Para-banking Activities

DBOD.FSC.No. 56/24.01.001/2003-04

December 12, 2003

Chief Executives of all Scheduled Commercial Banks
(excluding RRBs & LABs)

Dear Sir,

Master Circular - Para-banking Activities

As you are aware, the Reserve Bank of India has, from time to time, issued a number of circulars to banks containing instructions on matters relating to para-banking activities. In order to enable the banks to have all the existing instructions on the subject at one place, this Master Circular has been prepared. The Master Circular incorporates all the instructions/guidelines issued on para-banking activities upto June 30, 2003 which are operational as on date. The Master Circular has also been placed on the RBI web-site (http://www.rbi.org.in).

Yours faithfully,

(B.Mahapatra)
Chief General Manager

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MASTER CIRCULAR – PARA-BANKING ACTIVITIES

1.1 Introduction

Banks can undertake certain eligible financial services or para-banking activities either departmentally or by setting up subsidiaries. Banks may form a subsidiary company for undertaking the types of business which a banking company is otherwise permitted to undertake, with prior approval of Reserve Bank of India. The instructions issued by Reserve Bank of India to banks for undertaking certain financial services or para-banking activities as permitted by RBI have been compiled in this Master Circular.

1.2 Subsidiary Companies

Under the provisions of Section 19(1) of the Banking Regulation Act, 1949, banks may form subsidiary companies for undertaking types of banking business which they are otherwise permitted to undertake [under clauses (a) to (o) of sub-section 1 of Section 6 of the Banking Regulation Act, 1949], carrying on the business of banking exclusively outside India and for such other business purposes as may be approved by the Central Government. Prior approval of the Reserve Bank of India should be taken by a bank to set up a subsidiary company.

1.3 Investment ceiling in financial services companies, etc.

Under the provisions of Section 19(2) of the Banking Regulation Act, 1949, a banking company cannot hold shares in any company whether as pledgee or mortgagee or absolute owner of an amount exceeding 30 per cent of the paid-up share capital of that company or 30 per cent of its own paid-up share capital and reserves, whichever is less. Besides, the investment by a bank in a subsidiary company, financial services company, financial institution, stock and other exchanges should not exceed 10 per cent of the bank's paid-up capital and reserves and the investments in all such companies, financial institutions, stock and other exchanges put together should not exceed 20 per cent of the bank's paid-up capital and reserves. Banks cannot, however, participate in the equity of financial services ventures including stock exchanges, depositories, etc. without obtaining the prior specific approval of the Reserve Bank of India notwithstanding the fact that such investments may be within the ceiling prescribed under Section 19(2) of the Banking Regulation Act.

1.4 Equipment leasing, Hire purchase business and Factoring services

With the prior approval of the Reserve Bank of India, banks can form subsidiary companies for undertaking equipment leasing, hire purchase business and factoring services. The subsidiaries formed should primarily be engaged in any of these activities and such other activities as are incidental to equipment leasing, hire purchase business and factoring services. In other words, they should not engage themselves in direct lending or carrying on of activities which are not approved by the Reserve Bank and financing of other companies or concerns engaged in equipment leasing, hire purchase business and factoring services.

1.5 Equipment leasing, Hire purchase and Factoring services as departmental activities

Banks can also undertake equipment leasing, hire purchase and factoring services departmentally. Prior approval of the RBI is not necessary for undertaking these activities departmentally. The banks should, however, report to the RBI about the nature of these activities together with the names of the branches from where these activities are taken up. The banks should comply with the following prudential guidelines when they undertake these activities departmentally:

i) As activities like equipment leasing and factoring services require skilled personnel and adequate infrastructural facilities, they should be undertaken only by certain select branches of banks.

ii) These activities should be treated on par with loans and advances and should accordingly be given risk weight of 100 per cent for calculation of capital to risk asset ratio. Further, the extant guidelines on income recognition, asset classification and provisioning would also be applicable to them.

iii) The facilities extended by way of equipment leasing, hire purchase finance and factoring services would be covered within the exposure ceilings with regard to single borrower (15% of the bank's capital funds; 20 % provided the additional credit exposure is on account of extension of credit to infrastructure projects) and borrower group (40% of the bank's capital funds; 50% provided the additional credit exposure is on account of extension of credit to infrastructure projects).

iv) Banks should maintain a balanced portfolio of equipment leasing, hire purchase and factoring services vis-à-vis the aggregate credit. Their exposure to each of these activities should not exceed 10 per cent of total advances.

v) Banks are required to frame an appropriate policy on leasing business with the approval of the Boards and evolve safeguards to avoid possible asset liability mismatch. While banks are free to fix the period of lease finance in accordance with such policy framed by them, full depreciation should be provided for during the primary lease period of the asset.

(vi) Banks undertaking equipment leasing departmentally should follow prudential accounting standards. The entire lease rental should not be taken to the bank's income account. The lease rentals comprise two elements - a finance charge (i.e. interest charge) and a charge towards recovery of the cost of the asset. The interest component alone should be taken to the income account. The component representing the replacement cost of the asset should be carried to the balance sheet in the form of a provision for depreciation.

(vii) The net lease rentals (finance charge) on the leased asset accrued and credited to income account before the asset became non-performing, and remaining unrealised, should be reversed or provided for in the current accounting period.

The term 'net lease rentals' would mean the amount of finance charge taken to the credit of P&L account and would be worked out as gross lease rentals adjusted by amount of statutory depreciation and lease equalisation account.

viii) Any changes brought about in respect of guidelines in asset classification, income recognition and provisioning for loans/advances and other credit facilities would also be applicable to leased assets of banks undertaking leasing activity departmentally.

ix) Banks should not enter into leasing agreement with equipment leasing companies and other non-banking finance companies engaged in equipment leasing.

x) Lease rental receivables arising out of sub-lease of an asset by a Non-banking Financial Company undertaking leasing should not be included for the purpose of computation of bank finance for such company.

xi) Banks undertaking factoring services departmentally should carefully assess the client's working capital needs taking into account the invoices purchased. Factoring services should be extended only in respect of those invoices which represent genuine trade transactions. Banks should take particular care to ensure that by extending factoring services, the client is not overfinanced.

1.6 Mutual Fund business

i) Prior approval of the RBI should be obtained by banks before undertaking mutual fund business. Bank-sponsored mutual funds should comply with guidelines issued by SEBI from time to time.

ii) The bank-sponsored mutual funds should not use the name of the sponsoring bank as part of their name. Where a bank's name has been associated with a mutual fund, a suitable disclaimer clause should be inserted while publicising new schemes that the bank is not liable or responsible for any loss or shortfall resulting from the operations of the scheme.

1.7 Relationship with the subsidiaries

The sponsor bank is required to maintain an "arms length" relationship from the subsidiary/mutual fund sponsored by it in regard to business parameters such as, taking undue advantage in borrowing/lending funds, transferring/selling/buying of securities at rates other than market rates, giving special consideration for securities transactions, overindulgence in supporting/financing the subsidiary, financing the bank's clients through them when the bank itself is not able or is not permitted to do so, etc. Supervision by the parent bank should not, however, result in interference in the day-to-day management of the affairs of the subsidiary/mutual fund. Banks should evolve appropriate strategies such as:

i) The Board of Directors of the parent/sponsor bank may review the working of subsidiaries/mutual fund at periodical intervals (say once in six months) covering the major aspects relating to their functioning and give proper guidelines/suggestions for improvement, wherever considered necessary.

ii) The parent bank may cause inspection/audit of the books and accounts of the subsidiaries/mutual fund at periodical intervals, as appropriate, and ensure that the deficiencies noticed are rectified without lapse of time. If the bank's own inspection staff is not adequately equipped to undertake the inspection/audit, the task may be entrusted to outside agencies like firms of Chartered Accountants. In case there is technical difficulty for causing inspection/audit (e.g. on account of non-existence of an enabling clause in the Memorandum and Articles of Association of the subsidiary or Asset Management Company), steps should be taken to amend the same suitably.

iii) Where banks have equity participation by way of portfolio investment in companies offering financial services, they may review the working of the latter at least on an annual basis.

1.8 Credit Card and Smart/Debit Card Business

1.8.1 Credit Cards

Banks can undertake credit card business either departmentally or through a subsidiary company set up for the purpose. They could also undertake domestic credit card business by entering into tie-up arrangement with one of the banks already having arrangements for issue of credit cards. Prior approval of the Reserve Bank is not necessary for banks desirous of undertaking credit card business either independently or in tie-up arrangement with other card issuing banks. Banks can do so with the approval of their Boards. However, only banks with networth of Rs.100 crore and above should undertake credit card business. Banks desirous of setting up separate subsidiaries for undertaking credit card business would, however, require prior approval of the Reserve Bank.

Banks should adopt the following safeguards to ensure that their credit card operations are run on sound, prudent and profitable lines:

(a) Issue of cards

Banks should be selective in issuing credit cards and proper appraisal should be made taking into account the income, repaying capacity of the applicant and other relevant criteria before issuing credit cards.

(b) Recovery of overdues

(i) Banks should take immediate steps to reduce the incidence of default in credit card business and put in place appropriate mechanism for speedy recovery of dues from card holders. Banks should also closely monitor the recovery of credit card outstandings.
(ii) Banks may formulate specific Action Plans to this effect with the approval of their Boards of Directors.
(iii) Banks should also observe the code of ethics formulated by the Indian Banks' Association while engaging recovery agents for collection of credit card overdues.

(c) Review of credit card business

Banks engaged in credit card business should place before their Boards of Directors/Managing Committees of the Boards a comprehensive review report on half yearly basis, which should cover essential data on credit card business such as category and number of cards issued and amount outstanding, number of active cards, average turnover per card, number of establishments covered, average time taken for recovery of dues from the cardholders, debts classified as NPAs and provisions held thereagainst, or amounts written off, details of frauds on credit cards, steps taken to recover the dues, profitability analysis of the business, etc.

(d) Sharing of information on credit card holders
Banks should become members of one or more Credit Information Bureaus in order to maintain the selectivity of customers in their credit card business. Banks should also take advantage of the existing negative file projects to guard against defaults in this business.

(e) Fraud Control

Banks should set up internal control systems to combat frauds. Banks should actively participate in fraud prevention committees/task forces which formulate laws to prevent frauds and take proactive fraud control and enforcement measures.

(f) Processing

In order to provide efficient back-office solution to the cards management process and in the areas of accounts receivables, billing, settlement and other related services it is necessary that banks have in place a proper processing solution. Banks should make use of developments in this area to ensure better operating controls.

(g) Fees/Charges on credit cards

Banks should clearly spell out fees/charges to the cardholder at the time of their applying for credit card. In particular, banks should bring to the notice of the cardholder the rates of interest to be charged in case of delays and default in payments, besides the membership/renewal fees.

1.8.2 Smart/Debit Cards

Banks can introduce smart/on-line debit cards with the approval of their Boards, keeping in view the Guidelines contained in Annexure I. While banks need not obtain the prior approval of the Reserve Bank of India, the details of smart/on-line debit cards introduced may be advised to the Reserve Bank of India together with a copy each of the agenda note put up to their Boards and the resolution passed thereon. In the case of debit cards where authorization and settlement are off-line or where either authorization or settlement is off-line, banks should obtain prior approval of the Reserve Bank of India for introduction of the same after submitting the details on mode of authorization and settlement, authentication method employed, technology used, tie-ups with other agencies/service providers (if any), together with Board note/Resolution. However, only banks with networth of Rs.100 crore and above should undertake issue of off-line debit cards. Banks cannot issue smart/debit cards in tie-up with other non-bank entities. Banks should review operations of smart/debit cards and put up review notes to their Boards at half-yearly intervals, say at the end of March and September, every year.

A report on the operations of smart/debit cards issued by banks should be forwarded to the Department of Information Technology with a copy to the concerned regional office of Department of Banking Supervision on a half yearly basis, say at the end of March and September, every year, incorporating information as indicated in Annexure II.

1.9 Money Market Mutual Funds (MMMFs)

MMMFs would come under the purview of SEBI regulations. Banks and Financial Institutions desirous of setting up MMMFs would however have to seek necessary clearance from RBI for undertaking this additional activity before approaching SEBI for registration.

1.10 'Cheque Writing' Facility for investors of Money Market Mutual Funds (MMMFs)

Banks are permitted to tie-up with MMMFs as also with MFs in respect of Gilt Funds and Liquid Income Schemes which predominantly invest in money market instruments (not less than 80 per cent of the corpus) to offer cheque writing facilities to investors subject to the following safeguards.

(i) In the case of a MMMF set up by a bank, the tie-up arrangement should be with the sponsor bank. In other cases, the tie-up should be with a designated bank. The name of the bank should be clearly indicated in the Offer Document of the Scheme.

(ii) The Offer Document should clearly indicate that the tie-up to offer 'cheque writing' facility is purely a commercial arrangement between the MMMF/MF and the designated bank, and as such, the servicing of the units of MMMF/MF will not in any way be the direct obligation of the bank concerned. This should be clearly stated in all public announcements and communications to individual investors.

(iii) The facility to any single investor in the MMMF/MF can be permitted at the investor's option, in only one of the branches of the designated bank.

(iv) It should be in the nature of a drawing account, distinct from any other account, with clear limits for drawals, the number of cheques that can be drawn, etc, as prescribed by MMMF/MF. It should not however be used as a regular bank account and cheques drawn on this account should only be in favour of the investor himself (as part of redemption) and not in favour of third parties. No deposits can be made in the account. Each drawal made by the investor under the facility should be consistent with the terms prescribed by the MMMF/MF and treated as redemption of the holdings in the MMMF/MF to that extent.

(v) The facility can be availed of by investors only after the minimum lock-in period of 15 days for investments in MMMFs (not applicable in the case of eligible Gilt Funds and Liquid Income Schemes of Mutual Funds and any prescription of lock-in-period in such cases will be governed by SEBI Regulations).

(vi) The bank should ensure pre-funding of the drawing account by the MMMF/MF at all times and review the funds position on a daily basis.

(vii) Such other measures as may be considered necessary by the bank.

1.11 Entry of banks into Insurance business

With the issuance of Government of India Notification dated August 3, 2000, specifying 'Insurance' as a permissible form of business that could be undertaken by banks under Section 6(1)(o) of the Banking Regulation Act, 1949, banks were advised that any bank intending to undertake insurance business as per the guidelines set out in the Annexure III should obtain prior approval of Reserve Bank of India before engaging in such business. Banks may, therefore, submit necessary applications to RBI furnishing full details in respect of the parameters as specified in the above guidelines, details of equity contribution proposed in the joint venture/strategic investment, the name of the company with whom the bank would have tie-up arrangements in any manner in insurance business, etc. The relative Board note and Resolution passed thereon approving the bank's proposal together with viability report prepared in this regard may also be forwarded to Reserve Bank. However, insurance business will not be permitted to be undertaken departmentally by the banks. Further, banks need not obtain prior approval of the RBI for engaging in insurance agency business or referral arrangement without any risk participation, subject to certain conditions(**Annexure IV).**

1.12.1 Underwriting of Corporate Shares and Debentures

Generally, there are demands on the banks for underwriting the issues of shares and debentures. In order to ensure that there is no overexposure to underwriting commitments, the guidelines detailed below should be strictly adhered to.

(i) The statutory provision contained in Section 19(2) & (3) of the Banking Regulation Act, 1949 regarding holding of shares in any company as pledgee / mortgagee or absolute owner, should be strictly adhered to;

(ii) The banks have to ensure that the shares/debentures including PSU equities and shares of other banks, Mutual Funds (the corpus of which is not exclusively invested in corporate debt instruments), the units of UTI subscribed and/or devolving on them as a part of their underwriting obligations in any particular year comply with the ceiling prescribed for the banks' exposure to the capital markets.

a. It may be noted that the limit placed is on the shares and debentures, that may be held in the banks own portfolio as a result of devolvement and not on the amount of underwriting that the banks may engage in. Normally, the amount of underwriting is a multiple of the amount which devolves finally.

b. The underwriting exposure to any company which will include other funded and non-funded credit limits should not exceed 15 percent (upto 20 percent provided additional credit exposure is on account of infrastructure project) of capital funds of the banks in the case of a single company and 40 percent (up to 50 percent, provided the additional credit exposure is on account of extension of credit to infrastructure project) in the case of group of companies.

c. While taking up underwriting commitments, banks or their subsidiaries, should ensure that the aggregate of such commitments are included in the exposure limits fixed by the Reserve Bank.

d. In the case of underwriting, the commitments under a single obligation should be fixed taking into account the owned funds of banks and the capacity to meet the commitments that may devolve and should not in any case exceed 15 percent of an issue.

e. Banks could consider sub-underwriting for every underwritten issue so as to minimise chances of devolution on their own account. This is not mandatory. The need for and extent of such sub-underwriting is a matter of bank's discretion.

f. While taking up underwriting obligations, banks should carefully evaluate the proposals so as to ensure that the issues will have adequate public response and the prospect of devolution of such shares/debentures on the underwriting banks will be minimal.

g. Banks should ensure that the portfolio is diversified and that no unduly large underwriting obligations are taken up in the shares and debentures of a company or a group of companies. Banks should make enquiries regarding the other underwriters and their capacity to fulfil the obligations.

Banks should formulate within the above parameters, their own internal guidelines as approved by their Boards of Directors on investments in corporate shares/debentures of companies or group of companies including norms to ensure that excessive investment in any single company is avoided and that due attention is given to the maturity structure and quality of such investments.

iii) Banks should not underwrite issue of Commercial Paper by any Company or Primary Dealer.

iv) Banks should not extend Revolving Underwriting Facility to short-term Floating Rate Notes/Bonds or debentures issued by corporate entities.

v) An annual review covering the underwriting operations taken up during the year, with company-wise details of such operations, the shares/debentures devolved on the banks, the loss (or expected loss) from unloading the devolved shares/debentures indicating the face-value and market value thereof, the commission earned, etc. may be placed before their Boards of Directors within 2 months of the close of the fiscal year.

vi) Banks/ merchant banking subsidiaries of banks - undertaking underwriting activities- are also required to comply with the guidelines contained in the SEBI (Underwriters) Rules and Regulations, 1993, and those issued from time to time.

1.12.2 Underwriting of bonds of Public Sector Undertakings

The banks can play a useful role in relation to issue of bonds by Public Sector Undertakings (PSUs) by underwriting a part of these issues. Banks should subject the proposals for underwriting to proper scrutiny having regard to all the relevant factors and accept such commitments only on well-reasoned commercial considerations with the approval of the appropriate authority.

The banks should formulate their own internal guidelines as approved by their Boards of Directors on investments in and underwriting of PSU bonds, including norms to ensure that excessive investment in any single PSU is avoided and that due attention is given to the maturity structure of such investments. Banks would also need to take into account that such investments are subject to risk weight and necessary depreciation has to be fully provided for. Such investments in PSU bonds including shares and debentures and subscription to Commercial Papers of PSUs should be reckoned for the purpose of arriving at prudential norms of credit exposure for single borrower and group of borrowers.

Banks should undertake an annual review of the underwriting operations relating to bonds of the public sector undertakings, with PSU-wise details of such operations, bonds devolved on the banks, the loss (or expected loss) from unloading the devolved bonds indicating the face-value and market value thereof, the commission earned, etc. and place the same before their Boards of Directors within two months from the close of the fiscal year.

With a view to enabling the banks to deploy their surplus funds more remuneratively, the banks will have the freedom to acquire PSU bonds including through underwriting devolvements without any ceiling.

1.12.3 'Safety Net' Schemes

Reserve Bank had observed that some banks/their subsidiaries were providing buy-back facilities under the name of ‘Safety Net’ Schemes in respect of certain public issues as part of their merchant banking activities. Under such schemes, large exposures are assumed by way of commitments to buy the relative securities from the original investors at any time during a stipulated period at a price determined at the time of issue, irrespective of the prevailing market price. In some cases, such schemes were offered *suo motto* without any request from the company whose issues are supported under the schemes. Apparently, there was no undertaking in such cases from the issuers to buy the securities. There is also no income commensurate with the risk of loss built into these schemes, as the investor will take recourse to the facilities offered under the schemes only when the market value of the securities falls below the pre-determined price. Banks/their subsidiaries have therefore been advised that they should refrain from offering such ‘Safety Net’ facilities by whatever name called.

1.13 Annexure - I
[Paragraph 1.8.2]

<u>The guidelines for the Issue of the Smart Cards/Debit Cards by banks</u>

1 <u>Coverage</u>:

The guidelines apply to the smart cards/cards encompassing all or any of the following operations –

- Electronic payment involving the use of card, in particular at point of sale and such other places where a terminal/device for the use/access of the card is placed.
- The withdrawing of bank notes, the depositing of bank notes and cheques and connected operations in electronic devices such as cash dispensing machines and ATMs.
- Any card or a function of a card which contains real value in the form of electronic money which someone has paid for in advance, some of which can be reloaded with further funds or one which can connect to the cardholder’s bank account (on-line) for payment through such account and which can be used for a range of purposes.

2. Cash Withdrawals

No cash transaction, that is, cash withdrawals or deposits should be offered at the Point of Sale, with the smart/debit cards under any facility, without prior authorization of RBI under Section 23 of the Banking Regulation Act, 1949.

3. Eligibility of Customers:

The banks can issue smart (both on-line and off-line)/on-line debit cards to select customers with good financial standing even if they have maintained the accounts with the banks for less than six months subject to their ensuring the implementation of 'Know Your Customer' concept as stipulated in para 9.2 of the Report of the Study Group on Large Value Bank Frauds forwarded vide circular No.DBS. FGV.BC.56/23.04.001/98-99 dated 21st June 1999. However, banks introducing off-line mode of operation of debit cards should adhere to the minimum period of satisfactory maintenance of accounts for six months. Banks can extend the smart card/ debit card facility to those having saving bank account/current account/fixed deposit accounts with built-in liquidity features maintained by individuals, corporate bodies and firms. Smart card/debit card facility should not be extended to cash credit/loan account holders. The banks can, however, issue on-line debit cards against personal loan accounts, where operations through cheques are permitted.

4. Treatment of Liability:

The outstanding balances/unspent balances stored on the smart/debit cards shall be subject to the computation for the purpose of maintenance of reserve requirements. This position will be computed on the basis of the balances appearing in the books of the bank as on the date of reporting.

5. Payment of Interest:

In case of smart cards having stored value (as in case of the off-line mode of operation of the smart card), no interest may be paid on the balances transferred to the smart cards. In case of debit cards or on line smart cards, the payment of interest should be in accordance with the interest rate directives issued to banks from time to time under Sections 21 and 35A of the Banking Regulation Act, 1949.

6. Security and other aspects:

(a) The bank shall ensure full security of the smart card. The security of the smart card shall be the responsibility of the bank and the losses incurred by any party on account of breach of security, failure of the security mechanism shall be borne by the bank.

(b) No bank shall despatch a card to a customer unsolicited, except in the case where the card is a replacement for a card already held by the customer.

(c) Banks shall keep for a sufficient period of time, internal records to enable operations to be traced and errors to be rectified (taking into account the law of limitation for the time barred cases).
(d) The cardholder shall be provided with a written record of the transaction after he has completed it, either immediately in the form of receipt or within a reasonable period of time in another form such as the customary bank statement.
(e) The cardholder shall bear the loss sustained up to the time of notification to the bank of any loss, theft or copying of the card but only up to a certain limit (of fixed amount or a percentage of the transaction agreed upon in advance between the cardholder and the bank), except where the cardholder acted fraudulently, knowingly or with extreme negligence.
(f) Each bank shall provide means whereby his customers may at any time of the day or night notify the loss, theft or copying of their payment devices.
(g) On receipt of notification of the loss, theft or copying of the card, the bank shall take all action open to it to stop any further use of the card.

7. Terms and Conditions for issue:

The relationship between the bank and the card holder shall be contractual. In case of contractual relationship between the cardholder and the bank:

a) Each bank shall make available to the cardholders in writing, a set of contractual terms and conditions governing the issue and use of such a card. These terms shall maintain a fair balance between the interests of the parties concerned.
b) The terms shall be expressed clearly.
c) The terms shall specify the basis of any charges, but not necessarily the amount of charges at any point of time.

d) The terms shall specify the period within which the cardholder's account would normally be debited.
e) The terms may be altered by the bank, but sufficient notice of the change shall be given to the cardholder to enable him to withdraw if he so chooses. A period shall be specified after which time the cardholder would be deemed to have accepted the terms if he had not withdrawn during the specified period.
f) (i) The terms shall put the cardholder under an obligation to take all appropriate steps to keep safe the card and the means (such as PIN or code) which enable it to be used.
(ii) The terms shall put the cardholder under an obligation not to record the PIN or code, in any form that would be intelligible or otherwise accessible to any third party if access is gained to such a record, either honestly or dishonestly.
(iii) The terms shall put the cardholder under an obligation to notify the bank immediately after becoming aware:

- of the loss or theft or copying of the card or the means which enable it to be used;
- of the recording on the cardholder's account of any unauthorised transaction;
- of any error or other irregularity in the maintaining of that account by the bank.

(iv) The terms shall specify a contact point to which such notification can be made. Such notification can be made at any time of the day or night.
(v) The terms shall put the cardholder under an obligation not to countermand an order which he has given by means of his card.

g) The terms shall specify that the bank shall exercise care when issuing PINs or codes and shall be under an obligation not to disclose the cardholder's PIN or code, except to the cardholders.

h) The terms shall specify that the bank shall be responsible for direct losses incurred by a cardholder due to a system malfunction directly within the bank's control. However, the bank shall not be held liable for any loss caused by a technical breakdown of the payment system if the breakdown of the system was recognizable for the cardholder by a message on the display of the device or otherwise known. The responsibility of the bank for the non-execution or defective execution of the transaction is limited to the principal sum and the loss of interest subject to the provisions of the law governing the terms.

Annexure –II
[Paragraph 1.8.2]

Reporting format for the issue and operations of the Smart Cards/Debit Cards:

1. Name of the bank:
2. Period of reporting:
3. Type of the card with the hardware components – (I.C. Chip) e.g. Magnetic stripe, CPU, memory:
4. Type of the software used:
5. Names of products offered through the smart card:
6. Limits on the storage of the amount:
7. Re-loadability features:
8. Security standards followed:
9. Service provider: (self or otherwise)
10. Total no. of outlets where the smart cards can be used:

    of which
    a. POS Terminals:
    b. Merchant Establishments:
    c. ATMs:
    d. Others – (please specify)

11. Total no of cards issued:

of which
   a. against savings bank a/c:
   b. against current a/c.
   c. against float a/c.

12. Total amount of balance stored on the smart cards as on the date of reporting:
13. Total amount of unspent balance on the smart cards as on the date of reporting:
14. Total no. of transactions during the period:

15. Amount involved in the total no. of transactions:

16. Transaction settlement mechanism (full procedure):
    a. whether on-line or
    b. off-line

17. Instances of fraud, if any, during the period
    a. No. of frauds:
    b. Amount involved:
    c. Amount of loss to the bank:
    d. Amount of loss to the card holder:

Annexure-III
[Paragraph 1.11]
<u>Entry of banks into Insurance business</u>

1. Any scheduled commercial bank would be permitted to undertake insurance business as agent of insurance companies on fee basis, without any risk participation. The subsidiaries of banks will also be allowed to undertake distribution of insurance product on agency basis.

2. Banks which satisfy the eligibility criteria given below will be permitted to set up a joint venture company for undertaking insurance business with risk participation, subject to safeguards. The maximum equity contribution such a bank can hold in the joint venture company will normally be 50 per cent of the paid-up capital of the insurance company. On a selective basis the Reserve Bank of India may permit a higher equity contribution by a promoter bank initially, pending divestment of equity within the prescribed period (see Note 1 below).
The eligibility criteria for joint venture participant are as under:

(i) The net worth of the bank should not be less than Rs.500 crore;
(ii) The CRAR of the bank should not be less than 10 per cent;
(iii) The level of non-performing assets should be reasonable;
(iv) The bank should have net profit for the last three consecutive years;
(v) The track record of the performance of the subsidiaries, if any, of the concerned bank should be satisfactory.

3. In cases where a foreign partner contributes 26 per cent of the equity with the approval of Insurance Regulatory and Development Authority/Foreign Investment Promotion Board, more than one public sector bank or private sector bank may be allowed to participate in the equity of the insurance joint venture. As such participants will also assume insurance risk, only those banks which satisfy the criteria given in paragraph 2 above, would be eligible.

4. A subsidiary of a bank or of another bank will not normally be allowed to join the insurance company on risk participation basis. Subsidiaries would include bank subsidiaries undertaking merchant banking, securities, mutual fund, leasing finance, housing finance business, etc.

5. Banks which are not eligible as joint venture participant as above, can make investments up to 10% of the networth of the bank or Rs.50 crore, whichever is lower, in the insurance company for providing infrastructure and services support. Such participation shall be treated as an investment and should be without any contingent liability for the bank.

The eligibility criteria for these banks will be as under:

(i) The CRAR of the bank should not be less than 10%;
(ii) The level of NPAs should be reasonable;
(iii) The bank should have net profit for the last three consecutive years.

6. All banks entering into insurance business will be required to obtain prior approval of the Reserve Bank. The Reserve Bank will give permission to banks on case to case basis keeping in view all relevant factors including the position in regard to the level of non-performing assets of the applicant bank so as to ensure that non-performing assets do not pose any future threat to the bank in its present or the proposed line of activity, viz., insurance business. It should be ensured that risks involved in insurance business do not get transferred to the bank and that the banking business does not get contaminated by any risks which may arise from insurance business. There should be 'arms length' relationship between the bank and the insurance outfit.

Notes: -

1. Holding of equity by a promoter bank in an insurance company or participation in any form in insurance business will be subject to compliance with any rules and regulations laid down by the IRDA/Central Government. This will include compliance with Section 6AA of the Insurance Act as amended by the IRDA Act, 1999, for divestment of equity in excess of 26 per cent of the paid up capital within a prescribed period of time.

2. Latest audited balance sheet will be considered for reckoning the eligibility criteria.

3. Banks which make investments under paragraph 5 of the above guidelines, and later qualify for risk participation in insurance business (as per paragraph 2 of the guidelines) will be eligible to apply to the Reserve Bank for permission to undertake insurance business on risk participation basis.

Annexure-IV
[Paragraph 1.11]

Entry of banks into Insurance business - insurance agency business/referral arrangement

The banks need not obtain prior approval of the RBI for engaging in insurance agency business or referral arrangement without any risk participation, subject to the following conditions:

(i) The bank should comply with the IRDA regulations for acting as 'composite corporate agent' or referral arrangement with insurance companies.

(ii) The bank should not adopt any restrictive practice of forcing its customers to go in only for a particular insurance company in respect of assets financed by the bank. The customers should be allowed to exercise their own choice.

(iii) The bank desirous of entering into referral arrangement, besides complying with IRDA regulations, should also enter into an agreement with the insurance company concerned for allowing use of its premises and making use of the existing infrastructure of the bank. The agreement should be for a period not exceeding three years at the first instance and the bank should have the discretion to renegotiate the terms depending on its satisfaction with the service or replace it by another agreement after the initial period. Thereafter, the bank will be free to sign a longer term contract with the approval of its Board in the case of a private sector bank and with the approval of Government of India in respect of a public sector bank.

(iv) As the participation by a bank's customer in insurance products is purely on a voluntary basis, it should be stated in all publicity material distributed by the bank in a prominent way. There should be no 'linkage' either direct or indirect between the provision of banking services offered by the bank to its customers and use of the insurance products.

(v) The risks, if any, involved in insurance agency/referral arrangement should not get transferred to the business of the bank.

1.14 Appendix

Master Circular on Para-banking
List of Circulars consolidated by the Master Circular

No.	Circular No.	Date	Subject	Para No.
1.	DBOD.FSC.BC. 70/24.01.001/99	17.07. 1999	Equipment Leasing activity-Accounting/Provisioning norms	1.4 & 1.5
2.	DBOD.FSC.120/24.01.011/2000-01	12.05. 2001	Credit Card business of banks	1.8.1(3)
3.	DBOD.FSC.BC.41/24.01.011/2000-01	30.10.2000	Issue of Credit/Debit Cards by banks	1.8.1

4.	DBOD.FSC.BC.88/24.01.011A/2001-02	11.04.2002	Issue of Smart Cards by banks	Annexure-I
5.	DBOD.FSC.BC.32/24.01.019/2001-02	29.09.2001	Issue of Debit Cards by banks	1.8.2
6.	DBOD.FSC.BC.133/24.01.019/2000-01	18.06.2001	Guidelines for the issue of Smart/Debit Cards by banks	1.8.2
7.	DBOD.FSC.BC.123/24.01.019/99-2000	12.11.1999	Guidelines for the issue of Smart/Debit Cards by banks	1.8.2 & Annexures I & II
8.	DBOD.FSC.119/24.01.013/99-2000	02.11.1999	Scheme of Money Market Mutual Funds-Guidelines	1.9
9.	DBOD.FSC.BC.145/24.01.013-2000	07.03.2000	Guidelines relating to Money Market Mutual Funds (MMMFs)	1.9
10.	DBOD.FSC.BC.42/24.01.013-99	29.04.1999	'Cheque Writing' Facility for Investors of Money Market Mutual Funds (MMMFs)	1.11
11.	DBOD.FSC.99/24.01.013/99-2000	09.10.1999	Cheque Writing' Facility for Investors of Money Market Mutual Funds (MMMFs)	1.11
12.	DBOD.FSC.BC.120/24.01.013/99-2000	02.11.1999	'Cheque Writing' Facility for Investors of Gilt Funds and Liquid Income Schemes	1.11
13.	DBOD.FSC.BC/16/24.01.018/2000-2001	09.08.2000	Entry of banks into Insurance business	1.12 & Annexure III
14.	DBOD.FSC.BC.66/24.01.002/2002-03	31.01.2003	Public issue of shares and debentures-Underwriting by merchant banking subsidiaries of commercial banks	1.13
15.	DBOD.FSC.65/24.01.001-99	01.07.1999	Participation in the share capital of financial	1.3

			services companies	
16.	DBOD.FSC.BC.27/24.01.018/2003-2004	22.09.2003	Entry of banks into Insurance business	1.12 & Annexure IV