

Setting up of Offshore Banking Units (OBUs) in Special Economic Zones (SEZs)

DBOD.IBS.BC. 42/23.13.004/2002-03

November 12, 2002

All scheduled commercial banks
(excluding RRBs and LABs)

Dear Sir

Setting up of Offshore Banking Units (OBUs) in Special Economic Zones (SEZs)

Please refer to paragraph 132 of the Statement on Mid-term Review of Monetary and Credit Policy for the year 2002-2003 enclosed to Governor's letter MPD.No.BC.222/07.01.279/2002-03 dated October 29, 2002. The Union Commerce Minister in the EXIM Policy 2002-07 speech had announced that for the first time, Offshore Banking Units (OBUs) would be permitted to be set up in SEZs. Pursuant to the announcement, Reserve Bank of India has formulated a scheme for the setting up of OBUs in SEZs by banks, which is enclosed. A Notification No. FEMA 71/2002-RB dated September 7, 2002 issued by our Exchange Control Department in this regard and published in the Official Gazette of India No. 42 dated October 19, 2002 is also enclosed.

2. Banks intending to set up OBUs in SEZs may approach this department with an application under Section 23 of the Banking Regulation Act, 1949. The application must be accompanied by such additional information as would be needed for processing the application.

Yours faithfully

Sd/-

(M.R. Srinivasan)
Chief General Manager-in-Charge

Encl: As above

Scheme for setting up of Offshore Banking Units (OBUs) in Special Economic Zones (SEZs)

The Government of India has introduced the Special Economic Zone (SEZ) scheme with a view to providing an internationally competitive and a hassle free environment for export production. As per the Government's policy, SEZs will be a specially delineated duty free enclave and deemed to be a foreign territory for the purpose of trade operations and duties / tariffs so as to usher in export-led growth of the economy.

It was also indicated by the Union Commerce Minister in his speech announcing the EXIM Policy for 2002-07 that for the first time, Offshore Banking Units (OBUs) would be permitted to be set up in SEZs. These units would be virtually foreign branches of Indian

banks but located in India. These OBUs, *inter alia*, would be exempt from CRR, SLR and give access to SEZ units and SEZ developers to international finances at international rates.

In this background, RBI has prepared the following scheme to facilitate banks operating in India to set up OBUs.

2. The Scheme

2.1 Eligibility Criteria

Banks operating in India viz. public sector, private sector and foreign banks authorised to deal in foreign exchange are eligible to set up OBUs. Such banks having overseas branches and experience of running OBUs would be given preference. Each of the eligible banks would be permitted to establish only one OBU which would essentially carry on wholesale banking operations.

2.2 Licensing

Banks would be required to obtain prior permission of the RBI for opening an OBU in a SEZ under Section 23 (1)(a) of the Banking Regulation Act, 1949. Given the unique nature of business of the OBUs, Reserve Bank would stipulate certain licensing conditions such as dealing only in foreign currencies, restrictions on dealing with Indian rupee, access to domestic money market, etc. on the functioning of the OBUs. The parent bank's application for branch licence should itself state that it proposes to conduct business at the OBU branch in foreign currency only.

No separate authorisation with respect to the OBU branch would be issued under FEMA. As currently in vogue with respect to designating a specific branch for conducting foreign exchange business, the parent bank may designate the branch in SEZ as an OBU branch. A separate Notification No.FEMA71/2002-RB dated September 7, 2002 issued by the Exchange Control Department (ECD) of RBI on OBUs is enclosed.

2.3 Capital

Since OBUs would be branches of Indian banks, no separate assigned capital for such branches would be required. However, with a view to enabling them to start their operations, the parent bank would be required to provide a minimum of US\$ 10 million to its OBU.

2.4 Reserve Requirements

2.4.1 CRR

RBI would grant exemption from CRR requirements to the parent bank with reference to its OBU branch under Section 42(7) of the RBI Act, 1934.

2.4.2 SLR

Banks are required to maintain SLR under Section 24 (1) of the Banking Regulation Act, 1949 in respect of their OBU branches. However, in case of necessity, request from individual banks for exemption will be considered for a specified period under Section 53 of the B.R. Act, 1949.

2.5 Resources and deployment

The sources for raising foreign currency funds would be only external. Funds can also be raised from those resident sources to the extent such residents are permitted under the existing exchange control regulations to invest/maintain foreign currency accounts abroad. Deployment of funds would be restricted to lending to units located in the SEZ and SEZ developers. Foreign currency requirements of corporates in the domestic area can also be met by the OBUs. If funds are lent to residents in the Domestic Tariff Area (DTA), existing exchange control regulations would apply to the beneficiaries in DTA.

2.6 Permissible Activities of OBUs

OBUs would be permitted to engage in the form of business mentioned in Section 6(1) of the BR Act, 1949 as stipulated in the enclosed ECD Notification No. FEMA71/2002-RB dated September 7, 2002 and subject to the conditions of the licence issued to the OBU branches.

2.7 Prudential Regulations

All prudential norms applicable to overseas branches of Indian banks would apply to the OBUs. The OBUs would be required to follow the best international practice of 90 days' payment delinquency norm for income recognition, asset classification and provisioning. The OBUs may follow the credit risk management policy and exposure limits set out by their parent banks duly approved by their Boards.

The OBUs would be required to adopt liquidity and interest rate risk management policies prescribed by RBI in respect of overseas branches of Indian banks as well as within the overall risk management and ALM framework of the bank subject to monitoring by the Board at prescribed intervals.

The bank's Board would be required to set comprehensive overnight limits for each currency for these branches, which would be separate from the open position limit of the parent bank.

2.8 Anti-Money Laundering Measures

The OBUs would be required to scrupulously follow "Know Your Customer (KYC)" and other anti-money laundering instructions issued by RBI from time to time. Further, with a view to ensuring that anti-money laundering instructions are strictly complied with by the OBUs, they are prohibited from undertaking cash transactions, and transactions with individuals.

2.9 Regulation and Supervision

OBUs will be regulated and supervised by RBI through its Exchange Control Department, Department of Banking Operations and Development and Department of Banking Supervision.

2.10 Reporting requirements

OBUs will be required to furnish information relating to their operations as are prescribed from time to time by RBI.

2.11 Ring fencing the activities of OBUs

The OBUs would operate and maintain balance sheet only in foreign currency and would not be allowed to deal in Indian Rupees except for having a special Rupee account out of convertible fund to meet their day to day expenses. These branches would be prohibited to participate in domestic call, notice, term, etc. money market and payment system. Operations of the OBUs in rupees would be minimal in nature, and any such operations in the domestic area would be through the Authorised Dealers (distinct from OBUs) which would be subject to the current exchange control regulations in force.

The OBUs would be required to maintain separate nostro accounts with correspondent banks which would be distinct from nostro accounts maintained by other branches of the same bank. The ADs dealing with OBUs would be subject to ECD regulations.

2.12 Priority sector lending

The loans and advances of OBUs would not be reckoned as net bank credit for computing priority sector lending obligations.

2.13 Deposit insurance

Deposits of OBUs will not be covered by deposit insurance.

2.14 Choice of SEZ

OBUs would be permitted in SEZs approved by Government of India, where according to Government policy, OBUs can be set up.