

ANNEXURE VI

SUMMARY OF INSTRUCTIONS ISSUED BY RESERVE BANK OF INDIA ON REPOS

1. Ready Forward (buy-back) deals in Government and other approved Securities:

1.1 In April 1987, banks were advised to follow the guidelines given hereunder in respect of their buy-back arrangements with banks and others :

A. Prohibition against buy-back arrangements in respect of Corporate Securities and Bonds issued by Public Sector Undertakings:

Banks should not enter into buy-back arrangements in respect of their holdings of public sector bonds or corporate shares and debentures.

B. Buy-back arrangements in Government and Other Approved Securities with (non-bank) clients:

(i) The buy-back deals should be exclusively confined to Government and Other Approved Securities and the re-purchase dates should be fixed after a minimum period of 30 days from the date of sale of the securities in question.

(ii) The purchase/sale prices under the arrangement should be in alignment with the proximate market rates prevalent on the date of the original transaction for the relevant Government and Other Approved Securities.

(iii) No sales of Government and Other Approved Securities under the arrangement should be effected by banks unless the same were actually held by them on their own investment portfolio either in the form of actual scrips or in Subsidiary General Ledger (SGL) account maintained with Reserve Bank.

(iv) Immediately on sale, the corresponding amount should invariably be deducted from the investment account of the bank and its SLR assets for the entire period

(v) (minimum 30 days) of holding by the purchasers/counterparty.

(v) Interest on the securities at coupon rates would be paid by

the banks after deduction of tax on the lines indicated in the communication dated 14th August 1986.

C. Inter-Bank Buy-back Arrangement in Government and Other Approved Securities

(i) While inter-bank buy-back transactions in Government and Other Approved Securities may be undertaken for short periods without the stipulation of any minimum period, the net differential in sale and repurchase prices of the securities in question (spread over the transaction period), together with the coupon rate of interest on the securities, should not in aggregate exceed the prevailing ceiling on call-money rate in the inter bank market. In other words, the transactions should be done to yield a net return at the lower of the following :

(a) difference in sale and repurchase price of the securities (spread over the transaction period) together with interest at the coupon rate on the securities in question; or

(b) the prevailing ceiling on call-money rate in the inter-bank market.

(ii) The other stipulation mentioned at B (ii) to (v) above would be equally applicable to transactions with banks.

1.2 Banks were also advised that a report on the buy-back arrangements indicating, interalia, profitability of transactions, should be submitted to their Board of Directors on a quarterly basis. Further, they should place before the Board of Directors a copy of this communication for their information, under advice to the Reserve Bank.

1.3 Thereafter, in December 1987, following inquiries from banks whether they could enter into buy-back arrangements in units of Unit Trust of India (UTI) under 1964 Scheme, it was advised that the units were not approved security for buy-back arrangements in terms of the instructions of April 1987.

1.4 As there was a sharp increase in the commitments of banks under buy-back arrangements, they were cautioned in October 1987 to moderate their commitments as a sudden unwinding of these arrangements by investors could result in a serious liquidity bind.

However, these commitments remained large and had a depressing effect on the growth of deposits, apart from having an adverse impact on the profitability of banks. The banks were, therefore, prohibited from entering into buy-back arrangements in Government and Other Approved Securities with non-bank clients with effect from 4th April 1988 and were advised that all such existing arrangements must be terminated on the date they expire or

1st July 1988, whichever was earlier.

1.5 Banks were further advised in April 1988 that while they were permitted to undertake outright purchases/sales, such transactions must be effected at market prices. Besides, while existing procedures for outright purchase/sale transactions could be continued, the spirit of the instruction prohibiting buy-back arrangements with non-bank investor was required to be scrupulously observed. It was to be noted that outright sale and purchase transactions with the same party and for identical or similar amounts would be construed by the Reserve Bank as tacit arrangements violating the instructions prohibiting buy-back arrangements with non-bank clients. Accordingly, the instructions conveyed in April 1987, stood modified.

1.6 It was added that banks may continue to enter into buy-back arrangements with other banks (inter-bank) in Government and Other Approved Securities subject to strict adherence to guidelines of April 1987. It was emphasised that the top executives in banks should bestow their special attention to inter-bank buy-back arrangements to ensure that the guidelines on the subject were strictly complied with in both letter and spirit, any deviation/s was/were viewed seriously and accountability fixed at all levels.

1.7 In conclusion, it was advised that a report should be submitted to the Board of Directors setting out compliance with the instructions prohibiting buy-back arrangements with non-bank investors. The position regarding the phased unwinding of buy-back commitments was to be advised to the Reserve Bank at the end of each month and a full compliance report was also to be submitted to it immediately after 1st July 1988.

1.8 In January 1991, banks were informed that it had come to Reserve Bank's notice that some banks had entered into buy-back deals with certain financial institutions like National Bank for Agricultural and Rural Development, Industrial Development Bank of India and Unit Trust of India. It was clarified that buy-back arrangements in Government and Other Approved Securities were permitted between scheduled commercial banks only and for the purpose of the instructions issued in April 1988, financial institutions set up under Acts of Parliament or otherwise, both at the all-India and State levels and not undertaking banking business within the provisions of the Banking Regulations Act, 1949, were deemed as non-bank clients, and banks should not enter into any buy-back arrangements with them.

1.9 In this connection, banks were advised in January 1992 that the issue whether the prevailing 'repos' facilities in 182 days Treasury Bills (Government Securities) by Discount & Finance House of India Ltd. (DFHI) to banks would amount to violation of the instructions of April 1988 and January 1991, was examined by the Reserve Bank. It was clarified that as the basic objective of setting up of DFHI was to facilitate the development of active money market by smoothening short-term liquidity imbalances, DFHI was expected to actively trade in money market instruments, particularly in 182 days Treasury Bills. It was, accordingly, decided to exclude DFHI from the term "non-bank clients" for the purpose of buy-back arrangements in

Government and Other Approved Securities by commercial banks.

1.10 In June 1992, following the initial recommendations of the Janakiraman Committee, the following instructions were issued regarding 'Ready-Forward' (buy-back) deals :

(i) Banks were prohibited with effect from 22nd June 1992, and until further instructions, from undertaking inter-bank Ready Forward deals in dated Government and Approved/Trustee Securities. Existing deals in dated securities should be completed on due dates without resorting to any extension or roll overs. As such, inter-bank Ready Forward transactions might thereafter be undertaken only in Treasury Bills (of all maturities)

(ii) All double Ready Forward deals in Government securities, including Treasury Bills, were strictly prohibited.

(iii) No Ready Forward and double Ready Forward deals should be put through even among banks, and even on their own Investment Accounts in any other securities, such as Public Sector Undertakings' bonds and units of UTI.

(iv) Similarly, no Ready Forward and double Ready Forward deals should be put through in any security, including Government securities, on behalf of other constituents, including brokers.

1.11 In August 1994, banks were informed that the Notification No.S.O.2561 dated 27th June 1969, issued by the Central Government in exercise of the powers conferred by sub-section (I) of Section 16 of the Securities Contracts (Regulation) Act, 1956, with respect to restriction on sale or purchase of securities, had been further amended, vide Notification No. S.O. (E) dated 1st June 1994 and a copy each of the two Notifications was forwarded to them. (These are furnished in Annexure I.) It was added that in terms of the amended Notification Ready Forward contracts may be entered into by (i) a banking company (ii) a co-operative bank and (iii) the Discount and Finance House of India Ltd. in Treasury Bills of all maturities issued by the Government of India and in such dated securities of the Government of India, as were approved by the Reserve Bank of India, in consultation with the Central Government, provided all such Ready Forward transactions were put through SGL Account with the Reserve Bank of India.

1.12 Banks were further informed that in pursuance of the aforementioned Notification dated 1st June 1994, the Reserve Bank of India, in consultation with the Government of India, had approved the following four dated securities of the Government of India for the purpose of Ready Forward contracts :

<u>Sl. No.</u>	<u>Nomenclature of Security</u>
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- 1) 12.00 percent Government Stock 1995
- 2) 12.75 percent Government Stock 1996
- 3) 12.00 percent Government Stock 1999
- 4) 12.50 percent Government Stock 2004

1.13 In February 1995, banks were advised that the Reserve Bank of India in consultation with the Government of India, had approved the Zero Coupon Bonds, 2000 of the Government of India for the purpose of Ready Forward contracts, in addition to the four dated securities listed in the communication dated 16th August 1994.

1.14 Soon thereafter, the banks were advised that the Government of India, vide their Notification F.No. 1/9/SE/94 dated October 18, 1994, (copy furnished in Annexure II), had notified Securities Trading Corporation of India Ltd. as an eligible institution, in addition to the institutions indicated in the communication dated 16th August 1994, to undertake Ready Forward transactions in Treasury Bills and in such dated securities of the Government of India as were approved by the Reserve Bank in consultation with the Government. It would, therefore be in order for banks to enter into Ready Forward transactions in the securities specified above with Securities Trading Corporation of India Ltd.

1.15 Banks were further advised in March 1995 that it had been decided that Ready Forward deals in all the five approved securities (advised in the communications of August 1994 and February 1995) would be permitted only if the transactions were effected at Bombay and the deals were put through SGL Accounts.

1.16 Subsequently, banks were advised through different communications, that they may undertake Ready Forward transactions in the following securities subject to the condition that (a) the transactions were effected at Bombay and (b) the deals were put through SGL Accounts :

- (i) 13.25 percent Government Stock, 1997.
(in conversion of 12 percent Government Stock 1995)
- (ii) Government of India Zero Coupon Bonds, 2000.
(Second Series).
- (iii) 13.65 percent Government Stock, 1998.
- (iv) 13.50 percent Government Stock, 1997.
- (v) 14.00 percent Government Stock, 2005.
- (vi) Government of India Floating Rate Bonds, 1999.
- (vii) 13.50 percent Government Stock, 1997.
(Second Issue)
- (viii) 14.00 percent Government Stock, 2005.

(Second Issue)

(ix) 14.00 percent Government Stock, 2005.
(Third Issue)

(x) Government of India Floating Rate Bonds, 1999.
(Second Issue).

(xi) 13.85 percent Government Stock, 2000.

1.17 It was observed by the Reserve Bank that Ready Forward transactions were being used for as short a period as one day merely as a change in nomenclature from call money. With a view to ensuring that banks resort to Ready Forward transactions in accordance with the spirit of this facility, banks were advised on 29th September 1995, that effective from 30th September 1995, the minimum period for Ready Forward (repos) transactions will be three days.

2. Need to hold the security before sale

2.1 In July 1991, banks were advised inter alia, that it was observed that certain banks were resorting to buy-back deals in Government Securities amongst themselves without actually holding sufficient securities either in physical form or in their Subsidiary General Ledger (SGL) account (resulting in substitution of Bank Receipts (BRs)/ return of SGL forms for want of sufficient balance), at rates which had no relevance to market, with a view to window-dressing their profitability/ maintenance of SLR requirement, with the tacit understanding with the counter party banks. Some of the banks appeared to be taking outright oversold position in securities and in their desperate bid to cover the oversold position in a particular security/ies they had entered into double Ready Forward deals and other banks had obliged them in the matter.

In this regard, banks were instructed as under :

(i) Under no circumstances, a bank should hold a oversold position in any security; that is to say that no sale transactions should be put through without actually holding the security in its investment account.

(ii) All the transactions put through by a bank, either on outright basis or Ready Forward basis and whether through the mechanism of SGL Account or BR, should be reflected on the same day in its investment account and accordingly for SLR purpose, wherever applicable.

(iii) Any instance of return of SGL form from the Public Debt Office (PDO) 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.

2.1 Notwithstanding the issue of the above instructions, irregularities on the part of banks persisted and following the initial recommendations of the Janakiraman Committee, the following comprehensive instructions on the above subject were issued in June 1992 (along with those on other issues relating to investment transactions) :

(i) All transactions in Government securities for which SGL facility was available should be put through SGL Accounts only,

(ii) Before issue of SGL transfer forms covering their sale transactions, banks should ensure that they had sufficient balance in their respective SGL Accounts. Accordingly, under no circumstances, a SGL transfer form issued by a bank in favour of another bank should bounce for want of sufficient balance in the SGL Account. The purchasing banks should issue the cheques only after receipt of the SGL transfer forms from the selling banks.

(iii) The SGL transfer form received by purchasing banks should be deposited in their SGL Accounts immediately. No sale should be effected by way of return of SGL form held by the bank.

(iv) 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.

(v) 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.

(vi) If a SGL transfer form bounces for want of sufficient balance in the SGL Account, the (selling) bank which had issued the form would 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 over draft 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, and

(c) If the bouncing of the SGL form occurs thrice, the bank would be debarred from trading with the use of the SGL facility for a period of six 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.

2.4 Thereafter in December 1993, banks were advised [with reference to item (iii) of para. 4.3.3 above] that it was observed that the SGL transfer forms received by the purchasing banks were not being deposited in their SGL Accounts immediately and delays (of as much as 10 days in certain cases) had been observed. It should, therefore be ensured that SGL transfer forms were lodged in the SGL Accounts with the PDO immediately, i.e. within a maximum period of two working days from the date of transaction. It was added that any delay beyond the above mentioned period would be viewed seriously.

2.5 Subsequently, in respect of item (vi) (b) of para. 4.3.3 above, banks were advised in January 1994 that if the DFHI's closing call money rate was lower than the minimum lending rate of banks, as stipulated in the Reserve Bank's interest rate directive in force, the applicable penal rate to be charged would be 3 percentage point above the minimum lending rate.

3. Internal Control System in respect of investment transactions

3.1 The comprehensive instructions on Investment portfolio issued to banks in June 1992 following the initial Report of the Janakirman Committee included the following on Internal Control System of banks (which have been included in the Chapters on Frauds, Annual Accounts, etc.)

(i) There should be a clear functional separation of (a) trading, (b) settlement, monitoring and control and (c) 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. While providing portfolio management service to their clients, the banks should strictly follow the guidelines in regard thereto issued by the Reserve Bank on 18th January 1991. (These have been covered separately). Further, PMS Clients' Accounts should be subjected to a separate audit by external auditors.

(ii) 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 counterparty, whether it was 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 had been properly accounted for. Once the deal was 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.

(iii) Once a deal had been concluded, there should not be any substitution of the counterparty bank by another bank by the broker, through whom the deal had been entered into; likewise, the security sold/purchased in the deal should not be substituted by another security.

(IV(iv)(iv) 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 accounts.

(v) In the case of transaction relating to PMS Clients' Accounts (including brokers), all the relative records should give a clear indication that the transaction belonged to PMS Clients/Other Constituents and did not belong to banks' own Investment Account and the bank was acting only in its fiduciary/agency capacity.

(vi) Records of Subsidiary General Ledger (SGL) transfer forms issued/received, should be maintained. 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 also be periodically checked by the internal audit department. 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 Central Office of the Department of Banking Operations and Development of the Reserve Bank by the buying bank. Similarly, a record of Bank Receipts (BRs) issued/received should be maintained. 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.

(vii) Banks should put in place a reporting system to report 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.

(viii) 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. (Detailed instructions in this regard have been covered separately.)

(ix) 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.

3.2 In this regard, banks were advised in August 1992 that it was the primary responsibility of the bank managements to ensure that there were adequate internal control and audit procedures for ensuring proper

compliance of the instructions in regard to the conduct of the investment portfolio. Banks were instructed to undertake an immediate review of the adequacy of their internal audit departments and indicate details of their existing organisational set up and the scope of their operations to the Reserve Bank to enable it to review the adequacy of the internal machinery to oversee the implementation of the instructions given to banks. It was added that banks should also institute a regular system of monitoring compliance with the prudential and other guidelines issued by the Reserve Bank of India. Further, banks were advised to get compliance in key areas certified by their statutory auditors and to furnish such audit certificate to the Reserve Bank.

4. Engagement of brokers for Investment transactions

4.1 In July 1991, banks were advised to frame suitable investment policy. The various guidelines then furnished to them in this regard have been covered separately.) As regards engagement of brokers, they were advised as under :

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.

4.2 Thereafter, following the initial recommendations made by the Janakiraman Committee, Reserve Bank issued, in June 1992, comprehensive instructions to banks on the various aspects of conduct of their Investments Portfolio. As regards dealings through brokers, the following instructions were issued :

(i) If a deal was 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.

(ii) While negotiating the deal, the broker was not obliged to disclose the identity of the counterparty to the deal. However, on conclusion of the deal, he should disclose the counterparty and his contract note should clearly indicate the name of the counterparty.

(iii) 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.

(iv) 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.

(vi) A disproportionate part of the business should not be transacted through only one or a few brokers. Banks should consider fixing aggregate contract limits for each of the approved brokers and ensure that these limits were not exceeded.

4.3 There after, in December 1992 banks were informed that on a scrutiny of the investment policies evolved by the banks, it was observed that a number of them had not fixed aggregate contract limits for each of the approved brokers (vide item (v) above). The matter was, therefore reviewed by the Reserve Bank and it was decided that 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 became 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.

4.4 In this regard attention of banks was drawn to the instructions on 'Audit', Review and Reporting' contained in the communication dated 20th June 1992 and it was reiterated that the concurrent auditors who audit the treasury operations should scrutinise this aspect 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. It was added that these instructions shall also apply to subsidiaries and mutual funds of the banks.

4.5 Subsequently, some of the banks sought certain clarifications on the instructions of December 1992 and these were examined by the Reserve Bank. The clarifications sought and the replies thereto, issued in July 1993, are furnished in the Annexure.

4.6 On further review of the matter, banks were advised in November 1994 that it had been decided that inter-bank securities transactions should be undertaken directly between banks and no bank should engage the services of any broker in such transactions. Banks may, however, undertake securities transactions among themselves or with non-bank clients through members of the National Stock Exchange (NSE), wherein the transactions were transparent. Transactions with non-bank clients, if such transactions were not undertaken on the NSE, should be undertaken by banks directly, without engaging brokers.

4.6 Banks were also cautioned that any violation or circumvention of Reserve Bank's instructions would invite penal action against banks, which

could include raising of reserve requirements, withdrawal of refinance from the Reserve Bank and denial of access to money market, as also such other penalty under the provisions of the Banking Regulation Act, 1949, as the Reserve Bank may deem fit.

4.7 After the issue of instructions of November 1994, some of the banks sought clarification on the coverage of the term 'securities' appearing therein. Banks were advised in December 1994 that although the Securities Contracts (Regulation) Act, 1956 defines the term 'securities' to mean corporate shares, debentures, Government Securities and rights or interest in securities, for the purpose of the communication dated 16th November 1994, the term 'securities' would exclude corporate shares. Further, as regards the coverage of term 'non-bank clients' appearing in the aforementioned communication, it was clarified that Provident/Pension Funds and Trusts registered under the Indian Trusts Act, 1882, would be outside the preview of the expression 'non-bank clients' for the purpose of that communication.