ANNEXURE
(Ref : Paragraph No. 4.7.5)

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 arrive at the volume of total transactions ?	Yes. This is, however, only theoretical as R/F transactions in Govt. securities are now prohibited except in Treasury Bills and the 3 year dated securities issued by conversion of Treasury Bills recently
5.	Whether central loan/state loan/treasury bills etc. purchased through direct subscriptions/auction will be included in the volume of total transaction ?	No as brokers are not involved as intermidiaries.
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	If the offer received is more advantageous the limit for the broker may be exceeded, the reasons therefor recorded and approval of the competent authority/Board obtained post

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.	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 fleibility in as much 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 crores	As already observed, the limit of 5% can be exceeded subject to reporting the transactions to the competent authority postfacto. Hence, no change in our instructions are considered necessary.

5. Accounting standards for Investments

5.1 The comprehensive instructions issued by the Reserve Bank in April 1992 on Income Recognition, Asset Classification, Provisioning and Other Related Matters included the following on Accounting standards for Investments :

The investment portfolio of a bank would normally consist of both ‘‘approved securities’’ (predominantly Government securities) and ‘‘others’’ (shares, debentures and bonds). It has been decided that the investments in approved securities should be bifurcated into ‘‘permanent’’ and ‘‘current’’ investments. Permanent investments were those which banks intended to hold till maturity and current investments were those which banks intended to deal in, i.e. buy and sell on a day-to-day basis. On this basis, banks should classify the existing investments in approved securities into the aforesaid two categories. To begin with, banks should keep not more than 70 percent of their investments in the permanent category from the accounting year 1992-93. This ratio would have to be brought down to 50 percent in due course. All subsequent purchases would also be required to be classified suitably. Reserve Bank would have no objection to banks inter-changing the investments from one category to another with the prior authorisation of the Board of Directors, in which case depreciation, if any would have to be fully provided for.

5.2 While the depreciation in respect of permanent investments was not likely to affect their realisable value and, therefore, need not be provided for, depreciation in the current investments should be fully provided for. Permanent investments could be valued at cost unless it was more than the face value, in which case the premium has to be amortised over the period remaining for maturity of the security. Banks were not expected to sell securities in the permanent category freely, but if they do so, any loss on such transactions in securities in this category has to be written off. Besides, any gain should be taken to capital reserve account. (It was subsequently advised in December 1992 that banks which experienced difficulties in adopting the above standards could discuss the matter separately with the Reserve Bank.)

5.3 The detailed instructions relating to Investment transactions issued in June 1992 following the initial Report of the Janakiraman Committee, included the following additional instructions/modifications relating to Accounting Standards :

(i) All investments in securities, other than approved securities, should be classified under ‘‘current’’ category and should be valued at market price or cost whichever was less and depreciation should be provided for the shortfall, if any.

(ii) In the instructions of April 1992, the manner in which banks’ investments in approved securities should be bifurcated into ‘‘permanent’’ and ‘‘current’’ categories had been indicated. Dealing securities were marketable securities that were acquired and held with the intention of reselling them in the short term. The financial results arising from such transactions must be seen as volatile, generating trading profit or loss from deliberate position taking. Investment securities, on the other hand, were acquired and held for yield or capital growth purposes (apart from for compliance of SLR requirement) and were usually intended to be held till maturity, except when liquidity needs arise. Unless governed by the special rule described below, gains and losses on sale of securities should be recorded at the time of sale as capital gains/losses. As stated earlier, approved debt securities classified under ‘‘current’’ category should be carried in the Balance Sheet at market price or cost whichever was lower, wheras approved debt securities classified under ‘‘permanent’’ category should be carried in the Balance Sheet either at book value (cost) or at market value, at the discretion of the banks, subject to their following a consistent accounting policy. Accounting of securities under various categories should be as under :

Approved debt securities under “permanent” category

(a) If the investments were carried at book value, the difference between the acquisition price (acquisition cost) and the redemption price should be accrued over the period from the acquisition to the redemption date and should be recognised as income or expense.

(b) Alternatively, the banks may choose to value such investments, on a consistent basis, at market value.

(c) Should the banks elect to adopt the practice described in (a) above, when the securities were redeemed or sold before the original redemption date, the unaccrued portion of the amount reffered to at (a) above should immediately be charged to the profit and loss account as capital gain or loss, as the case may be.

(d) Should banks elect to follow the practice described in (b) above, the resulting revaluation gains/losses should be recognised as capital gain/loss.

Investments under ‘‘current’’ category

(e) The investment under ‘‘current’’ category should be carried at lower of cost or market value, on a consistent basis.

(f) Costs, such as, brokerage fees, commission or taxes, incurred at the time of acquisition of trading securities, should immediately be recognised as expenses, without any accrual.

(g) The carrying value of securities under current category should be revalued at market prices on a quarterly basis. The gains/losses arising out of this revaluation should not be taken to interest income/expenses accounts. Instead, revaluation gains/losses should be segregated by entering them in specific ‘‘realised/unrealised gains/losses on trading of debt securities’’ account. The net amount of gains/losses from trading of debt securities shall be taken to the income statement.

(iii) Each time a security was acquired, the bank should immediately record whether it was for investment account or for trading account and accordingly account for them in the respective accounts on the basis of laid down accounting policies. Transfer of securities from one account to another (i.e. Investment Account to Trading Account or vice versa) should be done only with the prior approval of the Board of Directors of the bank and should be properly documented.

(iv) Potential losses should be recognised prior to the transfer of securities from ‘‘current’’ category to ‘‘permanent’’ category where market value as on the date of transfer was less than the carrying value in the books.

(v) Banks may treat equity investments in subsidiaries as permanent investment.

5.4 It was clarified in January 1994 that, in respect of Zero Coupon Bonds (issued by Government of India, vide its Notification No. F. 4(5) W & M/93 dated 7th January 1994), the value of these Zero Coupon Bonds for the purpose of determining “cost” may be reckoned after taking into account the accrued discount pro rata. After this adjustment of the “cost”, banks could use the standard valuation procedures.

5.5 The clarifications/fresh guidelines issued to banks on ‘Income Recognition, etc.’ in February 1994, included those relating to ‘Valuation of Securities’. Thus, banks were informed that it was observed by the Reserve Bank that the practices followed by banks and auditors differed in respect of valuation of investments in ‘‘current’’ category. It was, therefore, decided that the Indian Banks’ Association (IBA), in consultation with the Institute of Chartered Accountants of India (ICAI), would evolve a method for valuation of Government and other securities and banks and auditors should adopt the method so evolved while finalising the balance sheet as on 31st March 1994.

5.6 In the context of bifurcation of investments in Government securities into ‘‘permanent’’ and ‘‘current’’ category, banks were not required to make provisions for depreciation in respect of investments held under ‘‘permanent’’ category. Hence, it was not necessary to show the difference between the book value and the market value of the investments under this category as a footnote to the balance sheet and the instructions contained at ‘‘Notes and instructions for compilation of balance sheet and profit and loss account’’, advised in February 1992, were withdrawn. However, the difference between the book value and market value could be mentioned by Statutory Auditors in the Long Form Audit Report for the information of the bank’s management.

5.7 In this connection, a reference was also invited to the instructions on accounting standards advised in June1992. It was clarified that while banks may, at their option, value the approved debt securities under the ‘‘permanent’’ category on a consistent basis at market value, they should refrain from doing so in respect of securities whose market price was higher than the book value (cost) on the balance sheet date. In other words, in these cases it was not permissible to carry these securities at a value higher than cost, as this would result in recognising unrealised gains in respect of such investments.

5.8 At a meeting of the Bank Audit Committee, comprising representatives of the Institute of Chartered Accountants of India (ICAI) and Chairmen of some major banks, held in March 1995, the guidelines on valuation of investments were reviewed and, in the light of the discussions held in the meeting, banks were advised as under in April 1995. :

(i) Valuation of ‘‘permanent’’ investments

Banks’ attention was drawn to the instructions of June 1992, in terms of which if the ‘‘permanent’’ investments were carried at book value, the difference between the acquisition price (acquisition cost) and the redemption price should be accrued over the period from the acquisition to the redemption date and should be recognised as income or expense. Further, in February 1994, it was clarified that while banks may, at their option value the approved debt securities under the ‘‘permanent’’ category on a consistent basis at market value, they should refrain from doing so in respect of securities whose market price was higher than the book value (cost) on the balance sheet date. In other words, in these cases, it would not be permissible to carry these securities at a value higher than face/redemption value as this would result in recognising unrealised gain in respect of such investments. It had since been decided that the ‘‘permanent’’ investments should be valued at cost and in case the cost price was higher than the face value, the premium should be amortized over the remaining period of maturity of the security. On the other hand, where the cost price was less than the face value, the difference should be ignored and should not be amortized or taken to income account since the amount represents unrealised gain.

(ii) Investments to be carried at gross or net of depreciation

It was decided that ‘‘investments’’ should be shown in the balance sheet net of depreciation. It would, however, be open to the banks, for disclosure purposes, to show in the balance sheet the book value of investments, the depreciation thereagainst and net amount of investments separately.

(iii) Valuation of investments on a quarterly basis

In the instructions of June 1992, it was mentioned that the carrying value of securities under ‘‘current’’ category should be revalued at market prices on a quarterly basis. It had since been decided that the investments under ‘‘current’’ category should be carried at lower of cost or market value, on a consistent basis and that the valuation should be done on a quarterly basis. In other words, the basis of valuation on quarterly basis would be the same as that followed for annual accounts. It was also decided that the rates of Yield To Maturity (YTM) of different kinds of securities circulated by the Reserve Bank for the final accounts of each year should be used for the subsequent quarters also for the purpose of quarterly valuation of investments. The banks may arrive at on notional basis gains or losses on the basis of such quarterly valuation and it may not be necessary to pass entries booking such gains or losses.

(iv) Treatment of excess depreciation, if any

It was decided that depreciation on ‘‘current’’ investments should be shown in the profit and loss account as a debit item under Schedule 14. It was also decided that where depreciation was provided on ‘‘current’’ investments but, in a subsequent year, the market price of the relevant securities had improved, the excess provision towards depreciation could be taken to the profit and loss account and, thereafter, it could be appropriated to the ‘‘capital reserve’’ account.

(v) <u>Treatment of recapitalisation bonds</u>

The recapitalisation bonds would not form part of ‘‘permanent’’ or ‘‘current’’ investments. It would not be necessary to provide for depreciation on the recapitalisation bonds received by the nationalised banks from Government. In case, however, banks acquired recapitalisation bonds of other bank for investment purposes, the depreciation, if any, would have to be provided for.

(vi) Modification of percentages in respect of classification of investments under <u>‘‘permanent’’ and ‘‘current’’ category</u>

It was advised in June 1992 that, to begin with, banks should keep not more than 70% of their investments in ‘‘permanent’’ category for the accounting year 1992-93, which would be brought down to 50% in due course. It was suggested in the meeting that there was a need for bringing down the ratio to 60:40. It was however, decided to maintain the ratio of approved securities into ‘‘permanent’’ and ‘‘current’’ investments at 70:30 for the year ended 31st March 1995 also.

(vii) <u>Routing of gain from sale of securities</u>

While in April 1992 banks were advised that any gain on sale of securities in the ‘‘permanent’’ category should be taken to ‘‘capital reserve’’ account, it had since been decided that such gain should be first taken to the profit and loss account and thereafter it could be appropriated to the ‘‘capital reserve’’ account.

6 Audit, review and reporting of Investment transactions

For implementing the recommendation contained in the initial Report of the Janakiraman Committee, the following instructions on the captioned subject were issued (alongwith other instructions on conduct of the investment portfolio) :

(i) Banks should undertake a half-yearly review (as of 30th September and 31st 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.

(ii) A copy of the review report put up to the bank’s Board, should be forwarded to the Reserve Bank by 15th November and 15th May respectively.

(iii) 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 Chairman and Managing Director of the Bank once every month. These audit reports should be sent to the Regional Office of Department of Banking Operations and Development (now to Department of Supervision) of the Reserve Bank under whose jurisdiction the Head Office of the bank fell.

7. Reconciliation of holdings of Government Securities, etc.

7.1 Following the initial report of the Janakiraman Committee, comprehensive guidelines/ instructions regarding the conduct of the Investments Portfolio were issued by the Reserve Bank in June 1992. In regard to the Subsidiary General Ledger (SGL) facility provided at the Public Debt Offices (PDOs) of the Reserve Bank, apart from detailed instructions (which have been covered separately), it was advised that records of SGL transfer forms issued/received, should be maintained by banks. Further, balances as per bank's book should be reconciled at quarterly intervals with the balances in the book 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. It was also advised that 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 (now Department of Supervision) 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 other banks and confirmation of authorised signatories should be put in place.

7.2 In this connection, banks were further advised in December 1992 that during the course of scrutiny of security transactions of banks/Financial Institutions, instances of shortages in holdings of securities had come to Reserve Bank's notice. Therefore, banks and their subsidiaries/Mutual Funds should reconcile the securities held by them, both on their own Investment Account, as well as Portfolio Management Scheme (PMS), as on 31st December 1992. Further, a reconciliation statement, in the prescribed proforma, should be furnished to the Reserve Bank, duly certified by the bank's auditors. (The format for the Statement is at Annexure I, while the instructions for compiling it are in Annexure II.)

7.3 In this connection, it was clarified in February 1993 that there was no objection to the aforementioned verification/certification being done either by the bank's own internal auditors or by external auditors.

8. Transactions in Securities — Custodial Functions

8.1 In continuation of the detailed instructions in regard to management of investment portfolio of banks, particularly relating to transactions in securities, issued in June 1992, banks were advised in August 1992 that when they exercised 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 had been executed. Banks were instructed to issue suitable instructions in this regard to the department/office undertaking the custodial functions on behalf of their subsidiaries.

8.2 Investment in Government securities by Trusts etc.

Banks were advised in January 1963 that under Section 6 of the Public Debt Act, 1944, no notice of any trust was receivable by Government in respect of Government securities. Consequently, the Public Debt Office of the Reserve Bank treats, and has to treat, every person, in whose name a Government security stands, as the full owner thereof, even though the said per

Son may be having no personal interest in the security but may be holding it merely as a trustee of a particular trust or as an office-holder of a society or a fund, i.e., in a fiduciary or representative capacity. Holding of securities in the personal names of officials or trusts was liable to lead to considerable difficulties under certain circumstances. Since the Public Debt Office was bound to treat the "holder" as the "owner", it followed that if a trustee or office-holders, in whose personal name a security (belonging to a trust or society) was held, dies, the Public Debt Office would refuse to make any payment on the security to the trust or society unless the said trust or society obtained legal representation (i.e. Probate, Letters of Administration or Succession Certificate) in the estate of the deceased trustee/office-holder. As the obtaining of such a grant entailed considerable inconvenience and expenses, the societies or trusts concerned were, as a rule, unwilling to adopt this course and approach the Reserve Bank for relaxations, which the Public Debt Office was understandably reluctant to make, except on the condition that the claimant body executed a bond of indemnity in the Reserve Bank's favour jointly with one or two sureties. Very often, it was difficult for the claimants to arrange for sureties of the requisite financial standing. It also sometimes happened that the office-holder/trustee, in whose favour a security was held, resigned and omitted or refused to transfer the security to his successor-in-office. In such cases, the Public Debt Office was unable to help the real beneficiary whose only course was to bring a suit against the ex-trustee or the ex-official in a civil court for obtaining a proper decree to enable the Public Debt Office to recognise the claimant's title.

It was further mentioned that a body which had a corporate status could, of course, hold Government securities in its corporate name, but this recourse was not available in the case of unincorporated bodies — to which category most trusts, provident funds, etc., usually belonged. The most convenient course for such bodies was to hold securities in the form of Stock Certificates (and not in the form of Government Promissory Notes). Under Rule 8 (2)(b) of Public Debt Rules, 1946, Stock Certificates could be issued in favour of officials/trustees ex-officio without mentioning their personal names, so that in the event of death or resignation, the security could be dealt with immediately by the successor-in-office, without any formality. No question of legal representation or indemnity bond would arise if securities were so held.

Besides the above advantage, holding in stock was very convenient from the point of view of a long-term investor. For example, the periodical interest on Stock Certificates was remitted by the Public Debt Office to the holder or to the holder's bankers on the due date, without any cost to the holder, whereas a Government promissory note had to be physically presented for drawal of interest every time such interest was drawn. Again, if a Government Promissory note was lost, the procedure for obtaining a duplicate was a long and expensive one, whereas a lost/destroyed Stock Certificate could be replaced by the Public Debt Office on the holder merely reporting the loss and executing an affidavit.

It was added that like Stock Certificates, Treasury Savings Deposit Certificates and Defence Deposit Certificates could also be issued in favour of office holders and trustees, ex-officio. Usually, all organisations like provident funds and trusts, made investments through, or on the advice of their bankers and, therefore, the expense and inconvenience caused to the beneficiaries in such cases would be obviated, if banks were to advise the above position to their customers.

Banks were advised that they might, therefore, take note of these instructions and also communicate them to such of their customers as belonged to the above categories with the advice that if any securities were held by their officials/trustees in their personal names, they would be well advised to contact the nearest Public Debt Office for getting the matter regularised.

In conclusion, it was indicated that in case any clarification or further information on any point was required, reference may be made to the Public Debt Office.

The stipulation of minimum period of three days for ready forward transactions has been withdrawn from October 31, 1998