Chapter - 12

Text of Important Circulars Issued

Banks advised to credit Interest Relief to Farmers' Accounts before March 31, 2006

Date: Mar 09, 2006

RBI/2005-06/319
RPCD.No.PLFS.BC.66/05.04.02(Kharif-05)/2005-06

March 09, 2006

All Scheduled Commercial Banks

Dear Sir,

Union Budget 2006-07 - Guidelines for Relief to Farmers

1. Paragraph 48 of the Union Budget Speech envisages grant of interest relief of two percentage points in the interest rate on the principal amount upto Rs1 lakh on crop loans availed by the farmers for Kharif and Rabi 2005-06. The amount of the relief is required to be credited to the borrower's account before March 31, 2006.
2. It has been decided that banks may first credit the proposed relief to the farmer's account before March 31, 2006 and thereafter seek reimbursement.
3. Banks may work out the interest relief on the following basis:
   (a) All crop loans for Kharif & Rabi disbursed to farmers during the financial year 2005-06 will be eligible for the interest relief of two percentage points. However, where each crop loan exceeds Rs.1 lakh, the interest relief will be applicable on the principal amount up to Rs.1 lakh only.
   (b) Interest relief may be calculated at two percentage points, on the

amount of the crop loan disbursed from the date of disbursement/ drawal up to the date of payment or upto the date beyond which the outstanding loan becomes overdue i.e. 31st March 2006 for Kharif and 30th June 2006 for Rabi, respectively, whichever is earlier.

4. For this purpose, the banks may submit their claims in the format given in Annex I to the Chief General Manager-in-Charge, Rural Planning and Credit Department, Reserve Bank of India, Central Office, Mumbai. Information with respect to crop loans disbursed and interest relief claimed (branch-wise) may be maintained in the format given in Annex II at the Head Office for the purpose of audit and RBI inspection. The format for the branches to provide information on relief to their Controlling Office/Head Office is given in Annex III.
5. It is clarified that banks can also furnish their claims to the Reserve Bank in installments, as convenient to them. Banks will be reimbursed their claims by way of credit to their accounts with RBI within one month of the date of receipt of the claim. The claims submitted by banks shall be subject to audit/RBI inspection subsequently.
6. For audit purposes all claims may be certified by the statutory auditors and certificates submitted before 30th June 2006 to the Chief General Manager-in- Charge, Rural Planning and Credit Department, Reserve Bank of India, Central Office, Mumbai.
7. Please acknowledge receipt.

Yours faithfully,

(G. Srinivasan)
Chief General Manager

ANNEX - I

Certificate for claiming Subsidy

Name of Bank:

(Amounts in Rupees)

Crop Loan Amount Disbursed			*Amount of Interest Relief Claimed*		
Kharif 2005-06	Rabi 2005-06	Total	Kharif 2005-06	Rabi 2005-06	Total
(1)	(2)	(3)	(4)	(5)	(6)

We hereby certify that the amounts of crop loan (Kharif and Rabi – 2005-06) disbursements and interest relief being claimed thereon, as shown above, have been correctly calculated in conformity with the Reserve Bank of India Circular letter RPCD. No. PLFS.BC.66/05.04.02 (Kharif-05)/ 2005-06 dated March 8, 2006. We undertake that in the event of any inaccuracy detected later during audit or otherwise, we shall immediately refund to the Reserve Bank any excess amount received by us.

(Authorised Signatory)

Place

Date

ANNEX - II

Data to be kept with the Bank's Head Office for verification/scrutiny by Auditors/RBI inspectors

(Amounts in Rupees)

S. No.	*Branch name and code*	*Crop Loan disbursed*			*Crop loan amount disbursed eligible for subsidy*			*Amount of Interest Relief claimed*		
		Kharif 2005-06	Rabi 2005-06	Total	Kharif 2005-06	Rabi 2005-06	Total	Kharif 2005-06	Rabi 2005-06	Total
(1)	(2)	(3)	(4)	(4)	(5)	(6)	(7)	(8)	(9)	(10)

ANNEX - III

Format for Branches to provide Information on Relief extended to their Controlling Office/Head Office

(Amount in Rupees)

Sr. No.	*A/c No.*	*Name of the Farmer*	*Crop Loan amount disbursed*			*Loan Amount disbursed which is eligible for subsidy*			*Amount of Interest Relief claimed*		
			Kharif 2005-06	Rabi 2005-06	Total	Kharif 2005-06	Rabi 2005-06	Total	Kharif 2005-06	Rabi 2005-06	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)

Revised Guidelines on Corporate Debt Restructuring (CDR) Mechanism

RBI /2005-06/ 206
DBOD.No.BP.BC. 45 / 21.04.132/ 2005-06

November 10, 2005

All Commercial Banks/Financial Institutions (excluding RRBs)

Dear Sir,

1. Please refer to our circular DBOD No. BP.BC. 68/21.04.114/2002-03 dated February 5, 2003 on the captioned subject wherein detailed guidelines on Corporate Debt Restructuring System were issued incorporating therein the recommendations of the High Level Group under the chairmanship of Shri Vepa Kamesam, then Deputy Governor, Reserve Bank of India, for facilitating timely and transparent mechanism for restructuring corporate debts of viable corporate entities affected by internal or external factors, outside the purview of BIFR, DRT and other legal proceedings, for the benefit of all concerned.
2. A Special Group was constituted in September 2004 with Smt.S.Gopinath, Deputy Governor, Reserve Bank of India to undertake a review of the Scheme. The Special Group had suggested certain changes / improvements in the existing Scheme for enhancing its scope and making it more efficient. Based on the recommendations made by the Special Group revised draft guidelines on Corporate Debt Restructuring were prepared and circulated among banks for comments. On the basis of the feedback received the draft guidelines have been reviewed and the revised guidelines on CDR mechanism are furnished in the **Annexure**.
3. The major modifications made in the existing CDR mechanism relate to
   a. extension of the scheme to entities with outstanding exposure of Rs.10 crore or more
   b. requirement of support of 60% of creditors by number in addition

to the support of 75% of creditors by value with a view to make the decision making more equitable

c. discretion to the core group in dealing with wilful defaulters in certain cases other than cases involving frauds or diversion of funds with malafide intentions.

d. linking the restoration of asset classification prevailing on the date of reference to the CDR Cell to implementation of the CDR package within four months from the date of approval of the package.

e. restricting the regulatory concession in asset classification and provisioning to the first restructuring where the package also has to meet norms relating to turn-around period and minimum sacrifice and funds infusion by promoters.

f. convergence in the methodology for computation of economic sacrifice among banks and FIs

g. limiting RBI's role to providing broad guidelines for CDR mechanism

h. enhancing disclosures in the balance sheet for providing greater transparency

i. pro-rata sharing of additional finance requirement by both term lenders and working capital lenders

j. allowing OTS as a part of the CDR mechanism to make the exit option more flexible and

k. regulatory treatment of non-SLR instruments acquired while funding interest or in lieu of outstanding principal and valuation of such instruments.

Yours faithfully,

(AnandSinha)
Chief General Manager-In-Charge

Mid-Term Review of Annual Policy Statement for the year 2005-06: Additional Provisioning Requirement for Standard Assets

Date: Nov 04, 2005

RBI/2005-06/198
DBOD.NO.BP. BC.40/ 21.04.048/ 2005-06

4 November 2005

All Scheduled Commercial Banks (Excluding RRBs)

Dear Sir,

1. In terms of the extant prudential guidelines, the standard assets attract a uniform provisioning requirement of 0.25 per cent of the funded outstanding on a portfolio basis. Traditionally, banks' loans and advances portfolio is pro-cyclical and tends to grow faster during an expansionary phase and grows slowly during a recessionary phase. During times of expansion and accelerated credit growth, there is a tendency to underestimate the level of inherent risk and the converse holds good during times of recession. This tendency is not effectively addressed by the above mentioned prudential specific provisioning requirements since they capture risk ex post but not ex ante. It is therefore necessary to build up provisioning to cushion banks' balance sheets in the event of a downturn in the economy or credit weaknesses surfacing later.
2. In this connection, please refer to Paragraph 85 of the Mid-Term Review of Annual Policy Statement for the year 2005-06 enclosed to the Governor's letter No.MPD.BC. 274/07.01.279/2005-06 dated 25 October 2005 (copy of the paragraph enclosed). Accordingly, taking into account the recent trends in credit growth it has been decided to increase the general provisioning requirement for 'standard advances' from the present level of 0.25 per cent to 0.40 per cent. Consequently, the standard assets with the exception of banks' direct advances to

agricultural and SME sectors would attract a uniform provisioning requirement of 0.40 per cent of the funded outstanding on a portfolio basis.

3. Banks would continue to make provision at 0.25 per cent for direct advances to agricultural and SME sectors in the standard category.
4. As hitherto, these provisions would be eligible for inclusion in Tier II capital for capital adequacy purposes up to the permitted extent.
5. Please acknowledge receipt.

Yours faithfully,

Sd/-

(Anand Sinha)
Chief General Manager-in-Charge

Extract of Mid-Term Review of Annual Policy Statement for the year 2005-06

Prudential Provisioning Requirements: Review

82. In terms of the prudential guidelines, banks are required to assess their entire loans and advances portfolio on an account-by-account basis with regard to the degree of delinquency and classify them into four broad asset classification categories, viz., standard, sub-standard, doubtful and loss. The standard assets attract a uniform provisioning requirement of 0.25 per cent of the funded outstanding on a portfolio basis. Banks are required to make specific provisions in respect of sub-standard assets at a uniform rate of 10 per cent of the funded outstanding and for doubtful accounts at rates ranging from 20 to 100 per cent, taking into account the period for which the account has remained non-performing and the realisable value of security charged to the bank.

83. Traditionally, banks' loans and advances portfolio is pro-cyclical and tends to grow faster during an expansionary phase and grows slowly during a recessionary phase. During times of expansion and accelerated credit growth, there is a tendency to underestimate the level of inherent risk and the converse holds good during times of recession. This tendency is not effectively addressed by the above mentioned prudential specific provisioning requirements since they capture risk ex post but not ex ante.

84. The various options available for reducing the element of pro-cyclicality include, among others, adoption of objective methodologies for dynamic provisioning requirements, as is being done by a few countries, by estimating the requirements over a business cycle rather than a year on the basis of the riskiness of the assets, establishment of a linkage between the prudential capital requirements and through-the-cycle ratings instead of point-in-time ratings and establishment of a flexible loan-to-value (LTV) ratio requirements where the LTV ratio would be directly related to the movement of asset values.

85. Taking into account the recent trends in credit growth, it is proposed:
    - to increase the general provisioning requirement for 'standard advances' from the present level of 0.25 per cent to 0.40 per cent. Banks' direct advances to agricultural and SME sectors would be exempted from the additional provisioning requirement. As hitherto, these provisions would be eligible for inclusion in Tier II capital for capital adequacy purposes up to the permitted extent. Operational guidelines in this regard would be issued separately.

Guidelines on compliance with Accounting Standards (AS) by banks

PRD/2004/187

DBOD No.BP.BC. 82/21.04.018/2003-04

April 30, 2004

All Scheduled Commercial Banks
(excluding RRBs)

Dear Sir,

Please refer to our circular DBOD No.BP.BC.89/21.04.018/2002-03 dated March 29, 2003 which contained detailed guidelines pertaining to the following Accounting Standards which are already operational.

AS 5, AS 9, AS 15, AS 17, AS 18, AS 22, AS 23, AS 25, and AS 27.

1. These guidelines were based on the recommendations made by the Working constituted under the Chairmanship of Shri N.D.Gupta, former president of ICAI to recommend steps to eliminate/reduce gaps in compliance by banks with the Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI).
2. The Working Group had also made recommendations in respect of the following three Accounting Standards.

Accounting Standard	*Pertaining to*
24	Discontinuing operations
26	Intangible assets
28	Impairment of assets

3. Of the above, AS 26 relating to intangible assets has become operational from the accounting period commencing from April 1, 2003. The remaining standards viz. AS 24 and AS 28 are effective for the accounting period commencing from April 1, 2004.
4. In terms of our guidelines on action to be taken by banks/auditors in connection with AS 25, Interim Financial Reporting contained in paragraph 11.2.4 of the Annexure to our circular DBOD No.BP.BC.89/

21.04.018/2002-03 dated March 29, 2003, **all banks** were advised to adopt the format prescribed for public sector banks by the RBI vide circular DBS.ARS.BC.13/08.91.001/2000-01 date May 17, 2001 with a view to ensure uniformity in disclosure. Since the above proforma for half yearly review has been revised vide our circular DBS.CO.ARS.17/08.91.001/2002-03 dated June 5, 2003, **all banks (listed and unlisted)**, including foreign banks, are advised to adopt the revised proforma.

5. ICAI, which was represented on the Working Group, has also agreed to furnish appropriate clarification on the Accounting Standards in question on the lines of the recommendations of the Group for the guidance of its members. RBI considers that with the issue of the guidelines as above and adoption of the prescribed procedures, there should normally be no need for any Statutory Auditor for qualifying balance sheet of the bank being audited for non-compliance with Accounting Standards. Hence, it is essential that both banks and the Statutory Central Auditors adopt the guidelines and procedures prescribed. Whenever specific difference in opinion arises among the auditors, the Statutory Central Auditors would take a final view. Persisting difference, if any, could be sorted out in prior consultation with RBI, if necessary. It is advised that any qualifications in the financial statements of banks for non-compliance with any Accounting Standard will be viewed seriously by the Reserve Bank.
6. Banks are advised to place these guidelines before the Board of Directors. Banks are further advised to ensure strict compliance with the standards.
7. Please acknowledge receipt.

Yours faithfully,

Sd/-

(**C.R. Muralidharan**)
Chief General Manager-in-Charge

ANNEXURE

Guidelines on compliance with Accounting Standards by banks

1. On the basis of the recommendations of the Working Group on Compliance with Accounting Standards by banks, which was constituted by the Reserve Bank of India with Shri N. D. Gupta, the then President of the Institute of Chartered Accountants of India, as Chairman, the following guidelines are issued to banks by RBI with a view to eliminating the gaps in compliance by banks with the Accounting Standard issued by ICAI.
2. These guidelines pertains to the following Accounting Standards (AS):

   AS 24, AS 26 and AS 28.
3. Banks should place these guidelines before the Board of Directors and ensure strict compliance with the Standards.
4. Accounting Standard 24-Discontinuing operations

4.1 Gist of the Accounting Standard

This Statement establishes principles for reporting information about discontinuing operations, thereby enhancing the ability of users of financial statements to make projections of an enterprise's cash flows, earnings-generating capacity, and financial position by segregating information about discontinuing operations from information about continuing operations. This Statement applies to all discontinuing operations of an enterprise. This Statement does not establish any recognition and measurement principles. Rather, it requires that an enterprise follow recognition and measurement principles established in other Accounting Standards, e.g., Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date and Accounting Standard (AS) 28, Impairment of Assets. This Statement requires an enterprise to make certain disclosures relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in the Statement) occurs. The disclosures required by the Statement should continue in financial statements for periods up to and including the period in which the discontinuance is completed.

4.2 Possible reasons for non-compliance

This Accounting Standard becomes effective from accounting period commencing on or after April 1, 2004. While adopting the Accounting Standard, a doubt may arise as to whether rationalisation of branches either in India or overseas without discontinuing any distinctly identifiable line of business of the bank should attract the applicability of the Standard since banks generally undertake rationalisation of branches more or less on a continuous basis depending on business requirements.

4.3 Action to be taken by banks

4.3.1 Merger/closure of branches of banks by transferring the assets/ liabilities to the other branches of the same bank may not be deemed as a discontinuing operation and hence this Accounting Standard will not be applicable to merger/closure of branches of banks by transferring the assets/liabilities to the other branches of the same bank.

4.3.2 Disclosures would be required under the Standard only when:

(i) Discontinuing of the operation has resulted in shedding of liability and realisation of the assets by the bank

or

Decision to discontinue an operation which will have the above effect has been finalised by the bank

and

(ii) The discontinued operation is substantial in its entirety.

5. AS 26 – Intangible asset

5.1 Gist of the Accounting Standard

his Statement prescribes the accounting treatment for intangible assets that are not dealt with specifically in another Accounting Standard. This Statement requires an enterprise to recognise an intangible asset if, and only if, certain criteria are met. The Statement also specifies how to measure the carrying amount of intangible assets and requires certain disclosures about intangible assets. This Statement is applied by all enterprises in accounting for intangible assets, except certain assets specified in the Statement including financial assets. The Statement

requires that an intangible asset should be measured initially at cost. The Statement requires that internally generated goodwill should not be recognised as an asset. The Statement also deals with subsequent expenditure on an intangible asset. The Statement requires that after initial recognition, an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment losses. This Statement also deals with amortisation of intangible assets, including amortisation period, amortisation method etc.

5.2 Action to be taken by banks

The issues that arise and require clarification while complying with the Accounting Standard have been identified. Banks may be guided by the following while complying with the Standard.

- This AS will not apply to intangible assets created in the books of banks before the effective date of this AS subject to the transitional provisions as laid down in paragraphs 99 and 100.
- It may be difficult to estimate the useful life of computer software which has been customised for the bank's use and is expected to be in use for some time. It is observed that the detailed recognition and amortisation principle in respect of computer software prescribed in Appendix A to the Standard adequately addresses these issues and may be followed by banks.
- Intangible assets recognised and carried in the balance sheet of banks in compliance with AS 26 will attract provisions of Section 15(1) of the BR Act in terms of which banks are prohibited from declaring any dividend until any expenditure not represented by tangible assets is carried in the balance sheet. The intangible assets which would be created in the books of banks consequent upon the adoption of AS 26 would generally represent payments made by enterprises towards acquisition of assets which may not be tangible like corporate computer software, brand equity etc. and would not be in the nature of deferred revenue expenditure like expenses incurred to raise capital, expenses incurred for launching any new products etc. All these items are intangible assets. Therefore, any expenditure incurred towards these intangible items would attract the provisions of BR Act and for carrying any such item in the books, banks would have to seek exemption from Section 15(1) of the BR Act, from the Government.

6. AS 28 – Impairment of assets

6.1 Gist of the Accounting Standard-

This Statement prescribes the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and this Statement requires the enterprise to recognise an impairment loss. This Statement also specifies when an enterprise should reverse an impairment loss and it prescribes certain disclosures for impaired assets. This Statement requires that an enterprise should assess at each balance sheet date whether there is any indication that an asset may be impaired. If any such indication exists, the enterprise should estimate the recoverable amount of the asset. The Statement also describes some minimum indications for this purpose. The Statement deals in detail with the determination of the recoverable amount of an asset. The Statement requires that if the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. That reduction is an impairment loss. The Statement requires that an impairment loss should be recognised as an expense in the statement of profit and loss immediately, unless the asset is carried at revalued amount in accordance with Accounting Standard (AS) 10, Accounting for Fixed Assets, in which case any impairment loss of a revalued asset should be treated as a revaluation decrease under that Accounting Standard.

6.2 Possible reasons for non-compliance

This Accounting Standard becomes effective from accounting period commencing on or after March 31, 2004. While adopting the Accounting Standard, there could be doubts regarding how frequently the assets covered by the Standard need to be reviewed to measure impairment or types of assets to which the Standard would not apply.

6.3 Action to be taken by banks

6.3.1 The Standard would not apply to investments, inventories and financial assets such as loans and advances and may generally be applicable to banks in so far as it relates to fixed assets.

6.3.2 Banks may also take into account the following specific factors while complying with the Standard.

(i) Paragraphs 7 and 8 of the Standard have clearly listed the triggers which may indicate impairment of the value assets. Hence, banks may be guided by these in determining the circumstances when the Standard is applicable to banks and how frequently the assets covered by the Standard need to be reviewed to measure impairment.

(ii) In addition to the assets of banks which are specifically identified at paragraph 6.3.1 above, viz. financial assets, inventories, investment, loans & advances etc to which the Standard does not apply, the Standard would apply to financial lease assets and non banking assets acquired in settlement of claims only when the indications of impairment of the entity are evident.

RBI/2004/117/Ref DBS. ARS. No. BC. 08/08:91:001/2003-04

March 26, 2004

The Chairman, State Bank of India/
The Managing Directors, Associate Banks of SBI/
The Chairmen & Managing Directors of all nationalised Banks

Dear Sir,

Assessment of performance of statutory auditors

As you are aware, at present public sector banks are required to forward to RBI every year a report on the performance of their statutory central and branch auditors based on certain parameters such as general performance, delay in taking up audit work/submission of report/ certification, wrong classification of assets, submission of fictitious bills etc. as soon as annual statutory audit is over. On a review of the existing system, it has been observed that the feedback received from banks on the quality of audit is very general and does not contain detailed observations/recommendations on continuance or otherwise of their auditors. With a view to assessing the performance of statutory central auditors of public sector banks more objectively, it has been decided, in consultation with a few public sector banks, to introduce a structured questionnaire eliciting information from the banks on the performance of their statutory central auditors. A copy of the questionnaire to be completed by banks for each of their statutory central auditors from the year 2003-04 is enclosed. We shall be glad if you will please forward to us the report on the performance of the statutory central auditors of your bank in the prescribed proforma immediately on finalization of the LFAR of the relevant year but not later than August 16, every year.

It has also been decided that the bank should collect similar data on performance of the statutory branch auditors in the said proforma as prescribed for the statutory central auditors for their internal use. Only adverse features, if any, observed against any statutory branch auditor may be communicated to RBI every year along with the report on the performance of their statutory central auditors.

Yours faithfully

(R.M. Thakkar)

General Manager

Encl: As above.

ANNEXURE

Report on performance of Statutory Central Auditors

(i) Name of the bank

(ii) Name of the audit firm

(iii) Year of statutory audit

(iv) Number of years completed with the bank

(v) Areas of audit allotted during the year under report.

(vi) Whether there is inordinate delay in

- taking up the statutory audit
- completion of audit work
- submission of audit report, LFAR and required various certificates

(vii) Actual period of audit From To

(viii) Details of visits undertaken by the partners during the course of statutory audit

Sr. No.	*Names of the Partners*	*Dates of visit*				*Total Man days spent on statutory Audit in bank*
		HO/ Controlling Offices		*Branches allotted to the firm*		
		From	To	From	To	

(ix) Names of the paid CAs visited the bank during the course of statutory audit

Sr. No.	*Names of the Partners*	*Dates of visit*				*Total Man days spent on statutory Audit*
		HO/ Controlling Offices		*Branches allotted to the firm*		
		From	To	From	To	

(x) No. of unqualified assistants/articled clerks deployed for statutory audit of the bank with dates (HO/Controlling Offices and branches separately)

(xi) Give comments on quality of audit undertaken by the firm of the areas allotted to them, highlighting the weaknesses/drawbacks, if any, noticed in their performance with full details.

(xii) Depth of the knowledge relating to audit practices, accounting standards, RBI instructions/guidelines etc. of the partners, paid chartered accountants and other audit staff.

(xiii) How the staff of the audit firm was maintaining relations with officials of other audit firms of the audit team.

(xiv) Total amount of TA/HA/Hotel bills/conveyance etc. claimed by the firm, whether the same is reasonable, if not reasons therefore.

(xv) Whether in your opinion, auditors can be considered for reappointment considering their performance with your bank, if not, reasons therefore may be indicated.

(xvi) Divergence in the provisioning recommended by the SCAs in respect of branches audited by them as also in the areas allotted to them at HO level during their statutory central audit and those recommended by the RBI inspectors during the course of inspection of the relevant branches/HO/CO.

(xvii) Others: Specific issues not included above but needs to be indicated for the performance appraisal.

Note:

- A separate report for each audit firm in the audit team may be prepared.
- The reports must be signed by the GM (Audit and Accounts) or (Inspection/Audit) or who is responsible for the liaison with the statutory central auditors and statutory audit work.
- This report must be perused by CMD or ED of the bank before forwarding to RBI.
- The assessment reports must be forwarded to RBI within one month from the date of finalisation of the LFAR of the relevant year but not later than 16th August every year.
- In case report in respect of Annual Financial Inspection of RBI for the relevant year has not been received, information on divergence in provisioning as per the Annual Financial Inspection of the previous year in respect of the continuing auditors may be indicated against item (xvi) above.

RBI No/2004-05/151
UBD. No. BPD. 15/12.05.01/2004-05

September 1, 2004

The Chief Executive Officers of all primary (Urban) Co-operative Banks

Dear Sir,

Frauds in the area of Housing Finance

We advise that a Group headed by General Manager, Central Bank of India constituted by Reserve Bank of India examined the causes for growing incidence of frauds in Housing Finance and submitted its report indicating remedial measures. We forward herewith a copy of the report containing the remedial measures suggested by the Group for your information and necessary action.

Please acknowledge receipt to our Regional Office concerned.

Yours faithfully,

sd/

(N.S.Vishwanathan)
Chief General Manager

ANNEXURE

REPORT OF THE COMMITTEE ON FRAUDS IN HOUSING FINANCE

Point No. 1

Type of Frauds Fabrication of Income Documents like Income-tax Return/Salary Slip/Balance Sheet etc.

Severity of fraud LOW

Modus Operandi Committed generally by borrowers in connivance with Direct Selling Agent/Estate Agent/Builders

Mitigating factors/Suggestions for Preventive cures 1. Verification of salary slips with employer

2. Income Tax Department should upload on their website the list of Income Tax payers and defaulters.

3. Salary amount should be compared with Bank Statement.

4. Cross verification of balance sheet.

5. Personal interview of the borrower plays very important role.

Point No.2

Type of fraudsLoan amount disbursed by way of cheque/Demand drafts are encashed by third party/agents etc.

Severity of fraud MEDIUM

Modus Operandi Disbursed amount cheques are collected by the Agents/third parties from the borrower's bank and deposited in fictitious account opened for this purpose and amounts are withdrawn from such bogus account.

Mitigating factors/Suggestions for preventive cures 1. Cheques should be issued in the name of bankers to the Builders with the bank account number on it.

2. Cheque should not be handed over to the borrower/agent/seller. Bank's Marketing Officials can be sent for delivery of cheque to the builders/sellers of property at the registered address mentioned in the title deeds.

Point No. 3

Type of fraud Title documents being forged-Stamped documents forged by Borrower customer/Builder

Severity of fraud HIGH

Modus Operandi Coloured Xerox copy of various documents are

produced including encumbrance certificate, fake stamp papers etc. which are difficult to identify/distinguish from the original one.

Mitigating factors/suggestions for preventive cures 1. Tracking and sharing of all information among the Banks & Housing Finance Companies about names of blacklisted builders & developers.

2. Agreement for sale/document of title should be in DEMAT form.

3. In case of large value loans. bank can approach the Sub-Registrar's Office to verify the genuineness of the stamp paper/documents/ registration receipts, etc.

Point No. 4

Type of Frauds Over valuation of the property

Severity of fraud MEDIUM

Modus Operandi

These frauds are committed to draw higher loan amount by the borrower in connivance with the Builders/valuers. The value of the property are inflated by including various expenditure and additional amenities, fixtures, legal charges, society advance, maintenance charges, etc. which are non-existing.

Mitigating Factors/Suggestions for preventive cures 1. For valuation over Rs. 25 lacs, valuation should be done by two independent valuers.

2. Govt. should introduce certification course for the approved valuers.

3. Banks should develop in house expertise for valuation of properties.

Point No. 5

Type of Frauds Multiple financing

Severity of fraud HIGH

Modus Operandi These frauds are extension of the fake documents that are produced to different banks/Housing Finance Agencies

Mitigating Factors/Suggestions for preventive cures 1. Tracking & sharing of information among the Banks & HFCs about names of black listed Builders & developers selling same properties to more than one buyer.

2. Agreement for sale/document of title should be in DEMAT form.

3. Bank/Housing Finance Agencies should insist on the original title deeds of the landed property on which structure is built.

Point No. 6

Type of Frauds 1. Cancellation of booking of flats/property i.e. collusion between customer and builder.

Severity of fraud MEDIUM

Modus Operandi In this case after availing the initial loan amount, the booking is cancelled and the borrower directly take the refund from the builders.

Mitigating Factors/Suggestions for Preventive cures Registration receipt issued by Registrar of stamps office should bear hypothecation Clause as in case of certificate of Registration has in case of Auto Loan.

Point No. 7

Type of Frauds

Sale of property by loanee without clearing existing loan

Severity of fraud MEDIUM

Modus Operandi

Property is sold through duplicate/fake title deeds even though the legal title is with the bank/Housing Finance Agencies.

Mitigating Factors/Suggestions for Preventive cures 1. Equitable Mortgage should be created at Registrar's office by deposit of title deeds. For this purpose all banks should represent to Central & State Government through I.B.A & R.B.I for enactment of necessary provisions.

2. Internal due diligence plays important role to prevent this type of frauds.

Point No. 8

Type of Frauds Mis-representation of end use of loan

Severity of fraud LOW

Modus Operandi

Loan taken for Residential Housing Property. However, Commercial property is purchased by availing such loan.

Mitigating Factors/Suggestions for Preventive cures

In order to ensure end use of loan, bank should depute Officer for inspection/verification of property, whether it is Residential Housing Property or Commercial Property.

Point No.9

Type of Frauds Sale of property by builder without clearing/ repaying Construction Funding Loan availed by them from banks/ Housing Finance Companies.

Severity of Fraud MEDIUM

Modus Operandi Builders/property developers after taking Construction loan from banks/Housing Finance Agencies are selling developed ready flats/Galas/developed plots, etc. without knowledge of their financiers & without repaying construction Funding loan to them.

Mitigating Factors/Suggestions for Preventive cures

1. This aspect of construction Funding Loan whether availed by the developer/builder or not, should be verified at Project clearance level by Banks/Housing Finance Companies.
2. Original documents should be called for verifications at the time of appraisals of any Housing Loans.

RBI/2004/254
DBOD No. BP. BC. No. 97/21.04.141/2003-04

June 17, 2004

All Scheduled Commercial Banks
(excluding RRBs)

Dear Sir,

Annual Policy Statement for the year 2004-05-Prudential Guidelines on Unsecured Exposures

Please refer to paragraph 4(iii) of our circular DBOD NO. Sch. 666/C.96Z-67-3 May 3, 1967 wherein it was stated that banks should limit their commitments by way of unsecured guarantees in such a manner that 20 per cent of a bank's outstanding unsecured guarantees plus the total of its outstanding unsecured advances should not exceed 15 per cent of its total outstanding advances. Over a period of time, certain types of unsecured guarantees and unsecured advances were allowed to be excluded from the total of unsecured guarantees or unsecured advances while applying the above norm.

2. In this connection, a reference is invited to Paragraph No. 116 of the annual policy Statement for the year 2004-05 dated May 18, 2004 (copy of the paragraph enclosed).

Withdrawal of extant limit

3. Banks have been requesting for flexibility in this regard considering the emerging shift towards financing borrowers based on estimated cash flows rather than placing reliance on collateral. It is further observed that banks are extending financial assistance to customers not only through the traditional 'loans and advances' route but also through the 'investment' route in the form of credit substitutes, viz. commercial papers, bonds, debentures etc.

4. Against this background and as a step towards further deregulation, it has been decided to withdraw the extant instructions on unsecured exposures to enable banks' Boards to formulate their own policies on unsecured exposures. Simultaneously, all exemptions allowed for computation of unsecured exposures also stand withdrawn.

Definitions

With a view to ensuring uniformity in approach and implementation, 'unsecured exposure' is defined as an exposure where the realisable value of the security, as assessed by the bank/approved valuers/Reserve Bank's inspecting officers, is not more than 10 percent, ab-initio, *of the outstanding exposure. 'Exposure' shall include all funded and non-funded exposures (including underwriting and similar commitments). 'Security' will mean tangible security properly charged to the bank and will not include intangible securities like guarantees, comfort letters etc.*

Prudential provisioning norms

In terms of our guidelines on income recognition, asset classification and provisioning pertaining to advances, the extant provisioning requirement for substandard assets envisage provisioning at a flat rate of 10 percent on total outstanding without making allowance for DICGC/ECGC guarantee cover and security cover available. With the withdrawal of the extant prescribed limits, the unsecured exposures, as defined above, which are identified, as 'substandard' would attract additional provision of 10 percent, i.e., a total of 20 percent on the outstanding balance. The provisioning requirement for unsecured 'doubtful' assets would remain unchanged at 100 percent.

At present, banks are required to limit their commitments by way of unsecured exposure in such a manner that 20 per cent of a bank's outstanding unsecured guarantees plus the total of its outstanding unsecured advances should not exceed 15 per cent of its total outstanding advances. In order to extend further flexibility to banks on their loan policies, it is proposed:

- To withdraw the extent limit on unsecured exposures to enable banks' Boards to fix their own policy on unsecured exposures.
- Banks would be required to make an additional provision of 10 per cent, i.e., a total provision of 20 per cent of the total outstanding advances in the substandard category to cover expected loss on unsecured exposures.
- Provision at the level of 100 per cent for unsecured exposures in doubtful and loss categories will continue as hitherto."

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

December 12, 2003

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 mortgage 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 over financed.

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/mortgage 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 (up to 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 fulfill 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]

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

1. Coverage:

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 dispatch 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 cardholder 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):
    1. whether on-line or
    2. 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]

Entry of banks into Insurance business

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 net worth 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.

ANNEXURES

Annexure 'A'

Table 'A'

Particulars	*Amount*	*Notes*
Loans & Advances as on 31-03-2005		
Loans & Advances as on 31-03-2006		
Net Increase/Decrease		
Closed Accounts		
(No. of Accounts) …….		
Fresh sanction of facilities		
(No of Accounts)……..		

Notes: (a) Identify loans facilities exceeding 2 crores to one borrower.

Table 'B'

Particulars	*Amount*	*Notes*
NPA as on 31-03-2005 as per Branch		
NPA as on 31-03-2006 as per Branch		
Net Increase/Decrease		
Closed Accounts		
(No. of Accounts) …….		
Fresh accretion to NPAs		
(No. of Accounts)……..		

Table 'C'

Particulars	*Amount*	*Notes*
NPA as on 31-03-2006 as per Branch		
NPA as on 31-03-2006 as per Audit		
Net Increase/Decrease		
Analysis		
Identified by the Auditors during the year		
(No. of Accounts) …….		
Reason for identification		
(No. of Accounts)……..		

Table 'D'
Provisions

Particulars	*Amount*		*Notes*
	As per Branch	*As per Auditor*	
Provisions as on 01-04-2005			
Provisions as on 31-03-2006			
Net Increase/Decrease			
Analysis			
(a) Increase of provision for substandard assets.	(No. of Accounts)		
(b) Increase/Decrease of provisions in doubtful assets.			
(c) Identification of fresh loss assets.			
Reason for identification			