RBI/2004/218
IDMD.PDRS.No/ 06/ 03.64.00/2004-05

October 15, 2004

All The Primary Dealers (PDs) in Government Securities Market

Dear Sirs,

Capital Adequacy Standards – Guidelines on Issue of Subordinated Debt Instruments – Tier II and Tier III Capital

Please refer to paragraphs 2.2.(v) and 2.3 of the Annex to our Circular No. IDMD.01/(PDRS)/03.64.00/ 2003-04 dated January 07, 2004 advising revised guidelines on Capital Adequacy Standards and Risk Management for Primary Dealers (PDs).

2. In terms thereof, PDs are permitted to include Subordinated Debt in Tiers II and III Capital subject to prescribed criteria. In this connection, guidelines relating to the process of issue of Subordinated Debt Instruments under Tier II and Tier III Capital have now been finalized and are enclosed in the **Annex**. These guidelines will come into force with immediate effect. PDs are requested to ensure adherence to these guidelines while issuing subordinated debt instruments.

Yours faithfully,

(B. Mahapatra)
Chief General Manager-in-Charge

Annex

Guidelines on Issue of Subordinated Debt Instruments

In continuation to RBI circular IDMD.No.01/PDRS/03.64.00/2003-04 dated January 07, 2004, the guidelines relating to issue of Subordinated Debt Instruments under Tier II and Tier III Capital are furnished below:

i. The amount of Subordinated Debt to be raised may be decided by the Board of Directors of the PD.

ii. The interest rate spread of the instrument over the yield of equal residual maturity of the Government of India dated security at the time of issue shall not exceed 200 bps.

iii. The instruments should be 'plain vanilla' with no special features like options, etc.

iv. The debt securities shall carry a credit rating from a Credit Rating Agency registered with the Securities and Exchange Board of India.

v. The issue of Subordinated Debt instruments should comply with the guidelines issued by SEBI vide their circular SEBI/MRD/SE/AT/36/2003/30/09 dated September 30, 2003 as amended from time to time, wherever applicable.

vi. In case of issue of unlisted issues of Subordinated Debt, the disclosure requirements as prescribed by the SEBI for listed companies in terms of the above guidelines should be complied with.

vii. Necessary permission from the Foreign Exchange Department of the Reserve Bank of India should be obtained for issuing the instruments to NRIs/FIIs. PDs should comply with the terms and conditions, if any, prescribed by SEBI/other regulatory authorities in regard to issue of the instruments.

viii. Investments by PDs in Subordinated Debt of other PDs/banks will be assigned 100% risk weight for capital adequacy purpose. Further, the PD’s aggregate investments in Tiers II and III bonds issued by other PDs, banks and financial institutions shall be restricted upto 5 percent of the investing PD's total capital. The capital for this purpose will be the same as that reckoned for the purpose of capital adequacy.

ix. The PDs should submit a report to the Internal Debt Management Department, Reserve Bank of India giving details of the capital raised, such as, amount raised, maturity of the instrument, rate of interest together with a copy of the offer document, soon after the issue is completed.

Notes:

Other general guidelines prescribed in RBI circular IDMD. No. 01/PDRS/03.64.00/2003-04 dated January 07, 2004 on Capital Adequacy Standards and Risk Management Guidelines for Primary Dealers may also be kept in view.