ANNEXURE

Guidelines on investments by SCBs and DCCBs in Non-SLR Debt Securities

Coverage

1. These guidelines cover banks' investments in Non-SLR debt instruments / securities issued by All-India Financial Institutions, and State and Central Government sponsored institutions, etc. The guidelines will apply to investments both in the primary market as well as the secondary market. However, these instructions are not applicable to a DCCB's investments in the share capital of the state co-operative bank of the state concerned.
2. Definitions of a few terms used in these guidelines have been furnished in Appendix I with a view to ensuring uniformity in approach while implementing the guidelines.

Regulatory requirements

3. Banks should not invest in non-SLR securities of original maturity of less than one year.
4. Banks should undertake usual due diligence in respect of investments in non-SLR securities. Present RBI regulations preclude banks from extending credit facilities for certain purposes. Banks should ensure that such activities are not financed by way of funds raised through the non-SLR securities.
5. Banks must not invest in unrated debt securities and unlisted shares of All-India Financial Institutions.
6. The Securities Exchange Board of India (SEBI), vide their circular dated September 30, 2003, have stipulated requirements to be complied with by listed companies for issuing debt securities on a private placement basis and listed on a stock exchange. According to this circular any listed company, making issue of debt securities on a private placement basis and listed on a stock exchange, has to make full disclosures (initial and continuing) in the manner prescribed in Schedule II of the Companies Act 1956, SEBI (Disclosure and Investor Protection) Guidelines, 2000 and the

Listing Agreement with the exchanges. Further, the debt securities should carry a credit rating of not less than investment grade from a Credit Rating Agency registered with the SEBI. Banks should ensure that they make all fresh Non-SLR debt investments only in listed debt securities of public sector undertakings and All-India Financial Institutions which comply with the requirements of the SEBI circular dated September 30, 2003.

Internal assessments

7. Since non-SLR securities are mostly in the form of credit substitutes, banks are advised to (i) subject all their investment proposals relating to non-SLR securities to credit appraisal on par with their credit proposals, irrespective of the fact that the proposed investments may be in rated securities, (ii) make their own internal credit analysis and rating even in respect of rated issues and that they should not entirely rely on the ratings of external agencies, and (iii) strengthen their internal rating systems which should also include building up of a system of regular (quarterly or half-yearly) tracking of the financial position of the issuer with a view to ensuring continuous monitoring of the rating migration of the issuers/issues.

Fixing of prudential limits

8. The Board of Directors of banks should fix a prudential limit for their total investment in non-SLR securities subject to existing limits prescribed by RBI and sub-limits for the following debt securities:

    a) bonds of public sector undertakings

    b) bonds / equity of All-India Financial Institutions (AFIs)

    The total investment in (a) and (b) above should not exceed 10 per cent of the bank's total deposits as on March 31, of the previous year, with a sub-ceiling of 5 per cent for investments covered under (a).

9. Banks which have exposure to investments in non-SLR securities in excess of the prudential limit prescribed above as on 31st March 2003 should not make any fresh investment in such securities till they ensure compliance with the above prudential limit.

10. 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.

Role of Boards

11. Banks should ensure that their investment policies duly approved by the Board of Directors are formulated after taking into account all the relevant issues specified in these guidelines on non-SLR investment. Banks should put in place proper risk management systems for capturing and analysing the risk in respect of non-SLR investment and taking remedial measures in time.

12. The Board should devise a system to ensure that the limits prescribed in paragraph 8 above are scrupulously complied with. The Boards should appropriately address the issue of ensuring compliance with the prudential limits on an ongoing basis.

13. Boards of banks should review the following aspects of non-SLR investments twice a year:
    a) Total business (investment and divestment) during the reporting period
    b) Compliance with the prudential limits prescribed by the Board for non-SLR investment
    c) Rating migration of the issuers/ issues held in the bank's books and consequent diminution in the portfolio quality
    d) Extent of non performing investments in the non-SLR category

Disclosures

14. Banks should disclose the details of the issuer composition of non-SLR investments and the non-performing non-SLR investments in the 'Notes on Accounts' of the balance sheet, as indicated in Appendix II.

Demat form

15. SCBs/DCCBs should make investments in non-SLR securities in dematerialised form only.

Trading and settlement in debt securities

16. As per the SEBI guidelines, all trades with the exception of the spot transactions, in a listed debt security, shall be executed only on the trading platform of a stock exchange. In addition to complying with the SEBI guidelines, banks should ensure that all spot transactions in listed debt securities are reported on the NDS and settled through the CCIL from a date to be notified by RBI.

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Appendix I

Guidelines on investments by SCBs/CCBs in non-SLR investment portfolio by banks – Definitions

(Vide paragraph 2 of the Guidelines)

1. With a view to imparting clarity and to ensure that there is no divergence in the implementation of the guidelines, some of the terms used in the guidelines are defined below.

2. A security will be treated as rated if it is subjected to a detailed rating exercise by an external rating agency in India which is registered with SEBI, and is carrying a current or valid rating. The rating relied upon will be deemed to be current or valid if

   i) The credit rating letter relied upon is not more than one month old on the date of opening of the issue, and

   ii) The rating rationale from the rating agency is not more than one year old on the date of opening of the issue, and

   iii) The rating letter and the rating rationale is a part of the offer document.

   iv) In the case of secondary market acquisition, the credit rating of the issue should be in force and confirmed from the monthly bulletin published by the respective rating agency.

   Securities which do not have a current or valid rating by an external rating agency would be deemed as unrated securities.

3. The investment grade ratings awarded by each of the external rating agencies operating in India would be identified by the IBA/ FIMMDA. These would also be reviewed by IBA/ FIMMDA at least once a year.

4. A 'listed' debt security is a security which is listed in a stock exchange. If not so, it is an 'unlisted' debt security.

5. A <u>non performing investment</u> (NPI), similar to a non performing advance (NPA), is one where

i) Interest/ instalment (including maturity proceeds) is due and remains unpaid for more than 180 days. The delinquency period would become 90 days with effect from 31st March 2004.

ii) The above would apply mutatis-mutandis to preference shares where the fixed dividend is not paid.

iii) In the case of equity shares, in the event the investment in the shares of any company is valued at Re.1 per company on account of the non availability of the latest balance sheet, those equity shares would also be reckoned as NPI.

iv) If any credit facility availed by the issuer is NPA in the books of the bank, investment in any of the securities issued by the same issuer would also be treated as NPI.

Appendix II

Prudential guidelines on management of the non-SLR investment portfolio by SCBs/CCBs – Disclosures requirements

(vide paragraph 15 of the Guidelines)

Banks should make the following disclosures in the 'Notes on Accounts' of the balance sheet in respect of their non-SLR investment portfolio, with effect from the financial year ending 31 March 2004.

i) Issuer composition of non-SLR investments

(Rs. in crore)

No. (1)	Issuer (2)	Amount (3)	Extent of private placement (4)	Extent of 'below investment grade' Securities already invested (5)	Extent of 'unrated' securities, already invested (6)	Extent of 'unlisted' securities (7)
1	P S Us					
2	FIs					
3	Provision held towards depreciation		X X X	X X X	XXX	XXX
	Total					

Amounts reported under columns 4 and 5 above may not be mutually exclusive.

ii) Non performing non-SLR investments

Particulars	Amount (Rs. Crore)
Opening balance	
Additions during the year since 1st April	
Reductions during the above period	
Closing balance	
Total provisions held	