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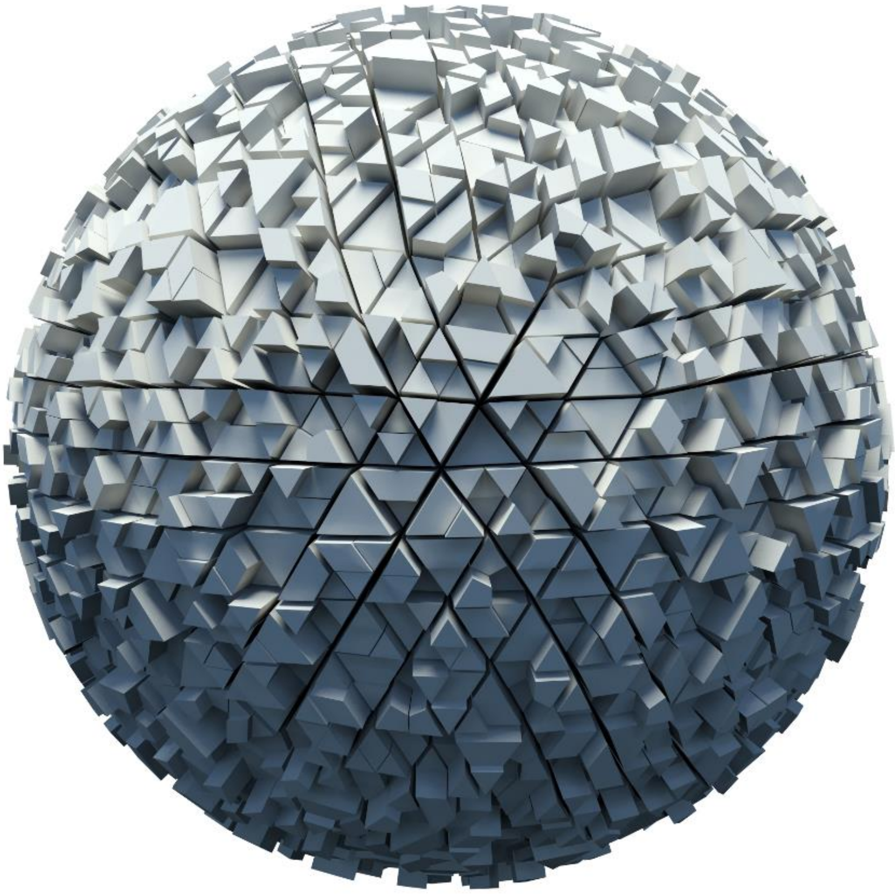

Regulatory Impact Assessment

Banking

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Preface

The inflation based on the consumer price index (CPI) reached 23 month high of about 6.07% in July from a year ago, the fourth straight reading that tops the RBI's target of 5% by March 2017. At the last monetary policy announced on August 9, 2016, the interest rates remained unchanged flagging upside risks to the inflation target. This has added increasing pressure on the new governor Urjit Patel to achieve the retail inflation target of 4% for next five years under the monetary policy framework as previously agreed and in line with the Centre's focus on macroeconomic stability to boost growth while keeping prices in check.

With Urjit Patel commencing his journey as the governor of the central bank from September 4, 2016, not only will he have to achieve the retail inflation target of 4%, but will also have to deal with the upcoming FCNR(B) redemption which starts in November which would result in an outflow of approximately USD 20 billion and the possible rate hike by US Federal Reserve in December. Apart from addressing these challenges, especially inflation which he will have to keenly monitor before biting the rate cut bullet, he is also expected to carry forward the book cleaning process of public sector banks with the same urgency of March 2017 as was taken up by Raghuram Rajan.

In a historic development, the parliament passed the GST bill on August 8, 2016. The reform is expected to bump up the tax-GDP ratio, reduce/eliminate tax evasion and corruption by introducing the one country one tax regime and is expected to subsume all indirect taxes at the central and state level thus reducing the cascading effect of taxes on taxes. Currently states have concerns over the possible revenue loss that this bill could bring, but once tax buoyancy takes place due to GDP growth and operational efficiency, it would be a wining situation for the states as well. As on August 24, 2016, Madhya Pradesh became the seventh state to ratify the GST Amendment Bill after Assam, Bihar, Jharkhand, Chhattisgarh, Gujarat and Himachal Pradesh.

The fast track merger of SBI with its associate banks has taken the market for a surprise who was expecting the announcement in FY 17. As per the media interaction of SBI, cleaning up of their books is expected to take one more quarter and the gross NPA of its five associated banks stood at 9.14% as on quarter ending June 2016 compared to 5.98% as on quarter ending March 2016. The five associate banks reported a loss of Rs 2,018 crore in the June quarter as compared to a standalone profit of Rs 2,521 crore by SBI. This merger will bring in stricter KYC norms and a centralized banking system keeping a watch on the assets thus enabling improved performance. Since the cumulative bad loans at the five associate banks stands at 35% of the bad loans of SBI and their slippage ratio at 20%, the merger raises a question on the impact on the health of SBI as the associate banks have not come clean before the merger. Despite the current status of the assets, the merger will result in SBI being the 44th largest global bank and the largest Indian bank by a mile.

On August 9, 2016, the Union Government has announced that the Non-Performing Assets (NPA) of commercial banks have increased by around 4% in the last one year (March 2015 to March 2016). What was considered to be an issue only amongst the public sector banks, has now engulfed the entire industry there by threatening the economy as a whole. It is hoped that the policy and judicial initiatives taken by the government and the central bank will, to some extent, alleviate the problems. However is also depends on the spirit with which bankers, promoters and the government respond to the concerns and bring about the necessary changes.

With the success of the previous tranches, RBI has announced the 4th tranche of Sovereign Gold bonds for investment by individuals and institutional investors. This scheme gives the option for investment in gold through a paper form without having to actually keep the physical gold. RBI also announced a set of operational guidelines around the scheme which is needed to be followed by every receiving office for the bonds. Apart from that, RBI has issued guidelines to discontinue reporting of Bank guarantees previously required to be done by service importers. It has also announced certain amendments to earlier guidelines issued pertaining to operationalisation of CKYCR, facilities for exchange of soiled/mutilated notes and has revised the reporting format for half yearly/quarterly review of accounts of public sector banks.

Our point of view on key RBI guidelines issued in July 2016

Sovereign Gold Bonds 2016-17 – Series I

RBI Circular Reference: RBI/2016-17/18
Date of Notification: July 14, 2016
Applicable Entities: The Chairman & Managing Director All Scheduled Commercial Banks, (Excluding RRBs) Designated Post Offices Stock Holding Corporation of India Ltd. (SHCIL) National Stock Exchange of India Ltd. & Bombay Stock Exchange

Background and Objective

Sovereign Gold Bonds Scheme is an indirect way of investing in Gold. Instead of buying physical gold, investors can invest in gold in a paper form through Sovereign Gold Bonds. The under-lying asset for these bonds is Gold. These bonds will track the price of gold, plus an extra interest earning on top of that. This is the 4th Tranche of Sovereign Gold Bonds and it will be open for investment by resident individuals and institutional investors from 18th to 22nd July 2016.

The first tranche (issue) of the Gold Bonds scheme was launched in November 2015 and had received a subscription of 919.95 kg of gold worth Rs 246 crore. The second tranche received subscriptions of Rs 726 crore for 2,790 kg gold while the third tranche received a poorer response getting subscription of 1,128 kg gold, amounting to Rs 329 crore. The gold bonds are issued in denominations of 5 grams, 10 grams, 50 grams and 100 grams for a term of 5-7 years with a rate of interest to be calculated on the metal's value at the time of investment.

Key directives issued by RBI

The guideline highlights the features and terms and conditions of the Sovereign Gold Bonds 2016-17- Series I. The same will be open for subscription from July 18, 2016 to July 22, 2016. Specifically, the guideline highlights the following:

- Eligibility criteria for investment
- Form of security being issuance in the form of Government of India Stock
- Date of issue of bonds being August 5, 2016
- Criteria for defining the denomination and the issue price of the bonds
- Interest rate of the bonds equal to 2.75 percent per annum of the initial investment
- Receiving offices for these bonds will be Scheduled commercial banks (excluding RRBs), designated Post Offices (as may be notified), Stock Holding Corporation of India Ltd (SHCIL) and recognized stock exchanges viz., National Stock exchange of India Limited and Bombay Stock Exchange who are authorized to receive applications for the Bonds either directly or through agents.
- Conditions pertaining to payment options, redemption and repayment of bonds
- Other aspects such as Tax treatment, loan against bonds, application form, nomination, transferability and tradability of bonds etc.

Impact

Major implications will include the following:

- The receiving offices may establish a structured process for facilitating the process of collection of applications and ensure compliance with the RBI requirements concerning issue of these bonds
- Receiving office is responsible for informing the investor of the date of maturity of the Bond one month before its maturity. In order to fulfill this requirement, a structured tracking mechanism may be developed to ensure timeliness of such an intimation.
- The RBI has vide its circular, RBI/2016-17/19, notified the operational guidelines with regards to the scheme which the receiving offices must comply with.

Sovereign Gold Bonds, 2016-17 - Operational Guidelines

RBI Circular Reference: RBI/2016-17/19
Date of Notification: July 14, 2016
Applicable Entities: The Chairman & Managing Director All Scheduled Commercial Banks (Excluding RRBs) Designated Post Offices Stock Holding Corporation of India ltd.(SHCIL) National Stock Exchange of India Ltd. & Bombay Stock Exchange

Background and Objective

This guideline is an extension of the earlier guideline issued by the RBI regarding issue of Sovereign Gold Bonds, 2016-17- Series I. Government of India has vide its Notification F.No. 4(7)-W&M/2016 dated July 14, 2016 announced that the Sovereign Gold Bonds 2016 – Series I ("the Bonds") will be open for subscription from July 18, 2016 to July 22, 2016. Section 20 of that guideline stated a reference to the operational guidelines relating to these bonds which the receiving offices needs to comply to.

Key directives issued by RBI

The guideline highlights all the operational guidelines that are required to be followed by the receiving offices under Section 20 of the RBI guideline namely RBI/2016-17/18- Sovereign Gold Bonds 2016-17- Series I.

Impact

Major implications will include the following:

- Receiving offices to ensure that the application from all the investors are complete in all respects and are to accepted within business hours only
- Receiving offices may cancel an application till the closure date of the issue of bonds, i.e. July 22, 2016. Part cancellation of the request for purchase of bonds is not permitted.
- Scheduled commercial banks may engage NBFCs, NSC agents and others to collect application forms on their behalf. Banks may enter into arrangements or tie-ups with such entities. Commission for distribution shall be paid at the rate of rupee one per hundred of the total subscription received by the receiving offices on the applications received and receiving offices shall share at least 50% of the commission so received with the agents or sub-agents for the business procured through them.
- The bonds are available for subscription through RBI's e-kuber system. The receiving offices thus need to enter the data or carry out bulk upload for the subscriptions received by them. They may ensure accuracy of entry of data to prevent occurrence of any inadvertent errors
- The receiving offices will need to download the holding certificates for the bonds and take printouts of the same in colour on A4 size 100 GSM paper.

Other Key Guidelines issued by RBI in July 2016

S.No	Guidelines Reference	Date of Issue	Particulars	Impact
1	RBI/2016 -2017/8	July 7, 2016	Discontinuation of Reporting of Bank Guarantee on behalf of service importers	Banks may discontinue the practice of submission of reports relating to invocation of bank guarantee for service imports which they were previously required to do under para no. 1, Part X of the Master Direction on "Reporting under Foreign Exchange Management Act, 1999" dated January 1, 2016.
2	RBI/2016 -2017/11	July 8, 2016	Amendment to Master Direction on KYC – Operationalisation of Central KYC Registry (CKYCR) and KYC norms for Foreign Portfolio Investors (FPIs)	Individuals and legal entities will be required to submit the KYC information with CKYCR in the revised templates as defined. RBI through this guideline announced the "live run" of the CKYCR with effect from July 15, 2016. Accordingly, the Res are required to do the following: - REs being SCBs may upload the data for their individual accounts opened on or after July 15, 2016. - REs other than SCBs may also participate in the live run - REs not ready for the CKYCR submission process are required to structure their systems and processes so as to make it ready
3	RBI/2016 -2017/17	July 14, 2016	Facility for Exchange of Soiled/ Mutilated/ Imperfect Notes	▪ Banks to ensure sufficient number of notes and coins of each denominations at every non-chest branches so that people can avail this facility ▪ Banks should have appropriate procedures in place to ensure quick and proper facility of supply of such notes and coins once their number has reached to its re-order level (minimum level) at all its branches. ▪ In case the non chest branches of the bank are unable to adjucate the mutilated notes, the notes should be received against a receipt and sent to the linked currency chest branch for adjudication. ▪ Banks may levy service charge if the number of notes to be exchanged is more than 20 in a day. ▪ Banks may institute a tracking mechanism for every branch with respect to the number of notes and coins exchanged under this facility and conduct due reconciliation

S.No	Guidelines Reference	Date of Issue	Particulars	Impact
4	RBI/2016-2017/25	July 21, 2016	Basel III Framework on Liquidity Standards – Liquidity Coverage Ratio (LCR), Liquidity Risk Monitoring Tools and LCR Disclosure Standards	▪ Banks will now be permitted to reckon government securities held by them up to another 1% of their NDTL under FALLCR within the mandatory SLR requirement as level 1 HQLA for the purpose of computing their LCR. ▪ Hence the total carve-out from SLR available to banks would be 11% of their NDTL ▪ For this purpose, banks should continue to value such reckoned government securities within the mandatory SLR requirement at an amount no greater than their current market value (irrespective of the category of holding the security i.e. HFT, AFS or HTM)
5	RBI/2016-2017/27	July 28, 2016	Priority Sector Lending – Targets and Classification-Bank loans to MFIs for on-lending - Qualifying asset - Revised loan limit	RBI has extended the limit of loans extended by Non-Banking Financial Company- Micro Finance Institutions (NBFC-MFIs) from INR 15,000 to INR 30,000 for all loans with a tenur of more than 24 months
6	RBI/2016-2017/29	July 28, 2016	Half yearly/Quarterly Review of Accounts of Public Sector Banks	RBI has revised the reporting format Half yearly/Quarterly Review of Accounts of Public Sector Banks. Public sector banks will be required to submit the reports in the new format from the next review date
7	RBI/2016-2017/30	July 28, 2016	Retail Participation by Demat Account Holders in the Government Securities Market: Access to NDS-OM Platform	The Depository Participant (DP) bank which is an SGL account holder and a direct member of Negotiated Dealing System Order Matching (NDS-OM) and Clearing Corporation of India (CCIL) will provide the necessary arrangements to enable retail investors who hold demat accounts (NSDL/CDSL) to put through trades in Government Securities on the NDS-OM platform.


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