-Based (IRB) Approaches for credit risk (foundation as well as advanced IRB)	April 1, 2012	March 31, 2014

Banks have been advised to undertake an internal assessment of their preparedness for migration to advanced approaches, in the light of the criteria envisaged in the Basel II document, as per the above time schedule and take a decision, with the approval of their Board, whether they would like to migrate to any of the advanced approaches. Banks deciding to migrate to the advanced approaches may approach the Reserve Bank for necessary approvals, in due course, as per the stipulated time schedule. If, the result of a bank's internal assessment indicates that it is not in a position to apply for implementation of advanced approach by the above indicated dates, it may choose a later date suitable to it based upon its preparation.

Banks, at their discretion, would have the option of adopting the advanced approaches for one or more of the risk categories as per their preparedness, while continuing with the simpler approaches for other risk categories, and it would not be necessary to adopt the advanced approaches for all the risk categories simultaneously. Banks should, however, invariably obtain the Reserve Bank's prior approval for adopting any of the advanced approaches.

In terms of the Reserve Bank's circular of April 27, 2007 on the new capital adequacy framework, foreign banks operating in India and Indian banks having operational presence outside India have migrated to the simpler approaches available under the Basel II Framework since March 31, 2008. Other commercial banks have also migrated to these approaches from March 31, 2009. Thus, the Standardised Approach for credit risk, Basic Indicator Approach for operational risk and the Standardised Duration Approach for market risk (as slightly amended under Basel II framework) have been implemented for banks in India.

FEMA

Issue of Indian Depository Receipts

With a view to facilitating eligible companies resident outside India to issue Indian Depository Receipts (IDRs) through a domestic depository and permitting persons resident in India and outside India to purchase, possess, transfer and redeem IDRs, it has been decided to operationalise the IDR Rules, notified by the Government of India, as amended from time to time, with immediate effect.

Accordingly, eligible companies resident outside India may issue IDRs through a domestic depository. The permission has been granted subject to compliance with the Companies (Issue of Depository Receipts) Rules, 2004 and subsequent amendments made thereto and the Securities and Exchange Board of India (SEBI) (DIP) Guidelines, 2000, as amended from time to time. In case of raising of funds through issuance of IDRs by financial/banking companies having presence in India, either through a branch or subsidiary, the approval of the sectoral regulator(s) should obtained before issuing the IDRs.

Investment by Persons Resident in India/FIIs/NRIs

The FEMA Regulations would not be applicable to persons resident in India as defined under section 2(v) of FEMA, 1999, for investing in IDRs and subsequent transfer arising out of transaction on a recognised stock exchange in India. Foreign institutional investors (FIIs) including SEBI approved sub-accounts of the FIIs, registered with SEBI and non-resident Indians (NRIs) may also invest, purchase, hold and transfer IDRs of eligible companies resident outside India and issued in the Indian capital market, subject to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 as amended from time to time. Further, NRIs can invest in IDRs out of funds held in their NRE/FCNR(B) account maintained with an authorised dealer/authorised bank.

Fungibility

Automatic fungibility of IDRs is not permitted.

Period of Redemption

IDRs shall not be redeemable into underlying equity shares before the expiry of a one year period from the date of issue of the IDRs.

Transfer and Redemption

At the time of redemption/conversion of IDRs into underlying shares, the Indian holders (persons resident in India) of IDRs should comply with the provisions of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 as amended from time to time. On redemption of IDRs, the following guidelines should be followed:

(i) Listed Indian companies may either sell or continue to hold the underlying shares subject to the terms and conditions as per Regulations 6B and 7 of Notification No. FEMA 120/ RB-2004 dated July 7, 2004, as amended from time to time.

(ii) Indian mutual funds registered with SEBI may either sell or continue to hold the underlying shares subject to the terms and conditions as per Regulation 6C of Notification

No. FEMA 120/RB-2004 dated July 7, 2004, as amended from time to time.

(iii) Other persons resident in India, including resident individuals, are allowed to hold the underlying shares only for the purpose of sale within a period of 30 days from the date of conversion of the IDRs into underlying shares.

(iv) The FEMA provisions would not apply to the holding of the underlying shares on redemption of IDRs by FIIs, including SEBI approved sub-accounts of FIIs and NRIs.

The proceeds of the issue of IDRs should be immediately repatriated outside India by the eligible companies issuing such IDRs. The IDRs issued should be denominated in Indian Rupees.

ECB Policy modified

Some aspects of the external commercial borrowing (ECB) policy have been modified as indicated below:

Integrated Township

As per the extant policy, corporates, engaged in the development of integrated township, are permitted to avail of ECB under the approval route until June 2009. On a review of the prevailing conditions, the permission has now been extended up to December 31, 2009, under the approval route. All other terms and conditions remain unchanged.

NBFC Sector

As per the current ECB norms, non-banking finance companies (NBFCs) which are exclusively involved in financing of the infrastructure sector, are permitted to avail of ECBs from multilateral/regional financial institutions and government owned development financial institutions for on-lending to borrowers in the infrastructure sector under the approval route, subject, *inter-alia*, to the condition that the direct lending portfolio of these lenders *vis-à-vis* their total ECB lending to NBFCs, at any point of time, should not be less than 3:1. This condition has been dispensed with from July 1, 2009. The proposals would, however, continue to be examined by the Reserve Bank under the approval route, as hitherto.

Development of SEZ

Special economic zone (SEZ) developers are now permitted to avail of ECB under the approval route for providing infrastructure facilities, as defined in the ECB policy, within the SEZ. ECBs would, however, not be permissible for development of integrated township and commercial real estate within the SEZ. The infrastructure sector includes (i) power, (ii) telecommunication, (iii) railways, (iv) roads, including bridges, (v) sea port and airport, (vi) industrial parks, (vii) urban infrastructure (water supply, sanitation and sewage projects) and (viii) mining, refining and exploration.

Earlier, units in the SEZ were permitted to access ECBs only for their own requirements and ECB was not permitted for the development of SEZ.

Corporates under Investigation

Corporates which have violated the extant ECB policy and are under investigation by the Reserve Bank and/or by the Directorate of Enforcement, will not be allowed to access the automatic route for ECB. Any request by such corporates for ECB would be examined under the approval route.

These modifications to the ECB guidelines have come into force from June 30, 2009. All other aspects of the ECB policy, such as, USD 500 million limit per company per financial year under the automatic route, eligible borrower, recognised lender, end-use, all-in-cost ceiling, average maturity period, prepayment, refinancing of existing ECB and reporting arrangements remain unchanged.

UCBs

Prudential Treatment of Provisions

The Reserve Bank has laid down the guidelines regarding the prudential treatment of different types of provisions in respect of loan portfolios of primary (urban) co-operative banks (UCBs). The guidelines are:

Additional Provisions for NPAs at Higher than Prescribed Rates

The regulatory norms for provisioning represent the minimum requirement. Banks may, therefore, voluntarily make specific provisions for non-performing assets (NPAs) at rates which are higher than the rates prescribed under existing regulations if, such higher rates are based on a policy approved by their board of directors, to provide for estimated actual loss in collectible amount and the policy is consistently adopted from year to year or if provided in the respective State Cooperative Societies Acts/Multi-State Cooperative Societies Act, 2002. The additional specific provisions for NPAs, like the minimum regulatory provision on NPAs, may be netted off from gross NPAs to arrive at the net NPAs. The additional specific provision for NPAs will not be reckoned as Tier II capital.

Excess Provisions on Sale of NPAs

Excess provisions which arise on sale of NPAs can be admitted as Tier II capital subject to the overall ceiling of 1.25 per cent of total risk weighted assets.

Provisions for Diminution of Fair Value

Provisions for diminution of fair value of restructured advances, both in respect of standard assets as well as NPAs, made on account of reduction in rate of interest and/or reschedulement of principal amount are permitted to be netted from the relative asset.

These guidelines are effective from June 29, 2009.

CUSTOMER SERVICE

Displaying Contact Details of Bank Officials

With a view to strengthening the grievance redressal mechanism, banks have been advised to ensure that the list of names of officials displayed at their branches who can be contacted for redressal of complaints also includes the name and other details of the concerned nodal officer appointed under the Banking Ombudsman Scheme, 2006.

Further, banks have also been advised to display on their web-sites, the names and other contact details of the officials at their head office/regional offices/zonal offices who can be contacted for redressal of complaints. This list should also include the names of the nodal officers/principal nodal officers appointed under the Banking Ombudsman Scheme, 2006.

Banks should also display on their web-sites, the names, addresses, telephone/fax numbers of their chairman and managing director/chief executive officer, line functioning heads for operations, such as, credit cards, loans and advances, retail banking, personal banking, rural/agricultural banking, small and medium enterprises (SME) banking etc., to enable their customers to approach them, if necessary.

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Recommendations of the G-20 Working Group on Enhancing Sound Regulation and Strengthening Transparency

(continued from the previous issue)

Recommendation 14

Capital should serve as an effective buffer to absorb losses over the cycle, so as to protect both the solvency of financial institutions in the event of losses, and their ability to lend.

In the near term, capital buffers above required minimums should be allowed to decline in response to deteriorating economic conditions and credit quality, and urgent consideration should be given to measures that would facilitate access to additional private sector capital in the downturn.

Once conditions in the financial system have recovered, the adequacy of the international standard for the minimum level of capital for banks should be reviewed and the quality and global consistency of capital should be enhanced. In addition, capital buffers above minimum requirements and loan-loss provisions should be built up in good times in order to enhance the ability of regulated financial institutions to withstand large shocks.

- Once conditions in the global financial system recover, the Reserve Bank would consider enhancing the minimum capital standards in tandem with the proposals at the international level. The build-up of capital and provisioning buffers in good times will be encouraged by the Reserve Bank so that capital can absorb unexpected losses and be drawn down during difficult times.

Recommendation 15

G-20 leaders should support the progressive adoption of the Basel II capital framework, which will continue to be improved on an ongoing basis, across the G-20.

- All commercial banks in India were Basel II compliant as on March 31, 2009. Initially the base approach of the Basel II framework have been adopted. The Reserve Bank has placed on its website a draft circular giving an indicative timeframe for implementation of the advanced approach of the Basel II framework. The enhancement to current Basel II framework by the international standard setting bodies will be considered for implementation as appropriate.

Recommendation 16

Prudential supervisors and central banks should deliver a global framework for promoting stronger liquidity buffers at banks, including cross-border institutions, to ensure that they can withstand prolonged periods of market and funding liquidity stress.

- Indian banks have a significant holding of liquid instruments as they are required to maintain cash reserve ratio and statutory liquidity ratio (5 per cent and 24 per cent of their net demand and time liabilities, as at present). The substantial CRR/SLR holding offers, in effect, a good liquidity buffer. There are prudential norms governing unsecured overnight borrowings by banks and inter-bank liabilities.
- The Reserve Bank has examined the issue of banks establishing a more robust liquidity risk management framework that is well integrated into the bank-wide risk management process by adopting global liquidity planning. In this context, banks will be required to integrate their various foreign currency assets and liabilities positions from their branch operations in India with the rupee asset liability position.

Recommendation 17

Financial institutions should continue to strengthen the infrastructure supporting OTC derivatives markets. In the case of credit derivatives, this includes standardizing contracts to facilitate their clearing through a central counterparty. National authorities should enhance incentives as needed for the use of central counterparties to clear OTC credit derivatives.

Recommendation 18

Central counterparties should be subject to transparent and effective oversight by prudential supervisors and other relevant authorities, including central banks, and meet high standards in terms of risk management, operational arrangements, default procedures, fair access and transparency. The CPSS and IOSCO should review their experiences in applying their recommendations for central counterparties to derivatives.

- The CCIL provides an institutional structure for the clearing and settlement of transactions undertaken in government securities, money market instruments and foreign exchange products and has adopted the core principles set by the CPSS and IOSCO. In October 2007, CCIL has joined as a member of the CCP 12, an international organisation of central counterparty (CCP) clearing organisations.
- CCIL's role is being gradually extended to the OTC derivatives segment, initially as a reporting platform and thereafter, covering the settlement aspect.
- The Payment and Settlement Systems Act, 2007 has designated the Reserve Bank as the authority to regulate and supervise the payment and settlement systems in the country.
- The netting procedure and settlement finality, earlier governed by contractual agreement/s, have been accorded legal recognition under the Act. The Reserve Bank is empowered to issue directions and guidelines to the system providers, prescribe the duties to be performed by them and audit and inspect their systems/premises.
- The recommendations of the CPSS and the IOSCO when available will be applied as appropriate to the CCIL.

Recommendation 19

Large financial institutions should ensure that their compensation frameworks are consistent with their long-term goals and with prudent risk-taking. As such, the Boards of Directors of financial institutions should set clear lines of responsibility and accountability throughout their organizations to ensure that the design and operation of its remuneration system supports the firm's goals, including its overall risk tolerance. Shareholders may have a role in this process. Boards should also ensure there are appropriate mechanisms for monitoring remuneration schemes.

(to be concluded in the next issue)

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