RBI PRESS RELEASES

General Permission to Sell Shares Underlying GDRs/ADRs (September 9, 1998)

It has now been decided to grant general permission for sale/transfer of underlying shares obtained after conversion of Global Depositary Receipts (GDRs)/American Depositary Receipts (ADRs) by persons not resident in India if the sale is proposed to be made through a stock exchange or when the underlying shares are being sold in terms of an offer made under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Take overs) Regulations, 1997. All other cases of sale of shares underlying the GDRs/ADRs will have to be referred to the Reserve Bank of India for necessary permission.

The scheme for issue of ordinary shares through depositary receipt mechanism provides that the holders of the GDRs/ADRs may ask the overseas depository to redeem the GDRs/ADRs. The overseas depositary then requests the domestic custodian bank to get the corresponding underlying shares released in favour of the non-resident investor for being sold in India. The non-resident holder, so far, had to approach the Reserve Bank of India for necessary permission under Foreign Exchange Regulation Act, 1973, for sale of the shares. It was pointed out by several investors that there was a risk that markets may move against the sellers during the time needed for obtaining necessary RBI approval for sale.

Proposed Guidelines on Asset-Liability Management System in Banks (September 16, 1998)

The Reserve Bank of India has issued broad draft guidelines for Asset-Liability Management (ALM) System in banks. The guidelines are intended to form the basis for initiating measures for collection, compilation and analysis of data required to support ALM system. The Reserve Bank has requested banks to study the guidelines and send in their suggestions and difficulties, if any, that may be encountered in implementation of the system. The Reserve Bank has also stated that it proposes to introduce the ALM system in banks from April 1, 1999 after issuing the final circular in January 1999.

It may be recalled that the Reserve Bank had, in October 1997, announced that it will issue broad guidelines for managing liquidity and interest rate risks faced by banks.

In normal course, banks are exposed to credit and market risks in view of the asset-liability transformation. With the gradual liberalisation of the Indian financial system and greater integration of domestic markets with external markets, the risks associated with banks' operations have become complex and large, requiring strategic management. The fast changing financial environment has exposed Indian banks to interest rate risk, forex risk, equity price risk and liquidity risk. Any adverse movements in market interest rates and currency rates would immediately affect the banks' earnings by changing their Net Interest Income (NII) or Net Interest Margin (NIM). In the long-term, any changes in market rates would impact the economic value or Market Value of Equity (MVE) through significant changes in the market value of the banks assets, liabilities and off-balance sheet positions. Further, imprudent liquidity management can put banks' earning and reputation at risk. It is, therefore, important that banks introduce effective risk management systems that address the issues related to market risks. Against this background, the Reserve Bank has issued draft guidelines for operationalisation of ALM system by banks.

In the draft guidelines, the Reserve Bank has advised banks to address market risks in a structural manner by upgrading their risk management skills and adopting more comprehensive ALM practices. As a part of the integrated approach, banks have been advised to set up Asset-Liability Management Committees, which should be headed by the Chief Executive Officer/Chairman and Managing Director or Executive Director of the bank. Banks have also been advised to constitute a professional management and supervisory committee consisting of 3/4 directors on boards to oversee implementation of the system and review its functions periodically.

The guidelines cover the measurement of liquidity and interest rate risks and at this stage, focus on simple methodologies.

Liquidity Risk

Measuring and managing liquidity needs are vital activities of banks. The importance of liquidity transcends individual institutions, as liquidity shortfall in one institution can have reprecussions on the entire system. Thus, banks should not only measure liquidity positions on an ongoing basis but also examine how liquidity requirements are likely to evolve under crisis scenarios. The draft guidelines suggest the use of maturity ladder and calculation of cumulative surplus or deficit of funds at selected maturity dates. The banks have been advised to prepare a statement of structural liquidity (static basis) by placing all cash inflows and outflows in the maturity ladder according to the expected timing of cash flows. Banks are expected to monitor mismatches in cash flows by establishing internal prudential limits with the approval of the board/management committee. The mismatch during 1-14 days and 15-28 days is sought to be restricted at 20 per cent of the cash outflows in these time buckets. In addition to the structural liquidity, the banks have also been advised to monitor their short-term liquidity for 90 days, on a dynamic basis, on the basis of business projections and other commitments.

Interest Rate Risk

Phased deregulation of interest rates and the operational flexibility given to banks in pricing most of the assets and liabilities have exposed the banking system to interest rate risk. Considering the problems associated with availability of data, the guidelines focus only on simple methodologies at this stage. Simple traditional gap analysis, under assumption of a parallel shift in yield curve has been suggested as a suitable method to measure interest rate risk. It is the intention of the Reserve Bank to move over to modern techniques like duration gap analysis, simulation and value at risk at a later date when banks acquire sufficient expertise and sophistication in Management Information System (MIS). The gap report can be prepared by grouping rate sensitive liabilities, assets and off-balance sheet position into time buckets according to residual maturity or next repricing period, whenever is earlier. Banks have been advised to set prudential limits on individual gaps, having a bearing on the total assets, earning assets or equity. Banks have also been advised to work out earnings at risk based on their views on interest rate movements.

Currency Risk

Presently, the banks are free to set gap limits with the Reserve Bank's approval and are required to adopt value at risk approach to measure the risk associated with forward exposures. Thus, the open position limits together with the gap limits continue to be the risk management approach to forex operations. The Reserve Bank had already issued detailed guidelines to banks in this area in December 1997.

Considering the inadequate MIS in the Indian banking system and that the Reserve Bank is prescribing guidelines in ALM for the first time, the banks have been advised to study the guidelines and forward to the Reserve Bank suggestions and difficulties, if any, that may be encountered in implementation of the system. Banks have also been advised to set up a small group under the charge of the General Manager (Funds Management/Treasury) for implementation of the ALM system.

The Reserve Bank will also hold 2/3 days seminar at Bankers Training College, Mumbai for disseminating and imparting knowledge on the subject to enable banks to overcome initial difficulties and implement the system smoothly.

RBI Guidelines on Hedging Commodity Price Risk (September 28, 1998)

It may be recalled that the Reserve Bank had constituted a committee on hedging through International Commodity Exchanges under the Chairmanship of its then Deputy Governor Shri R. V. Gupta. The recommendations of the committee were examined in consultation with the Government of India and it has been decided to allow Indian corporates having genuine underlying exposure to access international commodity exchanges for hedging of their commodity price risk.

The Reserve Bank of India has today issued detailed operational guidelines for hedging of commodity price risk by corporates. The handling of applications of corporates by authorised dealers as also the risk management, internal control, reporting and monitoring system to be put in place by the corporates for derivatives activity, etc., are covered in the guidelines.

As per the norms set out, access to recognised international commodity exchanges would be through brokerage firms which are clearing members of exchanges. This facility would not be allowed for oil and petroleum products. All exchange traded futures/options (purchases) contracts would be allowed. The focus would be on risk containment. Only offset hedge would be permitted. The tenure of the exposure would be limited to six months, tenure beyond six months would require the Reserve Bank's approval.

The Reserve Bank circular containing detailed guidelines is also available on the RBI website (at http://www.rbi.org.in).

Indian Companies Seeking NRI/OCB Investments–RBI Simplifies Procedure (October 3, 1998)

In order to further simplify the procedure for investments from Non-Resident Indians/ Overseas Corporate Bodies (NRI/OCB) in Indian companies, the Reserve Bank of India (RBI) has decided to grant general permission under the Foreign Exchange Regulation Act (FERA) 1973, in respect of 24 per cent/40 per cent Scheme. It will no longer be necessary for the Indian companies to approach the Reserve Bank of India for permission to receive remittances from NRIs/ OCBs and issue shares thereagainst. Necessary Notification No. F.E.R.A.187/98-RB dated October 3, 1998 under FERA to give effect to the revised simplified procedure has been issued.

Henceforth, Indian companies will not require RBI permission for the purpose of receiving inward remittances and issue shares to the NRI/OCB investors under the 24 per cent/ 40 per cent Scheme. These companies will, however, have to file the required documents with the concerned Regional Office of the Reserve Bank within 30 days after the issue of shares to NRIs/OCBs.

Applications pending with the Reserve Bank of India requiring examination will be dealt with expeditiously as per the procedure prevailing before the date of the Notification.

International Credit Cards

(October 3, 1998)

At present, the facility of international credit card is available to residents visiting foreign countries and they can utilise such cards up to their entitlement of foreign exchange for foreign visits. The Reserve Bank of India has relaxed the conditions for holding of international credit cards by residents. All residents are now permitted to hold international credit cards which can be used by them not only to meet their travel expenditure in accordance with their entitlement but also other payments like subscribing for a foreign journal, etc., as may be permissible under the exchange control regulations. Residents are also free to use such cards for payments within India.

Reimbursements to card issuing establishments will have to be through authorised dealers as usual who will satisfy themselves that the remittances are in accordance with the exchange control regulations and are covered by powers delegated to them.