RBI/2005-06/347

IDMD.PDRS.No.3007/03.64.00/2005-06

April 4, 2006

To

All Primary Dealers in the Government Securities Market and
scheduled commercial banks undertaking PD business departmentally

Revised Scheme of Underwriting Commitment and Liquidity Support

Please refer to our letter IDMC.No.4135/03.64.00/2000-01 dated April 19, 2001 on the Scheme for bidding, underwriting and liquidity support to Primary Dealers.

2. As you are aware, in terms of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003, the Reserve Bank of India's participation in the primary issues of Government securities stands withdrawn with effect from April 1, 2006 except under exceptional circumstances. To address the emerging needs, an internal Technical Group on Central Government Securities Market was constituted. The Group recommended restructuring of the current institutional process of bidding commitments by introducing a revised methodology for Primary Dealers' obligations in the primary issuance process. In line with the recommendations of the Group and keeping in view the discussions with the market participants, a revised scheme of underwriting has been formulated and is enclosed.

3. Following the discontinuance of bidding commitment as one of the obligations of Primary Dealers, the methodology for calculating limits for Primary Dealers under the Reserve Bank of India's Liquidity Support Scheme has also been revised. The revised methodology for computing the extent of liquidity support applicable to stand-alone Primary Dealers is enclosed.

4. The above schemes supersede the earlier schemes with immediate effect.

Yours faithfully

(G Mahalingam)
Chief General Manager

Enclosure : Revised Scheme for Underwriting Commitment and Liquidity Support

I Scheme for Underwriting Commitment

This scheme replaces the existing Scheme for Bidding Commitment and Underwriting to Primary Dealers (PDs) contained in circular IDMC No.4135/03.64.00/2000-01 dated April 19, 2001. PDs/Bank-PDs will be, hereinafter, collectively referred to as PDs.

Under the revised scheme, PDs will be required to meet underwriting commitment instead of the earlier requirements of bidding commitment and voluntary underwriting. The underwriting commitment will be divided into two parts - i) Minimum Underwriting Commitment (MUC) and ii) Additional Competitive Underwriting (ACU).

i) **Minimum Underwriting Commitment**: The MUC of each PD will be computed to ensure that at least 50 percent of each issue is mandatorily covered by the aggregate of all MUCs. For example, with the current number of PDs at 17, each PD will be deemed to underwrite about 3 per cent of the notified amount of each auction as MUC. The MUC will be uniform for all PDs, irrespective of their capital or balance sheet size.

Since the MUC would not be through a bidding process, the same would be incorporated in the Undertaking given by the PDs to RBI, every year to enable compulsory minimum underwriting for each auction. For the fiscal year 2006-07, the revised scheme will be applicable with effect from April 1, 2006.

ii) **Additional Competitive Underwriting:** The remaining portion of the notified amount will be open to competitive underwriting through underwriting auctions. Each PD would be required to bid for a minimum of 3 per cent of notified amount. The auctions could be either uniform price-based or multiple price-based depending upon the market conditions and other relevant factors, which will be announced before the underwriting auction for each issue. All successful bidders in the ACU auction will get commission as per auction rules.

iii) **Commission on MUC:** Those PDs who succeed in the ACU for 4 per cent and above of the notified amount of the issue, will get commission on their MUC (3 percent) at the weighted average of all the accepted bids in the ACU. Others will get commission on the 3 percent in MUC at the weighted average rate of the three lowest bids in the ACU.

2. The operational guidelines of the underwriting commitment / auction are detailed as below:

2.1 For the ACU underwriting auction:

a) RBI will announce the MUC of each PD and the amount for which ACU underwriting auction will be held. PDs have to bid in the ACU underwriting auction for the remaining portion (notified amount minus MUC) of the notified amount.
b) Bids will be tendered by PDs within the stipulated time, indicating both the amount of the underwriting commitments and underwriting commission rates. A PD can submit multiple bids for underwriting.
c) Each PD would be required to bid for a **minimum of 3 per cent** of the notified amount.
d) A PD **cannot bid for more than 30 per cent** of the notified amount.
e) Depending upon the bids submitted for underwriting, RBI will decide the cut-off rate of commission and inform the PDs.
f) Underwriting commission will be paid on the amount accepted for underwriting by the RBI, irrespective of the actual amount of devolvement, by credit to the current account of the respective PDs at the RBI, Fort, Mumbai, on the date of issue of security.

2.2 For the auction for GOI securities

a) A PD should bid for an amount not less than the amount successful in the ACU and MUC. If two or more issues are floated on the same day, the minimum bid amount will be applied to each issue separately.

b) In case of devolvement, PDs would be allowed to set-off the accepted bids in the auction against their underwriting commitment accepted by the Reserve Bank. Devolvement of securities, if any, on PDs will take place on pro-rata basis, depending upon the amount of underwriting obligation of each PD after setting off the successful bids in the auction.

3.0 Other issues

3.1 It may be recalled that in the earlier system of underwriting, it was prescribed that the total amount offered for underwriting by a PD on any single day should not exceed five times of its net owned funds. Under the revised system, this condition is being dispensed with.

3.2 In case of State Government floatation through auction, the existing system of underwriting will continue.

3.3 In the case of Treasury Bills, however, the existing stipulations in regard to separate bidding commitment as a percentage of notified amount for each auction and success ratio will continue.

4 Reserve Bank of India reserves its right to amend these guidelines from time to time, as may be considered necessary.

II Scheme for liquidity support to stand-alone Primary Dealers

In terms of the “Guidelines for Primary Dealers in the Government Securities Market”, PDs are provided with liquidity support by the Reserve Bank of India through repos /refinance against Central Government securities. In view of the revised scheme of underwriting commitment, the methodology of calculation of liquidity support to individual PDs has been changed. The liquidity support will be provided to stand-alone PDs only. The parameters based on which liquidity support will be allocated are given below:

a) **Liquidity Adjustment Facility :** The stand-alone PDs will be able to access the Liquidity Adjustment Facility as hitherto.

b) **Liquidity support:** Of the total liquidity support, half of the amount will be divided equally among all the stand-alone PDs. The remaining half (i.e. 50%) will be divided in the ratio of 1:1 based on market performance in primary market and secondary market. Performance in primary market will be computed on the basis of bids accepted in the T-Bill auction and G-sec auction in the proportion of 1:3. Similarly, the secondary market performance will be judged on the basis of outright turnover in T-Bills and G-secs in the proportion of 1:3.

c) The PD-wise quantum of liquidity support will be revised every half-year (April-September and October-March) based on the market performance of the PDs in the preceding six months.