RBI/20008-9/ 358
UBD.PCB. Cir.No. 39/09.16.900/08-09

January 23, 2009

The Chief Executive Officer of all
Primary (Urban) Co-operative Banks.

Dear Sir/Madam,

Financial restructuring of UCBs

Please refer to our circular UBD (PCB).Cir. 36/09.169.00/04-05 dated February 2, 2005 forwarding therewith the guidelines for merger / amalgamation of UCBs. As per the extant guidelines, the acquirer bank is required to protect the entire deposits of all the depositors of the acquired bank on its own or with the financial support from the State Government, even if the net worth of the acquired bank is negative. The extant guidelines set in motion the process of voluntary mergers in UCB sector. Over the last four years, several weak and non-viable UCBs have been merged with stronger UCBs providing a non-disruptive exit route for non-viable UCBs.

2. It is, however, observed that even financially stronger banks are unwilling to acquire banks, where the deposit erosion is large. In such situations, restructuring of the liabilities of the weak UCB may be a viable proposition, as the depositors above Rs. 1.00 lakh may stand to gain compared to what they would be entitled to receive from DICGC in case of liquidation of the bank.

3. **Financial restructuring**

Accordingly, the Reserve Bank is prepared to consider financial restructuring proposals as an additional option for resolution of problem banks provided they conform to the following norms:

(i) The interest of small depositors has to be protected in full. Accordingly, no conversion into equity will be permitted in the case of small depositors, i.e. depositor having deposit upto Rupees one lakh.

(ii) A portion of the deposit of individual depositors above Rupees one lakh may be converted into equity. Likewise, a portion of the deposits of the institutional depositors may be converted into Innovative Perpetual Debt Instrument (IPDI), which is eligible for inclusion as Tier I capital. The terms and conditions for issue of IPDI are given in the Annex.

(iii) The conversion of deposits into equities and IPDI would be subject to consent of the depositors/their forum.

(iv) Post-restructuring, no shares (equities) will be redeemed until the bank achieves a CRAR of 9%.

(v) The proportion of deposits converted into equity / IPDI should be such that the net worth of the bank after reconstruction turns positive.

(vi) The bank will have to maintain CRR / SLR on the restructured liabilities.

(vii) Post-restructuring, the management of the bank should be in the hands of a Board of Administrators consisting of representatives of individual depositors as well as professional bankers to ensure proper implementation of the reconstruction scheme including recovery of NPAs.

4. UCBs having negative net worth may approach the Regional Office concerned of the Reserve Bank of India with specific proposals after the same is approved by its Board of Directors.

5. Please acknowledge receipt to the Regional office concerned.

Yours faithfully,

(A. K. Khound)
Chief General Manager- in-Charge

Annex

Terms and conditions applicable to Innovative Perpetual Debt Instruments (IPDI)) for inclusion as Tier I capital

The Innovative Perpetual Debt Instruments (Innovative Instruments) that may be issued as bonds or debentures by banks should meet the following terms and conditions to qualify for inclusion as Tier I Capital for capital adequacy purposes.

1. Terms of Issue of Innovative Instruments

(i) RBI Approval

Banks shall obtain prior approval of the Reserve Bank of India, on a case-by-case basis, for issue of innovative instruments.

(ii) Amount

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

(iii) Limits

Innovative instruments shall not exceed 15 per cent of total Tier I capital. Innovative instruments in excess of the above limits shall be eligible for inclusion under Tier II, subject to limits prescribed for Tier II capital. However, investors' rights and obligations would remain unchanged.

(iv) Maturity period

The innovative instruments shall be perpetual.

(v) Rate of interest

The interest 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.

(vi) Options

Innovative instruments shall not be issued with a 'put option'. However, banks may issue the instruments with a call option subject to strict compliance with each of the following conditions :

(a) Call option may be exercised after the instrument has run for at least ten years; and

(b) Call option shall be exercised only with the prior approval of RBI (Urban Banks Department). 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.

(vii) 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.

(viii) Lock-in-Clause

(a) Innovative instruments shall be subjected to a lock-in-clause in terms of which the issuing bank shall not be liable to pay interest, if

1. the bank's CRAR is below the minimum regulatory requirement prescribed by RBI; OR

2. the impact of such payment results in bank's capital to risk assets ratio (CRAR) falling below or remaining below the minimum regulatory requirement prescribed by Reserve Bank of India;

(b) However, banks may pay interest with the prior approval of RBI when the impact of such payment may result in net loss or increase the net loss, provided the CRAR remains above the regulatory norm.

(c) The interest shall not be cumulative.

(d) All instances of invocation of the lock-in-clause should be notified by the issuing banks to the Chief General Managers-in-Charge of Urban Banks Department, Reserve Bank of India, Central Office, Mumbai.

(ix) Seniority of claim

The claims of the investors in innovative instruments shall be

(a) Superior to the claims of investors in equity shares; and

(b) Subordinated to the claims of all other creditors.

(x) Discount

The innovative instruments shall not be subjected to a progressive discount for capital adequacy purposes since these are perpetual.

(xi) Other conditions

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

2. Compliance with Reserve Requirements

The total amount raised by a bank through innovative instruments will not be reckoned as liability for the calculation of net demand and time liabilities for the purpose of reserve requirements and, as such, will not attract CRR /SLR requirements.