

Investment Portfolio of Banks-Transactions in securities

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July 02, 2003

Chief Executive Officers

All Primary (Urban) Co-operative Banks

Dear Sir,

Investment Portfolio of Banks-Transactions in securities

Reserve Bank of India had issued detailed guidelines relating to conduct of investment portfolio by primary (urban) co-operative banks. The important instructions contained in the various guidelines issued by the Reserve Bank of India were also consolidated in circular UBD No. Plan.PCB.CIR41/09.29.00/ 2001-2002 dated April 20, 2002. A summary of these instructions is given below:

- (i) Primary (urban) co-operative banks (UCBs) should not undertake any purchase / sale transactions with broking firms or other intermediaries on principal -to-principal basis.
- (ii) UCBs should seek a scheduled commercial bank, a Primary Dealer, a Financial Institution, another UCB, an insurance company, a provident fund or a mutual fund as a counter-party for their transactions. Preference should be for direct deals with such counter -parties. It will be desirable to check prices from other banks, relevant internet sites or PDs / banks with whom the bank may be maintaining constituent SGL Account (CSGL).
- (iii) UCBs should take advantage of non-competitive bidding facility provided to them for acquiring Government securities in the primary auctions conducted by the Reserve Bank of India.
- (iv) If a deal is put through with the help of broker, the role of the broker should be restricted to that of bringing the two parties to the deal together. Under no circumstances, bank should give power of attorney or any other authorization to brokers / intermediaries to deal on their behalf in the money and securities markets.
- (v) Only brokers registered with NSE or BSE or OTCEI should be utilised for **acting as intermediary**.
- (vi) A disproportionate part of the business should not be transacted with or through one or a few brokers. Banks should have a panel of approved brokers, which should be reviewed every year. A limit of 5% of total transactions (both purchases 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.
- (vii) Brokers should not be used in the settlement process at all, that is, both fund settlement and delivery of security should be done with the counter-parties directly. CSGL Accounts should be used for holding the securities and such

accounts should be maintained in the same bank with whom the current account is maintained. For all transactions, delivery versus payment must be insisted upon by the UCBs.

- (viii) All transactions must be monitored to see that delivery takes place on the settlement day. The funds account and investment account should be reconciled on the same day, before close of business.
- (ix) Dealing and back-office functions should be properly segregated. Officials deciding about purchase and sale transactions should be separate from those responsible for settlement and accounting.
- (x) All investment transactions should be perused by the Board at least once a month.
- (xi) The banks should keep a proper record of the SGL forms received / issued to facilitate counter-checking by their internal auditors.
- (xii) The concurrent auditors should certify that the investments held by the bank as on the last reporting Friday of each quarter and as reported to the Reserve Bank of India are actually owned / held by it, as evidenced by physical securities or the custodian's statement.

2. In the light of reports that UCBs are investing in certain illiquid securities, though they qualify for the purpose of Statutory Liquidity Ratio (SLR), it is reiterated that the UCBs should strictly comply with the guidelines on transactions in securities issued by the Reserve Bank of India. Further, while making investment in approved securities, the UCBs should adhere to the following additional guidelines:

- (a) In case a UCB proposes to buy the securities to meet its SLR requirements, the bank should ensure from the counterparties that the bonds they purchase are, and would continue, to have SLR status. They should also verify this from independent sources, in case of doubt.
- (b) While investing in long term debt instruments, the banks should thoroughly satisfy themselves about the terms and conditions of issue, namely, payment of interest and repayment of principal, and ensure that there are no clauses permitting the issuer for rescheduling such repayments.
- (c) The banks investing in non-SLR securities should take abundant precaution to satisfy themselves about the financial condition of the entity issuing the securities. The banks could be guided by the audited balance sheet of the issuer, rating accorded by a recognised credit rating agency, etc. in this regard.
- (d) In order to avoid concentration of risk, the banks should have a fairly diversified investment portfolio. Smaller investment portfolios should preferably be restricted to securities with high safety and liquidity, such as, Government securities.

3. It is further reiterated that the banks should scrupulously adhere to the prudential norm of 5% of the total transactions for routing through individual brokers, as stated paragraph 1(v) above. The UCBs should also verify the antecedents of each broker before empanelling and dealing with him.

4 The banks should ensure that the transactions in securities are undertaken strictly in conformity with Reserve Bank of India guidelines. Any deviations from the guidelines / instructions shall be viewed very seriously and would invite penal action as per the provisions of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies).

Please acknowledge receipt of this circular to our concerned Regional Office.

Yours faithfully,

(K.V. Rajan)
Chief General Manager