IMPORTANT GUIDELINES ON PARA-BANKING ACTIVITIES*

1. GUIDELINES

- Banks can undertake certain eligible financial services or Para-banking activities either departmentally or by setting up subsidiaries for undertaking the types of business which a banking company is otherwise permitted to undertake, with the prior approval of RBI.

- that investment by a banking company in a subsidiary company, financial services company, financial institution, stock and other exchanges should not exceed 10% of the bank's paid-up share capital and reserves and the investments in all such companies, financial institutions, stock and other exchanges put together should not exceed 20% of the bank's paid-up share capital and reserves (Sec. 19 (2) of B.R. Act 1949).

Banks can undertake either forming subsidiary company or departmentally, the said services/activities as under:-

1) **Equipment leasing, Hire purchase business and Factoring services through subsidiaries**

   Prior approval of RBI is to be obtained.

2) **Equipment leasing, Hire purchase and Factoring services as departmental activities**:

   No prior approval of RBI is necessary for undertaking the activities, but, has to report to RBI about the nature of the activities along with names of the branches from where these activities are taken up. Banks are required to comply with the prudential guidelines as under:-

   a) **Availability of Skilled personnel and adequate infrastructure.**
   b) **The activities are to be treated on par with loans and advances and accordingly be given the risk weight of 100% for calculation of risk asset.**
   c) **Applicability of IRAC norms.**
   d) **Compliance of Exposure Norms (15>20% of capital funds for single borrower>infrastructure and 40>50% of capital funds for borrower group>infrastructure).**
   e) **Maintenance of balanced portfolio and exposure should not exceed 10% of total advances.**
   f) **Banks should not enter into leasing agreement with equipment leasing companies and other non-banking finance companies engaged in equipment leasing, etc.**
3) **Primary Dealership (PD) Business:**

Banks and banks fulfilling the following minimum eligibility criteria are required to apply to RBI for approval for undertaking the PD business.

**Eligibility criteria**

a) Banks which do not have at present a partly or wholly owned subsidiary and fulfill the following criteria viz.
   i) Minimum Net Owned Funds of Rs. 1000 cr.
   ii) Minimum CRAR of 9 percent
b) Net NPAs of less than 3% and a profit making record for the last three years. Banks undertaking PD business through a partly or wholly owned subsidiary and proposing to undertake the business departmentally by merging/taking over the business from the entities have to fulfill the above criteria.

c) Foreign banks operating in India proposing to undertake the business departmentally by merging the business being undertaken by group companies are also required to fulfill the above criteria.

**Prudential Norms**

a) Usual capital adequacy requirement/risk management guidelines to apply. Banks are required to put in place adequate risk management systems to measure the risk emanating from the business.
   b) Government Dated Securities and Treasury Bills under PD business will count for SLR provided they are notified by RBI as SLR securities
   c) The classification, valuation, and operation of investment portfolio guidelines as applicable to banks in regard to “Held for Trading” portfolio will also apply to the portfolio of Government Dated Securities and Treasury Bills earmarked for PD business.
   d) The banks are required to maintain separate SGL accounts for their subsidiaries and also to develop proper MIS in this regard.

4) **Mutual Fund Business:**

- Prior approval of the RBI should be obtained by banks before undertaking mutual fund business. Bank-sponsored mutual funds should not use the name of the sponsoring bank as part of their name. Banks may enter into agreements with mutual funds for marketing the mutual fund units. Banks can act only as an agent of the customers.
- The purchase of units should be at the customers’ risk and without the bank guaranteeing any assured return. Banks should not acquire units of Mutual Funds from the secondary market. Banks are not required to buy back units of Mutual Funds from their customers. Any credit facility to individuals against the security
of units of Mutual Funds is to be considered as per the RBI guidelines on advances against such securities, etc.

- The sponsor bank is required to maintain an "arms length" relationship from the subsidiary/mutual fund sponsored by it in regard to various business parameters. 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 may evolve suitable strategies in this regard.

5) **Smart/Debit Card business:**

Banks can introduce smart/on-line debit cards with the approval of their Boards. In the case of debit cards, where authorization and settlement are off-line or where either authorization or settlement is off-line, Banks with net worth of Rs.100 crore and above are only eligible to undertake issue of off-line debit cards. Detailed guidelines on issuance of smart/debit cards are given in RBI Master Circular by way of annexure.

6) **Money Market Mutual Funds (MMMF):**

Banks desirous of setting up MMMFs are required to obtain clearance from RBI and thereafter required to obtain registration from SEBI as the business would come under the purview of SEBI.

7) **Cheque Writing Facility for Investors of 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 various safeguards listed out in the RBI M. Circular.

8) **Insurance Business:**

Insurance business is considered as a permissible form of business that banks can undertake under Sec. 6(1)(o) of B.R. Act 1949 as per GOI Notification dt. 03.08.2000. Prior approval of RBI is to be obtained in this regard. Insurance business is not permitted to be undertaken departmentally.

SCBs and its subsidiaries are permitted to undertake insurance business as agent of insurance companies on fee basis, without any risk participation. Banks can also set up Joint Venture Company with a maximum equity base of 50% for undertaking the business with risk participation subject to safeguards. The eligibility criteria for joint venture participant are as under:

1. Minimum net worth should be Rs. 500 crore.
2. The level of NPA should be reasonable.
3. Made net profit for the last three consecutive years.
iv) The track record of the performance of the subsidiaries, if any, of the concerned bank should be satisfactory.

- In cases where a foreign partner contributes 26 per cent of the equity with the approval of IRDA/FIPB, more than one public sector bank or private sector bank may be allowed to participate in the equity of the insurance joint venture.
- A subsidiary of a bank or of another bank will not normally be allowed to join the insurance company on risk participation basis.
- Banks which are not eligible as joint venture participant as above, can make investments up to 10% of their net worth or Rs.50 crore, whichever is lower, in the insurance company for providing infrastructure and services support without any contingent liability for the bank.

Insurance agency business/ referral arrangement

Banks are not required to obtain approval of RBI got engaging in insurance agency business or referral fee arrangement without any risk participation subject to compliance of certain conditions.

- Compliance of IRDA regulations for acting as ‘composite corporate agent’ or referral arrangement with insurance companies
- Not to 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.
- Banks are required to enter into an agreement with the insurance company concerned for a minimum period of 3 years at first instance for allowing use of its premises and making use of the existing infrastructure of the bank.
- 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.
- The risks, if any, involved in insurance agency/referral arrangement should not get transferred to the business of the bank, etc.

9. Pension Fund Management (PFM) by banks

‘Pension Fund Manager’ is considered as a form of lawful business that banks can undertake under Sec. 6(1)(o) of B.R. Act 1949 as per GOI Notification dt.24.05.2007. Prior approval of RBI is to be obtained in this regard. Banks can undertake PFM business through their subsidiaries set up for the purpose. PFM business is not permitted to be undertaken departmentally.

Eligibility criteria
a) Minimum net worth of the bank should be Rs.500 crore.
b) CRAR should be not less than 11% during the last three years.
c) Made net profit for the last three consecutive years
d) Return on Assets (ROA) should be at least 0.6% or more.
e) Level of net NPA should be less than 3%.
f) Performance of subsidiaries, if any, should be satisfactory.
g) Management of investment portfolio is good as per AFI Report.

Banks fulfilling the above eligibility criteria as also the criteria prescribed by PFRDA for Pension Fund Managers will be permitted to set up subsidiaries for pension fund management subject to the some conditions as listed out in the RBI Circular.

10. Underwriting of Corporate Shares and Debentures

Banks have to comply with the statutory provisions (B.R. Act 1949) as also the ceilings fixed for exposure to capital market while undertaking the business. Exposure limits to single and group should also be adhered to. Banks should not underwrite issue of Commercial Paper by any Company or Primary Dealer, etc.

11. Underwriting Bonds of Public Sector Undertakings

Banks are required to frame their internal guidelines approved by their on investments in and underwriting of PSU bonds, including norms to ensure that excessive investment in any single PSU is avoided.

11. ‘Safety Net’ Schemes

- Certain banks/subsidiaries provide buy-back facilities in respect of certain public issues at any time during a stipulated period at a price determined at the time of issue irrespective of the prevailing market price, being part of their merchant banking activities.

- There is no income commensurate with the risk of loss built into these schemes. 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. In view of these, Banks/their subsidiaries have been advised that they should refrain from offering such ‘Safety Net’ facilities by whatever name called.

OTHER GUIDELINES

a) RBI grants permission to banks for undertaking non-discretionary Investment Advisory Services on a case-to-case basis.
b) Banks have been permitted to offer discretionary Portfolio Management Services through their subsidiaries subject to certain conditions.
c) Banks are required, being increase in transparency, to disclose in the ‘Notes to Accounts’ the details of fees/remuneration received in respect of the bancassurance business undertaken by them from the year ending 31.03.2010.

(*SOURCE: RBI MASTER CIRCULAR)

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