

RBI/2004/91

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March 08, 2004

All Primary Dealers in Government Securities Market

Dear Sir,

Prudential guidelines on investment in non-government securities

In order to contain the risks arising out of investment in non-Government securities by the Primary Dealers (PDs), the investment guidelines have been finalized in consultation with the Primary Dealers Association of India (PDAI). These are furnished in the **Annex**. These guidelines come into force with immediate effect. The prudential guidelines on investment by PDs in non-government securities, *inter alia*, address the following:

- i) Coverage,
- ii) Regulatory requirements,
- iii) Listing and rating requirements,
- iv) Fixing of prudential limits,
- v) Time schedule for operationalisation,
- vi) Role of Boards,
- vii) Disclosures, and
- viii) Trading and settlement in securities.

Yours faithfully,

(H.R. Khan)
Chief General Manager-in-Charge

ANNEX

Guidelines on Investments by Primary Dealers (PDs) in non-Government Securities

Coverage

1. These guidelines cover PDs' investments in non-government securities (including capital gains bonds, bonds eligible for priority sector status, bonds issued by central or state public sector undertakings

with or without government guarantees and bonds issued by banks and financial companies) generally issued by corporates, banks, FIs and State and Central Government sponsored institutions, SPVs etc. These guidelines will, however, not be applicable to (i) units of equity oriented mutual fund schemes where any part of the corpus can be invested in equity, (ii) venture capital funds, (iii) commercial paper, (iv) certificate of deposit, and (v) investments in equity shares. The guidelines will apply to investments both in the primary market as well as the secondary market.

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. PDs should not invest in non-government securities of original maturity of less than one-year, other than Commercial Paper and Certificates of Deposits which are covered under RBI guidelines.

4. PDs should undertake usual due diligence in respect of investments in non-government securities.

Listing and rating requirements

5. PDs must not invest in unrated non-government securities.

6. The PDs will abide by the requirements stipulated by Securities and Exchange Board of India (SEBI) vide their circulars No.SEBI/MRD/SE/AT/36/2003 dated September 30, 2003 and No. SEBI/MRD/SE/AT/46/2003 dated December 22, 2003 in respect of corporate debt securities. Accordingly, while making fresh investments in non-government debt securities, PDs should ensure that such investment are made only in listed debt securities, except to the extent indicated in paragraphs 7 and 8 below.

Fixing of prudential limits

7. PDs' investment in unlisted non-government securities should not exceed 10% of the size of their non-government securities portfolio on an on-going basis. It is clarified that the ceiling of 10% will be inclusive of investment in Security Receipts issued by Securitization Companies/Reconstruction Companies and also the investment in Asset Backed Securities (ABS) and Mortgage Backed Securities (MBS). The unlisted non-government debt securities in which PDs may invest up to the limits specified above, should comply with the disclosure requirements as prescribed by the SEBI for listed companies.

Time schedule for operationalisation

8. Considering the time required by issuers to get their unlisted debt issues listed on the stock exchanges, the following transition time is provided :

- i. Investment by PDs in units of mutual fund schemes where the entire corpus is invested in debt securities will be outside the purview of the above guidelines until December 31, 2004.
- ii. With effect from January 01, 2005 only investment in units of such mutual fund schemes which have an exposure to unlisted securities of less than 10 per cent of the corpus of the fund will be treated on par with listed securities for the purpose of compliance with the prudential limits prescribed in the above guidelines.
- iii. The PDs may invest in existing unlisted securities (issued prior to December 31, 2003) till December 31, 2004 provided the issuers have applied to the stock exchange(s) for listing and the security(ies) is/are rated minimum investment grade.

9. With effect from January 01, 2005 only PDs whose investment in unlisted non-government securities are within the prudential limits prescribed in the above guidelines may make fresh investment in such securities and upto the prudential limits.

Role of Boards

10. PDs 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 investment in non-government securities. PDs should put in place proper risk management systems for capturing and analysing the risk in respect of non-government securities before making investments and taking remedial measures in time. PDs should also put in place appropriate systems to ensure that investment in privately placed instruments is made in accordance with the systems and procedures prescribed under respective PDs' investment policy.

11. Boards of PDs should review the following aspects of non-government investment at least at quarterly intervals:

- a) Total business (investment and divestment) during the reporting period.
- b) Compliance with the prudential limits prescribed by the Board for investment in non-government securities.
- c) Compliance with the prudential guidelines on non-government securities prescribed in paragraphs 7 and 8 above.
- d) Rating migration of the issuers/ issues held in the PDs' books and consequent diminution in the portfolio quality.

Disclosures

12. In order to help in the creation of a central database on private placement of debt, a copy of all offer documents should be filed with the Credit Information Bureau (India) Ltd. (CIBIL) by the PDs. Further, any default relating to interest/ instalment in respect of any privately placed debt should also be reported to CIBIL by the investing PDs along with a copy of the offer document.

13. PDs should also disclose the details of the issuer composition of non-government securities investments in the 'Note on Accounts' of the balance sheet, as indicated in Appendix II.

Trading and settlement in debt securities

14. 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 these SEBI guidelines, (as and when applicable) PDs should ensure that all spot transactions in listed and unlisted debt securities are reported on the NDS and settled through the CCIL from a date to be notified by RBI.

Appendix I

Guidelines on investments by PDs in non-government investment portfolio– 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' security is a security which is listed in a stock exchange. If not so, it is an 'unlisted' security.

Appendix II

Prudential guidelines on management of the non-government investment portfolio by PDs – Disclosures requirements

(vide paragraph 13 of the Guidelines)

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

Issuer composition of investments in non Government securities

(Rs. in crore)

No.	Issuer	Amount	Extent of private place-ment	Extent of 'below investment grade' securities	Extent of 'unrated' securities	Extent of 'unlisted' securities
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1	PSUs					
2	FIs					
3	Banks					
4	Other PDs					
5	Private corporates					
6	Subsidiaries/Joint ventures					
7	Others					
8	Provision held towards depreciation		X X X	X X X	X X X	X X X
	Total *					

NOTE: 1. * Total under column 3 should tally with the total of investments included under the following categories in respective schedule to the balance sheet:

- a. Commercial Papers
- b. Corporate Debentures & Bonds
- c. Others

2. Amounts reported under columns 4, 5, 6 and 7 above may not be mutually exclusive.