

**Terms and Conditions Applicable to Subordinated Debt to  
Qualify for Inclusion as Lower Tier 2 Capital**

The Reserve Bank has given autonomy to Indian banks to raise rupee subordinated debt as Tier 2 capital, subject to strict compliance with the following terms and conditions. Foreign banks have also been given autonomy for raising subordinated debt in foreign currency through borrowings from Head Office for inclusion in Tier 2 capital, subject to strict compliance with the terms and conditions given in Part 2 of this **Annex**.

**PART 1 – Issue of Rupee-denominated subordinated debt by Indian banks,  
which is eligible for inclusion in lower Tier 2 capital**

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**1. Terms of Issue of Bond**

To be eligible for inclusion in Tier - II Capital, terms of issue of the bonds as subordinated debt instruments should be in conformity with the following:

- (i) Amount:: The amount of subordinated debt to be raised may be decided by the Board of Directors of the banks.
- (ii) Maturity period:
- a) Subordinated debt instruments with an initial maturity period of less than 5 years, or with a remaining maturity of one year should not be included as part of Tier-II Capital. Further, they should be subjected to progressive discount as they approach maturity at the rates shown below:

<b>Remaining Maturity of Instruments</b>	<b>Rate of Discount (%)</b>
Less than one year	100
More than One year and less than Two years	80
More than Two years and less than Three years	60
More than Three years and less than Four years	40
More than Four years and less than Five years	20

(b) The bonds should have a minimum maturity of 5 years. However if the bonds are issued in the last quarter of the year i.e. from 1st January to 31st March, they should have a minimum tenure of sixty three months.

- (iii) Rate of interest: The banks may issue Subordinated Tier 2 bonds at coupon rates decided by their Boards. <sup>62</sup>The instruments should be 'vanilla' with no special features like options etc.

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<sup>62</sup> Vide DBOD Mailbox clarification dated January 9, 2008

(iv) Other conditions:

- a) The instruments should be fully paid-up, unsecured, subordinated to the claims of other creditors, free of restrictive clauses and should not be redeemable at the initiative of the holder or without the consent of the RBI.
- b) Necessary permission from Foreign Exchange Department of the RBI should be obtained for issuing the instruments to NRIs/OCBs/FIIs.
- c) Banks should comply with the terms and conditions, if any, set by SEBI/other regulatory authorities in regard to issue of the instruments.
- d) In the case of foreign banks, rupee subordinated debt should be issued by the Head Office of the bank, through the Indian branch, after obtaining specific approval from Foreign Exchange Department, RBI.

**2. Inclusion in Tier 2 capital**

Subordinated debt instruments will be limited to 50 per cent of Tier-I Capital of the bank. These instruments, together with other components of Tier 2 capital, should not exceed 100 per cent of Tier 1 capital.

**3. Grant of advances against bonds**

Banks should not grant advances against the security of their own bonds.

**4. Compliance with Reserve Requirements**

The total amount of Subordinated Debt raised by the bank has to be reckoned as liability for the calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will attract CRR/SLR requirements.

**5. Treatment of Investment in subordinated debt**

Investments by banks in subordinated debt of other banks will be assigned risk weight as per para 5.6.1 of this Master Circular, for capital adequacy purpose. Also, the bank's aggregate investment in Tier 2 bonds issued by other banks and financial institutions shall be within the overall ceiling of 10 percent of the investing bank's total capital funds.. The capital for this purpose will be the same as that reckoned for the purpose of capital adequacy.

**6. Subordinated Debt in foreign currency**

Banks may take approval of RBI on a case-by-case basis, for issuing subordinated debt in foreign currency.

## 7. Reporting Requirements

The banks should submit a report to Reserve Bank of India giving details of the capital raised through subordinated-debt, such as, amount raised, maturity of the instrument, and rate of interest together with a copy of the offer document soon after the issue is completed.

### **Part 2 - Raising of Head Office borrowings in foreign currency by foreign banks operating in India for inclusion in Tier 2 Capital**

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#### **1. Terms of borrowings:**

Detailed guidelines on the standard requirements and conditions for Head Office borrowings in foreign currency raised by foreign banks operating in India for inclusion , as subordinated debt in Tier 2 capital are as indicated below:-

- i) Amount of borrowing : The total amount of HO borrowing in foreign currency will be at the discretion of the foreign bank. However, the amount eligible for inclusion in Tier 2 capital as subordinated debt will be subject to a maximum ceiling of 50 per cent of the Tier 1 capital maintained in India, and the applicable discount rate mentioned in paragraph 5 below. Further as per extant instructions, the total of Tier 2 capital should not exceed 100 per cent of Tier 1 capital.
- ii) Maturity period: Head Office borrowings should have a minimum initial maturity of 5 years. If the borrowing is in tranches, each tranche will have to be retained in India for a minimum period of five years. HO borrowings in the nature of perpetual subordinated debt, where there may be no final maturity date, will not be permitted.
- iii) Features: The HO borrowings should be fully paid up, i.e. the entire borrowing or each tranche of the borrowing should be available in full to the branch in India. It should be unsecured, subordinated to the claims of other creditors of the foreign bank in India, free of restrictive clauses and should not be redeemable at the instance of the HO.
- iv) Rate of discount: The HO borrowings will be subjected to progressive discount as they approach maturity at the rates indicated below:

<b>Remaining maturity of borrowing</b>	<b>Rate of discount</b>
More than 5 years	Not Applicable (the entire amount can be included as subordinated debt in Tier 2 capital subject to the ceiling mentioned in paragraph 2)
More than 4 years and less than 5 years	20%
More than 3 years and less than 4 years	40%
More than 2 years and less than 3 years	60%
More than 1 year and less than 2 years	80%
Less than 1 year	100% (No amount can be treated as subordinated debt for Tier 2 capital)

- v) Rate of interest: The rate of interest on HO borrowings should not exceed the on-going market rate. Interest should be paid at half yearly rests.

- vi) Withholding tax: The interest payments to the HO will be subject to applicable withholding tax.
- vii) Repayment: All repayments of the principal amount will be subject to prior approval of Reserve Bank of India, Department of Banking Operations and Development.
- viii) Documentation: The bank should obtain a letter from its HO agreeing to give the loan for supplementing the capital base for the Indian operations of the foreign bank. The loan documentation should confirm that the loan given by HO would be subordinated to the claims of all other creditors of the foreign bank in India. The loan agreement will be governed by, and construed in accordance with the Indian law. Prior approval of the RBI should be obtained in case of any material changes in the original terms of issue.

## **2. Disclosure**

The total amount of HO borrowings may be disclosed in the balance sheet under the head 'Subordinated loan in the nature of long term borrowings in foreign currency from Head Office'.

## **3. Reserve Requirements**

The total amount of HO borrowings is to be reckoned as liability for the calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will attract CRR/SLR requirements.

## **4. Hedging**

The entire amount of HO borrowing should remain fully swapped with banks at all times. The swap should be in Indian rupees.

## **5. Reporting & Certification**

Such borrowings done in compliance with the guidelines set out above would not require prior approval of Reserve Bank of India. However, information regarding the total amount of borrowing raised from Head Office under this Annex, along with a certification to the effect that the borrowing is as per the guidelines, should be advised to the Chief General Managers-in-Charge of the Department of Banking Operations & Development (International Banking Division), Department of External Investments & Operations and Foreign Exchange Department (Fore Markets Division), Reserve Bank of India, Mumbai.