PRUDENTIAL NORMS- INVESTMENT PORTFOLIO BY BANKS

Short Sale

Short Sale' is defined as sale of securities one does not own. Banks undertake short sale of Central Government dated securities, subject to the short position being covered within a maximum period of five trading days, including the day of trade. A bank can also undertake 'notional' short sale where it can sell a security short from HFT even if the security is held under its HFT/AFS/HTM book. There are certain conditions under which the Banks can undertake the Short Sale transactions as elaborated in the RBI Master Circular dt. 01.07.2013.

‘When Issued Market ‘

‘When, as and if issued’ (commonly known as ‘when-issued’ (WI)) security refers to a security that has been authorized for issuance but not yet actually issued. ‘WI’ trading takes place between the time a new issue is announced and the time it is actually issued. The mechanics of operation of WI is detailed in the RBI Circular.

Policy and internal control mechanisms (Short Sale/WI)

Banks are required to have in place a written policy giving the guidelines/instructions duly approved by Board before undertaking short sale/WI transactions. Besides this, the transactions are to be verified by concurrent auditors in respect of compliance with the instructions, as well as with internal guidelines and report violations, if any, to the respective Public Debt Office (PDO) where the Subsidiary General Ledger (SGL) account is maintained and Internal Debt Management Department, RBI, Mumbai.

Investment Policy

■ Banks are required to frame Internal Investment Policy Guidelines with proviso to include Primary Dealer (PD) activities duly approved by respective Boards. The PD business undertaken by the bank will be limited to dealing, underwriting and market-making in Government Securities. Other Investments in corporate/PSUs/FI bonds, CPs, CDs, debt MF, and other fixed income securities will not be deemed to be part of PD business.

■ Banks are permitted to undertake **investment in equity shares/ debentures** subject to have in place adequate expertise in equity research by establishing a dedicated equity research department as warranted by their scale of operations.

■With the approval of respective Boards, banks may clearly lay down the broad investment objectives to be followed while undertaking transactions in securities on their own investment account and on behalf of clients. While framing the policy guidelines, RBI instructions may strictly be observed in respect of:-

1) **STRIPS**

"STRIPS" (Separate Trading of Registered Interest and Principal of Securities) are distinct, separate securities that are created from the cash flows of a Government security and shall consist of -

■ Coupon STRIPS, where the single cash flow of the STRIP represents a coupon flow of the
original security

■ Principal STRIP, where the single cash flow of the STRIP represents the principal cash flow of the original security.

<u>Explanation:</u> Stripping of a security shall result in Coupon STRIPS for all outstanding coupon payments and one Principal STRIP for the redemption payment. Each STRIP accordingly becomes a zero coupon bond since it has only one cash flow at maturity. Each STRIP shall be a distinct Government security and shall have a separate and distinct International Securities Identification Number (ISIN).

b)"Stripping" means the process of separating the cash flows associated with a regular Government security i.e., each outstanding semi-annual coupon payment and the final principal payment into separate securities.

c) "Reconstitution" means the reverse process of stripping, where the individual STRIPS i.e., both coupon STRIPS and Principal STRIPS are reassembled to get back the original security.

d) "Authorized entity" means a Primary Dealer or any other entity recognized by the RBI to accept requests from the holders of Government Securities for stripping/reconstitution of the securities and submission to the RBI.

The terms and conditions for STRIPS include, among others:-

■ All dated Government securities other than floating rate bonds having coupon payment dates on 2nd January and 2nd July, irrespective of the year of maturity shall be eligible for Stripping/Reconstitution and they are carried out at Public Debt Office, RBI in the PDO-NDS (Negotiated Dealing System)

■ Stripping/reconstitution shall be permitted only in the eligible Government securities held in the Subsidiary General Leger (SGL)/Constituent Subsidiary General Ledger (CSGL) accounts maintained at the Public Debt Office, RBI. Physical securities shall not be eligible for stripping/reconstitution.

■ The amount of securities that could be tendered for stripping/reconstitution shall be a minimum of Rs.1 crore and multiples thereof. RBI will not charge any fees on stripping/reconstitution.

■ STRIPS will be reckoned as eligible Government Securities for SLR purposes. Short sale of STRIPS not permitted.

2) Ready Forward (buy Back) deals in G-Sec

The terms and conditions subject to which ready forward contracts (including reverse ready forward contracts) may be entered into are as under:

■ Ready forward contracts may be undertaken only in (i) Dated Securities and Treasury Bills issued by Government of India and (ii) Dated Securities issued by State Governments.

■ Ready forward contracts in the above-mentioned securities may be entered into by:
i) Persons or entities maintaining a Subsidiary General Ledger (SGL) Account with RBI, Mumbai, and
ii) Entities who do not maintain SGL accounts with the RBI but maintain gilt accounts (i.e gilt account holders) with a bank or any other entity (i.e. the custodian) permitted by the RBI to maintain Constituent Subsidiary General Ledger (CSGL) account with its Public Debt Office, Mumbai, such as:-

■ Any Scheduled Bank
■ Any Primary Dealer authorized by RBI.
■ Any Non-Banking Financial Company (NBFC) registered with the Reserve Bank, other than ■ Government companies as defined in Section 617 of the Companies Act, 1956.
■ Any mutual fund registered with the SEBI.
■ Any housing finance company registered with the National Housing Bank (NHB)).
■ Any insurance company registered with the Insurance Regulatory and Development Authority (IRDA).
■ Any non-scheduled Urban Co-operative bank.
■ Any listed company, having a gilt account with a scheduled commercial bank, subject to certain conditions as listed out in the RBI Circular, etc.

All persons or entities specified at (ii) above can enter into ready forward transactions among themselves subject to the following restrictions:-

i) An SGL account holder may not enter into a ready forward contract with its own constituent. That is, ready forward contracts should not be undertaken between a custodian and its gilt account holder,
ii) Any two gilt account holders maintaining their gilt accounts with the same custodian (i.e., the CSGL account holder) may not enter into ready forward contracts with each other, and

iii) Cooperative banks may not enter into ready forward contracts with NBFCs. This restriction would not apply to repo transactions between Urban Co-operative banks and authorised PDs in Government Securities.

■ All ready forward contracts including ready forward contracts involving gilt account holders shall be reported on the Negotiated Dealing System (NDS).

■ All ready forward contracts shall be settled through the SGL Account / CSGL Account maintained with the RBI, Mumbai, with the Clearing Corporation of India Ltd. (CCIL) acting as the central counter party for all such ready forward transactions.

■ The custodians should put in place an effective system of internal control and concurrent audit.

■ The RBI regulated entities can undertake ready forward transactions only in securities held in excess of the prescribed Statutory Liquidity Ratio (SLR) requirements.

■ No sale transaction shall be put through, in the first leg of a ready forward transaction by CSGL constituent entities without actually holding the securities in the portfolio.

■ Securities purchased under the ready forward contracts shall not be sold during the period of the contract except by entities permitted to undertake short selling,

■ Double ready forward deals in any security are strictly prohibited, etc.

3) Transactions through SGL account

■ Banks are required to follow the instructions for purchase/sale of securities through SGL A/c. under Delivery Versus Payment system wherein the transfer of securities takes place simultaneously with the transfer of funds, as under:-

■ All transactions in Govt. securities for which SGL facility is available are to be put through SGL A/c. only.

■ Under no circumstances, a SGL transfer form issued by a bank in favour of another bank bounce for want of sufficient balance of securities in the SGL A/c of seller or for want of sufficient balance of funds in the current a/c of the buyer.

■ The SGL transfer form received by purchasing banks need to be deposited in their SGL A/cs. immediately i.e. the date of lodgment of the SGL Form with RBI shall be within one working day after the date of signing of the Transfer Form.

■ No sale should be effected by way of return of SGL form held by the bank, etc.

4) Use of Bank Receipt (BR)

■ No BR can be issued under any circumstances in respect of transactions in Govt. securities for which SGL facility is available.

■ Even in the case of other securities, BR may be issued for ready transactions only (under certain circumstances).

■ No BR can be issued on the basis of a BR (of another bank) held by the bank and no transaction can take place on the basis of a mere exchange of BRs held by the bank.

■ BRs could be issued covering transactions relating to banks' own Investments Accounts only, and no BR can be issued by banks covering transactions relating to either the Accounts of Portfolio Management Scheme (PMS) Clients or Other Constituents' Accounts, including brokers.

■ No BR remains outstanding for more than 15 days.

■ A BR can be redeemed only by actual delivery of scrips and not by cancellation of the transaction/set off against another transaction.

■ Maintenance of Separate registers of BRs and banks should also have a proper system for the custody of unused B.R. Forms and their utilization, etc.

5) Retailing of Government Securities

The banks may undertake retailing of Government securities with non-bank clients subject to the following conditions:

■ Such retailing can be on outright basis and there is no restriction on the period between sale and purchase.

■ The retailing of Government securities may be on the basis of ongoing market rates/ yield curve emerging out of secondary market transactions.

6) Internal Control System

■ There must be a clear functional separation of (i) trading, (ii) settlement, monitoring and control and (iii) accounting, besides 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.

■ Compliance of all other operational instructions in respect of accounting, recording, & reconciliation of balances at quarterly intervals with the balances in the books of PDOs.

■ Any bouncing of SGL transfer forms issued by selling banks in favour of the buying bank may immediately be brought to the notice of the Regional Office of Department of Banking Supervision of RBI by the buying bank.

■ Banks are required to put in place a reporting system to report to the top management, on a weekly basis

■ The banks' management is supposed to ensure that there are adequate internal control and audit procedures for ensuring proper compliance of the instructions in regard to the conduct of the investment portfolio, etc.

7) Engagement of brokers

■ Transactions between one bank and another bank cannot be put through the brokers' accounts.

■ If a deal is put through with the help of a broker, the role of the broker is restricted to that of bringing the two parties to the deal together.

■ With the approval of their top managements, banks may prepare a panel of approved brokers which may be reviewed annually or more often if so warranted. A disproportionate part of the business should not be transacted through only one or a few brokers.

■ Proper monitoring/scrutiny of the business done through the brokers need be carried out by the concurrent auditors who audit the treasuring operations and report to CEO of Bank for review by its Board on half yearly basis.

■ Inter-bank securities transactions can be undertaken directly between banks and no bank can engage the services of any broker in such transactions of course with some exceptions, etc.

8) Audit, review and reporting

■ Half yearly review (as on 30th September and 31st March) of the investment portfolio certifying compliance of RBI guidelines and report to respective Boards within a month i.e. by end-April, and end-October and a copy thereof to be forwarded to RBI by 15th May and 15th November on an on-going basis

■ The treasury operations need be separately subjected to concurrent and internal audit and their reports need be placed before the CMD of the bank once in every month and major irregularities and their compliance are to be included in the half yearly review.

Non-SLR Investment

Considering the significant investment in privately placed unrated bonds both from borrowers as well as from non-borrowers and in the absence of standardized and mandated disclosures, including credit rating, Banks are not be in a position to conduct proper due diligence to take an investment decision leading to chances of deficiencies in the appraisal.

In order to minimize the inadequacies in the disclosure offer for private placements, a disclosure format containing the minimum disclosure requirement and other conditions thereof has been designed which serve as a 'best practice model' for the banks (Recommendations of the Technical Group appointed by RBI). Banks are required to have an Investment Policy duly approved by respective Boards taking into account various factors such as investment in bonds and debentures, degree of credit risk, internal control system, etc. The banks are required to put in place proper risk management systems for capturing and analyzing the risk in respect of these investments and taking remedial measures in time.

Prudential guidelines on investment in Non-SLR securities

Coverage

Prudential Guidelines cover banks' investments in non-SLR securities issued by corporate, banks, FIs, State & Central Government sponsored institutions, SPVs etc. including capital gains bonds eligible for priority sector status. The guidelines will apply to investments both in the primary market as well as the secondary market.

The Listing & Rating guidelines pertaining to non-SLR securities are not applicable to banks' investments in securities issued by State & Central Governments (which are not reckoned for SLR purposes), Equity shares, Units of equity oriented mutual fund schemes, Equity/debt instruments / Units issued by Venture Capital funds, CP, CDs, and NCDs with original or initial maturity of less than 1 year issued by corporate.

Regulatory Requirements

Banks cannot invest in Non-SLR securities of original maturity of less than one-year, other than CP and CD and NCDs with original or initial maturity up to one year issued by corporate. (Including NBFCs).

Banks may undertake usual due diligence in respect of investments in non- SLR securities.

Listing and rating requirements

Banks cannot invest in unrated non-SLR securities except in unrated bonds of companies engaged in infrastructure activities, within the ceiling of 10% for unlisted non-SLR securities.

Fresh investments in non-SLR debt securities, banks are required to ensure that such investment are made only in listed debt securities of companies which comply with the requirements of the SEBI.

Fixing of prudential limits

■ Bank's investment in unlisted non-SLR securities should not **exceed 10 per cent** of its total investment in non-SLR securities as on March 31, of the previous year, and such investment should comply with the disclosure requirements as prescribed by the SEBI for listed companies.

■ If the security is within the time lag between issuance and listing of securities and is proposed to be listed in Exchange(s), the same may be considered as investment in listing security at the time of making investment and if security is not listed within the specified period, the investment is to be reckoned for the 10% limit.

■ In case of breach of the 10 per cent limit, the bank would not be allowed to make further investment in non-SLR securities (both primary and secondary market) as also in unrated bonds issued by companies engaged in infrastructure activities till such time bank's investment in unlisted non-SLR securities comes within the limit of 10 per cent.

■ Bank's investment in unlisted non-SLR securities is permitted **further 10%** upto a maximum limit of **20%** of non-SLR investment , provided the investment is on account of investment in Securitization papers issued for infrastructure projects, and bonds/debentures issued by SCs and RCs set up under the SARFEASI Act 2002and registered with RBI.

■ Investment in 'unlisted non-SLR securities' in respect of Security Receipts issued by SCs/RCs registered with RBI, Asset Backed Securities (ABS) and Mortgage Backed Securities (MBS) which are rated at or above the minimum investment grade, convertible debentures will not be reckoned for computing the prudential limit (convertible debentures to be treated as 'capital exposure).

■ Investments in RIDF/SIDBI/RHDF Deposits not to be reckoned for computing the limit.

■ Banks whose investment in unlisted non-SLR securities are within the prudential limit of 10% of its total non-SLR securities as on March 31 of the previous year may make fresh investments in such securities and upto the prudential limits.

Trading and Settlement in Corporate Debt Securities

In addition to complying with the SEBI guidelines that all trades with the exception of the spot transactions, in a listed debt security, shall be executed only on the trading platform of a stock exchange, banks should ensure that all spot transactions in listed and unlisted debt securities are reported on the NDS and settled through the CCIL from a date to be notified by RBI.

All OTC trades in corporate bonds shall necessarily be cleared and settled through the NSCCL or ICCL as per the norms specified by the NSCCL and the ICCL from time to time

Repo in Corporate Debt Securities

Eligible entities can undertake repo in corporate debt securities which are rated 'AA' or above by the rating agencies, that are held in the security account of the repo seller, in demat form. However, Commercial Papers (CPs), Certificates of Deposit (CDs) and other instruments including Non-Convertible Debentures (NCDs) of less than one year of original maturity shall not be eligible securities for undertaking repo in corporate debt securities.

Limits on Banks' Exposure to Capital Markets

The aggregate exposure of a bank to the capital markets in all forms (both fund based and non-fund based) shall not **exceed 40% of its net worth** as on March 31 of the previous year on Solo Basis and **40% on Consolidated Net Worth** in case of on Consolidated Basis. Within this overall ceiling, the bank's direct investment in shares, convertible bonds / debentures, units of equity-oriented mutual funds and all exposures to Venture Capital Funds (VCFs) [both registered and unregistered] should not **exceed 20 per cent** of its net worth/consolidated net worth.

General

Transactions in securities - Custodial functions

Custodial functions on behalf of their merchant banking subsidiaries are subject to the same procedures and safeguards as would be applicable to other constituents and subsidiaries should have full details of the transactions. Suitable instructions in this regard to be issued by Banks to the department/office undertaking the custodial functions on behalf of their subsidiaries.

Portfolio Management (PMS) on behalf of clients

Banks are not permitted to undertake PMS and similar schemes without RBI specific approval. However, bank-sponsored NBFCs are allowed to offer discretionary PMS to their clients, on a case-to-case basis for which applications should be submitted to the DBOD, RBI, World Trade Centre, Mumbai.

Classification

The entire investment portfolio of the banks (including SLR securities and non-SLR securities) should be classified under three categories, viz.

a. 'Held to Maturity' (HTM)
b. 'Available for Sale' (AFS) and
c. 'Held for Trading'. (HFT).

a. 'Held to Maturity' (HTM)

The securities acquired by the banks with the intention to hold them up to maturity will be classified under 'Held to Maturity **(**HTM**)'**. Banks are allowed to include investments included under HTM category **upto 25% of their total investments**.

Banks may hold the following securities under HTM:_

■ SLR Securities up to 25% of their DTL as on the last Friday of the second preceding fortnight.
■ Non-SLR securities included under HTM as on September 2, 2004.
■ Fresh re-capitalization bonds received from the Government of India towards their re-capitalization requirement and held in Investment portfolio.
■ Fresh investment in the equity of subsidiaries and joint ventures
■ RIDF/SIDBI/RHDF deposits.
■ Investment in long-term bonds (with a minimum residual maturity of seven years) issued by companies engaged in infrastructure activities.

Profit on sale of investments in this category should be first taken to P & L Account and thereafter be appropriated to the 'Capital Reserve Account' net of taxes and amount required to be transferred to Statutory Reserves.

b) Available for Sale (AFS) & Held for Trading (HFT)

The securities acquired by the banks with the intention to trade by taking advantage of the short-term price/interest rate movements will be classified under 'Held for Trading (HFT)'.

The securities which do not fall within the above two categories i.e. HTM & HFT will be classified under 'Available for Sale (AFS)'.

The banks will have the freedom to decide on the extent of holdings under HFT and AFS considering various aspects such as basis of intent, trading strategies, risk management capabilities, tax planning, manpower skills, capital position etc.

The investments classified under HFT would be those from which the bank expects to make a gain by the movement in the interest rates/market rates. These securities are to be sold within **90** days. Profit or loss on sale of investments in both the categories will be taken to the Profit & Loss Account.

Shifting among categories

Banks may shift investments to/from HTM once a year, normally at the beginning of the accounting year with the approval of the Board of Directors. No further shifting to/from HTM will be allowed during the remaining part of that accounting year. However, in order to enable banks to shift their SLR securities from the HTM category to AFS / HFT once in each it has been decided to allow such shifting at the beginning of each quarter during 2013-14. Banks may shift investments from AFS to HFT with the approval of their Board of Directors/ ALCO/ Investment Committee.

Shifting of investments from HFT to AFS is generally not allowed. However, it will be permitted only under exceptional circumstances like not being able to sell the security within 90 days due to tight liquidity conditions, or extreme volatility, or market becoming unidirectional, of course, with the approval of the Board of Directors/ ALCO/ Investment Committee.

Transfer of scrip from AFS / HFT category to HTM category should be made at the lower of book value or market value.

Balance Sheet classification/allocation

The investments continue to be disclosed in the Balance Sheet under six heads as under:-

a.	Government securities	d.	Debentures & Bonds
b.	Other approved securities	e.	Subsidiaries / Joint Ventures
c.	Shares	f.	Others (C.P., Mutual Fund Units, etc.

Banks to decide the category of the investment at the time of acquisition and the decision should be recorded on the investment proposals.

Valuation

Held to Maturity (HTM)

Investments classified under HTM need not be marked to market and will be carried at acquisition cost, unless it is more than the face value, in which case the premium should be amortized over the period remaining to maturity.

Banks may recognize any diminution, other than temporary, in the value of their investments in subsidiaries/ joint ventures, which are included under HTM and provide therefore.

The need to determine whether impairment has occurred is a continuous process and the need for such determination will arise in the following circumstances:-

a) Happening of an impairment which includes :
   i. The company has defaulted in repayment of its debt obligations.
   ii. The loan amount of the company with any bank has been restructured.
   iii. The credit rating of the company has been downgraded to below investment grade.

b) When the company has incurred losses for a continuous period of three years and the net worth has consequently been reduced by 25% or more.

c) The company or the project has not achieved break-even within the gestation period as originally envisaged.

Available for Sale (AFS)

The individual scrip in the category will be marked to market at quarterly or at more frequent intervals. Domestic Securities and foreign investments under this category shall be valued scrip-wise and depreciation/ appreciation shall be aggregated for investment classifications (viz. Government securities (including local authorities), Shares, Debentures & Bonds, Subsidiaries and/or joint ventures abroad and other investments (to be specified).

Held for Trading (HFT)

The individual scrip in the HFT category will be marked to market at monthly or at more frequent intervals and provided for as in the case of those in the AFS category. Consequently, the book value of the individual securities in this category would also not undergo any change after marking to market.

Investment Fluctuation Reserve & Investment Reserve Account

Investment Fluctuation Reserve
With a view to building up of adequate reserves to guard against any possible reversal of interest rate environment in future due to unexpected developments, banks were advised to build up Investment Fluctuation Reserve (IFR) of a minimum **5%** of the investment portfolio within a period of 5 years.

Investment Reserve Account (IRA)
Investment Reserve Account (IRA) represents the excess depreciation provision in the 'AFS' or 'HFT' categories credited to the Profit & Loss account and an equivalent amount (net of taxes, if any and net of transfer to Statutory Reserves as applicable to such excess provision) is appropriated to an IRA Account under the head "Revenue and other Reserves", and the same is eligible for inclusion under Tier-II within the overall ceiling of 1.25 per cent of total Risk Weighted Assets prescribed for General Provisions/ Loss Reserves.

Market value

The market value for periodical valuation of investments is carried out as under:-

Investment/Security	Basis	Sources
Investments under AFS/HFT category	Trades/Quotes	Stock Exchanges, SGL Account transactions, price list of RBI, prices declared by Primary Dealers Association of India (PDAI) jointly with the Fixed Income Money Market and Derivatives Association of India (FIMMDA) periodically.

Unquoted SLR securities

Investment/Securi	Basis	Sources

ty		
Central Government	Prices/ YTM rates. The 6% Capital Indexed Bonds at "cost" and Treasury Bills at carrying cost.	PDAI jointly with the FIMMDA periodically.
State Government securities / Other 'approved' Securities	YTM - by marking it up by 25 bps above the yields of the Central Govt. Securities	Put up by PDAI/ FIMMDA periodically.

Unquoted Non-SLR securities

Debentures/ Bonds	YTM - with appropriate mark-up over the YTM rates for Central Government securities	PDAI/ FIMMDA periodically
Zero coupon bonds (ZCBs)	Carrying cost / acquisition cost plus discount accrued at the rate prevailing at the time of acquisition.	FIMMDA
Preference Shares	YTM - mark-up over the YTM rates for Central Govt. securities (with grading according to the ratings assigned)	PDAI/FIMMDA periodically
Equity Shares	Marked to market preferably on a daily/ but at least on a weekly basis. Unquoted shares at break-up value from its latest Balance Sheet	Stock Exchange Quotes (In case quotes/ BS not available, shares are to be valued at Re.1 per company)
Mutual Funds Units (MF Units)	Repurchase price by the MF (scheme wise)/ NAV if RP is not available/ cost if NAV not available till end of lock-in –period	Stock Exchange Quotes
Commercial Paper	Carrying Cost	Corporate
Investments in RRBs	Carrying Cost (Book value)	RRBs
Investments in SC/	Carrying Cost	SC /RC

RC	(Redemption Value of SRs/PTCs)	
Investment in VCFs	Held under AFS (Quoted Equity) – marked to market on daily / at least weekly basis. Unquoted shares/ bonds/ units held under HTM(initial 3 years) at cost. Afterwards, transfer to AFS	Stock Exchange Quotes / VCFs Balance sheets

Non-Performing Investments (NPI)

In respect of securities included in any of the three categories where interest/ principal is in arrears, the banks should **not** reckon income on the securities and should also make appropriate provisions for the depreciation in the value of the investment. The banks should not set-off the depreciation requirement in respect of these non-performing securities against the appreciation in respect of other performing securities.

The norms applicable for NPA Advance in respect of overdue interest/instalment unpaid for more than 90 days, would apply mutatis-mutandis to Preference shares wherein fixed dividend is not paid/declared.

State Government guaranteed investments

Investment in State Government guaranteed securities, including those in the nature of 'deemed advance', will attract prudential norms for identification of non-performing investments and provisioning, when interest/ instalment of principal (incl. maturity proceeds) or any other amount due to the bank remains unpaid for more than 90 days.

Bank's investments in bonds guaranteed by Central Government need not be classified as non-performing investments (NPI) until the Central Government have repudiated the guarantee when invoked. However, this exemption from classification as NPI is not for the purpose of recognition of income.

Uniform Accounting for Repo/Reverse Repo Transactions

■ Repo transaction, viz., borrowing (lending) of funds by selling (purchasing) securities shall be reflected in the books of the repo participants, by accounting the same as collateralized lending and borrowing transaction, with an agreement to repurchase, on the agreed terms.
■ The revised accounting guidelines effective from April 1, 2010 are applicable to market repo transactions in government securities and corporate debt securities and they are applicable to repo/reverse repo transactions conducted under the Liquidity Adjustment Facility (LAF) with RBI.

■ Market participants may undertake repos from any of the three categories of investments, viz., Held For Trading, Available For Sale and Held To Maturity.

■ The first leg of the repo transaction should be contracted at the prevailing market rates. The reversal (second leg) of the transaction shall be such that the difference between the consideration amounts of first and second legs should reflect the repo interest.

■ The accounting procedure to be followed is explained in the RBI Master Circular dt. 01.07.13.

General

Income recognition

■ Income can be recognized on securities of corporate bodies/public sector undertakings wherein the interest and principal have been guaranteed by State or Central Government provided interest is serviced regularly and not in arrears.

■ Banks may book income from dividend on shares of corporate bodies on accrual basis provided dividend on the shares has been declared by the corporate body in its Annual General Meeting and the owner's right to receive payment is established.

■ Banks may book income from Government securities and bonds and debentures of corporate bodies on accrual basis, where interest rates on these instruments are predetermined and provided interest is serviced regularly and is not in arrears.

■ Banks can book income from units of mutual funds on cash basis.

Broken Period Interest

■ Broken Interest paid to seller should be treated as expenditure under P & L in respect of investments in Government and other approved securities.

■ For dematerialized Holding Banks should settle the transactions in securities as notified by SEBI only through depositories.

Investment in Zero Coupon Bonds issued by corporate

In view of high credit risk involved, Banks are not supposed to invest in long term Zero Coupon Bonds (ZCBs) issued by corporate (including those issued by NBFCs) unless the issuer builds up sinking fund for all accrued interest and keeps it invested in liquid investments/securities (Government bonds). Further, banks are also required to put in place conservative limits for their investments in ZCBs.

(Source: RBI M. Circular dt. 1.7.13)

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