RBI/2007-2008/169
DBOD.No. BP. BC. 42 /21.01.002/2007-2008

October 29, 2007

The Chairman and Managing Director/
Chief Executive Officers of Commercial Banks
(Excluding Foreign Banks, RRBs and LABs)

Dear Sir,

Guidelines for issuing preference shares as part of regulatory capital

Please refer to our circular DBOD.No.BP.BC.57/21.01.002/2005-06 dated January 25, 2006 on the enhancement of banks' capital raising options for capital adequacy purposes. With a view to providing a wider choice of instruments to Indian banks for raising Tier I and Upper Tier II capital, it has been decided to allow the banks to issue the following types of preference shares in Indian Rupees, subject to extant legal provisions as per guidelines contained in Annex I and II:

i) Tier I capital

Perpetual Non-Cumulative Preference Shares (PNCPS)

ii) Upper Tier II capital

a) Perpetual Cumulative Preference Shares (PCPS)
b) Redeemable Non-Cumulative Preference Shares (RNCPS)
c) Redeemable Cumulative Preference Shares (RCPS)

2. The Perpetual Non-Cumulative Preference Shares will be treated on par with equity, and hence, the coupon payable on these instruments will be treated as dividend (an appropriation of Profit & Loss Account). All other types of preference shares mentioned above will be treated as liabilities and the coupon payable thereon will be treated as interest (charged to Profit and Loss Account).

3. The addition of above instruments is expected to significantly enhance the range of eligible instruments available to the banks for capital adequacy purposes. Hence, it is not considered necessary to allow the banks to issue preference shares in foreign currency in overseas markets at this stage.

Yours faithfully

(Prashant Saran)
Chief General Manager-In-Charge

ANNEX 1

Guidelines on Perpetual Non-Cumulative Preference shares (PNCPS) as part of Tier I capital

1.Terms of Issue

1.1. Limits

The outstanding amount of Tier 1 preference shares along with Innovative Tier 1 instruments shall not exceed 40% of total Tier 1 capital at any point of time. The above limit will be based on the amount of Tier 1 capital after deduction of goodwill and other intangible assets but before the deduction of investments. Tier 1 preference shares issued in excess of the overall ceiling of 40%, shall be eligible for inclusion under Upper Tier 2 capital, subject to limits prescribed for Tier 2 capital. However, investors' rights and obligations would remain unchanged.

1.2 Amount

The amount of PNCPS to be raised may be decided by the Board of Directors of banks.

1.3 Maturity

The PNCPS shall be perpetual.

1.4 Options

i) PNCPS shall not be issued with a 'put option' or 'step up option'.

ii) However, banks may issue the instruments with a call option at a particular date subject to following conditions:

a) The call option on the instrument is permissible after the instrument has run for at least ten years; and

b) Call option shall be exercised only with the prior approval of RBI (Department of Banking Operations & Development). While considering the proposals received from banks for exercising the call option the RBI would, among other things, take into consideration the bank's CRAR position both at the time of exercise of the call option and after exercise of the call option.

1.5 Classification in the Balance sheet

These instruments will be classified as capital and shown under "Schedule I-Capital" of the Balance sheet.

1.6 Dividend

The rate of dividend payable to the investors may be either a fixed rate or a floating rate referenced to a market determined rupee interest benchmark rate

1.7 Payment of Dividend

(a) The issuing bank shall pay dividend subject to availability of distributable surplus out of current year's earnings, and if

i) the bank's CRAR is above the minimum regulatory requirement prescribed by RBI;

ii) the impact of such payment does not result in bank's capital to risk weighted assets ratio (CRAR) falling below or remaining below the minimum regulatory requirement prescribed by Reserve Bank of India;

iii) In the case of half yearly payment of dividends, the balance sheet as at the end of the previous year does not show any accumulated losses; and

iv) In the case of annual payment of dividends, the current year's balance sheet does not show any accumulated losses

(b) The dividend shall not be cumulative. i.e., dividend missed in a year will not be paid in future years, even if adequate profit is available and the level of CRAR conforms to the regulatory minimum.

(c) All instances of non-payment of dividend in consequence of conditions as at (a) above should be reported by the issuing banks to the Chief General Managers-in-Charge of Department of Banking Operations & Development and Department of Banking Supervision, Central Office of the Reserve Bank of India, Mumbai.

1.8 Seniority of claim

The claims of the investors in PNCPS shall be senior to the claims of investors in equity shares and subordinated to the claims of all other creditors and the depositors.

Other conditions

a. PNCPS should be fully paid-up, unsecured, and free of any restrictive clauses.
b. Investment by FIIs and NRIs shall be within an overall limit of 49% and 24% of the issue respectively, subject to the investment by each FII not exceeding 10% of the issue and investment by each NRI not exceeding 5% of the issue. Investment by FIIs in these instruments shall be outside the ECB limit for rupee denominated corporate debt as fixed by Government of India from time to time. The overall non-resident holding of preference shares and equity shares in public sector banks will be subject to the statutory/regulatory limit.
c. Banks should comply with the terms and conditions, if any, stipulated by SEBI/other regulatory authorities in regard to issue of the instruments.

2. Compliance with Reserve Requirements

a) The funds collected by various branches of the bank or other banks for the issue and held pending finalisation of allotment of the Tier 1 preference shares will have to be taken into account for the purpose of calculating reserve requirements.

b) However, the total amount raised by the bank by issue of PNCPS shall not be reckoned as liability for calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will not attract CRR/SLR requirements.

3. Reporting Requirements

3.1 Banks issuing PNCPS shall submit a report to the Chief General Manager-in-charge, Department of Banking Operations & Development, Reserve Bank of India, Mumbai giving details of the capital raised, including the terms of issue specified at item 1 above together with a copy of the offer document soon after the issue is completed.

3.2 The issue-wise details of amount raised as PNCPS qualifying for Tier I capital by the bank from FIIs/NRIs are required to be reported within 30 days of the issue to the Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Foreign Investment Division, Central Office, Mumbai 400 001 in the proforma given in the Appendix. The details of the secondary market sales / purchases by FIIs and the NRIs in these instruments on the floor of the stock exchange shall be reported by the custodians and designated banks, respectively to the Reserve Bank of India through the soft copy of the LEC Returns, on a daily basis, as prescribed in Schedule 2 and 3 of the FEMA Notification No.20 dated 3rd May 2000, as amended from time to time.

4. Investment in perpetual non-cumulative preference shares issued by other banks/ FIs

a) A bank's investment in PNCPS issued by other banks and financial institutions will be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10 percent of investing banks' capital funds as prescribed vide circular DBOD.BP.BC.No.3/ 21.01.002/ 2004-05 dated 6th July 2004.

b) Bank's investments in PNCPS issued by other banks/ financial institutions will attract a 100% risk weight for capital adequacy purposes.

c) A bank's investments in the PNCPS of other banks will be treated as exposure to capital market and be reckoned for the purpose of compliance with the prudential ceiling for capital market exposure as fixed by RBI.

5. Grant of advances against Tier 1 preference shares

Banks should not grant advances against the security of the PNCPS issued by them.

ANNEX 2

Terms and conditions applicable to Perpetual Cumulative Preference shares (PCPS) / Redeemable Non-Cumulative Preference Shares(RNCPS)/ Redeemable Cumulative Preference Shares(RCPS) as part of Upper Tier 2 Capital

1.Terms of Issue

1.1 Characteristics of the instruments

- **a)** These instruments could be either perpetual **(PCPS)** or dated **(RNCPS and RCPS**) instruments with a fixed maturity of minimum 15 years.
- **b)** The perpetual instruments shall be cumulative. The dated instruments could be cumulative or non-cumulative

1.2 Limits

The outstanding amount of these instruments along with other components of Tier 2 capital shall not exceed 100% of Tier 1 capital at any point of time. The above limit will be based on the amount of Tier 1 capital after deduction of goodwill and other intangible assets but before the deduction of investments.

1.3 Amount

The amount to be raised may be decided by the Board of Directors of banks.

1.4 Options

i) These instruments shall not be issued with a 'put option'.

ii) However, banks may issue the instruments with a call option at a particular date subject to strict compliance with each of the following conditions:

- a) The call option on the instrument is permissible after the instrument has run for at least ten years; and

- b) Call option shall be exercised only with the prior approval of RBI (Department of Banking Operations & Development). While considering the proposals received from banks for exercising the call option the RBI would, among other things, take into consideration the bank's CRAR position both at the time of exercise of the call option and after exercise of the call option.

1.5. Step-up option

The issuing bank may have a step-up option which may be exercised only once during the whole life of the instrument, in conjunction with the call option, after the lapse of ten years from the date of issue. The step-up shall not be more than 100 bps. The limits on step-up apply to the all-in cost of the debt to the issuing banks.

1.6. Classification in the balance sheet

These instruments will be classified as borrowings under Schedule 4 of the Balance sheet as item No.1.

1.7 Coupon

The coupon payable to the investors may be either at a fixed rate or at a floating rate referenced to a market determined rupee interest benchmark rate.

1.8. Payment of coupon

1.8.1 The coupon payable on these instruments will be treated as interest and accordingly debited to P& L Account. However, it will be payable only if

a) The bank's CRAR is above the minimum regulatory requirement prescribed by RBI
b) The impact of such payment does not result in bank's CRAR falling below or remaining below the minimum regulatory requirement prescribed by RBI
c) The bank does not have a net loss. For this purpose the Net Loss is defined as either (i) the accumulated loss at the end of the previous financial year/half year as the case may be; or (ii) the loss incurred during the current financial year.
d) In the case of PCPS and RCPS the unpaid coupon will be treated as a liability. The interest amount due and remaining unpaid may be allowed to be paid in later years subject to the bank complying with the above requirements.
e) In the case of RNCPS, deferred coupon will not be paid in future years, even if adequate profit is available and the level of CRAR conforms to the regulatory minimum.

1.8.2. All instances of non-payment of interest should be notified by the issuing banks to the Chief General Managers-in-Charge of Department of Banking Operations & Development and Department of Banking Supervision, Central Office of the Reserve Bank of India, Mumbai.

1.9. Redemption/repayment of redeemable preference shares included in Upper Tier II

1.9.1. All these instruments shall not be redeemable at the initiative of the holder.

1.9.2. Redemption of these instruments at maturity shall be made only with the prior approval of the Reserve Bank of India (Department of Banking Operations and Development, subject *inter alia* to the following conditions:

a) the bank's CRAR is above the minimum regulatory requirement prescribed by RBI
b) the impact of such payment does not result in bank's CRAR falling below or remaining below the minimum regulatory requirement prescribed by RBI

1.10. Seniority of claim

The claims of the investors in these instruments shall be senior to the claims of investors in instruments eligible for inclusion in Tier 1 capital and subordinate to the claims of all other creditors including those in Lower Tier 2 and the depositors. Amongst the investors of various instruments included in Upper Tier 2, the claims shall rank pari-passu with each other.

1.11 Amortisation for the purpose of computing CRAR

The Redeemable Preference Shares(both cumulative and non-cumulative) shall be subjected to a progressive discount for capital adequacy purposes over the last five years of their tenor, as they approach maturity as indicated in the table below for being eligible for inclusion in Tier 2 capital.

Remaining Maturity of Instruments	**Rate of Discount (%)**
Less than one year	100
One year and more but less than two years	80
Two years and more but less than three years	60
Three years and more but less than four years	40
Four years and more but less than five years	20

1.12 Other conditions

a) These instruments should be fully paid-up, unsecured, and free of any restrictive clauses.

b) Investment by FIIs and NRIs shall be within an overall limit of 49% and 24% of the issue respectively, subject to the investment by each FII not exceeding 10% of the issue and investment by each NRI not exceeding 5% of the issue. Investment by FIIs in these instruments shall be outside the ECB limit for rupee denominated corporate debt as fixed by Government of India from time to time. However, investment by FIIs in these instruments will be subject to separate ceiling of USD 500 million. The overall non-resident holding of preference shares and equity shares in public sector banks will be subject to the statutory/regulatory limit.

c) Banks should comply with the terms and conditions, if any, stipulated by SEBI/other regulatory authorities in regard to issue of the instruments.

2. Compliance with Reserve Requirements

a) The funds collected by various branches of the bank or other banks for the issue and held pending finalization of allotment of these instruments will have to be taken into account for the purpose of calculating reserve requirements.

b) The total amount raised by a bank through the issue of these instruments shall be reckoned as liability for the calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will attract CRR/SLR requirements.

3. Reporting Requirements

Banks issuing these instruments shall submit a report to the Chief General Manager-in-charge, Department of Banking Operations & Development, Reserve Bank of India, Mumbai giving details of the debt raised, including the terms of issue specified at item 1 above together with a copy of the offer document soon after the issue is completed.

4. Investment in these instruments issued by other banks/ FIs

a) A bank's investment in these instruments issued by other banks and financial institutions will be reckoned along with the investment in other instruments eligible for capital status while computing compliance with the overall ceiling of 10 percent of investing banks' capital find prescribed vide circular DBOD.BP.BC.No.3/ 21.01.002/ 2004-05 dated 6th July 2004 and also subject to cross holding limits.

b) Bank's investments in these instruments issued by other banks/ financial institutions will attract a 100% risk weight for capital adequacy purposes.

5. Grant of advances against these instruments

Banks should not grant advances against the security of these instruments issued by them.

Appendix

Details of Investments by FIIs and NRIs in Perpetual Non-Cumulative Preference Shares qualifying as Tier-I capital

a) Name of the bank :

b) Total issue size/ amount raised (in Rupees):

c) Date of issue:

FIIs			**NRIs**		
No of FIIs	Amount raised		No. of NRIs	Amount raised	
	in Rupees	as a percentage of the total issue size		in Rupees	as a percentage of the total issue size

It is certified that

i. the aggregate investment by all FIIs does not exceed 49 percent of the issue size and investment by no individual FII exceeds 10 percent of the issue size.

ii. It is certified that the aggregate investment by all NRIs does not exceed 24 percent of the issue size and investment by no individual NRI exceeds 5 percent of the issue size.

Authorised Signatory

Date

Seal of the bank