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MONETARY AND CREDIT
INFORMATION REVIEW

POLICY

Guidelines for Issuance and Operation of Pre-paid Payment Instruments

The Reserve Bank has on April 27, 2009, notified the guidelines for the issuance and operation of pre-paid payment instruments in India. All persons currently operating payment systems involved in the issuance of pre-paid payment instruments and those proposing to operate such systems would have to seek authorisation from the Reserve Bank's Department of Payment and Settlement Systems. All persons currently operating such payment systems should comply with the guidelines within three months from the date of issuance of these guidelines, which are -

Eligibility

- Banks which comply with the eligibility criteria would be permitted to issue all categories of pre-paid payment instruments.
- Only banks which have been permitted to provide mobile banking transactions by the Reserve Bank would be permitted to launch mobile based pre-paid payment instruments (mobile wallets and mobile accounts).
- Non-banking financial companies (NBFCs) and other persons would be permitted to issue only semi-closed system payment instruments.

Capital

Banks and NBFCs which comply with the capital adequacy requirements prescribed by the Reserve Bank, would be permitted to issue pre-paid payment instruments. All other persons should have a minimum paid-up capital of Rs 100 lakh and positive net owned funds.

Types of Instruments

The types of pre-paid payment instruments which can be issued on carrying out customer due diligence are -

- Semi-closed system payment Instruments up to Rs 1000 may be issued against any identity document furnished by the customer subject to reporting of annual turnover/suspicious transactions. It should be ensured that under no circumstances, more than one active instrument is issued to the same holder by the same issuer.
- Pre-paid payment instruments up to Rs 5000 can be issued by accepting any 'officially valid document' defined under Rule 2(d) of the Prevention of Money Laundering Act, as proof of identity. Such instruments should not permit cash withdrawal.

- Semi-closed system payment instruments which permit only payment of utility bills/essential services up to a limit of Rs 10,000 can be issued without any 'know your customer' (KYC) exercise being undertaken by the issuer. Persons issuing such instruments should ensure that these instruments are made acceptable only at institutions which maintain the full identity of their customers. Utility bills/essential services should include only electricity bills, water bills, telephone/mobile phone bills, insurance premium, cooking gas payments, rental for internet/broadband connections, cable/DTH subscriptions and citizen services by government/government bodies.
- Semi-closed system payment instruments can be issued to institutions/companies for further issuance by them to their employees or other beneficiaries. Persons issuing such payment instruments should ensure that these institutions/companies maintain full details of their employees or beneficiaries to whom such payment instruments are issued. The maximum value of such payment instruments issued by institutions/companies should not exceed Rs 5000.

The maximum value of any pre-paid payment instrument (where specific limits have not been prescribed) should not exceed Rs 50,000.

Deployment of Money

For the schemes operated by banks, the outstanding balance shall be part of the 'net demand and time liabilities' for

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the purpose of maintenance of reserve requirements. This position would be computed on the basis of the balances appearing in the bank's books as on the date of reporting.

Other non-bank persons issuing payment instruments are required to maintain their outstanding balance in an escrow account with any scheduled commercial bank subject to the conditions that –

- (i) The amount so maintained is used only for making payments to the participating merchant establishments.
- (ii) No interest is payable by the bank on such balances.
- (iii) A quarterly certificate from the auditors is submitted certifying that the entity has been maintaining adequate balance in the account to cover the outstanding volume of payment instruments issued.
- (iv) An annual certificate from the auditor is submitted to the Reserve Bank, coinciding with the accounting year of the entity.
- (v) Adequate records indicating the daily position of the value of instruments outstanding *vis-à-vis* balances maintained in escrow accounts with banks are made available for scrutiny to the Reserve Bank or the bank where the account is maintained.

The entity can, however, enter into an agreement with the bank where the escrow account is maintained, to transfer “core portion” of the amount in the escrow account, to a separate account on which interest is payable, subject to the conditions that –

- (a) The bank satisfies itself that the amount deposited represents the “core portion” after due verification of necessary documents.
- (b) The amount is linked to the escrow account, i.e., the amounts held in the interest bearing account should be available to the bank, to meet payment requirements of the entity, in case of any shortfall in the escrow account.
- (c) This facility is permissible to persons who have been in the business for at least one year and whose accounts have been duly audited for the full accounting year.
- (d) No loan is permissible against such deposits. Banks should not issue any deposit receipts or mark any lien on the amount held in such form of deposits.

Issuance and Reloading

All persons issuing pre-paid payment instruments are permitted to issue reloadable or non-reloadable pre-paid payment instruments.

Banks are permitted to issue and reload such payment instruments at their branches and ATMs against payment by cash/debit to bank account/credit card. Banks can also issue and reload such payment instruments through their business correspondents appointed as per the Reserve Bank's guidelines issued in this regard.

Other persons can issue and reload such payment instruments through their authorised outlets or through their agents against payment by cash/debit to bank account/credit card subject to the conditions that –

- Issuers should carry out proper due diligence of the persons appointed as authorised agents for sale of such instruments.
- Issuers would be responsible for all the payment instruments issued by their appointed agents.
- Issuers would be responsible as the principal for all the acts of omission or commission of their agents.
- The sale/reloading by cash at the agent locations does not exceed to Rs. 5000 per customer.

Validity

- All pre-paid payment instruments issued in the country should have a minimum validity period of six months from the date of activation/issuance to the holder.
- In the case of non-reloadable pre-paid payment instruments, the transfer of outstanding amount on the expiry of the payment instrument to a new similar payment instrument of the same issuer, purchased by the holder, is permitted.
- The outstanding balance against any payment instrument should not be forfeited unless the holder is cautioned at least 15 days in advance regarding the expiry of the validity.

Pre-paid Payment Instruments - Definitions

Issuer - Persons operating the payment systems issuing pre-paid payment instruments to individuals/organisations. The money collected is retained by these persons and they make payment to the merchants who are part of the acceptance arrangement directly, or through a settlement arrangement.

Holder - Individuals/organisations who acquire pre-paid payment instruments for purchase of goods and services.

Pre-paid Payment Instruments - These payment instruments facilitate purchase of goods and services against the value stored on such instruments. Pre-paid instruments can be issued as smart cards, magnetic stripe cards, internet accounts, internet wallets, mobile accounts, mobile wallets, paper vouchers and any such instrument which can be used to access the pre-paid amount. Pre-paid payment instruments that can be issued in the country are classified under three categories viz. (i) Closed system payment instruments (ii) Semi-closed system payment instruments and (iii) Open system payment instruments.

Closed System Payment Instruments - These are payment instruments issued by a person for facilitating the purchase of goods and services from him/it. These instruments do not permit cash withdrawal or redemption. As these instruments do not facilitate payments and settlement for third party services, their issue and operation are not classified as payment systems.

Semi-Closed System Payment Instruments - These payment instruments are redeemable at a group of clearly identified merchant locations/establishments which contract specifically with the issuer to accept them. These instruments do not permit cash withdrawal or redemption by the holder.

Open System Payment Instruments - These payment instruments can be used for purchase of goods and services at any card accepting merchant location (point of sale terminals) and also permit cash withdrawal at ATMs.

Net Owned Funds - For the purpose of these guidelines “net owned fund” (NOF) will consist of paid up equity capital, free reserves, balance in share premium account and capital reserves representing surplus arising out of sale proceeds of assets but not reserves created by revaluation of assets. From the aggregate of items so computed, the NOF would be arrived at after deducting the accumulated loss balance and book value of intangible assets, if any. The NOF should be computed on the basis of last audited balance sheet and any capital raised after the balance sheet date should not be accounted for while computing NOF.

Redemption

- Issuers of such instruments should not dishonour customer instructions for payments/transfer of money at approved locations, if there is sufficient balance outstanding against the instrument.
- The holders of pre-paid payment instrument should be permitted to redeem the balance outstanding within the expiry date, if for any reason, the scheme is wound-up or is directed by the Reserve Bank to be discontinued.
- Where redemption is provided as indicated above, the redemption value should not exceed the amount outstanding or the face value (loading limit) of the instrument.

Customer Protection

While issuing pre-paid payment instruments, all issuers should disclose the important terms and conditions in clear and simple language (preferably in English, Hindi and the local language) comprehensible to the holders. The disclosures should include (i) all charges and fees associated with the use of the instrument; (ii) the expiry period and the terms and conditions pertaining to expiration of the instrument; and (iii) the customer service telephone numbers and the website URL.

An effective mechanism for redressal of customer complaints should be put in place by the entity issuing pre-paid payment instruments. In case of pre-paid payment instruments issued by banks, customers should have recourse to the Banking Ombudsman Scheme for grievance redressal.

Interest on Savings Bank Account on Daily Basis

In view of the present satisfactory level of computerisation in commercial bank branches, the Reserve Bank has proposed that from April 1, 2010, scheduled commercial banks would calculate payment of interest on savings bank accounts on a daily product basis. In order to ensure a smooth transition, banks have been advised to work out the modalities in this regard.

BRANCH BANKING

Reconciliation of Nostro Account Entries

Reviewing the position regarding long pending outstanding debit and credit entries in nostro accounts of banks, the Reserve Bank has advised that -

- a) Banks should continue to make efforts to reconcile outstanding debit/credit entries of individual value USD 2500 and above or equivalent in nostro accounts.
- b) In respect of outstanding credit entries of individual value less than USD 2500 or equivalent in nostro account originated up to March 31, 2002 -
 - (i) banks may transfer to profit and loss account -
 - the credit balance arising out of the netting of entries pertaining to the period prior to April 1, 1996 and parked in the blocked account in terms of the Reserve Bank's circular of July 1, 1999.
 - the aggregate of individual unreconciled credit entries in nostro and mirror accounts originated between April 1, 1996 and March 31, 2002 and parked in the blocked account in terms of Reserve Bank's circular of August 24, 2001.
 - (ii) the amount credited to the profit and loss account should be appropriated to the general reserve and will not be available for declaration of dividend;

(iii) appropriate disclosure should be made in the Notes to Accounts including the impact on the profit and loss account; and

(iv) any future claim in respect of these entries should be honoured.

- c) Banks may, at their discretion, write off unreconciled debit entries of individual value less than USD 2500 or equivalent in nostro and mirror accounts originated up to March 31, 2002 against the provision already held.
- d) All unreconciled credit entries in nostro accounts originated on or after April 1, 2002 which are outstanding for more than 3 years should be transferred to blocked account and shown as outstanding liabilities which would be reckoned for the purpose of cash reserve ratio (CRR)/ statutory liquidity ratio (SLR).
- e) Banks should make 100 per cent provision in respect of all unreconciled debit entries in nostro accounts originated on or after April 1, 2002 which are outstanding for more than two years (instead of three years as at present).

Banks have been further advised to minimise the number of nostro accounts to have a better control over reconciliation and put in place a system of fast reconciliation and close monitoring of pending items in nostro accounts by top management at short intervals.

UCBs

Extension of Area of Operation

The Reserve Bank would now consider requests for expansion of area of operation to the entire state from licensed Tier II urban co-operative banks (UCBs) registered in states that have entered into MoU with the Reserve Bank and are classified as grade I as per the last statutory inspection and/or conform to the financials of a grade I bank as per the latest audited reports. While considering such applications, the Reserve Bank would give due consideration to the system of internal controls prevailing in the bank and supervisory comfort.

In respect of Tier I UCBs, the existing norms would continue to be applicable.

For the purpose of classification of UCBs into Tier I and II, the definition to be adopted hereafter for all regulatory purposes, in supersession of the instructions contained in the Reserve Bank's circular of March 7, 2008, is as follows:

Tier I Banks

The following UCBs would be classified as Tier I :

- (i) Having deposits below Rs.100 crore and operating in a single district.
- (ii) Having deposits below Rs.100 crore and operating in more than one district provided, the branches are in contiguous districts and deposits and advances of branches in one district separately constitute at least 95 per cent of the total deposits and advances respectively of the bank.
- (iii) Having deposits below Rs.100 crore and whose branches were originally in a single district but subsequently, became multi-district due to reorganisation of the district.

Tier II Banks

All other banks.

The deposit and advances referred to in the definition may be reckoned as on March 31 of the immediate preceding financial year.

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

(continued from the previous issue)

Recommendation 6

The systemic importance of financial institutions, markets and instruments depends on a wide range of factors, including their size, leverage, interconnectedness, as well as funding mismatches. The IMF, in consultation with the BIS and the expanded FSF and other bodies, should jointly develop a common international framework and guidelines to help national authorities assess whether a financial institution, market or an instrument is systemically important as consistently as possible across jurisdictions.

- The Reserve Bank is committed to follow sound international practices and standards. When a common international framework is available to help national authorities to assess whether a financial institution, market or an instrument is systemically important, the Reserve Bank will use the framework to further sharpen its focus with regard to the supervision of those institutions considered systemically important in consultation with the Government and other regulatory authorities, as necessary, consistent with the legal framework.

Recommendation 7

Large complex financial institutions require particularly robust oversight given their systemic importance, which arises in part from their size and interconnectedness (or correlation) with other institutions, and from their influence on markets.

- Following the report on financial conglomerates (FCs), a monitoring mechanism for the identified FCs has been in place since 2004 in co-operation with other regulators. Since April 2005, the FC monitoring mechanism has been further strengthened with the introduction of half-yearly discussion with the CEOs of the major group entities within the FC.
- As indicated in the Mid-term Review of October 2008, an 'approach paper' on the supervision of financial conglomerates has since been prepared by an Internal Group. The recommendations of the Group are being examined from the regulatory and supervisory perspectives for initiating appropriate action.
- As part of its endeavour to strengthen the supervision of banking groups, the Reserve Bank extended the major elements of prudential regulations, viz., capital adequacy and exposure norms to all the subsidiaries of commercial banks in 2003.

Recommendation 8

The boundaries of the regulatory framework should be reviewed periodically within national jurisdictions, in light of financial innovation and broader trends in the financial system. International bodies will promote good practice and consistent approaches in this area.

- The Reserve Bank regularly interacts with other regulators of the financial system within the national jurisdiction, viz.,

SEBI, the securities regulator, IRDA, the insurance regulator and PFRDA, the regulator of pension funds. The Reserve Bank has also been associated with various international bodies such as G-20 and the BIS, and now also with the FSB and the BCBS.

- The issue of review of the boundaries of the regulatory framework will be kept in focus, both in the interaction with sectoral regulators within the national jurisdiction and with international bodies.

Recommendation 9

All credit rating agencies whose ratings are used for regulatory purposes should be subject to a regulatory oversight regime that includes registration and that requires compliance with the substance of the IOSCO Code of Conduct Fundamentals. National authorities should obtain the authority to enforce compliance and require changes to a rating agency's practices and procedures for managing conflicts of interest and for assuring the transparency and quality of the rating process.

- In India, all credit rating agencies are registered with the SEBI. The Reserve Bank has accorded accreditation to four credit rating agencies registered with the SEBI for the limited purpose of using their ratings for assigning risk weights within the framework of the Basel II Accord which has been implemented by all banks as at the end of March 2009. Prior to the accreditation, the Reserve Bank had undertaken a review of the rating agencies' practices and procedures to ensure that they comply with the criteria prescribed for accreditation in the Basel II framework.
- Since the Indian banking system has migrated to the Basel II framework, there is a need to review the performance of the credit rating agencies for continuation of the accreditation, especially by looking at the latest data relating to cumulative default rate and transition matrix of the rating agencies. The Reserve Bank will liaise with the SEBI on the issue of rating agencies' adherence to the IOSCO Code of Conduct Fundamentals.

Recommendation 10

Private pools of capital, including hedge funds, can be a source of risk owing to their combined size in the market, their use of leverage and maturity mismatches, and their connectedness with other parts of the financial system. They or their managers should therefore be required to register with financial authorities and disclose appropriate information to assess the risks they pose.

- In India, venture capital funds and mutual funds are registered and regulated by the SEBI. Hedge funds do not operate in India at present. The Reserve Bank proposes to issue a paper on prudential issues in banks' floating and managing private pools of capital to finalise the regulatory guidelines.

(to be continued in the next issue)