

Master Circular on Investment

RESERVE BANK OF INDIA

Urban Banks Department,
Central Office, Mumbai.

December____, 2003

UBD.BPD(PCB).MC.No. __/16.20.00/2003-04

Chief Executive Officers of
All Primary (Urban) Co-operative Banks

Dear Sir,

Master Circular on Investments by Primary (Urban) Co-operative Banks

The Reserve Bank of India has been issuing instructions on matters relating to investments either directly to primary (urban) co-operative banks or through the Registrar of Co-operative Societies of the concerned States. In order to enable the primary (urban) co-operative banks to have all the currently operative instructions on the subject at one place, a Master Circular has been prepared which is enclosed.

2. Please acknowledge receipt of this Master Circular to the concerned Regional Office of this Department.

Yours faithfully,

(S. Karuppasamy)
Chief General Manager-in-Charge

Encl: As above.

Master Circular on Investments by Primary (Urban) Co-op. Banks

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Master Circular on Investments by Primary (Urban) Co-operative Banks

1 RESTRICTIONS ON HOLDING SHARES IN OTHER

CO-OPERATIVE SOCIETIES

1.1 Section 19 of the Banking Regulation Act, 1949 (as applicable to co-operative societies) stipulates that no co-operative bank shall hold shares in any other co-operative society except to such extent and subject to such conditions as the Reserve Bank may specify in that behalf. However nothing contained in the section applies to -

1. shares acquired through funds provided by the State Government for that purpose;
2. in the case of a central co-operative bank, the holding of shares in the State co-operative bank to which it is affiliated; and
3. in the case of a primary (urban) co-operative bank, holding of shares in the central co-operative bank to which it is affiliated or in the State co-operative bank of the State in which it is registered.

1.2 In pursuance of the powers conferred by Section 19 read with Section 56 of the said Act, the Reserve Bank has specified that the extent and conditions subject to which co-operative banks may hold shares in any other co-operative society shall be as follows:

1. The total investments of a co-operative bank in the shares of co-operative institutions, other than those falling under any of the categories stated at paras 1.1.1 to 1.1.3 above, shall not exceed 2 per cent of its owned funds (paid-up share capital and reserves).

1.2.2 The investment of a bank in the shares of any one co-operative institution coming under para 1.2.1 above shall not exceed 5 per cent of the subscribed capital of that institution.

Note: When more than one co-operative bank contributes to the shares in a co-operative society falling under category under para 1.2.1, the limit of 5 per cent of the subscribed capital indicated above should apply not in respect of the investment of each of the banks but in respect of the investment of all the banks taken together. In other words, the total investment of all the co-operative banks should be limited to 5 per cent of the subscribed capital of the enterprise concerned.

A co-operative bank should offer to make its contribution to the shares of a co-operative society coming under para 1.2.1 above only if the by-laws of the recipient society provide for the retirement of share capital contributed by it.

1.2.3 The retirement of the share capital contributed by a bank to the shares of any society coming under para 1.2.1 above should be completed in 10 equal annual instalments commencing

from the co-operative year immediately following the year in which the concern commences business or production.

1.2.4 A co-operative bank should not, except with the permission of the Reserve Bank, contribute to the share capital of a society coming under category para 1.2.1 above, if it is situated outside its area of operation.

1.2.5 Provided that the above restrictions will not apply to holdings by co-operative banks of shares in non-profit making co-operative societies such as those formed for the protection of mutual interests, (e.g. co-operative banks' association) or for the promotion of co-operative education etc. (e.g. state co-operative union), or housing co-operatives for the purpose of acquiring premises on ownership basis, etc.

2. MANDATORY INVESTMENTS

2.1 Need for Mandatory Investments

2.1.1 In terms of provisions of Section 24 of the Banking Regulation Act 1949, (As applicable to co-operative societies), every primary (urban) co-operative bank is required to maintain liquid assets which at the close of business on any day should not be less than 25 percent of its time and demand liabilities in India (in addition to the minimum cash reserves requirement).

2.1.2 The banks may hold such liquid assets in the form of cash, gold or unencumbered approved securities.

2.1.3 'approved securities' as defined by Section 5(a) (i) & (ii) of the Banking Regulation Act, 1949 (AACs) mean -

- i. Securities in which a trustee may invest money under clause (a), (b), (bb), (c) or (d) of Section 20 of the Indian Trust Act, 1882.
- ii. Such of the securities authorised by the Central Government under clause (f) of Section 20 of the Indian Trust Act, 1882 as may be prescribed.

2.1.4 All primary (urban) co-operative banks are required to achieve certain minimum level of their SLR holdings in the form of government and other approved securities as percentage of Net Demand and Time Liabilities (NDTL) as indicated below:

Sr.No.	Category of bank	Minimum SLR holding in government and other approved securities as percentage of Net Demand and Time Liabilities
1.	Scheduled banks	25%
2.	Non-Scheduled banks a) with NDTL of Rs.25 crore & above 1. b) with NDTL of less than Rs.25 crore	15% • • 10%

2.2 Manner of Holding Mandatory Investments

2.2.1 The Securities may be held in either of the three forms viz: (a) Physical scrip form, (b) Subsidiary General Ledger (SGL) Account. In respect of securities with SGL facility, the SGL account can be maintained in the bank's own name directly with the Reserve Bank of India, or in a Constituents SGL Account opened with any scheduled commercial bank/state co-operative bank/primary dealer (PD) or Stock holding Corporation of India Ltd. (SHCIL), or (c) in a dematerialised account with depositories (NSDL/CDSL, NSCCL).

2.2.2 Both scheduled & non-scheduled primary (urban) co-operative banks with NDTL of Rs.25 crores & above are required to maintain investments in government securities only in SGL

Accounts with Reserve Bank of India or in Constituent SGL Accounts with PDs, scheduled commercial banks, state co-operative banks, depositories and SHCIL.

3 INVESTMENT POLICY

3.1 Keeping in view the various regulatory/statutory and the bank's own internal requirements, primary (urban) co-operative banks should lay down, with the approval of their Board of Directors, the broad Investment Policy and objectives to be achieved while undertaking investment transactions. The investment policy should be reviewed each year. The Board/Committee/Top Management should actively oversee investment transactions. Banks should not undertake any transactions on behalf of Portfolio Management Scheme (PMS) clients in their fiduciary capacity, and on behalf of other clients, either as custodians of their investments or purely as their agents.

3.2 The bank's investment policy should clearly -

3.2.1 define the authority to put through deals,

3.2.2 procedure to be followed for obtaining sanction of the appropriate authority,

3.2.3 procedure to be followed while putting through deals,

3.2.4 various prudential exposure limits, and

3.2.5 reporting system.

3.3 The investment policy of the bank should include guidelines on the quantity (ceiling) and quality of each type of security to be held on its own investment account. Bank should clearly indicate the authority to put through investment deals and the reporting system to be adopted. It should be prepared strictly observing the instructions issued by the Registrar of Co-operative Societies and the Reserve Bank of India from time to time and clearly spell out the internal control mechanism, accounting standards, audit, review and reporting system to be evolved.

3.4 All the transactions should be clearly recorded indicating full details. The top management should undertake a periodical review of investment transactions in a critical manner and put up large transactions to the Board, for information.

3.5 A copy of the internal investment policy guidelines framed by the banks with the approval of their Boards should be forwarded to the concerned Regional Office of the RBI, certifying that the policy is in accordance with the prescribed guidelines and the same has been put in place.

Subsequent changes, if any, in the Investment Policy should also be advised to the Regional Office of the RBI.

4 GENERAL GUIDELINES/PRECAUTIONS TO BE OBSERVED WHILE UNDERTAKING SECURITY TRANSACTIONS

4.1 Primary (urban) co-operative banks should not undertake any purchase/sale transactions with broking firms or other intermediaries on principal to principal basis.

4.2 Banks should seek a scheduled commercial bank, a primary dealer, a financial institution, another primary (urban) co-operative bank, insurance company, mutual funds or provident fund, as a counter-party for their transactions. Preference should be given for direct deals with such counter parties. It will be desirable to check prices from the other banks or PDs with whom the primary (urban) co-operative bank may be maintaining constituent SGL Account (CSGL). The prices of all trades done in government securities, including those traded through Negotiated Dealing System, are also available at RBI website (www.rbi.org.in).

4.3 Banks may take advantage of the non-competitive bidding facility in the auction of Government of India dated securities, provided by RBI. Under this scheme, primary (urban) co-operative banks may bid upto Rs.two crore (face value) in any auction of Government of India dated securities, either directly or through a bank or through a primary dealer. For availing this facility, no bidding skill is required, as allotment upto Rs. two crores (face value) is made at the weighted average cut-off rate which emerges in the auction. Primary (urban) co-operative banks may also participate directly or through a bank or a primary dealer in the auctions of state development loans, where coupon is mostly fixed in advance and notified by RBI. An advertisement in leading newspapers is issued 4-5 days in advance of the date of auction. Half yearly auction calendar of Government of India securities is also issued by RBI.

4.4 CSGL Accounts should be used for holding the securities and such accounts should be maintained in the same bank with whom the cash account is maintained. For all transactions delivery versus payment must be insisted upon by the banks

4.5 In case CSGL account is opened with any of the non-banking institutions indicated above, the particulars of the designated funds account (with a bank) should be intimated to that institution.

4.6 All transactions must be monitored to see that delivery takes place on settlement day. The fund account and investment account should be reconciled on the same day before close of business.

4.7 Officials deciding about purchase and sale transactions should be separate from those responsible for settlement and accounting.

4.8 All investment transactions should be perused by the Board at least once a month.

4.9 The banks may keep a proper record of the SGL forms received/issued to facilitate counter-checking by their internal control systems/RBI inspectors/other auditors.

4.10 All purchase/sale transactions in Government securities by the primary (urban) co-operative banks should necessarily be through SGL account (with RBI) or constituent SGL account (with a scheduled commercial bank/state co-operative bank/primary dealer/Stock Holding Corporation of India) or in a dematerialised account with depositories (NSDL/CDSL/NSCCL).

4.11 No transactions in Government securities by a primary (urban) co-operative bank should be undertaken in physical form with any broker.

4.12 In addition to one SGL/CSGL Account, banks may also open a demat account with a bank depository participant of NSDL/CDSL or with SHCIL for holding PSU Bonds.

4.13 The entities maintaining the CSGL/designated funds accounts are required to ensure availability of clear funds in the designated funds accounts for purchases and of sufficient securities in the CSGL account for sales before putting through the transactions.

14. The security dealings of banks generally being for large values, it may be necessary to ensure, before concluding the deal, the ability of the counter-party to fulfil the contract, particularly where the counter-party is not a bank.

15. While buying securities for SLR purposes, the bank should ensure from the counter parties that the bonds it intend to purchase is and would continue to have SLR status. The bank should also verify this from independent sources in case of doubt.

16. While investing in long term debt instruments, the banks should thoroughly satisfy themselves about the terms & conditions of issue, namely payment of interest and repayment of principal, and ensure that there are no clauses permitting the issuer for rescheduling such repayments.

17. In order to avoid concentration of risk, the banks should have a fairly diversified investment portfolio. Smaller investment portfolios should preferably be restricted to securities with high safety and liquidity such as Government security.

4.18 The primary (urban) co-operative banks may seek the guidance of Primary Dealer's Association of India/Fixed Income and Money Market Dealers' Association (FIMMDA) on investment in Government Securities.

5. NON-SLR INVESTMENTS

5.1 Holding Shares & Debentures in Private Sector Companies or Institutions other than Co-operative Sector

The primary (urban) co-operative banks should not subscribe to the initial or subsequent issue of shares/debentures of private sector companies or bodies or organisations other than in co-operative sector unless specifically permitted by the Reserve Bank.

5.2 Deposits with other institutions and other primary (urban) co-operative banks

5.2.1 Primary (urban) co-operative banks should not park their funds as deposits with other institutions/companies/corporations etc. Keeping of term deposits with other institutions/companies amounts to granting of unsecured advances to such institutions, thereby, attracting the provisions of directives on maximum limits on advances/exposure norms.

5.2.2 A scheduled primary (urban) co-operative bank should not place deposits with any other primary (urban) co-operative bank.

5.2.3 Non-scheduled primary (urban)co-operative banks may place deposits with strong scheduled primary (urban) co-operative banks, fulfilling following norms:

- i. The bank is complying with the prescribed level of CRAR.

- ii. Net NPAs of the bank is less than 7%
- iii. The bank has not defaulted in the maintenance of CRR/SLR requirements for the last two years.
- iv. The bank has declared net profits for the last three consecutive years.
- v. The bank has earned 'A' rating from Co-operative Auditors for the last three consecutive years.
- vi. The bank is complying with prudential norms on income recognition, asset classification and provisioning, exposure ceilings and loans & advances to directors.

5.2.4 Acceptance of deposits from non-scheduled banks by the schedule banks will be subject to the following conditions:

- i. The total of all such deposits accepted by a scheduled bank should not exceed 10% of its deposit liabilities as on 31 March of the previous financial year.
- ii. The rate of interest offered on such deposits should be market related.
- iii. The total amount of deposits placed by a non-scheduled primary (urban) co-operative bank with a scheduled bank should not exceed 20% of its capital funds so as to be in consonance with the extant exposure norms. Capital funds for this purpose would comprise of paid up capital and free reserves as per audited accounts. Reserves, if any, created out of revaluation of fixed assets or those created to meet outside liabilities should not be included in the capital funds. While free reserves may include 'building fund', it shall exclude all reserves/provisions, which are created to meet anticipated loan losses, losses on account of frauds etc., depreciation in investments and other assets and outside liabilities.

5.2.5 Primary (urban) co-operative banks may, however, maintain balances in the current accounts with other banks for meeting their clearing and remittance requirements.

5.3 Investment of Funds in Public Sector Undertakings/Companies

5.3.1 Normally the deposit resources of the co-operative sector should remain within the co-operative fold. However, the primary (urban) co-operative banks are allowed to invest their surplus funds up to 10% of their deposits in:-

1. Bonds of Public Sector Undertakings (PSUs),
2. Infrastructure bonds floated by the financial institutions, such as, IDBI, LIC, GIC etc.
3. Unsecured redeemable bonds floated by the nationalised banks,
4. Equity/Bonds of all India financial institutions.
5. Units of UTI upto 5% of their incremental deposits of the previous year but within the overall ceiling of 10% of their deposits.

5.3.2 These investments may be made subject to the following conditions/safety measures:

5.3.2.1 A provision should exist for such investments in respective State Co-operative Societies Act/Multi State Co-operative Societies Act and a general or specific permission should be obtained from the Registrar of Co-operative Societies of the concerned State.

2. Banks should comply with the instructions regarding investment policy and the dealings in securities transactions.

5.3.2.3 There should be no default by the banks in maintenance of statutory cash reserve and liquid assets requirements as prescribed by the Reserve Bank Act, 1934/Banking Regulation Act, 1949 (As Applicable to Co-operative Societies).

4. Banks should have achieved the targets fixed by the Reserve Bank from time to time for lending to priority sectors/weaker sections.

5.3.2.5 Overdues of banks should not be more than 15% of their outstanding loans and advances.

5.3.2.6 Banks should comply with the Reserve Bank instructions regarding non-performing assets, income recognition, assets classification and provisioning.

7. Banks should formulate Investment Policy, as approved by their Board of Directors, for investments in PSUs bonds including norms to ensure that there is no excessive investment in one or two public sector bonds and that such investments are well spread. The banks should assess the soundness of the investment relative to pricing, maturity rate, security, liquidity and yield, etc. while investing in PSUs bonds. The banks should also keep in mind that necessary depreciation will have to be fully provided for in the Investment Depreciation Reserve against the erosion of value.
8. While investing in non SLR securities, the banks should take abundant precaution to satisfy themselves about the financial position of the entity issuing the securities. The banks may take a decision regarding investments, keeping in view the audited balance sheet of the issuer, the rating accorded to it by a recognised credit rating agency etc.

5.4 Investment in Certificates of Deposits (CDs)

5.4.1 Primary (urban) co-operative banks are permitted to make investments in CDs issued by scheduled commercial banks and other financial institutions approved by the Reserve Bank, subject to fulfilment of the following conditions:

2. The banks should have reached the level stipulated by the Reserve Bank for lendings to priority sector at the time of making investment in CDs.
3. The banks should, with the approval of their Board of Directors, evolve policy guidelines governing their investments and obtain the approval of their Boards for placing funds in CDs.
4. The investments in CDs should not result in resource crunch necessitating borrowings from higher financing agencies. In other words, the banks should not resort to borrowings from higher financing agencies while making investments in CDs, excepting for temporary periods to meet exigencies. It should, however, be ensured that the borrowings are need-based and cost-effective.
5. The banks should have achieved the requisite level of investments in Government and other approved securities.

6 INVESTMENT TRADING ACTIVITIES

6.1 Dealing through Brokers

6.1.1 The inter-bank securities transactions should be undertaken directly between banks and no bank should engage the services of any broker in such transactions. Banks may, however, undertake securities transactions among themselves or with non-bank clients through members of the National Stock Exchange (NSE), the Stock Exchange, Mumbai (BSE)/OTC Exchange wherein the transactions are transparent. In case any transactions in securities are not undertaken on NSE, OTC Exchange of India or the Stock Exchange, Mumbai (BSE), the same should be undertaken by the banks directly without the use of brokers.

2. Purchase of permissible shares and PSU bonds in the secondary market (other than inter-bank transactions) should be only through recognised stock exchanges and registered stock brokers.

6.1.3 The Discount and Finance House of India Ltd. (DFHI) has been permitted to operate as a broker in the inter-bank participation market. This would enable the banks to seek intermediation of DFHI for borrowing/lending, if required. However, the banks shall be free to settle transactions in the inter-bank participations market directly, if so desired.

4. It should be ensured that the applications of the banks in respect of their own subscription to Central/State Government loans are submitted directly to the receiving offices of the RBI/State Bank of India and intermediaries or brokers should not be used for the purpose.
5. Similarly, where the investments are made by the banks on account of their clients, the relative applications bearing the bank's own stamps should be tendered direct to the receiving offices.

6.1.6 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.

6.1.7 Disclosure of counter party should be insisted upon on conclusion of the deal put through brokers.

8. Contract confirmation from the counter party should be insisted upon.
9. The brokers should not be involved in settlement process at all i.e. both the fund settlement and delivery of security should be done with the counter party directly.

6.2 Empanelment of Brokers

6.2.1 The banks should prepare a panel of brokers with the approval of their Board of Directors.

2. Brokers should be empanelled after verifying their credentials e.g. :

1. SEBI registration
2. Membership of BSE/NSE/OTCEI for debt market.

6.2.2.3 Market turnover in the preceding year as certified by the Exchange/s.

6.2.2.4 Market reputation etc.

6.2.3 The bank should check websites of SEBI/respective exchanges, to ensure that the broker has not been put in the banned list.

6.3 Broker Limits

6.3.1 A disproportionate part of the business should not be transacted through only one or a few brokers. Banks should consider fixing aggregate contract limits for each of the approved brokers, and ensure that these limits are not exceeded. A record of broker-wise details of deals put through and brokerage paid should be maintained.

2. A limit of 5% of total transactions (both purchases and sales) entered into by the banks during a year should be treated as the aggregate upper contract limit for each of the approved brokers.
3. This limit should cover both the business initiated by the bank and the business offered/brought to the bank by a broker.
4. For fixing broker limits, financial year should be preferred. However, the banks may follow calendar year or any other period of 12 months, provided it is consistently followed in future.
5. The limit should be observed with reference to the year under review. While operating the limit, the banks 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.
6. To arrive at total transactions of the year, the transactions entered into directly with counter-parties i.e. where no brokers are involved should not be taken into account.
7. In case of ready-forward deals, both the legs of the deals i.e. purchase as well as sale should be included to arrive at the volume of total transactions.

8. Central loan/State loan/treasury bills, etc. purchased through direct subscriptions/auction should not be included in the volume of total transactions.
9. Transactions conducted on behalf of the clients should also be included in the total transactions of the year, if they are conducted through the brokers.
10. It should be ensured that the transactions entered through individual brokers during a year normally do not exceed the prescribed limit. However, if 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. In such cases, post-facto approval of the Board may be obtained after explaining the circumstances in which the limit was exceeded.
11. It may be desirable to have periodical review of broker's performance and relationships, not to allow direct settlements by the dealers with the counter-party/banks.

7 SETTLEMENT OF TRANSACTIONS

7.1 SGL Account

7.1.1 Transfers through SGL accounts by the banks having SGL facility can be made only if they maintain a regular current account with the Reserve Bank. All transactions in Government securities for which SGL facility is available, should be put through SGL accounts only.

7.1.2 Before issue of SGL transfer forms covering the sale transactions, banks should ensure that they have sufficient balance in the respective SGL accounts. Under no circumstances, an SGL transfer form issued by a bank in favour of another bank should bounce for want of sufficient balance in the SGL account. The purchasing bank should issue the cheques only after receipt of the SGL transfer forms from the selling bank.

3. If the SGL transfer form bounces for want of sufficient balance in the SGL Account, the bank which has issued the form will be liable for the following penal action:

7.1.3.1 The amount of SGL form (cost of purchase paid by the purchaser of the security) will be debited immediately to the current account of the selling bank with the Reserve Bank.

7.1.3.2 In the event of an overdraft arising in the current account following such a debit, penal interest will be charged by the Reserve Bank on the amount of the overdraft at a rate 3% points above the Discount and Finance House of India's call money lending rate on the day in question.

7.1.3.3 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 date of occurrence of the third bouncing. If after restoration of the facility, any SGL form of the bank bounces again, the bank will be permanently debarred from the use of the SGL facility in all the PDOs of the Reserve Bank.

7.2 SGL Forms

1. The SGL transfer forms should be in the standard format prescribed by the Reserve Bank and printed on semi-security paper of uniform size. These should be serially numbered and there should be a control system in place to account for each SGL form.
2. SGL transfer forms should be signed by two authorised officials of the bank whose signatures should be recorded with the respective Public Debt Office (PDO) of Reserve Bank and other banks.
3. The SGL transfer form received by the purchasing bank should be deposited in its SGL account immediately. No sale should be effected by way of return of SGL transfer form held by the bank.
4. Any bouncing of SGL transfer forms issued by selling bank in favour of the buying bank should immediately be brought to the notice of the Reserve Bank by the buying bank.

7.3 Control, Violation and Penalty Provisions

7.3.1 Record of SGL transfer forms issued/received should be maintained. Balances as per the bank's books in respect of SGL accounts should be reconciled with the balances in the books of

PDOs. The concerned PDO will forward a monthly statement of balances of SGL/CSGL account to all account holders. Primary (urban) co-operative banks having SGL/CSGL accounts with PDOs may use these statements for the purpose of monthly reconciliation of their SGL/CSGL balances as per their books and the position in this regard should be placed before the Audit Committee of the Board. This reconciliation should also be periodically checked by the internal audit department. A system for verification of the authenticity of the SGL transfer forms received from other banks and confirmation of authorised signatories should be put in place.

2. Banks should also forward a quarterly certificate to the concerned PDO, indicating that the balances held in the SGL accounts with the PDO have been reconciled and that it has been placed before the Audit Committee of the Board. A copy thereof should be sent to the concerned Regional Office of the Urban Banks Department.
3. Banks should put in place a system to report to the top management on a monthly basis the details of transactions in securities, details of bouncing of SGL transfer forms issued by other banks and review of investment transactions undertaken during the period.
4. All promissory notes, debentures, shares, bonds, etc. should be properly recorded and held under joint custody. A separate register may be maintained to record the particulars of securities taken out/re-lodged. These should be subjected to periodical verification say once in a quarter or half-year, by persons unconnected with their custody.

7.3.5 Certificates should be obtained at quarterly/half-yearly intervals in respect of securities lodged with other institutions. Similarly, it is necessary to reconcile the outstanding BRs with the counter-party at monthly intervals and reconciliation of SGL Account balance with the PDO at monthly intervals.

7.3.6 The internal inspectors and concurrent auditors should peruse the transactions to ensure that the deals have been undertaken in the best interest of the bank. The Vigilance Cell should also make surprise sample checks of large transactions.

7.3.7 The concurrent auditors should certify that investments held by the bank, as on the last reporting Friday of each quarter and as reported to RBI, are actually owned/held by it as evidenced by the physical securities or the outstandings statement. Such a certificate should be submitted to the Regional Office of Urban Banks Department having jurisdiction over the bank, within 30 days from the end of the relative quarter.

7.4 Settlement in respect of Government Securities Transactions – Compulsory settlement through Clearing Corporation of India Ltd.

7.4.1 Reserve Bank of India has extended to all market participants the facility of settlement in Government Securities transactions over NDS - CCIL System besides the settlement under Delivery vs. Payment system. With effect from 1st April, 2003, all Government Securities transactions (both outright and Repo) are being settled compulsorily through Clearing Corporation of India Ltd. (CCIL) only. Any transactions in Govt. Securities for settlement by the banks outside the NDS-CCIL system are not being entertained by Reserve Bank of India since that date.

7.4.2 Primary (urban) co-operative banks which are not a member of NDS-CCIL system, should undertake their transactions in Government securities through gilt account/demat account maintained with a Negotiated Dealing System (NDS) member.

7.5 Bank Receipts (BRs)

7.5.1 When to use BRs

7.5.1.1 No BR should be issued under any circumstances in respect of transactions in Government securities for which SGL facility is available.

2. Even in the case of other securities, BR may be issued for ready transactions only, under the following circumstances:
 - (a) The scrips are yet to be issued by the issuer and the bank is holding the allotment advice.
 - (b) 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.

- (c) 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.
3. No BR should be issued on the basis of a BR held by the bank and no transaction should take place on the basis of mere exchange of BRs held by the bank.
 4. BRs may be issued covering transactions relating to bank's own Investment Accounts only, and no BR should be issued by bank covering transactions relating to either the Accounts of Portfolio Management Scheme Clients or Other Constituents' Account including brokers.

7.5.2 BR Form Issue, Custody, Record

7.5.2.1 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 control system in place to account for each BR form.

2. There should be a proper system for the custody of unused BR forms and their utilisation.
3. 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.
4. A system for verification of the authenticity of the BRs received from other banks and confirmation of authorised signatures should be put in place.

7.5.3 Settlement through BRs

7.5.3.1 No BR should remain outstanding for more than 15 days.

7.5.3.2 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 Reserve Bank explaining the reasons under which the scrips could not be delivered within the stipulated period and the proposed manner of settlement of the transactions.

7.5.4 Control, Violation and Penalty Provisions

7.5.4.1 The existence and operation of controls at the concerned offices should be reviewed, among others, by the statutory auditors and a certificate to this effect may be forwarded to Reserve Bank of India, Urban Banks Department, Central Office, Mumbai 400 018 every year.

7.5.4.2 The violation of the instructions relating to the BRs would invite penal action which could include raising of reserve requirements, withdrawal of refinance 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 (AACs).

7.5.4.3 The reconciliation should be periodically checked by the internal audit department.

7.6 Accounting for the Deals

7.6.1 For every transaction entered into, a deal slip should be prepared which should contain details relating to name of the counter-party, whether it is direct deal or through a broker, and if through a broker, details of security, amount, price, contract date and time. For each deal, there must be a system of issue of confirmation to the counter-party.

7.6.2 The Deal Slips should be serially numbered and controlled separately to ensure that each deal slip has been properly accounted for.

7.6.3 On the basis of vouchers passed after verification of actual contract notes received from the broker/counter-party and confirmation of the deal by the counter-party the Accounts Section should independently write the books of accounts.

7.6.4 A record of broker-wise details of deals put through and brokerage paid, should be maintained.

7.6.5 The Internal Audit Department should audit the transactions in securities on an ongoing basis and monitor compliance with the laid down management policies and prescribed procedures and report the deficiencies directly to the management of the bank.

8 READY FORWARD CONTRACTS IN GOVERNMENT SECURITIES

8.1 Primary (urban) co-operative banks are permitted to undertake ready forward contracts (including reverse ready forward contracts), subject to undernoted terms and conditions:

1. Ready forward contracts should be undertaken only in Treasury Bills and dated securities of all maturities issued by the Government of India and State Governments.

8.1.2 Ready forward contracts in the securities specified at paragraph 8.1.1 above may be entered into by a banking company, a co-operative bank, or any person maintaining a Subsidiary General Ledger Account with Reserve Bank, Mumbai.

3. Such ready forward contracts shall be settled through the SGL Accounts of the participants with Reserve Bank or through the SGL Accounts of the Clearing Corporation of India Ltd. with Reserve Bank.
4. No sale transaction should be put through without actually holding the securities in the portfolio.
5. The banks should comply with all other instructions on securities transactions issued from time to time.

8. UNIFORM ACCOUNTING FOR REPO/REVERSE REPO TRANSACTION

9. In order to ensure uniform accounting treatment for repo/reverse repo transactions and to impart an element of transparency, the banks should follow the uniform accounting principles detailed below:

9.2 The uniform accounting principles will be applicable from the financial year 2003-04. On implementation, market participants may undertake repos from any of the three categories of investments, viz. Held for Trading, Available for Sale and Held to Maturity.

9.3 The legal character of repo under the current law, viz. as outright purchase and outright sale transactions will be kept intact by ensuring that 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.

9.4 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.

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

9.5.1 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.

9.5.2 Repo Interest Income/Expenditure

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

9.5.2.1 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;

9.5.2.2 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

9.5.2.3 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.

9.5.3 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 who 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.

9.5.3.1 In respect of the repo transactions outstanding as on the balance sheet date:- 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 RBI.

9.5.3.2 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.

9.5.3.3 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

9.5.3.4 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.

9.5.3.5 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.

9.5.3.6 Disclosure

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

(Rs. in crores)

Particulars	Minimum outstanding during the year	Maximum outstanding during the year	Daily Average outstanding during the year	As on March 31
Securities sold under repos				
Securities purchased under reverse repos				

9.5.3.7 Accounting methodology

The accounting methodology to be followed along with illustrations are given in the Annexure I and II (enclosed to our circular UBD.BPD.PCB. Cir.44/09.80.00/2002-03 dated May 12, 2003). 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 finalised by FIMMDA.

10 TRADING OF GOVERNMENT SECURITIES ON STOCK EXCHANGES

10.1 With a view to encouraging wider participation of all classes of investors, including retail, in government securities, it has been decided to introduce trading in government securities through a nation-wide anonymous, order driven, screen-based trading system of the stock exchanges, in the same manner in which trading takes place in equities. This facility of trading of government securities on the stock exchanges, in the dematerialized mode only, would be available to banks in addition to the present NDS of the Reserve Bank, which will continue to remain in place.

10.2 The primary (urban) co-operative banks have the option to undertake transactions in dated Government of India (GOI) securities in dematerialized form on automated order driven system of the National Stock Exchange (NSE), The Stock Exchange, Mumbai (BSE) and Over the Counter Exchange of India (OTCEI) in addition to the existing mode of dealing through SGL accounts with Reserve Bank of India or Constituent SGL accounts with the designated entities such as Scheduled Commercial Bank/Primary Dealer/State Cooperative Bank etc.

10.3 As the trading facility on the above stock exchanges will operate in parallel to the present system of trading in government securities, the trades concluded on the exchanges will be cleared by their respective clearing corporations/clearing houses. However, trading members of the stock exchanges shall not be involved in the, settlement process for any RBI regulated entity. All stock exchange trades of banks have to be settled either directly with clearing corporation/clearing house (in case they are clearing members) or else through a clearing member custodian.

10.4 Banks, as institutional investors on the stock exchanges, can undertake transactions only on the basis of giving and taking delivery of securities. In other words, short selling of government securities, even on an intra-day basis, is not permissible.

10.5 With a view to facilitating participation on the stock exchanges within the regulations prescribed by RBI, SEBI and the exchanges, banks are being extended the following facilities:

10.5.1 Open demat accounts with a bank depository participant (DP) of NSDL/CDSL or with SHCIL in addition to their SGL/CSGL accounts with RBI.

10.5.2 Value free transfer of securities between SGL/CSGL and demat Accounts is being enabled at Public Debt Office (PDO), Mumbai, subject to operational guidelines issued separately by our Department of Government and Bank Accounts (DGBA) to all SGL account holders.

10.6 The balances in government securities maintained by the banks in the depositories will be included for SLR purpose. Also, any shortfall in maintenance of CRR/SLR resulting from settlement failure (on either the NDS-OTC market or the stock exchanges) will attract the usual penalties.

10.7 The Boards of primary (urban) co-operative banks may take a conscious decision in regard to using the stock exchange platform for making investments in government securities in addition to the existing NDS-OTC market and the direct bidding facility. As regulations of SEBI will also apply in so far as trading of government securities is concerned, the Board should frame and implement a suitable policy to ensure that operations are conducted in accordance with the norms laid down by RBI/SEBI and the respective stock exchange. Prior to commencing operations, the dealing officials should also familiarise themselves with the basic operating procedures of the stock exchanges.

10.8 Operational Guidelines relating to trading of Govt. Securities on Stock Exchanges

Banks should also put in place appropriate internal control systems catering to stock exchange trading and settlement before commencing operations on the exchanges. The back office arrangement should be such that trading on the NDS/OTC market and on the stock exchanges can be tracked easily for settlement, reconciliation and management reporting. Banks should, therefore, install enabling IT infrastructure and adequate risk management systems.

10.9 Only SEBI registered brokers who are authorized by the permitted exchanges (NSE, BSE or OTCEI) to undertake transactions in government securities can be used for placing buy/sell orders. A valid contract note indicating the time of execution must be obtained from the broker at end of day.

10.10 The dealing officials should independently check prices in the market or on the stock exchange screens before placing their orders with the brokers. The decision-making processes cannot be delegated to brokers by the banks.

10.11 The transactions done through any broker will be subjected to the current guidelines on transactions done through brokers.

10.12 Brokers/trading members shall not be involved in the settlement process; all trades have to be settled through clearing member custodians. Hence, it will be necessary for primary (urban) co-operative banks to enter into a bilateral clearing agreement with such service providers beforehand.

10.13 All transactions must be monitored with a view to ensuring timely receipt of funds and securities. Any delay or failure should be promptly taken up with the concerned exchange/authorities.

10.14 At the time of trade, securities must be available with the banks either in their SGL or in the demat account with depositories.

10.15 Any settlement failure on account of non-delivery of securities/non-availability of clear funds will be treated as SGL bouncing and the current penalties in respect of SGL bouncing will be applicable. The stock exchanges will report such failures to the respective Public Debt Offices.

10.16 For the limited purpose of dealing through the Screen based trading system of the stock exchanges the condition that a primary (urban) co-operative bank should seek a scheduled commercial bank, a primary dealer, a financial institution, another primary (urban) co-operative bank, insurance company, mutual fund or provident fund as a counter party while undertaking transactions in Government securities will not apply.

10.17 Banks should report on weekly basis to their Audit Committee of the Board, giving the details of trades on aggregate basis done on the stock exchanges and details of any "closed-out" transactions on the exchanges.

10.18 The banks should take all necessary precautions and strictly adhere to all instructions/guidelines issued by the Reserve Bank relating to transaction in Government securities as hitherto.

11 Investment Accounting & Internal Controls

11.1 Accounting Standards

In order to bring about uniform accounting practice among banks in booking of income on units of UTI and equity of All-India Financial Institutions, as a prudent practice, such income should be booked on cash basis and not on accrual basis. However, in respect of income from Government securities/bonds of public sector undertakings and All-India Financial Institutions, where interest rates on the instruments are predetermined, income may be booked on accrual basis, provided interest is serviced regularly and is not in arrears.

11.2 Broken Period Interest - Government and Other Approved Securities

11.2.1 With a view to bringing about uniformity in the accounting treatment of broken period interest on Government securities paid at the time of acquisition and to comply with the Accounting Standards prescribed by the Institute of Chartered Accountants of India, the bank should not capitalise the broken period interest paid to seller as part of cost, but treat it as an item of expenditure under Profit & Loss Account.

2. It is to be noted that the above accounting treatment does not take into account taxation implications and hence the bank should comply with the requirements of income tax authorities in the manner prescribed by them.

12 INTERNAL CONTROL - RECOMMENDATIONS BY GHOSH COMMITTEE

The following recommendations made by the Ghosh Committee should be implemented by the banks to prevent frauds and malpractices:

12.1 Concurrent Audit

12.1.1 In view of the possibility of abuse, treasury functions viz. investments, funds management including inter-bank borrowings, bills rediscounting, etc. should be subjected to concurrent audit and the results of audit should be placed before the Chairman and Managing Director of the bank at prescribed intervals.

12.1.2 It is the primary responsibility of the banks to ensure that there are adequate audit procedures for ensuring proper compliance of the instructions in regard to the conduct of investment portfolio.

12.1.3 The concurrent audit should cover the following aspects:

12.1.3.1 Ensure that in respect of purchase and sale of securities the concerned department has acted within its delegated powers.

2. Ensure that the securities other than those in SGL and in demat form, as shown in the books, are physically held.
3. Ensure that the Accounting Unit is complying with the guidelines regarding BRs, SGL forms, delivery of scrips, documentation and accounting.
4. Ensure that the sale or purchase transactions are done at rates beneficial to the bank.
5. Scrutinise conformity with broker limits and include excesses observed in their periodical reports.
6. Banks should formulate internal control guidelines for acquisition of permissible shares, debentures and PSU bonds in the secondary market duly approved by their Boards.

12.2 Internal Audit

In view of the possibility of abuse, purchase and sale of government securities etc. should be separately subjected to audit by internal auditors (and in the absence of internal auditors by Chartered Accountants out of the panel maintained by the Registrar of Co-operative Societies) and the results of their audit should be placed before the Board of Directors once in every quarter. These audit reports should be sent to the concerned Regional Office of the Urban Banks Department, Reserve Bank of India, at half-yearly intervals i.e. for half-year ended 30th September and 31st March.

12.3 Review

Banks should undertake a half-yearly review (as of 31st March and 30th September) of their investment portfolio, which should, apart from other operational aspects of investment portfolio, clearly indicate and certify adherence to the laid down internal investment policy and procedures and RBI guidelines, and put up the same before the Board within a month.

12.4 Penalties for Violation

Banks should scrupulously follow the above instructions. Any violation of these instructions will invite penal action against defaulting banks which could include raising of reserve requirements, withdrawal of refinance from the Reserve Bank, denial of access to money markets, denial of new branches/extension counters and advising the President of Clearing House to take appropriate action including suspension of membership of the Clearing House.

13 Categorisation of Investments

13.1 Primary (urban) co-operative banks are required to classify their entire investment portfolio (including SLR and non-SLR securities) under three categories viz. -

1. Held to Maturity (HTM)
2. Available for Sale (AFS)
3. Held for Trading (HFT)

banks should decide the category of the investment at the time of acquisition and the decision should be recorded on the investment proposals.

13.2 Held to Maturity

13.2.1 Securities acquired by the banks with the intention to hold them up to maturity will be classified under "Held to Maturity" category.

2. The investments included under "Held to Maturity" category should not exceed 25 per cent of the bank's total investments.
3. Primary (urban) co-operative banks are not permitted to invest in bonds and debentures of private sector companies. Their investments in bonds of PSUs and shares (as permitted by RBI) should be classified under 'Held to Maturity' category but these will not be counted for the purpose of ceiling of 25% specified for this category.

2. Held for Trading

13.3.1 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' category.

13.3.2 If banks are not able to sell the security within 90 days due to exceptional circumstances such as tight liquidity conditions, or extreme volatility, or market becoming unidirectional, the security should be shifted to the 'Available for Sale' category, subject to conditions stipulated in paragraphs 13.5.3 and 13.5.4 below.

13.4 Available for Sale

13.4.1 Securities which do not fall within the above two categories will be classified under 'Available for Sale' category.

13.4.2 Banks have the freedom to decide on the extent of holdings under 'Available for Sale' category. This may be decided by them considering various aspects such as basis of intent, trading strategies, risk management capabilities, tax planning, manpower skills, capital position, etc.

13.5 Shifting of investments

13.5.1 Banks may shift investments to/from 'Held to Maturity' category with the approval of the Board of Directors once in a year. Such shifting will normally be allowed at the beginning of the accounting year. No further shifting to/from this category will be allowed during the remaining part of that accounting year.

2. Banks may shift investments from 'Available for Sale' category to 'Held for Trading' category with the approval of their Board of Directors. In case of exigencies, such shifting may be done with the approval of the Chief Executive of the Bank, but should be ratified by the Board of Directors.
3. Shifting of investments from 'Held for Trading' category to 'Available for Sale' category is generally not allowed. However, it will be permitted only under exceptional circumstances such as mentioned in paragraph 13.3.2 above, subject to depreciation, if any, applicable on the date of transfer, with the approval of the Board of Directors/Investment Committee.
4. 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.

13.6 Classification of Investments in the Balance Sheet

For the purpose of Balance Sheet, the investments should continue to be classified in the following categories:

1. Government securities
2. Other approved securities
3. Shares
4. Bonds of PSUs
5. Others

13.7 Investment Fluctuation Reserve

1. Banks should build up Investment Fluctuation Reserve (IFR) out of realised gains on sale of investments, and subject to available net profit, of a minimum of 5 per cent of the investment portfolio within a period of 5 years. This minimum requirement should be computed with reference to investments in two categories, viz., 'Held for Trading (HFT)' and 'Available for Sale (AFS)'. It will not be necessary to include investment under 'Held to Maturity' category for the purpose. However, banks are free to build up a higher percentage of IFR up to 10 per cent of the portfolio depending on the size and composition of their portfolio, with the approval of their Board of Directors.
2. Banks should transfer maximum amount of the gains realised on sale of investment in securities to the IFR. Transfer to IFR shall be as an appropriation of net profit after appropriation to Statutory Reserve.
3. The IFR, consisting of realised gains from the sale of investments from the two categories, viz., 'Held for Trading' and 'Available for Sale', would be eligible for inclusion in Tier II capital.
4. Transfer from IFR to the Profit & Loss Account to meet depreciation requirement on investments would be a 'below the line' extraordinary item.
5. Banks should ensure that the unrealised gains on valuation of the investment portfolio are not taken to the Income Account or to the IFR.
6. Banks may utilise the amount held in IFR to meet, in future, the depreciation requirement on investment in securities.
7. Creation of IFR as per the above guidelines is mandatory for primary (urban) co-operative banks having aggregate Demand and Time Liabilities of Rs. 100 crore and above, and optional for smaller banks.
8. It may be noted that Investment Fluctuation Reserve (IFR) is the realised profit out of sale of investments held under 'HFT' or 'AFS' category, and qualifies as Tier II capital, whereas Investment Depreciation Reserve (IDR) is a provision created by charging diminution in investment value to Profit & Loss Account.

14 Investment Valuation

14.1 Valuation Standards

14.1.1 Investments classified under 'Held to Maturity' category 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.

2. The individual scrip in the 'Available for Sale' category will be marked to market at the year-end or at more frequent intervals. While the net depreciation under each classification i.e. HTM, AFS, or HFT should be recognised and fully provided for the net appreciation should be ignored. The book value of the individual securities would not undergo any change after the revaluation.

Note: *Securities under this category shall be valued scrip-wise and depreciation/appreciation shall be aggregated for each classifications viz. HTM, AFS or HFT. 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.*

3. Investment Depreciation Reserve required to be created on account of depreciation in value of investments held under 'AFS' or 'HFT' categories in any year should be debited to the Profit & Loss Account and an equivalent amount (net of tax benefit, if any, and net

of consequent reduction in the transfer to Statutory Reserve) or the balance available in the Investment Fluctuation Reserve Account, whichever is less, shall be transferred from the Investment Fluctuation Reserve Account to the Profit & Loss Account.

4. In the event, investment depreciation reserve created on account of depreciation in investments is 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 the Investment Fluctuation Reserve Account to be utilised to meet future depreciation requirement for investments. The amounts debited to the Profit & Loss Account for depreciation provision and the amount credited to the Profit & Loss Account for reversal of excess provision should be debited and credited respectively under the head "Expenditure - Provisions & Contingencies". The amounts appropriated from Profit & Loss Account and the amount transferred from IFR to the Profit & Loss Account should be shown as 'below the line' items after determining the profit for the year.
5. The individual scrip in the "Held for Trading" category will be marked to market at monthly or at more frequent intervals, the book value of individual securities in this category would not undergo any change after marking to market i.e. while the net depreciation in the value of investments, if any, shall be provided for, net appreciation, if any, should be ignored. Net depreciation required to be provided for any one category should not be netted with net appreciation in any other category.
6. 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.

1. Market Value

14.2.1 Quoted Securities

The 'market value' for the purpose of periodical valuation of investments included in the "Available for Sale" and the "Held for Trading" categories 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.

2. Unquoted SLR Securities

In respect of unquoted securities, the procedure as detailed below should be adopted.

(i) Central Government Securities

- a. The Reserve Bank of India will not announce the YTM rates for unquoted Government securities, for the purpose of valuation of investments by banks. The 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.
- b. The 6.00 per cent Capital Indexed Bonds may be valued at "cost" which may be reckoned by using the index ratio calculated by taking the Wholesale Price Index (WPI) with a three months' lag. For example, the WPI for the month of November 1997 may be used to calculate the index ratio for month of March 1998. An illustrative example is given below:

The bonds were issued in December 1997 at par. The Wholesale Price Index (WPI) for August 1997 was taken as the Base WPI. Similarly, the Reference WPI for payment of redemption value in December 2002, is taken as the WPI for August 2002. Thus, a clear 3 months' lag is followed for indexation of capital. The same principle can be applied for arriving at 'Cost' for the purpose of valuation of Capital Indexed Bonds. If the valuation of the bond is to be done in March 1998, the index ratio can be calculated by taking the WPI for November 1997 as the Reference WPI. While thus for every quarter ending March of a year, the numerator will take WPI of November of the previous year, for other quarters ending in months viz. June, September and December, every year, the index ratio will take in the numerator WPI for February, May and August of the respective years.

Assuming that the Monthly Average Index of Wholesale Prices (1981 - 82 = 100) for November 1997 is 329.90. The Reference WPI is 329.90. The base WPI, i.e. the WPI for August 1997 is 326.00. The calculation of 'Cost' of Capital Indexed Bonds is illustrated below:

$$\begin{aligned}
 &\text{Index Ratio for} \\
 &\text{March 1998} \qquad \qquad \text{WPI for November 1997} \\
 &= \frac{\text{-----}}{\text{Base WPI}} \\
 &= \frac{329.9}{326.00} \\
 &\qquad \qquad \qquad \text{-----} = 1.01196 \text{ or } 1.01 \text{ (rounded to two decimal} \\
 &\qquad \qquad \qquad \text{places)}
 \end{aligned}$$

Cost of the bonds for valuation as on 31 March 1998 Rs. 100 x 1.01 = Rs. 101.00.

- It is clarified that the reckoning of number of years for the purpose of deciding upon appropriate YTM Rate be done by rounding off the fractional period of a year to the nearest completed year.
- As regards valuation of other unquoted securities including PSU bonds, banks should uniformly follow 'Yield to Maturity' method for arriving at valuation of unquoted securities.

(ii) Treasury Bills should be valued at carrying cost.

(iii) 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.

(iv) 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.

2. Unquoted non-SLR securities

(i) Debentures/Bonds of AIFIs and PSUs

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 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,

(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 interest/principal on the debenture/bonds is in arrears, the provision should be made for the debentures as in the case of debentures/bonds treated as advances. The depreciation/provision requirement towards debentures where the interest is in arrears or principal is not paid as per due date, shall not be allowed to be set-off against appreciation against other debentures/bonds.

(ii) Where the debentures/bond 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.

(iii) Shares of Co-operative Institutions

If primary (urban) co-operative banks have regularly received dividends from co-operative institutions, then their shares should be valued at face value. In a number of cases, the co-operative institutions in whose shares the primary (urban) co-operative banks have made investments have either gone into liquidation or have not declared dividend at all. In such cases, the banks should make full provision in respect of their investments in shares of such co-operative institutions. In cases where the financial position of co-operative institutions in whose shares banks have made investments is not available, the shares have to be taken at Re. 1/- per co-operative institution.

14.2.4 Shares of All India Financial Institutions

Primary (urban) co-operative banks are allowed to invest in the shares of all India Financial Institutions.

Where stock exchange quotations are available, the shares should be valued accordingly. 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.

(i) Units of UTI

(a) Investments in quoted Mutual Fund Units should be valued as per stock exchange quotations. Investments in non-quoted Mutual Funds Units are to be valued on the basis of the latest repurchase price declared by the Mutual Funds in respect of each particular Scheme. In case of funds with a lock-in period, or where repurchase price/market quote is not available, Units could be valued at NAV. If NAV is not available, then these could be valued at cost, till the end of the lock-in period.

(ii) Commercial Paper

(a) Commercial paper should be valued at the carrying cost.

15 REPORTING

Scheduled primary (urban) co-operative banks are required to submit a statement containing information on their investments in approved securities and money market instruments, etc. on quarterly basis. The statement as at the end of each calendar quarter should reach RBI, Central Office, Urban Banks Department within 10 days from the close of the quarter.

Appendix

Master Circular on Investments by Primary (urban) Co-op. Banks

A. List of Circulars consolidated in the Master Circular

No.	Circular No.	Date	Subject
1	UBD.BPD.PCB.Cir.12/09.29.00/2003-04	04-09-2003	Investment Portfolio of UCBs – Guidelines for Investment Fluctuation Reserve
2	UBD.BPD.Cir.No.11/09.29.00/2003-04	02-09-2003	Investment Portfolio of UCBs – Classification & Valuation of

			investments
3	UBD.BPD.PCB.Cir.8/9.2900/2003-04	16-08-2003	Trading of Government Securities in Stock Exchanges
4	UBD.BPD.Cir.No.1/09.11.00/2003-04	08-07-2003	Settlement in respect of Government Securities Transaction – Compulsory settlement through CCIL
5	UBD.BPD.PCB.Cir.No.2/09.80.00/2003-04	08-07-2003	Scheme for Non-Competitive Bidding Facility in the Auction of Government of India dated securities
6	UBD.PCB.56/09.29.00/2003-04	02-07-2003	Investment Portfolio of Banks – Transactions in Securities
7	UBD.BPD.PCB.Cir.No.46/16.20.00/2002-03	17-05-2003	Placement of deposits by non-scheduled UCBs with Scheduled UCBs
8	UBD.BPD.PCB.No.44/09.80.00/2002-03	12-05-2003	Guidelines for uniform accounting for Repo/Reverse Repo transactions
9	UBD.BPD.PCB.Cir.No.39/09.29.00/2002-03	13.03.2003	Trading of Government Securities on Stock Exchange
10	UBD.BP.No.35/16.26.00/2002-03	18-02-2003	Prices of Government Securities in the Secondary Market
11	UBD.BPD.SPCB.Cir.No.9/09.29.00/2002-03	27-01-2003	Reconciliation Procedure for Government Loans
12	UBD.POT.PCB.Cir.No.06/09.29.00/2002-03	06-08-2002	Investment Portfolio of UCBs – Transactions in Government Securities
13	UBD.POT.PCB.Cir.No.5/09.29.00/ 2002-03	22-07-2002	Investment portfolio of banks – transaction in securities
14	UBD.POT.No.49/09.80.00/2001-02	17-06-2002	Ready Forward Contracts
15	UBD.CO.POT.PCB.Cir.No.48/09.29.00/2001-02	11-06-2002	Certification of holding of securities in banks' investment portfolio
16	UBD.BR.No.47/16.26.00/2001-02	07-06-2002	Investments in Government and other approved securities by Urban Co-op Banks

17	UBD.PCB.Cir.No.46/09.29.00/2001-02	06-06-2002	Investment Portfolio of Banks – Transaction in Securities
18	UBD.Plan.SCB.Cir.No.10/09.29.00/2001-02	26-04-2002	Investment Portfolio of Urban Banks – Transactions in Government Securities
19	UBD.Plan.PCB.Cir.No.41/09.29. 00/2001-02	20-04-2002	Investment Portfolio of Banks – Transactions in Securities
20	UBD.BR.Cir.No.19/16.26.00/2001-02	22-10-2001	B.R.Act, 1949 (AACS) Section 24 – Investment in Government and other approved securities
21	UBD.No.BR.6/16.26.00/2000-01	09-08-2001	B.R. Act, 1949 (AACS) Section 24 – Investment in Government and other approved securities
22	UBD.No.CO.BSD.I.PCB.44/12.05.05/2000-2001	23-04-2001	Guidelines for Classification and Valuation of Investments by Banks
23	UBD.No.BR.Cir/42/16.26.00/2000-01	19-04-2001	Banking Regulation Act, 1949 (As Applicable to Co-operative Societies) - Section 24 - Investment in Government and other approved Securities by Urban Co-operative Banks (UCBS)
24	UBD.No.43/16.20.00/2000-01	19-04-2001	Investment of Funds by Urban Co-operative Banks as deposits with other institutions and other Urban Co-operative Banks
25	UBD.No.POT.Cir.PCB.39/09.29.00/ 2000	18-04-2001	Sale of Government Securities Allotted in the Auctions of Primary Issues
26	UBD.No.Plan.PCB.Cir/22/09.29.00/ 2000-2001	30-12-2000	Investment Portfolio of banks - Transactions in securities - Role of brokers
27	UBD.Plan.PCB.Cir/26/09.80.00/99-2000	28-03-2000	Ready Forward Contracts
28	UBD.Plan.18/09.80.00/1999-2000	30-12-1999	Banks' own investment in State Government Loans -Payment of brokerage commission
29	UBD.No.Plan.PCB.04/09.80.00/99-2000	25-08-1999	Ready Forward Transactions
30	Ref. UBD No.BR. 26/18.20.00/98-99	07-04-1999	Investment of funds by primary (urban) co-operative banks In

			public sector undertakings/ companies
31	UBD.No.Plan.PCB.DIR.3/09.80.00/98-99	17-08-1998	Reverse Ready forward transactions
32	UBD.No.BR.1/16.20.00/98-99	10-07-1998	Investment by urban co-op. banks – Valuation of Investments – US – 64 units
33	UBD No.61/16.20.00/97-98	04-06-1998	Investment of Investment by Urban Cooperative Banks - Valuation of Investment - US- 64 Units funds by primary (urban) co- operative banks in public sector undertakings/companies
34	UBD.No.Pl.an.PCB/Cir.56/09.60.00/ 97-98	13-05-1998	Investment in Certificates of Deposit (CDs) by primary (urban) co-operative banks
35	UBD.No.Plan.SUB.20/09.81.00/97-98	19-02-1998	Retailing of Government Securities
36	UBD.No.BP.37/16.20.00/97-98	29-01-1998	Investment by Urban Co-operative Banks - Valuation of Investments
37	UBD.No.BSD.I (PCB) 22/12.05.00/97-98	26-11-1997	Investment by Urban Co-operative Banks Valuation of Investments
38	UBD.No.Plan.SUB.No.17/09.83.00/97-98	19-11-1997	Statistical data relating to investments in Money Market Instruments/Government Securities
39	UBD.No.Plan.PCB/Cir.21/09.60.00/97-98	11-11-1997	Investment in certificates of deposit (CDs) by Urban Co- operative Banks
40	UBD.No.Plan.PCB.Cir.19/09.29. 00/97-98	10-11-1997	Investment Portfolio of banks- Transactions in securities-Role of brokers
41	UBD.No.Plan.PCB.56/09.60.00/96-97	06-06-1997	Investment in Certificates of Deposit (CDs) by Urban Co- operative Banks
42	UBD.No.DS.SUB.CIR.7/13.07.00/96-97	07-01-1997	Investment of Surplus Funds by primary co-operative Banks in Bills Rediscounting Scheme
43	UBD.No.Plan.PCB.34/09.29.07/96-97	30-12-1996	Investment portfolio of banks Transactions in securities

44	UBD.No.Plan.PCB.No.30/09.82.00/96-97	27-11-1996	Investment by Urban Co-operative Banks in the Units of Unit Trust of India (UTI)
45	UBD.No.Plan.PCB.19/09.29.00/96-97	11-09-1996	Investment portfolio of banks - System for custody and control of unused B. R. Forms
46	UBD.No.Plan.PCB.7/09.60.00/96-97	19-07-1996	Investment in certificates of deposit by Urban Co-operative Banks
47	UBD.No.Plan/PCB/69/09.29.00/95-96	21-06-1996	Investment portfolio of banks - Transactions in securities
48	UBD.No.BR.Cir.52/16.20.00/95-96	16-03-1996	Investment of funds by Urban Co-operative Banks in Public Sector Undertakings/Companies
49	UBD.No.Plan.PCB.47/09.60.00/95-96	29-02-1996	Investment in Certificates of Deposit (CDs) by Urban Co-operative Banks
50	UBD.No.BR.12/16.20.00/95-96	06-01-1996	Investment of funds by urban co-operative banks in bonds of public sector undertakings
51	UBD.No.BR.Cir.33/16.26.00/95-96	03-01-1996	Banking Regulation Act, 1949 (As applicable to Co-operative Societies) Section 24-Investment in Government and other approved securities by primary co-operative banks
52	UBD.No.Cir.63/16.26.00/94-95	16-06-1995	Banking Regulation Act, 1949 (As applicable to Co-operative Societies) Section 24-Investment in Government and other approved securities by primary co-operative banks
53	UBD.No.BR.CIR.53/16.20.00/94-95	24-04-1995	Investment of funds by Urban Co-operative Banks in Public Sector Undertakings/Companies
54	UBDNo.Plan.PCB.32/09.29.00/94-95	24-11-1994	Investment Portfolio of Banks - Transactions in Securities - Bank Receipts/Role of brokers
55	UBD.No.Plan.PCB.29/09.80.00/94/95	09-11-1994	Ready Forward Transactions
56	UBD.No.Plan.PCB.14/09.80.00/94-95	24-08-1994	Ready Forward Transactions

57	UBD.BR.10/PCB (CIR)/16.20.00/94-95	01-08-1994	Investment of funds by primary co-operative banks in public sector undertakings/companies
58	UBD.BR.CIR.72/16.20.00/93-94	16-05-1994	Investment of funds by urban co-operative banks in public sector undertakings/companies
59	UBD.No.PLAN (PCB).CIR.56/09.29.00/93-94	11-02-1994	Investment portfolio of banks - Transactions in Securities.
60	UBD.No.Plan.51/09.29.00/93-94	20-01-1994	Investment portfolio of banks - Transactions in Securities - Bouncing of SGL transfer forms - Penalties to be imposed:
61	UBD.No.3/09.29.00/93-94	02-08-1993	Investment port-folio of banks - Transactions in securities - Aggregate contract limit for individuals brokers - Clarifications
62	UBD.No.Plan.74/UB.81-92/93	17-05-1993	Investment portfolio or banks - Transactions in securities
63	UBD.No.Plan.13/UB.81/92-93	15-09-1992	Investments portfolio of banks Transactions in securities
64	UBD.No.BR.1866/A.12(19)-87/88	13-06-1988	Investments of Funds by Urban Co-operative Banks as Deposits with Public Sector Undertakings/ Companies/Corporations/Co-operative Institutions
65	UBD.No.DC.84 /R.1(B).87/88	13-02-1988	Bills Rediscounting Scheme - Rediscounting of Bills with Banks and Financial Institutions
66	UBD.No.BR.1455/A12(24)-85/86	31-05-1986	Banking Regulation Act, 1949 (as applicable to co-operative societies) - Section 24 - Investment in Units issued by the Unit Trust of India
67	UBD.BR.871/A.12 (24)-84/85	10-05-1985	Banking Regulation Act, 1949 (as applicable to co-operative societies) - Section 24 - Investment made under national deposit scheme
68	UBD.BR.498/A.12 (24) -84/85	08-01-1985	Banking Regulation Act, 1949 (As Applicable to Co-operative Societies) Section 24 - Investment in Government and Other Trustee

			Securities by primary co-operative banks
69	UBD.NO.DC.597/R.41-84/85	31-10-1984	7% Capital Investment Bonds
70	UBD.P&O.1121/UB. -63-83/84	01-06-1984	Bank's own investment in central state government loans-payment of brokerage
71	ACD.ID (DC) 1799/R.36/79/80	10-01-1980	Subscription/purchase of 7 year national rural development bonds
72	ACD.ID. (DC) 1800/R.36-79/80	10-01-1980	Directive relating to subscription/purchase of 7 year national rural development bonds
73	ACD.BR.446/A.12 (19)/72-3	01-11-1972	Banking Regulation Act, 1949 (As Applicable to Co-operative Societies) Section 19
74	ACD.BR.463/A.12 (19)/70-7	09-11-1970	Banking Regulation Act, 1949 (As Applicable to Co-operative Societies): Section 19
75	ACD.BR.1/A.12 (19)/68-9	01-07-1968	Section 19 of the Banking Regulation act 1949 (as applicable to co-operative societies): Restriction on holding shares in other co-operative societies
76	ACD.BR.3/A.12 (19)/68-9	01-07-1968	Section 19 of the Banking Regulation Act, 1949 (as applicable to co-operative societies): Restriction on holding shares in other co-operative societies
77	ACD.BR.903/A.12 (19)/67-8	22-12-1967	Banking Regulation Act, 1949 (as applicable to Co-operative Societies): Section 19: Restriction on holding of shares in other co-operative societies
78	ACD.BR.388/A.11 (19) 65-6	01-03-1966	Section 19 of the Banking Regulation Act: Restriction on holding shares in other co-operative societies

B. List of Other Circulars from which instructions relating to Investments have also been consolidated in the Master Circular

No.	Circular No.	Date	Subject
	UBD.No.POT.PCB.Cir.No.45/09.116.00/2000-	25-	Application of

	01	04-2001	Capital Adequacy Norms to Urban (Primary) Co-operative Banks
	UBD.CO.No.BSD-I.PCB(Cir)34/ 12.05.05/99-2000	24-05-2000	Income Recognition, Asset Classification, Provisioning and Valuation of Investments
	UBD.No.BSD.PCB./25/12.05.05/ 99-2000	28-02-2000	Income Recognition, Asset Classification, Provisioning and other related matters
	UBD.No.I&L(PCBs)42/12.05.00/ 96-97	20-03-1997	Prudential norms - Income Recognition, Assets Classification, Provisioning and other related matters -
	UBD.No.I&L(PCBs)68/12.05.00/ 95-96	10-06-1996	Income Recognition, assets classification, provisioning and other related matters Clarifications
	UBD.No.I&L(PCB)61/12.05.00/94-95	06-06-1995	Income recognition, asset classification, provisioning and other related matters Valuation of investment and others
	UBD.No.I&L86/12.05.00/93-94	28-06-1994	Income recognition, assets classification, provisioning and other related matters
	UBD.21/12:15:00/93-94	21-09-1993	Committee to enquire into various aspects relating to frauds and malpractices in banks primary (urban) co-operative banks
	UBD.NO.I&L.38/J.1-92/93	09-02-	Income recognition, assets classification,

		1993	provisioning and other related matters
	UBD.BR.16/A.6-84/85	09-07-1984	Banking Law (Amendment) Act, 1983
	ACD.Plan.358/UB.1-78/9	20-04-1979	Report on the committee on urban co-operative banks
	ACD.BR.184/A.12(19)-78/9	23-08-1978	The Banking Regulation Act, 1949 (as applicable to co-operative societies) : Section 10 : Restriction on holding shares in other co-operative societies
	ACD.BR.760/A.1/68-9	23-01-1969	The Banking Laws (Amendment) Act, 1968
	ACD.BR. 464/A. 12(24)/68-9	12-11-1968	Section 24 of the Banking Regulation Act 1949 (As Applicable to Co-operative Societies): Maintenance of Percentage of Assets