Summary of Instructions Issued by Reserve Bank of India on Repos

Annexure VI

1. Ready Forward (buy-back) deals in Government and other approved Securities:

1.1 In April 1987, banks were advised to follow the guidelines given hereunder in respect of their buy-back arrangements with banks and others :

A. Prohibition against buy-back arrangements in respect of Corporate Securities and Bonds issued by Public Sector Undertakings:

Banks should not enter into buy-back arrangements in respect of their holdings of public sector bonds or corporate shares and debentures.

B. Buy-back arrangements in Government and Other Approved Securities with (non-bank) clients:

(i) The buy-back deals should be exclusively confined to Government and Other Approved Securities and the re-purchase dates should be fixed after a minimum period of 30 days from the date of sale of the securities in question.

(ii) The purchase/sale prices under the arrangement should be in alignment with the proximate market rates prevalent on the date of the original transaction for the relevant Government and Other Approved Securities.

(iii) No sales of Government and Other Approved Securities under the arrangement should be effected by banks unless the same were actually held by them on their own investment portfolio either in the form of actual scrips or in Subsidiary General Ledger (SGL) account maintained with Reserve Bank.

(iv) Immediately on sale, the corresponding amount should invariably be deducted from the investment account of the bank and its SLR assets for the entire period
(v) (minimum 30 days) of holding by the purchasers/counterparty.

(vi) Interest on the securities at coupon rates would be paid by the banks after deduction of tax on the lines indicated in the communication dated 14th August 1986.

C. Inter-Bank Buy-back Arrangement in Government and Other Approved Securities

(i) While inter-bank buy-back transactions in Government and Other Approved Securities may be undertaken for short periods without the stipulation of any minimum period, the net differential in sale and repurchase prices of the securities in question (spread over the transaction period), together with the coupon rate of interest on the securities, should not in aggregate exceed the prevailing ceiling on call-money rate in the inter bank market. In other words, the transactions should be done to yield a net return at the lower of the following :

(a) difference in sale and repurchase price of the securities (spread over the transaction period) together with interest at the coupon rate on the securities in question; or

(b) the prevailing ceiling on call-money rate in the inter-bank market.

(ii) The other stipulation mentioned at B (ii) to (v) above would be equally applicable to transactions with banks

1.2 Banks were also advised that a report on the buy-back arrangements indicating, interalia, profitability of transactions, should be submitted to their Board of Directors on a quarterly basis. Further, they should place before the Board of Directors a copy of this communication for their information, under advice to the Reserve Bank.

1.3 Thereafter, in December 1987, following inquiries from banks whether they could enter into buy-back arrangements in units of Unit Trust of India (UTI) under 1964 Scheme, it was advised that the units were not approved security for buy-back arrangements in terms of the instructions of April 1987.

1.4 As there was a sharp increase in the commitments of banks under buy-back arrangements, they were cautioned in October 1987 to moderate their commitments as a sudden unwinding of these arrangements by investors could result in a serious liquidity bind. However, these commitments remained large and had a depressing effect on the growth of deposits, apart from having an adverse impact on the profitability of banks. The banks were, therefore, prohibited from entering into buy-back arrangements in Government and Other Approved Securities with non-bank clients with effect from 4th April 1988 and were advised that all such existing arrangements must be terminated on the date they expire or 1st July 1988, whichever was earlier.

1.5 Banks were further advised in April 1988 that while they were permitted to undertake outright purchases/sales, such transactions must be effected at market prices. Besides, while existing procedures for outright purchase/sale transactions could be continued, the spirit of the instruction prohibiting buy-back arrangements with non-bank investor was required to be scrupulously observed. It was to be noted that outright sale and purchase transactions with the same party and for identical or similar amounts would be construed by the Reserve Bank as tacit arrangements violating the instructions prohibiting buy-back arrangements with non-bank clients. Accordingly, the instructions conveyed in April 1987, stood modified.

1.6 It was added that banks may continue to enter into buy-back arrangements with other banks (inter-bank) in Government and Other Approved Securities subject to strict adherence to guidelines of April 1987. It was emphasised that the top executives in banks should bestow their special attention to inter-bank buy-back arrangements to ensure that the guidelines on the subject were strictly complied with in both letter and spirit, any deviation/s was/were viewed seriously and accountability fixed at all levels.

1.7 In conclusion, it was advised that a report should be submitted to the Board of Directors setting out compliance with the instructions prohibiting buy-back arrangements with non-bank investors. The position regarding the phased unwinding of buy-back commitments was to be advised to the Reserve Bank at the end of each month and a full compliance report was also to be submitted to it immediately after 1st July 1988.

1.8 In January 1991, banks were informed that it had come to Reserve Bank's notice that some banks had entered into buy-back deals with certain financial institutions like National Bank for Agricultural and Rural Development. Industrial Development Bank of India and Unit Trust of India. It was clarified that buy-back arrangements in Government and Other Approved Securities were permitted between scheduled commercial banks only and for the purpose of the instructions issued in April 1988, financial institutions set up under Acts of Parliment or otherwise, both at the all-India and State levels and not undertaking banking business within the provisions of the Banking Regulations Act, 1949, were deemed as non-bank clients, and banks should not enter into any buy-back arrangements with them.

1.9 In this connection, banks were advised in January 1992 that the issue whether the prevailing 'repos' facilities in 182 days Treasury Bills (Government Securities) by Discount & Finance House of India Ltd. (DFHI) to banks would amount to violation of the instructions of April 1988 and January 1991, was examined by the Reserve Bank. It was clarified that as the basic objective of setting up of DFHI was to facilitate the development of active money market by smoothening short-term liquidity imbalances, DFHI was expected to actively trade in money market instruments, particularly in 182 days Treasury Bills. It was, accordingly, decided to exclude DFHI from the term ''non-bank clients'' for the purpose of buy-back arrangements in Government and Other Approved Securities by commercial banks.

1.10 In June 1992, following the initial recommendations of the Janakiraman Committee, the following instructions were issued regarding 'Ready-Forward' (buy-back) deals :

(i) Banks were prohibited with effect from 22nd June 1992, and until further instructions, from undertaking inter-bank Ready Forward deals in dated Government and Approved/Trustee Securities. Existing deals in dated securities should be completed on due dates without resorting to any extension or roll overs. As such, inter-bank Ready Forward transactions might thereafter be undertaken only in Treasury Bills (of all maturities)

(ii) All double Ready Forward deals in Government securities, including Treasury Bills, were strictly prohibited.

(iii) No Ready Forward and double Ready Forward deals should be put through even among banks, and even on their own Investment Accounts in any other securities, such as Public Sector Undertakings' bonds and units of UTI.

(iv) Similarly, no Ready Forward and double Ready Forward deals should be put through in any security, including Government securities, on behalf of other constituents, including brokers.

1.11 In August 1994, banks were informed that the Notification No.S.O.2561 dated 27th June 1969, issued by the Central Government in exercise of the powers conferred by sub-section (I) of Section 16 of the Securities Contracts (Regulation) Act, 1956, with respect to restriction on sale or purchase of securities, had been further amended, vide Notification No. S.O. (E) dated 1st June 1994 and a copy each of the two Notifications was forwarded to them. (These are furnished in Annexure I.) It was added that in terms of the amended Notification Ready Forward contracts may be entered into by (I) a banking company (ii) a co-operative bank and (iii) the Discount and Finance House of India Ltd. in Treasury Bills of all maturities issued by the Government of India and in such dated securities of the Government of India, as were approved by the Reserve Bank of India, in consulation with the Central Government,

provided all such Ready Forward transactions were put through SGL Account with the Reserve Bank of India.

1.12 Banks were further informed that in pursuance of the aforementioned Notification dated 1st June 1994, the Reserve Bank of India, in consultation with the Government of India, had approved the following four dated securities of the Government of India for the purpose of Ready Forward contracts :

Sl. No.	**Nomenclature of Security**
1)	12.00 percent Government Stock 1995
2)	12.75 percent Government Stock 1996
3)	12.00 percent Government Stock 1999
4)	12.50 percent Government Stock 2004

1.13 In February 1995, banks were advised that the Reserve Bank of India in consultation with the Government of India, had approved the Zero Coupon Bonds, 2000 of the Government of India for the purpose of Ready Forward contracts, in addition to the four dated securities listed in the communication dated 16th August 1994.

1.14 oon thereafter, the banks were advised that the Government of India, vide their Notification F.No. 1/9/SE/94 dated October 18, 1994, (copy furnished in Annexure II), had notified Securities Trading Corporation of India Ltd. as an eligible institution, in addition to the institutions indicated in the communication dated 16th August 1994, to undertake Ready Forward transactions in Treasury Bills and in such dated securities of the Government of India as were approved by the Reserve Bank in consultation with the Government. It would, therefore be in order for banks to enter into Ready Forward transactions in the securities specified above with Securities Trading Corporation of India Ltd.

1.15 Banks were further advised in March 1995 that it had been decided that Ready Forward deals in all the five approved securities (advised in the communications of August 1994 and February 1995) would be permitted only if the transactions were effected at Bombay and the deals were put through SGL Accounts.

1.16 Subsequently, banks were advised through different communications, that they may undertake Ready Froward transactions in the following securities subject to the condition that (a) the transactions were effected at Bombay and (b) the deals were put through SGL Accounts :

(i) 13.25 percent Government Stock, 1997.
(in conversion of 12 percent Government Stock 1995)

(ii) Government of India Zero Coupon Bonds, 2000.
(Second Series).

(iii) 13.65 percent Government Stock, 1998.

(iv) 13.50 percent Government Stock, 1997.

(v) 14.00 percent Government Stock, 2005.

(vi) Government of India Floating Rate Bonds, 1999.

(vii) 13.50 percent Government Stock, 1997.
(Second Issue)

(viii) 14.00 percent Government Stock, 2005.
(Second Issue)

(ix) 14.00 percent Government Stock, 2005.
(Third Issue)

(x) Government of India Floating Rate Bonds, 1999.
(Second Issue).

(xi) 13.85 percent Government Stock, 2000.

1.17 It was observed by the Reserve Bank that Ready Forward transactions were being used for as short a period as one day merely as a change in nomenclature from call money. With a view to ensuring that banks resort to Ready Forward transactions in accordance with the spirit of this facility, banks were advised on 29th September 1995, that effective from 30th September 1995, the minimum period for Ready Forward (repos) transactions will be three days.

2. Need to hold the security before sale

2.1 In July 1991, banks were advised inter alia, that it was observed that certain banks were resorting to buy-back deals in Government Securities amongst themselves without actually holding sufficient securities either in physical form or in their Subsidiary General Ledger (SGL) account (resulting in substitution of Bank Receipts (BRs)/ return of SGL forms for want of sufficient balance), at rates which had no relevance to market, with a view to window-dressing their profitability/ maintenance of SLR requirement, with the tacit understanding with the counter party banks. Some of the banks appeared to be taking outright oversold position in securities and in their desparate bid to cover the oversold position in a particular security/ies they had entered into double Ready Forward deals and other banks had obliged them in the matter.

In this regard, banks were instructed as under :

(i) Under no circumstances, a bank should hold a oversold position in any security; that is to say that no sale transactions should be put through without actually holding the security in its investment account.

(ii) All the transactions put through by a bank, either on outright basis or Ready Forward basis and whether through the mechanism of SGL Account or BR, should be reflected on the same day in its investment account and accordingly for SLR purpose, wherever applicable.

(iii) Any instance of return of SGL form from the Public Debt Office (PDO) of the Reserve Bank for want of sufficient balance in the account should be immediately brought to Reserve Bank's notice with the details of the transactions.

2.2 Not withstanding the issue of the above instructions, irregularities on the part of banks persisted and following the initial recommendations of the Janakiraman Committee, the following comprehensive instructions on the above subject were issued in June 1992 (along with those on other issues relating to investment transactions) :

(i) All transactions in Government securities for which SGL facility was available should be put through SGL Accounts only,

(ii) Before issue of SGL transfer forms covering their sale transactions, banks should ensure that they had sufficient balance in their respective SGL Accounts. Accordingly, under no circumstances, a SGL transfer form issued by a bank in favour of another bank should bounce for want of sufficient balance in the SGL Account. The purchasing banks should issue the cheques only after receipt of the SGL transfer forms from the selling banks.

(iii) The SGL transfer form received by purchasing banks should be deposited in their SGL Accounts immediately. No sale should be effected by way of return of SGL form held by the bank.

(iv) SGL transfer forms should be signed by two authorised officials of the bank whose signatures should be recorded with the respective PDOs of the Reserve Bank and other banks.

(v) The SGL transfer forms should be in the standard format prescribed by the Reserve Bank and printed on semi-security paper of uniform size. They should be serially numbered and there should be a control system in place to account for each SGL form.

(vi) If a SGL transfer form bounces for want of sufficient balance in the SGL Account, the (selling) bank which had issued the form would be liable to the following penal action against it ;-

(a) The amount of the SGL form (cost of purchase paid by the purchaser of the security) would be debited immediately to the current account of the selling bank with the Reserve Bank.

(b) In the event of an overdraft arising in the current account following such a debit, penal interest would be charged by the Reserve Bank on the amount of the over draft at a rate of 3 percentage points above the Discount and Finance House of India's (DFHI) call money lending rate on the day in question, and

(c) If the bouncing of the SGL form occurs thrice, the bank would be debarred from trading with the use of the SGL facility for a period of six months from the occurrence of the third bouncing. If, after restoration of the facility, any SGL form of the concerned bank bounces again, the bank will be permanently debarred from the use of the SGL facility in all the PDOs of the Reserve Bank.

2.4 Thereafter in December 1993, banks were advised [with reference to item (iii) of para. 4.3.3 above] that it was observed that the SGL transfer forms received by the purchasing banks were not being deposited in their SGL Accounts immediately and delays (of as much

as 10 days in certain cases) had been observed. It should, therefore be ensured that SGL transfer forms were lodged in the SGL Accounts with the PDO immediately, i.e. within a maximum period of two working days from the date of transaction. It was added that any delay beyond the above mentioned period would be viewed seriously.

2.5 Subsequently, in respect of item (vi) (b) of para. 4.3.3 above, banks were advised in January 1994 that if the DFHI's closing call money rate was lower than the minimum lending rate of banks, as stipulated in the Reserve Bank's interest rate directive in force, the applicable penal rate to be charged would be 3 percentage point above the minimum lending rate.

3. Internal Control System in respect of investment transactions

3.1 The comprehensive instructions on Investment portfolio issued to banks in June 1992 following the initial Report of the Janakirman Committee included the following on Internal Control System of banks (which have been included in the Chapters on Frauds, Annual Accounts, etc.)

(i) There should be a clear functional separation of (a) trading, (b) settlement, monitoring and control and (c) accounting. Similarly, there should be a functional separation of trading and back office functions relating to banks' own Investment Accounts, Portfolio Management Scheme (PMS) Clients' Accounts and other Constituents' (including brokers') Accounts. While providing portfolio management service to their clients, the banks should strictly follow the guidelines in regard thereto issued by the Reserve Bank on 18th January 1991. (These have been covered separately). Further, PMS Clients' Accounts should be subjected to a separate audit by external auditors.

(ii) For every transaction entered into, the trading desk should prepare a deal slip which should contain data relating to nature of the deal, name of the counterparty, whether it was a direct deal or through a broker, and if through a broker, name of the broker, details of security, amount, price, contract date and time. The deal slips should be serially numbered and controlled separately to ensure that each deal slip had been properly accounted for. Once the deal was concluded, the dealer should immediately pass on the deal slip to the back office for recording and processing. For each deal there must be a system of issue of confirmation to the counterparty. The timely receipt of requisite written confirmation from the counterparty, which must include all essential details of the contract, should be monitored by the back office.

(iii) Once a deal had been concluded, there should not be any substitution of the counterparty bank by another bank by the broker, through whom the deal had been entered into; likewise, the security sold/purchased in the deal should not be substituted by another security.

(iv) On the basis of vouchers passed by the back office (which should be done after verification of actual contract notes received from the broker/counterparty and confirmation of the deal by the counterparty), the Accounts Section should independently write the books of accounts.

(v) In the case of transaction relating to PMS Clients' Accounts (including brokers), all the relative records should give a clear indication that the transaction belonged to

PMS Clients/Other Constituents and did not belong to banks' own Investment Account and the bank was acting only in its fiduciary/agency capacity.

(vi) Records of Subsidiary General Ledger (SGL) transfer forms issued/received, should be maintained. Balances as per bank's books should be reconciled at quarterly intervals with the balances in the books of PDOs. If the number of transactions so warrant, the reconciliation should be undertaken more frequently, say on a monthly basis. This reconciliation should also be periodically checked by the internal audit department. Any bouncing of SGL transfer forms issued by selling banks in favour of the buying bank, should immediately be brought to the notice of the Central Office of the Department of Banking Operations and Development of the Reserve Bank by the buying bank. Similarly, a record of Bank Receipts (BRs) issued/received should be maintained. A system for verification of the authenticity of the BRs and SGL transfer forms received from the other banks and confirmation of authorised signatories should be put in place.

(vii) Banks should put in place a reporting system to report the top management, on a weekly basis, the details of transactions in securities, details of bouncing of SGL transfer forms issued by other banks and BRs outstanding for more than one month and a review of investment transactions undertaken during the period.

(viii) Banks should not draw cheques on their account with the Reserve Bank for third party transactions, including inter-bank transactions. For such transactions, bankers' cheques/pay orders should be issued. (Detailed instructions in this regard have been covered separately.)

(ix) The Internal Audit Department should audit the transactions in securities on an on going basis, monitor the compliance with the laid down managament policies and prescribed procedures and report the deficiencies directly to the management of the bank.

3.2 In this regard, banks were advised in August 1992 that it was the primary responsibility of the bank managements to ensure that there were adequate internal control and audit procedures for ensuring proper compliance of the instructions in regard to the conduct of the investment portfolio. Banks were instructed to undertake an immediate review of the adequacy of their internal audit departments and indicate details of their existing organisational set up and the scope of their operations to the Reserve Bank to enable it to review the adequacy of the internal machinery to oversee the implementation of the instructions given to banks. It was added that banks should also institute a regular system of monitoring compliance with the prudential and other guidelines issued by the Reserve Bank of India. Further, banks were advised to get compliance in key areas certified by their statutory auditors and to furnish such audit certificate to the Reserve Bank.

4. Engagement of brokers for Investment transactions

4.1 In July 1991, banks were advised to frame suitable investment policy. The various guidelines then furnished to them in this regard have been covered separately.) As regards engagement of brokers, they were advised as under :

Transactions between one bank and another bank should not be put through the brokers' accounts. The brokerage on the deal payable to the broker, if any (if the deal was put through with the help of a broker), should be clearly indicated on the notes/memorandum put up to the top management seeking approval for putting through the transaction and separate account of brokerage paid, broker-wise, should be maintained.

4.2 Thereafter, following the initial recommendations made by the Janakiraman Committee, Reserve Bank issued, in June 1992, comprehensive instructions to banks on the various aspects of conduct of their Investments Portfolio. As regards dealings through brokers, the following instructions were issued :

(i) If a deal was put through with the help of a broker, the role of the broker should be restricted to that of bringing the two parties to the deal together.

(ii) While negotiating the deal, the broker was not obliged to disclose the identity of the counterparty to the deal. However, on conclusion of the deal, he should disclose the counterparty and his contract note should clearly indicate the name of the counterparty.

(iii) On the basis of the contract note disclosing the name of the counterparty, settlement of deals between banks, viz., both fund settlement and delivery of security, should be directly between the banks and the borker should have no role to play in the process.

(iv) With the approval of their top managements, banks should prepare a panel of approved brokers which should be reviewed annually, or more often if so warranted. Clear-cut criteria should be laid down for empanelment of brokers, including verification of their creditworthiness, market reputation, etc. A record of broker-wise details of deals put through and brokerage paid, should be maintained.

(v) A disproportionate part of the business should not be transacted through only one or a few brokers. Banks should consider fixing aggregate contract limits for each of the approved brokers and ensure that these limits were not exceeded.

4.3 There after, in December 1992 banks were informed that on a scrutiny of the investment policies evolved by the banks, it was observed that a number of them had not fixed aggregate contract limits for each of the approved brokers (vide item (v) above). The matter was, therefore reviewed by the Reserve Bank and it was decided that a limit of 5% of total transactions (both purchase and sales) entered into by a bank during a year should be treated as the aggregate upper contract limit for each of the approved brokers. This limit should cover both the business initiated by a bank and the business offered/brought to the bank by a broker. Banks should ensure that the transactions entered into through individual brokers during a year normally did not exceed this limit. However, if for any reason it became necessary to exceed the aggregate limit for any broker, the specific reasons therefor should be recorded, in writing, by the authority empowered to put through the deals. Further, the Board should be informed of this, post facto.

4.4 In this regard attention of banks was drawn to the instructions on 'Audit', Review and Reporting' contained in the communication dated 20th June 1992 and it was reiterated that the concurrent auditors who audit the treasury operations should scrutinise this aspect also and include it in their monthly report to the Chief Executive Officer of the bank. Besides, the business put through any individual broker or brokers in excess of the limit, with the reasons therefor, should be covered in the half-yearly review to the Board of Directors/Local Advisory Board. It was added that these instructions shall also apply to subsidiaries and mutual funds of the banks.

4.5 Subsequently, some of the banks sought certain clarrifications on the instructions of December 1992 and these were examined by the Reserve Bank. The clarifications sought and the replies therto, issued in July 1993, are furnished in the Annexure.

4.6 On further review of the matter, banks were advised in November 1994 that it had been decided that inter-bank securities transactions should be undertaken directly between banks and no bank should engage the services of any broker in such transactions. Banks may, however, undertake securities transactions among themselves or with non-bank clients through members of the National Stock Exchange (NSE), wherein the transactions were transparent. Transactions with non-bank clients, if such transactions were not undertaken on the NSE, should be undertaken by banks directly, without engaging brokers.

4.7 Banks were also cautioned that any violation or circumvention of Reserve Bank's instructions would invite penal action against banks, which could include raising of reserve requirements, withdrawal of refinance from the Reserve Bank and denial of access to money market, as also such other penalty under the provisions of the Banking Regulation Act, 1949, as the Reserve Bank may deem fit.

4.8 After the issue of instructions of November 1994, some of the banks sought clarification on the coverage of the term 'securities' appearing therein. Banks were advised in December 1994 that although the Securities Contracts (Regulation) Act, 1956 defines the term 'securities' to mean corporate shares, debentures, Government Securities and rights or interest in securities, for the purpose of the communication dated 16th November 1994, the term 'securities' would exclude corporate shares. Further, as regards the coverage of term 'non-bank clients' appearing in the aforementioned communication, it was clarified that Provident/Pension Funds and Trusts registered under the Indian Trusts Act, 1882, would be outside the preview of the expression 'non-bank clients' for the purpose of that communication.

CLARIFICATIONS

Investment port-folio of banks-Transactions in securities- Aggregate contract limit for individual brokers- clarifications

Sr. No.	Issue Raised	Response
1.	The year should be calendar year or financial year ?	Since banks close their accounts at the end of Marcl it may be more convenient to follow the financi year. However, the banks may follow calendar yea or any other period of 12 months provided, it i consistently followed in future.
2.	Whether the limit is to be observed with reference to total transactions of the previous year as the total transactions of the current year would be known only at the end of the year ?	The limit has to be observed with reference to th year under review. While operating the limit the ban should keep in view the expected turnover of th current year which may be based on turnover of th previous year and anticipated rise or fall in th volume of business in the current year.
3.	Whether to arrive at the total transactions of the year, transactions entered into directly with counter-parties i.e. where no brokers are involved would also be taken into account ?	Not necessary. However, if there are any direct deal with the brokers as purchasers or sellers the sam would have to be included in the total transactions t arrive at the limit of transactions to be done throug an individual broker.
4.	Whether in case of ready forward deals both the legs of the deals i.e. purchase as well as sale will be included to arrive at the volume of total transactions ?	Yes. This is, however, only theoretical as R/ transactions in Govt. securities are now prohibite except in Treasury Bills and the 3 year date securities issued by conversion of Treasury Bill recently
5.	Whether central loan/state loan/treasury bills etc. purchased through direct subscriptions/auction will be included in the volume of total transaction ?	No as brokers are not involved as intermidiaries.
6.	It is possible that even though bank considers that a particular broker has touched the prescribed limit of 5% he may come with an offer during the remaining period of the year which the bank may find it to be to its advantage as compared to offers received from the other brokers who have not yet done business upto the prescribed limit.	If the offer received is more advantageous the lim for the broker may be exceeded, the reasons therefc recorded and approval of the competer authority/Board obtained post facto.
7.	Whether the transaction conducted on behalf of the clients would also be included in the	Yes. If they are conducted through the brokers.

	total transactions of the year ?	
8.	For a bank which rarely deals through brokers and consequently the volume of business is small maintaining the brokerwise limit of 5% may mean splitting the orders in small values amongst different brokers and there may also arise price differential.	There may be no need to split an order. If any dea causes the particular broker's share to exceed 5% limit, our circular provides the necessary fleibility i as much as Board's post facto approval can b obtained.
9.	During the course of the year it may not be possible to reasonably predict what will be the total quantum of transactions through brokers as a result of which there could be deviation in complying with the norm of 5%.	The bank may get post facto approval from the Boar after explaining to it the circumstances in which th limit was exceeded.
10.	Some of the small private sector banks have mentioned that where the volume of business particularly the transactions done through brokers is small the observance of 5% limit may be difficult. A suggestion has therefore been made that the limit may be required to be observed if the business done through a broker, exceeds a cut-off point of, say Rs. 10 crores	As already observed, the limit of 5% can b exceeded subject to reporting the transactions to th competent authority postfacto. Hence, no change i our instructions are considered necessary.

5. Accounting standards for Investments

5.1 The comprehensive instructions issued by the Reserve Bank in April 1992 on Income Recognition, Asset Classification, Provisioning and Other Related Matters included the following on Accounting standards for Investments :
The investment portfolio of a bank would normally consist of both ‘‘approved securities’’ (predominantly Government securities) and ‘‘others’’ (shares, debentures and bonds). It has been decided that the investments in approved securities should be bifurcated into ‘‘permanent’’ and ‘‘current’’ investments. Permanent investments were those which banks intended to hold till maturity and current investments were those which banks intended to deal in, i.e. buy and sell on a day-to-day basis. On this basis, banks should classify the existing investments in approved securities into the aforesaid two categories. To begin with, banks should keep not more than 70 percent of their investments in the permanent category from the accounting year 1992-93. This ratio would have to be brought down to 50 percent in due course. All subsequent purchases would also be required to be classified suitably. Reserve Bank would have no objection to banks inter-changing the investments from one category to another with the prior authorisation of the Board of Directors, in which case depreciation, if any would have to be fully provided for.

5.2 While the depreciation in respect of permanent investments was not likely to affect their realisable value and, therefore, need not be provided for, depreciation in the current investments should be fully provided for. Permanent investments could be valued at cost unless it was more than the face value, in which case the premium has to be amortised over the period remaining for maturity of the security. Banks were not expected to sell securities in the permanent category freely, but if they do so, any loss on such transactions in securities in this category has to be written off. Besides, any gain should be taken to capital reserve account. (It was subsequently advised in December 1992 that banks which experienced difficulties in adopting the above standards could discuss the matter separately with the Reserve Bank.)

5.3 The detailed instructions relating to Investment transactions issued in June 1992 following the initial Report of the Janakiraman Committee, included the following additional instructions/modifications relating to Accounting Standards :

(i) All investments in securities, other than approved securities, should be classified under ‘‘current’’ category and should be valued at market price or cost whichever was less and depreciation should be provided for the shortfall, if any.

(ii) In the instructions of April 1992, the manner in which banks’ investments in approved securities should be bifurcated into ‘‘permanent’’ and ‘‘current’’ categories had been indicated. Dealing securities were marketable securities that were acquired and held with the intention of reselling them in the short term. The financial results arising from such transactions must be seen as volatile, generating trading profit or loss from deliberate position taking. Investment securities, on the other hand, were acquired and held for yield or capital growth purposes (apart from for compliance of SLR requirement) and were usually intended to be held till maturity, except when liquidity needs arise. Unless governed by the special rule described below, gains and losses on sale of securities should be recorded at the time of sale as capital gains/losses. As stated earlier, approved debt securities classified under ‘‘current’’ category should be

carried in the Balance Sheet at market price or cost whichever was lower, wheras approved debt securities classified under ‘‘permanent’’ category should be carried in the Balance Sheet either at book value (cost) or at market value, at the discretion of the banks, subject to their following a consistent accounting policy. Accounting of securities under various categories should be as under :

Approved debt securities under “permanent” category

(a) If the investments were carried at book value, the difference between the acquisition price (acquisition cost) and the redemption price should be accrued over the period from the acquisition to the redemption date and should be recognised as income or expense.

(b) Alternatively, the banks may choose to value such investments, on a consistent basis, at market value.

(c) Should the banks elect to adopt the practice described in (a) above, when the securities were redeemed or sold before the original redemption date, the unaccrued portion of the amount reffered to at (a) above should immediately be charged to the profit and loss account as capital gain or loss, as the case may be.

(d) Should banks elect to follow the practice described in (b) above, the resulting revaluation gains/losses should be recognised as capital gain/loss.

Investments under ‘‘current’’ category

(e) The investment under ‘‘current’’ category should be carried at lower of cost or market value, on a consistent basis.

(f) Costs, such as, brokerage fees, commission or taxes, incurred at the time of acquisition of trading securities, should immediately be recognised as expenses, without any accrual.

(g) The carrying value of securities under current category should be revalued at market prices on a quarterly basis. The gains/losses arising out of this revaluation should not be taken to interest income/expenses accounts. Instead, revaluation gains/losses should be segregated by entering them in specific ‘‘realised/unrealised gains/losses on trading of debt securities’’ account. The net amount of gains/losses from trading of debt securities shall be taken to the income statement.

(iii) Each time a security was acquired, the bank should immediately record whether it was for investment account or for trading account and accordingly account for them in the respective accounts on the basis of laid down accounting policies. Transfer of securities from one account to another (i.e. Investment Account to Trading Account or vice versa) should be done only with the prior approval of the Board of Directors of the bank and should be properly documented.

(iv) Potential losses should be recognised prior to the transfer of securities from ‘‘current’’ category to ‘‘permanent’’ category where market value as on the date of transfer was less than the carrying value in the books.

(v) Banks may treat equity investments in subsidiaries as permanent investment.

5.4 It was clarified in January 1994 that, in respect of Zero Coupon Bonds (issued by Government of India, vide its Notification No. F. 4(5) W & M/93 dated 7th January 1994), the value of these Zero Coupon Bonds for the purpose of determining "cost" may be reckoned after taking into account the accrued discount pro rata. After this adjustment of the "cost", banks could use the standard valuation procedures.

5.5 The clarifications/fresh guidelines issued to banks on 'Income Recognition, etc.' in February 1994, included those relating to 'Valuation of Securities'. Thus, banks were informed that it was observed by the Reserve Bank that the practices followed by banks and auditors differed in respect of valuation of investments in ''current'' category. It was, therefore, decided that the Indian Banks' Association (IBA), in consultation with the Institute of Chartered Accountants of India (ICAI), would evolve a method for valuation of Government and other securities and banks and auditors should adopt the method so evolved while finalising the balance sheet as on 31st March 1994.

5.6 In the context of bifurcation of investments in Government securities into ''permanent'' and ''current'' category, banks were not required to make provisions for depreciation in respect of investments held under ''permanent'' category. Hence, it was not necessary to show the difference between the book value and the market value of the investments under this category as a footnote to the balance sheet and the instructions contained at ''Notes and instructions for compilation of balance sheet and profit and loss account'', advised in February 1992, were withdrawn. However, the difference between the book value and market value could be mentioned by Statutory Auditors in the Long Form Audit Report for the information of the bank's management.

5.7 In this connection, a reference was also invited to the instructions on accounting standards advised in June1992. It was clarified that while banks may, at their option, value the approved debt securities under the ''permanent'' category on a consistent basis at market value, they should refrain from doing so in respect of securities whose market price was higher than the book value (cost) on the balance sheet date. In other words, in these cases it was not permissible to carry these securities at a value higher than cost, as this would result in recognising unrealised gains in respect of such investments.

5.8 At a meeting of the Bank Audit Committee, comprising representatives of the Institute of Chartered Accountants of India (ICAI) and Chairmen of some major banks, held in March 1995, the guidelines on valuation of investments were reviewed and, in the light of the discussions held in the meeting, banks were advised as under in April 1995. :

(i) Valuation of ''permanent'' investments

Banks' attention was drawn to the instructions of June 1992, in terms of which if the ''permanent'' investments were carried at book value, the difference between the acquisition price (acquisition cost) and the redemption price should be accrued over the period from the acquisition to the redemption date and should be recognised as income or expense. Further, in February 1994, it was clarified that while banks may, at their option value the approved debt securities under the ''permanent'' category on a consistent basis at market value, they should refrain from doing so in respect of

securities whose market price was higher than the book value (cost) on the balance sheet date. In other words, in these cases, it would not be permissible to carry these securities at a value higher than face/redemption value as this would result in recognising unrealised gain in respect of such investments. It had since been decided that the ''permanent'' investments should be valued at cost and in case the cost price was higher than the face value, the premium should be amortized over the remaining period of maturity of the security. On the other hand, where the cost price was less than the face value, the difference should be ignored and should not be amortized or taken to income account since the amount represents unrealised gain.

(ii) Investments to be carried at gross or net of depreciation

It was decided that ''investments'' should be shown in the balance sheet net of depreciation. It would, however, be open to the banks, for disclosure purposes, to show in the balance sheet the book value of investments, the depreciation thereagainst and net amount of investments separately.

(iii) Valuation of investments on a quarterly basis

In the instructions of June 1992, it was mentioned that the carrying value of securities under ''current'' category should be revalued at market prices on a quarterly basis. It had since been decided that the investments under ''current'' category should be carried at lower of cost or market value, on a consistent basis and that the valuation should be done on a quarterly basis. In other words, the basis of valuation on quarterly basis would be the same as that followed for annual accounts. It was also decided that the rates of Yield To Maturity (YTM) of different kinds of securities circulated by the Reserve Bank for the final accounts of each year should be used for the subsequent quarters also for the purpose of quarterly valuation of investments. The banks may arrive at on notional basis gains or losses on the basis of such quarterly valuation and it may not be necessary to pass entries booking such gains or losses.

(iv) Treatment of excess depreciation, if any

It was decided that depreciation on ''current'' investments should be shown in the profit and loss account as a debit item under Schedule 14. It was also decided that where depreciation was provided on ''current'' investments but, in a subsequent year, the market price of the relevant securities had improved, the excess provision towards depreciation could be taken to the profit and loss account and, thereafter, it could be appropriated to the ''capital reserve'' account.

(v) Treatment of recapitalisation bonds

The recapitalisation bonds would not form part of ''permanent'' or ''current'' investments. It would not be necessary to provide for depreciation on the recapitalisation bonds received by the nationalised banks from Government. In case, however, banks acquired recapitalisation bonds of other bank for investment purposes, the depreciation, if any, would have to be provided for.

(vi) Modification of percentages in respect of classification of investments under ''permanent'' and ''current'' category

It was advised in June 1992 that, to begin with, banks should keep not more than 70% of their investments in ''permanent'' category for the accounting year 1992-93, which would be brought down to 50% in due course. It was suggested in the

meeting that there was a need for bringing down the ratio to 60:40. It was however, decided to maintain the ratio of approved securities into ‘‘permanent’’ and ‘‘current’’ investments at 70:30 for the year ended 31st March 1995 also.

(vii) Routing of gain from sale of securities
While in April 1992 banks were advised that any gain on sale of securities in the ‘‘permanent’’ category should be taken to ‘‘capital reserve’’ account, it had since been decided that such gain should be first taken to the profit and loss account and thereafter it could be appropriated to the ‘‘capital reserve’’ account.

6. Audit, review and reporting of Investment transactions

For implementing the recommendation contained in the initial Report of the Janakiraman Committee, the following instructions on the captioned subject were issued (alongwith other instructions on conduct of the investment portfolio) :

(i) Banks should undertake a half-yearly review (as of 30th September and 31st March) of their investment portfolio, which should, apart from other operational aspects of investment portfolio, clearly indicate and certify adherence to laid down internal investment policy and procedures and Reserve Bank guidelines, and put up the same before their respective Boards within a month, i.e., by end-April and end-October.

(ii) A copy of the review report put up to the bank’s Board, should be forwarded to the Reserve Bank by 15th November and 15th May respectively.

(iii) In view of the possibility of abuse, treasury transactions should be separately subjected to a concurrent audit by internal auditors and the results of their audit should be placed before the Chairman and Managing Director of the Bank once every month. These audit reports should be sent to the Regional Office of Department of Banking Operations and Development (now to Department of Supervision) of the Reserve Bank under whose jurisdiction the Head Office of the bank fell.

7. Reconciliation of holdings of Government Securities, etc.

7.1 Following the initial report of the Janakiraman Committee, comprehensive guidelines/ instructions regarding the conduct of the Investments Portfolio were issued by the Reserve Bank in June 1992. In regard to the Subsidiary General Ledger (SGL) facility provided at the Public Debt Offices (PDOs) of the Reserve Bank, apart from detailed instructions (which have been covered separately), it was advised that records of SGL transfer forms issued/received, should be maintained by banks. Further, balances as per bank’s book should be reconciled at quarterly intervals with the balances in the book of PDOs. If the number of transactions so warrant, the reconciliation should be undertaken more frequently, say on a monthly basis. This reconciliation should also be periodically checked by the internal audit department. It was also advised that any bouncing of SGL transfer forms issued by selling banks in favour of the buying bank, should immediately be brought to the notice of the Central Office of the Department of Banking Operations and Development (now Department of Supervision) of the Reserve Bank by the buying bank. Similarly, a record of Bank Receipts (BRs) issued/received should be maintained. A system for verification of the authenticity of the BRs and SGL transfer forms received from other banks and confirmation of authorised signatories should be put in place.

7.2 In this connection, banks were further advised in December 1992 that during the course of scrutiny of security transactions of banks/Financial Institutions, instances of shortages in holdings of securities had come to Reserve Bank's notice. Therefore, banks and their subsidiaries/Mutual Funds should reconcile the securities held by them, both on their own Investment Account, as well as Portfolio Management Scheme (PMS), as on 31st December 1992. Further, a reconciliation statement, in the prescribed proforma, should be furnished to the Reserve Bank, duly certified by the bank's auditors. (The format for the Statement is at Annexure I, while the instructions for compiling it are in Annexure II.)

7.3 In this connection, it was clarified in February 1993 that there was no objection to the aforementioned verification/certification being done either by the bank's own internal auditors or by external auditors.

8. Transactions in Securities — Custodial Functions

8.1 In continuation of the detailed instructions in regard to management of investment portfolio of banks, particularly relating to transactions in securities, issued in June 1992, banks were advised in August 1992 that when they exercised custodial functions on behalf of their merchant banking subsidiaries, these functions should be subject to the same procedures and safeguards as would be applicable to other constituents. Accordingly, full particulars should be available with the subsidiaries of banks of the manner in which the transactions had been executed. Banks were instructed to issue suitable instructions in this regard to the department/office undertaking the custodial functions on behalf of their subsidiaries.

8.2 Banks were advised in January 1963 that under Section 6 of the Public Debt Act, 1944, no notice of any trust was receivable by Government in respect of Government securities. Consequently, the Public Debt Office of the Reserve Bank treats, and has to treat, every person, in whose name a Government security stands, as the full owner thereof, even though the said per Son may be having no personal interest in the security but may be holding it merely as a trustee of a particular trust or as an office-holder of a society or a fund, i.e., in a fiduciary or representative capacity. Holding of securities in the personal names of officials or trusts was liable to lead to considerable difficulties under certain circumstances. Since the Public Debt Office was bound to treat the "holder" as the "owner", it followed that if a trustee or office-holders, in whose personal name a security (belonging to a trust or society) was held, dies, the Public Debt Office would refuse to make any payment on the security to the trust or society unless the said trust or society obtained legal representation (i.e. Probate, Letters of Administration or Succession Certificate) in the estate of the deceased trustee/office-holder. As the obtaining of such a grant entailed considerable inconvenience and expenses, the societies or trusts concerned were, as a rule, unwilling to adopt this course and approach the Reserve Bank for relaxations, which the Public Debt Office was understandably reluctant to make, except on the condition that the claimant body executed a bond of indemnity in the Reserve Bank's favour jointly with one or two sureties. Very often, it was difficult for the claimants to arrange for sureties of the requisite financial standing. It also sometimes happened that the office-holder/trustee, in whose favour a security was held, resigned and omitted or refused to transfer the security to his successor-in-office. In such cases, the Public Debt Office was unable to help the real beneficiary whose only course was to bring a suit against the ex-trustee or the ex-official in a civil court for obtaining a proper decree to enable the Public Debt Office to recognise the claimant's title.

It was further mentioned that a body which had a corporate status could, of course, hold Government securities in its corporate name, but this recourse was not available in the case of unincorporated bodies — to which category most trusts, provident funds, etc., usually belonged. The most convenient course for such bodies was to hold securities in the form of Stock Certificates (and not in the form of Government Promissory Notes). Under Rule 8 (2)(b) of Public Debt Rules, 1946, Stock Certificates could be issued in favour of officials/trustees ex-officio without mentioning their personal names, so that in the event of death or resignation, the security could be dealt with immediately by the successor-in-office, without any formality. No question of legal representation or indemnity bond would arise if securities were so held.

Besides the above advantage, holding in stock was very convenient from the point of view of a long-term investor. For example, the periodical interest on Stock Certificates was remitted by the Public Debt Office to the holder or to the holder's bankers on the due date, without any cost to the holder, whereas a Government promissory note had to be physically presented for drawal of interest every time such interest was drawn. Again, if a Government Promissory note was lost, the procedure for obtaining a duplicate was a long and expensive one, whereas a lost/destroyed Stock Certificate could be replaced by the Public Debt Office on the holder merely reporting the loss and executing an affidavit.

It was added that like Stock Certificates, Treasury Savings Deposit Certificates and Defence Deposit Certificates could also be issued in favour of office holders and trustees, ex-officio. Usually, all organisations like provident funds and trusts, made investments through, or on the advice of their bankers and, therefore, the expense and inconvenience caused to the beneficiaries in such cases would be obviated, if banks were to advise the above position to their customers.

Banks were advised that they might, therefore, take note of these instructions and also communicate them to such of their customers as belonged to the above categories with the advice that if any securities were held by their officials/trustees in their personal names, they would be well advised to contact the nearest Public Debt Office for getting the matter regularised.

In conclusion, it was indicated that in case any clarification or further information on any point was required, reference may be made to the Public Debt Office. The stipulation of minimum period of three days for ready forward transactions has been withdrawn from October 31, 1998