

# Gist of Important RBI Circulars Issued During July–September 2006

## Urban Banks Department (UBD) Circulars

### Priority sector lending – Investment in special bonds issued by NHB/ HUDCO

With a view to rationalising the banks' investments under priority sector lending and encouraging banks to increasingly lend directly to priority sector borrowers, it has been decided that investments that may be made by banks on or after April 1, 2007 in the bonds issued by NHB / HUDCO shall not be eligible for classification under priority sector lending. The banks are therefore, advised to align their priority sector lending/ investments suitably so as to comply with the above guidelines.

(UBD.PCB.BPD. 1/09.09.001/2006-07 dated July 11, 2006)

### Package of relief measures to the Vidarbha region in Maharashtra

In order to mitigate distress of farmers in the six debt-ridden districts of Vidarbha, the Hon'ble Prime Minister has announced the following rehabilitation package in respect of agricultural credit. (a) the package is applicable to the districts of Amravati, Wardha, Yavatmal, Akola, Washim and Buldhana (b) the entire interest on overdue loans to farmers as on 01.07.2006 will be waived in the above mentioned six districts and all farmers will have no past interest burden as on that date, so that they will be immediately eligible for fresh loan from the banking system (c) the overdue loans of the farmers as on 01.07.2006 will be rescheduled over a period of 3-5 years with a one-year moratorium and (d) after rescheduling as above, fresh need based credit facility may be extended to the farmers.

The burden of waiver of overdue interest will be shared equally by the State and Central Governments in such manner as the Central Government may specify in respect of its share of 50% of the waived amount. While apportioning the overdue interest as above, due care will be taken to offset releases if any, already made by the State Government on this count. The banks are, therefore, advised to ensure that all the farmers' loan-accounts, which are overdue as on July 01, 2006, are rescheduled on the lines of the package and the interest thereon (as on July 01, 2006) is fully waived. The amount of interest waived may be advised to the SLBC convenor bank and to us in the enclosed format (Annex – I) in order to enable us to reimburse the same. While the branches may provide information to the Controlling / Head Office as per Annex – III, the latter may maintain branch-wise information in the format given in Annex –II for the purpose of RBI Inspection and State Government Audit.

(UBD(PCB)Cir.No. 3/13.05.000/06-07 dated July 21, 2006); (RPCD.PLFS. BC. No. 12 /05.04.02 (Vidarbha)/ 2006-07 dated July 17, 2006)

### Fair Practices Code-Display of bank charges

The banks are advised that service charges and fees may be placed on the homepage of bank's website at a prominent place under the title of 'Service Charges and Fees' so as to facilitate easy access to the bank customers. The banks may also provide a complaint form, along with the name of the nodal officer for complaint redressal,

in the homepage itself to facilitate complaint submission by bank's customers. The complaint form should also indicate that the first point for redressal of complaints is the bank itself and that complainants may approach the Banking Ombudsman only if the complaint is not resolved at the bank level within a month. Similar information may be displayed in the boards put up in all the bank branches to indicate the name and address of the Banking Ombudsman. In addition, the name, address and telephone numbers of the controlling authority of the bank to whom complaints can be addressed may also be given prominently. A weblink to the websites of the banks will be provided in the RBI website to enable the bank's customers to know the service charges and fees prevailing in the banks for various services.

(UBD.PCB.Cir.No. 4 /09.39.000/06-07 dated July 24, 2006)

### **Providing clearing and settlement services for internet based electronic purse schemes**

It has come to RBI's notice that some companies have launched internet based electronic purse schemes with the following features: (i) any individual who wishes to be a member of the scheme can register himself by going to the website and filing up a simple form which contains only his / her personal details (ii) the registered person will thereafter own an account with the service provider (iii) accounts are funded by transferring the money from bank accounts or credit card accounts (iv) the money is credited into electronic purse account of the account holder and the actual money is credited into the current account of the service provider with the clearing and settlement bank and (v) the electronic purse account holder can use the funds in his account either to transfer the funds to another electronic purse account or transfer to any other account anywhere (which is done through RTGS/DD) or do on line purchases.

The above mentioned activities are in the nature of acceptance of deposits which can be withdrawn on demand. The act of accepting deposits repayable on demand is in violation of the provisions of Reserve Bank of India Act, 1934, governing registration of NBFCs and acceptance of deposits. Reserve Bank has asked a company providing such services to desist from doing so. Banks are advised not to associate themselves with such schemes as described in the paragraph 1 above.

(UBD.SUB.Cir.No. 1/09.69.000/06-07 dated July 26, 2006); (RPCD.RF.BC. 14/07.40.06/2006-07 dated August 7, 2006 for SCBs and DCCBs) and (RPCD.RRB.BC 15/03.05.33/ 06-07 dated August 7, 2006 for RRBs); (DBOD No. BP. BC 22 / 08.12. 01/ 2006-2007 dated July 14, 2006)

### **Section 42(1) of Reserve Bank of India Act, 1934 – Maintenance of CRR**

It was earlier advised that the Reserve Bank will not be paying any interest on the CRR balances maintained by scheduled banks with effect from the fortnight beginning June 24,2006. Consequently, with effect from the fortnight beginning June 24,2006 penal interest will be charged as under in cases of default in maintenance of CRR by scheduled banks.

(i) in case of default in maintenance of CRR requirement on a daily basis, which is presently 70% of the total Cash Reserve Ratio requirement, penal interest will be recovered for that day at the rate of three per cent per annum above the bank rate on the amount by which the amount actually maintained falls short of the prescribed minimum on that day and if the shortfall continues on the next succeeding day/s, penal interest will be recovered at a rate of five per cent per annum above the bank rate and (ii) in cases of default in maintenance of CRR on average basis during a fortnight, penal interest will be recovered as envisaged in sub-section (3) of Section 42 of Reserve Bank of India Act, 1934

(UBD.(PCB-)Cir.No.6/16.26.000/2006-2007 dated August 16,2006); (PCD. RF. BC.17 /07.02.01/ 2006-07 dated August 11, 2006 for SCBs and RRBs); (DBOD. No. Ret. BC.26/12.01.001/2006-07 dated August 10, 2006 for scheduled commercial banks)

### 'When Issued' transactions in Central Government securities – Accounting and related aspects

RBI's Internal Debt Management Department had issued a circular on May 3, 2006 allowing all NDS – OM members to undertake 'When issued transactions' on the NDS – OM platform. The accounting treatment of transactions undertaken in 'When Issued' (WI) securities would be as follows:

**1. Accounting Treatment:** (a) the 'WI' security should be recorded in books as an off balance sheet item till issue of the security (b) the off balance sheet net position in 'WI' market should be marked to market scrip-wise on a daily basis at the day's closing price of the 'WI' security. In case the price of the 'WI' security is not available, the value of the underlying security (as stipulated in the Master Circular No: 8 dated July 12, 2006) be used instead. Depreciation, if any, should be provided for and appreciation, if any, should be ignored (c) the off balance sheet (net) position in 'WI' securities, scrip wise, would attract a risk weight of 2.5%. and (d) on delivery, the underlying security may be classified in any of the three categories, viz; 'Held to Maturity', 'Available for Sale' or 'Held for Trading', depending upon the intent of holding, at the contracted price.

**2. Eligibility for SLR status:** The securities bought in the 'When Issued' market would be eligible for SLR purposes, only on delivery.

(UBD BPD Cir No: 7 /09.29.000/2006-07 dated August 18, 2006); (RPCD. RF.BC.19/ 07.02.03/ 2006-07 dated August 25, 2006); (DBOD. No.BP.BC.24/21.04.141/2006-07 dated August 1, 2006)

### Guidelines on relief measures to be extended by banks in areas affected by natural calamities

Reserve Bank of India has from time to time issued guidelines/instructions to banks in regard to relief measures to be provided in areas affected by natural calamities. These guidelines focus on various relief and concessions that may be extended to existing borrowers, mainly agriculturalists. Reserve Bank had recently constituted an internal working group to look into the whole gamut of the issues involved and to suggest suitable revisions and additions to the existing guidelines. Based on the recommendations of the group, it has been decided that additional guidelines as indicated in the annex may be followed by banks expeditiously especially in the context of the recent floods that have affected various parts of the country. (For details of the additional guidelines, please refer to the annex to the original circular).

(UBD.PCB. Cir.No.8/ 13.05.000/ 06-07 dated August 21, 2006); (RPCD. CO.PLFS. No. BC 16/ 05.04.02 / 2006-07 dated August 09, 2006)

Attention is invited to the earlier circulars on the subject, which deals with restructuring of existing loans of borrowers affected by natural calamities. We advise that instructions on moratorium, maximum repayment period, additional collateral for restructured loans and asset classification norms in respect of fresh finance will be applicable to all affected restructured borrowal accounts, including accounts of industries and trade, besides agriculture. The asset classification as on the date of natural calamity will continue, if the restructuring is completed within a period of three months from the date of natural calamity. The restructured accounts would, otherwise, be governed by provisions of circular March 9, 2006. In respect of commercial banks, the restructured accounts will be governed by the guidelines applicable to such accounts as contained in paragraphs 4.2.14 to 4.2.16 of the master circular DBOD. No. BP. BC. 15 / 21.04.048 / 2006-07 dated July 01, 2006. These would apply to non-SME advances as well. Further, the guidelines applicable to sub-standard accounts, will apply, mutatis mutandis to doubtful accounts.

(UBD.PCB.Cir.No.10 /13.05.000/2006-07 dated September 4, 2006); (RPCD.PLFS.No.BC. 21 /05.05.02/ 2006-07 dated September 04, 2006)

## Rural Planning and Credit Department (RPCD) Circulars

### Bank credit to Khadi and Village Industries (KVI) sector

RBI had advised banks on September 11, 2003 to recognize Interest Subsidy Eligibility Certificate (ISEC) issued by Khadi and Village Industries Commission (KVIC) for extending credit to khadi institutions and entrepreneurs provided KVIC's assessment for working capital requirement does not exceed the assessment made by banks by more than 10%. KVIC has recently brought to our notice that some of the banks are not honouring the Interest Subsidy Eligibility Certificate (ISEC) issued by them for extending credit to khadi institutions and entrepreneurs. They have further pointed out that some of the banks are insisting on collateral for extending credit to khadi institutions and entrepreneurs. Since the KVI sector is playing an important role in creating employment opportunities for poor people in rural areas, banks are advised to initiate necessary steps to rectify the above position.

(RPCD.PLNFS.BC. No.18/06.06.12 (D)/2006-07 dated August 24, 2006)

### Prime Minister's 15 Point programme for the welfare of minorities

Government of India have recently finalised a new ' Prime Minister's 15- Point programme for the welfare of minorities'. An important objective of the aforesaid programme is to ensure that an appropriate percentage of the priority sector lending is targeted for the minority communities and that the benefits of various Government sponsored schemes reach the under-privileged, which includes the disadvantaged sections of the minority communities. Banks should ensure that within the overall target for priority sector lending and the sub- target of 10 per cent for the weaker sections, the minority communities also receive an equitable portion of the credit. The above requirement should be kept in view by Lead Banks while preparing district credit plans.

(RPCD.SP.BC.No. 22 / 09.10.01 / 2006-07 dated Sept 1, 2006)

### Delegation of adequate powers to the bank managers for sanctioning loans without referring to higher authorities and following of the procedure for calculating interest on loans excluding subsidy amount under SGSY scheme

It has been brought to RBI's notice by Ministry of Rural Development, GOI, New Delhi that some banks are charging interest on the full loan amount without excluding subsidy amount given by the Government. In this connection, it is advise that as per extant guidelines banks should not charge/ calculate the interest on the subsidy amount. Banks are, therefore, advised to instruct the concerned branch officials to follow the correct procedure for calculating interest on loan amounts.

(RPCD.SP.BC. 24 /CLCC/09.01.01/2006-07 dated September 14, 2006)

### Address / telephone number of the branch in pass books / statement of accounts

In order to improve the quality of service available to customers in branches, banks are advised to ensure that full address / telephone number of the branch is invariably mentioned in the pass books / statement of accounts issued to account holders.

(RPCD.CO.RRB.BC.No./25/03.05.28A/2006-07 dated September 15, 2006 for RRBs) and (RPCD.RF.BC. 26/ 07.40.06/ 2006-07 dated September 22, 2006 for SCBs and DCCBs); (DBOD. No. Leg. BC.28 / 09.07.005/ 2006-07 dated September 1, 2006)

## Department of Banking Operations and Development (DBOD) Circulars

### Additional provisioning requirement for standard assets

In terms of the circular dated May 29, 2006, provisioning requirement on standard advances in specific sectors, i.e., personal loans, loans and advances qualifying as capital market exposures, residential housing loans beyond Rs.20 lakh and commercial real estate loans has been increased from 0.40 per cent to 1.0 per cent, for the funded outstanding on portfolio basis. In order to ensure that the above additional general provisioning on standard advances in specific sectors are made in a smooth and non-disruptive manner, it has now been decided to permit banks to phase in the additional provisioning requirement over the financial year 2006-07 as under (a) 0.55% for the quarter ended June 2006 (b) 0.70% for the half-year ending September 2006 (c) 0.85% for the quarter ending December 2006 and (d) 1% for the year ending March 2007.

(DBOD.No.BP.BC. 21 / 21.04.048 / 2006-2007 dated July 12, 2006)

### Enhancement of banks' capital raising options for capital adequacy purposes

It was decided to allow banks to augment their capital funds by issue of, among others, Innovative Perpetual Debt Instruments (IPDI) eligible for inclusion as Tier 1 capital and Debt Capital Instruments qualifying for Upper Tier II capital (Upper Tier II Instruments). The guidelines governing IPDI and Upper Tier II capital have been reviewed and it has been decided to make the following changes:

*Innovative Perpetual Debt Instruments (IPDI):* (i) the total amount raised by a bank through IPDIs shall not be reckoned as liability for calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will not attract CRR/SLR requirements. (ii) the total amount raised by a bank through IPDIs shall not exceed 15 per cent of total Tier 1 capital. The eligible amount will be computed with reference to the amount of Tier 1 capital as on March 31 of the previous financial year, after deduction of goodwill and other intangible assets but before the deduction of investments (iii) investment by FIIs in IPDI raised in Indian rupees shall be outside the ECB limit for rupee denominated corporate debt (currently USD 1.5 billion) fixed for investment by FIIs in corporate debt instruments (iv) banks may augment their capital funds through the issue of IPDI in foreign currency without seeking the prior approval of the Reserve Bank of India, subject to compliance with the under mentioned requirements (a) IPDI issued in foreign currency should comply with all terms and conditions applicable in the guidelines issued on January 25, 2006, unless specifically modified in these guidelines (b) not more than 49% of the eligible amount can be issued in foreign currency (c) IPDI issued in foreign currency shall be outside the limits for foreign currency borrowings indicated in sub paragraphs (ii) and (iii) below.

*Upper Tier II Instruments:* Banks may augment their capital funds through the issue of Upper Tier II Instruments in foreign currency without seeking the prior approval of the Reserve Bank of India, subject to compliance with the under mentioned requirements (i) upper Tier II Instruments issued in foreign currency should comply with all terms and conditions applicable as detailed in the guidelines issued on January 25, 2006, unless specifically modified in these guidelines (ii) the total amount of Upper Tier II Instruments issued in foreign currency shall not exceed 25% of the unimpaired Tier I capital. This eligible amount will be computed with reference to the amount of Tier 1 capital as on March 31 of the previous financial year, after deduction of goodwill and other intangible assets but before the deduction of investments (iii) this will be in addition to the existing limit for foreign currency borrowings by Authorised Dealers in terms of Master Circular No. RBI/2006-07/24 dated July 1, 2006 on Risk Management and Inter-Bank Dealings (iv) investment by FIIs in Upper

Tier II instruments raised in Indian rupees shall be outside the limit for investment in corporate debt instruments i.e., USD 1.5 billion. However, investment by FIIs in these instruments will be subject to a separate ceiling of USD 500 million.

(DBOD.No.BP.BC. 23 / 21.01.002 / 2006-2007 dated July 21, 2006)

### **Guidelines for banks undertaking PD business**

In terms of paragraphs 4 and 5 (iv) of the guidelines in our circular dated February 27, 2006, the banks are required to maintain separate SGL account for their PD business. On a re-examination of the matter, it has been decided that it would not be necessary for banks to maintain a separate SGL account for PD business, as envisaged in the aforesaid circular. In other words, henceforth, banks undertaking PD business departmentally may maintain a single SGL account. The banks would, however, need to keep separate books of accounts internally for monitoring on an ongoing basis, maintenance of the minimum stipulated balance of Rs. 100 crore of Government securities and for recording the transactions undertaken by the PD business.

(DBOB. FSD.BC.No. 25 / 24.92.001/ 2006-07 dated August 9, 2006)

### **Internet banking – internet based platforms for dealing in foreign exchange**

It has been decided that banks may be permitted to offer Internet based foreign exchange services, for permitted underlying transactions, in addition to the local currency products already allowed to be offered on Internet based platforms, subject to the following terms and conditions (i) banks will remain responsible for secrecy, confidentiality and integrity of data (ii) the data relating to Indian operations will be kept segregated (iii) the data will be made available to RBI inspection / audit as and when called for (iv) the services offered through Internet, for banks' customers on an Internet based platform for dealing in foreign exchange, should allow only reporting and initiation of foreign exchange related transactions, with the actual trade transactions being permitted only after verification of physical documents (v) banks should comply with FEMA regulations in respect of instructions involving cross-border transactions. In all other matters relating to internet banking services, banks may continue to be guided by the instructions contained in our circular DBOD. COMP. BC. No. 130/ 07.03.23 / 2001-01 dated June 14, 2001 on internet banking.

(DBOD No. Comp. BC. 1658 /07.23.29/2006-07 dated August 22, 2006)

### **Prudential guidelines – Banks' investment in Venture Capital Funds (VCFs )**

The exposure of banks to Venture Capital Funds (VCFs) has been steadily increasing over the last few years. While significance of venture capital activities and need for banks' involvement in financing of venture capital funds is well recognized, it is also considered important to address the relatively higher risks inherent in such exposures. In view of this, we have reviewed the entire issue of financing of VCFs and revised the prudential framework governing banks' exposure to VCFs. Banks are advised to comply with the prudential requirements relating to financing of VCFs set out in the Annex. (For details on the prudential guidelines, please refer to annex to the original circular).

(DBOD. No. BP. BC. 27/21.01.002/ 2006- 2007 dated August 23, 2006)

### **Banks' exposure to entities for setting up Special Economic Zones (SEZs) / acquisition of units in SEZs**

It has been decided that the exposure of banks to entities for setting up Special Economic Zones (SEZs) or for acquisition of units in SEZs which includes real estate would be treated as exposure to commercial real estate sector with immediate effect and banks would have to make provisions as also assign appropriate risk weights for such exposures as per the existing guidelines.

(DBOD.BP.BC. 30 /21.01.002/ 2006-2007 dated September 20, 2006)

### Section 17 (2) of Banking Regulation Act, 1949 – Appropriation from Reserve Fund

In terms of Sec 17(2), where a banking company appropriates any sum or sums from the reserve fund or the share premium account, it shall, within twenty-one days from the date of such appropriation, report the fact to the Reserve Bank explaining the circumstances relating to such appropriation. In order to ensure that their recourse to drawing down the Statutory Reserve is done prudently and is not in violation of any of the regulatory prescriptions, banks are advised in their own interest to take prior approval from the Reserve Bank before any appropriation is made from the statutory reserve or any other reserves.

Banks are further advised that (i) all expenses including provisions and write-offs recognized in a period, whether mandatory or prudential, should be reflected in the profit and loss account for the period as an 'above the line' item (i.e. before arriving at the net profit) (ii) wherever draw down from reserves takes place with the prior approval of Reserve Bank, it should be effected only 'below the line' (i.e. after arriving at the profit/loss for the year) and (iii) it should also be ensured that suitable disclosures are made of such draw down of reserves in the 'Notes on Accounts' to the Balance Sheet.

(DBOD.BP.BC No. 31 / 21.04.018/ 2006-07 dated September 20, 2006)

## Department of Payment and Settlement System (DPSS) Circulars

### Electronic Clearing Service - Debit clearing – Customer mandates

Transactions under ECS have been growing rapidly. The pace of growth of Debit Clearing transactions is much higher than Credit Clearing and many utility companies / banks have been utilising the system for collection of bills relating to utility payments, EMIs, etc.

ECS (Debit) works on the **strength of the mandates** given by the destination account holders to the user institutions for raising a debit in their accounts. A copy of the mandate is sent either by the account holder or the user institution to the bank for the bank to check the validity of the debit instruction raised through ECS (Debit Clearing). A recent informal survey conducted by the RBI revealed that several of the bank branches do not maintain the requisite mandate forms in proper order. They raise debits purely on the basis of the ECS (Debit) file received from the clearing house as a matter of routine. The bank branches also indicate that the software being used by them do not have the provision to record any ECS (Debit) mandate. If available, it may be for only one or two mandates whereas certain account holders have given mandate to several utility organizations for raising debit through ECS.

Debit mandate management system would have to be a part of the house keeping function. The mandate may also contain the validity period and upper limit for individual transaction. The upper limit may vary from mandate to mandate. We had earlier advised that withdrawal instructions of a customer has to be treated equivalent to a stop payment instruction in cheque clearing system. Therefore, it has to be ensured that adequate care is taken on recording of mandates and withdrawal, if any. The banks may initiate steps for incorporating an appropriate mandate management routine for handling ECS(Debit) transactions as early as possible.

(DPSS (CO) No.5/04.01.01/2006-2007 dated July 04, 2006)

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