Prudential guidelines on banks' investment in non-SLR securities

DBOD.BP.BC.44/21.04.141/2003-04

November 12, 2003

All Scheduled commercial banks
(excluding RRBs and LABs)

Dear Sir,

Prudential guidelines on banks'
<u>investment in non-SLR securities</u>

In terms of paragraph 68 of the Statement on Mid-Term Review of Monetary and Credit Policy for the year 2001-02, draft operating guidelines on management of non-SLR investment portfolio by banks was issued vide letter DBOD.BP.858/ 21.04.141/ 2001-02 dated October 27, 2001 for obtaining views / comments of banks. The draft guidelines were revised on the basis of feedback received and was forwarded to a select group of banks, FIMMDA and IBA in May 2002 for their comments and views. Paragraph 133 of the Statement on Monetary and Credit Policy for the year 2002-03 also emphasized that banks should observe further prudence in order to contain the risk arising out of non-SLR investment portfolio of banks and FIs, in particular through private placement route.

2. SEBI has since advised the guidelines required to be complied with by listed companies making issue of debt securities on a private placement basis and listed on a stock exchange vide circular SEBI/MRD/SE/AT/36/2003/30/9 dated September 30, 2003.

3. In order to contain the risks arising out of non-SLR investment portfolio of banks, in particular through private placement, draft guidelines were issued to banks vide our letter DBOD. No. BP. 711/ 21.04.141/ 2002-03 dated October 27, 2003 inviting their comments. Taking into account the feedback received in this regard the guidelines have been finalized and are furnished in the Annex. These guidelines come into force with immediate effect. The prudential guidelines on investment by banks in non-SLR securities, *inter alia*, address the following:

i) Coverage,
ii) Regulatory requirements,

iii) Listing and rating requirements,
iv) Fixing of prudential limits,
v) Internal assessments,
vi) Role of Boards,
vii) Disclosures, and
viii) Trading and settlement in debt securities.

Yours faithfully,

(C. R. Muralidharan)
Chief General Manager-in-Charge

ANNEX

Guidelines on investments by banks in non-SLR Securities

Coverage

1. These guidelines cover banks' investments in non-SLR securities issued by corporates, banks, FIs and State and Central Government sponsored institutions, SPVs etc. These guidelines will, however, not be applicable to investments in securities issued directly by the Central and State Governments, which are not reckoned for SLR purpose, and investments in equity shares. The guidelines will apply to investments both in the primary market as well as the secondary market.

2. Definitions of a few terms used in these guidelines have been furnished in Appendix I with a view to ensure uniformity in approach while implementing the guidelines.

Regulatory requirements

3. Banks should not invest in Non-SLR securities of original maturity of less than one-year, other than Commercial Paper and Certificates of Deposits which are covered under RBI guidelines.

4. Banks should undertake usual due diligence in respect of investments in non-SLR securities. Present RBI regulations preclude banks from extending credit facilities for certain purposes. Banks should ensure that such activities are not financed by way of funds raised through the non-SLR securities.

Listing and rating requirements

5. Banks must not invest in unrated non-SLR securities.

6. The Securities Exchange Board of India (SEBI) vide their circular dated September 30, 2003 have stipulated requirements that listed companies are required to comply with, for making issue of debt securities on a private placement basis and listed on a stock exchange. According to this circular any listed company, making issue of debt securities on a private placement basis and listed on a stock exchange, has to make full disclosures (initial and continuing) in the manner prescribed in Schedule II of the Companies Act 1956, SEBI (Disclosure and Investor Protection)

Guidelines, 2000 and the Listing Agreement with the exchanges. Furthermore, the debt securities shall carry a credit rating of not less than investment grade from a Credit Rating Agency registered with the SEBI.

Accordingly, while making fresh investments in non-SLR debt securities, banks should ensure that such investment are made only in listed debt securities of companies which comply with the requirements of the SEBI circular dated September 30, 2003, except to the extent indicated in paragraphs 7 and 8 below.

Fixing of prudential limits

7. Bank's investment in unlisted non-SLR securities should not exceed 10 per cent of its total investment in non-SLR securities as on March 31, of the previous year. The unlisted non-SLR securities in which banks may invest up to the limits specified above, should comply with the disclosure requirements as prescribed by the SEBI for listed companies.

8. Bank's investment in unlisted non-SLR securities may exceed the limit of 10 per cent, by an additional 10 per cent, provided the investment is on account of investment in securities issued by SPVs for Mortgage Backed Securities (MBS), securitisation papers issued for infrastructure projects, and bonds/debentures/Security Receipts/Pass Through Certificates issued by Securitisation Companies and Reconstruction Companies set up under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and registered with RBI. In other words investment exclusively in securities specified in this paragraph could be up to the maximum permitted limit of 20 per cent of non-SLR investment.

9. Banks which have exposure to investments in unlisted non-SLR securities in excess of the prudential limit prescribed above as on March 31, 2003 should not make any fresh investment in such securities till they ensure compliance with the above prudential limit.

Internal assessment

10. Since non-SLR securities are mostly in the form of credit substitutes, banks were advised in June 2001 to (i) subject all their investment proposals relating to non-SLR securities to credit appraisal on par with their credit proposals, irrespective of the fact that the proposed investments may be in rated securities, (ii) make their own internal credit analysis and rating even in respect of rated issues and that they should not entirely rely on the ratings of external agencies, and (iii) strengthen their internal rating systems which should also include building up of a system of regular (quarterly or half-yearly) tracking of the financial position of the issuer with a view to ensuring continuous monitoring of the rating migration of the issuers/issues.

Role of Boards

11. Banks should ensure that their investment policies duly approved by the Board of Directors are formulated after taking into account all the relevant issues specified in these guidelines on investment in non-SLR securities. Banks should put in place proper risk management systems for capturing and analysing the risk in respect of non-SLR investment and taking remedial measures in time. Banks should also put in place appropriate systems to ensure that investment in privately placed instruments is made in accordance with the systems and procedures prescribed under respective bank's investment policy.

12. Boards of banks should review the following aspects of non-SLR investment at least at quarterly intervals:

    a) Total business (investment and divestment) during the reporting period.

    b) Compliance with the prudential limits prescribed by the Board for non-SLR investment.

    c) Compliance with the prudential guidelines on non-SLR securities prescribed in paragraphs 7 to 9 above.

    d) Rating migration of the issuers/ issues held in the bank's books and consequent diminution in the portfolio quality.

    e) Extent of non performing investments in the non-SLR category.

Disclosures

13. In order to help in the creation of a central database on private placement of debt, a copy of all offer documents should be filed with the Credit Information Bureau (India) Ltd. (CIBIL) by the investing banks. Further, any default relating to interest/ instalment in respect of any privately placed debt should also be reported to CIBIL by the investing banks along with a copy of the offer document.

14. Banks should disclose the details of the issuer composition of non-SLR investments and the non-performing non-SLR investments in the 'Notes on Accounts' of the balance sheet, as indicated in Appendix II.

Trading and settlement in debt securities

15. As per the SEBI guidelines, all trades with the exception of the spot transactions, in a listed debt security, shall be executed only on the trading platform of a stock exchange. In addition to complying with the SEBI guidelines, banks should ensure that all spot transactions in listed and unlisted debt securities are reported on the NDS and settled through the CCIL from a date to be notified by RBI.

Appendix I

Guidelines on investments by banks in non-SLR investment portfolio by banks – Definitions

(Vide paragraph 2 of the Guidelines)

1. With a view to imparting clarity and to ensure that there is no divergence in the implementation of the guidelines, some of the terms used in the guidelines are defined below.

2. A security will be treated as rated if it is subjected to a detailed rating exercise by an external rating agency in India which is registered with SEBI and is carrying a current or valid rating. The rating relied upon will be deemed to be current or valid if

   i) The credit rating letter relied upon is not more than one month old on the date of opening of the issue, and

   ii) The rating rationale from the rating agency is not more than one year old on the date of opening of the issue, and

   iii) The rating letter and the rating rationale is a part of the offer document.

   iv) In the case of secondary market acquisition, the credit rating of the issue should be in force and confirmed from the monthly bulletin published by the respective rating agency.

Securities which do not have a current or valid rating by an external rating agency would be deemed as unrated securities.

3. The investment grade ratings awarded by each of the external rating agencies operating in India would be identified by the IBA/ FIMMDA. These would also be reviewed by IBA/ FIMMDA at least once a year.

4. A 'listed' security is a security which is listed in a stock exchange. If not so, it is an 'unlisted' security.

5. A non performing investment (NPI), similar to a non performing advance (NPA), is one where

   i) Interest/ instalment (including maturity proceeds) is due and remains unpaid for more than 180 days. The delinquency period would become 90 days with effect from 31st March 2004.

   ii) The above would apply mutatis-mutandis to preference shares where the fixed dividend is not paid.

   iii) In the case of equity shares, in the event the investment in the shares of any company is valued at Re.1 per company on account of the non availability of the latest balance sheet in accordance with the instructions contained in para 28 of the

Annexure to circular DBOD.BP.BC.32/ 21.04.048/ 2000-01 dated October 16, 2000, those equity shares would also be reckoned as NPI.

iv) If any credit facility availed by the issuer is NPA in the books of the bank, investment in any of the securities issued by the same issuer would also be treated as NPI.

Appendix II

Prudential guidelines on management of the non-SLR investment portfolio by banks – Disclosures requirements

(vide paragraph 14 of the Guidelines)

Banks should make the following disclosures in the 'Notes on Accounts' of the balance sheet in respect of their non-SLR investment portfolio, with effect from the financial year ending 31 March 2004.

i) Issuer composition of Non SLR investments

(Rs. in crore)

No.	**Issuer**	**Amount**	**Extent of private placement**	**Extent of 'below investment grade' securities**	**Extent of 'unrated' Securities**	**Extent of 'unlisted' securities**
(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**
1	PSUs					
2	FIs					
3	Banks					
4	Private corporates					
5	Subsidiaries/ Joint ventures					
6	Others					
7	Provision held towards depreciation		X X X	X X X	X X X	X X X
	Total *					

NOTE: 1. * Total under column 3 should tally with the total of investments included under the following categories in Schedule 8 to the balance sheet:

a. Shares

b. Debentures & Bonds

c. Subsidiaries/ joint ventures

d. Others

2. Amounts reported under columns 4, 5, 6 and 7 above may not be mutually exclusive.

ii) <u>Non performing Non-SLR investments</u>

Particulars	**Amount (Rs. Crore)**
Opening balance	
Additions during the year since 1st April	
Reductions during the above period	
Closing balance	
Total provisions held	