

Master Circular- Prudential norms for classification, valuation and operation of investment portfolio by banks.

DBOD No. BP. BC. 3 / 21.04.141 / 2002- 2003

July 11, 2002

**Chief Executives of all Scheduled Commercial Banks
(excluding RRBs and LABs)**

Dear Sir,

Master Circular- Prudential norms for classification, valuation and operation of investment portfolio by banks.

Please refer to the Master Circular No. DBOD. BP. BC. 23/ 21.04.141/ 2001- 2002 dated 6 September 2001 consolidating instructions/ guidelines issued to banks till 30 June 2001 on matters relating to prudential norms for classification, valuation and operation of investment portfolio by banks. The Master Circular has been suitably updated by incorporating instructions issued upto 30 June 2002 and has also been placed on the RBI web-site ([http: // www.rbi.org.in](http://www.rbi.org.in)).

This Master Circular is a compilation of all the instructions issued by RBI on the above subject, which are operational as on the date of this circular.

**Yours faithfully,
Sd/-**

(M. R. Srinivasan)
Chief General Manager-in-Charge

Encls : As above

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**MASTER CIRCULAR – PRUDENTIAL NORMS FOR CLASSIFICATION,
VALUATION AND OPERATION OF INVESTMENT PORTFOLIO BY BANKS**

1. Introduction

With the introduction of prudential norms on capital adequacy, income recognition, asset classification and provisioning requirements, the financial position of banks in India has improved in the last few years. Simultaneously, trading in the securities market has improved in terms of turnover and the range of maturities dealt with. In view of these developments and taking into consideration the evolving international practices, Reserve Bank of India has issued guidelines on classification, valuation and operation of investment portfolio by banks from time to time as detailed below :

Investment Policy

- i) Banks should frame and implement a suitable investment policy to ensure that operations in securities are conducted in accordance with sound and acceptable business practices. While framing the investment policy, the following guidelines are to be kept in view by the banks;
 - (a) No sale transactions should be put through without actually holding the security in its investment account i.e. under no circumstances, a bank should hold an oversold position in any security. However, banks successful in the auction of primary issue of **Government securities**, may, enter into contracts for sale of the allotted securities in accordance with the terms and conditions as per [Annexure I](#) .
 - (b) All the transactions put through by a bank, either on outright basis or ready forward basis and whether through the mechanism of Subsidiary General Ledger (SGL) Account or Bank Receipt (BR), should be reflected on the same day in its investment account and, accordingly, for SLR purpose wherever applicable.
 - (c) The brokerage on the deal payable to the broker, if any, (if the deal was put through with the help of a broker) should be clearly indicated on the notes/ memoranda put up to the top management seeking approval for putting through the transaction and a separate account of brokerage paid, broker-wise, should be maintained.
 - (d) For issue of BRs, the banks should adopt the format prescribed by the Indian Banks' Association (IBA) and strictly follow the guidelines prescribed by them in this regard. The banks, subject to the above, could issue BRs covering their own sale transactions only and should not issue BRs on behalf of their constituents, including brokers.
 - (e) The banks should be circumspect while acting as agents of their broker clients for carrying out transactions in securities on behalf of brokers.
 - (f) Any instance of return of SGL form from the Public Debt Office of the Reserve Bank for want of sufficient balance in the account should be immediately brought to Reserve Bank's notice with the details of the transactions.
 - (g) Banks desirous of making investment in equity shares / debentures should observe the following guidelines:
 - (i) Build up adequate expertise in equity research by establishing a dedicated equity research department, as warranted by their scale of operations ;
 - (ii) Formulate a transparent policy and procedure for investment in shares, etc., with the approval of the Board.
 - (iii) The decision in regard to direct investment in shares, convertible bonds and debentures should be taken by the Investment Committee set up by the bank's

Board. The Investment Committee should be held accountable for the investments made by the bank.

ii) With the approval of respective Boards, banks should clearly lay down the broad investment objectives to be followed while undertaking transactions in securities on their own investment account and on behalf of clients, clearly define the authority to put through deals, procedure to be followed for obtaining the sanction of the appropriate authority, procedure to be followed while putting through deals, various prudential exposure limits and the reporting system. While laying down such investment policy guidelines, banks should strictly observe Reserve Bank's detailed instructions on the following aspects :

- | | |
|--|-------------------|
| (a) Ready Forward (buy back) deals | (Paragraph 1.2.1) |
| (b) Transactions through Subsidiary General Ledger A/c | (Paragraph 1.2.2) |
| (c) Use of Bank Receipts | (Paragraph 1.2.3) |
| (d) Retailing of Government securities | (Paragraph 1.2.4) |
| (e) Internal Control System | (Paragraph 1.2.5) |
| (f) Dealings through Brokers | (Paragraph 1.2.6) |
| (g) Audit, Review and Reporting | (Paragraph 1.2.7) |
| (h) Non- SLR investments | (Paragraph 1.2.8) |

iii) A copy of the Internal Investment Policy Guidelines, duly framed by the bank with the approval of its Board, should be forwarded to the Reserve Bank (if not already done) certifying that the same is in accordance with the RBI guidelines and that, the same has been put in place.

iv) The aforesaid instructions will be applicable mutatis mutandis, to the subsidiaries and mutual funds established by banks, except where they are contrary to or inconsistent with, specific regulations of Securities and Exchange Board of India and Reserve Bank of India governing their operations.

1.2.1 Ready Forward Contracts in Government Securities.

(i) In terms of the notification No.S.O.185(E) dated 1st March 2000 issued by Reserve Bank of India under powers derived under Section 29A of the Securities Contracts (Regulation) Act (SCRA), 1956, ready forward contracts in all Government Securities put through Subsidiary General Accounts with Reserve Bank of India, in accordance with terms and conditions specified by Reserve Bank of India, were permitted.

(ii) It is advised that the terms and conditions subject to which ready forward contracts (including reverse ready forward contracts) may be entered into, are as under :

- (a) Ready forward contracts may be undertaken only in (i) Dated Securities and Treasury Bills issued by Government of India and (ii) Dated Securities issued by State Governments.
- (b) Ready forward contracts in the securities specified at (a) above may be entered into by a banking company, a co-operative bank or any person maintaining a Subsidiary General Ledger Account with Reserve Bank of India, Mumbai.
- (c) Such ready forward contracts shall be settled through the Subsidiary General Ledger Accounts of the participants with Reserve Bank of India or through the Subsidiary General Ledger Account of the Clearing Corporation of India Ltd. with Reserve Bank of India, and

- (d) No sale transaction shall be put through without actually holding the securities in the portfolio.
 - (e) Compliance with all other instructions on securities transactions in force and issued from time to time.
- (iii) These terms and conditions will be the relevant terms and conditions specified by Reserve Bank of India under the notification No.S.O.185(e) dated 1st March 2000 issued under powers derived under Section 29A of SCRA 1956.

(iv) Prohibition against buy-back arrangements

- a) Banks should not enter into buy-back arrangements with non-bank clients in respect of their holding of securities (such as in permitted Govt. and other approved securities, public sector bonds or corporate shares, debentures or units of UTI etc.). The spirit of the instructions prohibiting buy back arrangements with non-bank investors may be scrupulously observed. Outright sales and purchases transactions with the same party and for identical or similar amount will be construed as tacit arrangements violating the instructions prohibiting buy-back arrangements with non-bank clients.
- b) Financial institutions set up under Acts of Parliament or otherwise both at the all India and state level's and not undertaking banking business within the provisions of the Banking Regulations Act, 1949, are deemed as non-bank clients and bank should not enter into any buy back arrangements with them unless they are specifically permitted by the Reserve Bank of India.
- c) Banks should not undertake inter-bank ready forward deals in approved/ trustee securities unless specifically authorised.
- d) Double ready forward deals in Government securities including treasury bills are strictly prohibited.
- e) No ready forward and double ready forward deals should be put through even among banks and even on their investment accounts in other securities such as public sector undertakings bonds, units of UTI, etc.
- f) Similarly, no ready forward and double ready forward deals should be put through in any securities including Govt. securities, on behalf of other constituents including brokers.

1.2.2 Transactions through SGL account

The following instructions should be followed by banks for purchase/ sale of securities through SGL A/c under the Delivery Versus Payment (DVP) System wherein the transfer of securities takes place simultaneously with the transfer of funds. It is, therefore, necessary for both the selling bank and the buying bank to maintain current account with the RBI. As no Overdraft facility in the current account would be extended, adequate balance in current account should be maintained by banks for effecting any purchase transaction.

- i) All transactions in Govt. securities for which SGL facility is available should be put through SGL A/cs only.

ii) Under no circumstances, a SGL transfer form issued by a bank in favour of another bank should bounce for want of sufficient balance of securities in the SGL A/c of seller or for want of sufficient balance of funds in the current a/c of the buyer.

iii) The SGL transfer form received by purchasing banks should be deposited in their SGL A/cs. immediately i.e. the date of lodgement of the SGL Form with RBI shall be within one working day after the date of signing of the Transfer Form. While in cases of OTC trades, the settlement has to be only on 'spot' delivery basis as per Section 2(i) of the Securities Contract Act, 1956, in cases of deals on the recognised Stock Exchanges, settlement should be within the delivery period as per their rules, bye laws and regulations. In all cases, participants must indicate the deal/trade/contract date in Part C of the SGL Form under 'Sale date'. Where this is not completed the SGL Form will not be accepted by the Reserve Bank of India (RBI).

iv) No sale should be effected by way of return of SGL form held by the bank.

v) SGL transfer forms should be signed by two authorised officials of the bank whose signatures should be recorded with the respective PDOs of the Reserve Bank and other banks.

vi) The SGL transfer forms should be in the standard format prescribed by the Reserve Bank and printed on semi-security paper of uniform size. They should be serially numbered and there should be a control system in place to account for each SGL form.

vii) If a SGL transfer form bounces for want of sufficient balance in the SGL A/c, the (selling) bank which has issued the form will be liable to the following penal action against it :

a) The amount of the SGL form (cost of purchase paid by the purchaser of the security) would be debited immediately to the current account of the selling bank with the Reserve Bank.

b) In the event of an overdraft arising in the current account following such a debit, penal interest would be charged by the Reserve Bank on the amount of the overdraft at a rate of 3 percentage points above the Discount and Finance House of India's (DFHI) call money lending rate on the day in question. However, if the DFHI's closing call money rate is lower than the prime lending rate of banks, as stipulated in the Reserve Bank's interest rate directive in force, the applicable penal rate to be charged will be 3 percentage points above the prime lending rate of the bank concerned, and

c) If the bouncing of the SGL form occurs thrice, the bank will be debarred from trading with the use of the SGL facility for a period of 6 months from the occurrence of the third bouncing. If, after restoration of the facility, any SGL form of the concerned bank bounces again, the bank will be permanently debarred from the use of the SGL facility in all the PDOs of the Reserve Bank.

d) The bouncing on account of insufficient balance in the current account of the buying bank would be reckoned (against the buying bank concerned) for the purpose of debarment from the use of SGL facility on par with the bouncing on account of insufficient balance in SGL a/c. of the selling bank (against selling bank). Instances of bouncing in both the accounts (i.e SGL a/c and current a/c) will be reckoned together against the SGL account holder concerned for the purpose of debarment (i.e three in a half-year for temporary suspension and any bouncing after restoration of SGL facility, for permanent debarment.)

1.2.3 Use of Bank Receipt (BR)

- i) The banks should follow the following instructions for issue of BRs :
 - (a) No BR should be issued under any circumstances in respect of transactions in Govt. securities for which SGL facility is available.
 - (b) Even in the case of other securities, BR may be issued for ready transactions only, under the following circumstances:
 - i. The scrips are yet to be issued by the issuer and the bank is holding the allotment advice.
 - ii. The security is physically held at a different centre and the bank is in a position to physically transfer the security and give delivery thereof within a short period.
 - iii. The security has been lodged for transfer / interest payment and the bank is holding necessary records of such lodgements and will be in a position to give physical delivery of the security within a short period.
 - (c) No BR should be issued on the basis of a BR (of another bank) held by the bank and no transaction should take place on the basis of a mere exchange of BRs held by the bank.
 - (d) BRs could be issued covering transactions relating to banks' own Investments Accounts only, and no BR should be issued by banks covering transactions relating to either the Accounts of Portfolio Management Scheme (PMS) Clients or Other Constituents' Accounts, including brokers.
 - (e) No BR should remain outstanding for more than 15 days.
 - (f) A BR should be redeemed only by actual delivery of scrips and not by cancellation of the transaction/set off against another transaction. If a BR is not redeemed by delivery of scrips within the validity period of 15 days, the BR should be deemed as dishonoured and the bank which has issued the BR should refer the case to the RBI, explaining the reasons under which the scrips could not be delivered within the stipulated period and the proposed manner of settlement of the transaction.
 - (g) BRs should be issued on semi-security paper, in the standard format (prescribed by IBA), serially numbered and signed by two authorised officials of the bank, whose signatures are recorded with other banks. As in the case of SGL forms, there should be a control system in place to account for each BR form.
 - (h) Separate registers of BRs issued and BRs received should be maintained and arrangements should be put in place to ensure that these are systematically followed up and liquidated within the stipulated time limit.
 - (i) The banks should also have a proper system for the custody of unused B.R. Forms and their utilisation. The existence and operations of these controls at the concerned offices/ departments of the bank should be reviewed, among others, by the statutory auditors and a certificate to this effect may be forwarded every year to the Regional Office of DBS, under whose jurisdiction the Head Office of the bank is located.
 - (j) Any violation of the instructions relating to BRs would invite penal action, which could include raising of reserve requirements, withdrawals of refinance facility from the Reserve Bank and denial of access to money markets. The Reserve Bank may also levy such other

penalty as it may deem fit in accordance with the provisions of the Banking Regulation Act, 1949.

1.2.4 Retailing of Government Securities

The banks may undertake retailing of Government securities with non-bank clients subject to the following conditions :

- i) Such retailing should be on **outright** basis and there is no restriction on the period between sale and purchase.
- ii) The retailing of Government securities should be on the basis of ongoing market rates/ yield curve emerging out of secondary market transactions.
- iii) No sale of Government securities should be effected by banks unless they hold the securities in their portfolio either in the form of physical scrips or in the SGL Account maintained with the Reserve Bank of India.
- iv) Immediately on sale, the corresponding amount should be deducted by the bank from its investment account and from its SLR assets.
- v) Banks should put in place adequate internal control checks/ mechanisms as indicated in paragraph 1.2.5.
- vi) These transactions should be subjected to concurrent audit by internal auditors/ external auditors and results of their audit should be placed before the CMD of the bank every month. These audit reports are also to be submitted to a separately constituted Cell on supervision of funds management operations in banks in RBI.

1.2.5 Internal Control System

i) The banks should observe the following guidelines for internal control system in respect of investment transactions :

(a) There should be a clear functional separation of (i) trading, (ii) settlement, monitoring and control and (iii) accounting. Similarly, there should be a functional separation of trading and back office functions relating to banks' own Investment Accounts, Portfolio Management Scheme (PMS) Clients' Accounts and other Constituents (including brokers') accounts. The Portfolio Management service may be provided to clients, subject to strictly following the guidelines in regard thereto (covered in paragraph 1.3.3). Further, PMS Clients Accounts should be subjected to a separate audit by external auditors.

(b) For every transaction entered into, the trading desk should prepare a deal slip which should contain data relating to nature of the deal, name of the counter-party, whether it is a direct deal or through a broker, and if through a broker, name of the broker, details of security, amount, price, contract date and time. The deal slips should be serially numbered and controlled separately to ensure that each deal slip has been properly accounted for. Once the deal is concluded, the dealer should immediately pass on the deal slip to the back office for recording and processing. For each deal there must be a system of issue of confirmation to the counterparty. The timely receipt of requisite written confirmation from the counterparty, which must include all essential details of the contract, should be monitored by the back office.

(c) Once a deal has been concluded, there should not be any substitution of the counter party bank by another bank by the broker, through whom the deal has been

entered into; likewise, the security sold/purchased in the deal should not be substituted by another security.

(d) On the basis of vouchers passed by the back office (which should be done after verification of actual contract notes received from the broker/ counterparty and confirmation of the deal by the counterparty), the Accounts Section should independently write the books of account.

(e) In the case of transaction relating to PMS Clients' Accounts (including brokers), all the the relative records should give a clear indication that the transaction belongs to PMS Clients/ other constituents and does not belong to bank's own Investment Account and the bank is acting only in its fiduciary/ agency capacity.

(f) (i) Records of SGL transfer forms issued/ received, should be maintained.

(ii) Balances as per bank's books should be reconciled at quarterly intervals with the balances in the books of PDOs. If the number of transactions so warrant, the reconciliation should be undertaken more frequently, say on a monthly basis. This reconciliation should be periodically checked by the internal audit department.

(iii) Any bouncing of SGL transfer forms issued by selling banks in favour of the buying bank, should immediately be brought to the notice of the Regional Office of Department of Banking Supervision of RBI by the buying bank.

(iv) A record of BRs issued/ received should be maintained.

(v) A system for verification of the authenticity of the BRs and SGL transfer forms received from the other banks and confirmation of authorised signatories should be put in place.

(g) Banks should put in place a reporting system to report to the top management, on a weekly basis, the details of transactions in securities, details of bouncing of SGL transfer forms issued by other banks and BRs outstanding for more than one month and a review of investment transactions undertaken during the period.

(h) Banks should not draw cheques on their account with the Reserve Bank for third party transactions, including inter-bank transactions. For such transactions, bankers' cheques/ pay orders should be issued.

(i) In case of investment in shares, the surveillance and monitoring of investment should be done by the Audit Committee of the Board, which shall review in each of its meetings, the total exposure of the bank to capital market both fund based and non-fund based, in different forms as stated above and ensure that the guidelines issued by RBI are complied with and adequate risk management and internal control systems are in place;

(j) The Audit Committee should keep the Board informed about the overall exposure to capital market, the compliance with the RBI and Board guidelines, adequacy of risk management and internal control systems;

(k) In order to avoid any possible conflict of interest, it should be ensured that the stockbrokers as directors on the Boards of banks or in any other capacity, do not involve themselves in any manner with the Investment Committee or in the decisions in regard to making investments in shares, etc., or advances against shares.

(l) The internal audit department should audit the transactions in securities on an on going basis, monitor the compliance with the laid down management policies and prescribed procedures and report the deficiencies directly to the management of the bank.

(m) The banks' managements should ensure that there are adequate internal control and audit procedures for ensuring proper compliance of the instructions in regard to the conduct of the investment portfolio. The banks should institute a regular system of monitoring compliance with the prudential and other guidelines issued by the RBI. The banks should get compliance in key areas certified by their statutory auditors and furnish such audit certificate to the Regional Office of Department of Banking Supervision of RBI under whose jurisdiction the HO of the bank falls.

1.2.6 Engagement of brokers

i) For engagement of brokers to deal in investment transactions, the banks should observe the following guidelines:

(a) Transactions between one bank and another bank should not be put through the brokers' accounts. The brokerage on the deal payable to the broker, if any (if the deal was put through with the help of a broker), should be clearly indicated on the notes/memorandum put up to the top management seeking approval for putting through the transaction and separate account of brokerage paid, broker-wise, should be maintained.

(b) If a deal is put through with the help of a broker, the role of the broker should be restricted to that of bringing the two parties to the deal together.

(c) While negotiating the deal, the broker is not obliged to disclose the identity of the counterparty to the deal. On conclusion of the deal, he should disclose the counterparty and his contract note should clearly indicate the name of the counterparty.

(d) On the basis of the contract note disclosing the name of the counterparty, settlement of deals between banks, viz. both fund settlement and delivery of security, should be directly between the banks and the broker should have no role to play in the process.

(e) With the approval of their top managements, banks should prepare a panel of approved brokers which should be reviewed annually, or more often if so warranted. Clear-cut criteria should be laid down for empanelment of brokers, including verification of their creditworthiness, market reputation, etc. A record of broker-wise details of deals put through and brokerage paid, should be maintained.

(f) A disproportionate part of the business should not be transacted through only one or a few brokers. Banks should fix aggregate contract limits for each of the approved brokers. A limit of 5% of total transactions (both purchase and sales) entered into by a bank during a year should be treated as the aggregate upper contract limit for each of the approved brokers. This limit should cover both the business initiated by a bank and the business offered/ brought to the bank by a broker. Banks should ensure that the transactions entered into through individual brokers during a year normally did not exceed this limit. However, if for any reason it becomes necessary to exceed the aggregate limit for any broker, the specific reasons therefor should be recorded, in writing, by the authority empowered to put through the deals. Further, the board should be informed of this, post facto. However, the norm of 5% would not be applicable to banks' dealings through Primary Dealers.

(g) The concurrent auditors who audit the treasury operations should scrutinise the business done through brokers also and include it in their monthly report to the Chief

Executive Officer of the bank. Besides, the business put through any individual broker or brokers in excess of the limit, with the reasons therefor, should be covered in the half-yearly review to the Board of Directors/ Local Advisory Board. These instructions also apply to subsidiaries and mutual funds of the banks.

Explanation : Certain clarifications on the instructions are furnished in the [Annexure III](#).

- ii) Inter-bank securities transactions should be undertaken directly between banks and no bank should engage the services of any broker in such transactions.

Exceptions:

Note (i)

Banks may undertake securities transactions among themselves or with non bank clients through members of the National Stock Exchange (NSE), OTC Exchange of India (OTCEI) and the Stock Exchange, Mumbai(BSE). If such transactions are not undertaken on the NSE, OTCEI or BSE, the same should be undertaken by banks directly, without engaging brokers.

Note (ii)

Although the Securities Contracts (Regulation) Act, 1956 defines the term 'securities' to mean corporate shares, debentures, Govt. securities and rights or interest in securities, the term 'securities' would exclude corporate shares. The Provident/ Pension Funds and Trusts registered under the Indian Trusts Act, 1882, will be outside the purview of the expression 'non-bank clients' for the purpose of note (i) above.

1.2.7 Audit, review and reporting of investment transactions

The banks should follow the following instructions in regard to audit, review and reporting of investment transactions :

- a) Banks should undertake a half-yearly review (as of 30 September and 31 March) of their investment portfolio, which should, apart from other operational aspects of investment portfolio, clearly indicate and certify adherence to laid down internal investment policy and procedures and Reserve Bank guidelines, and put up the same before their respective Boards within a month, i.e by end-April and end-October.
- b) A copy of the review report put up to the Bank's Board, should be forwarded to the Reserve Bank (concerned Regional Office of DBS) by 15 November and 15 May respectively.
- c) In view of the possibility of abuse, treasury transactions should be separately subjected to a concurrent audit by internal auditors and the results of their audit should be placed before the CMD of the bank once every month. These audit reports should be sent to the Regional Office of Department of Banking Supervision (DBS) of the Reserve Bank under whose jurisdiction the Head Office of the bank falls.

1.2.8 Non- SLR investments

- i) Banks have made significant investment in privately placed unrated bonds and, in certain cases, in bonds issued by corporates who are not their borrowers. While assessing such investment proposals on private placement basis, in the absence of standardised and mandated disclosures, including credit rating, banks may not be in a position to conduct proper due diligence to take an investment decision. Thus, there could be deficiencies in the appraisal of privately placed issues. While it is not the intention to prohibit banks from subscribing to unrated

instruments on private placement basis, however, as such investments could cause some concern, banks should put in place appropriate systems to ensure that investment in privately placed unrated instruments is made in accordance with the systems and procedures prescribed under the respective bank's investment policy approved by the Board.

ii) Further, the risk arising from inadequate disclosure in offer documents should be recognised and banks should prescribe minimum disclosure standards as a policy with Board approval. In this connection, Reserve Bank of India had constituted a Technical Group comprising officials drawn from treasury departments of a few banks and experts on corporate finance to study, *inter-alia*, the methods of acquiring, by banks, of non-SLR investments in general and private placement route, in particular, and to suggest measures for regulating these investments. The Group had designed a format containing the minimum disclosure requirements as well as certain conditionalities regarding documentation and creation of charge for private placement issues, which may serve as a 'best practice model' for the banks. The details of the Group's recommendations are given in the [Annexure IV](#) and banks may introduce with immediate effect a suitable format of disclosure requirements on the lines of the recommendations of the Technical Group with the approval of their Board.

iii) With a view to ensuring that the investments by banks in unrated issues through private placement, both of the borrower customers and non-borrower customers, do not give rise to systemic concerns, it is necessary that banks should ensure that their investment policies duly approved by the Board of Directors are formulated after taking into account the following aspects:

- a) The Boards of banks should lay down policy and prudential limits on investments in bonds and debentures including cap on unrated issues and on private placement basis, sub limits for PSU bonds, corporate bonds, guaranteed bonds, issuer ceiling, etc.
- b) Investment proposals should be subjected to the same degree of credit risk analysis as any loan proposal. Banks should make their own internal credit analysis and rating even in respect of rated issues and should not entirely rely on the ratings of external agencies. The appraisal should be more stringent in respect of investments in instruments issued by non-borrower customers.
- c) In case of unrated issues or issues of companies who are not their borrowers, banks should have an internal system of rating. For this purpose, banks should insist on obtaining adequate information from the issuers in a suitable manner as indicated in paragraph 3 above.
- d) As a matter of prudence, banks should stipulate entry level minimum ratings/ quality standards and industry-wise, maturity-wise, duration-wise, issuer-wise etc. limits to mitigate the adverse impacts of concentration and the risk of illiquidity. The investments in unrated privately placed bonds and debentures should be well diversified.
- (e) The banks should put in place proper risk management systems for capturing and analysing the risk in respect of these investments and taking remedial measures in time. The 'rating' migration of the issuers and the consequent diminution in the portfolio quality should also be tracked at periodic intervals.

(iv) Some banks / FIs have not exercised due precaution by reference to the list of defaulters circulated / published by RBI while investing in bonds, debentures, etc., of companies. Banks

may, therefore, exercise due caution while taking any investment decision to subscribe to bonds, debentures, shares etc., and refer to the 'Defaulters List' to ensure that investments are not made in companies / entities who are defaulters to banks / FIs. Some of the companies may be undergoing adverse financial position turning their accounts to sub-standard category due to recession in their industry segment, like textiles. Despite restructuring facility provided under RBI guidelines, the banks have been reported to be reluctant to extend further finance, though considered warranted on merits of the case. Banks may not refuse proposals for such investments in companies whose director's name(s) find place in the defaulter companies list circulated by RBI at periodical intervals and particularly in respect of those loan accounts, which have been restructured under extant RBI guidelines, provided the proposal is viable and satisfies all parameters for such credit extension.

(v) Direct investment in shares, convertible bonds and debentures etc.

Banks are free to acquire shares, convertible debentures of corporates and units of equity-oriented mutual funds, subject to a ceiling of 5 per cent of the total outstanding domestic credit (excluding inter-bank lendings and advances outside India) as on March 31 of the previous year. Within the overall ceiling of 5 per cent for total exposure to capital market, the total investment in shares, convertible bonds and debentures and units of equity-oriented mutual funds by a bank should not exceed 20 per cent of its net worth. While making investment in equity shares etc., whose prices are subject to volatility, the banks should keep in view the following guidelines :

- a) The ceiling for investment in shares, etc., as stated in the above paragraph (i.e., 20 per cent of net worth), is the maximum permissible ceiling and a bank's Board of Directors is free to adopt a lower ceiling for the bank, keeping in view its overall risk profile and corporate strategy.
- b) Banks may make investment in shares directly taking into account the in-house expertise available within the bank as per the investment policy approved by the Board of Directors subject to compliance with the risk management and internal control systems indicated below.
- c) Banks may also make investment in units of UTI and SEBI - approved other diversified mutual funds with good track records as per the investment policy approved by the Board of Directors. Such investments should be in specific schemes of UTI / Mutual Funds and not by way of placement of funds with UTI / Mutual Funds for investment in the capital market on their behalf.
- d) Underwriting commitments taken up by the banks in respect of primary issues through book building route would also be within the above overall ceiling.
- e) Investment in equity shares and convertible bonds and debentures of corporate entities should as hitherto, be reckoned for the purpose of arriving at the prudential norm of single-borrower and borrower-group exposure ceilings.

General

1.3.1 Reconciliation of holdings of Govt. securities, etc.

Banks should furnish to the Reserve Bank the statement of the reconciliation of bank's investments (held in own Investment account, as also under PMS) as at the end of every accounting year duly certified by the bank's auditors. Further, the statement should reach Reserve Bank within one month from the close of the accounting year. The aforementioned requirement of reconciliation may be suitably included by banks in the letters of appointment which may be issued to the bank's external auditors, in future. The format for the statement and the instructions for compiling thereto are given in [Annexure V](#).

1.3.2 Transactions in securities - Custodial functions

While exercising the custodial functions on behalf of their merchant banking subsidiaries, these functions should be subject to the same procedures and safeguards as would be applicable to other constituents. Accordingly, full particulars should be available with the subsidiaries of banks of the manner in which the transactions have been executed. Banks should also issue suitable instructions in this regard to the department/office undertaking the custodial functions on behalf of their subsidiaries.

1.3.3 Portfolio Management on behalf of clients

i) The general powers vested in banks to operate PMS and similar schemes have been withdrawn. No bank should, therefore, restart or introduce any new PMS or similar scheme in future without obtaining specific prior approval of the Reserve Bank.

ii) The following conditions are to be strictly observed by the banks operating PMS or similar scheme with the specific prior approval of RBI:

(a) PMS should be entirely at the customer's risk, without guaranteeing, either directly or indirectly, a pre-determined return.

(b) Funds should not be accepted for portfolio management for a period less than one year.

(c) Portfolio funds should not be deployed for lending in call/ notice money, inter-bank term deposits and bills rediscounting markets and lending to/placement with corporate bodies.

(d) Banks should maintain clientwise account/record of funds accepted for management and investments made thereagainst and the portfolio clients should be entitled to get a statement of account.

(e) Bank's own investments and investments belonging to PMS clients should be kept distinct from each other, and any transactions between the bank's investment account and client's portfolio account should be strictly at market rates.

(f) There should be a clear functional separation of trading and back office functions relating to banks' own investment accounts and PMS clients' accounts.

iii) PMS clients' accounts should be subjected by banks to a separate audit by external auditors as covered in paragraph 1.6 (i) (a).

iv) Banks should note that violation of RBI's instructions will be viewed seriously and will invite deterrent action against the banks which will include raising of reserve requirements, withdrawal of facility of refinance from the Reserve Bank and denial of access to money markets, apart from prohibiting the banks from undertaking PMS activity.

v) Further, the aforesaid instructions will apply, *mutatis mutandis*, to the subsidiaries of banks except where they are contrary to specific regulations of the Reserve Bank or the Securities and Exchange Board of India, governing their operations.

vi) Banks/ merchant banking subsidiaries of banks operating PMS or similar scheme with the specific prior approval of the RBI are also required to comply with the guidelines contained in the SEBI (Portfolio Managers) Rules and Regulations, 1993 and those issued from time to time.

1.3.4 Investment Portfolio of banks - transactions in Government Securities

In the light of fraudulent transactions in the guise of Government securities transactions in physical format by a few co-operative banks with the help of some broker entities, it has been decided to accelerate the measures for further reducing the scope of trading in physical forms. These measures are as under :

- (i) For banks which do not have SGL account with RBI, only one CSGL account can be opened.
- (ii) In case the CSGL accounts are opened with a scheduled commercial bank, the account holder has to open a designated funds account (for all CSGL related transactions) with the same bank.
- (iii) The entities maintaining the CSGL / designated funds accounts will be required to ensure availability of clear funds in the designated funds accounts for purchases and of sufficient securities in the CSGL account for sales before putting through the transactions.
- (iv) No transactions by the bank should be undertaken in physical form with any broker.
- (v) Banks should ensure that brokers approved for transacting in Government securities are registered with the debt market segment of NSE/BSE/OTCEI.

2. Classification

- i) The entire investment portfolio of the banks (including SLR securities and non-SLR securities) should be classified under three categories viz. 'Held to Maturity', 'Available for Sale' and 'Held for Trading'. However, in the balance sheet, the investments will continue to be disclosed as per the existing six classifications viz. a) Government securities, b) Other approved securities, c) Shares, d) Debentures & Bonds, e) Subsidiaries/ joint ventures and f) Others (CP, Mutual Fund Units, etc.).
- ii) Banks should decide the category of the investment at the time of acquisition and the decision should be recorded on the investment proposals.

Held to Maturity

- i) The securities acquired by the banks with the intention to hold them up to maturity will be classified under ***Held to Maturity***.
- ii) The investments included under 'Held to Maturity' should not exceed 25 per cent of the bank's total investments. The banks may include, at their discretion, under 'Held to Maturity' category securities less than 25 per cent of total investment.
- iii) The following investments will be classified under 'Held to Maturity' but will not be counted for the purpose of ceiling of 25% specified for this category:
 - a) Re-capitalisation bonds received from the Government of India towards their re-capitalisation requirement and held in their investment portfolio. *This will **not** include re-capitalisation bonds of other banks acquired for investment purposes.*

- b) Investment in subsidiaries and joint ventures. *[A joint venture would be one in which the bank, along with its subsidiaries, holds more than 25% of the equity.]*
- c) The investments in debentures/ bonds, which are deemed to be in the nature of an advance.

Debentures/ bonds must be treated in the nature of an advance when:

- ? The debenture/bond is issued as part of the proposal for project finance and the tenure of the debenture is for a period of three years and above

or

The debenture/bond is issued as part of the proposal for working capital finance and the tenure of the debenture/ bond is less than a period of one year

and
- ? the bank has a significant stake i.e.10% or more in the issue

and
- ? the issue is part of a private placement, i.e. the borrower has approached the bank/FI and not part of a public issue where the bank/FI has subscribed in response to an invitation.

The debentures/ bonds deemed to be in the nature of advance will be subject to the usual prudential norms applicable to advances.

- iv) Profit on sale of investments in this category should be first taken to the Profit & Loss Account and thereafter be appropriated to the 'Capital Reserve Account'. Loss on sale will be recognised in the Profit & Loss Account.

Available for Sale & Held for Trading

- i) The securities acquired by the banks with the intention to trade by taking advantage of the short-term price/ interest rate movements will be classified under ***Held for Trading***.
- ii) The securities which do not fall within the above two categories will be classified under ***Available for Sale***
- iii) The banks will have the freedom to decide on the extent of holdings under Available for Sale and Held for Trading categories. This will be decided by them after considering various aspects such as basis of intent, trading strategies, risk management capabilities, tax planning, manpower skills, capital position.
- iv) The investments classified under Held for Trading category would be those from which the bank expects to make a gain by the movement in the interest rates/ market rates. These securities are to be sold within 90 days.
- v) Profit or loss on sale of investments in both the categories will be taken to the Profit & Loss Account.

2.3 Shifting among categories

- i) Banks may shift investments **to/from Held to Maturity** category with the approval of the Board of Directors once a year. Such shifting will normally be allowed at the beginning of the accounting year. No further shifting to/ from this category will be allowed during the remaining part of that accounting year.
- ii) Banks may shift investments **from Available for Sale** category to Held for Trading category with the approval of their Board of Directors/ ALCO/ Investment Committee. In case of exigencies, such shifting may be done with the approval of the Chief Executive of the bank/ Head of the ALCO, but should be ratified by the Board of Directors/ ALCO.
- iii) Shifting of investments **from Held for Trading** category to Available for Sale category is generally not allowed. However, it will be permitted only under exceptional circumstances like not being able to sell the security within 90 days due to tight liquidity conditions, or extreme volatility, or market becoming unidirectional. Such transfer is permitted only with the approval of the Board of Directors/ ALCO/ Investment Committee.
- iv) Transfer of scrips from one category to another, under all circumstances, should be done at the acquisition cost/ book value/ market value on the date of transfer, whichever is the least, and the depreciation, if any, on such transfer should be fully provided for.

3. Valuation

Held to Maturity

- i) Investments classified under Held to Maturity category need not be marked to market and will be carried at acquisition cost unless it is more than the face value, in which case the premium should be amortised over the period remaining to maturity.
- ii) Banks should recognise any diminution, other than temporary, in the value of their investments in subsidiaries/ joint ventures which are included under Held to Maturity category and provide therefor. Such diminution should be determined and provided for each investment individually.

Available for Sale

- i) The individual scrips in the Available for Sale category will be marked to market at the quarterly or at more frequent intervals. While the net depreciation under each classification referred to in item 2(i) above should be recognised and fully provided for, the net appreciation under each classification referred to in item 2(i) above should be ignored. The book value of the individual securities would not undergo any change after the revaluation.

[Note: Securities under this category shall be valued scrip-wise and depreciation/ appreciation shall be aggregated for each classification referred to in item 2(i) above. Net depreciation, if any, shall be provided for. Net appreciation, if any, should be ignored. Net depreciation required to be provided for in any one classification should not be reduced on account of net appreciation in any other classification.]

- ii) The provisions required to be created on account of depreciation in the Available for Sale category in any year should be debited to the Profit & Loss Account and an equivalent amount (net of tax benefit, if any, and net of consequent reduction in the transfer to Statutory Reserve) or the balance available in the Investment Fluctuation Reserve Account, whichever is less, shall be transferred from the Investment Fluctuation Reserve Account to the Profit & Loss Account. In

the event provisions created on account of depreciation in the Available for Sale category are found to be in excess of the required amount in any year, the excess should be credited to the Profit & Loss Account and an equivalent amount (net of taxes, if any, and net of transfer to Statutory Reserves as applicable to such excess provision) should be appropriated to the Investment Fluctuation Reserve Account to be utilised to meet future depreciation requirement for investments in this category. The amounts debited to the Profit & Loss Account for provision and the amount credited to the Profit & Loss Account for reversal of excess provision should be debited and credited respectively under the head “Expenditure – Provisions & Contingencies”. The amounts appropriated from the Profit & Loss Account and the amount transferred from the Investment Fluctuation Reserve to the Profit & Loss Account should be shown as ‘below the line’ items after determining the profit for the year.

Held for Trading

The individual scrips in the Held for Trading category will be marked to market at monthly or at more frequent intervals as in the case of those in the Available for Sale category. The book value of the individual securities in this category would not undergo any change after marking to market.

Investment Fluctuation Reserve

- (i) With a view to building up of adequate reserves to guard against any possible reversal of interest rate environment in future due to unexpected developments, banks are advised to build up Investment Fluctuation Reserve (IFR) of a minimum 5 per cent of the investment portfolio within a period of 5 years. IFR should be computed with reference to investments in two categories, viz., “Held for Trading” and “Available for Sale”. It will not be necessary to include investment under “Held to Maturity” category for the purpose of computation of IFR. However, banks are free to build up a higher percentage of IFR up to 10 per cent of the portfolio depending on the size and composition of their portfolio, with the approval of their Board of Directors.
- (ii) Banks should transfer maximum amount of the gains realized on sale of investment in securities to the IFR.
- (iii) The IFR, consisting of realized gains from the sale of investments from the two categories, viz., “Held for Trading” and “Available for Sale”, would be eligible for inclusion in Tier 2 capital as hitherto.
- (iv) Transfer to IFR shall be as an appropriation of net profit “below the line” after appropriation to statutory reserve.

3.5 General

3.5.1 The equity shares in the bank's portfolio should be marked to market preferably on a daily basis, but at least on a weekly basis.

3.5.2 In respect of securities included in any of the three categories where interest/ principal is in arrears, the banks should not reckon income on the securities and should also make appropriate provisions for the depreciation in the value of the investment. The banks should not set-off the depreciation requirement in respect of these non-performing securities against the appreciation in respect of other performing securities.

Market value

The 'market value' for the purpose of periodical valuation of investments included in the Available for Sale and the Held for Trading categories would be the market price of the scrip as available from the trades/ quotes on the stock exchanges, SGL account transactions, price list of RBI, prices declared by Primary Dealers Association of India (PDAI) jointly with the Fixed Income Money Market and Derivatives Association of India (FIMMDA) periodically. In respect of **unquoted securities**, the procedure as detailed below should be adopted.

Unquoted SLR securities

3.7.1 Central Government Securities

- i) The Reserve Bank of India will not announce the YTM rates for unquoted Government securities, as hitherto, for the purpose of valuation of investments by banks. The banks should value the unquoted Central Government securities on the basis of the prices/ YTM rates put out by the PDAI/ FIMMDA at periodical intervals.
- ii) The 6.00 per cent Capital Indexed Bonds may be valued at "cost" as defined in circular DBOD. NO.BC.8/12.02.001 / 97-98 dated January 22, 1998 and BC.18/12.02.001/2000-2001 dated August 16, 2000.
- iii) Treasury Bills should be valued at carrying cost.

3.7.2 State Government Securities

State Government securities will be valued applying the YTM method by marking it up by 25 basis points above the yields of the Central Government Securities of equivalent maturity put out by PDAI/ FIMMDA periodically.

3.7.3 Other 'approved' Securities

Other approved securities will be valued applying the YTM method by marking it up by 25 basis points above the yields of the Central Government Securities of equivalent maturity put out by PDAI/ FIMMDA periodically.

Unquoted Non-SLR securities

3.8.1 Debentures/ Bonds

All debentures/ bonds other than debentures/ bonds which are in the nature of advance should be valued on the YTM basis. Such debentures/ bonds may be of different companies having different ratings. These will be valued with appropriate mark-up over the YTM rates for Central Government securities as put out by PDAI/ FIMMDA periodically. The mark-up will be graded according to the ratings assigned to the debentures/ bonds by the rating agencies subject to the following:-

- (a) The rate used for the YTM for rated debentures/ bonds should be at least 50 basis points above the rate applicable to a Government of India loan of equivalent maturity.
- (b) The rate used for the YTM for unrated debentures/ bonds should not be less than the rate applicable to rated debentures/ bonds of equivalent maturity. The mark-up for the

unrated debentures/ bonds should appropriately reflect the credit risk borne by the bank.

- (c) Where interest/ principal on the debenture/ bonds is in arrears, the provision should be made for the debentures as in the case of debentures/ bonds treated as advances. The depreciation/ provision requirement towards debentures where the interest is in arrears or principal is not paid as per due date, shall not be allowed to be set-off against appreciation against other debentures/ bonds.

Where the debenture/ bonds is quoted and there have been transactions within 15 days prior to the valuation date, the value adopted should not be higher than the rate at which the transaction is recorded on the stock exchange.

3.8.2 Preference Shares

The valuation of preference shares should be on YTM basis. The preference shares will be issued by companies with different ratings. These will be valued with appropriate mark-up over the YTM rates for Central Government securities put out by the PDAI/FIMMDA periodically. The mark-up will be graded according to the ratings assigned to the preference shares by the rating agencies subject to the following:

- a) The YTM rate should not be lower than the coupon rate/ YTM for a GOI loan of equivalent maturity.
- b) The rate used for the YTM for unrated preference shares should not be less than the rate applicable to rated preference shares of equivalent maturity. The mark-up for the unrated preference shares should appropriately reflect the credit risk borne by the bank.
- c) Investments in preference shares as part of the project finance may be valued at par for a period of two years after commencement of production or five years after subscription whichever is earlier.
- d) Where investment in preference shares is as part of rehabilitation, the YTM rate should not be lower than 1.5% above the coupon rate/ YTM for GOI loan of equivalent maturity.
- e) Where preference dividends are in arrears, no credit should be taken for accrued dividends and the value determined on YTM should be discounted by at least 15% if arrears are for one year, and more if arrears are for more than one year. The depreciation/ provision requirement arrived at in the above manner in respect of non-performing shares where dividends are in arrears shall not be allowed to be set-off against appreciation on other performing preference shares.
- f) The preference share should not be valued above its redemption value.
- g) When a preference share has been traded on stock exchange within 15 days prior to the valuation date, the value should not be higher than the price at which the share was traded.

3.8.3 Equity Shares

Equity shares for which current quotations are not available or where the shares are not quoted on the stock exchanges, should be valued at break-up value (without considering 'revaluation reserves', if any) which is to be ascertained from the company's latest balance sheet (which should not be more than one year prior to the date of valuation). In case the latest balance sheet is not available the shares are to be valued at Re.1 per company.

3.8.4 Mutual Funds Units

Investment in quoted Mutual Fund Units should be valued as per Stock Exchange quotations. Investment in non-quoted Mutual Fund Units is to be valued on the basis of the latest re-purchase price declared by the Mutual Fund in respect of each particular Scheme. In case of funds with a lock-in period, where repurchase price/ market quote is not available, Units could be valued at NAV. If NAV is not available, then these could be valued at cost, till the end of the lock-in period. Wherever the re-purchase price is not available the Units could be valued at the NAV of the respective scheme.

3.8.5 Commercial Paper

Commercial paper should be valued at the carrying cost.

3.8.6 Investments in RRBs

Investment in RRBs is to be valued at Carrying Cost (i.e. book value) on consistent basis.

4. General

4.1 Income recognition

i) Banks may book income on accrual basis on securities of corporate bodies/ public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the Central Government or a State Government, provided interest is serviced regularly and as such is not in arrears.

ii) Banks may book income from dividend on shares of corporate bodies on accrual basis provided dividend on the shares has been declared by the corporate body in its Annual General Meeting and the owner's right to receive payment is established.

iii) Banks may book income from Government securities and bonds and debentures of corporate bodies on accrual basis, where interest rates on these instruments are pre-determined and provided interest is serviced regularly and is not in arrears.

iv) Banks should book income from units of mutual funds on cash basis.

4.2 Broken Period Interest

Banks should not capitalise the Broken Period Interest paid to seller as part of cost, but treat it as an item of expenditure under Profit and Loss Account in respect of investments in Government and other approved securities. It is to be noted that the above accounting treatment does not take into account taxation implications and hence the banks should comply with the requirements of Income Tax Authorities in the manner prescribed by them.

Dematerialised Holding

Banks have been advised to settle the transactions in securities as notified by Securities and Exchange Board of India (SEBI) only through depositories. Banks were also advised that after the commencement of mandatory trading in demat form, they would not be able to sell the shares of listed companies if they were held in physical form. In order to extend the demat form of holding to other instruments like bond, debentures and equities, it was decided that, with effect from October 31, 2001, banks, FIs, PDs and SDs will be permitted to make fresh investments and hold bonds and debentures, privately placed or otherwise, only in dematerialized form. Outstanding investments in scrip forms shall have to be converted into dematerialized form by June 30, 2002. As regards equity instruments, they will be permitted to be held by the above-mentioned institutions only in dematerialized form, from a date to be notified in consultation with SEBI.

ANNEXURE – I

Investment portfolio of banks – Transactions in securities – Conditions subject to which securities allotted in the auctions for primary issues can be sold

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- (i) The contract for sale can be entered into only once by the allottee bank on the basis of an authenticated allotment advice issued by Reserve Bank of India. The selling bank should make suitable noting/stamping on the allotment advice indicating the sale contract number etc., the details of which should be intimated to the buying entity. The buying entity should not enter into a contract to further resell the securities until it actually holds the securities in its investment account.
 - (ii) The contract for sale of allotted securities can be entered into by banks only with entities maintaining SGL Account with Reserve Bank of India for delivery and settlement on the next working day through the Delivery versus Payment(DVP) system.
 - (iii) The face value of securities sold should not exceed the face value of securities indicated in the allotment advice.
 - (iv) The sale deal should be entered into directly without the involvement of broker/s.
 - (v) Separate record of such sale deals should be maintained containing details such as number and date of allotment advice, description and the face value of securities allotted, the purchase consideration, the number, date of delivery and face value of securities sold, sale consideration, the date and details of actual delivery i.e. SGL Form No., etc. This record should be made available to Reserve Bank of India for verification. Banks should immediately report any cases of failure to maintain such records.
 - (vi) Such type of sale transactions of Government securities allotted in the auctions for primary issues on the same day and based on authenticated allotment advice should be subjected to concurrent audit and the relative audit report should be placed before the Executive Director or the Chairman and Managing Director of the Bank once every month. A copy thereof should also be sent to the Department of Banking Supervision, Reserve Bank of India, Central Office, Mumbai.
 - (vii) Banks will be solely responsible for any failure of the contracts due to the securities not being credited to their SGL account on account of non-payment / bouncing of cheque etc.

ANNEXURE II

The list of non-bank entities for entering into ready forward contracts

- 1) The Discount and Finance House of India Ltd.
- 2) Gilt Securities Trading Corporation Ltd.
- 3) ICICI Securities and Finance Co. Ltd.
- 4) PNB Gilts Ltd.
- 5) SBI Gilts Ltd.
- 6) Securities Trading Corporation of India Ltd.
- 7) DSP Merrill Lynch Ltd.
- 8) Kotak Mahindra Capital Company (unlimited)
- 9) Birla Global Finance Company Ltd.
- 10) Hoare Govett (India) Securities Ltd.
- 11) Dil Vikas Finance Ltd.
- 12) SREI International Securities Pvt.Ltd.
- 13) Tower Capital and Securities Pvt.Ltd.
- 14) Tata TD Waterhouse Securities Ltd.
- 15) Canbank Mutual Fund
- 16) Export Credit Guarantee Corporation of India Ltd.
- 17) Export Import Bank of India
- 18) General Insurance Corporation of India
- 19) GIC Mutual Fund
- 20) Indian Bank Mutual Fund
- 21) Industrial Credit & Investment Corporation of India Ltd.
- 22) Industrial Development Bank of India
- 23) IDBI Mutual Fund
- 24) ITC Thread Needle Mutual Fund
- 25) Life Insurance Corporation of India
- 26) National Bank for Agriculture and Rural Development
- 27) National Housing Bank
- 28) New India Assurance Company Ltd.
- 29) Oriental Insurance Company Ltd.
- 30) Reliance Capital Mutual Fund
- 31) SBI Mutual Fund
- 32) Small Industries Development Bank of India
- 33) Unit Trust of India
- 34) LIC Mutual Fund
- 35) J.M. Mutual Fund
- 36) Birla Mutual Fund
- 37) Kothari Pioneer Mutual Fund
- 38) Jardine Fleming Mutual Fund
- 39) Kotak Mahindra Mutual Fund
- 40) JP Morgan Securities India Private Ltd.
- 41) ABN AMRO Securities (India) Pvt.Ltd.
- 42) Deutsche Securities (India) Pvt.Ltd.
- 43) Industrial Investment Bank of India Ltd.
- 44) Bank of India Mutual Fund
- 45) Sun F & C Mutual Fund
- 46) Prudential ICICI Mutual Fund
- 47) Housing Development Finance Corporation Ltd.
- 48) Stock Holding Corporation of India Ltd.

- 49) SICOM Limited
- 50) Dundee Mutual Fund
- 51) Templeton Mutual Fund
- 52) IDBI Capital Market Services Ltd.
- 53) Tata Trustee Company Limited A/c Tata Mutual Fund
- 54) DSP Merrill Lynch Mutual Fund
- 55) Deposit Insurance and Credit Guarantee Corporation
- 56) Industrial Finance Corporation of India
- 57) Corpbank Securities
- 58) Zurich India Mutual Fund
- 59) Alliance Capital Mutual Fund
- 60) II&FS Mutual Fund
- 61) BoB Mutual Fund
- 62) National Securities Clearing Corporation Ltd.
- 63) National Securities Depository Ltd

ANNEXURE - III

Investment port-folio of banks-Transactions in securities-Aggregate contract limit for individual brokers - clarifications

Sr. No.	Issue Raised	Response
1.	The year should be calendar year or financial year?	Since banks close their accounts at the end of March, it may be more convenient to follow the financial year. However, the banks may follow calendar year or any other period of 12 months provided, it is consistently followed in future.
2.	Whether the limit is to be observed with reference to total transactions of the previous year as the total transactions of the current year would be known only at the end of the year?	The limit has to be observed with reference to the year under review. While operating the limit the bank should keep in view the expected turnover of the current year which may be based on turnover of the previous year and anticipated rise or fall in the volume of business in the current year.
3.	Whether to arrive at the total transactions of the year, transactions entered into directly with counter parties i.e. where no brokers are involved would also be taken into account?	Not necessary. However, if there are any direct deals with the brokers as purchasers or sellers the same would have to be included in the total transactions to arrive at the limit of transactions to be done through an individual broker.
4.	Whether in case of ready forward deals both the legs of the deals i.e. purchase as well as sale will be included to	Yes. This is, however, only theoretical as R/F transactions in Govt. securities are now prohibited except in Treasury Bills

- arrive at the volume of total and specified Govt. Securities transactions?
5. Whether central loan/state loan/treasury bills etc. purchased through direct subscriptions/auction will be included in the volume of total transactions? No, as brokers are not involved as intermediaries.
 6. It is possible that even though bank considers that a particular broker has touched the prescribed limit of 5% he may come with an offer during the remaining period of the year which the bank may find it to be to its advantage as compared to offers received from the other brokers who have not yet done business upto the prescribed limit. If the offer received is more advantageous the limit for the broker may be exceeded, the reasons therefor and approval of the competent authority/Board obtained post facto.
 7. Whether the transaction conducted on behalf of the clients would also be included in the total transactions of the year? Yes. If they are conducted through the brokers.
 8. For a bank which rarely deals through brokers and consequently the volume of business is small maintaining the brokerwise limit of 5% may mean splitting the orders in small values amongst different brokers and there may also arise price differential. There may be no need to split an order. If any deal causes the particular broker's share to exceed 5% limit, our circular provides the necessary flexibility inasmuch as Board's post facto approval can be obtained
 9. During the course of the year it may not be possible to reasonably predict what will be the total quantum of transactions through brokers as a result of which there could be deviation in complying with the norm of 5%. The bank may get post facto approval from the Board after explaining to it the circumstances in which the limit was exceeded.
 10. Some of the small private sector banks have mentioned that where the volume of business particularly the transactions done through brokers is small the observance of 5% limit may be difficult. A suggestion has therefore been made that the limit may be required to be observed if the business done through a broker exceeds a cut-off point of, say Rs. 10 crore. As already observed, the limit of 5% can be exceeded subject to reporting the transactions to the competent authority post facto. Hence, no change in our instructions are considered necessary.

ANNEXURE - IV

Recommendations of the Group on Non-SLR investments of banks

Pro-forma of minimum disclosure requirements in respect of private placement issues - Model Offer Document

All issuers must issue an offer document with terms of issue, authorised by Board Resolution not older than 6 months from the date of issue. The offer document should specifically mention the Board Resolution authorising the issue and designations of the officials who are authorised to issue the offer document. The offer document may be printed or typed “For Private Circulation Only”. The Offer Document should be signed by the authorised signatory. The offer document should contain the following minimum information :

I. General Information

1. Name and address of registered office of the company
2. Full names (expanded initials), addresses of Directors and the names of companies where they are Directors.
3. Listing of the issue (If listed, name of the Exchange)
4. Date of opening of the issue
Date of closing of the issue
Date of earliest closing of the issue.
5. Name and addresses of auditors and Lead Managers/arrangers
6. Name address of the trustee – consent letter to be produced (in case of debenture issue)
7. Rating from any Rating Agency and / or copy of the rationale of latest rating.

II. Particulars of the issue

- a) Objects
- b) Project cost and means of financing (including contribution of promoters) in case of new projects.

III. The model offer document should also contain the following information :

- (1) Interest rate payable on application money till the date of allotment.
- (2) Security : If it is a secured issue, the issue is to be secured, the offer documents should mention description of security, type of security, type of charge, Trustees, private charge-holders, if any, and likely date of creation of security, minimum security cover, revaluation, if any.
- (3) If the security is collateralised by a guarantee, a copy of the guarantee or principal terms of the guarantee are to be included in the offer document.
- (4) Interim Accounts, if any.
- (5) Summary of last audited Balance Sheet and Profit & Loss Account with qualifications by Auditors, if any.
- (6) Last two published Balance Sheet may be enclosed.

(7) Any conditions relating to tax exemption, capital adequacy etc. are to be brought out fully in the documents.

(8) The following details in case of companies undertaking major expansion or new projects :- (copy of project appraisal may be made available on request)

- a) Cost of the project, with sources and uses of funds
- b) Date of commencement with projected cash flows
- c) Date of financial closure (details of commitments by other institutions to be provided)
- d) Profile of the project (technology, market etc)
- e) Risk factors

(9) If the instrument is of tenor of 5 years or more, projected cash flows.

IV . Banks may agree to insist upon the following conditionalities for issues under private placements

All the issuers in particular private sector corporates, should be willing to execute a subscription agreement in case of all secured debt issues, pending the execution of Trust Deed and charge documents. A standardised subscription agreement may be used by the banks, inter-alia, with the following important provisions.

- (a) Letter of Allotment should be made within 30 days of allotment. Execution of Trust Deed and charge documents will be completed and debentures certificates will be despatched within the time limit laid down in the Companies Act but not exceeding in any case, 6 months from the date of the subscription agreement.
- (b) In case of delay in complying with the above, the company will refund the amount of subscription with agreed rate of interest, or, will pay penal interest of 2% over the coupon rate till the above conditions are complied with, at the option of the bank.
- (c) Pending creation of security, during the period of 6 months (or extended period), the principal Directors of the company should agree to indemnify the bank for any loss that may be suffered by the bank on account of the subscription to their debt issue. (This condition will not apply to PSUs).
- (d) It will be the company's responsibility to obtain consent of the prior charge-holders for creation of security within the stipulated period. Individual banks may insist upon execution of subscription agreement or a suitable letter to comply with the terms of offer such as appointment of trustee, creation of security etc. on the above lines.
- (e) **Rating** : The Group recommends that the extant regulations of SEBI in regard to rating of all debt instruments in public offers would be made applicable to private placement also. This stipulation will also apply to preference shares which are redeemable after 18 months.
- (f) **Listing** : Currently, there is a lot of flexibility regarding listing required by banks in private placement issues. However, the Group recommends that listing of companies should be insisted upon, (exceptions, if any, to this rule shall be provided in the Investment Policy of the banks) which would in due course help develop secondary market. The advantage of listing would be that the listed companies would be required to disclose information periodically to the Stock Exchanges which would also help develop the secondary markets by way of investor information. In fact, SEBI has advised all the Stock Exchanges that all listed companies should publish unaudited financial results on a quarterly basis and that they should inform the Stock Exchanges immediately

of all events which would have a bearing on the performance/operations of the company as well as price sensitive information.

- (g) **Security / documentation** : To ensure that the documentation is completed and security is created in time, the Group has made recommendations which is contained in this model offer document. It may be noted that in case of delay in execution of Trust Deed and Charge documents, the company will refund the subscription with agreed rate of interest or will pay penal interest of 2% over the coupon rate till these conditions are complied with at the option of the bank. Moreover, Principal Directors of the company will have to agree to indemnify the bank for any loss that may be suffered by the bank on account of the subscription to the debt issue during the period of 6 months (or extended period) pending creation of security.

ANNEXURE V

RETURN/STATEMENT NO. 9

Proforma

Statement showing the position of Reconciliation of Investment

Account as on 31st March

Name of the bank/ Institution : _____

(Face value Rs. in crore)							
Particulars of securities	General Ledger Balance	SGL Balance As per PDO books	As per bank's/ institution's books	BRs held	SGL forms held	Actual scrips held	Outstanding deliveries
1.	2.	3.	4.	5.	6.	7.	8.
I. Central Government							
II. State Government							
III. Other approved securities							
IV. Public Sector bonds							
V. Units of UTI (1964)							

VI. Others
(Shares
&
debentures
etc.)

TOTAL :

Note : Similar statements may be furnished in respect of PMS client's Accounts and other constituents' Accounts (including Brokers). In the case of PMS/other constituents' accounts, the face value and book value of securities appearing in the relevant registers of the bank should be mentioned under Column 2.

Signature of the Authorised Official with the
Name and Designation.

General instructions for compiling reconciliation statement

a) Column - 2 (GL balances)

It is not necessary to give complete details of securities in the format. Only aggregate amount of face value against each category may be mentioned. The corresponding book value of securities may be indicated in bracket under the amount of **face value** of securities under each category.

b) Column - 3 and 4 (SGL balances)

In the normal course balances indicated against item three and four should agree with each other. In case of any difference on account of any transaction not being recorded either in PDO or in the books of the bank this should be explained giving full details of each transaction.

c) Column - 5 (BRs held)

If the bank is holding any BRs for purchases for more than 30 days from the date of its issue, particulars of such BRs should be given in a separate statement.

d) Column - 6 (SGL forms held)

Aggregate amount of SGL forms received for purchases which have not been tendered with Public Debt Office should be given here.

e) Column - 7

Aggregate amount of all scrips held in the form of bonds, letters of allotments, subscription receipts as also certificates of entries in the books of accounts of the issuer (for other than government securities), etc. including securities which have been sold but physical delivery has not been given should be mentioned.

f) Column - 8 (outstanding deliveries)

This relates to BRs issued by the bank, where the physicals/scrips have not been delivered but the balance in General Ledger has been reduced. If any BR issued is outstanding for more than thirty days the particulars of such BRs may be given in a separate list indicating reasons for not affecting the delivery of scrips.

g) General

Face value of securities indicated against each item in column two should be accounted for under any one of the columns from four to seven. Similarly, amount of outstanding

deliveries (BRs issued) which has been indicated in column eight will have to be accounted for under one of the columns four to seven. Thus the total of columns two and eight should tally with total of columns four to seven.

Appendix

Master Circular

Classification, valuation and operation of investments

List of Circulars consolidated by the Master Circular

No	Circular No.	Date	Relevant para no. of the circular	Subject	Para no. of the master circular
1	DBOD.No.Dir.BC.42/C.347-87	15 April 1987	2.B(ii), (iii) and 3,4	Buy-back arrangements in Government & Other Approved Securities entered into by commercial banks	1.2.1 (ii) (e) (f) (g)
2	DBOD.No.Dir.BC.127 / C.347(PSB)-88	11 April 1988	1,3	Buy-back arrangements in Government & Other Approved Securities entered into by commercial banks	1.2 .1 (ii) (f), (iv) (a) & (b)
3	DBOD.No.FSC. BC.69/C.469-90/91	18 Jan 1991	1,2,4	Portfolio Management on behalf of clients	1.3. 3
4	DO.DBOD.No. FSC.46/ C.469-91/92	26 July 1991	4(i),(ii),(iii), (iv),(v),(iv)	Investment portfolio of banks- Transaction in securities	1.2 (i)
5	DBOD.No.FSC.BC.14 3A/ 24.48.001/91-92	20 June 1992	3(I), 3(I)-(ii)-(iii)-(iv)-(v)-(xi)-(xii)-(xvi)-(xvii), 3(II),3(III), 3(V)-(i)-(ii)-(iii),(3) & (4)	Investment portfolio of banks- Transaction in securities	1.2 (ii),(iii) & (iv), 1.2.2,1.2.3, 1.2.5, 1.2.6 1.2.7
6	DBOD.No.FSC.BC.11 /24.01.009/92-93	30 July 1992	3,4,5,6	Portfolio Management on behalf of clients	1.3.3
7	DBOD.No.FMC/BC/1 7/24.48.001.92/93	19 Aug 1992	2	Investment portfolio of banks- Transaction in securities	1.3.2
8	DBOD.FMC.BC. 62/27.02.001/92-93	31 Dec 1992	1	Investment portfolio of banks- Transaction in securities	1.2.6

No	Circular No.	Date	Relevant para no. of the circular	Subject	Para no. of the master circular
9	DBOD.No.FMC.1095/27.01.002/93	15 April 1993	1 & enclosed format	Investment portfolio of banks-Reconciliation of holdings	1.3.1 & Annexure-V
10	DBOD.No.FMC.BC.141/27.02.006/93/94	19 July 1993	Annexure	Investment portfolio of banks-Transaction in securities-Aggregate contract limit for individual brokers-Clarifications	Annexure-III
11	DBOD.No.FMC.BC.1/27.02.001/93-94	10 Jan 1994	1	Investment portfolio of banks-Transaction in securities- Bouncing of SGL transfer forms- Penalties to be imposed.	1.2.2
12	DBOD.No.FMC.73/27.07.001/94-95	7 June 1994	1,2	Acceptance of deposits under Portfolio Management Scheme	1.3.3
13	DBOD.No.FSC.BC.130/24.76.002/94-95	15 Nov 1994	1	Investment portfolio of banks-Transaction in securities-Bank Receipts(BRs)	1.2.3
14	DBOD.No.FSC.BC.129/24.76.002/94-95	16 Nov 1994	2 & 3	Investment portfolio of banks-Transaction in securities-Role of brokers	1.2.6
15	DBOD.No.FSC.BC.142/24.76.002/94-95	9 Dec 1994	1& 2	Investment portfolio of banks-Transaction in securities-Role of brokers	1.2.6
16	DBOD.No.FSC.BC.70/24.76.002/95-96	8 June 1996	2	Retailing of Government Securities	1.2.4
17	DBOD.No.FSC.BC.71/24.76.001/96	11 June 1996	1	Investment portfolio of banks-Transaction in securities	1.2.2
18	DBOD.No.BC.153/24.76.002/96	29 Nov 1996	1	Investment portfolio of banks-Transaction in securities	1.2.6

No	Circular No.	Date	Relevant para no. of the circular	Subject	Para no. of the master circular
19	BP. BC. 9/ 21.04.048/ 98	29 Jan 1997	3	Prudential norms - capital adequacy, income recognition, asset classification and provisioning.	5.1 (iii) & (iv)
20	BP. BC. 32/ 21.04.048 / 97	12 April 1997	1&2	Prudential norms - capital adequacy, income recognition, asset classification and provisioning	4.1 (i) & (ii)
21	DBOD.FSC.BC. 129/24.76.002-97	22 Oct 1997	1	Retailing of Government Securities	1.2.4
22	DBOD.No.BC.112/24.76.002/ 1997	14 Oct 1997	1	Investment portfolio of banks- Transaction in securities-Role of brokers	1.2.6
23	BP. BC. 75/ 21.04.048/ 98	4 Aug 1998	All	Acquisition of Government and other approved securities - Broken Period Interest, - Accounting Procedure	5.2
24	DBS.CO.FMC. BC.18/22.53.014/99-2000	28 Oct 1999	2,3,4 & 5	Investment portfolio of banks- Transaction in securities	1.2.2
25	DBOD.No.FSC.BC.15 0/ 24.76.002/99-2000	23 March 2000	1,2, Annexure(I), & (V)	Ready Forward Contracts	1.2.1, Annexures II
26	DBOD.No.FSC. BC.26/24.76. 002/2000	6 Oct 2000	2	Sale of Government securities allotted in the auctions for Primary issues	1.2(i)(a)
27	BP. BC. 32/ 21.04.048 /2000- 01	16 Oct 2000	All	Guidelines on classification and valuation of investments.	2,3 & 4
28	DBOD.FSC.BC. No.39/24.76.002/2000	25 Oct 2000	1	Investment portfolio of banks- Transaction in securities-Role of brokers	1.2.6
29	Dir.BC.107/13.03.00/2 000-01	19 April 2001	6	Monetary and Credit Policy for the year 2000-2002 – Interest Rate Policy	4.3

No	Circular No.	Date	Relevant para no. of the circular	Subject	Para no. of the master circular
30	BP. BC. 119/ 21.04.137/ 2000- 2001	11 May 2001	Annex - 5&12	Bank financing of equities and investments in shares - Revised guidelines	1.2, 1.2.5 1.3, 1.3.1
31	BP. BC. 127/ 21.04.048/ 2000- 01	7 June 2001	All	Non- SLR Investments of Banks	2,3 &4 Annexure- IV
32	BP.BC. 57/21.04.048/2001-02 BP.BC.99/21.01.002/2 001-02	10, Jan 2002 3 May 2002	Para 2 Para 2	Valuation of investment by banks Monetary & Credit Policy 2002-03 - IFRA	3.4
33	BP.BC.61/21.04.048/2 001-02	Jan 25, 2002	All	Guidelines for investments by banks/Fis and Guidelines for financing of restructured accounts by banks/Fis	1.2.8 (iv)