Subordinated debt for inclusion in Tier II capital –
Head Office borrowings in foreign currency by
Foreign Banks operating in India

DBOD. No. IBS. BC. 65/23.10.015/2001-02

February 14, 2002

The Chief Executives of
all Foreign Banks in India

Dear Sir,

Subordinated debt for inclusion in Tier II capital –
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Please refer to our circular DBOD. No. BP. BC. 5/21.01.002/99 dated February 8, 1999 regarding 'Issue of subordinated debt for raising Tier II capital'. In terms of paragraph II of the guidelines annexed to the circular, foreign banks were advised to take approval of RBI, on a case by case basis, for raising (a) subordinated debt in foreign currency and (b) subordinated debt in the form of foreign currency borrowings from Head office for inclusion in Tier II capital.

2. To ensure transparency and uniformity, as requested during informal consultations with foreign banks, it is now proposed to issue detailed guidelines for raising subordinated debt through Head Office borrowings in foreign currency for inclusion in Tier II capital. The guidelines are given in the enclosed Annexure.

3. Please acknowledge receipt.

Yours faithfully,

(B. Mahapatra)
General Manager

Encls: 3 sheets.

Annexure

Tier II capital - Subordinated debt - Head Office borrowings in foreign currency raised by foreign banks operating in India for inclusion in Tier II capital

In terms of para II (b) of RBI circular No. DBOD. BP. BC. 5/21.01.002/98-99 dated February 8, 1999 foreign banks are required to obtain the approval of RBI, for raising subordinated debt in the form of foreign currency borrowings from Head Office. The requests are presently examined on a case-by-case approach. Detailed guidelines on the standard requirements and conditions for inclusion of such Head Office borrowings in foreign currency, as subordinated debt in Tier II capital are as indicated below:-

Amount of borrowing

2. The total amount of HO borrowing in foreign currency will be at the discretion of the foreign bank. However, the amount eligible for inclusion in Tier II capital as subordinated debt will be subject to a maximum ceiling of 50% of the Tier I capital maintained in India, and the applicable discount rate mentioned in para 5 below. Further as per extant instructions, the total of Tier II capital should not exceed 100% of Tier I capital.

Maturity period

3. Head Office borrowings should have a minimum initial maturity of 5 years. If the borrowing is in tranches, each tranche will have to be retained in India for a minimum period of five years. HO borrowings in the nature of perpetual subordinated debt, where there may be no final maturity date, will not be permitted.

Features

4. The HO borrowings should be fully paid up, i.e. the entire borrowing or each tranche of the borrowing should be available in full to the branch in India. It should be unsecured, subordinated to the claims of other creditors of the foreign bank in India, free of restrictive clauses and should not redeemable at the instance of the HO.

Rate of discount

5. The HO borrowings will be subjected to progressive discount as they approach maturity at the rates indicated below:

Remaining maturity of borrowing	Rate of discount
More than 5 years	Not Applicable (the entire amount can be included as subordinated debt in Tier II capital subject to the ceiling mentioned in para 2)
More than 4 years and less than 5 years	20%
More than 3 years and less than 4 years	40%
More than 2 years and less than 3 years	60%
More than 1 year and less than 2 years	80%
Less than 1 year	100% (No amount can be treated as subordinated debt for Tier II capital)

Rate of interest

6. The rate of interest on HO borrowings should not exceed the on-going market rate. Interest should be paid at half yearly rests.

Withholding tax

7. The interest payments to the HO will be subject to applicable withholding tax.

Repayment

8. All repayments of the principal amount will be subject to prior approval of Reserve Bank of India, Department of Banking Operations and Development.

Documentation

9. The bank 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 would be subordinated to the claims of all other creditors of the foreign bank in India. The loan agreement will be governed by, and construed in accordance with the Indian law. Prior approval of the RBI should be obtained in case of any material changes in the original terms of issue.

Disclosure

10. The total amount of HO borrowings may be disclosed in the balance sheet under the head `Subordinated loan in the nature of long term borrowings in foreign currency from Head Office'.

Reserve requirements

11. The total amount of HO borrowings is to 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.

Hedging

12. The entire amount of HO borrowing should remain fully swapped with banks at all times. The swap should be in Indian rupees.

Reporting & Certification

13. Such borrowings done in compliance with the guidelines set out above, would not require prior approval of Reserve Bank of India. However, information regarding the total amount of borrowing raised from Head Office under this circular, along with a certification to the effect that the borrowing is as per the 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 Exchange Control Department (Forex Markets Division), Reserve Bank of India, Mumbai.