ANNEX 2

Terms and conditions for inclusion of Innovative Perpetual Debt Instruments as Tier I capital

The Innovative Perpetual Debt Instruments (Innovative Instruments) that may be issued as bonds or debentures by Indian banks should meet the following terms and conditions to qualify for inclusion as Tier I Capital for capital adequacy purposes.

1. Terms of issue of innovative instruments

i) Currency of issue

Banks shall issue innovative instruments in Indian Rupees as well as in foreign currency. Banks may augment their capital funds through the issue of IPDI in foreign currency, subject to compliance with the under mentioned requirements:

a) IPDI issued in foreign currency should comply with all terms and conditions applicable in the guidelines issued on January 25, 2006, unless specifically modified in these guidelines.

b) Not more than 49% of the eligible amount can be issued in foreign currency.

c) IPDI issued in foreign currency shall be outside the limits for foreign currency borrowings indicated in sub paragraphs 1.i.a and 1.i.b of Annex 2.

ii) Amount

The amount of innovative instruments to be raised may be decided by the Board of Directors of banks.

iii) Limits

Innovative instruments shall not exceed 15 per cent of total Tier I capital. The above limit will be based on the amount of Tier I capital as on March 31 of previous year after deduction of goodwill and other intangible assets but before the deduction of investments. Innovative instruments in excess of the above limits shall be eligible for inclusion under Tier II, subject to the limits prescribed for Tier II capital. However, investors' rights and obligations would remain unchanged.

iv) Maturity period

The innovative instruments shall be perpetual.

v) Rate of interest

The interest 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.

vi) Options

Innovative instruments shall not be issued with a 'put option'. However banks may issue the instruments with a 'call option' subject to strict compliance with each of the following conditions:

a) Call option can be exercised 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 the exercise of the call option.

vii) 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.

viii) Lock-In Clause

a) Innovative instruments shall be subjected to a lock-in clause in terms of which the issuing bank shall not be liable to pay interest, if

- the bank's CRAR is below the minimum regulatory requirement prescribed by RBI; or
- the impact of such payment results in bank's CRAR falling below or remaining below the minimum regulatory requirement prescribed by RBI.

b) However, banks may pay interest with the prior approval of RBI when the impact of such payment may result in net loss or increase the net loss, provided the CRAR remains above the regulatory norm. For this purpose 'Net Loss' would mean either (a) the accumulated loss at the end of the previous financial year; or (b) the loss incurred during the current financial year.

c) The interest shall not be cumulative.

d) All instances of invocation of the lock-in clause 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 of the Reserve Bank of India, Mumbai.

ix) Seniority of claim

The claims of the investors in innovative instruments shall be

a) Superior to the claims of investors in equity shares; and
b) Subordinated to the claims of all other creditors.

x) Discount

The innovative instruments shall not be subjected to a progressive discount for capital adequacy purposes since these are perpetual.

xi) Other conditions

a) Innovative instruments should be fully paid-up, unsecured, and free of any restrictive clauses.
b) Investment in these instruments by FIIs and NRIs shall be within an overall limit of 49% and 24% of the issue respectively, subject to the investment by each FII not exceeding 10% of the issue and investment by each NRI not exceeding 5% of the issue.
c) Investment by FIIs in IPDI raised in Indian Rupees shall be outside the ECB limit for rupee denominated corporate debt fixed for investment by FIIs in corporate debt instruments.
d) Banks should compute their overall eligibility level for raising capital through Innovative Perpetual Debt Instruments with reference to the Tier I capital as on the last annual balance sheet date (i.e. March 31). A bank may raise fresh capital through Innovative Perpetual Debt Instruments from FIIs and NRIs up to 49 percent and 24 percent, respectively, of the amount proposed to be raised within one year or the eligible limit whichever is less. The bank should, however, raise the remaining amount from the domestic investors within a period of one year from the date of issue to FIIs / NRIs, to ensure compliance with the limits set for FIIs and NRIs at the end of the one year period.
e) 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

The total amount raised by a bank through IPDIs shall not be reckoned as liability for calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will <u>not</u> attract CRR/SLR requirements.

3. Reporting Requirements

Banks issuing innovative 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 item 1 above together with a copy of the offer document soon after the issue is completed.

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

A bank's investment in innovative 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 for cross holding of capital among banks/FIs prescribed vide circular DBOD.BP.BC.No.3/ 21.01.002/ 2004-05 dated 6th July 2004 and also subject to cross holding limits.

Bank's investments in innovative instruments issued by other banks/ financial institutions will attract a 100% risk weight for capital adequacy purposes.

5. Grant of advances against innovative instruments

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

6. Disclosure Banks may indicate the amount raised by issue of IPDI by way of explanatory notes / remarks in the Balance Sheet as well as Schedule 5 under 'Other Liabilities & Provisions"

7. Raising of innovative Instruments for inclusion as Tier I capital by foreign banks in India

Foreign banks in India may raise Head Office (HO) borrowings in foreign currency for inclusion as Tier I capital subject to the same terms and conditions as mentioned in items 1 to 5 above for Indian banks. In addition, the following terms and conditions would also be applicable:

i) Maturity period

If the amount of innovative Tier I capital raised as Head Office borrowings shall be retained in India on a perpetual basis.

ii) *Rate of interest*

Rate of interest on innovative Tier I capital raised as HO borrowings should not exceed the on-going market rate. Interest should be paid at half-yearly rests.

iii) *Withholding tax*

Interest payments to the HO will be subject to applicable withholding tax.

iv) *Documentation*

The foreign bank raising innovative Tier I capital as HO borrowings should obtain a letter from its HO agreeing to give the loan for supplementing the capital base for the Indian operations of the foreign bank. The loan documentation should confirm that the loan given by Head Office shall be eligible for the same level of seniority of claim as the investors in innovative instruments capital instruments issued by Indian banks. The loan agreement will be governed by and construed in accordance with the Indian law.

v) *Disclosure*

The total eligible amount of HO borrowings shall be disclosed in the balance sheet under the head 'Innovative Tier I capital raised in the form of Head Office borrowings in foreign currency'.

vi) *Hedging*

The total eligible amount of HO borrowing should remain fully swapped in Indian Rupees with the bank at all times.

vii) *Reporting and certification*

Details regarding the total amount of innovative Tier I capital raised as HO borrowings, along with a certification to the effect that the borrowing is in accordance with these guidelines, should be advised to the Chief General Managers-in-Charge of the Department of Banking Operations & Development (International Banking Section), Department of External Investments & Operations and Foreign Exchange Department (Forex Markets Division), Reserve Bank of India, Mumbai.