



भारतीय रिज़र्व बैंक  
RESERVE BANK OF INDIA  
www.rbi.org.in

**RBI/ 2009-10/20**

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July 1, 2009

**All Commercial Banks  
(excluding Regional Rural Banks)**

Dear Sir,

**Master Circular – Prudential norms for classification,  
valuation and operation of investment portfolio by banks**

Please refer to the Master Circular No. [DBOD. BP. BC.5 / 21.04.141/ 2007-08](#) dated July 1, 2008, containing consolidated instructions/guidelines issued to banks till June 30, 2008, on matters relating to prudential norms for classification, valuation and operation of investment portfolio by banks. The above Master Circular has since been suitably updated by incorporating instructions/guidelines issued between July 1, 2008 and June 30, 2009, and furnished in the Annex. This updated version has also been placed on the RBI web-site (<http://www.rbi.org.in>).

2. An appendix containing a list of circulars referred for the purpose of the current Master circular is furnished at the end of the Annex.

Yours faithfully,

(B.Mahapatra)  
Chief General Manager

Encl: As above

**MASTER CIRCULAR – PRUDENTIAL NORMS FOR CLASSIFICATION,  
VALUATION AND OPERATION OF INVESTMENT PORTFOLIO BY BANKS**

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**MASTER CIRCULAR – PRUDENTIAL NORMS FOR CLASSIFICATION,  
VALUATION AND OPERATION OF INVESTMENT PORTFOLIO BY BANKS**

**1. Introduction**

With the introduction of prudential norms on capital adequacy, income recognition, asset classification and provisioning requirements, the financial position of banks in India has improved in the last few years. Simultaneously, trading in securities market has improved in terms of turnover and the range of maturities dealt with. In view of these developments and taking into consideration the evolving international practices, Reserve Bank of India (RBI) has issued guidelines on classification, valuation and operation of investment portfolio by banks from time to time as detailed below:

**1.1 Investment Policy**

**i)** Banks should frame Internal Investment Policy Guidelines and obtain the Board's approval. The investment policy may be suitably framed/amended to include Primary Dealer (PD) activities also. Within the overall framework of the investment policy, the PD business undertaken by the bank will be limited to dealing, underwriting and market-making in Government Securities. Investments in Corporate/ PSUs/ FIs bonds, Commercial Papers, Certificate of Deposits, debt mutual funds and other fixed income securities will not be deemed to be part of PD business. The investment policy guidelines should be implemented to ensure that operations in securities are conducted in accordance with sound and acceptable business practices. While framing the investment policy, the following guidelines are to be kept in view by the banks:

**(a)** Banks may sell a government security already contracted for purchase, provided:

**(i)** The purchase contract is confirmed prior to the sale,

**(ii)** The purchase contract is guaranteed by CCIL or the security is contracted for purchase from the Reserve Bank and,

**(iii)** The sale transaction will settle either in the same settlement cycle as the preceding purchase contract, or in a subsequent settlement cycle so that the delivery obligation under the sale contract is met by the securities acquired under the purchase contract (e.g. when a security is purchased on T+0 basis, it can be sold on either T+0 or T+1 basis on the day of the purchase; if however it is purchased on T+1 basis, it can be sold on T+1 basis on the day of purchase or on T+0 or T+1 basis on the next day).

For purchase of securities from RBI through Open Market Operations (OMO), no sale transactions should be contracted prior to receiving the confirmation of the deal/advice of allotment from the RBI.

- In addition to the above, the Scheduled Commercial Banks (other than RRBs and LABs) and Primary Dealers have been permitted to short sell Government securities in accordance with the requirements specified in **Annexure I - A**.
- Further, the NDS-OM members have been permitted to transact on 'When Issued' basis in Central Government dated securities, subject to the guidelines specified in **Annexure I-B**.

**(b)** Banks successful in the auction of primary issue of government may enter into contracts for sale of the allotted securities in accordance with the terms and conditions as per **Annexure I-C**.

**(c)** The settlement of all outright secondary market transactions in Government Securities will be done on a standardized T+1 basis effective May 24, 2005.

**(d)** All the transactions put through by a bank, either on outright basis or ready forward basis and whether through the mechanism of Subsidiary General Ledger (SGL) Account or Bank Receipt (BR), should be reflected on the same day in its investment account and, accordingly, for SLR purpose wherever applicable.

**(e)** 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/ memoranda put up to the top management seeking approval for putting through the transaction and a separate account of brokerage paid, broker-wise, should be maintained.

**(f)** For issue of BRs, the banks should adopt the format prescribed by the Indian Banks' Association (IBA) and strictly follow the guidelines prescribed by them in this regard. The banks, subject to the above, could issue BRs covering their own sale transactions only and should not issue BRs on behalf of their constituents, including brokers.

**(g)** The banks should be circumspect while acting as agents of their broker clients for carrying out transactions in securities on behalf of brokers.

**(h)** Any instance of return of SGL form from the Public Debt Office 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.

**(i)** Banks desirous of making investment in equity shares/ debentures should observe the following guidelines:

**(i)** Build up adequate expertise in equity research by establishing a dedicated equity research department, as warranted by their scale of operations;

**(ii)** Formulate a transparent policy and procedure for investment in shares, etc., with the approval of the Board; and

**(iii)** The decision in regard to direct investment in shares, convertible bonds and debentures should be taken by the Investment Committee set up by the bank's Board. The Investment Committee should be held accountable for the investments made by the bank.

**ii)** With the approval of respective Boards, banks should clearly lay down the broad investment objectives to be followed while undertaking transactions in securities on their own investment account and on behalf of clients, clearly define the authority to put through deals, procedure to be followed for obtaining the sanction of the appropriate authority, procedure to be followed while putting through deals, various prudential exposure limits and the reporting system. While laying down such investment policy guidelines, banks should strictly observe Reserve Bank's detailed instructions on the following aspects:

- |  |                   |
|--|-------------------|
| (a) Ready Forward (buy back) deals                     | (Paragraph 1.1.1) |
| (b) Transactions through Subsidiary General Ledger A/c | (Paragraph 1.1.2) |
| (c) Use of Bank Receipts                               | (Paragraph 1.1.3) |
| (d) Retailing of Government Securities                 | (Paragraph 1.1.4) |
| (e) Internal Control System                            | (Paragraph 1.1.5) |
| (f) Dealings through Brokers                           | (Paragraph 1.1.6) |
| (g) Audit, Review and Reporting                        | (Paragraph 1.1.7) |
| (h) Non- SLR investments                               | (Paragraph 1.1.8) |

**iii)** The aforesaid instructions will be applicable mutatis mutandis, to the subsidiaries and mutual funds established by banks, except where they are contrary to or inconsistent with, specific regulations of Securities and Exchange Board of India (SEBI) and RBI governing their operations.

### **1.1.1 Ready Forward Contracts in Government Securities.**

The terms and conditions subject to which ready forward contracts (including reverse ready forward contracts) may be entered into are as under:

**(a)** Ready forward contracts may be undertaken only in (i) Dated Securities and Treasury Bills issued by Government of India and (ii) Dated Securities issued by State Governments.

**(b)** Ready forward contracts in the above-mentioned securities may be entered into by:

**i)** persons or entities maintaining a Subsidiary General Ledger (SGL) account with RBI, Mumbai and

**ii)** the following categories of entities who do not maintain SGL accounts with the RBI but maintain gilt accounts (i.e gilt account holders) with a bank or any other entity (i.e. the custodian) permitted by the RBI to maintain Constituent Subsidiary General Ledger (CSGL) account with its Public Debt Office, Mumbai:

**(a)** Any scheduled bank,

**(b)** Any primary dealer authorised by the RBI,

**(c)** Any non-banking financial company registered with the RBI, other than Government companies as defined in Section 617 of the Companies Act, 1956,

**(d)** Any mutual fund registered with the SEBI,

**(e)** Any housing finance company registered with the National Housing Bank,

**(f)** Any insurance company registered with the Insurance Regulatory and Development Authority,

**(g)** Any non-scheduled Urban Co-operative bank,

**(h)** Any listed company, having a gilt account with a scheduled commercial bank, subject to the following conditions:

**(1)** The minimum period for Reverse Repo (lending of funds) by listed companies is seven days. However, listed companies can borrow funds through repo for shorter periods including overnight;

**(2)** Where the listed company is a 'buyer' of securities in the first leg of the repo contract (i.e. lender of funds), the custodian through which the repo transaction is settled should block these securities in the gilt account and ensure that these securities are not further sold or re-repoed during the repo period but are held for delivery under the second leg; and

**(3)** The counterparty to the listed companies for repo / reverse repo transactions should be either a bank or a Primary Dealer maintaining SGL Account with the RBI.

**(c)** All persons or entities specified at (ii) above can enter into ready forward transactions among themselves subject to the following restrictions:

**i)** An SGL account holder may not enter into a ready forward contract with its own constituent. That is, ready forward contracts should not be undertaken between a custodian and its gilt account holder,

**ii)** Any two gilt account holders maintaining their gilt accounts with the same custodian (i.e., the CSGL account holder) may not enter into ready forward contracts with each other, and

**iii)** Cooperative banks may not enter into ready forward contracts with the non-banking financial companies. This restriction would not apply to repo transactions between Urban Co-operative banks and authorised Primary Dealers in Government Securities.

**(d)** All ready forward contracts shall be reported on the Negotiated Dealing System (NDS). In respect of ready forward contracts involving gilt account holders, the custodian (i.e., the CSGL account holder) with whom the gilt accounts are maintained will be responsible for reporting the deals on the NDS on behalf of the constituents (i.e. the gilt account holders).

**(e)** All ready forward contracts shall be settled through the SGL Account / CSGL Account maintained with the RBI, Mumbai, with the Clearing Corporation of India Ltd. (CCIL) acting as the central counter party for all such ready forward transactions.

**(f)** The custodians should put in place an effective system of internal control and concurrent audit to ensure that:

**i)** ready forward transactions are undertaken only against the clear balance of securities in the gilt account,

**ii)** all such transactions are promptly reported on the NDS, and



**iii)** other terms and conditions referred to above have been complied with.

**(g)** The RBI regulated entities can undertake ready forward transactions only in securities held in excess of the prescribed Statutory Liquidity Ratio (SLR) requirements.

**(h)** No sale transaction shall be put through, in the first leg of a ready forward transaction by CSGL constituent entities, without actually holding the securities in the portfolio.

**(i)** Securities purchased under the ready forward contracts shall not be sold during the period of the contract except by entities permitted to undertake short selling.

**(j)** Double ready forward deals in any security are strictly prohibited.

**(k)** The guidelines for uniform accounting for Repo / Reverse Repo transactions are furnished in paragraph 4.

### **1.1.2 Transactions through SGL account**

The following instructions should be followed by banks for purchase / sale of securities through SGL A/c, under the Delivery Versus Payment (DvP) System wherein the transfer of securities takes place simultaneously with the transfer of funds. It is, therefore, necessary for both the selling bank and the buying bank to maintain current account with the RBI. As no 'Overdraft facility' in the current account would be extended, adequate balance in current account should be maintained by banks for effecting any purchase transaction.

**i)** All transactions in Govt. securities for which SGL facility is available should be put through SGL A/cs only.

**ii)** Under no circumstances, a SGL transfer form issued by a bank in favour of another bank should bounce for want of sufficient balance of securities in the SGL A/c of seller or for want of sufficient balance of funds in the current a/c of the buyer.

**iii)** The SGL transfer form received by purchasing banks should be deposited in their SGL A/cs. immediately i.e. the date of lodgement of the SGL Form with RBI shall be within one working day after the date of signing of the Transfer Form. While in cases

of OTC trades, the settlement has to be only on 'spot' delivery basis as per Section 2(i) of the Securities Contracts (Regulations) Act, 1956, in cases of deals on the recognised Stock Exchanges; settlement should be within the delivery period as per their rules, bye laws and regulations. In all cases, participants must indicate the deal/trade/contract date in Part C of the SGL Form under 'Sale date'. Where this is not completed the SGL Form will not be accepted by the RBI.

- iv)** No sale should be effected by way of return of SGL form held by the bank.
  
- v)** SGL transfer forms should be signed by two authorised officials of the bank whose signatures should be recorded with the respective PDOs of the RBI and other banks.
  
- vi)** The SGL transfer forms should be in the standard format prescribed by the RBI 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.
  
- vii)** If a SGL transfer form bounces for want of sufficient balance in the SGL A/c, the (selling) bank which has issued the form will 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 RBI.
  
  - b)** In the event of an overdraft arising in the current account following such a debit, penal interest would be charged by the RBI, on the amount of the overdraft, at a rate of 3 percentage points above the SBI Discount and Finance House of India's (SBIDFHI) call money lending rate on the day in question. However, if the SBIDFHI's closing call money rate is lower than the prime lending rate of banks, as stipulated in the RBI's interest rate directive in force, the applicable penal rate to be charged will be 3 percentage points, above the prime lending rate of the bank concerned, and
  
  - c)** If the bouncing of the SGL form occurs thrice, the bank will be debarred from trading with the use of the SGL facility for a period of 6 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 RBI.

**d)** The bouncing on account of insufficient balance in the current account of the buying bank would be reckoned (against the buying bank concerned) for the purpose of debarment from the use of SGL facility on par with the bouncing on account of insufficient balance in SGL a/c. of the selling bank (against selling bank). Instances of bouncing in both the accounts (i.e SGL a/c and current a/c) will be reckoned together against the SGL account holder concerned for the purpose of debarment (i.e three in a half-year for temporary suspension and any bouncing after restoration of SGL facility, for permanent debarment.)

### **1.1.3 Use of Bank Receipt (BR)**

The banks should follow the following instructions for issue of BRs:

- a)** No BR should be issued under any circumstances in respect of transactions in Govt. securities for which SGL facility is available.
- b)** Even in the case of other securities, BR may be issued for ready transactions only, under the following circumstances:
  - (i)** The scrips are yet to be issued by the issuer and the bank is holding the allotment advice.
  - (ii)** The security is physically held at a different centre and the bank is in a position to physically transfer the security and give delivery thereof within a short period.
  - (iii)** The security has been lodged for transfer / interest payment and the bank is holding necessary records of such lodgements and will be in a position to give physical delivery of the security within a short period.
- c)** No BR should be issued on the basis of a BR (of another bank) held by the bank and no transaction should take place on the basis of a mere exchange of BRs held by the bank.
- d)** BRs could be issued covering transactions relating to banks' own Investments Accounts only, and no BR should be issued by banks covering transactions relating to

either the Accounts of Portfolio Management Scheme (PMS) Clients or Other Constituents' Accounts, including brokers.

- e) No BR should remain outstanding for more than 15 days.
- f) A BR should be redeemed only by actual delivery of scrips and not by cancellation of the transaction/set off against another transaction. If a BR is not redeemed by delivery of scrips within the validity period of 15 days, the BR should be deemed as dishonoured and the bank which has issued the BR should refer the case to the RBI, explaining the reasons for which the scrips could not be delivered within the stipulated period and the proposed manner of settlement of the transaction.
- g) BRs should be issued on semi-security paper, in the standard format (prescribed by IBA), serially numbered and signed by two authorised officials of the bank, whose signatures are recorded with other banks. As in the case of SGL forms, there should be a control system in place to account for each BR form.
- h) Separate registers of BRs issued and BRs received should be maintained and arrangements should be put in place to ensure that these are systematically followed up and liquidated within the stipulated time limit.
- i) The banks should also have a proper system for the custody of unused B.R. Forms and their utilisation. The existence and operations of these controls at the concerned offices/ departments of the bank should be reviewed, among others, by the statutory auditors and a certificate to this effect may be forwarded every year to the Regional Office of Department of Banking Supervision (DBS), RBI, under whose jurisdiction the Head Office of the bank is located.
- j) Any violation of the instructions relating to BRs would invite penal action, which could include raising of reserve requirements, withdrawals of refinance facility from the RBI and denial of access to money markets. The RBI may also levy such other penalty as it may deem fit in accordance with the provisions of the Banking Regulation Act, 1949.

#### **1.1.4 Retailing of Government Securities**

The banks may undertake retailing of Government securities with non-bank clients subject to the following conditions:

- i) Such retailing should be on outright basis and there is no restriction on the period between sale and purchase.
- ii) The retailing of Government securities should be on the basis of ongoing market rates/ yield curve emerging out of secondary market transactions.

### **1.1.5 Internal Control System**

The banks should observe the following guidelines for internal control system in respect of investment transactions:

**(a)** There should be a clear functional separation of (i) trading, (ii) settlement, monitoring and control and (iii) 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. The Portfolio Management service may be provided to clients, subject to strictly following the guidelines in regard thereto (covered in paragraph 1.3.3). Further, PMS Clients Accounts should be subjected to a separate audit by external auditors.

**(b)** 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 counter-party, whether it is 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 has been properly accounted for. Once the deal is 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.

**(c)** With respect to transactions matched on the NDS-OM module, since CCIL is the central counterparty to all deals, exposure of any counterparty for a trade is only to CCIL and not to the entity with whom a deal matches. Besides, details of all deals on NDS-OM are available to the counterparties as and when required by way of reports on NDS-OM itself. In view of the above, the need for counterparty confirmation of deals matched on NDS-OM does not arise. However, all government securities transactions,

other than those matched on NDS-OM, will continue to be physically confirmed by the back offices of the counterparties, as hitherto.

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

**(e)** 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 account.

**(f)** In the case of transaction relating to PMS Clients' Accounts (including brokers), all the relative records should give a clear indication that the transaction belongs to PMS Clients/ other constituents and does not belong to bank's own Investment Account and the bank is acting only in its fiduciary/ agency capacity.

**(g) (i)** Records of SGL transfer forms issued/ received, should be maintained.

**(ii)** 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 be periodically checked by the internal audit department.

**(iii)** 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 Regional Office of Department of Banking Supervision of RBI by the buying bank.

**(iv)** A record of BRs issued/ received should be maintained.

**(v)** 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.

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

- (i)** Banks should not draw cheques on their account with the RBI for third party transactions, including inter-bank transactions. For such transactions, bankers' cheques/ pay orders should be issued.
- (j)** In case of investment in shares, the surveillance and monitoring of investment should be done by the Audit Committee of the Board, which shall review in each of its meetings, the total exposure of the bank to capital market both fund based and non-fund based, in different forms as stated above and ensure that the guidelines issued by RBI are complied with and adequate risk management and internal control systems are in place;
- (k)** The Audit Committee should keep the Board informed about the overall exposure to capital market, the compliance with the RBI and Board guidelines, adequacy of risk management and internal control systems;
- (l)** In order to avoid any possible conflict of interest, it should be ensured that the stockbrokers as directors on the Boards of banks or in any other capacity, do not involve themselves in any manner with the Investment Committee or in the decisions in regard to making investments in shares, etc., or advances against shares.
- (m)** 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.
- (n)** The banks' managements should ensure that there are adequate internal control and audit procedures for ensuring proper compliance of the instructions in regard to the conduct of the investment portfolio. The banks should institute a regular system of monitoring compliance with the prudential and other guidelines issued by the RBI. The banks should get compliance in key areas certified by their statutory auditors and furnish such audit certificate to the Regional Office of DBS, RBI under whose jurisdiction the HO of the bank falls.

### 1.1.6 Engagement of brokers

i) For engagement of brokers to deal in investment transactions, the banks should observe the following guidelines:

(a) 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.

(b) If a deal is 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.

(c) While negotiating the deal, the broker is not obliged to disclose the identity of the counterparty to the deal. On conclusion of the deal, he should disclose the counterparty and his contract note should clearly indicate the name of the counterparty. It should also be ensured by the bank that the broker note contains the exact time of the deal. Their back offices may ensure that the deal time on the broker note and the deal ticket is the same. The bank should also ensure that their concurrent auditors audit this aspect.

(d) 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.

(e) 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.

(f) A disproportionate part of the business should not be transacted through only one or a few brokers. Banks should fix aggregate contract limits for each of the approved brokers. 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 do not exceed this limit. However, if for any reason it becomes 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. However, the norm of 5% would not be applicable to banks' dealings through Primary Dealers.

**(g)** The concurrent auditors who audit the treasury operations should scrutinise the business done through brokers 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. These instructions also apply to subsidiaries and mutual funds of the banks.

[Certain clarifications on the instructions are furnished in the **Annexure II.**]

**ii)** Inter-bank securities transactions should be undertaken directly between banks and no bank should engage the services of any broker in such transactions.

#### **Exceptions:**

**Note (i)** Banks may undertake securities transactions among themselves or with non-bank clients through members of the National Stock Exchange (NSE), OTC Exchange of India (OTCEI) and the Stock Exchange, Mumbai (BSE). If such transactions are not undertaken on the NSE, OTCEI or BSE, the same should be undertaken by banks directly, without engaging brokers.

**Note (ii)** Although the Securities Contracts (Regulation) Act, 1956 defines the term 'securities' to mean corporate shares, debentures, Govt. securities and rights or interest in securities, the term 'securities' would exclude corporate shares. The Provident / Pension Funds and Trusts registered under the Indian Trusts Act, 1882, will be outside the purview of the expression 'non-bank clients' for the purpose of note (i) above.

#### **1.1.7 Audit, review and reporting of investment transactions**

The banks should follow the following instructions in regard to audit, review and reporting of investment transactions:

**a)** Banks should undertake a half-yearly review (as of 30 September and 31 March) of their investment portfolio, which should, apart from other operational aspects of investment portfolio, clearly indicate amendments made to the Investment Policy and certify adherence to laid down internal investment policy and procedures and RBI guidelines, and put up the same before their respective Boards within a month, i.e by end-April and end-October.

**b)** A copy of the review report put up to the Bank's Board, should be forwarded to the RBI (concerned Regional Office of DBS, RBI) by 15 May and 15 November respectively.

**c)** In view of the possibility of abuse, treasury transactions should be separately subjected to concurrent audit by internal auditors and the results of their audit should be placed before the CMD of the bank once every month. Banks need not forward copies of the above mentioned concurrent audit reports to RBI of India. However, the major irregularities observed in these reports and the position of compliance thereto may be incorporated in the half yearly review of the investment portfolio.

## **1.2 Non- SLR investments**

### **1.2.1**

#### **(i) Appraisal**

Banks have made significant investment in privately placed unrated bonds and, in certain cases, in bonds issued by corporates who are not their borrowers. While assessing such investment proposals on private placement basis, in the absence of standardised and mandated disclosures, including credit rating, banks may not be in a position to conduct proper due diligence to take an investment decision. Thus, there could be deficiencies in the appraisal of privately placed issues.

#### **(ii) Disclosure requirements in offer documents**

The risk arising from inadequate disclosure in offer documents should be recognised and banks should prescribe minimum disclosure standards as a policy with Board approval. In this connection, RBI had constituted a Technical Group comprising officials drawn from treasury departments of a few banks and experts on corporate finance to study, *inter alia*, the methods of acquiring, by banks, of non-SLR investments in general and private placement route, in

particular, and to suggest measures for regulating these investments. The Group had designed a format containing the minimum disclosure requirements as well as certain conditionalities regarding documentation and creation of charge for private placement issues, which may serve as a 'best practice model' for the banks. The details of the Group's recommendations are given in the Annexure III and banks should have a suitable format of disclosure requirements on the lines of the recommendations of the Technical Group with the approval of their Board.

**(iii) Internal assessment**

With a view to ensuring that the investments by banks in issues through private placement, both of the borrower customers and non-borrower customers, do not give rise to systemic concerns, it is necessary that banks should ensure that their investment policies duly approved by the Board of Directors are formulated after taking into account the following aspects:

**(a)** The Boards of banks should lay down policy and prudential limits on investments in bonds and debentures including cap and on private placement basis, sub limits for PSU bonds, corporate bonds, guaranteed bonds, issuer ceiling, etc.

**(b)** Investment proposals should be subjected to the same degree of credit risk analysis as any loan proposal. Banks should make their own internal credit analysis and rating even in respect of rated issues and should not entirely rely on the ratings of external agencies. The appraisal should be more stringent in respect of investments in instruments issued by non-borrower customers.

**(c)** 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.

**(d)** As a matter of prudence, banks should stipulate entry-level minimum ratings/ quality standards and industry-wise, maturity-wise, duration-wise, issuer-wise etc. limits to mitigate the adverse impacts of concentration and the risk of illiquidity.

**(e)** The banks should put in place proper risk management systems for capturing and analysing the risk in respect of these investments and taking remedial measures in time.

(iv) Some banks / FIs have not exercised due precaution by reference to the list of defaulters circulated / published by RBI while investing in bonds, debentures, etc., of companies. Banks may, therefore, exercise due caution, while taking any investment decision to subscribe to bonds, debentures, shares etc., and refer to the 'Defaulters List' to ensure that investments are not made in companies / entities who are defaulters to banks / FIs. Some of the companies may be undergoing adverse financial position, turning their accounts to sub-standard category due to recession in their industry segment, like textiles. Despite restructuring facility provided under RBI guidelines, the banks have been reported to be reluctant to extend further finance, though considered warranted on merits of the case. Banks may not refuse proposals for such investments in companies whose director's name(s) find place in the 'Defaulter Companies List' circulated by RBI, at periodical intervals and particularly in respect of those loan accounts, which have been restructured under extant RBI guidelines, provided the proposal is viable and satisfies all parameters for such credit extension.

### **Prudential guidelines on investment in Non-SLR securities**

#### **1.2.2 Coverage**

These guidelines cover banks' investments in non-SLR securities issued by corporates, banks, FIs and State and Central Government sponsored institutions, SPVs etc, including, capital gains bonds, bonds eligible for priority sector status. The guidelines will apply to investments both in the primary market as well as the secondary market.

**1.2.3** The guidelines on listing and rating pertaining to non-SLR securities vide paragraphs 1.2.7 to 1.2.16 are not applicable to banks' investments in:

- (a) Securities directly issued by the Central and State Governments, which are not reckoned for SLR purposes.
- (b) Equity shares
- (c) Units of equity oriented mutual fund schemes, viz. those schemes where any part of the corpus can be invested in equity
- (d) Equity/debt instruments/Units issued by Venture capital funds
- (e) Commercial Paper
- (f) Certificates of Deposit

**1.2.4** Definitions of a few terms used in these guidelines have been furnished in **Annexure IV** with a view to ensure uniformity in approach while implementing the guidelines.

### **Regulatory requirements**

**1.2.5** 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.

**1.2.6** 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**

**1.2.7** Banks must not invest in unrated non-SLR securities. However, the banks may invest in unrated bonds of companies engaged in infrastructure activities, within the ceiling of 10 per cent for unlisted non-SLR securities as prescribed vide paragraph 1.2.10 below.

**1.2.8** The Securities Exchange Board of India (SEBI) vide their circular dated September 30, 2003(amended vide circular dated May 11, 2009) 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.

**1.2.9** 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(amended vide circular dated May 11, 2009), except to the extent indicated in paragraph 1.2.10 and 1.2.11 below.

## **Fixing of prudential limits**

**1.2.10** 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, and such investment should comply with the disclosure requirements as prescribed by the SEBI for listed companies.

**1.2.11** 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 securitisation papers issued for infrastructure projects, and bonds/debentures issued by Securitisation Companies (SCs) and Reconstruction Companies (RCs) set up under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFEASI Act) and registered with RBI. In other words, investments exclusively in securities specified in this paragraph could be up to the maximum permitted limit of 20 per cent of non-SLR investment.

**1.2.12** Investment in the following will not be reckoned as 'unlisted non-SLR securities' for computing compliance with the prudential limits prescribed in the above guidelines:

- (i)** Security Receipts issued by SCs / RCs registered with RBI.
- (ii)** Investment in Asset Backed Securities (ABS) and Mortgage Backed Securities (MBS), which are rated at or above the minimum investment grade. However, there will be close monitoring of exposures to ABS on a bank specific basis based on monthly reports to be submitted to RBI as per proforma being separately advised by the Department of Banking Supervision.
- (iii)** Investments in unlisted convertible debentures. However, investments in these instruments would be treated as "Capital Market Exposure".

**1.2.13** The investments in RIDF / SIDBI Deposits may not be reckoned as part of the numerator as well as denominator for computing compliance with the prudential limit of 10 per cent of its total non-SLR securities as on March 31, of the previous year.

**1.2.14** With effect from January 1, 2005, only investment in units of such mutual fund schemes, which have an exposure to unlisted securities of less than 10 per cent of the corpus of the fund, will be treated on par with listed securities for the purpose of compliance with the prudential limits prescribed in the above guidelines. While computing the exposure to the

unlisted securities for compliance with the norm of less than 10 percent of the corpus of the mutual fund scheme, Treasury Bills, Collateralised Borrowing and Lending Obligations (CBLO), Repo/Reverse Repo and Bank Fixed Deposits may not be included in the numerator.

**1.2.15** For the purpose of the prudential limits prescribed in the guidelines, the denominator viz., 'non-SLR investments', would include investment under the following four categories in Schedule 8 to the balance sheet viz., 'shares', 'bonds & debentures', 'subsidiaries/joint ventures' and 'others'.

**1.2.16** Banks whose investment in unlisted non-SLR securities are within the prudential limit of 10 per cent of its total non-SLR securities as on March 31, of the previous year may make fresh investment in such securities and up to the prudential limits.

### **Role of Boards**

**1.2.17** 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.

**1.2.18** 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 issued by RBI on non-SLR securities.
- 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**

**1.2.19** 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.

**1.2.20** 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 **Annexure V**.

## **Trading and settlement in debt securities**

**1.2.21** 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.

## **1.2.22 Limits on Banks' Exposure to Capital Markets**

### **A. Solo Basis**

The aggregate exposure of a bank to the capital markets in all forms (both fund based and non-fund based) should not exceed 40 per cent of its net worth as on March 31 of the previous year. Within this overall ceiling, the bank's direct investment in shares, convertible bonds / debentures, units of equity-oriented mutual funds and all exposures to Venture Capital Funds (VCFs) [both registered and unregistered] should not exceed 20 per cent of its net worth.

### **B Consolidated Basis**

The aggregate exposure of a consolidated bank to capital markets (both fund based and non-fund based) should not exceed 40 per cent of its consolidated net worth as on March 31 of the previous year. Within this overall ceiling, the aggregate direct exposure by way of the consolidated bank's investment in shares, convertible bonds / debentures, units of equity-oriented mutual funds and all exposures to Venture Capital Funds (VCFs) [both registered and unregistered] should not exceed 20 per cent of its consolidated net worth.



The above-mentioned ceilings are the maximum permissible and a bank's Board of Directors is free to adopt a lower ceiling for the bank, keeping in view its overall risk profile and corporate strategy. Banks are required to adhere to the ceilings on an ongoing basis.

### **1.3 General**

#### **1.3.1 Reconciliation of holdings of Govt. securities – Audit Certificate**

Banks should furnish a 'Statement of the Reconciliation of Bank's Investments (held in own Investment account, as also under PMS)', as at the end of every accounting year duly certified by the bank's auditors. The statement should reach the Regional Office of the DBS, RBI, under whose jurisdiction the bank's head office is located within one month from the close of the accounting year. Banks in the letters of appointment, issued to their external auditors, may suitably include the aforementioned requirement of reconciliation. The format for the statement and the instructions for compiling thereto are given in **Annexure VI**.

#### **1.3.2 Transactions in securities - Custodial functions**

While exercising the 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 have been executed. Banks should also issue suitable instructions in this regard to the department/office undertaking the custodial functions on behalf of their subsidiaries.

#### **1.3.3 Portfolio Management on behalf of clients**

i) The general powers vested in banks to operate PMS and similar schemes have been withdrawn. No bank should, therefore, restart or introduce any new PMS or similar scheme in future without obtaining specific prior approval of the RBI. However, bank-sponsored NBFCs are allowed to offer discretionary PMS to their clients, on a case-to-case basis. Applications in this regard should be submitted to the Department of Banking Operations and Development (DBOD), RBI, World Trade Centre, Mumbai – 400 005.

ii) The following conditions are to be strictly observed by the banks operating PMS or similar scheme with the specific prior approval of RBI:

(a) PMS should be entirely at the customer's risk, without guaranteeing, either directly or indirectly, a pre-determined return.

**(b)** Funds should not be accepted for portfolio management for a period less than one year.

**(c)** Portfolio funds should not be deployed for lending in call/notice money; inter-bank term deposits and bills rediscounting markets and lending to/placement with corporate bodies.

**(d)** Banks should maintain client wise account/record of funds accepted for management and investments made there against and the portfolio clients should be entitled to get a statement of account.

**(e)** Bank's own investments and investments belonging to PMS clients should be kept distinct from each other, and any transactions between the bank's investment account and client's portfolio account should be strictly at market rates.

**(f)** There should be a clear functional separation of trading and back office functions relating to banks' own investment accounts and PMS clients' accounts.

**iii)** PMS clients' accounts should be subjected by banks to a separate audit by external auditors as covered in paragraph 1.1.5 (a).

**iv)** Banks should note that violation of RBI instructions will be viewed seriously and will invite deterrent action against the banks, which will include raising of reserve requirements, withdrawal of facility of refinance from the RBI and denial of access to money markets, apart from prohibition from undertaking PMS activity.

**v)** Further, the aforesaid instructions will apply, *mutatis mutandis*, to the subsidiaries of banks except where they are contrary to specific regulations of the RBI or SEBI, governing their operations.

**vi)** Banks / merchant banking subsidiaries of banks operating PMS or similar scheme with the specific prior approval of the RBI are also required to comply with the guidelines contained in the SEBI (Portfolio Managers) Rules and Regulations, 1993 and those issued from time to time.

#### **1.3.4 Investment Portfolio of bank - transactions in Government Securities**

In the light of fraudulent transactions in the guise of Government securities, transactions in physical format by a few co-operative banks with the help of some broker entities, it has been

decided to accelerate the measures for further reducing the scope of trading in physical forms. These measures are as under:

- (i) For banks, which do not have SGL account with RBI, only one gilt account can be opened.
- (ii) In case the gilt accounts are opened with a scheduled commercial bank, the account holder has to open a designated funds account (for all gilt account related transactions) with the same bank.
- (iii) The entities maintaining the gilt / designated funds accounts will be required to ensure availability of clear funds in the designated funds accounts for purchases and of sufficient securities in the gilt account for sales before putting through the transactions.
- (iv) No transactions by the bank should be undertaken in physical form with any broker.
- (v) Banks should ensure that brokers approved for transacting in Government securities are registered with the debt market segment of NSE/BSE/OTCEI.

## 2. Classification

i) The entire investment portfolio of the banks (including SLR securities and non-SLR securities) should be classified under three categories

viz. 'Held to Maturity',  
'Available for Sale' and  
'Held for Trading'.

- However, in the balance sheet, the investments will continue to be disclosed as per the existing six classifications:

viz. a) Government securities,  
b) Other approved securities,  
c) Shares,  
d) Debentures & Bonds,  
e) Subsidiaries/ joint ventures and  
f) Others (CP, Mutual Fund Units, etc.).

- ii) Banks should decide the category of the investment at the time of acquisition and the decision should be recorded on the investment proposals.

## 2.1 Held to Maturity

- i) The securities acquired by the banks with the intention to hold them up to maturity will be classified under 'Held to Maturity (HTM)'.
- ii) Banks are allowed to include investments included under HTM category upto 25 per cent of their total investments.

The following investments are required to be classified under HTM but are not accounted for the purpose of ceiling of 25 per cent specified for this category:

- (a) Re-capitalisation bonds received from the Government of India towards their re-capitalisation requirement and held in their investment portfolio. This will not include re-capitalisation bonds of other banks acquired for investment purposes.
  - (b) Investment in subsidiaries and joint ventures (A Joint Venture would be one in which the bank, along with its subsidiaries, holds more than 25 percent of the equity).
  - (c) The investments in debentures/bonds, which are deemed to be in the nature of advance. [Refer sub-paragraph (vii) below]
- iii) Banks are, however, allowed since September 2, 2004 to exceed the limit of 25 percent of total investment under HTM category provided:
  - (a) the excess comprises only of SLR securities, **and**
  - (b) the total SLR securities held in the HTM is not more than 25 percent of their DTL as on the last Friday of the second preceding fortnight.
- iv) The non-SLR securities, held as part of HTM as on September 2, 2004 may remain in that category. No fresh non-SLR securities, are permitted to be included in HTM, except the following:
  - (a) Fresh re-capitalisation bonds, received from the Government of India, towards their re-capitalisation requirement and held in their investment portfolio. This will not include re-capitalisation bonds of other banks acquired for investment purposes.

(b) Fresh investment in the equity of subsidiaries and joint ventures.

(c) RIDF / SIDBI deposits

v) To sum up, banks may hold the following securities under HTM:

(a) SLR Securities upto 25 percent of their DTL as on the last Friday of the second preceding fortnight.

(b) Non-SLR securities included under HTM as on September 2, 2004.

(c) Fresh re-capitalisation bonds received from the Government of India towards their re-capitalisation requirement and held in Investment portfolio.

(d) Fresh investment in the equity of subsidiaries and joint ventures

(e) RIDF/SIDBI deposits.

(vi) Profit on sale of investments in this category should be first taken to the Profit & Loss Account, and thereafter be appropriated to the 'Capital Reserve Account'. Loss on sale will be recognised in the Profit & Loss Account.

(vii) The debentures/ bonds must be treated in the nature of an advance when:

- The debenture/bond is issued as part of the proposal for project finance and the tenure of the debenture is for a period of three years and above

**Or**

The debenture/bond is issued as part of the proposal for working capital finance and the tenure of the debenture/ bond is less than a period of one year

**And**

- the bank has a significant stake i.e.10% or more in the issue

**And**

- the issue is part of a private placement, i.e. the borrower has approached the bank/FI and not part of a public issue where the bank/FI has subscribed in response to an invitation.

Since, no fresh non-SLR securities are permitted to be included in the HTM, these investments should not be held under HTM category and they should be subjected to mark- to-market discipline. They would be subjected to prudential norms for identification of non-performing investment and provisioning as applicable to investments.

## **2.2 Available for Sale & Held for Trading**

- i)** The securities acquired by the banks with the intention to trade by taking advantage of the short-term price/interest rate movements will be classified under 'Held for Trading (HFT)'.
- ii)** The securities which do not fall within the above two categories will be classified under 'Available for Sale (AFS)'.
- iii)** The banks will have the freedom to decide on the extent of holdings under HFT and AFS. This will be decided by them after considering various aspects such as basis of intent, trading strategies, risk management capabilities, tax planning, manpower skills, capital position.
- iv)** The investments classified under HFT would be those from which the bank expects to make a gain by the movement in the interest rates/market rates. These securities are to be sold within 90 days.
- v)** Profit or loss on sale of investments in both the categories will be taken to the Profit & Loss Account.

## **2.3 Shifting among categories**

- i)** Banks may shift investments to/from HTM with the approval of the Board of Directors once a year. Such shifting will normally be allowed at the beginning of the accounting year. No further shifting to/from HTM will be allowed during the remaining part of that accounting year.
- ii)** Banks may shift investments from AFS to HFT with the approval of their Board of Directors/ ALCO/ Investment Committee. In case of exigencies, such shifting may be done with the approval of the Chief Executive of the bank/Head of the ALCO, but should be ratified by the Board of Directors/ ALCO.
- iii)** Shifting of investments from HFT to AFS is generally not allowed. However, it will be permitted only under exceptional circumstances like not being able to sell the

security within 90 days due to tight liquidity conditions, or extreme volatility, or market becoming unidirectional. Such transfer is permitted only with the approval of the Board of Directors/ ALCO/ Investment Committee.

**iv)** Transfer of scrips from one category to another, under all circumstances, should be done at the acquisition cost/ book value/ market value on the date of transfer, whichever is the least, and the depreciation, if any, on such transfer should be fully provided for. Banks may apply the values as on the date of transfer and in case, there are practical difficulties in applying the values as on the date of transfer, banks have the option of applying the values as on the previous working day, for arriving at the depreciation requirement on shifting of securities.

### **3. Valuation**

#### **3.1 Held to Maturity**

**i)** Investments classified under HTM need not be marked to market and will be carried at acquisition cost, unless it is more than the face value, in which case the premium should be amortised over the period remaining to maturity. The banks should reflect the amortised amount in 'Schedule 13 – Interest Earned : Item II – Income on Investments', as a deduction. However, the deduction need not be disclosed separately. The book value of the security should continue to be reduced to the extent of the amount amortised during the relevant accounting period.

**ii)** Banks should recognise any diminution, other than temporary, in the value of their investments in subsidiaries/ joint ventures, which are included under HTM and provide therefore. Such diminution should be determined and provided for each investment individually.

#### **3.2 Available for Sale**

The individual scrips in the Available for Sale category will be marked to market at quarterly or at more frequent intervals. Domestic Securities under this category shall be valued scrip-wise and depreciation/ appreciation shall be aggregated for each classification referred to in item 2(i) above and foreign investments under this category shall be valued scrip-wise and depreciation/ appreciation shall be aggregated for five classifications (viz. Government securities (including local authorities), Shares, Debentures & Bonds, Subsidiaries and/or joint ventures abroad and Other investments (to be specified)). Further, the investment in a particular classification, both

in domestic and foreign securities, may be aggregated for the purpose of arriving at net depreciation/appreciation of investments under that category. Net depreciation, if any, shall be provided for. Net appreciation, if any, should be ignored. Net depreciation required to be provided for in any one classification should not be reduced on account of net appreciation in any other classification. The banks may continue to report the foreign securities under three categories (Government securities (including local authorities), Subsidiaries and/or joint ventures abroad and Other investments (to be specified)) in the balance sheet. The book value of the individual securities would not undergo any change after the marking of market.

### **3.3 Held for Trading**

The individual scrips in the Held for Trading category will be marked to market at monthly or at more frequent intervals and provided for as in the case of those in the Available for Sale category. Consequently, the book value of the individual securities in this category would also not undergo any change after marking to market.

### **3.4 Investment Fluctuation Reserve**

(i) With a view to building up of adequate reserves to guard against any possible reversal of interest rate environment in future due to unexpected developments, banks were advised to build up Investment Fluctuation Reserve (IFR) of a minimum 5 per cent of the investment portfolio within a period of 5 years.

(ii) To ensure smooth transition to Basel II norms, banks were advised in June 24, 2004 to maintain capital charge for market risk in a phased manner over a two year period, as under:

(a) In respect of securities included in the HFT category, open gold position limit, open foreign exchange position limit, trading positions in derivatives and derivatives entered into for hedging trading book exposures by March 31, 2005, and

(b) In respect of securities included in the AFS category by March 31, 2006.



**(iii)** With a view to encourage banks for early compliance with the guidelines for maintenance of capital charge for market risks, it was advised in April 2005 that banks which have maintained capital of at least 9 per cent of the risk weighted assets for both credit risk and market risks for both HFT (items as indicated at (a) above) and AFS category may treat the balance in excess of 5 per cent of securities included under HFT and AFS categories, in the IFR, as Tier I capital. Banks satisfying the above were allowed to transfer the amount in excess of the said 5 per cent in the IFR to Statutory Reserve.

**(iv)** Banks were advised in October 2005 that, if they have maintained capital of at least 9 per cent of the risk weighted assets for both credit risk and market risks for both HFT (items as indicated at (a) above) and AFS category as on March 31, 2006, they would be permitted to treat the entire balance in the IFR as Tier I capital. For this purpose, banks may transfer the balance in the Investment Fluctuation Reserve 'below the line' in the Profit and Loss Appropriation Account to Statutory Reserve, General Reserve or balance of Profit & Loss Account.

#### **Investment Reserve Account (IRA)**

**(v)** In the event, provisions created on account of depreciation in the 'AFS' or 'HFT' categories are found to be in excess of the required amount in any year, the excess should be credited to the Profit & Loss account and an equivalent amount (net of taxes, if any and net of transfer to Statutory Reserves as applicable to such excess provision) should be appropriated to an IRA Account in Schedule 2 – "Reserves & Surplus" under the head "Revenue and other Reserves", and would be eligible for inclusion under Tier-II within the overall ceiling of 1.25 per cent of total Risk Weighted Assets prescribed for General Provisions/ Loss Reserves.

**(vi)** Banks may utilise IRA as follows:

The provisions required to be created on account of depreciation in the AFS and HFT categories should be debited to the P&L Account and an equivalent amount (net of tax benefit, if any, and net of consequent reduction in the transfer to Statutory Reserve), may be transferred from the IRA to the P&L Account.

Illustratively, banks may draw down from the IRA to the extent of provision made during the year towards depreciation in investment in AFS and HFT categories (net of taxes, if any, and net of transfer to Statutory Reserves as applicable to such

excess provision). In other words, a bank which pays a tax of 30% and should appropriate 25% of the net profits to Statutory Reserves, can draw down Rs.52.50 from the IRA, if the provision made for depreciation in investments included in the AFS and HFT categories is Rs.100.

**(vii)** The amounts debited to the P&L Account for provision should be debited under the head 'Expenditure - Provisions & Contingencies'. The amount transferred from the IRA to the P&L Account, should be shown as 'below the line' item in the Profit and Loss Appropriation Account, after determining the profit for the year. Provision towards any erosion in the value of an asset is an item of charge on the profit and loss account, and hence should appear in that account before arriving at the profit for the accounting period. Adoption of the following would not only be adoption of a wrong accounting principle but would, also result in a wrong statement of the profit for the accounting period:

**(a)** the provision is allowed to be adjusted directly against an item of Reserve without being shown in the profit and loss account, **OR**

**(b)** a bank is allowed to draw down from the IRA before arriving at the profit for the accounting period (i.e., above the line), **OR**

**(c)** a bank is allowed to make provisions for depreciation on investment as a below the line item, after arriving at the profit for the period,

Hence none of the above options are permissible.

**(viii)** In terms of our guidelines on payment of dividend by banks, dividends should be payable only out of current year's profit. The amount drawn down from the IRA will, therefore, not be available to a bank for payment of dividend among the shareholders. However, the balance in the IRA transferred 'below the line' in the Profit and Loss Appropriation Account to Statutory Reserve, General Reserve or balance of Profit & Loss Account would be eligible to be reckoned as Tier I capital.

### **3.5 Market value**

The 'market value' for the purpose of periodical valuation of investments included in the AFS and HFT would be the market price of the scrip as available from the trades/ quotes on the stock exchanges, SGL account transactions, price list of RBI, prices declared by Primary Dealers Association of India (PDAI) jointly with the Fixed Income Money Market and

Derivatives Association of India (FIMMDA) periodically. In respect of unquoted securities, the procedure as detailed below should be adopted.

### **3.6 Unquoted SLR securities**

#### **3.6.1 Central Government Securities**

i) Banks should value the unquoted Central Government securities on the basis of the prices/ YTM rates put out by the PDAI/ FIMMDA at periodical intervals.

ii) The 6.00 per cent Capital Indexed Bonds may be valued at “cost”, as defined in circular DBOD.No.BC.8/12.02.001/ 97-98 dated January 22, 1998 and BC.18/12.02.001/ 2000-2001 dated August 16, 2000.

iii) Treasury Bills should be valued at carrying cost.

#### **3.6.2 State Government Securities**

State Government securities will be valued applying the YTM method by marking it up by 25 basis points above the yields of the Central Government Securities of equivalent maturity put out by PDAI/ FIMMDA periodically.

#### **3.6.3 Other ‘approved’ Securities**

Other approved securities will be valued applying the YTM method by marking it up by 25 basis points above the yields of the Central Government Securities of equivalent maturity put out by PDAI/ FIMMDA periodically.

### **3.7 Unquoted Non-SLR securities**

#### **3.7.1 Debentures/ Bonds**

All debentures/ bonds other than debentures/bonds, which are in the nature of advance, should be valued on the YTM basis. Such debentures/ bonds may be of different companies having different ratings. These will be valued with appropriate mark-up over the YTM rates for Central Government securities as put out by PDAI/ FIMMDA periodically. The mark-up will be graded according to the ratings assigned to the debentures/ bonds by the rating agencies subject to the following: -

(a) The rate used for the YTM for rated debentures/ bonds should be at least 50 basis points above the rate applicable to a Government of India loan of equivalent maturity.

**NOTE:**

The special securities, which are directly issued by Government of India to the beneficiary entities, which do not carry SLR status, may be valued at a spread of 25 basis points above the corresponding yield on Government of India securities, with effect from the financial year 2008 - 09. At present, such special securities comprise: Oil Bonds, Fertiliser Bonds, bonds issued to the State Bank of India (during the recent rights issue), Unit Trust of India, Industrial Finance Corporation of India Ltd., Food Corporation of India, Industrial Investment Bank of India Ltd., the erstwhile Industrial Development Bank of India and the erstwhile Shipping Development Finance Corporation.

**(b)** The rate used for the YTM for unrated debentures/ bonds should not be less than the rate applicable to rated debentures/ bonds of equivalent maturity. The mark-up for the unrated debentures/ bonds should appropriately reflect the credit risk borne by the bank.

**(c)** Where the debenture/ bonds is quoted and there have been transactions within 15 days prior to the valuation date, the value adopted should not be higher than the rate at which the transaction is recorded on the stock exchange.

**3.7.2 Zero coupon bonds (ZCBs)**

ZCBs should be shown in the books at carrying cost, i.e., acquisition cost plus discount accrued at the rate prevailing at the time of acquisition, which may be marked to market with reference to the market value. In the absence of market value, the ZCBs may be marked to market with reference to the present value of the ZCB. The present value of the ZCBs may be calculated by discounting the face value using the 'Zero Coupon Yield Curve', with appropriate mark up as per the zero coupon spreads put out by FIMMDA periodically. In case the bank is still carrying the ZCBs at acquisition cost, the discount accrued on the instrument should be notionally added to the book value of the scrip, before marking it to market.

**3.7.3 Preference Shares**

The valuation of preference shares should be on YTM basis. The preference shares will be issued by companies with different ratings. These will be valued with appropriate mark-up over the YTM rates for Central Government securities put out by the PDAI/FIMMDA periodically. The mark-up will be graded according to the ratings assigned to the preference shares by the rating agencies subject to the following:

- a) The YTM rate should not be lower than the coupon rate/ YTM for a GOI loan of equivalent maturity.
- b) The rate used for the YTM for unrated preference shares should not be less than the rate applicable to rated preference shares of equivalent maturity. The mark-up for the unrated preference shares should appropriately reflect the credit risk borne by the bank.
- c) Investments in preference shares as part of the project finance may be valued at par for a period of two years after commencement of production or five years after subscription whichever is earlier.
- d) Where investment in preference shares is as part of rehabilitation, the YTM rate should not be lower than 1.5% above the coupon rate/ YTM for GOI loan of equivalent maturity.
- e) Where preference dividends are in arrears, no credit should be taken for accrued dividends and the value determined on YTM should be discounted by at least 15% if arrears are for one year, and more if arrears are for more than one year. The depreciation/provision requirement arrived at in the above manner in respect of non-performing shares where dividends are in arrears shall not be allowed to be set-off against appreciation on other performing preference shares.
- f) The preference share should not be valued above its redemption value.
- g) When a preference share has been traded on stock exchange within 15 days prior to the valuation date, the value should not be higher than the price at which the share was traded.

#### **3.7.4 Equity Shares**

The equity shares in the bank's portfolio should be marked to market preferably on a daily basis, but at least on a weekly basis. Equity shares for which current quotations are not available or where the shares are not quoted on the stock exchanges, should be valued at break-up value (without considering 'revaluation reserves', if any) which is to be ascertained from the company's latest balance sheet (which should not be more than one year prior to the

date of valuation). In case the latest balance sheet is not available the shares are to be valued at Re.1 per company.

### **3.7.5 Mutual Funds Units (MF Units)**

Investment in quoted MF Units should be valued as per Stock Exchange quotations. Investment in un-quoted MF Units is to be valued on the basis of the latest re-purchase price declared by the MF in respect of each particular Scheme. In case of funds with a lock-in period, where repurchase price/ market quote is not available, Units could be valued at Net Asset Value (NAV). If NAV is not available, then these could be valued at cost, till the end of the lock-in period. Wherever the re-purchase price is not available, the Units could be valued at the NAV of the respective scheme.

### **3.7.6 Commercial Paper**

Commercial paper should be valued at the carrying cost.

### **3.7.7 Investments in Regional Rural Banks (RRBs)**

Investment in RRBs is to be valued at carrying cost (i.e. book value) on a consistent basis.

## **3.8. Investment in securities issued by SC/RC**

When banks / FIs invest in the SRs / Pass-Through Certificates (PTCs) issued by SCs / RCs, in respect of the financial assets sold by them to the SCs / RCs, the sale shall be recognised in books of the banks / FIs at the lower of:

- the redemption value of the SRs /PTCs, and
- the net book value (NBV) (i.e. Book value less provisions held), of the financial asset.

The above investment should be carried in the books of the bank / FI at the price as determined above until its sale or realisation, and on such sale or realisation, the loss or gain must be dealt with as under:

- (i) if the sale to SC /RC is at a price below the NBV, the shortfall should be debited to the profit and loss account of that year.

(ii) If the sale is for a value higher than the NBV, the excess provision will not be reversed but will be utilised to meet the shortfall / loss on account of sale of other financial assets to SC / RC. All instruments received by banks / FIs from SC / RC as sale consideration for financial assets sold to them and also other instruments issued by SC / RC in which banks / FIs invest will be in the nature of non-SLR securities. Accordingly, the valuation, classification and other norms applicable to investment in non-SLR instruments prescribed by RBI from time to time would be applicable to bank's / FI's investment in debentures / bonds / security receipts / PTCs issued by SC / RC. However, if any of the above instruments issued by SC / RC is limited to the actual realisation of the financial assets assigned to the instruments in the concerned scheme the bank / FI shall reckon the Net Asset Value (NAV), obtained from SC / RC from time to time, for valuation of such investments.

### **3.9. Valuation and classification of banks' investment in VCFs**

**3.9.1** The quoted equity shares / bonds/ units of VCFs in the bank's portfolio should be held under AFS and marked to market preferably on a daily basis, but at least on a weekly basis, in line with valuation norms for other equity shares as per existing instructions.

**3.9.2** Banks' investments in unquoted shares/bonds/units of VCFs made after August 23, 2006 (i.e issuance of guidelines on valuation, classification of investments in VCFs) will be classified under HTM for initial period of three years and will be valued at cost during this period. For the investments made before issuance of these guidelines, the classification would be done as per the existing norms.

**3.9.3** For this purpose, the period of three years will be reckoned separately for each disbursement made by the bank to VCF as and when the committed capital is called up. However, to ensure conformity with the existing norms for transferring securities from HTM, transfer of all securities which have completed three years as mentioned above will be effected at the beginning of the next accounting year in one lot to coincide with the annual transfer of investments from HTM category.

**3.9.4** After three years, the unquoted units/shares/bonds should be transferred to AFS category and valued as under:

**i) Units:** In the case of investments in the form of units, the valuation will be done at the NAV shown by the VCF in its financial statements. Depreciation, if any, on the units based on NAV has to be provided at the time of shifting the investments to AFS category from HTM category as also on subsequent valuations which should be done at quarterly or more frequent intervals based on the financial statements received from the VCF. At least once in a year, the units should be valued based on the audited results. However, if the audited balance sheet/ financial statements showing NAV figures are not available continuously for more than 18 months as on the date of valuation, the investments are to be valued at Rupee 1.00 per VCF.

**ii) Equity:** In the case of investments in the form of shares, the valuation can be done at the required frequency based on the break-up value (without considering 'revaluation reserves', if any) which is to be ascertained from the company's (VCF's) latest balance sheet (which should not be more than 18 months prior to the date of valuation). Depreciation, if any on the shares has to be provided at the time of shifting the investments to AFS category as also on subsequent valuations which should be done at quarterly or more frequent intervals. If the latest balance sheet available is more than 18 months old, the shares are to be valued at Rupee.1.00 per company.

**(iii) Bonds:** The investment in the bonds of VCFs, if any, should be valued as per prudential norms for classification, valuation and operation of investment portfolio by banks issued by RBI from time to time.

### **3.9.5 Valuation norms on conversion of outstanding**

(a) Equity, debentures and other financial instruments acquired by way of conversion of outstanding principal and / or interest should be classified in the AFS category, and valued in accordance with the extant instructions on valuation of banks' investment portfolio, except to the extent that (a) equity may be valued as per market value, if quoted, (b) in cases, where equity is not quoted, valuation may be at breakup value in respect of standard assets and in respect of substandard / doubtful assets, equity may be initially valued at Re1 and at breakup value after restoration / up gradation to standard category.



### **3.10 Non-Performing Investments (NPI)**

**3.10.1** In respect of securities included in any of the three categories where interest/ principal is in arrears, the banks should not reckon income on the securities and should also make appropriate provisions for the depreciation in the value of the investment. The banks should not set-off the depreciation requirement in respect of these non-performing securities against the appreciation in respect of other performing securities.

**3.10.2** An 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 90 days.
- (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 paragraph 28 of the Annex to the 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, including preference shares issued by the same issuer would also be treated as NPI and vice versa. However, if only the preference shares are classified as NPI, the investment in any of the other performing securities issued by the same issuer may not be classified as NPI and any performing credit facilities granted to that borrower need not be treated as NPA.
- (v) The investments in debentures / bonds, which are deemed to be in the nature of advance would also be subjected to NPI norms as applicable to investments.
- (vi) In case of conversion of principal and / or interest into equity, debentures, bonds, etc., such instruments should be treated as NPA abinitio in the same asset classification category as the loan if the loan's classification is substandard or doubtful on implementation of the restructuring package and provision should be made as per the norms.

### **3.10.3 State Government guaranteed investments**

For the year ending March 31, 2005, investment in State Government guaranteed securities would attract prudential norms for identification of NPI and provisioning, if interest and/or principal or any other amount due to the bank remains overdue for more than 180 days. With effect from the year ending March 31, 2006, investment in State Government guaranteed securities, including those in the nature of 'deemed advance', will attract prudential norms for

identification of non- performing investments and provisioning, when interest/ instalment of principal (including maturity proceeds) or any other amount due to the bank remains unpaid for more than 90 days.

#### **4. Uniform accounting for Repo / Reverse Repo transactions.**

**4.1** In order to ensure uniform accounting treatment for accounting repo /reverse repo transactions and to impart an element of transparency, uniform accounting principles, have been laid down for repo / reverse repo transactions undertaken by all the regulated entities. However, for the present, these norms would not apply to repo / reverse repo transactions under the Liquidity Adjustment Facility (LAF) with RBI.

**4.2** The uniform accounting principles were made applicable from the financial year 2003-04. The market participants may undertake repos from any of the three categories of investments, viz., Held for Trading, Available For Sale and Held to Maturity.

**4.3** The securities sold under repo (the entity selling referred to as “seller”) are excluded from the Investment Account of the seller of securities and the securities bought under reverse repo (the entity buying referred to as “buyer”) are included in the Investment Account of the buyer of securities. Further, the buyer can reckon the approved securities acquired under reverse repo transaction for the purpose of Statutory Liquidity Ratio (SLR) during the period of the repo.

**4.4** At present repo transactions are permitted in Central Government securities including Treasury Bills and dated State Government securities. Since the buyer of the securities will not hold it till maturity, the securities purchased under reverse repo by banks should not be classified under Held to Maturity category. The first leg of the repo should be contracted at prevailing market rates. Further, the accrued interest received / paid in a repo / reverse repo transaction and the clean price (i.e. total cash consideration less accrued interest) should be accounted for separately and distinctly.

**4.5** The other accounting principles to be followed while accounting for repos / reverse repos will be as under:

##### **4.5.1 Coupon**

In case the interest payment date of the security offered under repo falls within the repo period, the coupons received by the buyer of the security should be passed on to the seller on the date

of receipt as the cash consideration payable by the seller in the second leg does not include any intervening cash flows. While the buyer will book the coupon during the period of the repo, the seller will not accrue the coupon during the period of the repo. In the case of discounted instruments like Treasury Bills, since there is no coupon, the seller will continue to accrue the discount at the original discount rate during the period of the repo. The buyer will not therefore accrue the discount during the period of the repo.

#### **4.5.2 Repo Interest Income / Expenditure**

After the second leg of the repo / reverse repo transaction is over,

- (a) the difference in the clean price of the security between the first leg and the second leg should be reckoned as Repo Interest Income / Expenditure in the books of the buyer / seller respectively;
- (b) the difference between the accrued interest paid between the two legs of the transaction should be shown as Repo Interest Income/ Expenditure account, as the case may be; and
- (c) the balance outstanding in the Repo interest Income / Expenditure account should be transferred to the Profit and Loss account as an income or an expenditure.

As regards repo / reverse repo transactions outstanding on the balance sheet date, only the accrued income / expenditure till the balance sheet date should be taken to the Profit and Loss account. Any repo income / expenditure for the subsequent period in respect of the outstanding transactions should be reckoned for the next accounting period.

#### **4.5.3 Marking to Market**

The buyer will mark to market the securities acquired under reverse repo transactions as per the investment classification of the security. To illustrate, for banks, in case the securities acquired under reverse repo transactions have been classified under Available for Sale category, then the mark to market valuation for such securities should be done at least once a quarter. For entities that do not follow any investment classification norms, the valuation for securities acquired under reverse repo transactions may be in accordance with the valuation norms followed by them in respect of securities of similar nature.

In respect of the repo transactions outstanding as on the balance sheet date

- (a) the buyer will mark to market the securities on the balance sheet date and will account for the same as laid down in the extant valuation guidelines issued by the respective regulatory departments of RBI.
- (b) the seller will provide for the price difference in the Profit & Loss account and show this difference under "Other Assets" in the balance sheet if the sale price of the security offered under repo is lower than the book value.
- (c) the seller will ignore the price difference for the purpose of Profit & Loss account but show the difference under "Other Liabilities" in the Balance Sheet, if the sale price of the security offered under repo is higher than the book value; and
- (d) similarly the accrued interest paid / received in the repo / reverse repo transactions outstanding on balance sheet dates should be shown as "Other Assets" or "Other Liabilities" in the balance sheet.

#### **4.5.4 Book value on re-purchase**

The seller shall debit the repo account with the original book value (as existing in the books on the date of the first leg) on buying back the securities in the second leg.

#### **4.5.5 Disclosure**

The disclosures to be made by banks in the "Notes on Accounts" to the Balance Sheet is given in **Annexure VII**.

#### **4.5.6 Accounting methodology**

The accounting methodology to be followed is given below and illustrations are furnished in **Annexure VIII**. While market participants, having different accounting systems, may use accounting heads different from those used in the illustration, there should not be any deviation from the accounting principles enunciated above. Further, to obviate disputes arising out of repo transactions, the participants may consider entering into bilateral Master Repo Agreement as per the documentation finalized by FIMMDA.

#### **4.5.7 Recommended Accounting Methodology for Uniform Accounting of Repo / Reverse Repo transactions**

- a) The following accounts may be opened, viz. (i) Repo Account, (ii) Repo Price Adjustment Account, (iii) Repo Interest Adjustment Account, (iv) Repo Interest Expenditure Account, (v) Repo Interest Income Account, (vi) Reverse Repo Account,

(vii) Reverse Repo Price Adjustment Account, and (viii) Reverse Repo Interest Adjustment Account.

**b)** The securities sold/ purchased under repo should be accounted for as an outright sale / purchase.

**c)** The securities should enter and exit the books at the same book value. For operational ease, the weighted average cost method whereby the investment is carried in the books at their weighted average cost, may be adopted.

### **Repo**

**d)** In a repo transaction, the securities should be sold in the first leg at market related prices and re-purchased in the second leg at the derived price. The sale and repurchase should be accounted in the Repo Account.

**e)** The balances in the Repo Account should be netted from the bank's Investment Account for balance sheet purposes.

**f)** The difference between the market price and the book value in the first leg of the repo should be booked in Repo Price Adjustment Account. Similarly the difference between the derived price and the book value in the second leg of the repo should be booked in the Repo Price Adjustment Account.

### **Reverse repo**

**g)** In a reverse repo transaction, the securities should be purchased in the first leg at prevailing market prices and sold in the second leg at the derived price. The purchase and sale should be accounted for in the Reverse Repo Account.

**h)** The balances in the Reverse Repo Account should be part of the Investment Account for balance sheet purposes and can be reckoned for SLR purposes if the securities acquired under reverse repo transactions are approved securities.

**i)** The security purchased in a reverse repo will enter the books at the market price (excluding broken period interest). The difference between the derived price and the book value in the second leg of the reverse repo should be booked in the Reverse Repo Price Adjustment Account.

### **Other aspects relating to Repo / Reverse Repo**

**j)** In case the interest payment date of the security offered under repo falls within the repo period, the coupons received by the buyer of the security should be passed on to the seller on the date of receipt as the cash consideration payable by the seller in the second leg does not include any intervening cash flows.

**k)** The difference between the amounts booked in the first and second legs in the Repo / Reverse Repo Price Adjustment Account should be transferred to the Repo Interest Expenditure Account or Repo Interest Income Account, as the case may be.

**l)** The broken period interest accrued in the first and second legs will be booked in Repo Interest Adjustment Account or Reverse Repo Interest Adjustment Account, as the case may be. Consequently the difference between the amounts booked in this account in the first and second legs should be transferred to the Repo Interest Expenditure Account or Repo Interest Income Account, as the case may be.

**m)** At the end of the accounting period the, for outstanding repos, the balances in the Repo / Reverse Repo Price Adjustment Account and Repo / Reverse repo Interest Adjustment account should be reflected either under item VI - 'Others' under Schedule 11 - 'Other Assets' or under item IV 'Others (including Provisions)' under Schedule 5 - 'Other Liabilities and Provisions' in the Balance Sheet, as the case may be.

**n)** Since the debit balances in the Repo Price Adjustment Account at the end of the accounting period represent losses not provided for in respect of securities offered in outstanding repo transactions, it will be necessary to make a provision therefore in the Profit & Loss Account.

**o)** To reflect the accrual of interest in respect of the outstanding repo/ reverse repo transactions at the end of the accounting period, appropriate entries should be passed in the Profit and Loss account to reflect Repo Interest Income / Expenditure in the books of the buyer / seller respectively and the same should be debited / credited as an income / expenditure accrued but not due. Such entries passed should be reversed on the first working day of the next accounting period.

**p)** In respect of repos in interest bearing (coupon) instruments, the buyer would accrue interest during the period of repo. In respect of repos in discount instruments like Treasury Bills, the seller would accrue discount during the period of repo based on the original yield at the time of acquisition.

**q)** At the end of the accounting period the debit balances (excluding balances for repos which are still outstanding) in the Repo Interest Adjustment Account and Reverse Repo Interest Adjustment Account should be transferred to the Repo Interest Expenditure Account and the credit balances (excluding balances for repos which are still outstanding) in the Repo Interest Adjustment Account and Reverse Repo Interest Adjustment Account should be transferred to the Repo Interest Income Account.

**r)** Similarly, at the end of accounting period, the debit balances (excluding balances for repos which are still outstanding) in the Repo / Reverse Repo Price Adjustment Account should be transferred to the Repo Interest Expenditure Account and the credit balances (excluding balances for repos which are still outstanding) in the Repo / Reverse Repo Price Adjustment Account should be transferred to the Repo Interest Income Account.

## **5. General**

### **5.1 Income recognition**

**i)** Banks may book income on accrual basis on securities of corporate bodies/ public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the Central Government or a State Government, provided interest is serviced regularly and as such is not in arrears.

**ii)** Banks may book income from dividend on shares of corporate bodies on accrual basis provided dividend on the shares has been declared by the corporate body in its Annual General Meeting and the owner's right to receive payment is established.

**iii)** Banks may book income from Government securities and bonds and debentures of corporate bodies on accrual basis, where interest rates on these instruments are pre-determined and provided interest is serviced regularly and is not in arrears.

**iv)** Banks should book income from units of mutual funds on cash basis.

## **5.2 Broken Period Interest**

Banks should not capitalise the Broken Period Interest paid to seller as part of cost, but treat it as an item of expenditure under Profit and Loss Account in respect of investments in Government and other approved securities. It is to be noted that the above accounting treatment does not take into account taxation implications and hence the banks should comply with the requirements of Income Tax Authorities in the manner prescribed by them.

## **5.3 Dematerialised Holding**

Banks should settle the transactions in securities as notified by SEBI only through depositories. After the commencement of mandatory trading in demat form, banks would not be able to sell the shares of listed companies if they were held in physical form. In order to extend the demat form of holding to other instruments like bonds, debentures and equities, it was decided that, with effect from October 31, 2001, banks, FIs, PDs and SDs would be permitted to make fresh investments and hold bonds and debentures, privately placed or otherwise, only in dematerialised form. Outstanding investments in scrip forms were required to be converted into dematerialised form by June 30, 2002. As regards equity instruments, banks were required to convert all their equity holding in scrip form into dematerialised form by December 31, 2004.



**Short sale in Government Securities**

Banks may undertake short sale of Central Government dated securities, subject to the short position being covered within a maximum period of five trading days, including the day of trade. In other words, the short sale position initiated today (trade date, T+0) will have to be covered on or before close of T+4 day. Such short positions shall be covered only by outright purchase of an equivalent amount of the same security. The short positions may be reflected in 'Securities Short Sold (SSS) A/c', specifically created for this purpose. For the purposes of this circular short sale and notional short sale are defined as under:

'Short Sale' is defined as sale of securities one does not own. A bank can also undertake 'notional' short sale where it can sell a security short from HFT even if the security is held under its AFS/HTM book. The resultant 'notional' short position would be subject to the same regulatory requirements as in the case of a short sale. For the purpose of these guidelines, short sale would include 'notional' short sale as well. The short sale by banks and the cover transaction shall not affect the holdings and valuation of the same security in AFS/HTM categories in any way.

Short sale transactions can be undertaken by banks, subject to the following conditions:

**Minimum requirements:**

In respect of short sales, banks shall ensure adherence to the following conditions:

- a) The sale leg of the transaction should be executed only on the Negotiated Dealing System – Order Matching (NDS-OM) platform. The cover leg of the short sale transaction can, however, be executed either on or outside the NDS-OM platform.
- b) The sale leg as well as the cover leg of the transaction should be accounted in the HFT category.
- c) Under no circumstances, should participants fail to deliver, on settlement date, the securities sold short. Failures to deliver securities short sold shall be treated as an instance of 'SGL bouncing' and the concerned banks will be liable to disciplinary action

prescribed in respect of SGL bouncing, besides attracting such further regulatory action as may be considered necessary.

- d) At no point of time should a bank accumulate a short position (face value) in any security in the HFT category in excess of the following limits:
  - i) 0.25% of the total outstanding stock issued of each security in case of securities other than liquid securities.
  - ii) 0.50% of the total outstanding stock issued of each security in case of liquid securities.
- e) Banks shall be entirely responsible for ensuring strict compliance with the above prudential limits on real time basis for which they may put in place appropriate systems and internal controls. The controls provided in the trading platform (NDS-OM) are merely in the nature of additional tools and should not be cited as a reason for any breach of internal or regulatory limits. The information regarding the outstanding stock of each Government of India dated security is being made available on the RBI website (URL: <http://rbi.org.in/Scripts/NDSUserXsl.aspx>). The list of liquid securities for compliance with the limits shall be provided by FIMMDA from time to time.
- f) Banks which undertake short sale transactions shall mark-to-market their entire HFT portfolio, including the short positions, **on a daily basis** and account for the resultant mark-to-market gains / losses as per the relevant guidelines for marking-to-market of the HFT portfolio.
- g) Gilt Accounts Holders (GAHs), under CSGL facility, are not permitted to undertake short sales. Entities maintaining CSGL Accounts are required to ensure that no short sale is undertaken by the GAHs.

**Borrowing security (through the repo market) to meet delivery obligations:**

Since securities that are short sold are to be **invariably** delivered on the settlement date, participants are permitted to meet their delivery obligations by acquiring securities in the repo market. Accordingly, with a view to enable participants to run short positions across settlement cycles, banks have been permitted to use the securities acquired under a reverse repo to meet

the delivery obligation of the short sale transaction. While the reverse repos can be rolled over, it is emphasised that the delivery obligations under the successive reverse repo contracts are also to be invariably met, failing which the concerned banks shall attract the regulatory action as specified above. It may, however, be noted that the permission to use securities acquired under reverse repo as above applies only to securities acquired under market repo and **not** to securities acquired under RBI's Liquidity Adjustment Facility.

**Policy and internal control mechanisms:**

**Before actually undertaking transactions in terms of this circular**, banks shall put in place a written policy on short sale, which should be approved by their respective Boards of Directors. The policy should lay down the internal guidelines which should include, *inter alia*, risk limits on short position, an aggregate nominal short sale limit (in terms of Face Value) across all eligible securities, stop loss limits, the internal control systems to ensure adherence to regulatory and internal guidelines, reporting of short selling activity to the Board and the RBI, procedure to deal with violations, etc. Banks shall also put in place a system to detect violations if any, immediately, certainly within the same trading day.

In addition to the internal control mechanisms, the concurrent auditors should specifically verify compliance with these instructions, as well as with internal guidelines and report violations, if any, within a reasonably short time, to the appropriate internal authority. As part of their monthly reporting, concurrent auditors may verify whether the independent back/mid office has taken cognizance of lapses, if any, and whether they have reported the same within the required time frame to the appropriate internal authority. Any violation of regulatory guidelines noticed in this regard should immediately be reported to the respective Public Debt Office (PDO) where the SGL account is maintained and Internal Debt Management Department, Reserve Bank of India, Mumbai.

**When Issued Market - Guidelines****Definition**

'When, as and if issued' (commonly known as 'when-issued' (WI)) security refers to a security that has been authorized for issuance but not yet actually issued. 'WI' trading takes place between the time a new issue is announced and the time it is actually issued. All 'when issued' transactions are on an 'if' basis, to be settled if and when the actual security is issued.

**Mechanics of Operation**

Transactions in a security on a 'When Issued' basis shall be undertaken in the following manner:

- a) 'WI' transactions can be undertaken in the case of securities that are being reissued as well as newly issued, on a selective basis.
- b) 'WI' transactions would commence on the issue notification date and it would cease on the working day immediately preceding the date of issue.
- c) All 'WI' transactions for all trade dates will be contracted for settlement on the date of issue.
- d) At the time of settlement on the date of issue, trades in the 'WI' security will be netted off with trades in the existing security, in the case of reissued securities.
- e) The originating transactions (sale or purchase of 'WI' securities) shall be undertaken only on NDS-OM. Any reversal of a When Issued transaction can, however, be undertaken on or outside the NDS-OM platform.
- f) Only PDs can take a short position in the 'WI' market. In other words, non-PD entities can sell the 'WI' security to any counterparty only if they have a preceding purchase contract for equivalent or higher amount.
- g) Open Positions in the 'WI' market are subject to the following limits:

Category	Reissued security	Newly issued security
Non-PDs	Long Position, not exceeding 5 per cent of the notified amount.	Long Position, not exceeding 5 per cent of the notified amount.
PD	Long or Short Position, not exceeding 10 per cent of the notified amount	Short Position, not exceeding 6 per cent and Long Position, not exceeding 10 per cent of the notified amount.

h) In the event of cancellation of the auction for whatever reason, all 'WI' trades will be deemed null and void *ab initio* on grounds of force majeure.

### **Internal Control**

All banks participating in the 'WI' market are required to have in place a written policy on 'WI' trading which should be approved by the Board of Directors. The policy should lay down the internal guidelines which should include, inter alia, risk limits on 'WI' position (including, in the case of reissued securities, overall position in the security, i.e., 'WI' plus the existing security), an aggregate nominal limit (in terms of Face Value) for 'WI' and in the case of reissued securities, 'WI' plus the existing security, the internal control arrangements to ensure adherence to regulatory and internal guidelines, reporting of 'WI' activity to the top management, procedure to deal with violations, etc. A system should be in place to detect violations immediately, certainly within the trading day.

The concurrent auditors should specifically verify compliance with these instructions and report violations on the date of trade itself, within a reasonably short time, to the appropriate internal authority. As part of their monthly reporting, concurrent auditors may verify whether the independent back/mid office has taken cognizance of all such lapses and reported the same within the required time frame. Any violation of regulatory guidelines noticed in this regard should immediately be reported to the Public Debt Office (PDO), Mumbai and IDMD, Reserve Bank of India.

**Investment portfolio of banks – Transactions in securities –  
Conditions subject to which securities allotted in the auctions for primary issues can be  
sold**

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(i) The contract for sale can be entered into only once by the allottee bank on the basis of an authenticated allotment advice issued by Reserve Bank of India. The buyer from an allottee in a primary auction is also permitted to re-sell the security subject to compliance with the terms and conditions stipulated in our circular No. IDMD.PDRS.05/10.02.01/2003-04 dated March 29, 2004. Any sale of securities should be only on a T + 0 or T + 1 settlement basis.

(ii) The contract for sale of allotted securities can be entered into by banks with entities maintaining SGL Account with RBI as well as with and between CSGL account holders for delivery and settlement on the next working day through the Delivery versus Payment (DvP) system.

(iii) The face value of securities sold should not exceed the face value of securities indicated in the allotment advice.

(iv) The sale deal should be entered into directly without the involvement of broker/s.

(v) Separate record of such sale deals should be maintained containing details such as number and date of allotment advice, description and the face value of securities allotted, the purchase consideration, the number, date of delivery and face value of securities sold, sale consideration, the date and details of actual delivery i.e. SGL Form No., etc. This record should be made available to RBI for verification. Banks should immediately report any cases of failure to maintain such records.

(vi) Such type of sale transactions of Government securities allotted in the auctions for primary issues on the same day and based on authenticated allotment advice should be subjected to

concurrent audit and the relative audit report should be placed before the Executive Director or the Chairman and Managing Director of the Bank once every month. A copy thereof should also be sent to the Department of Banking Supervision, RBI, Central Office, Mumbai.

(vii) Banks will be solely responsible for any failure of the contracts due to the securities not being credited to their SGL account on account of non-payment / bouncing of cheque etc.

**Annexure – II**

**Para 1.1.6 (i) (g)**

**Investment portfolio of banks - Transactions in securities -  
Aggregate contract limit for individual brokers**

<b>Sr. No.</b>	<b>Issue Raised</b>	<b>Response</b>
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 should 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. security 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 subscriptions/ auction will be, included in the volume of total transactions?	No, as brokers are not involved as intermediaries.
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 year which the bank may find it to its advantage as compared to offers	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 facto.



	received from the other brokers who have not yet done business upto the prescribed limit.	
7.	Whether the transactions 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 broker-wise 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 flexibility 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 post facto. Hence, no change in our instructions is considered necessary.

**Recommendations of the Group on Non-SLR Investments of Banks**

**Pro-forma of minimum disclosure requirements in respect of private placement issues - Model Offer Document**

All issuers must issue an offer document with terms of issue, authorised by Board Resolution not older than 6 months from the date of issue. The offer document should specifically mention the Board Resolution authorising the issue and designations of the officials who are authorised to issue the offer document. The offer document may be printed or typed "For Private Circulation Only". The 'Offer Document' should be signed by the authorised signatory. The offer document should contain the following minimum information:

**I. General Information**

1. Name and address of registered office of the company
2. Full names (expanded initials), addresses of Directors and the names of companies where they are Directors.
3. Listing of the issue (If listed, name of the Exchange)
4. Date of opening of the issue  
Date of closing of the issue  
Date of earliest closing of the issue.
5. Name and addresses of auditors and Lead Managers / arrangers
6. Name address of the trustee - consent letter to be produced (in case of debenture issue)
7. Rating from any Rating Agency and / or copy of the rationale of latest rating.

**II. Particulars of the issue**

- (a) Objects
- (b) Project cost and means of financing (including contribution of promoters) in case of new projects.

**III. The model offer document should also contain the following information:**

- (1) Interest rate payable on application money till the date of allotment.
- (2) Security: If it is a secured issue, the issue is to be secured, the offer documents should mention description of security, type of security, type of charge, Trustees, private charge-holders, if any, and likely date of creation of security, minimum security cover, revaluation, if any.
- (3) If the security is collateralised by a guarantee, a copy of the guarantee or principal terms of the guarantee are to be included in the offer document.
- (4) Interim Accounts, if any.
- (5) Summary of last audited Balance Sheet and Profit & Loss Account with qualifications by Auditors, if any.
- (6) Last two published Balance Sheet may be enclosed.
- (7) Any conditions relating to tax exemption, capital adequacy etc. are to be brought out fully in the documents.
- (8) The following details in case of companies undertaking major expansion or new projects :- (copy of project appraisal may be made available on request)
  - (a) Cost of the project, with sources and uses of funds
  - (b) Date of commencement with projected cash flows
  - (c) Date of financial closure (details of commitments by other institutions to be provided)
  - (d) Profile of the project (technology, market etc)
  - (e) Risk factors
- (9) If the instrument is of tenor of 5 years or more, projected cash flows.

**IV. Banks may agree to insist upon the following conditionalities for issues under private placements**

All the issuers in particular private sector corporates, should be willing to execute a subscription agreement in case of all secured debt issues, pending the execution of Trust Deed and charge documents. A standardised subscription agreement may be used by the banks, inter-alia, with the following important provisions:

- (a) Letter of Allotment should be made within 30 days of allotment. Execution of Trust Deed and charge documents will be completed and debentures certificates will be dispatched within the time limit laid down in the Companies Act but not exceeding in any case, 6 months from the date of the subscription agreement.

(b) In case of delay in complying with the above, the company will refund the amount of subscription with agreed rate of interest, or, will pay penal interest of 2% over the coupon rate till the above conditions are complied with, at the option of the bank.

(c) Pending creation of security, during the period of 6 months (or extended period), the principal Directors of the company should agree to indemnify the bank for any loss that may be suffered by the bank on account of the subscription to their debt issue. (This condition will not apply to PSUs).

(d) It will be the company's responsibility to obtain consent of the prior charge-holders for creation of security within the stipulated period. Individual banks may insist upon execution of subscription agreement or a suitable letter to comply with the terms of offer such as appointment of trustee, creation of security etc. on the above lines.

(e) Rating: The Group recommends that the extant regulations of SEBI in regard to rating of all debt instruments in public offers would be made applicable to private placement also. This stipulation will also apply to preference shares, which are redeemable after 18 months.

(f) Listing: Currently, there is a lot of flexibility regarding listing required by banks in private placement issues. However, the Group recommends that listing of companies should be insisted upon, (exceptions, if any, to this rule shall be provided in the Investment Policy of the banks) which would in due course help develop secondary market. The advantage of listing would be that the listed companies would be required to disclose information periodically to the Stock Exchanges which would also help develop the secondary markets by way of investor information. In fact, SEBI has advised all the Stock Exchanges that all listed companies should publish unaudited financial results on a quarterly basis and that they should inform the Stock Exchanges immediately of all events which would have a bearing on the performance / operations of the company as well as price sensitive information.

(g) Security / documentation: To ensure that the documentation is completed and security is created in time, the Group has made recommendations, which is contained in this model offer document. It may be noted that in case of delay in execution of Trust Deed and Charge documents, the company will refund the subscription with agreed rate of interest or will pay penal interest of 2% over the coupon rate till these conditions are complied with at the option of the bank. Moreover, Principal Directors of the company will have to agree to indemnify the bank for any loss that may be suffered by the bank on account of the subscription to the debt issue during the period of 6 months (or extended period) pending creation of security.

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**Guidelines on Investments by Banks in Non-SLR Investment Portfolio by Banks -**  
**Definitions**

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 on non-SLR investments 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.

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**Prudential Guidelines on Management of the Non-SLR Investment Portfolio by Banks -  
Disclosures Requirements**

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)						
Sl. 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		XXX	XXX	XXX	XXX
	<b>Total *</b>					

**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) **Non-performing Non-SLR investments**

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

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**RETURN/STATEMENT NO. 9**

Proforma Statement showing the position of Reconciliation of Investment Account as on 31st March

Name of the bank/ Institution: \_\_\_\_\_

(Face value Rs. in crore)

Particulars of securities	General Ledger Balance	SGL Balance		BRs held	SGL Forms held	Actual Scrips Held	Outstanding deliveries
		As per PDO Books	As per bank's / institution's books				
1	2	3	4	5	6	7	8
Central Govt							
State Government							
Other approved securities							
Public Sector Bonds							
Units of UTI (1964)							
Others (Shares & Debenture etc)							
<b>TOTAL</b>							

Signature of the Authorised Official  
with the Name and Designation

**Note :** Similar statements may be furnished in respect of PMS client's Accounts and other constituents' Accounts (including Brokers). In the case of PMS/other constituents' accounts, the face value and book value of securities appearing in the relevant registers of the bank should be mentioned under Column 2.

**General instructions for compiling reconciliation statement**



**a) Column - 2 (GL balances)**

It is not necessary to give complete details of securities in the format. Only aggregate amount of face value against each category may be mentioned. The corresponding book value of securities may be indicated in bracket under the amount of face value of securities under each category.

**b) Column - 3 and 4 (SGL balances)**

In the normal course balances indicated against item three and four should agree with each other. In case of any difference on account of any transaction not being recorded either in PDO or in the books of the bank this should be explained giving full details of each transaction.

**c) Column - 5 (BRs held)**

If the bank is holding any BRs for purchases for more than 30 days from the date of its issue, particulars of such BRs should be given in a separate statement.

**d) Column - 6 (SGL forms held)**

Aggregate amount of SGL forms received for purchases, which have not been tendered with PDO, should be given here.

**e) Column - 7**

Aggregate amount of all scrips held in the form of bonds, letters of allotments, subscription receipts as also certificates of entries in the books of accounts of the issuer (for other than government securities), etc. including securities which have been sold but physical delivery has not been given should be mentioned.

**f) Column - 8 (outstanding deliveries)**

This relates to BRs issued by the bank, where the physicals/scrips have not been delivered but the balance in General Ledger has been reduced. If any BR issued is outstanding for more than thirty days the particulars of such BRs may be given in a separate list indicating reasons for not affecting the delivery of scrips.

**g) General**

Face value of securities indicated against each item in column two should be accounted for under any one of the columns from four to seven. Similarly, amount of outstanding deliveries (BRs issued) which has been indicated in column eight will have to be accounted for under one of the columns four to seven. Thus the total of columns two and eight should tally with total of columns four to seven.

**Annexure - VII  
Para 4.5.5**

**Disclosures**

The following disclosures should be made by banks in the 'Notes on Accounts' to the Balance Sheet.

(Rs. in crore)				
	<b>Minimum outstanding during the year</b>	<b>Maximum outstanding during the year</b>	<b>Daily Average outstanding during the year</b>	<b>As on March 31</b>
Securities sold under repos				
Securities purchased under reverse repos				

**Illustrative examples for uniform accounting of  
Repo / Reverse repo transactions**

**A. Repo / Reverse Repo of Coupon bearing security**

**1. Details of Repo in a coupon bearing security:**

Security offered under Repo	11.43% 2015	
Coupon payment dates	7 August and 7 February	
Market Price of the security offered under Repo (i.e. price of the security in the first leg)	Rs.113.00	<b>(1)</b>
Date of the Repo	19 January, 2003	
Repo interest rate	7.75%	
Tenor of the repo	3 days	
Broken period interest for the first leg*	$11.43\% \times 162 / 360 \times 100 = 5.1435$	<b>(2)</b>
Cash consideration for the first leg	$(1) + (2) = 118.1435$	<b>(3)</b>
Repo interest**	$118.1435 \times 3 / 365 \times 7.75\% = 0.0753$	<b>(4)</b>
Broken period interest for the second leg	$11.43\% \times 165 / 360 \times 100 = 5.2388$	<b>(5)</b>
Price for the second leg	$(3) + (4) - (5) = 118.1435 + 0.0753 - 5.2388 = 112.98$	<b>(6)</b>
Cash consideration for the second leg	$(5) + (6) = 112.98 + 5.2388 = 118.2188$	<b>(7)</b>

\* Computation of days based on 30 / 360 day count convention

\*\* Computation of days based on Actual / 365 day count convention applicable to money market instruments

**2. Accounting for seller of the security**

We assume that the security was held by the seller at the book value (BV) of Rs.120.0000

### First leg Accounting

	<b>Debit</b>	<b>Credit</b>
Cash Repo Account	118.1435	120.0000 (Book value)
Repo Price Adjustment account	7.0000 (Difference between BV & repo price)	
Repo Interest Adjustment account		5.1435

### Second Leg Accounting

	<b>Debit</b>	<b>Credit</b>
Repo Account Repo Price Adjustment account	120.0000	7.02 (the difference between the BV and 2nd leg price)
Repo Interest Adjustment account Cash account	5.2388	118.2188

The balances in respect of the Repo Price Adjustment Account and Repo Interest Adjustment Account at the end of the second leg of repo transaction are transferred to Repo Interest Expenditure Account. In order to analyse the balances in these accounts, the ledger entries are shown below :

#### ***Repo Price Adjustment account***

<b>Debit</b>		<b>Credit</b>	
Difference in price for the 1st leg	7.00	Difference in price for the 2nd leg	7.02
Balance carried forward to Repo Interest Expenditure account	0.02		
<b>Total</b>	<b>7.02</b>	<b>Total</b>	<b>7.02</b>

#### ***Repo Interest Adjustment account***

<b>Debit</b>		<b>Credit</b>	
Broken period interest for the 2nd leg	5.2388	Broken period interest for the 1st leg	5.1435

		Balance carried forward to Repo Interest Expenditure account	0.0953
<b>Total</b>	<b>5.2388</b>	<b>Total</b>	<b>5.2388</b>

***Repo Interest Expenditure Account***

Debit		Credit	
Balance from Repo Interest Adjustment account	0.0953	Balance from Repo Price Adjustment account	0.0200
		Balance carried forward to P & L a/c.	0.0753
<b>Total</b>	<b>0.0953</b>	<b>Total</b>	<b>0.0953</b>

**3. Accounting for buyer of the security**

When the security is bought, it will bring its book value with it. Hence market value is the book value of the security.

**First leg Accounting**

	Debit	Credit
Reverse Repo Account	113.0000	
Reverse Repo Interest Adjustment account	5.1435	
Cash account		118.1435

**Second Leg Accounting**

	Debit	Credit
Cash account	118.2188	
Reverse Repo Price Adjustment account (Difference between the 1st and 2 <sup>nd</sup> leg prices)	0.0200	
Reverse Repo account		113.0000
Reverse Repo Interest Adjustment account		5.2388

The balances in respect of the Reverse Repo Interest Adjustment Account and Reverse Repo Price adjustment account at the end of the second leg of reverse repo in these accounts are transferred to Repo Interest Income Account. In order to analyse the balances in these two accounts, the ledger entries are shown below:

***Reverse Repo Price Adjustment Account***

Debit		Credit	
Difference in price of 1st & 2nd leg	0.0200	Balance to Repo Interest Income a/c.	0.0200
<b>Total</b>	<b>0.0200</b>	<b>Total</b>	<b>0.0200</b>

***Reverse Repo Interest Adjustment Account***

Debit		Credit	
Broken period interest for the 1st leg	5.1435	Broken period interest for the 2nd leg	5.2388
Balance carried forward to Repo Interest Income Account	0.0953		
<b>Total</b>	<b>5.2388</b>	<b>Total</b>	<b>5.2388</b>

***Reverse Repo Interest Income Account***

Debit		Credit	
Difference between the 1st & 2nd leg prices	0.0200	Balance from Reverse Repo Interest Adjustment account	0.0953
Balance carried forward to P & L account	0.0753		
<b>Total</b>	<b>0.0953</b>	<b>Total</b>	<b>0.0953</b>

***4. Additional accounting entries to be passed on a Repo / Reverse Repo transaction on a coupon bearing security, when the accounting period is ending on an intervening day***

Transaction Leg --- >	1st leg	End of accounting period	2nd leg
Dates --- >	19 Jan 03	21 Jan 03*	22 Jan 03

The difference in the clean price of the security between the first leg and the second leg should be apportioned upto the Balance Sheet date and should be shown as Repo Interest Income / Expenditure in the books of the seller / buyer respectively and should be debited / credited as an income / expenditure accrued but not due. The balances under Income / expenditure accrued but not due should be taken to the balance sheet

The coupon accrued by the buyer should also be credited to the Repo Interest Income account. No entries need to be passed on " Repo / Reverse Repo price adjustment account and Repo / Reverse repo interest adjustment account" . The illustrative accounting entries are shown below:

a) **Entries in Seller's books on January 21, 2003**

Account Head	Debit	Credit
Repo Interest Income account [Balances under the account to be transferred to P & L]		0.0133 ( Notional credit balance 0.0133 in the Repo Price Adjustment Account by way of apportionment of price difference for two days i.e. upto the balance sheet day)
Repo interest Income accrued but not due	0.0133	

\* January 21, 2003 is assumed to be the balance sheet date

b) **Entries in Seller's books on January 21, 2003**

Account Head	Debit	Credit
Repo interest income	0.0133	
P & L a/c		0.0133

(c) **Entries in Buyer's Books on January 21, 2003**

Account Head	Debit	Credit
Repo interest income accrued but not due	0.0502	
Repo Interest Income account [Balances under the account to be transferred to P & L]		0.0502 (Interest accrued for 3 days of Rs. 0.0635* - Apportionment of the difference in the clean price of Rs. 0.0133)

\* For the sake of simplicity the interest accrual has been considered for 2 days.

(d) **Entries in Buyer's Books on January 21, 2003**

Account Head	Debit	Credit
Repo interest income account	0.0502	
P& L a/c		0.0502

The difference between the repo interest accrued by the seller and the buyer is on account of the accrued interest forgone by the seller on the security offered for repo.

**B. Repo / Reverse Repo of Treasury Bill**

**1. Details of Repo on a Treasury Bill**

Security offered under Repo	GOI 91 day Treasury Bill maturing on 28 February, 2003	
Price of the security offered under Repo	Rs.96.0000	(1)
Date of the Repo	19 January, 2003	
Repo interest rate	7.75%	
Tenor of the repo	3 days	
Total cash consideration for the first leg	96.0000	(2)
Repo interest	0.0612	(3)
Price for the second leg	(2)+(3) = 96.0000 + 0.0612 = 96.0612	
Cash consideration for the 2nd leg	96.0612	



## 2. Accounting for seller of the security

We assume that the security was held by the seller at the book value (BV) of Rs.95.0000

### First leg Accounting

	Debit	Credit
Cash Repo Account	96.0000	95.0000 (Book value)
Repo Price adjustment account		1.0000 (Difference between BV & repo price )

### Second Leg Accounting

Repo Account Repo Price adjustment account	95.0000 1.0612 (the difference between the BV and 2nd leg price)	
Cash account		96.0612

The balances in respect of the Repo Price Adjustment Account at the end of the second leg of repo transaction are transferred to Repo Interest Expenditure Account. In order to analyse the balances in this account, the ledger entries are shown:

### *Repo Price Adjustment account*

Debit		Credit	
Difference in price for the 2nd leg	1.0612	Difference in price for the 1st leg	1.0000
		Balance carried forward to Repo Interest Expenditure account	0.0612
<b>Total</b>	<b>1.0612</b>	<b>Total</b>	<b>1.0612</b>

### *Repo Interest Expenditure Account*

Debit		Credit	
Balance from Repo Price Adjustment account	0.0612	Balance carried forward to P & L a/c.	0.0612
<b>Total</b>	<b>0.0612</b>	<b>Total</b>	<b>0.0612</b>

The Seller will continue to accrue the discount at the original discount rate during the period of the repo.

### 3. Accounting for buyer of the security

When the security is bought, it will bring its book value with it. Hence market value is the book value of the security.

#### First leg Accounting:

	Debit	Credit
Reverse Repo Account	96.0000	
Cash account		96.0000

#### Second Leg Accounting

	Debit	Credit
Cash account	96.0612	
Repo Interest Income account (Difference between the 1st and 2nd leg prices)		0.0612
Reverse Repo account		96.0000

The Buyer will not accrue for the discount during the period of the repo.

### 4. Additional accounting entries to be passed on a Repo / Reverse Repo transaction on a Treasury Bill, when the accounting period is ending on an intervening day

Transaction Leg ->	1st leg	B/S date	2 <sup>nd</sup> leg
Date ->	19 Jan.03	21 Jan.03*	22 Jan.03

\* 21 January, 2003 is assumed to be the balance sheet date

**(a) Entries in Seller's books on January 21, 2003**

Account Head	Debit	Credit
Repo Interest Expenditure account (after apportionment of repo interest for two days) [ Balances under the account to be transferred to P & L]	0.0408	
Repo interest expenditure accrued but not due		0.0408

**(b) Entries in Seller's books on January 21, 2003**

Account Head	Debit	Credit
Repo interest expenditure account		0.0408
P & L a/c	0.0408	

**(c) Entries in Buyer's Books on January 21, 2003**

Account Head	Debit	Credit
Repo interest income accrued but not due	0.0408	
Repo Interest Income account [Balances under the account to be transferred to P & L]		0.0408

**(d) Entries in Buyer's Books on January 21, 2003**

Account Head	Debit	Credit
Repo interest income account	0.0408	
P & L a/c		0.0408

## Appendix

### List of Circulars consolidated by the Master Circular

No.	Circular No.	Date	Relevant para no. of the circular	Subject	Para no. of the master circular
1.	<u>DBOD.No.FSC.BC.69/C.469- 90/91</u>	Jan 18, 1991	1,2,4	Portfolio Management on behalf of clients	1.3. 3
2.	<u>DO.DBOD.No.FSC.46/C.469- 91/92</u>	July 26, 1991	4(i), (ii), (iii), (iv), (v), (iv)	Investment portfolio of banks- Transaction in securities	1.2 (i)
3.	<u>DBOD.No.FSC.BC.143A/24.48. 001/ 91-92</u>	June 20, 1992	3(I), 3(I)- (ii)- (iii)- (iv)- (v)- (xi)- (xii)- (xvi)- (xvii), 3(II), 3(III), 3(V)- (i)- (ii)- (iii), (3) & (4)	Investment portfolio of banks- Transaction in securities	1.2 (ii), (iii) & (iv), 1.2.2, 1.2.3, 1.2.5, 1.2.6, 1.2.7
4.	<u>DBOD.No.FSC.BC.11/24.01.009/ 92-93</u>	July 30, 1992	3,4,5,6	Portfolio Management on behalf of clients	1.3.3
5.	<u>DBOD.No.FMC/BC/17/24.48.001. 92/93</u>	Aug 19, 1992	2	Investment portfolio of banks- Transaction in securities	1.3.2
6.	<u>DBOD.FMC.BC.62/27.02.001/ 92-93</u>	Dec 31, 1992	1	Investment portfolio of banks- Transaction in securities	1.2.6
7.	<u>DBOD.No.FMC.1095/27.01.002/93</u>	April 15, 1993	1 & enclosed format	Investment portfolio of banks- Reconciliation of	1.3.1 & Anne-xure VI

				holdings	
8.	<u>DBOD.No.FMC.BC.141/27.02.006/ 93/94</u>	July 19, 1993	Annex	Investment portfolio of banks- Transaction in securities- Aggregate contract limit for individual brokers- Clarifications	Anne-xure II
9	<u>DBOD.No.FMC.BC.1/27.02.001/ 93-94</u>	Jan 10, 1994	1	Investment portfolio of banks- Transaction in securities- Bouncing of SGL transfer forms- Penalties to be imposed.	1.2.2
10	<u>DBOD.No.FMC.73/27.07.001/ 94-95</u>	June 7, 1994	1,2	Acceptance of deposits under Portfolio Management Scheme	1.3.3
11.	<u>DBOD.No.FSC.BC.130/24.76.002/ 94-95</u>	Nov 15, 1994	1	Investment portfolio of banks- Transaction in securities-Bank Receipts (BRs)	1.2.3
12.	<u>DBOD.No.FSC.BC.129/24.76.002/ 94-95</u>	Nov 16, 1994	2 & 3	Investment portfolio of banks- Transaction in securities-Role of brokers	1.2.6
13.	<u>DBOD.No.FSC.BC.142/24.76.002/ 94-95</u>	Dec 9, 1994	1 & 2	Do	1.2.6
14.	<u>DBOD.No.FSC.BC.70/24.76.002/ 95-96</u>	June 8, 1996	2	Retailing of Government Securities	1.2.4
15.	<u>DBOD.No.FSC.BC.71/24.76.001/ 96</u>	June 11, 1996	1	Investment portfolio of banks- Transaction in securities	1.2.2
16.	<u>DBOD.No.BC.153/24.76.002/96</u>	Nov 29, 1996	1	Do	1.2.6
17.	<u>DBOD.BP.BC.9/21.04.048/98</u>	29 Jan 1997	3	Prudential norms - capital adequacy, income recognition, asset classification and provisioning.	5.1 (iii) & (iv)

18.	<a href="#">DBOD.BP.BC.32/21.04.048/97</a>	April 12, 1997	1&2	Do	5.1 (i) &(ii)
19.	<a href="#">DBOD.FSC.BC.129/24.76.002-97</a>	Oct 22, 1997	1	Retailing of Government Securities	1.2.4
20.	<a href="#">DBOD.No.BC.112/24.76.002/1997</a>	Oct 14, 1997	1	Investment portfolio of banks- Transaction in securities-Role of brokers	1.2.6
21.	<a href="#">DBOD.BP.BC.75/21.04.048/98</a>	4 Aug 1998	All	Acquisition of Government and other approved securities - Broken Period Interest, - Accounting Procedure	5.2
22.	<a href="#">DBS.CO.FMC.BC.1/22.53.014/98-99</a>	July 7, 1999	1	Investment portfolio of banks – Transactions in securities	1.3.1(i)
23.	<a href="#">DBS.CO.FMC.BC.18/22.53.014/ 99-2000</a>	Oct 28, 1999	2, 3, 4 & 5	Do	1.2.2
24.	<a href="#">DBOD.No.FSC.BC.26/24.76.002/ 2000</a>	Oct 6, 2000	2	Sale of Government securities allotted in the auctions for Primary issues	1.2(i)(b)
25.	<a href="#">DBOD.BP.BC.32/21.04.048/ 2000-01</a>	Oct 16, 2000	All	Guidelines on classification and valuation of investments.	2 & 3
26.	<a href="#">DBOD.FSC.BC.No.39/24.76.002/ 2000</a>	Oct 25, 2000	1	Investment portfolio of banks- Transaction in securities-Role of brokers	1.2.6
27.	<a href="#">Dir.BC.107/13.03.00/2000-01</a>	April 19, 2001	6	Monetary and Credit Policy for the year 2000-2002 - Interest Rate Policy	5.3
28.	<a href="#">DBOD.BP.BC.119/21.04.137/ 2000-2001</a>	May 11, 2001	Annex - 5 &12	Bank financing of equities and investments in shares - Revised guidelines	1.2, 1.2.5 1.3, 1.3.1
29.	<a href="#">DBOD.BP.BC.127/21.04.048/ 2000- 01</a>	June 7, 2001	All	Non- SLR Investments of	1.2.8 Anne-

				Banks	Annexure III
30.	<a href="#">DBOD.BP.BC.61/21.04.048/ 2001-02</a>	Jan 25, 2002	All	Guidelines for investments by banks/Fis and Guidelines for financing of restructured accounts by banks/FIs	1.2.8 (iv)
31.	<a href="#">DBOD.No.FSC.BC.113/24.76.002/ 2001-02</a>	June 7 2002	All	On Investment Portfolio of Banks Transaction in Govt. Securities	1.3.4
32.	<a href="#">DBS.CO.FMC.BC.7/22.53.014/ 2002-03</a>	Nov 7, 2002	Para 2	Operation of investment portfolio by banks- submission of concurrent audit reports by banks	1.2.7(c)
33.	<a href="#">DBOD.No.FSC.BC.90/24.76.002/ 2002-03</a>	March 31 2003	All	Ready Forward Contracts	1.2.1(i), (ii) and (iii)
34.	<a href="#">IDMC.3810/11.08.10/2002-03</a>	March 24 2003	All	Guidelines for uniform accounting for Repo / Reverse Repo transactions	4, Annexure VII & Annexure VIII
35.	<a href="#">DBOD.BP.BC.44/21.04.141/03-04</a>	Nov 12, 2003	All	Prudential guidelines on banks' investment in non-SLR securities	1.2.8 Annexure IV, V
36.	<a href="#">DBOD.BP.BC.53/21.04.141/03-04</a>	Dec 10, 2003	All	do	1.2.8
37.	<a href="#">DBOD.FSC.BC.59/24.76.002 /03-04</a>	Dec 26, 2003	All	Sale of Government securities allotted in the auctions for primary issues on the same day	Annexure I C
38.	<a href="#">IDMD.PDRS.05/10.02.01/ 2003-04</a>	Mar 29, 2004	3, 4, 6 & 7	Transactions in Government Securities	1.2(i) (a)
39.	<a href="#">IDMD.PDRS/4777/10.02.01/ 2004-05</a>	May 11, 2005	3	Sale of securities allotted in primary issues	1.2(i) (b)
40.	<a href="#">IDMD.PDRS/4779/10.02.01/ 2004-05</a>	May 11, 2005	2,3,4,5	Ready forward contracts	1.2.1 (b),

					1.2.1 (c)
41.	<a href="#">IDMD.PDRS/4783/10.02.01/ 2004-05</a>	May 11, 2005	3	Government securities transactions - T+1 settlement	1.2(i) (c)
42.	<a href="#">DBOD.FSC.BC.28/24.76.002/ 2004-05</a>	Aug 12, 2004	2	Transactions in Government securities	1.2(i)(a)
43.	<a href="#">DBOD.BP.BC. 29/21.04.141/ 2004-05</a>	Aug 13, 2004	2(b) of Annex	Prudential norms - State Government guaranteed exposures	3.5.2
44.	<a href="#">DBOD.Dir.BC.32/13.07.05/ 2004-05</a>	Aug 17, 2004	2	Dematerialisation of banks' investment in equity	5.3
45.	<a href="#">DBOD.BP.BC.37/21.04.141/ 2004-05</a>	Sep 2, 2004	1(i) & (ii)	Prudential norms on classification of investment portfolio of banks	2.1 (ii) & (iii)
46.	<a href="#">DBOD.FSD.BC.No.31/24.76.002/ 2005-06</a>	Sep 1, 2005	2, 3	NDS-OM - Counterparty Confirmation	1.2.5 (i) (c)
47.	<a href="#">DBOD.BP.BC.38/21.04.141/ 2005-06</a>	Oct 10, 2005	All	Capital Adequacy - Investment Fluctuation Reserve	3.4
48.	<a href="#">IDMD.No.03/11.01.01(B)/2005-06</a>	Feb 28, 2006	2,3,4,5	Secondary Market transactions in Government Securities- Intra day short selling	1.2 (i) (a)
49.	<a href="#">IDMD.No.3426 /11.01.01 (D)/ 2005-06</a>	May 3, 2006	All	'When Issued' transactions in Central Government Securities'	1.2 (i) (a)
50	<a href="#">DBOD.No.BP.BC.27/21.01.002/2006-07</a>	Aug 23, 2006	2, 4	Prudential guidelines – Bank's investments in VCF	3.9
51	<a href="#">IDMD.No.2130/11.01.01(D)/2006-07</a>	Nov 16, 2006	All	When Issued transactions in Central Government Securities	1.2(i)(a)



52	<a href="#">DBOD.No.FSD.BC.46/24.01.028/2006-07</a>	Dec 12, 2006	16B(ii)	Financial Regulation of Systemically Important NBFCs and Bank's Relationship with them	1.3.3(i)
53	<a href="#">IDMD.No. /11.01.01(B)/2006-07</a>	Jan 31, 2007	All	Secondary Market transactions in Government Securities- Short selling	1.2.(i)a
54	<u>Mailbox Clarification</u>	July 11, 2007	All	HTM Securities	3.1.(i)
55	<a href="#">DBOD.No.BP.BC.56/21.04.141/2007-08</a>	December 6, 2007	All	Limits on investment in unrated Non-SLR securities- infrastructure bonds	1.2.7
56.	<a href="#">DBOD.No.BP.BC.86/21.04.141/2007-08</a>	May 22, 2008	All	Valuation of securities	3.7.1
57.	<u>Mailbox Clarification</u>	February 6, 2009	All	Non-SLR Securities	1.2.12
58.	<u>Mailbox Clarification</u>	February 5, 2009	All	Unlisted Non-SLR Securities	1.2.13
59.	<u>Mailbox Clarification</u>	March 16, 2009	All	Classification of Securities	3.2
60.	<u>Mailbox Clarification</u>	February 11, 2009	All	Investment Portfolio of Banks	Annexure 1(c)(i)