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MONETARY AND CREDIT INFORMATION REVIEW

POLICY

Priority Sector Status for Bank Loans to MFIs

The Reserve Bank has advised that bank credit to micro finance institutions (MFIs) extended on, or after, April 1, 2011 for on-lending to individuals and also to members of self help groups (SHGs)/joint liability groups (JLGs) will be eligible for categorisation as priority sector advance under respective categories viz., agriculture, micro and small enterprise, and micro credit (for other purposes), as indirect finance, provided not less than 85 per cent of the total assets of the MFI (other than cash, balances with banks and financial institutions, government securities and money market instruments) are in the nature of "qualifying assets". In addition, aggregate amount of loan extended for income generating activity, is not less than 75 per cent of the total loans given by the MFI.

A "qualifying asset" shall mean a loan disbursed by a MFI which satisfies the following criteria :

(i) The loan is extended to a borrower whose household annual income in rural areas does not exceed Rs.60,000 while in non-rural areas it should not exceed Rs.1,20,000.

(ii) The loan does not exceed Rs.35,000 in the first cycle and Rs.50,000 in subsequent cycles.

(iii) Total indebtedness of the borrower does not exceed Rs.50,000.

(iv) Tenure of loan is not less than 24 months when the loan amount exceeds Rs.15,000 with right to the borrower to prepay without penalty.

(v) The loan is without collateral.

(vi) The loan is repayable in weekly, fortnightly or monthly installments according to the choice of the borrower.

Further, to be eligible to classify these loans under priority sector, banks have to ensure that MFIs comply with the caps on margin and interest rate as also other 'pricing guidelines' as folllows:

(a) For all MFIs the margin cap would be 12 per cent. The interest cost is to be calculated on average fortnightly balances of outstanding borrowings and interest income is to be calculated on average fortnightly balances of outstanding loan portfolio of qualifying assets.

(b) Interest rate cap on individual loans at 26 per cent per annum is to be calculated on a reducing balance basis.

(c) Only three components are to be included in pricing of loans viz., (i) a processing fee not exceeding 1 per cent of the gross loan amount; (b) the interest charge; and (c) the insurance premium.

(d) The processing fee is not to be included in the margin cap or the interest cap of 26 per cent.

(e) Only the actual cost of insurance i.e., actual cost of group insurance for life, health and livestock for borrower and spouse can be recovered; administrative charges to be recovered as per Insurance Regulatory and Development Authority (IRDA) guidelines.

(f) No penalty should be levied for delayed payment.

(g) No security deposit/margin is to be taken.

At the end of each quarter, banks should obtain from the MFI, a chartered accountant's certificate stating, *inter-alia*, that (i) 85 per cent of the total assets of the MFI are in the nature of "qualifying assets"; (ii) the aggregate amount of loan extended for income generation activity is not less than 75 per cent of the total loans given by the MFI; and (iii) pricing guidelines have been followed.

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The guidelines relating to categorisation of (i) investment by banks in securitised assets originated by MFIs; and (ii) outright purchase of loan portfolios of MFIs as priority sector advances in the banks' books, would be issued in due course. In the meantime, fresh assets would qualify for priority sector treatment only if they satisfy the criteria of qualifying assets and adhere to the pricing guidelines as specified above.

Bank loans to MFIs which do not comply with the above conditions and bank loans to other non-banking finance companies (NBFCs), will not be reckoned as priority sector loans from April 1, 2011. Bank loans extended prior to April 1, 2011, classified under priority sector, will continue to be reckoned under priority sector till they mature.

Enhanced Provisioning for NPAs/Restructured Advances

The provisioning requirements on certain categories of non-performing advances and restructured advances have been enhanced. The enhanced rates are -

- the secured portion of advances which have remained in "doubtful" category up to one year will attract a provision of 25 per cent (as against the earlier 20 per cent);
- the secured portion of advances which have remained in "doubtful" category for more than one year but up to 3 years will attract a provision of 40 per cent (as against the earlier 30 per cent);
- restructured accounts classified as standard advances will attract a provision of 2 per cent in the first 2 years from the date of restructuring, or in cases of moratorium on payment of interest/principal after restructuring, for the period covering moratorium and 2 years thereafter (as against the earlier provision of 0.25-1.00 per cent, depending upon the category of advances); and
- restructured accounts classified as non-performing advances, when upgraded to standard category will attract a provision of 2 per cent in the first year from the date of upgradation (as against earlier provision of 0.25-1.00 per cent, depending upon the category of advances).

Sub-Standard Advances

Advances classified as "sub-standard" will attract a provision of 15 per cent as against the earlier 10 per cent. The "unsecured exposures" classified as sub-standard assets will attract an additional provision of 10 per cent, *i.e.,* a total of 25 per cent as against the earlier provision of 20 per cent. "Unsecured exposures" in respect of infrastructure loan accounts classified as sub-standard, in case of which certain safeguards, such as, escrow accounts are available as indicated in the Reserve Bank's circular of April 23, 2010, will attract an additional provision of 5 per cent only i.e., a total of 20 per cent as against the earlier 15 per cent.

Doubtful Advances

Doubtful advances will continue to attract 100 per cent provision to the extent the advance is not covered by the realisable value of the security to which the bank has a valid recourse and the realisable value is estimated on a realistic basis. In respect of the secured portion, however, the following provisioning requirements will be applicable:

- the secured portion of advances which have remained in "doubtful" category up to one year will attract a provision of 25 per cent (as against the earlier 20 per cent);
- the secured portion of advances which have remained in "doubtful" category for more than one year but up to 3 years will attract a provision of 40 per cent (as against the earlier 30 per cent); and
- the secured portion of advances which have remained in "doubtful" category for more than 3 years will continue to attract a provision of 100 per cent.

Restructured Advances

(i) Restructured accounts classified as standard advances will attract a provision of 2 per cent in the first two years from the date of restructuring. In cases of moratorium on payment of interest/principal after restructuring, such advances will attract a provision of 2 per cent for the period covering moratorium and two years thereafter (as against earlier provision of 0.25-1.00 per cent, depending upon the category of advances); and

(ii) Restructured accounts classified as non-performing advances, when upgraded to standard category will attract a provision of 2 per cent in the first year from the date of upgradation (as against earlier provision of 0.25-1.00 per cent, depending upon the category of advances).

Provisioning Coverage Ratio for Advances

Till such time that the Reserve Bank introduces a more comprehensive methodology of countercyclical provisioning taking into account the international standards as are being currently developed by the Basel Committee on Banking Supervision (BCBS) and other provisioning norms, banks are advised that:

- the provisioning coverage ratio (PCR) of 70 per cent may be with reference to the gross NPA position in banks as on September 30, 2010;
- the surplus of the provision under PCR *vis-a-vis* as required as per prudential norms, should be segregated into an account styled as "countercyclical provisioning buffer; and
- banks will be allowed to use this buffer for making specific provisions for NPAs during periods of system wide downturn, with the Reserve Bank's prior approval.

Banks that had been granted extension of time beyond the stipulated date i.e., September 30, 2010 for achieving PCR of 70 per cent on their request, should calculate the required provisions for 70 per cent PCR as on September 30, 2010 and compute the shortfall therefrom. This shortfall should be built up at the earliest and these banks should reassess the further time required beyond March 31, 2011, if any, to build up the buffer and seek the Reserve Bank's approval for the purpose.

Further, as hitherto, the PCR should be disclosed in the 'Notes to Accounts' to the balance sheet.

Interest Rates Increased

Savings Deposits

The interest rate on domestic and ordinary non-resident savings deposits as well as savings deposits under non-resident (external) accounts scheme has been increased by 0.5

percentage point from 3.5 per cent to 4.0 per cent per annum from May 3, 2011.

Repo/Reverse Repo Rates

The repo rate under the liquidity adjustment facility (LAF) has been increased by 50 basis points from 6.75 per cent to 7.25 per cent from May 3, 2011. The reverse repo rate under the LAF, determined with a spread of 100 basis points below the repo rate, stands at 6.25 per cent from May 3, 2011.

Housing Loan limit under Priority Sector Increased

The limit of housing loans for being eligible for classification under priority sector has now been enhanced from Rs.20 lakh to Rs.25 lakh. The increased limit will be applicable to housing loans sanctioned on or after April 1, 2011 to individuals for purchase/construction of dwelling unit per family, excluding loans granted by banks to their own employees.

Regulatory and Audit Compliance

The Reserve Bank has advised all foreign banks operating in India, that the chief executive officer would be responsible for effective oversight of regulatory and statutory compliance as also the audit process and compliance thereof in respect of all operations in India.

It has been observed that Indian operations of foreign banks functioning in India as branches of the parent banks generally do not have a separate audit committee vested with the responsibility of examining and reviewing inspection/audit reports for their compliance.

Marginal Standing Facility – Scheme

A new marginal standing facility (MSF) has been introduced from May 9, 2011. The salient features of the Scheme are :

Eligibility

All scheduled commercial banks having current account and subsidiary general ledger (SGL) account with the Reserve Bank, Mumbai are eligible to participate in the MSF Scheme.

Tenor and Amount

Under the facility, eligible entities can avail overnight, up to one per cent of their respective net demand and time liabilities (NDTL) outstanding at the end of the second preceding fortnight. But for the intervening holidays, the MSF facility will be for one day except on Fridays when the facility will be for three days or more, maturing on the following working day. If banks' statutory liquidity ratio (SLR) holdings fall below the statutory requirement up to one per cent of their NDTL, they will not have the obligation to seek a specific waiver for default in SLR compliance arising out of use of this facility in terms of notification issued under sub section (2A) of Section 24 of the Banking Regulation Act, 1949.

Timing

The facility will be available on all working days in Mumbai, excluding Saturdays, between 3.30 P.M. and 4.30 P.M.

Rate of Interest

The rate of interest on amount availed under this facility will be 100 basis points above the LAF repo rate, or as decided by the Reserve Bank from time to time.

Discretion

The Reserve Bank reserves the right to accept or reject partially or fully, the request for funds under this facility.

Operations

(i) The requests will be submitted electronically in the negotiated dealing system (NDS). Eligible members facing genuine system problem on any specific day, may submit physical requests in a sealed cover in the box provided in the Reserve Bank's Mumbai Office addressed to the Manager, Reserve Bank of India, Securities Section, Public Accounts Department, Mumbai by 4.30 P.M.

(ii) The NDS provides for submission of single or multiple applications by members. As far as possible, however, applicants should submit only one request.

(iii) The MSF will be conducted as "Hold-in-Custody" repo, similar to LAF - Repo.

(iv) On acceptance of MSF requests, the applicant's RC SGL account will be debited by the required quantum of securities and credited to the bank's RC SGL account. Accordingly, the applicant's current account will be credited with the MSF application amount. The transactions will be reversed in the second leg. In case the second leg falls on a holiday, the reversal date will be the next working day.

(v) The MSF transactions between the Reserve Bank and counter parties which involve operation of the RC SGL account would not require separate SGL forms.

(vi) Pricing of all securities, including treasury bills, will be at face value for MSF operations by the Reserve Bank. Accrued interest as on the date of transaction will be ignored for the purpose of pricing of securities.

Minimum Request Size

Requests will be received for a minimum amount of Rs. one crore and in multiples of Rs. one crore thereafter.

Eligible Securities

MSF will be undertaken in all SLR-eligible transferable Government of India (GoI) dated securities/treasury bills and state development loans (SDLs).

Margin Requirement

A margin of five per cent will be applied in respect of GoI dated securities and treasury bills. In respect of SDLs, a margin of 10 per cent will be applied. Thus, the amount of securities offered on acceptance of a request for Rs.100 will be Rs.105 (face value) of GoI dated securities and treasury bills or Rs.110 (face value) of SDLs.

Settlement

The settlement of all applications received under the MSF scheme will take place on the same day after the closure of the window for acceptance of applications.

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Payment System

Issuance and Operation of Semi Closed M-Wallets

Keeping in view the need to facilitate larger acceptance of mobile phone based prepaid payment instruments (m-wallets) as a mode of payment, it has been decided to bring semi closed m-wallets on par with other semi-closed prepaid instruments subject to the conditions that –

- The maximum value of such prepaid semi-closed m-wallet should not exceed Rs. 50,000.
- The monetary ceilings on prepaid instruments issued, based on customer due diligence as laid down in Para 6.4 of the 'policy guidelines for issuance and operation of prepaid payment instruments in India' dated April 27, 2009, would be applicable to such m-wallets.
- The purchase/reloading of these instruments against the value of airtime/talktime is not permitted.
- This facility shall be enabled only to facilitate purchase of goods and services. Person-to-person transfer of value shall not be permitted.
- All other conditions specified in the "policy guidelines for issuance and operation of prepaid instruments in India" would mutatis mutandis apply to such m-wallets.

Mobile Banking Transactions in India

The limit for mobile banking transactions without end-to-end encryption has been increased to Rs. 5000 from the earlier limit of Rs. 1000. The revised limit is effective from May 4, 2011. Banks have been advised to put in place adequate security measures and velocity limits based on their own risk perception.

CO-OPERATIVE BANKING

Exposure to Housing/Real Estate/Commercial Real Estate

Urban (primary) co-operative banks (UCBs) are now permitted to lend up to an additional 5 per cent of their total assets, for housing loans to individuals up to Rs.15 lakh. Earlier, in November 2010, UCBs were permitted to lend up to 10 per cent of their total assets to housing, real estate and commercial real estate and an additional 5 per cent of total assets for purchase and construction of dwelling units costing up to Rs. 10 lakh.

FEMA

Import of Rough/Cut/Polished Diamonds

AD Category – I banks have been advised that 'suppliers' and 'buyers' credit (trade credit) including the usance period of letters of credit opened for import of rough, cut and polished diamonds should not exceed 90 days from the date of shipment.

AD Category – I banks have also been advised to ensure that due diligence is undertaken and 'know your customer' (KYC) norms and anti-money laundering (AML) standards, issued by the Reserve Bank are adhered to while undertaking the import transactions. Further, any large or abnormal increase in the volume of business should be closely examined to ensure that the transactions are bonafide and are not intended for interest/currency arbitrage.

Pledge of Shares for Business Purposes

With a view to further liberalise, rationalise and simplify the processes associated with foreign direct investment (FDI) flows to India and reduce the transaction time, AD Category – I banks have been delegated powers to allow pledge of shares of an Indian company held by non-resident investor/s in accordance with the FDI policy, in the following cases:

(i) Shares of an Indian company held by the non-resident investor can be pledged in favour of an Indian bank in India to secure the credit facilities being extended to the resident investee company for bonafide business purposes, subject to the conditions that -

  (a) in case of invocation of pledge, transfer of shares should be in accordance with the FDI policy in vogue at the time of creation of pledge;

  (b) submission of a declaration/annual certificate from the statutory auditor of the investee company that the loan proceeds will be/have been utilised for the declared purpose;

  (c) the Indian company has to follow the relevant Securities and Exchange Board of India (SEBI) disclosure norms; and

  (d) pledge of shares in favour of the lender (bank) would be subject to compliance with Section 19 of the Banking Regulation Act, 1949.

(ii) Shares of the Indian company held by the non-resident investor can be pledged in favour of an overseas bank to secure the credit facilities being extended to the non-resident investor/non-resident promoter of the Indian company or its overseas group company, subject to the conditions that -

  (a) loan is availed of only from an overseas bank;

  (b) loan is utilised for genuine business purposes overseas and not for any investments either directly or indirectly in India;

  (c) overseas investment should not result in any capital inflow into India;

  (d) in case of invocation of pledge, the transfer should be in accordance with the FDI policy in vogue at the time of creation of pledge; and

  (e) submission of a declaration/annual certificate from a chartered accountant/certified public accountant of the non-resident borrower that the loan proceeds will be/have been utilised for the declared purpose.

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