

Non-SLR Investments of Banks

June 7, 2001

DBOD.BP.BC. 127 / 21.04.048 / 2000-01

All Commercial Banks
(excluding RRBs and LABs)

Dear Sir,

Non-SLR Investments of Banks

Please refer to para 4.3 of our circular DBOD.No.BP.BC.32/ 21.04.048/ 2000-01 dated October 16, 2000, advising banks to formulate investment policy with the approval of their Board of Directors, which should also adequately address risk management aspects. Banks have also been advised vide para 4 of our circular DBOD. No. BP.(SC).BC.98 / 21.04.103/ 99 dated October 7, 1999 on Risk Management Guidelines to look into specific risk management aspects while processing investment proposals.

2. A recent review of the non-SLR investment portfolio of banks has revealed that some 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. While it is not the intention to prohibit banks from subscribing to unrated instruments on private placement basis, however, as such investments could cause some concern, banks should put in place appropriate systems to ensure that investment in privately placed unrated instruments is made in accordance with the systems and procedures prescribed under the respective bank's investment policy approved by the Board.

3. Further, 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, we may state that Reserve Bank of India 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. We enclose the details of the Group's recommendations in the Annexure and advise that banks may introduce with immediate effect suitable format of disclosure requirements on the lines of the recommendations of the Technical Group with the approval of their Board.

4. With a view to ensuring that the investments by banks in unrated 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 on unrated issues 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) In case of unrated issues or issues of companies who are not their borrowers, banks should have an internal system of rating. For this purpose, banks should insist on obtaining adequate information from the issuers in a suitable manner as indicated in paragraph 3 above.
- 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. The investments in unrated privately placed bonds and debentures should be well diversified.
- (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. The 'rating' migration of the issuers and the consequent diminution in the portfolio quality should also be tracked at periodic intervals.

5. These instructions may be placed before the Investment Committee/ Board of Directors of the bank for their information.

6. Please acknowledge receipt.

Yours faithfully,

(M.R. Srinivasan)

Chief General Manager-in-Charge

Encls: As above

ANNEXURE

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 despatched 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.