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MONETARY AND CREDIT INFORMATION REVIEW

POLICY

Issuance and Operation of Prepaid Payment Instruments

Amending its guidelines on issuance and operation of prepaid payment instruments in India, the Reserve Bank has now decided to permit 'other persons' to issue mobile phone based semi-closed system pre-paid payment instruments.

Entities issuing mobile phone based semi-closed payment instruments should ensure full compliance to the safeguards against money laundering [know your customer (KYC)/anti-money laundering (AML)/combating financing of terrorism (CFT)] provisions stipulated in Para 6 of the guidelines on issuance and operation of prepaid payment instruments in India.

'Other persons' issuing mobile phone based semi-closed payment instruments should also comply with the following conditions:

(i) The maximum value of such instruments should not exceed Rs 5,000.

(ii) The purchase/reloading of these instruments against the value of airtime/talktime shall not be permitted.

(iii) This facility should be enabled only to facilitate purchase of goods and services. Person-to-person transfer of value should not be permitted.

All persons proposing to operate payment systems involving the issuance of these pre-paid payment instruments should seek authorisation from the Reserve Bank's Department of Payment and Settlement Systems, under the Payment and Settlement Systems Act, 2007. The application for authorisation should also include the risk management process that would be adopted by the entity.

CO-OPERATIVE BANKING

Housing Finance

Reviewing its instructions on housing finance granted by state co-operative banks (StCBs) and central co-operative banks (CCBs), the Reserve Bank has advised that -

(i) The maximum quantum of housing loan that can be granted to an individual borrower by a StCB/CCB is revised to Rs. 20 lakh. In case a bank's net worth is Rs.100 crore and above [as per the assessment made in National Bank for Agriculture and Rural Development's (NABARD's) latest inspection report], the limit will be Rs. 30 lakh.

(ii) The aggregate of housing loans outstanding on any day against individuals, institutions, and societies should not exceed 10 per cent of the total loans and advances of the bank as on March 31 of the preceding year. This limit can, however, be exceeded to the extent of funds obtained for the purpose, from the higher financing agency and refinance from the National Housing Bank.

(iii) Housing loans would not include finance to the commercial real estate sector (in May 2009 the Reserve Bank had advised StCBs/CCBs to desist from financing the commercial real estate sector).

(iv) For repairs, additions, alterations etc., carried out to existing houses, the maximum amount of loan per individual borrower is revised to Rs. 1 lakh.

Opening New Place of Business

The Reserve Bank has reviewed the policy for opening of new place of business by state co-operative banks and has advised that -

Opening of Branches/Extension Counters

(i) In a three-tier structure consisting of StCBs at the apex level,CCBs at the intermediate level and primary

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agricultural credit societies (PACS) at the ground level, StCBs will normally be allowed to open branches/extension counters in state capitals. In case a branch is required in district head quarters, the bank may open a branch only for maintaining and servicing deposits of co-operative banks. In semi-urban/rural areas where CCBs are non-existent, weak or virtually defunct, StCBs would be allowed to open branches, provided the CCB in the adjoining district is not in a position to extend its area of operation to cover the area (where CCB is non-existent) or to take over the weak/defunct CCB through merger. In all such cases, the recommendations of the Registrar of Co-operative Societies of the concerned state would be required.

(ii) In a two-tier co-operative credit structure consisting of StCB and PACS, StCBs would be allowed (except in the north-eastern states, where general permission has been granted for opening branches anywhere in the states) to open branches in urban as well as rural centres.

(iii) For opening branches/extension counters, StCBs should have (as per the latest inspection report) -

- (a) capital to risk-weighted assets ratio (CRAR) of at least 9 per cent;
- (b) complied with cash reserve ratio (CRR) and statutory liquidity ratio (SLR);
- (c) net non-performing asset (NPA) of not more than 10 per cent; and
- (d) no serious irregularities.

(iv) For a StCB to be eligible for opening new place of business, the concerned state government should have signed the memorandum of understanding (MoU) in connection with the Government of India's Revival Package for short term rural co-operative credit structure.

These instructions supersede all instructions issued by the Reserve Bank earlier in this regard. Applications for licence for opening of branches/extension counters should be made to the Reserve Bank's Rural Planning and Credit Department, Central Office in the prescribed format through NABARD. StCBs which have already submitted proposals for opening branches, etc., should forward the additional information required to be furnished in terms of these revised instructions, to the Reserve Bank through NABARD.

Inter-Bank Participation

Regional rural banks (RRBs) have now been permitted to issue inter-bank participation certificate (IBPC) of a tenor of 180 days on risk sharing basis to scheduled commercial banks against their priority sector advances in excess of 60 per cent of their outstanding advances.

INFORMATION

Cash Management Bills

The Government of India, in consultation with the Reserve Bank, has decided to issue a new short-term instrument, known as Cash Management Bills, to meet the temporary cash flow mismatches of the Government. The Cash Management Bills will be non-standard, discounted instruments issued for maturities less than 91 days.

The Cash Management Bills will have features as follows:

a) The tenure, notified amount and date of issue of the proposed Cash Management Bills will depend upon the temporary cash requirement of the Government. The tenure of the proposed Bills will be less than 91 days.

b) The proposed Bills will be issued at discount to the face value through auctions as in the case of the treasury bills.

c) The announcement of the auction of the proposed Bills will be made by the Reserve Bank through separate press release to be issued one day prior to the date of auction.

d) The settlement of the auction will be on T+1 basis.

e) The Non-Competitive Bidding Scheme for treasury bills will not be extended to the Cash Management Bills.

f) The proposed Bills will be tradable and qualify for ready forward facility. Investment in the proposed Bills will be reckoned as an eligible investment in government securities by banks for SLR purpose under Section 24 of the Banking Regulation Act, 1949.

Working Group to Review the BC Model

A Working Group to Review the Business Correspondent Model set up by the Reserve Bank, has recommended the following new entities for appointment as Business Correspondents (BCs) for banks in rural and semi-urban areas:

i) Individual kirana/medical/fair price shop owners

ii) Individual public call office (PCO) operators

iii) Agents of small savings schemes of Government of India/ insurance companies

iv) Individuals who own petrol pumps

v) Retired teachers

vi) Authorised functionaries of well run self help groups (SHGs) linked to banks

vii) Non deposit taking NBFCs (non-banking finance companies) in the nature of loan companies whose micro finance portfolio is not less than 80 per cent of their loan outstanding in the financially excluded districts as identified by the Committee on Financial Inclusion (Chairman: Dr. C. Rangarajan)

While making this recommendation, the Working Group has expressed the view that banks would need to accept the BC model as extremely vital for achieving the goals of financial inclusion. As the traditional 'brick and mortar' branches could penetrate into remote areas of the vast country only to a limited extent, this model presented banks with a workable option to provide banking services in inaccessible areas in a cost-effective manner.

The Working Group has noted that BCs should be used not only for opening and servicing no-frills accounts but for the full range of financial activities. Further, with the central and state governments planning to route various government payments through the banking system, the BCs could be the ideal medium for banks to handle the huge volumes of low value transactions. As experience showed, the BC model coupled with ICT solutions could help banks substantially increase their outreach facilitating financial inclusion.

The Working Group has further opined that as recommended by the High Power Committee to Review the Lead Bank Scheme in its draft report, the objective of having a banking outlet at every village with a population of over 2000 at least once a week on a regular basis by March 2011 could be achieved by substantially scaling up the BC model.

The other major recommendations of the Working Group include measures for improving the long term viability of the BC Model by permitting banks to collect reasonable service charges from the customer in a transparent manner for delivering the services through the BC and handholding of BCs by banks in the initial stages. The Working Group has also suggested some relaxation in the requirement of obtaining 'no objection' from district consultative committees (DCCs) regarding distance criterion.

As regards common service centres (CSCs), the Working Group has recommended that a few pilots should be run in at least a couple of states before deciding on further course of action.

In the North Eastern Region, as recommended by the Committee on Financial Sector Plan for the North Eastern Region (Chairperson: Smt. Usha Thorat), such of those local organisations/associations not falling under any of the available entities listed in the Reserve Bank's guidelines, may be considered for appointment as BCs, provided banks propose such entities after due diligence and are recommended by the district level consultative committee (DLCC). The regional offices of the Reserve Bank will be the decision making authority in such cases.

It may be recalled that the Reserve Bank had, in January 2006, permitted banks to use intermediaries as Business Facilitators (BFs) or Business Correspondents (BCs) for providing financial and banking services. The BCs are allowed to conduct banking business as agents of the banks at places other than the bank premises. In recent times, however, there were demands from various sectors that the eligible entities to act as BCs be enlarged, with a view to facilitating increased outreach of the banking system. Following this, the Reserve Bank constituted a Working Group to review the Business Correspondent Model. The Working Group included officials from select commercial banks and the Reserve Bank as members and Shri P. Vijaya Bhaskar, CGM in-Charge, Department of Banking Operations and Developments as the Chairman.

First Quarter Review of Monetary Policy 2009-10

Dr D. Subbarao, Governor, Reserve Bank of India, in a meeting with chief executives of major commercial banks presented the First Quarter Review of the Monetary Policy Statement for 2009-10 on July 28, 2009. The highlights are :

Projections

- GDP growth for 2009-10 placed at 6.0 per cent with an upward bias.
- WPI inflation projected at around 5.0 per cent by end-March 2010.
- Money supply (M_3) growth for 2009-10 placed at 18 per cent.
- Aggregate deposits of commercial banks projected to grow by 19 per cent.
- Growth in adjusted non-food credit placed at 20 per cent.

Challenges

The immediate and medium term challenges facing the economy are to:

(a) manage the balance between the short-term compulsions of providing ample liquidity and the potential build-up of inflationary pressure on the way forward by maintaining the accommodative monetary stance till demand conditions further improve and credit flow takes hold;

(b) manage the Government's large borrowing programme without crowding out present or potential private credit demand. Despite active liquidity management by the Reserve Bank, the large and abrupt increase in government borrowing has resulted in hardening of yields which clearly militated against the low interest rate regime that the economy requires in the current situation;

(c) maintain policy rates and liquidity conditions conducive for spurring private investment demand, which has been dented by the crisis;

(d) restore the fiscal consolidation process by laying down the roadmap. Large fiscal deficits, if continued strictly beyond the recovery period, can crowd out private investment and trigger inflationary pressures. The large government borrowing has already led to hardening of yields which have impeded monetary transmission. The Government will, therefore, need to return to a path of fiscal consolidation which will lend credibility to the fiscal stance and also give predictability to economic agents. It is also necessary to focus on the quality of fiscal adjustment even while pursuing quantitative targets; and

(e) improve the investment climate and expand the absorptive capacity of the economy by (i) moving forward with financial sector reforms to promote financial inclusion, further widen and deepen financial markets and strengthen financial institutions while factoring in the lessons of the global economic crisis; and (ii) giving a big thrust to governance reforms.

Stance

On the basis of the above overall assessment, the stance of monetary policy for the remaining period of 2009-10 will be to:

- Manage liquidity actively so that the credit demand of the Government is met while ensuring the flow of credit to the private sector at viable rates.
- Keep a vigil on the trends and signals of inflation, and be prepared to respond quickly and effectively through policy adjustments.
- Maintain a monetary and interest rate regime consistent with price stability and financial stability supportive of returning the economy to the high growth path.

Monetary Measures

* Bank Rate kept unchanged at 6.0 per cent.
* Repo rate under the liquidity adjustment facility (LAF) retained at 4.75 per cent.
* Reverse repo rate under the LAF retained at 3.25 per cent.
* The Reserve Bank has the flexibility to conduct repo/reverse repo auctions at a fixed rate or at variable rates as circumstances warrant.
* The Reserve Bank retains the option to conduct overnight or longer term repo/reverse repo under the LAF depending on market conditions and other relevant factors. The Reserve Bank would continue to use this flexibly including the right to accept or reject tender(s) under the LAF, wholly or partially, so as to make efficient use of the LAF in daily liquidity management.
* Cash reserve ratio (CRR) of scheduled banks kept unchanged at 5.0 per cent of net demand and time liabilities (NDTL).

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

(continued from the previous issue)

Recommendation 20

In order to promote incentives for prudent risk taking, each financial institution must review its compensation framework to ensure it follows sound practice principles developed by the FSF. These include the need for remuneration systems to provide incentives consistent with the firm's long-term goals, to be adjusted for the risk taken by employees, and for the variable components of compensation to vary symmetrically according to performance.

Recommendation 21

Prudential supervisors should enhance their oversight of compensation schemes by taking the design of remuneration systems into account when assessing risk management practices. The BCBS should more explicitly integrate this dimension in its guidance for the assessment of risk management practices by national prudential supervisors.

- In terms of Section 35 B of the Banking Regulation Act, 1949 banks in the private sector and foreign banks in India are required to obtain the approval of the Reserve Bank for remuneration payable to their CEOs (the remuneration of public sector bank CEOs is fixed by the Government of India).
- While devising the total remuneration package (including all perquisites and bonus) of CEOs and whole-time directors, Boards of private banks are required to ensure that the total package is reasonable in the light of industry norms including size of the business in India. The Compensation Committee which looks into the remuneration issue is required to have adequate representation of independent directors and directors, if any, representing major institutional shareholders in India. Remuneration of foreign banks' CEOs is mainly driven by the policies of their head offices.
- The Reserve Bank would recommend the implementation of the sound procedures/principles developed by the FSB for financial institutions regarding the compensation packages.

Recommendation 22

Accounting standard setters should accelerate efforts to reduce the complexity of accounting standards for financial instruments and enhance presentation standards to allow the users of financial statements to better assess the uncertainty surrounding the valuation of financial instruments.

- International Accounting Standards/International Financial Reporting Standards (IAS/IFRS) are adopted as a basis for formulation of Indian standards and due consideration is given to local customs, usage, practices, legal and regulatory environment. The Reserve Bank has taken a proactive role in the area of adherence by banks to the Accounting Standards. The Reserve Bank also actually participates in the standard setting process through its nominees in the Accounting Standards Board and the National Advisory Committee on Accounting Standards.
- IASB is in the process of issuing a new globally accepted standard in place of the existing financial instruments standard (IAS 39 *Financial Instruments: Recognition and Measurement)* that would address issues arising from the financial crisis in a comprehensive manner. Implementation of the standard in the Indian context will arise after it is finalised by IASB and adopted by ICAI as a part of its convergence programme.
- The Reserve Bank has, over the years, issued guidelines on valuation of various instruments/assets in conformity with the international best practices while keeping India-specific conditions in view.
- The securitisation framework in India is considered to be reasonably prudent and has been able to minimise the incentives that have led to the problems which surfaced in the current crisis.

Recommendation 23

The IASB should enhance its efforts to facilitate the global convergence towards a single set of high-quality accounting standards by sharing the experience of countries that have completed this process and by providing technical assistance.

- The recently published report of the CFSA on India's financial sector assessment has stated that the Indian accounting standards are generally in alignment with international accounting standards, except for some modifications to suit local customs, usages and level of development in the country. There has been significant progress in the area of convergence of accounting standards. The Indian accounting standards are expected to be fully convergent with IFRSs with effect from April 1, 2011 when IFRSs are likely to be adopted in India for listed and other public interest entities.

Recommendation 24

The effective enforcement of regulation should be a priority of all financial regulators. As such, national financial regulators and oversight authorities should ensure the effectiveness of their enforcement activities and that appropriate resources are available for monitoring the application of regulation and for prosecuting offenders. The enforcement function should be independent from other activities or from external influences.

- Regulations issued by the Reserve Bank are monitored by its supervisory department. The Banking Regulation Act, 1949 has prescribed extensive penalties for non submission or willful omission of information, for making false statements, and for not following directions issued by the Reserve Bank. Apart from this, the Reserve Bank can impose penalties under specific powers granted to it under the Act. Similar provisions exist in the Credit Information Companies (Regulation) Act, 2005 and the Payment and Settlement Systems Act, 2007. The penalties imposed by the Reserve Bank under the BR Act are placed in public domain.

Recommendation 25

Recognising that the degree of development of financial systems varies considerably across the G20, national authorities should commit to assist each other in enhancing their capacity to strengthen regulatory frameworks. In addition, IOSCO, the IAIS and the BCBS should have the appropriate capacity to provide technical assistance. The needs of emerging market economies deserve particular consideration.

- India has been striving for adopting the international best practices, tailored to country-specific conditions. Accordingly, the capacity building of all stakeholders has been progressively upgraded. The Reserve Bank has also conducted several international seminars often in collaboration with international bodies, to upgrade the skill levels in various developing economies. The Reserve Bank will continue such efforts.

(concluded)

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