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POLICY

Commercial Real Estate Exposures

The Reserve Bank has finalised the guidelines on classification of commercial real estate (CRE) exposures. The guidelines which have come into effect from September 9, 2009 are -

Definition

Real Estate is generally defined as an immovable asset-land (earth space) and the permanently attached improvements to it. Income-producing real estate (IPRE) as defined in the Basel-II framework, is reproduced below:

"Income-producing real estate (IPRE) refers to a method of providing funding to real estate (such as, office buildings to let, retail space, multifamily residential buildings, industrial or warehouse space and hotels) where the prospects for repayment and recovery on the exposure depend primarily on the cash flows generated by the asset. The primary source of these cash flows would generally be lease or rental payments or the sale of the asset. The borrower may be, but is not required to be, an SPE (special purpose entity), an operating company focused on real estate construction or holdings, or an operating company with sources of revenue other than real estate. The distinguishing characteristic of IPRE versus other corporate exposures that are collateralised by real estate is the strong positive correlation between the prospects for repayment of the exposure and the prospects for recovery in the event of default, with both depending primarily on the cash flows generated by a property".

From the above definition of IPRE, it may be seen that for an exposure to be classified as IPRE/CRE, the essential feature would be that the funding will result in the creation/acquisition of real estate (such as, office buildings to let, retail space, multifamily residential buildings, industrial or warehouse space, and hotels) where the prospects for repayment would depend primarily on the cash flows generated by the asset. Additionally, the prospect of recovery in the event of default would also depend primarily on the cash flows generated from such funded asset which is taken as security. The primary source of cash flow (i.e. more than 50 per cent of cash flows) for repayment would generally be lease or rental payments or the sale of the assets

as also for recovery in the event of default, where such asset is taken as security.

These guidelines would also be applicable to certain cases where the exposure may not be directly linked to the creation or acquisition of CRE but the repayment would come from the cash flows generated by CRE. For example, exposures taken against existing commercial real estate whose prospects of repayments primarily depend on rental/sale proceeds of the real estate should be classified as CRE. Other such cases may include - extension of guarantees on behalf of companies engaged in commercial real estate activities, exposures on account of derivative transactions undertaken with real estate companies, corporate loans extended to real estate companies and investment made in the equity and debt instruments of real estate companies.

Reserve Bank's Approach

The definition of CRE exposure is closely aligned to the Basel II definition and would be as indicated above. If the repayment primarily depends on other factors, such as,

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operating profit from business operations, quality of goods and services, tourist arrivals etc., the exposure would not be counted as commercial real estate.

In terms of the Reserve Bank's Master Circular on Housing Finance dated July 1, 2009, banks may extend finance to public agencies, and not to private builders, for acquisition and development of land provided, it is a part of the complete project including development of infrastructure, such as, water systems, drainage, roads, provision of electricity, etc. Where land is acquired and developed by state housing boards and other public agencies, banks may extend credit to private builders on commercial terms by way of loans linked to each specific project. Banks are, however, not permitted to extend fund based or non fund based facilities to private builders for acquisition of land even as part of a housing project.

Bank finance can also be granted to individuals for purchase of a plot, provided a declaration is obtained from the borrower that he intends to construct a house on the plot, within such period as may be laid down by the bank.

CRE exposures collateralised by eligible credit risk mitigants would be reduced to the extent of risk mitigating effects of the collateral. CRE exposures to the extent secured by commercial real estate would attract a risk weight of 100 per cent. In cases where a part of the CRE exposure is not covered by the security of commercial real estate, that part would attract a risk weight for CRE exposure or as warranted by the external rating of the borrower, whichever is higher.

Multiple Classification

It is possible for an exposure to get classified simultaneously into more than one category, as different classifications are driven by different considerations. In such cases, the exposure would be reckoned for regulatory/prudential exposure limit, if any, fixed by the Reserve Bank or by the bank itself, for all the categories to which the exposure is assigned. For the purpose of capital adequacy, the largest of the risk weights applicable among all the categories would be applicable for the exposure. Similarly, if an exposure has sensitivity to more than one risk factor it should be subjected to the risk management framework applicable to all the relevant risk factors.

The Reserve Bank has given some illustrative examples on exposures which should be classified as CRE and also of exposures which should not be classified as CRE which are available on its website www.rbi.org.in. Based on the principles and the examples given, banks should be able to determine whether an exposure is CRE or not and should record a reasoned note justifying the classification.

These guidelines supercede all previous instructions issued by the Reserve Bank regarding classification of exposures as CRE Exposures. The regulatory instructions governing other aspects of real estate exposure, including those contained in the Reserve Bank's circular of June 29, 2005, remain unchanged.

Maintenance of SLR

The Reserve Bank has issued a notification on September 8, 2009 enumerating the form and manner of assets to be maintained by scheduled commercial banks for

the purpose of Section 24 of the Banking Regulation Act, 1949. The specified assets are :

- (a) cash, or
- (b) gold valued at a price not exceeding the current market price, or
- (c) unencumbered investment in the following instruments which will be referred to as "statutory liquidity ratio (SLR) securities":

- * dated securities issued up to September 8, 2009;
- * treasury bills of the Government of India;
- * dated securities of the Government of India issued from time to time under the market borrowing programme and the market stabilisation scheme;
- * state development loans (SDLs) of the state governments issued from time to time under the market borrowing programme; and
- * any other instrument as may be notified by the Reserve Bank.

Explanations

- A. "Unencumbered investment" of a banking company shall include its investment in the aforesaid securities lodged with another institution for an advance or any other credit arrangement to the extent to which such securities have not been drawn against or availed of.
- B. "market borrowing programme" shall mean the domestic rupee loans raised by the Government of India and the state governments from the public and managed by the Reserve Bank of India through issue of marketable securities, governed by the Government Securities Act, 2006 and the Regulations framed thereunder, through an auction or any other method, as specified in the Notification issued in this regard.
- C. In computing the amount for the above purpose, the following shall be deemed to be cash maintained in India:
 - (i) the deposit required under sub-section (2) of Section 11 of the Banking Regulation Act, 1949 to be made with the Reserve Bank by a banking company incorporated outside India;
 - (ii) any balances maintained by a scheduled bank with the Reserve Bank in excess of the balance required to be maintained by it under Section 42 of the Reserve Bank of India Act, 1934 (2 of 1934); and
 - (iii) net balances in current accounts with other scheduled commercial banks in India.

Further, with a view to disseminating information on the SLR status of a government security, the Reserve Bank has decided that -

- the SLR status of securities issued by the Government of India and the state governments will be indicated in the press release issued by the Reserve Bank at the time of issuance of the securities; and
- an updated and current list of SLR securities will be posted on the Reserve Bank's website (www.rbi.org.in) under the link "Database on Indian Economy".

Priority Sector Lending

Pursuant to the Government of India announcing the categorisation of activities under services under the Micro Small and Medium Enterprises Development (MSMED) Act, 2006, the Reserve Bank has advised that loans granted by banks for certain activities under micro and small (service) enterprises would be included within the priority sector provided, such enterprises satisfy the definition of micro and small (service) enterprises in respect of investment in equipment (i.e., original cost excluding land and building, furniture, fittings and other items not directly related to the service rendered or as may be notified under the MSMED Act, 2006 should not exceed Rs. 10 lakh and Rs. 2 crore respectively). The activities which would be included within priority sector are -

- (a) Consultancy services including management services.
- (b) Composite broker services in risk and insurance management.
- (c) Third party administration (TPA) services for medical insurance claims of policy holders.
- (d) Seed grading services.
- (e) Training-cum-incubator centre.
- (f) Educational institutions.
- (g) Training institutes.
- (h) Retail trade.
- (i) Practice of law, i.e. legal services.
- (j) Trading in medical instruments (brand new).
- (k) Placement and management consultancy services.
- (l) Advertising agency and training centres

Accordingly, there will be no separate category for "retail trade" under priority sector. Loans granted by banks for retail trade [i.e., advances granted to retail traders dealing in essential commodities (fair price shops), consumer co-operative stores and advances granted to private retail traders with credit limits not exceeding Rs. 20 lakh] would henceforth be part of the small (service) enterprises.

Agricultural Debt Waiver and Debt Relief Scheme, 2008

The Government of India has extended the last date of payment of 75 per cent of overdue portion by the 'other farmer' under the Debt Relief Scheme (under the Agricultural Debt Waiver and Debt Relief Scheme, 2008) for another six months beyond June 30, 2009, i.e., up to December 31, 2009. The Government of India has also advised that banks/lending institutions are allowed to receive even less than 75 per cent of the eligible amount under one time settlement (OTS) provided they bear the difference themselves and do not claim it either from the government or from the farmer. The government will pay only 25 per cent of the actual eligible amount under debt relief.

The Government has clarified that the lending institutions would not charge any interest on the eligible amount for the period from February 29, 2008 to June 30, 2009. Banks may, however, charge normal rate of interest on the eligible amount from July 1, 2009 up to the date of settlement.

Where farmers covered under the Debt Relief Scheme have given an undertaking agreeing to pay their share under the OTS, banks may treat their relevant accounts as "standard"/"performing" provided :

- (a) banks make adequate provision for the loss in present value (PV) terms for all the receivables due from the borrowers. (For computing the amount of loss in PV terms under the Scheme, the balance amount receivable from the farmers may be assumed to be due on December 31, 2009, and the interest payments would be as indicated above. The cash flows should be discounted to the present value at the interest rate at which the loan was granted including the element of interest subsidy, if any, available from the government).
- (b) such farmers pay their share of the settlement latest by the revised last date i.e., December 31, 2009.

In case, however, payments are delayed by farmers beyond December 31, 2009, the outstanding amount in the relevant accounts of such farmers should be treated as NPA. The asset classification of such accounts should be determined with reference to the original date of NPA, (as if the account had not been treated as performing in the interregnum based on the aforesaid undertaking). On such down-gradation of the accounts, additional provisions as per the extant prudential norms should also be made.

It may be recalled that in June 2009, it was announced that the accounts of "other farmers" would be eligible for a debt relief of 25 per cent from the Government of India, even if they pay their entire share of 75 per cent as one single instalment, provided the instalment is deposited by such farmers till June 30, 2009.

Mortgage of Property to Bank - Disclosure of Information

Pursuant to an observation made in a case by the Hon'ble High Court of Judicature at Bombay, the Reserve Bank has advised banks that while granting finance to specific housing/development projects, they should stipulate, as part of the terms and conditions that, the builder/developer/company should -

- (i) disclose in the pamphlets/brochures etc., the name(s) of the bank(s) to which the property is mortgaged;
- (ii) append the information relating to mortgage while publishing advertisement of a particular scheme in newspapers/magazines etc.; and
- (iii) indicate in their pamphlets/brochures that they would provide no objection certificate (NOC)/permission of the mortgagee bank for sale of flats/property, if required.

Banks should ensure that the terms and conditions are complied with and funds are not released unless the builder/developer/company fulfils the these requirements.

Issue of Subordinated Debt for Raising Tier II Capital

On a review of international practices, the Reserve Bank has decided to permit banks to issue subordinated debt as Tier II capital with call and step-up options.

Earlier, banks were permitted to raise lower Tier II subordinated bonds without special features, such as, call and step up options.

Stand-alone Primary Dealers

Minimum Net Owned Funds

The minimum net owned fund (NOF) for stand-alone primary dealers (PDs) has been enhanced to Rs. 150 crore from the earlier amount of Rs. 50 crore. The revised NOF requirement for stand-alone PDs, which intend to undertake other permissible activities, has been enhanced to Rs.250 crore from the earlier level of Rs. 100 crore. The NOF should be computed in terms of the explanatory note to section 45-IA of Chapter III-B of the Reserve Bank of India Act, 1934.

The enhanced level of NOF requirement for PDs would be effective from April 1, 2010.

Call/Notice Money Borrowing Limit

The limit on borrowing by PDs from the call/notice money market, on an average in a reporting fortnight, has been increased to 225 per cent of their NOF from the earlier ceiling of 200 per cent of NOF, as at end March of the preceding financial year.

The increased borrowing limit is effective from September 2, 2009.

UCBs

Payment of Savings Bank A/c Interest on Daily Basis

Urban co-operative banks (UCBs) have been advised to calculate interest on balances in savings bank accounts on a daily product basis from April 1, 2010. Accordingly, UCBs should put in place the requisite infrastructure to ensure a smooth transition to the revised procedure.

It may be recalled that in June 1987, UCBs were instructed to calculate interest on savings deposits on the minimum balance to the credit of the deposit account from the 10th to the last day of each calendar month.

FEMA

Credit of Visa Fees to Foreign Currency A/c

In consultation with the Government of India, diplomatic missions have been permitted to credit the visa fees collected in India in Indian rupees, by way of transfer from the rupee account, to their foreign currency account.

NBFCs

NBFCs permitted to participate in Interest Rate Futures

NBFCs have been permitted to participate in designated interest rate futures exchanges recognised by

INFORMATION

Protection to Small Depositors and Investors

Depositors and their interest form the focal point of the regulatory frame work for banking in India and it has been appropriately enshrined at various places in the Banking Regulation Act, 1949. Depositors' interest is the prime consideration for the Reserve Bank while taking any decision relating to banks. The Banking Regulation Act enables the Reserve Bank to control advances made by banking companies, give direction, appoint additional directors, etc., for the protection of interest of depositors. To further strengthen the regulatory powers, the central government has been empowered to acquire undertaking of a banking company in India if it is satisfied that the banking company "is being managed in a manner detrimental to the interests of its depositors". Further, the Reserve Bank can make an application to the High Court for winding up of a bank in India if, in the opinion of the Reserve Bank, *inter alia*, "the continuance of the banking company is prejudicial to the interest of its depositors".

The Deposit Insurance and Credit Guarantee Corporation Act, 1961 grants protection to depositors of all commercial banks (including regional rural banks and co-operative banks) which are registered as insured banks. Each depositor of an insured bank which goes in liquidation is entitled to receive from the Corporation, an amount of Rs.1,00,000 (Rupees one lakh).

Provisions are also made in the Reserve Bank of India (RBI) Act, 1934 to protect the interest of small depositors in non-banking financial companies and unincorporated bodies.

On pursuance by the Reserve Bank, 14 states and 1 union territory have also enacted legislation on the lines of the Tamil Nadu Protection of Interests of Depositors (in Financial Establishments) Act, 1997 which contains stiff penal provisions for promoters of financial establishments defaulting in repayment of deposits and interest.

Similarly, under the provisions of the Securities and Exchange Board of India (SEBI) Act, 1992, it is the duty of SEBI to protect the interest of investors in securities and to promote the development of and to regulate the securities market. In discharge of its statutory duty under the SEBI Act, 1992, the Companies Act, 1956, the Securities Contracts (Regulation) Act, 1956 and the Depositors Act, 1996, SEBI has framed various regulations/guidelines for the protection of investors in the securities market.

Source : Parliament Questions