ANNEX - 4
(Cf. Para 4.3.3)

Terms and Conditions Applicable to Perpetual Cumulative Preference Shares (PCPS)/ Redeemable Non-Cumulative Preference Shares (RNCPS) / Redeemable Cumulative Preference Shares (RCPS) to Qualify for Inclusion as Part of Upper Tier 2 Capital

1. Terms of Issue

i) Characteristics of the instruments:

a. These instruments could be either perpetual (PCPS) or dated (RNCPS and RCPS) instruments with a fixed maturity of minimum 15 years.

b. The perpetual instruments shall be cumulative. The dated instruments could be cumulative or non-cumulative

ii) Limits: The outstanding amount of these instruments along with other components of Tier 2 capital shall not exceed 100 per cent of Tier 1 capital at any point of time. The above limit will be based on the amount of Tier 1 capital after deduction of goodwill and other intangible assets but before the deduction of investments.

iii) Amount: The amount to be raised may be decided by the Board of Directors of banks.

iv) Options:

(i) These instruments shall not be issued with a 'put option'.

(ii) However, banks may issue the instruments with a call option at a particular date subject to strict compliance with each of the following conditions:

(a) The call option on the instrument is permissible after the instrument has run for at least ten years; and

(b) Call option shall be exercised only with the prior approval of RBI (Department of Banking Operations & Development). While considering the proposals received from banks for exercising the call option the RBI would, among other things, take into consideration the bank's CRAR position both at the time of exercise of the call option and after exercise of the call option.

v) Step-up option: The issuing bank may have a step-up option which may be exercised only once during the whole life of the instrument, in conjunction with the call option, after the lapse of ten years from the date of issue. The step-up shall not be more than 100 bps. The limits on step-up apply to the all-in cost of the debt to the issuing banks.

vi) Classification in the balance sheet: These instruments will be classified as ‘Borrowings’ under Schedule 4 of the Balance Sheet under item No.I (i.e., Borrowings in India’).

vii) <u>Coupon</u>: The coupon payable to the investors may be either at a fixed rate or at a floating rate referenced to a market determined rupee interest benchmark rate.

vii) <u>Payment of coupon</u>:

a) The coupon payable on these instruments will be treated as interest and accordingly debited to P& L Account. However, it will be payable only if

I. The bank's CRAR is above the minimum regulatory requirement prescribed by RBI

II. The impact of such payment does not result in bank's CRAR falling below or remaining below the minimum regulatory requirement prescribed by RBI

III. The bank does not have a net loss. For this purpose the Net Loss is defined as either (i) the accumulated loss at the end of the previous financial year / half year as the case may be; or (ii) the loss incurred during the current financial year.

IV. In the case of PCPS and RCPS the unpaid coupon will be treated as a liability. The interest amount due and remaining unpaid may be allowed to be paid in later years subject to the bank complying with the above requirements.

V. In the case of RNCPS, deferred coupon will not be paid in future years, even if adequate profit is available and the level of CRAR conforms to the regulatory minimum.

b) All instances of non-payment of interest should be notified by the issuing banks to the Chief General Managers-in-Charge of Department of Banking Operations & Development and Department of Banking Supervision, Central Office of the Reserve Bank of India, Mumbai.

ix) <u>Redemption / repayment</u>:

a) The RNCPS and RCPS shall not be redeemable at the initiative of the holder.

b) Redemption of these instruments at maturity shall be made only with the prior approval of the Reserve Bank of India (Department of Banking Operations and Development), subject, *inter alia,* to the following conditions :

I. the bank's CRAR is above the minimum regulatory requirement prescribed by the RBI, and

II. the impact of such payment does not result in bank's CRAR falling below or remaining below the minimum regulatory requirement prescribed by RBI.

1.10. <u>Seniority of claim</u>: The claims of the investors in these instruments shall be senior to the claims of investors in instruments eligible for inclusion in Tier 1 capital and subordinate to the claims of all other creditors including those in Lower Tier 2 and the depositors. Amongst the investors of various instruments included in Upper Tier 2, the claims shall rank pari-passu with each other.

1.11 *Amortisation for the purpose of computing CRAR:* The Redeemable Preference Shares (both cumulative and non-cumulative) shall be subjected to a progressive discount for capital adequacy purposes over the last five years of their tenor, as they approach maturity as indicated in the table below for being eligible for inclusion in Tier 2 capital.

Remaining Maturity of Instruments	**Rate of Discount (%)**
Less than one year	100
One year and more but less than two years	80
Two years and more but less than three years	60
Three years and more but less than four years	40
Four years and more but less than five years	20

1.12 *Other conditions:*

a) These instruments should be fully paid-up, unsecured, and free of any restrictive clauses.

b) Investment by FIIs and NRIs shall be within an overall limit of 49 per cent and 24 per cent of the issue respectively, subject to the investment by each FII not exceeding 10 per cent of the issue and investment by each NRI not exceeding 5 per cent of the issue. Investment by FIIs in these instruments shall be outside the ECB limit for rupee denominated corporate debt as fixed by Government of India from time to time. However, investment by FIIs in these instruments will be subject to separate ceiling of USD 500 million. The overall non-resident holding of Preference Shares and equity shares in public sector banks will be subject to the statutory / regulatory limit.

c) Banks should comply with the terms and conditions, if any, stipulated by SEBI / other regulatory authorities in regard to issue of the instruments.

2. Compliance with Reserve Requirements

a) The funds collected by various branches of the bank or other banks for the issue and held pending finalization of allotment of these instruments will have to be taken into account for the purpose of calculating reserve requirements.

b) The total amount raised by a bank through the issue of these instruments shall be reckoned as liability for the calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will attract CRR / SLR requirements.

3. Reporting Requirements

Banks issuing these instruments shall submit a report to the Chief General Manager-in-charge, Department of Banking Operations & Development, Reserve Bank of India, Mumbai giving details of the debt raised, including the terms of issue specified at para 1 above ,together with a copy of the offer document soon after the issue is completed.

4. Investment in these instruments issued by other banks / FIs

a) A bank's investment in these instruments issued by other banks and financial institutions will be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10 percent of investing banks' total capital funds prescribed vide circular DBOD.BP.BC.No.3/ 21.01.002/ 2004-05 dated 6th July 2004 and also subject to cross holding limits.

b) Bank's investments in these instruments issued by other banks / financial institutions will attract risk weight for capital adequacy purposes as provided vide paragraph 5.6 of this Master Circular.

5. Grant of advances against these instruments

Banks should not grant advances against the security of these instruments issued by them.