Chokshi & Chokshi

Weekly Update ● May 2011 ● Vol 1

Reserve Bank of India

RBI ups provisioning on select types of non-performing loans: The RBI tightened the provisioning requirement for banks on certain types of bad and restructured loans as part of its prudential provisioning framework. Banks' bad loans are classified into three categories -- sub-standard, doubtful and loss. The advances classified as 'sub-standard' will now attract a provision of 15 per cent as against the existing 10 per cent, the apex bank said in its monetary policy statement for FY12. However, a provision of 40 per cent has been prescribed for the secured portion of advances which remained in the 'doubtful' category for more than one-year but up to three years. The existing provision is 30 per cent. In the case of restructured accounts classified as standard advances, provisioning has been increased to 2 per cent in the first two years from the date of restructuring as against the existing range of 0.25-1 per cent, depending upon the category of advances, the RBI said. In the case of restructured accounts classified as non-performing advances, when upgraded to the standard category, banks will now have to make a provision of 2 per cent in the first year from the date of upgradation as against the existing provision of 0.25-1 per cent, the apex bank said.

RBI to extend short sale period of G-sec to 3-months: The Reserve Bank of India said that it has proposed to extend the period of short sale in the Central Government securities from the present five days to the maximum of three-months. The move will provide a fillip to the interest rate futures market and the term repo market, the Reserve Bank said in its monetary policy statement for FY 12.

NBFCs will Need Rs.150-cr Net-owned Funds for Primary Dealer Entry: The Reserve Bank of India has said non-banking finance companies (NBFCs),who intend to get into primary dealership business, should have minimum net-owned funds of Rs.150 crore. Banks who intend to expand to primary dealership business should have a minimum net worth of Rs.1000 crore. Primary dealers, or are specialized traders in government bonds who have the market making mandate for government bonds and offer two-way quotes on bond trading. The revised guidelines, put up on RBIs website ,have also said, in case a primary dealer intends to diversify into other permissible activities, such as brokerage and merchant banking, the minimum NOF shall be Rs.250 crore. The guidelines stipulate that banks should also have ratio of capital to risk-weighted assets of 9% and net non-performing assets or net of less than 3%, in addition to a profit making record for the last 3 years.

Interest rates on savings deposits increased: It has been decided to increase the interest rate on domestic and ordinary Non-Resident savings deposits as well as savings deposits under Non-Resident (External) Accounts Scheme by 0.5 percentage point from 3.5 per cent to 4.0 per cent per annum with immediate effect. [Circular no. DBOD. Dir. BC. 90/13.03.00/2010-11, dated 3-5-2011]

FY12 Monetary Policy: The Reserve Bank of India has hiked the Repo rate by 50bps, higher than expectations. Repo rate now stands at 7.25% and reverse repo rate at 6.25% (100bps below the policy rate). As expected, RBI is going to remain focused on containing inflation by moderating growth in the near term, as the RBI

believes that elevated inflation will harm the medium-term sustainability of economic growth. For FY12, RBI has set an estimate of 8%, we have a growth target of 7.5%-8%. Our year-end inflation target is at 6.5% vs. 6% set by the Reserve Bank. We believe that banks would increase the lending rates by 50-100bps, clubbing for higher repo and savings rate (savings rate has been increased from 3.5% to 4%). Impact of higher interest rates and inflation is already showing in the ongoing weakness in the investment cycle. Order flow has been weak for the last two quarters and is expected to remain sluggish in the current quarter. Thus, the demand situation is expected to remain weak for the entire FY12. Consumption, so far has remained strong, however, the first signs of weakness are being seen in the form of muted volumes of automobile sales and FMCG products. Companies' profitability would be impaired from higher borrowing cost, higher input cost, inability to completely pass on the higher input cost in a weak demand scenario, and higher wage cost. Going ahead, we expect RBI to further tighten rates by 50bps in a calibrated manner, assuming stable commodity prices and normal monsoon. Inflation is expected to remain high for the full-year and across all the segments. Higher inflationary pressures and moderating economic growth may result in subdued capital flows, already showing in slower FDI flows. Higher interest rates would also increase the interest payment for the Central Government. Yield on 7.80% 2021 paper rose to 8.22% (up 7bps post the rate hike was announced).

SEBI

Modification of methodology for calculation of annual issuers charges: SEBI has partially modified its earlier circular No. MRD/DoP/SE/Dep/Cir-4/2005, dated January 28, 2005 and No. MRD/DoP/SE/Dep/Cir-2/2009, dated February 10, 2009 regarding calculation of annual issuers charges. The annual issuer charges would be based on the average No. of folios (ISIN positions) during the previous financial year instead of the total number of folios (ISIN positions) as on 31st March of the previous financial year. The average No. of folios (ISIN positions) for an Issuer may be arrived at by dividing the total number of folios for the entire financial year by the total number of working days in the said financial year.

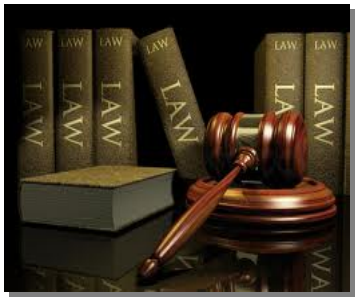
FEMA

Procedure liberalized for advance remittance for import of goods: Authorised Dealer Category - I banks are required to obtain an unconditional, irrevocable standby Letter of Credit or a guarantee from an international bank of repute situated outside India or a guarantee of an AD Category - I bank in India, if such a guarantee is issued against the counter guarantee of an international bank of repute situated outside India, for an advance remittance exceeding USD 100,000 or its equivalent. With a view to liberalising the procedure, it has been decided to enhance the aforesaid limit of USD 100,000 to USD 200,000 or its equivalent, with immediate effect for importers (other than a Public Sector Company or a Department / Undertaking of Central / State Governments where the requirement of bank guarantee is to be specifically waived by the Ministry of Finance, Government of India for advance remittances exceeding USD 100,000 or its equivalent). [A.P. (Dir Series) Circular No. 56, Dated 29-4-2011]

FII investment limit in listed NCDs/Bonds enhanced: SEBI registered Foreign Institutional

Investor (FII) may purchase, on repatriation basis, listed non-convertible debentures / bonds issued by an Indian company, subject to such terms and conditions mentioned therein and limits as prescribed for the same by the RBI & the SEBI from time to time. The present limits for such investments is USD 15 billion for FII investment in corporate debt with an additional limit of USD 5 billion for FII investment in bonds with a residual maturity of over five years, issued by Indian companies which are in the infrastructure sector, where "infrastructure" is defined in terms of the extant guidelines on External Commercial Borrowings (ECB). It has now been decided, in consultation with the Government, to enhance the FII investment limit in listed non-convertible debentures/bonds, with a residual maturity of five years and above, and issued by Indian companies in the infrastructure sector, where 'infrastructure' is defined in terms of the extant ECB guidelines, by an additional limit of USD 20 billion taking this limit from USD 5 billion to USD 25 billion (with this the total limit available to FIIs for investment in listed non convertible debentures/bonds would be USD 40 billion with a sub-limit of USD 25 billion for investment in listed non-convertible debentures/ bonds issued by corporate in the infrastructure sector). Further, such investment by FIIs in listed non-convertible debentures / bonds would have a minimum lock-in period of three years. However, FIIs are allowed to trade amongst themselves during the lock-in period. It has also been decided to allow SEBI registered FIIs to invest in unlisted non-convertible debentures / bonds issued by corporate in the infrastructure sector, provided that such investment is as per the aforementioned terms and conditions. [A.P. (Dir Series) Circular No. 55, Dated 29-4-2011]

Opening of escrow accounts for FDI transactions liberalized: Authorised Dealer Category - I banks to open Escrow account and Special account on behalf of non-resident corporate for acquisition/transfer of shares/ convertible debentures of an Indian company through open offers/ delisting/exit offers, subject to compliance with the relevant SEBI [Substantial Acquisition of Shares and Takeovers (SAST)] Regulations, 1997 and other applicable SEBI regulations. In all other cases of opening /maintaining of Escrow accounts for FDI related transactions, prior approval from the Reserve Bank is necessary. It is observed that the Escrow mechanism facilitates FDI transactions in cases where parties to the share purchase agreement desire to complete the due diligence process before they finalize the agreement for the same and accordingly, there is a time lag between payment of purchase consideration and the receipt of the shares. To provide operational flexibility and ease the procedure for such transactions, it has been decided to permit AD Category - I banks to open and maintain, without prior approval of the Reserve Bank, non-interest bearing Escrow accounts in Indian Rupees in India on behalf of residents and/or non-residents, towards payment of share purchase consideration and/or provide Escrow facilities for keeping securities to facilitate FDI transactions subject to the terms and conditions as given in Annex. It has also been decided to permit SEBI authorised Depository Participants, to open and maintain, without prior approval of the Reserve Bank, Escrow accounts for securities subject to the terms and conditions as given in Annex. In both cases, the Escrow agent shall necessarily be an AD Category - I bank or SEBI authorised DP (in case of securities' accounts). These facilities will be applicable for both issue of fresh shares to the non-residents as well as transfer of shares from/to the non-residents. [A.P. (Dir Series) Circular No. 58, Dated 2-5-2011]



CORPORATE LAW

Clarification on effective date of companies (particulars of employees) amendment rules: The Ministry had notified Companies (Particulars of Employees) Amendment Rules, 2011 *vide* GSR 289 (E), dated 31-3-2011 raising the limit of employee's salary to be disclosed in Directors Report. In this regard, it is clarified by general circular no. 23/2011, dated 3-5-2011 that the said notification shall be applicable to all Director's Reports under section 217 of the Companies Act, 1956 approved by the Board of Directors on or after 1-4-2011, irrespective of the accounting year of the annual account, being approved by the Board.

Clarification on general circular no. 2/2011: It has been observed that certain companies are seeking clarification in respect of circular No. 2/11, dated 8-2-2011 issued by the Ministry in respect of exemption u/s 212(8) of the Companies Act, 1956. The point raised is in respect of applicability of condition No. (*ii*) of the circular, requesting the Ministry to delete the condition in respect of unlisted companies as this condition is applicable to listed companies as per SEBI guidelines. The Ministry is aware of the limited scope of the SEBI Rule. However, the decision has been taken to ensure transparency in those cases where balance sheets of subsidiaries are not attached. In this regard, it is clarified by general circular no. 22/2011; dated 2-5-2011 that companies which desire to take benefit of exemption allowed under this circular would have to fulfill the conditions stipulated therein even if they are unlisted.

Appointment of agency for providing electronic platform for electronic voting: The Ministry of Corporate Affairs has taken a "Green Initiative in the Corporate Governance" by allowing paperless compliances by the Companies Section 192A of the Companies Act, 1956 read with Companies (Passing of the Resolution by Postal Ballot) Rules, 2001 already recognizes voting by electronic mode for postal ballot. Some of the listed companies have already started using electronic platform of certain agencies for providing and supervising the electronic platform for electronic voting. In order to have secured electronic platform for capturing accurate electronic voting processes, It is clarified by circular no. 21/2011, dated 2-5-2011 that the agency appointed for providing and supervising electronic platform for electronic voting shall be an agency duly approved by the Ministry of Corporate Affairs. It is further clarified that for the above purpose, National Securities Depository Limited (NSDL) and Central Depository Services (India) Ltd. (CDSL) are being approved by the Ministry of Corporate Affairs subject to the condition that they obtain a certificate from Standardization Testing and Quality Certification Directorate. Once they obtain the same and inform the Ministry, they will be authorized to undertake these activities.

MSME

Favorable procurement policy will help SMEs: CII: Closer links between large and small units will benefit the entire supply chain. Many of the problems faced by micro, small and medium enterprises lack of structured markets, delayed payments from large customers, low availability and high cost of capital, obsolete technology and lack of skilled manpower can be addressed through preferential procurement of goods and services produced by MSMEs, according to a paper by the Confederation of Indian Industry. Such a procurement policy would be a powerful tool

for exercising a positive influence on the fortunes of MSMEs, considering that the government and public sector units (PSUs) are the biggest buyers in the country, according to CII.

Technology, branding must for MSME growth: Experts: The micro, small and medium enterprises (MSMEs) in India should pay special attention to technology up-gradation and brand building to expand growth avenues in the global markets, informed industry experts at the second global convention. Experts and entrepreneurs from the MSME sector in India discussed growth prospects and factors affecting it for the MSME sector in the country. "The big challenge for the MSMEs is to build a brand. There is a need for proper branding of the products to win consumer confidence over other established multinational corporation (MNC) brands" said JS Juneja, Chairman - SME Taskforce, All India Management Association.

IRDA

Fraud-detection in health, general insurance to be more stringent: The health and general insurance segments could be largely 'fraud-free' soon. Taking cue from the practices in Europe and the US, the Authority is now working on developing a 'predictive statistical model' to prevent frauds in the general insurance industry. "In view of the large number of claims in the health and general insurance segments, there is a tendency of fraudulent behaviour by various stakeholders." a top IRDA official told. While no official data are available on the quantum of fraud, both regulatory and industry experts believe that it could be about 10 per cent of the health and general insurance markets. Globally, general insurance and motor insurance are more prone to frauds than other segments of insurance business," he said. The IRDA intends to enter into partnerships with a organisation to report on the industry-wide trends of fraudulent behaviour affecting the insurance industry. It had already called for a tender asking the interested firm to respond before May 20, 2011.

TAXATION

AAR upholds nil tax position for contribution of shares of a listed Indian company: The Authority for Advance Rulings (AAR), has in its latest ruling, held that contribution of shares of an Indian listed company without any consideration was not chargeable to tax in the hands of the transferor as capital gains or in the hands of the transferee as income from other sources. This is the first ruling on tax implications arising from transfer of shares without consideration in hands of transferee under the newly introduced clause (viia) of sub-section (2) of section 56 of Income-tax Act, 1961

Contact: contact@chokshiandchokshi.com