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Changing Regulatory Landscape

Newsletter
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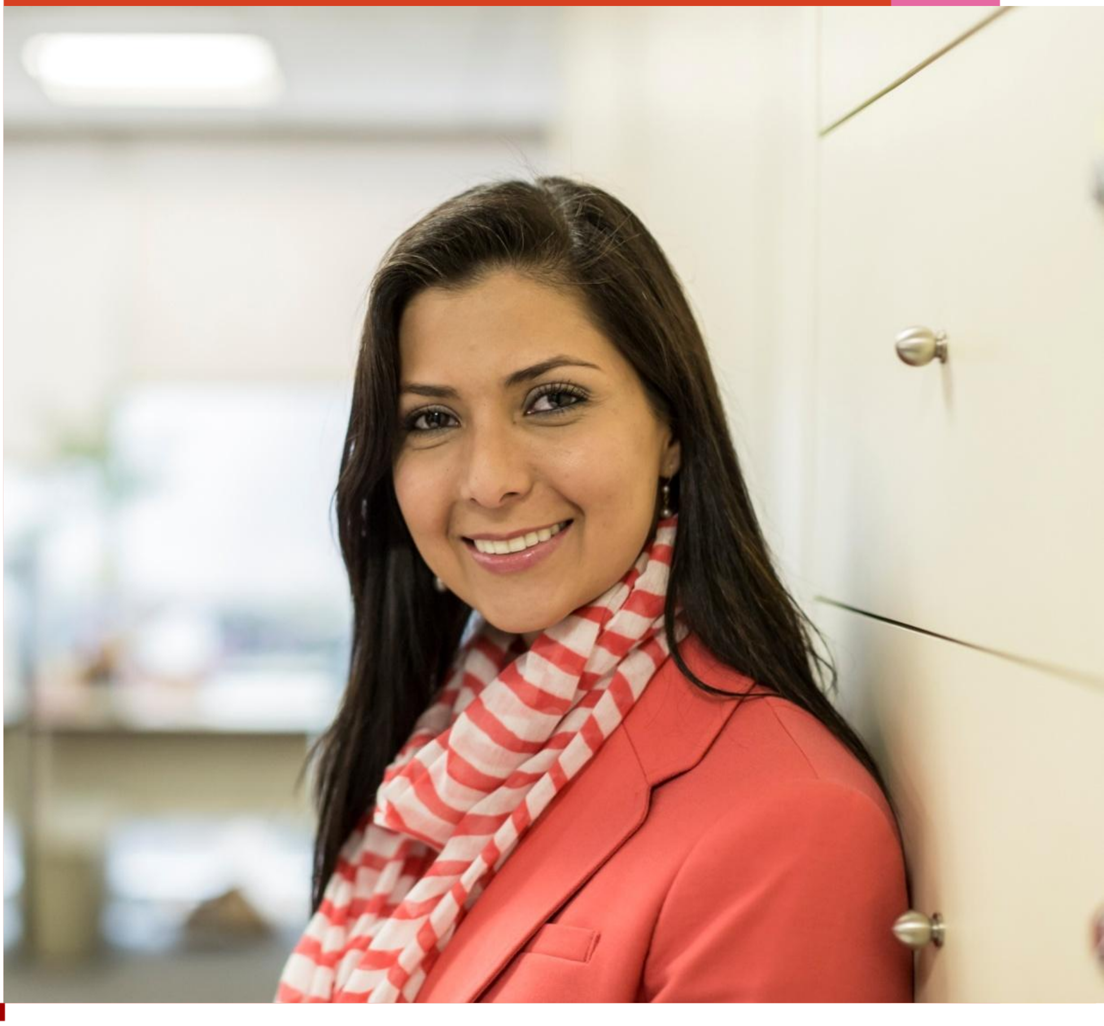

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In this Issue

Sectoral regulations

Financial services

RBI relaxes collateral rules for foreign investors

- The RBI, in consultation with the SEBI, has relaxed collateral rules for FIIs vide circular no 90 dated 14 March 2013.

- FIIs are now permitted to use their investments in corporate bonds as collateral in the cash segment and government securities, and corporate bonds as collaterals in the F&O segment, in addition to the already permitted collaterals.

- Henceforth, FIIs will be eligible to offer government securities or corporate bonds (acquired by FIIs in accordance with provisions of schedule 5 to notification no FEMA 20 dated 3 May 2000), cash and foreign sovereign securities with AAA ratings in both cash and F&O segments.

SEBI's operational guidelines for revised collateral rules for FIIs

- Further to the RBI circular dated 14 March 2013, the SEBI has issued (vide circular dated 20 March 2013) operational guidelines for offering corporate bonds and government securities as collateral in the future and options segment. The SEBI has directed clearing corporations to ensure the following before accepting such securities as collateral:

  - Bonds to have a rating of AA or above by recognised credit rating agencies
  - Bonds to be in dematerialised form
  - Bonds to be treated as part of the non-cash component of the liquid assets of the clearing member and shall not exceed 10% of the total liquid assets of the clearing member
  - Bonds to have a fixed percentage based or VaR based haircut

Note: A higher haircut may be considered to cover the expected time frame for liquidation. To begin with the haircut shall be a minimum of 10%.

Telecommunication

No roaming charges across nation

The TRAI has issued a consultation paper to review the tariff applicable on national roaming in India. Under this consultation paper, the TRAI has proposed new norms wherein no roaming charges would be applicable even though the subscriber will avail of roaming services. The term proposed for not charging roaming has been defined as the 'Home Price Rule' in the consultation paper.

To rationalise roaming charges, the consultation paper proposes to modify certain charges including interconnect usage charges i.e. the charge to be paid by the operator of the customer to the operator of the area where the customer is roaming. The TRAI has sought comments on the following issues under the consultation paper:

- Tariff on video calls and outgoing SMS
- Impact of such change on fair competition in the telecom sector
- Appropriateness of rationalising the tariff based of the present costs

Recommendations or suggestions on the issues specified in consultation paper have been sought from the stakeholders till 5 April 2013

Dated: 25 Feb 2013

Aerospace

Guidelines for FDI in the civil aviation sector

The DGCA recently released guidelines for FDI. According to the guidelines, regulators will continue with 49% foreign investment limit in the aviation sector, which includes both FDI and foreign institutional investor (FII) investments. FDI policy in the civil aviation sector will be subject to the Aircraft Act and Aircraft rules.

Key highlights of the guidelines are as follows:-

Scheduled air transport service or domestic scheduled passenger airline

- Positions of the CEO, CFO and COO, if held by foreign nationals, required to be security vetted by the MHA.
- Applicants need to furnish detailed information regarding the shareholding of any airline in the foreign investing institution, if any, and composition of the board of directors and senior management.
- The representation of foreign investing institution or entity including foreign airlines on the board of directors of the company seeking to hold equity in the scheduled air transport service or domestic scheduled passenger airlines shall not exceed one-third of the total number of board of directors.
- The scheduled air transport service or domestic scheduled passenger airline, other than those having FDI by foreign airlines, shall not enter into agreement with a foreign airline, which may give such foreign airline, the right to interfere in the management of the domestic operator.

Non-scheduled air transport service or non-scheduled airlines or chartered airlines

- Majority of the board of directors shall be Indian citizens.

- Positions of the chairman, managing director, CEO, CFO and COO, if held by foreign nationals, required to be security vetted by the MHA.

- Applicants required to furnish detailed information regarding the shareholding of any airline in the foreign investing institution, if any, and composition of the board of directors and senior management.

- Non-scheduled air transport service or non-scheduled airlines, chartered airlines, other than those having FDI by foreign airlines, shall not enter into an agreement with a foreign airline which may give such foreign airline the right to interfere in the management of the domestic operator.

Cargo airlines (scheduled and non-scheduled), helicopter services or sea plane services

- Majority of the board of directors shall be Indian citizens.

- Positions of the chairman, managing director, CEO, CFO and COO, if held by foreign nationals, required to be security vetted by the MHA.

- Applicants required to furnish detailed information regarding the shareholding of any airline in the foreign investing institution, if any, and composition of the board of directors and senior management.

Maintenance and repair organisations, flying training institutes, and technical training institutes

- The foreign company shall have the option of being as an incorporated entity by incorporating a company under the Companies Act, 1956.

- An applicant will need approval by the DGCA subject to the fulfillment of the guidelines issued in this respect.

Corporate regulations

ECB Policy - Corporates under investigation

In 2009, the RBI prohibited corporates under investigation by any law enforcing agencies such as the Directorate of Enforcement, etc. from accessing the ECB under the automatic route.

The RBI has reviewed these norms and now permitted all entities to avail of ECBs under the automatic route, notwithstanding the pending investigations, adjudications, appeals by the law enforcing agencies, without prejudice to the outcome of such investigations, adjudications or appeals.

The AD bank or the RBI needs to intimate the concerned agencies of such entity availing the ECB by endorsing a copy of the approval letter.

AP (DIR Series) Circular no. 87 dated 5 March 2013

Export of goods and services - Write-off unrealised export dues

The RBI has amended the existing policy on write off un-realised export proceeds. The same is set out below:

- By an exporter (Other than Status Holder Exporter) - up to 5% of **the total export proceeds realized** during the previous calendar year
- By Status Holder Exporters - up to 10% of the **total export proceeds realized** during the previous calendar year
- 'Write-off" by Authorized Dealer bank - up to 10% of **the total export proceeds realized** during the previous calendar year.

Conditions to be fulfilled

- The relevant amount has remained outstanding for more than one year.

  As per the earlier policy, self write-off could be done only for the amount, which has remained outstanding for the period prescribed for realisation of export dues i.e. 12 months from the date of export.

- The benefit of self write-off can now be availed subject to the fulfilment of various conditions establishing the bonafides of the transaction and production of a chartered accountant's certificate giving required details. This requirement was earlier applicable only in the case of write off which required the AD bank approval.

- The CA certificate is now required to certify export proceeds realised during the **preceding calendar year** as compared to the previous **three financial years** with respect to write- off with AD bank's approval

Source: AP (DIR Series) circular no 88 dated 12 March 2013

Perspective

Banking in India has drawn upon influences from across the world. The RBI, established in 1934,- is responsible for managing foreign exchange flows in and out of India, issues government debt and sets policy interest rates. Above all, the RBI is a bankers' bank and plays the role of a regulator for all banks in India.

However, since nationalisation of the 14 largest commercial banks with effect from the midnight of 19 July 1969 followed by the nationalisation of six more commercial banks in 1980, the process of liberalisation was initiated in the 90s and the new generation private sector banks such as the Global Trust Bank, the Oriental Bank of Commerce, ICICI Bank and HDFC Bank were granted licence under the Banking Regulation Act, 1949 (Banking Act). As per provisions of the Banking Act, banks desirous of establishing their presence in India are required to seek a licence under section 22 of the Banking Act. Section 5 of the Act defines the term banking company to include any company which transacts in the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise.

Since 2002, despite the mechanism for grant of licences mentioned under the Banking Act, no new licences have been granted (Yes Bank was the last to receive a banking licence). With an objective to increase the density of banks, especially in the rural areas, thereby achieving the government's objective of financial inclusion, the RBI has released the 'Guidelines for Licensing of New Banks in the Private Sector' (Guidelines) on 22 February 2013 inviting participants to apply for a licence on or before 1 July 2013.

The structure for investments as prescribed under the Guidelines mandates companies desirous of setting up a bank to establish a NOFHC which is wholly-owned by the promoter or promoter group (as defined). To bring NBFCs into the banking net, the Guidelines have listed existing NBFCs as eligible promoters for setting up banking companies in India. NOFHCs will be treated as a separate class of NBFCs and detailed guidelines are to be issued by the RBI.

The NOFHC would, through a JV, subsidiary or associate carry on specialised activities such as insurance, mutual fund, stock broking, infrastructure debt fund, etc. These entities would, in turn, be regulated by the sector-specific regulators.

A banking company would need to be set up with a minimum capitalisation of 5 billion INR (40% of which to would be locked in for five years). The Guidelines also mandate a requirement to reduce promoter holding in a phased manner to 15% of the total paid-up share capital within 12 years with all banks to go public within a period of three years. Additionally, the bank and NOFHC are required to maintain a minimum capital adequacy ratio of 13% for at least three years.

To ensure ownership and control by Indian promoters, the level of foreign investment has been restricted to 49% of the total paid up share capital for the first five years of the bank which may subsequently be enhanced to the sectoral cap of 74%. Also, for the first five years, no non-resident (i.e. an FII, NRI, QFI or foreign body corporate), is allowed to either directly or indirectly hold more than 5% of 'voting equity'. Interestingly, guidelines use the term 'voting equity' and not 'equity' per se. With the SEBI contemplating listing of NCRPS, which may be treated at par with NCDs upon adequate amendments by the RBI; investments through NCRPS may be allowed in the future.

Basic prudential norms, such as basel II/III norms applicable to other banks would also be applicable to NOFHCs. Additionally, the prudential norms would be applicable to both on consolidated and individual basis; i.e. on the NOHFC as a whole and each subsidiary under the NOHFC. These norms include a cap on leverage (1.25 times it's paid-up capital and free reserves) and transfer of 25% of profits to reserves, each year at the NOHFC level.

Other than the regulatory framework, the RBI has mandated that at least 25% of new branches in unbanked rural areas with a population of less than 9,999 as per the latest census to ensure penetration of new banks in the rural landscape to ensure, among other things, better implementation of subsidy schemes such as the Direct Cash Transfer Sscheme of the central government

Some of the other key conditions are as follows:

- Greater than 5% holding in the bank subject to approval by the RBI
- Arms length relation with the promoter group
- Greater than 10% holding in the bank other than by the NOFHC forbidden, directly or indirectly
- RBI approval required for raising voting equity capital beyond 10 billion INR for every block of five billion INR (if greater than 40% of promoter group income or assets from non-financial business)
- NBFC conversion or setting up bank, permission to convert existing branches of NBFC to be granted only in Tier 2 to Tier 6 cities (Tier 1 conversion subject to the RBI approval)

The new banking regulations intend to increase access to funds and subsidy to the common Indian, much the same way the Italian banks funded the European Renaissance.

- (Vandana Sagar and Mayank Arora, Regulatory Services)

Glossary

Act	Companies Act, 1956
AAC	Annual activity certificate
AGM	Annual general meeting
AGR	Adjusted gross revenue
AMC	Asset management company
ARCs	Asset reconstruction companies
BCP	Business continuity plans
BoA	Board of approvals
CBDT	Central Board of Direct Taxes
CCI	Competition Commission of India
CEO	Chief Executive Officer
CFO	Chief Financial Officer
COO	Chief Operating Officer
CME	Capital market exposures
CMTS	Cellular mobile telephone service
CoR	Certificate of registration
CRE	Commercial real estate exposures
DC	Development Commissioner
DDA	Diamond dollar account
DGIT	Director General of Income Tax
DGCA	Directorate General of Civil Aviation
DoC	Department of commerce
DoT	Department of telecom
DR	Disaster recovery
ECB	External commercial borrowing
EEFC	Exchange earner's foreign currency accounts
EOU	Export oriented unit
EPZ	Export processing zone
FDI	Foreign direct investment
FEMA	Foreign Exchange Management Act
FII	Foreign institutional investor
FIPB	Foreign Investment Promotion Board
FY	Financial year
HFCs	Housing finance companies
IDF	Infrastructure debt funds
IDR	Indian depository receipts
IECRS	Integrated Emergency Communication and Response System
INR	Indian rupee
IT	Information technology
ITA	Income-tax Act, 1961
ITeS	Information technology enabled services
JV	Joint venture
LoA	Letter of approval
MSA	Master service agreement
MHA	Ministry of Home Affairs
NBFC-IFCs	Non-banking finance companies

NBFCs	Non-banking financial company
NHB	National housing bank
NCRPS	Non-convertible redeemable preference shares in the near future
NOF	Net owned fund
NOFHC	non-operating financial holding company
NPA	Net performing assets
OPC	One person company
PFIs	Public financial institutions
R&D	Research and development
RBI	Reserve Bank of India
RFC	Resident foreign currency
SEBI	Securities Exchange Board of India
SEZ	Special economic zone
SOW	Statement of Work
SPVs	Special purpose vehicles
SRs	Security receipts
STPI	Software technology parks of India
TRAI	Telecom Regulatory Authority of India
UASL	Unified access service licence
UL (AS)	Unified licences (access services)
USD	United States dollar
WoL	Wireless operating licence
WOS	Wholly-owned subsidiary

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