

**RESERVE BANK OF INDIA  
DEPARTMENT OF NON-BANKING REGULATION  
CENTRAL OFFICE, CENTRE I, WORLD TRADE CENTRE  
CUFFE PARADE, COLABA MUMBAI - 400 005.**

**RBI/DNBR/2016-17/42**

**Master Direction DNBR.PD.004/03.10.119/2016-17**

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**Master Direction - Standalone Primary Dealers (Reserve Bank) Directions, 2016**

The Reserve Bank of India (the Bank), having considered it necessary in the public interest, and being satisfied that, for the purpose of enabling the Bank to regulate the financial system to the advantage of the country and to prevent the affairs of any Standalone Primary Dealer (SPD) from being conducted in a manner detrimental to the interest of investors or in any manner prejudicial to the interest of such SPD, and in exercise of the powers conferred under Section 45JA, 45L and 45M of the Reserve Bank of India Act, 1934 (2 of 1934), hereby issues to every SPD, in supersession of the list of circulars as provided for in Chapter XI, the Directions hereinafter specified.

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## **Section – I Introduction**

### **Chapter – I PRELIMINARY**

#### **1. Short Title and Commencement.**

- (1) These Directions shall be called the **Standalone Primary Dealers (Reserve Bank) Directions, 2016**
- (2) These directions shall come into force with immediate effect.

#### **2. Applicability**

- (1) The provisions of these Directions shall apply to all Standalone Primary Dealers (SPDs) registered as non-banking financial company with the Bank.
- (2) This Direction consolidates the regulations as issued by Department of Non-Banking Regulation, Reserve Bank of India. However, any other Directions/guidelines issued by any other Department of the Bank, as applicable to a Standalone Primary Dealer shall be adhered to by it.

### **Chapter II Definitions**

#### **3. For the purpose of these Directions, unless the context otherwise requires:**

- (i) "Act" means the Reserve Bank of India Act, 1934;
- (ii) "Bank" means the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act, 1934
- (iii) Subordinated Debt (SD): means an instrument which is fully paid-up, unsecured, subordinate to the claims of other creditors, free of restrictive clauses, and shall not be redeemable at the initiative of the holder or without the consent of the Bank. SD instruments with an initial maturity of less than 5 years or with a remaining maturity of less than one year shall not be included as part of Tier-II capital. SD instruments eligible to be reckoned as Tier-II capital will be limited to 50 percent of Tier-I capital. The issuance shall be in adherence to the Guidelines on SD Bonds (Tier-II Capital), as provided in Annex I. The SD instruments shall be subjected to progressive discount at the rates shown below:

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

(iv) Tier-I capital means paid-up capital, statutory reserves and other disclosed free reserves. Investment in subsidiaries (where applicable), intangible assets, losses in current accounting period, deferred tax asset and losses brought forward from previous accounting periods will be deducted from the Tier-I capital.

In case any SPD is having substantial interest/exposure (as defined for NBFCs) by way of loans and advances not related to business relationship in other Group companies, such amounts will be deducted from its Tier-I capital.

(v) Tier-II capital includes the following:

- i. Undisclosed reserves and cumulative preference shares<sup>1</sup> (other than those which are compulsorily convertible into equity). Cumulative preferential shares shall be fully paid-up and shall not contain clauses which permit redemption by the holder.
- ii. Revaluation reserves, discounted at a rate of fifty five percent.
- iii. General provisions and loss reserves (to the extent these are not attributable to actual diminution in value or identifiable potential loss in any specific asset and are available to meet unexpected losses), up to a maximum of 1.25 percent of total risk weighted assets.
- iv. Hybrid debt capital instruments, which combine certain characteristics of equity and debt.
- v. Subordinated debt

**4.** Words or expressions used but not defined herein and defined in the RBI Act shall have the same meaning as assigned to them in the RBI Act. Any other words or expressions not defined in the RBI Act or any of the Directions issued by the Bank,

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<sup>1</sup> Cumulative preference shares (prefs) will accumulate any dividend that is not paid when due and no dividends can be paid on ordinary shares until the entire backlog of unpaid dividends on cumulative prefs is cleared.

shall have the meanings respectively assigned to them under the Companies Act, 1956 or Companies Act, 2013 (Act 18 of 2013) as the case may be.

### **Chapter III Registration**

5. In exercise of the powers conferred under clause (b) of sub-section (1) of section 45-IA of the Reserve Bank of India Act, 1934 (Act 2 of 1934) and all the powers enabling it in that behalf, the Bank, hereby specifies two hundred lakhs rupees as the net owned fund (NOF) required for a non-banking financial company to commence or carry on the business of non-banking financial institution, except wherever otherwise a specific requirement as to NOF is prescribed by the Bank. Authorisation to act as a Standalone Primary Dealer is subject to the NBFC fulfilling the eligibility conditions as prescribed by Internal Debt Management Department of the Bank from time to time.

### **Section –II Prudential Issues**

### **Chapter IV Capital Funds and Capital Requirements**

#### **6. Capital Funds**

Capital funds include Tier-I and Tier-II capital.

#### **7. Minimum CRAR Ratio**

SPDs are required to maintain a minimum Capital to Risk-Weighted Assets Ratio (CRAR) of 15 per cent on an ongoing basis.

#### **8. Measurement of Risk Weighted Assets**

The details of credit risk weights for various on-balance sheet and off-balance sheet items and methodology of computing the risk weighted assets for the credit risk are listed in **Annex II**. The procedure for calculating capital charge for market risk is detailed in **Annex III**.

#### **9. Capital Adequacy requirements**

- (i) The capital charge for credit risk and market risk as indicated in **Annex II** and **Annex III**, shall be maintained at all times.

(ii) In calculating eligible capital, it will be necessary first to calculate the SPD's minimum capital requirement for credit risk, and thereafter its market risk requirement, to establish how much Tier-I and Tier-II capital is available to support market risk. Of the 15% capital charge for credit risk, at least 50% shall be met by Tier-I capital, that is, the total of Tier-II capital, if any, shall not exceed one hundred per cent of Tier-I capital, at any point of time, for meeting the capital charge for credit risk.

(iii) Subordinated debt as Tier-II capital shall not exceed 50 per cent of Tier-I capital.

(iv) The total of Tier-II capital shall not exceed 100% of Tier-I capital.

(v) Eligible capital will be the sum of the whole of the SPD's Tier-I capital, plus all of its Tier-II capital under the limits imposed, as summarized above.

(vi) The overall capital adequacy ratio will be calculated by establishing an explicit numerical link between the credit risk and the market risk factors, by multiplying the market risk capital charge with 6.67 i.e. the reciprocal of the minimum credit risk capital charge of 15 per cent.

(vii) The resultant figure shall be added to the sum of risk weighted assets worked out for credit risk purpose. The numerator for calculating the overall ratio will be the SPD's total capital funds (Tier-I and Tier-II capital, after applicable deductions, if any). The calculation of capital charge is illustrated in **Annex IV**.

## 10. Diversification of SPD Activities

(i) The guidelines on diversification of activities by SPDs shall be as contained in the Operational Guidelines for Primary Dealers issued vide [Master Direction IDMD.PDRD.01/03.64.00/2016-17 dated July 01, 2016](#) in addition to that prescribed in these directions.

(ii) The capital charge for market risk {Value-at-Risk (VaR) calculated at 99 per cent confidence level, 15-day holding period, with multiplier of 3.3} for the activities defined below shall not be more than 20 per cent of the Net Owned Fund<sup>2</sup> (NOF) as per the last audited balance sheet:

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<sup>2</sup> In terms of the explanatory note to Section 45-IA of Chapter III-B of the RBI Act, 1934, NOF is calculated as (a) the aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance-sheet of the company after deducting there from– (i) accumulated balance of loss; (ii) deferred revenue expenditure; and (iii) other intangible assets; and (b) further reduced by the amounts representing– (1) investments of such company in shares of– (i) its subsidiaries; (ii) companies in the same group; (iii) all other non-banking financial companies; and (2) the book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease

- (a) Investment / trading in equity and equity derivatives
- (b) Investment in units of equity oriented mutual funds
- (c) Underwriting public issues of equity
- (d) Participation in Currency Futures Market

(iii) SPDs shall calculate the capital charge for market risk on the stock positions/ underlying stock positions /units of equity oriented mutual funds using Internal Models (VaR based) as per the directions contained in Annex VII of the Operational Guidelines for Primary Dealers issued vide [Master Direction IDMD.PDRD.01/03.64.00/2016-17 dated July 01, 2016](#). As regards credit risk arising out of exposure in equity, equity derivatives and equity oriented mutual funds, SPDs shall calculate the capital charge as per the guidelines prescribed in **Annex II**.

## **Chapter V Sources and Application of Funds**

### **11. Sources of funds**

(1) SPDs are permitted to borrow funds from call/notice/term money market, repo (including CBLO) market, Inter-Corporate Deposits, FCNR (B) loans, Commercial Paper and Non-Convertible Debentures. They are also eligible for liquidity support from the Bank.

#### **(2) Call/Notice Market**

(i) SPDs are allowed to borrow from call/notice market, on an average in a 'reporting fortnight', up to 225 percent of their NOF as at the end March of the preceding financial year. They may lend up to 25 percent of their NOF in call/notice money market, on an average in a 'reporting fortnight'. These limits on borrowing and lending are subject to periodic review by the Bank. SPDs are governed by the provisions of the RBI [Master Circular FMRD.DIRD. 01/14.01.001/2015-16 dated July 1, 2015](#) on "Call/Notice Money Market Operations" and as amended from time to time,

### **(3) Inter-Corporate Deposits (ICDs)**

(i) ICDs may be raised by SPDs as per their funding needs. The SPDs shall put in place a Board approved policy for ICDs which takes due consideration of the associated risks and shall include the following general principles:

- a) The ICD borrowings shall in no case exceed 150 per cent of the NOF as at the end of March of the preceding financial year.
- b) ICDs accepted by SPD shall be for a minimum period of one week.
- c) ICDs accepted from parent/promoter/group companies or any other related party shall be on 'arm's length basis' and disclosed in financial statements as "related party transactions".
- d) Funds raised through ICDs are subject to ALM discipline.

(ii) SPDs are prohibited from placing funds in ICD market.

### **(4) FCNR (B) loans / External Commercial Borrowing**

(i) SPDs may avail of FCNR(B) loans up to a maximum of 25% of the NOF as at the end of March of the preceding financial year and subject to the foreign exchange risk of such loans being hedged at all times at least to the extent of 50 per cent of the exposure.

SPDs are governed by the provisions of the [RBI Circular IDMC.PDRS.No. 3820 /03.64.00/2002-03 dated March 24, 2003](#), as amended from time to time, on "Availment of FCNR (B) Loans by Primary Dealers (PDs)".

(ii) SPDs are **not** permitted to raise funds through External Commercial Borrowings.

### **(5) Non-Convertible Debentures (NCDs):**

SPDs may issue NCDs of maturity up to one year, without the requirement of having a working capital limit with a bank. They shall be governed by the directions, "Issuance of Non-Convertible Debentures (Reserve Bank) Directions, 2010", issued vide circular [RBI/2009-10/505-IDMD.DOD.10/11.01.01\(A\)/2009-10 dated June 23, 2010](#), as amended from time to time.

### **(6) Commercial Paper**

Issuance of Commercial Paper by SPDs shall be as per "Guidelines for Issue of Commercial Paper" issued vide [RBI Master Circular](#)



[FMRD.DIRD.02/14.01.002/2015-16 dated July 1, 2015](#) and as amended from time to time.

## **12. Application of Funds**

(1) SPDs are permitted to undertake a set of core and non-core activities. SPDs which undertake only the core activities shall maintain a minimum NOF of ₹ 150 crore. SPDs which also undertake non-core activities shall maintain a minimum NOF of ₹.250 crore.

(2) The investment in G-Sec must have predominance over the non-core activities in terms of investment pattern. SPDs shall ensure predominance by maintaining at least 50 per cent of their total financial investments (both long term and short term) in G-Sec at any point of time. Investment in G-Sec shall include the SPD's Own Stock, Stock with the Bank under Liquidity Support / Intra-day Liquidity (IDL)/ LAF, Stock with market for repo borrowings and G-Sec pledged with the CCIL.

(3) An SPD's investment in G-Sec (including T-Bills and CMBs) and Corporate Bond (to the extent of 50% of NOF) on a daily basis shall be at least equal to its net call/notice/repo (including CBLO) borrowing plus net RBI borrowing (through LAF/ Intra-Day Liquidity/ Liquidity Support) plus the minimum prescribed NOF.

(4) The following are permitted under core activities:

- (i) Dealing and underwriting in G-Sec,
- (ii) Dealing in Interest Rate Derivatives,
- (iii) Providing broking services in G-Sec,
- (iv) Dealing and underwriting in Corporate / PSU / FI bonds/ debentures,
- (v) Lending in Call/ Notice/ Term/ Repo/ CBLO market,
- (vi) Investment in Commercial Papers (CPs),
- (vii) Investment in Certificates of Deposit (CDs),
- (viii) Investment in Security Receipts issued by Securitization Companies/ Reconstruction Companies, Asset Backed Securities (ABS), Mortgage Backed Securities (MBS),
- (ix) Investment in debt mutual funds where entire corpus is invested in debt securities,
- (x) Investments in NCDs, and
- (xi) Dealing in Credit Default Swaps.

(5) SPDs are permitted to undertake the following non-core activities:

(i) Activities which are expected to consume capital such as:

- a) Investment / trading in equity and equity derivatives market,
- b) Investment in units of equity oriented mutual funds,
- c) Underwriting public issues of equity, -
- d) Participation in Currency Futures Market, and
- e) offer foreign exchange products to their FPI clients as permitted by the Bank from time to time.

(ii) Services which may not require significant capital outlay such as:

- a) Professional Clearing Services,
- b) Portfolio Management Services,
- c) Issue Management Services,
- d) Merger & Acquisition Advisory Services,
- e) Private Equity Management Services,
- f) Project Appraisal Services,
- g) Loan Syndication Services,
- h) Debt restructuring services ,
- i) Consultancy Services,
- j) Distribution of mutual fund units, and
- k) Distribution of insurance products.

(iii) For distribution of insurance products, SPDs are advised to make an application along with necessary particulars duly certified by their statutory auditors to the Regional Office of Department of Non-Banking Supervision under whose jurisdiction the registered office of the SPD is situated. SPDs may take up insurance agency business on fee basis and without risk participation, without the approval of the Bank subject to the certain eligibility conditions. The Detailed Guidelines are as provided for in **Annex V**.

(iv) SPDs registered with the Bank are allowed to distribute mutual fund products subject to compliance with the SEBI guidelines / regulations, including its code of conduct, for distribution of mutual fund products. The detailed guidelines are as provided in **Annex VI**.

(v) Specific approvals of other regulators, if needed, shall be obtained for undertaking the activities detailed above.

(vi) SPDs are **not** allowed to undertake broking in equity, trading / broking in commodities and gold.

(vii) The exposure to non-core activities shall be subject to the regulatory and prudential norms for diversification of activities by SPD as provided for in the Directions.

(viii) SPDs choosing to diversify into non-core business segments shall define internally the scope of diversification, organization structure and reporting levels for those segments. They shall clearly lay down exposure and risk limits for those segments in their Board approved investment policy.

(6) The exposure to core and non-core activities of SPD shall be subject to risk capital allocation (credit risk & market risk) as prescribed in Chapter IV of these Directions.

## **Chapter VI Prudential Regulations**

### **13. Accounting Standards for securities transactions**

(1) All securities in trading portfolio shall be marked to market, at appropriate intervals.

(2) Costs such as brokerage fees, commission or taxes incurred at the time of acquisition of securities, are of revenue/deferred nature. The broken period interest received/paid also gets adjusted at the time of coupon payment. SPDs can adopt either the IAS or GAAP accounting standards, but have to ensure that the method shall be true and fair and shall not result in overstating the profits or assets value. It shall be followed consistently and be generally acceptable especially to the tax authorities.

(3) Broken period interest paid to seller as part of cost on acquisition of Government and other securities shall not be capitalized but treated as an item of expenditure

under Profit and Loss Account. The SPDs may maintain separate adjustment accounts for the broken period interest.

(4) The valuation of the securities portfolio shall be independent of the dealing and operations functions and shall be done by obtaining the prices declared by FIMMDA periodically.

(5) SPDs shall publish their audited annual results in leading financial dailies and on their website in the format prescribed (**Annex VII**). The following minimum information shall be included by way of notes on accounts to the Balance Sheet:

- (i) Net borrowings in call (average and peak during the period),
- (ii) Basis of valuation,
- (iii) Leverage Ratio (average and peak),
- (iv) CRAR (quarterly figures), and
- (v) Details of the issuer composition of non-G-Sec investments.

SPDs may also furnish more information by way of additional disclosures.

#### **14. Exposure Norms**

(1) The extant exposure norms for SPDs are as follows:

- (i) The exposure shall not exceed 25 percent of Net Owned Funds (NOF) as per last audited accounts in case of a single borrower/counterparty and 40 percent of NOF in case of a group borrower/counterparty except for investments in AAA rated corporate bonds wherein exposure shall not exceed 50 percent of Net Owned Funds (NOF) as per last audited accounts in case of a single borrower/counterparty and 65 percent of NOF in case of a group borrower/counterparty.
- (ii) The ceilings on single /group exposure limit shall not be applicable where principal and interest are fully guaranteed by the Government of India.
- (iii) SPDs shall include credit risk exposures to all other categories of non-Government securities including investments in mutual funds, commercial papers, certificate of deposits, positions in OTC derivatives not settled through Qualifying CCP (QCCP) etc. to compute extent of credit exposure to adhere to the prescribed prudential limits.
- (iv) Clearing exposure to a QCCP shall be kept outside of the exposure ceiling of 25 per cent of its NOF applicable to a single counter party.

- (v) Clearing exposure to QCCP shall include trade exposure and default fund exposure as defined in the guidelines on capital requirements for SPDs' exposure to central counterparties issued vide [Circular IDMD.PCD.11/14.03.05/2013-14 dated March 27, 2014](#) and as amended from time to time.
- (vi) Other permissible exposures to QCCPs such as investments in the capital of CCP etc. shall continue to be within the existing exposure ceiling of 25 per cent of NOF to a single borrower/counterparty. However, all exposures of a SPD to a non-QCCP shall be within the exposure ceiling of 25 per cent.
- (vii) Presently, there are four CCPs viz. Clearing Corporation of India Ltd. (CCIL), National Securities Clearing Corporation Ltd. (NSCCL), Indian Clearing Corporation Ltd. (ICCL), and MCX-SX Clearing Corporation Ltd. (MCX-SXCCL) that are subjected, on an ongoing basis, to rules and regulations that are consistent with CPSS-IOSCO Principles for Financial Market Infrastructures. While the CCIL has been granted the status of a QCCP by the Bank, the other three CCPs have been granted the status of QCCP by SEBI.

(2) SPDs shall calculate exposure for various items as per the Directions contained in Chapter IV of these Directions.

### **Section – III Governance Issues**

#### **Chapter VII Corporate Governance**

##### **15. Constitution of Committees of the Board**

###### **(1) Audit Committee**

(i) SPDs shall constitute an Audit Committee, consisting of not less than three members of its Board of Directors.

**Explanation I:** The Audit Committee constituted by an SPD as required under Section 177 of the Companies Act, 2013 shall be the Audit Committee for the purposes of this paragraph.

**Explanation II:** The Audit Committee constituted under this paragraph shall have the same powers, functions and duties as laid down in Section 177 of the Companies Act, 2013.

(ii) The Audit Committee must ensure that an Information System Audit of the internal systems and processes is conducted at least once in two years to assess operational risks faced by the SPDs.

### **(2) Nomination Committee**

SPDs shall form a Nomination Committee to ensure 'fit and proper' status of proposed/ existing directors.

**Explanation I :** The Nomination Committee constituted under this paragraph shall have the same powers, functions and duties as laid down in Section 178 of the Companies Act, 2013.

### **(3) Risk Management Committee**

To manage the integrated risk, SPDs shall form a Risk Management Committee, besides the Asset Liability Management Committee.

## **16. Fit and Proper Criteria**

(1) SPDs shall

- (i) ensure that a policy is put in place with the approval of the Board of Directors for ascertaining the fit and proper criteria of the directors at the time of appointment, and on a continuing basis. The policy on the fit and proper criteria shall be on the lines of the Guidelines contained in **Annex VIII**;
- (ii) obtain a declaration and undertaking from the directors giving additional information on the directors. The declaration and undertaking shall be on the lines of the format given in **Annex IX**;
- (iii) obtain a Deed of Covenant signed by the directors, which shall be in the format as given in **Annex X**;
- (iv) furnish to the Bank a quarterly statement on change of directors, and a certificate from the Managing Director of the SPD that fit and proper criteria in selection of the directors has been followed. The statement must reach the Regional Office of the Department of Non-Banking Supervision of the Bank where the company is registered, within 15 days of the close of the respective quarter. The statement

submitted by SPD for the quarter ending March 31, shall be certified by the auditors.

Provided that the Bank, if it deems fit and in public interest, reserves the right to examine the fit and proper criteria of directors of any SPD.

## **17. Disclosure and transparency**

(1) SPDs shall put up to the Board of Directors, at regular intervals, as may be prescribed by the Board in this regard, the following:

- (i) the progress made in putting in place a progressive risk management system and risk management policy and strategy followed by the SPD;
- (ii) conformity with corporate governance standards viz., in composition of various committees, their role and functions, periodicity of the meetings and compliance with coverage and review functions, etc.

(2) SPDs shall also disclose the following in their Annual Financial Statements, with effect from March 31, 2015:

- (i) registration/ licence/ authorisation, by whatever name called, obtained from other financial sector regulators;
- (ii) ratings assigned by credit rating agencies and migration of ratings during the year;
- (iii) penalties, if any, levied by any regulator;
- (iv) information namely, area, country of operation and joint venture partners with regard to Joint ventures and overseas subsidiaries and
- (v) Asset-Liability profile, extent of financing of parent company products, NPAs and movement of NPAs, details of all off-balance sheet exposures, structured products issued by them as also securitization/ assignment transactions and other disclosures, as given in **Annex XI**.

(3) In respect of penalty levied by the Bank, a Press Release will be issued by the Bank, giving details of the circumstances under which the penalty is imposed on the SPD along with the communication on the imposition of penalty in public domain.

## **18. Rotation of partners of the Statutory Auditors Audit Firm**

SPDs shall rotate the partner/s of the Chartered Accountant firm conducting the audit, every three years so that same partner does not conduct audit of the company continuously for more than a period of three years. However, the partner so rotated will be eligible for conducting the audit of the SPD after an interval of three years, if the SPD, so decides. SPD shall incorporate appropriate terms in the letter of appointment of the firm of auditors and ensure its compliance.

## **19. Framing of Internal Guidelines**

SPDs shall frame their internal guidelines on corporate governance with the approval of the Board of Directors, enhancing the scope of the guidelines without sacrificing the spirit underlying the above guidelines and it shall be published on the company's web-site, if any, for the information of various stakeholders.

### **Section IV Miscellaneous Issues**

#### **Chapter - VIII Miscellaneous Instructions**

## **20. Change in shareholding pattern**

Any change in the shareholding pattern / capital structure of a SPD shall need prior approval of the Bank. SPDs shall report any other material changes such as business profile, organization, etc. affecting the conditions of licensing as SPD to the Bank immediately.

## **21. Norms for Ready Forward transactions**

SPDs are permitted to participate in ready forward (Repo) market both as lenders and borrowers in corporate debt securities and Government securities subject to directions issued by FMRD and IDMD vide [circulares FMRD.DIRD.03/14.03.002/2014-15 dated February 3, 2015](#), [FMRD.DIRD.6/14.03.002/2016-17 dated August 25, 2016](#) and [IDMD.PDRS.05/10.02.01/2003-04 dated March 29, 2004](#), respectively, as amended from time to time. Further, such NBFCs participating in repo transactions shall comply with guidelines on uniform accounting for repo/ reverse repo transactions issued by IDMD vide [circular IDMD/4135/11.08.43/2009-10 dated March 23, 2010](#)



and [FMRD.DIRD.10/14.03.002/2015-16 dated May 19, 2016](#), as amended from time to time.

2. An SPD shall not enter into a repo in Corporate Debt Securities with its own constituent or facilitate a repo between two of its constituents

3. Listed companies can enter into repo transactions subject to the following condition:

Where the listed company is a 'buyer' of securities in the first leg of the repo contract (i.e. lender of funds), the custodian through which the repo transaction is settled should block these securities in the gilt account and ensure that these securities are not further sold or re-repoed during the repo period but are held for delivery under the second leg.

## **22. Portfolio Management Services by SPDs**

(1) SPDs may offer Portfolio Management Services (PMS) to their clients under the SEBI scheme of PMS, subject to the following conditions:

- (i) Before undertaking PMS, the SPD must have obtained the Certificate of Registration as Portfolio Manager from the SEBI and also a specific approval from the Bank.
- (ii) PMS cannot be offered to any RBI regulated entity. However, advisory services can be provided to them with suitable disclaimers.
- (iii) Where applicable, the clients regulated by any other authority should obtain clearance from the regulatory or any other authority before entering into any PMS arrangement with the SPD.
- (iv) SPDs are required to comply with the SEBI (Portfolio Managers) Regulations, 1993 and any amendments issued thereto or instructions issued there under.

(2) SPDs shall adhere to the under noted conditions:

- (i) A clear mandate from the PMS clients shall be obtained and the same shall be strictly followed. In particular, there should be full understanding on risk disclosures, loss potential and the costs (fees and commissions) involved.
- (ii) PMS shall be entirely at the customer's risk without guaranteeing, either directly or indirectly, any return.
- (iii) Funds/securities, each time they are placed with the SPD for portfolio management, shall not be accepted for a period less than one year.

- (iv) Portfolio funds shall not be deployed for lending in call/notice/term money/Bills rediscounting markets, badla financing or lending to/placement with corporate/non-corporate bodies.
- (v) Client-wise accounts/records of funds accepted for management and investments made there against shall be maintained and the clients shall be entitled to get statements of account at frequent intervals.
- (vi) Investments and funds belonging to PMS clients shall be kept segregated and distinct from each other and from those of the SPD. As far as possible, all client transactions shall be executed in the market and not off-set internally, either with the SPD or any other client. All transactions between the SPD and any PMS client or between two PMS clients shall be strictly at market rates.

### **23. Guidelines on Interest Rate Derivatives**

(1) SPDs shall adhere to the guidelines applicable to interest rate derivatives as laid down in [circular DBOD.No.BP.BC.86/21.04.157/2006-07 dated April 20, 2007](#) and Interest Rate Futures (Reserve Bank) Directions, 2013 dated December 05, 2013, as amended from time to time. SPDs are allowed to deal in Interest Rate Futures (IRFs) for both hedging and trading on own account and not on client's account, as given in the [circular IDMD.PDRD.No.1056/03.64.00/2009-10 dated September 1, 2009](#) and as amended from time to time.

(2) As per RBI [circular IDMD/11.08.15/809/2007-08 dated August 23, 2007](#), SPDs shall report all their IRS/FRA trades, except with clients, on the CCIL reporting platform within 30 minutes from the deal time. Further, as per [circular FMD.MSRG.No.94/02.05.002/2013-14 dated December 4, 2013](#), all transaction with clients in INR FRA/IRS shall be reported before 12 noon of the following business day.

### **24. Guidelines on Credit Default Swaps**

SPDs shall adhere to the guidelines laid down in [circular IDMD.PCD.No.10/14.03.04/2012-13 dated January 07, 2013](#) as applicable to Credit Default Swaps.

SPDs intending to act as market makers in CDS shall fulfill the following criteria:

- (i) Minimum Net Owned Funds of ₹ 500 crore
- (ii) Minimum CRAR of 15 percent
- (iii) Have robust risk management systems in place to deal with various risks

The regulatory approval to SPDs to act as market makers in the CDS market would be accorded by the Chief General Manager, Internal Debt Management Department, Central office, RBI, Mumbai on a case by case basis, on application for the same.

## **25. Guidelines on investments in non-G-Sec**

(1) SPDs shall adhere to guidelines on investments in non-G-Sec (including capital gain bonds, bonds eligible for priority sector status, bonds issued by Central or State public sector undertakings with or without Government guarantees and bonds issued by banks and financial companies) generally issued by corporate, banks, FIs and State and Central Government sponsored institutions, Special Purpose Vehicles (SPVs), etc. These guidelines will, however, not be applicable to

- (i) units of equity oriented mutual fund schemes where any part of the corpus can be invested in equity,
- (ii) venture capital funds,
- (iii) CPs,
- (iv) CDs, and
- (v) investments in equity shares.

The guidelines will apply to investments both in the primary and secondary market.

(2) SPDs are permitted to become members of SEBI approved Stock Exchanges for the purpose of undertaking proprietary transactions in corporate bonds. While doing so, SPDs shall comply with all the regulatory norms laid down by SEBI and all the eligibility criteria/rules of stock exchanges.

(3) In terms of instructions contained in the Master Direction – Operational Guidelines for Primary Dealers issued vide [Master Direction IDMD.PDRD.01/03.64.00/2016-17 dated July 01, 2016](#), SPDs are allowed a sub-limit of 50% of NOF for investment in corporate bonds within the overall permitted average fortnightly limit of 225 per cent of NOF as at the end of March of the preceding financial year for call /notice money market borrowing.

(4) SPDs shall not invest in non-G-Sec of original maturity of less than one year, other than NCDs, CPs and CDs, as provided for in Master Direction on Money Market Instruments: Call/Notice Money Market, Commercial Paper, Certificates of Deposit and Non-Convertible Debentures (original maturity up to one year) vide

[FMRD.Master Direction No. 2/2016-17 dated July 07, 2016](#). SPDs are permitted to invest in NCDs with original or initial maturity up to one year issued by the corporates (including NBFCs). However, their investments in such unlisted NCDs shall not exceed 10 per cent of the size of their non-G-Sec portfolio on an on-going basis. While investing in such instruments, SPDs shall be guided by the extant prudential guidelines in force and instructions contained in the [circulars IDMD.DOD.10/11.01.01\(A\)/2009-10 dated June 23, 2010](#), [IDMD.PCD.No.24/14.03.03/2010-11 dated December 6, 2010](#) and [IDMD.PCD.08/14.03.03/2011-12 dated August 23, 2011](#) as amended from time to time.

(5) SPDs shall undertake usual due diligence in respect of investments in non-G-Sec.

(6) SPDs shall not invest in unrated non-G-Sec.

(7) SPDs shall abide by the requirements stipulated by SEBI in respect of corporate debt securities. Accordingly, while making fresh investments in non-Government debt securities, SPDs shall ensure that such investments are made only in listed debt securities, except to the extent indicated in (6) above.

(8) SPD's investment in unlisted non-G-Sec shall not exceed 10% of the size of their non-G-Sec portfolio on an on-going basis. The ceiling of 10% shall be inclusive of investment in Security Receipts issued by Securitization Companies/Reconstruction Companies and also the investment in ABS and MBS. The unlisted non-Government debt securities in which SPDs shall invest up to the limits specified above, should comply with the disclosure requirements as prescribed by the SEBI for listed companies.

(9) As per SEBI guidelines, 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. All entities regulated by the Reserve Bank shall report their secondary market OTC trades in Corporate Bonds and Securitized Debt Instruments within 15 minutes of the trade on any of the stock exchanges (NSE, BSE and MCX-SX). These trades may be cleared and settled through any of the clearing corporations (NSCCL, ICCL and MCX-SX CCL).

(10) SPDs shall ensure that their investment policies are formulated after taking into account all the relevant issues specified in the guidelines on investment in non-G-Sec. They should put in place proper risk management systems for capturing and analysing the risk in respect of non-G-Sec before making investments and taking remedial measures in time. SPDs shall also put in place appropriate systems to ensure that investment in privately placed instruments is made in accordance with the systems and procedures prescribed under respective SPD's investment policy.

(11) Boards of the SPDs shall review the following aspects of investment in non-G-Sec at least at quarterly intervals:

- (i) Total business (investment and divestment) during the reporting period.
- (ii) Compliance with the prudential limits as well as prudential guidelines prescribed by the Board for investment in non-G-Sec.
- (iii) Rating migration of the issuers/ issues held in the SPD's books.

(12) In order to help creation of a central database on private placement of debt, a copy of all offer documents shall be filed with the Credit Information Bureau (India) Ltd. (CIBIL) by the SPDs. Further, any default relating to interest/ installment in respect of any privately placed debt shall also be reported to CIBIL by the investing SPDs along with a copy of the offer document.

## **26. Trading of G-Sec on Stock Exchanges**

(1) With a view to encouraging wider participation of all classes of investors, including retail, in G-Sec, trading in G-Sec through a nationwide, anonymous, order driven screen based trading system on stock exchanges, in the same manner in which trading takes place in equities, has been permitted. Accordingly, trading of dated G-Sec in demat form is allowed on automated order driven system of the National Stock Exchange (NSE) of India, the Bombay Stock Exchange Ltd., Mumbai (BSE), the Over the Counter Exchange of India (OTCEI) and the MCX Stock Exchange. This trading facility is in addition to the reporting/trading facility in the NDS. Being a parallel system, the trades concluded on the exchanges will be cleared by their respective clearing corporations/clearing houses.

(2) SPDs shall play an active role in providing liquidity to the G-Sec market and promote retailing. They shall, therefore, make full use of the facility to distribute G-Sec to all categories of investors through the process of placing and picking-up orders on the exchanges. SPDs may open demat accounts with a Depository Participant (DP) of NSDL/CDSL in addition to their accounts with RBI. Value free transfer of securities between SGL/CSGL and own demat account is enabled by PDO-Mumbai subject to guidelines issued by Department of Government and Bank Accounts (DGBA), RBI.

(3) For trading of G-Sec on Stock Exchanges the following shall be adhered to by SPDs:

- (i) SPDs shall take specific approval from their Board to enable them to trade in the Stock Exchanges.
- (ii) SPDs shall undertake transactions only on the basis of giving and taking delivery of securities.
- (iii) Brokers/trading members shall not be involved in the settlement process. All trades shall be settled either directly with clearing corporation/clearing house (in case they are clearing members) or else through clearing member custodians.
- (iv) The trades done through any single broker shall also be subject to the current regulations on transactions done through brokers.
- (v) A standardized settlement on T+1 basis of all outright secondary market transactions in G-Sec has been adopted to provide the participants more processing time for transactions and to help in better funds as well as risk management.
- (vi) In the case of repo transactions in G-Sec, however, market participants will have the choice of settling the first leg on either T+0 basis or T+1 basis, as per their requirements.
- (vii) Any settlement failure on account of non-delivery of securities/ non-availability of clear funds will be treated as SGL bouncing and the current penalties in respect of SGL transactions will be applicable. Stock Exchanges will report such failures to the respective PDOs.
- (viii) SPDs who are trading members of the Stock Exchanges may have to put up margins on behalf of their non-institutional client trades. Such margins are required to be collected from the respective clients. SPDs shall not pay up margins on behalf of their client trades and incur overnight credit exposure to their clients. In so far as

the intraday exposures on clients for margins are concerned, the SPDs shall be conscious of the underlying risks in such exposures.

(ix) SPDs who intend to offer clearing /custodial services shall take specific approval from SEBI in this regard. Similarly, SPDs who intend to take trading membership of the Stock Exchanges shall satisfy the criteria laid down by SEBI and the Stock Exchanges.

## **27. Participation of SPDs in Currency Futures Market**

SPDs are permitted to deal in currency futures contracts traded on recognized exchanges subject to the following conditions:

### **(1) Eligibility:**

i. Exposure to currency futures shall be treated as a non- core activity for SPDs and only SPDs having a minimum Net Owned Fund of ₹ 250 crore or any amount as prescribed for undertaking diversified activity shall be allowed to participate in currency futures.

ii. As prescribed in the Directions on capital requirements, the capital charge for market risk for the non-core activities (including currency futures) which are expected to consume capital shall not be more than 20 per cent of the NOF as per last audited balance sheet.

### **(2) Membership:**

i. SPDs are permitted to participate in the currency futures market either as clients or direct trading / clearing members of the currency derivatives segment of the Stock Exchanges recognized by SEBI.

ii. SPDs shall trade only on their own account and they are not permitted to take positions on behalf of clients.

### **(3) Position limits:**

i. SPDs are permitted to take long and short positions in the currency futures market with or without having an underlying exposure subject to the position limits specified by the exchanges. However, the aggregate gross open positions across all contracts in all the stock exchanges in the respective currency pairs shall not exceed the limits as mentioned below:

<b>Currency Pairs</b>	<b>Position Limits</b>
USD-INR	Gross open position across all contracts shall not exceed 15% of the total open interest or USD 50 million, whichever is higher.
EUR-INR	Gross open position across all contracts shall not exceed 15% of the total open interest or EUR 25 million, whichever is higher.
GBP-INR	Gross open position across all contracts shall not exceed 15% of the total open interest or GBP 25 million, whichever is higher.
JPY-INR	Gross open position across all contracts shall not exceed 15% of the total open interest or JPY 1000 million, whichever is higher.

**(4) Risk Management:**

- i. SPDs shall lay down detailed guidelines on risk management including exposure, risk limits and reporting requirements with Board's approval for conduct of this activity and management of risks.
- ii. SPDs shall put in place appropriate system to ensure strict adherence to the above prescribed position limits.
- iii. SPDs shall maintain adequate infrastructure in terms of systems and manpower for participation in currency futures.

**(5) General:**

- i. For capital adequacy purpose, SPDs shall adhere to the guidelines given in **Annex XII** to this circular and other instructions prescribed in the Directions for providing capital charge for various risks arising from outstanding contracts.
- ii. In case of failure to meet the obligations of Primary Dealership business in the Government securities market or any other violations leading to supervisory concern, the Bank reserves the right to impose restrictions or withdraw permission to deal in currency futures contracts.

**28. Foreign exchange business for FPI clients**

SPDs are permitted to offer foreign exchange products to the FPI clients, as permitted by the Bank from time to time. Such activities shall be part of their non-core activities. The SPDs shall adhere to the following prudential regulations:

- SPDs, while calculating the total risk weighted assets, shall include the forex exposures for maintenance of minimum Capital to Risk-Weighted Assets



Ratio (CRAR) of 15 per cent on an ongoing basis. Details of capital charge calculation shall be as per the directions given in this direction.

- SPDs shall adhere to the guidelines for foreign exchange exposure limits as prescribed by the Bank from time to time.
- SPDs shall frame a Board approved policy to undertake and monitor the foreign exchange business.

(b) SPDs desirous of offering forex products to their FPI clients shall approach the Reserve Bank of India, Foreign Exchange Department, Central Office, Mumbai for the necessary AD licence.

(c) While offering foreign exchange derivative contracts to their FPI clients, SPDs shall comply with the provisions of the Foreign Exchange Management Act 1999, and all rules, regulations and directions issued thereunder. In particular, they shall adhere to the provisions of the following instructions to the extent of foreign exchange products allowed to the SPDs:

i. Comprehensive Guidelines on Derivatives ([DBOD No.BP.BC.86/21.04.157/2006-07 dated April 20, 2007](#)), as amended from time to time;

ii. Master Direction on Risk Management and Inter-Bank Dealings ([RBI/FMRD/2016-17/31 dated July 5, 2016](#)), as updated from time to time; and

iii. Guidelines for Internal Control over Foreign Exchange Business (FE.CO.FMD.No.18380/02.03.137/2010-11 dated February 3, 2011), as amended from time to time.

## **29. Business through brokers**

(1) Business through brokers and limits for approved brokers

SPDs may undertake securities transactions among themselves or with clients through the members of the BSE, NSE and OTCEI. However, if the SPDs undertake OTC interest rate derivative transactions through brokers, they shall ensure that these brokers are accredited by FIMMDA. SPDs shall fix aggregate contract limits for each of the approved brokers. A limit of 5% of total broker transactions (both purchase and sales) entered into by a SPD during a year shall be treated as the aggregate upper limit for each of the approved brokers. However, if for any reason it becomes necessary to exceed the aggregate limit for any broker, the specific reasons thereof shall be recorded and the Board shall be informed of this, post facto.

(2) With the approval of their top management, SPDs shall prepare a panel of approved brokers, which shall be reviewed annually or more often if so warranted. Clear-cut criteria shall 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, shall be maintained.

(3) Brokerage payable to the broker, if any (if the deal was put through with the help of a broker), shall be clearly indicated on the notes/memorandum put up seeking approval for putting through the transaction, and a separate account of brokerage paid, broker-wise, shall be maintained.

(4) The role of the broker shall be restricted to that of bringing the two parties to the deal together. Settlement of deals between SPDs and counter-parties shall be directly between the counter-parties and the broker will have no role in the settlement process.

(5) While negotiating the deal, the broker is not obliged to disclose the identity of the counter-party to the deal. On conclusion of the deal, he should disclose the counter-party and his contract note should clearly indicate the name of the counter-party.

### **30. Guidelines on declaration of dividend**

SPDs shall follow the following guidelines while declaring dividend distribution:

- (i) The SPD shall have complied with the regulations on transfer of profits to statutory reserves and the regulatory guidelines relating to provisioning and valuation of securities, etc.
- (ii) SPDs having CRAR below the regulatory minimum of 15 per cent in any of the previous four quarters shall not declare any dividend. For SPDs having CRAR at or above the regulatory minimum of 15 per cent during all the four quarters of the previous year, but lower than 20 per cent in any of the four quarters, the dividend payout ratio (DPR) shall not exceed 33.3 per cent. For SPDs having CRAR at 20 per cent or above during all the four quarters of the previous year, the DPR shall not exceed 50 per cent. DPR shall be calculated as a percentage of dividend payable in a year (excluding dividend tax) to net profit during the year.

- (iii) The proposed dividend shall be payable out of the current year's profits. In case the profit for the relevant period includes any extraordinary income, the payout ratio shall be computed after excluding such extraordinary items for reckoning compliance with the prudential payout ratio ceiling.
- (iv) The financial statements pertaining to the financial year for which the SPD is declaring dividend shall be free of any qualifications by the statutory auditors, which have an adverse bearing on the profit during that year. In case of any qualification to that effect, the net profit shall be suitably adjusted downward while computing the DPR.
- (v) In case there are special reasons or difficulties for any SPD in strictly adhering to the guidelines, it shall approach RBI in advance for an appropriate ad hoc dispensation in this regard.
- (vi) All the SPDs declaring dividend shall report details of dividend declared during the accounting year as per the prescribed pro forma (**Annex XIII**) along with the Board resolution passed for declaration of dividend. The report shall be furnished within a fortnight of payment of dividend.

### **31. Applicability of Know Your Customer (KYC) Direction, 2016**

All SPDs having customer interface shall be required to follow the Know Your Customer (KYC) Direction, 2016, issued by the Department of Banking Regulation and as amended from time to time.

### **32. Managing Risks and Code of Conduct in Outsourcing of Financial Services by SPDs.**

SPDs shall conduct a self-assessment of their existing outsourcing arrangements and bring these in line with the directions as provided at Annex XIV.

## **Chapter IX Reporting Requirements**

**33.** The reporting requirements as prescribed by Internal Debt Management Department and Department on Non-Banking Supervision shall be adhered to by the SPDs.

**34.** All operational guidelines issued by Internal Debt Management Department shall also be adhered to by the SPDs.

### **Chapter – X Interpretations**

**35.** For the purpose of giving effect to the provisions of these Directions, the Bank may, if it considers necessary, issue necessary clarifications in respect of any matter covered herein and the interpretation of any provision of these Directions given by the Bank shall be final and binding on all the parties concerned. Any violation/circumvention of the above guidelines would be viewed seriously and such violation would attract penal action including the withdrawal of liquidity support, denial of access to the money market, withdrawal of authorization for carrying on the business as a SPD, and/or imposition of monetary penalty or liquidated damages, as the Bank may deem fit. Further, these provisions shall be in addition to, and not in derogation of the provisions of any other laws, rules, regulations or directions, for the time being in force.

### **Chapter - XI Repeal Provisions**

**36.** With the issue of these directions, the instructions / guidelines contained in the following circulars issued by the Bank stand repealed (list as provided below). All approvals / acknowledgements given under these circulars shall be deemed as given under these directions. Notwithstanding such repeal, any action taken/purported to have been taken or initiated under the instructions/guidelines having repealed shall continue to be guided by the provisions of said instructions/guidelines.

<b>Sr. No.</b>	<b>Circular no</b>	<b>Date</b>	<b>Subject</b>
1	IDMC.PDRS.1532/03.64.00/1999-00	November 2, 1999	Primary Dealers – Leverage
2	IDMC.PDRS.2049A/03.64.00/1999-2000	December 31, 1999	Guidelines on Securities transactions to be followed by Primary Dealers
3	IDMC.PDRS.5122/03.64.00/1999-00	June 14, 2000	Guidelines on Securities Transactions by Primary dealers
4	IDMC.PDRS.4135/03.64.00/2000-01	April 19, 2001	Scheme for Bidding, Underwriting and Liquidity support to Primary Dealers
5	IDMC.PDRS.87/03.64.00/2001-02	July 5, 2001	Liquidity support to Primary Dealers
6	IDMC.PDRS.1382/03.64.00/2000-01	September 18, 2001	Dematerialised holding of bonds and debentures
7	IDMC.PDRS.3369/03.64.00/2001-02	January 17, 2002	Guidelines on Counter party limits and Inter-corporate deposits
8	IDMC.PDRS.4881/03.64.00/2001-02	May 8, 2002	Guidelines to Primary Dealers
9	IDMC.PDRS.5018/03.64.00/2001-02	May 17, 2002	Scheme for Bidding, Underwriting and liquidity support to Primary dealers
10	IDMC.PDRS.5039/03.64.00/2001-02	May 20, 2002	Transactions in Government securities
11	IDMC.PDRS.5323/03.64.00/2001-02	June 10, 2002	Transactions in Government securities
12	IDMC.PDRS.418/03.64.00/2002-03	July 26, 2002	Publication of Financial results
13	IDMC.PDRS.1724/03.64.00/2002-03	October 23, 2002	Underwriting of Government dated securities by Primary Dealers
14	IDMC.PDRS.2269/03.64.00/2002-03	November 28, 2002	Publication of Financial results
15	<a href="#">IDMC.PDRS.2896/03.64.00/2002-03</a>	January 14, 2003	Trading in Government securities on Stock Exchanges
16	<a href="#">IDMC.PDRS.3432/03.64.00/2002-03</a>	February 21, 2003	Ready Forward Contracts
17	<a href="#">IDMC.PDRS.3820/03.64.00/2002-03</a>	March 24, 2003	Availment of FCNR(B) loans by Primary Dealers
18	IDMC.PDRS.1/03.64.00/2002-03	April 10, 2003	Portfolio Management Services by Primary Dealers – Guidelines
19	<a href="#">IDMC.PDRS.4802/03.64.00/2002-03</a>	June 3, 2003	Guidelines on Exchange Traded Interest Rate Derivatives
20	IDMC.PDRS.122/03.64.00/2002-03	September 22, 2003	Rationalisation of returns submitted by Primary Dealers
21	IDMD.1/(PDRS)03.64.00/2003-04	January 07, 2004	Capital Adequacy Standards and Risk Management Guidelines for Primary Dealers
22	<a href="#">IDMD.PDRS.No.3/03.64.00/2003-04</a>	March 08, 2004	Prudential guidelines on investment in non-Government securities
23	<a href="#">IDMD.PDRS.05/10.02.01/2003-04</a>	March 29, 2004	Transactions in Government Securities
24	<a href="#">IDMD.PDRS.06/03.64.00/2003-04</a>	June 03, 2004	Declaration of dividend by Primary Dealers
25	<a href="#">IDMD.PDRS.01/10.02.01/2004-05</a>	July 23, 2004	Transactions in Government securities
26	<a href="#">IDMD.PDRS.02/03.64.00/2004-05</a>	July 23, 2004	Success Ratio in Treasury Bill

			auctions for Primary Dealers
27	<a href="#">IDMD.PDRS.No.03/10.02.16/2004-05</a>	August 24, 2004	Dematerialization of Primary Dealer's investment in equity
28	<a href="#">IDMD.PDRS.No.06/03.64.00/2004-05</a>	October 15, 2004	Capital Adequacy Standards – Guidelines on Issue of Subordinated Debt Instruments – Tier-II and Tier-III Capital
29	<a href="#">IDMD.PDRS.4783/10.02.01/2004-05</a>	May 11, 2005	Government Securities Transactions – T+1 settlement
30	<a href="#">IDMD.PDRS.4779/10.02.01/2004-05</a>	May 11, 2005	Ready Forward Contracts
31	<a href="#">IDMD.PDRS/4907/03.64.00/2004-05</a>	May 19, 2005	Conduct of Dated Government Securities Auction under Primary Market Operations (PMO) module of PDO-NDS – Payment of Underwriting Commission
32	<a href="#">IDMD.PDRS.337/10.02.01/2005-06</a>	July 20, 2005	Transactions in Government Securities
33	<a href="#">IDMD.No.766/10.26.65A/2005-06</a>	August 22, 2005	NDS-OM – Counterparty Confirmation
34	<a href="#">DBOD.FSD.BC.No.64/24.92.01/2005-06</a>	February 27, 2006	Guidelines for banks' undertaking PD business
35	<a href="#">IDMD.PDRS/26/03.64.00/2006-07</a>	July 4, 2006	Diversification of activities by standalone Primary Dealers-Operational Guidelines
36	<a href="#">IDMD.PDRS.No.148/03.64.00/2006-07</a>	July 10, 2006	Risk reporting of derivatives business
37	<a href="#">FMD.MOAG No.13/01.01.01/2006-07</a>	March 30, 2007	Liquidity Adjustment Facility – Acceptance of State Development Loans under Repos
38	<a href="#">IDMD.530/03.64.00/2007-08</a>	July 31, 2007	FIMMDA Reporting Platform for Corporate Bond Transactions
39	<a href="#">DBOD.FSD.BC.No.25/24.92.001/2006-07</a>	August 9, 2006	Guidelines for banks undertaking PD business
40	<a href="#">IDMD.PDRS.1431/03.64.00/2006-07</a>	October 5, 2006	Operational guidelines for banks undertaking/proposing to undertake PD business
41	<a href="#">IDMD/11.08.15/809/2007-08</a>	August 23, 2007	Reporting platform for OTC Interest Rate Derivatives
42	<a href="#">IDMD.PDRS.No.2382/03.64.00/2007-08</a>	November 14, 2007	Revised Scheme of Underwriting Commitment and Liquidity Support
43	<a href="#">IDMD.PDRD.1393/03.64.00/ 2008-09</a>	September 19, 2008	Settlement of Primary Auctions – Shortage of Funds
44	<a href="#">IDMD.PDRD.No.4878/03.64.00/2008-09</a>	April 1, 2009	Issue of Tier-II and Tier-III Capital
45	<a href="#">IDMD.PDRD.1050/03.64.00/2009-10</a>	August 31, 2009	Investment Portfolio of Primary Dealers-Relaxation in the existing norms
46	<a href="#">IDMD.PDRD.1097/03.64.00/2009-10</a>	September 2, 2009	Enhancement of Minimum Net Owned Funds
47	<a href="#">IDMD.PDRD.1096/03.64.00/2009-10</a>	September 2, 2009	Increase in Call/Notice Money Borrowing Limit
48	<a href="#">IDMD.PDRD.2424/03.64.00/2009-10</a>	December 1, 2009	Waiver of trade confirmation in Government Securities transactions in OTC market

49	<a href="#">IDMD.PDRD.3843/03.64.00/2009-10</a>	March 9, 2010	Extension of HTM Category for PDs
50	IDMD.PDRD.No./03.64.00/2009-10	April 9, 2010	Mail box clarifications - on conversion factor for off-balance sheet items
51	<a href="#">IDMD.PDRD.4537/03.64.00/2009-10</a>	April 12, 2010	Quantum of Government securities to be held in the HTM category by PDs
52	<a href="#">IDMD.PDRD.5533/03.64.00/2009-10</a>	June 15, 2010	Primary Dealers – Imposition of Penalties – Disclosure
53	<a href="#">IDMD.PDRD.5573/03.64.00/2009-10</a>	June 17, 2010	Cash Management Bills – Bidding Commitment and Success Ratio
54	<a href="#">IDMD.PDRD.No.19/03.64.00/2010-11</a>	July 27, 2010	Applicability of Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 to Primary Dealers
55	<a href="#">IDMD.PCD.No.20/14.03.05/2010-11</a>	October 1, 2010	Raising resources through Inter Corporate Deposits (ICDs)
56	<a href="#">IDMD.PCD.No.1652/14.03.05/2010-11</a>	November 11, 2010	Exposure Norms: Applicability of Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 to standalone Primary Dealers
57	<a href="#">IDMD.PCD.No.26/14.03.05/2010-11</a>	February 10, 2011	Investment in non-Government Securities- Non-Convertible Debentures (NCDs) of maturity up to one year by standalone Primary Dealers (PDs).
58	<a href="#">IDMD.PDRD.No.3961/03.64.00/2010-11</a>	March 18, 2011	FIMMDA accredited brokers for transactions in OTC Interest Rate Derivatives Market.
59	IDMD.PCD.No./03.64.00/2009-10	April 5, 2011	Mail box clarifications- Tier-III bonds issued by standalone PDs
60	<a href="#">IDMD.PCD.9/14.03.05/2011-12</a>	August 30, 2011	Authorisation Guidelines for Primary Dealers (PDs)
61	<a href="#">IDMD.PCD.No.5053/14.03.04/2010-11</a>	May 23, 2011	Guidelines on Credit Default Swaps (CDS) for Corporate Bonds
62	<a href="#">IDMD.PCD.06/14.03.07/2011-12</a>	July 06, 2011	Transactions in Government Securities-Extension of DVP III facility to Gilt Account holders
63	IDMD.PDRD.No.3464/06.64.00/2011-12	March 07, 2012	Bidding in Primary Auctions-Clarification
64	<a href="#">IDMD.PCD.08/14.03.03/2011-12</a>	August 23, 2011	Issuance of Non-Convertible Debentures (NCDs) - Minimum Rating of NCDs
65	<a href="#">IDMD.PCD.9/14.03.05/2011-12</a>	August 30, 2011	Authorisation Guidelines for Primary Dealers (PDs)
66	<a href="#">IDMD.PCD.No.2301/14.03.04/2011-12</a>	November 30, 2011	Guidelines on Capital Adequacy and Exposure Norms for Credit Default Swaps (CDS)
67	<a href="#">IDMD.PCD.14/14.03.07/2011-12</a>	December 28, 2011	Secondary market transactions in Government Securities - Short Selling

68	<a href="#">IDMD.PCD.17/14.03.01/2011-12</a>	December 30, 2011	Exchange-traded Interest Rate Futures
69	<a href="#">IDMD.PCD.15/ED (RG)-2011</a>	December 30, 2011	Interest Rate Futures (Reserve Bank) (Amendment) Directions, 2011
70	<a href="#">IDMD.PCD.19/14.03.07/2011-12</a>	February 06, 2012	Transactions in Government Securities
71	<a href="#">IDMD.PCD.21/14.03.07/2011-12</a>	June 21, 2012	Secondary market transactions in Government Securities-Short Selling
72	<a href="#">IDMD.PCD.No.4896/14.03.05/2011-12</a>	June 27, 2012	Phasing out Tier-III capital for standalone PDs
73	<a href="#">IDMD.PDRD.188/03.64.00/2012-13</a>	July 16, 2012	Sale of securities allotted in Primary issues on the same day
74	<a href="#">IDMD.PCD.No.718/14.03.05/2012-13</a>	September 3, 2012	Applicability of credit exposure norms for bonds guaranteed by the Government of India
75	<a href="#">IDMD.PCD.No.2223/14.03.05/2012-13</a>	January 30, 2013	Measures to enhance the role of standalone Primary Dealers in Corporate Bond Market
76	<a href="#">IDMD.PCD.No.2310/14.03.05/2012-13</a>	February 06, 2013	Permission to standalone PDs for membership in SEBI approved Stock Exchanges for trading in corporate bonds
77	<a href="#">IDMD.PDRD.No.3089/03.64.027/ 2012-13</a>	May 08, 2013	Submission of Undertaking: Renewal of Authorisation
78	<a href="#">IDMD.PCD.13/14.03.07/2012-13</a>	June 26, 2013	Guidelines on Securities Transactions to be followed by Primary Dealers
79	<a href="#">IDMD.PDRD.No.346/10.02.23/2013-14</a>	July 31, 2013	Revised PD returns for Primary Dealers
80	<a href="#">IDMD.PDRD.No.828/03.64.00/2013-14</a>	September 10, 2013	Increase in HTTM limits for Standalone PDs
81	<a href="#">IDMD.PCD.12/14.03.05/2013-14</a>	March 27, 2014	Exposure norms for standalone PDs
82	<a href="#">IDMD.PCD.11/14.03.05/2013-14</a>	March 27, 2014	Capital requirements for standalone Primary Dealers' exposure to interest rate derivative contracts, repo/reverse repo transactions and central counterparties
83	<a href="#">IDMD.PDRD.No.3404/03.64.000/2013-14</a>	June 5, 2014	Annual Turnover Target on behalf of Mid-segment and Retail investors for Primary Dealers (PDs)
84	<a href="#">IDMD.PDRD.No.7/03.64.00/2014-15</a>	December 15, 2014	Decrease in Held to Maturity (HTM) limits for Standalone PDs
85	IDMD Mailbox	January 19, 2012	Maintenance of Distinct PD Book
86	IDMD Mailbox	February 06, 2012	Secondary Market Transactions in Government Securities-Short Selling
87	IDMD Mailbox	February 28, 2012	Investment in Cash Management Bills by Foreign Institutional Investors
88	<a href="#">DNBR.(PD).CC.No.021/03.10.001/2014-15</a>	February 20, 2015	Raising Money through Private Placement of Non-Convertible Debentures (NCDs) by NBFCs
89	<a href="#">DNBR.CO.PD.No.068/03.10.01/2015-16</a>	August 06,	Exposure Norms limit for the



		2015	Standalone Primary Dealers (SPDs)
90	<a href="#">FMRD.FMD.No.02.03.183/7/2015-16</a>	March 17, 2016	Participation of Standalone Primary Dealers in Currency Futures Market
91	<a href="#">DNBR.CO.PD.No.080/03.10.01/2015-16</a>	April 28, 2016	Risk Weight in respect of investments in Corporate Bonds by Standalone Primary Dealers (SPDs)

**Manoranjan Mishra**  
**(Chief General Manager)**

**Guidelines on Subordinated Debt (SD) Bonds (Tier-II Capital)**

- (i) The amount to be raised may be decided by the Board of Directors of the SPD.
- (ii) The SPDs may fix coupon rates as decided by their Board.
- (iii) The instruments should be 'plain vanilla' with no special features like options, etc.
- (iv) The debt securities should carry a credit rating from a Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI).
- (v) The issue of SD instruments should comply with the guidelines issued by SEBI vide their circular SEBI/MRD/SE/AT/36/2003/30/09 dated September 30, 2003 (ref: [www.sebi.gov.in/circulars](http://www.sebi.gov.in/circulars)), as amended from time to time, wherever applicable.
- (vi) In case of unlisted issues of SD, the disclosure requirements as prescribed by the SEBI for listed companies in terms of the above guidelines should be complied with.
- (vii) Necessary permission from the Foreign Exchange Department of the Bank should be obtained for issuing the instruments to Non-Resident Indians/Foreign Institutional Investors (FIIs). SPDs should comply with the terms and conditions, if any, prescribed by SEBI / other regulatory authorities with regard to issue of the instruments.
- (viii) Investments by SPDs in SD of other PDs/banks will be assigned 100% risk weight for capital adequacy purpose. Further, the SPD's aggregate investments in Tier-II bonds issued by other PDs, banks and financial institutions should be restricted to 10 percent of the investing SPD's total capital funds. The capital funds for this purpose will be the same as those reckoned for the purpose of capital adequacy.
- (ix) The SPDs should submit a report to the Chief General Manager, Department of Non-Banking Supervision (DNBS), RBI, giving details of the capital raised, such as, amount raised, maturity of the instrument, rate of interest together with a copy of the offer document, soon after the issue is completed.

### Capital Adequacy for Credit Risk

Credit risk is defined as the risk that a party to a contractual agreement or transaction will be unable to meet its obligations or will default on commitments.

#### Risk weights for calculation of CRAR

##### 1. On-Balance Sheet Assets

All the on-balance sheet items are assigned percentage weights as per degree of credit risk. The value of each asset/item is to be multiplied by the relevant risk weight to arrive at risk adjusted value of the asset, as detailed below. The aggregate of the risk weighted assets will be taken into account for reckoning the minimum capital ratio.

Nature of asset/item		Percentage weight
(i)	Cash balances and balances in Current Account with RBI	0
(ii)	Amounts lent in call/notice money market/ other money market instruments of banks/ Financial Institutions (FIs) including Certificate of Deposits (CDs) and balances in Current account with banks	20
(iii)	<u>Investments</u>	
(a)	Government securities/Approved securities guaranteed by Central/State Governments [other than at (e) below]	0
(b)	Fixed Deposits, Bonds of banks and FIs	20
(c)	Bonds issued by banks/FIs as Tier-II capital	100
(d)	Shares of all Companies and debentures/bonds/ Commercial Paper of Companies other than in (b) above /units of mutual funds	@

	(e)	Securities of Public Sector Undertakings guaranteed by Government but issued outside the market borrowing programme	20
	(f)	Securities of and other claims on PDs	100
	(g)	Subordinated debts issued by other PDs	100
(iv)	<u>Current assets</u>		
	(a)	Loans to staff	100
	(b)	Other secured loans and advances considered good	100
	(c)	Others (to be specified)	100
(v)	<u>Fixed Assets (net of depreciation)</u>		
	(a)	Assets leased out (net book value)	100
	(b)	Fixed Assets	100
(vi)	<u>Other assets</u>		
	(a)	Income tax deducted at source (net of provision)	0
	(b)	Advance tax paid (net of provision)	0
	(c)	Interest accrued on Government securities	0
	(d)	Others (to be specified and risk weight indicated as per counter party)	X

<b>Notes:</b>	(1)	<i>Netting shall be done only in respect of assets where provisions for depreciation or for bad and doubtful debts have been made.</i>
	(2)	<i>Assets which have been deducted from capital fund, shall have a risk weight of 'zero'.</i>
	(3)	<i>The PDs may net off the Current Liabilities and Provisions from the Current Assets, Loans and Advances in their Balance Sheet, as the Balance Sheet is drawn up as per the format prescribed under the Companies Act. For capital adequacy purposes, no such netting off should be done except to the extent indicated above.</i>

@ Risk weights to be assigned by SPDs to their investments in corporate bonds, to the rating of the bonds as under:

**A. Short term instruments (bonds = 1 year maturity)**

CARE	CRISIL	India Rating	ICRA	Brickwork	ACUITE	Risk weight (%)
CARE A1+	CRISIL A1+	IND A1+	ICRA A1+	BWR A1+	ACUITE A1+	20
CARE A1	CRISIL A1	IND A1	ICRA A1	BWR A1	ACUITE A1	30
CARE A2	CRISIL A2	IND A2	ICRA A2	BWR A2	ACUITE A2	50
CARE A3	CRISIL A3	IND A3	ICRA A3	BWR A3	ACUITE A3	100
CARE A4&D	CRISIL A4&D	IND A4&D	ICRA A4&D	BWR A4&D	ACUITE A4&D	150
Unrated	Unrated	Unrated	Unrated	Unrated	Unrated	100

**B. Long term instruments (bonds > 1 year maturity)**

Rating	AAA	AA	A	BBB	≤ BB	Unrated
Risk Weight	20	30	50	100	150	100

**2. Off-Balance Sheet items**

The credit risk exposure attached to off-Balance Sheet items has to be first calculated by multiplying the face value of each of the off-Balance Sheet items by 'credit conversion factor (CCF)' as indicated below. This will then have to be again multiplied by the weights attributable to the relevant counter-party as specified under on-balance sheet items.

	Nature of item	CCF percentage
(i)	Share/debenture/stock underwritten	50
(iii)	Partly-paid shares/debentures/other securities and actual devolvement	100
(iii)	Notional Equity/Index position underlying the equity Derivatives *	100
(iv)	Bills discounted/rediscounted	100
(vi)	Other contingent liabilities/commitments like standby commitments like standby facility with original maturity of over one year	50
(vii)	Similar contingent liabilities/ commitments with original maturity of upto one year or which can be unconditionally cancelled at any time	0

\* For guidelines on calculation of notional positions underlying the equity derivatives, please refer to section A2, **Annex III** (Measurement of Market Risk)

**Note:** Cash margins/deposits should be deducted before applying the Conversion Factor

### 3. Interest Rate Contracts

#### 3.1 General

The total risk weight for Interest Rate Derivative Contracts should be calculated by means of a two-step process:

- (a) Compute counterparty credit exposure by converting the notional amount of the transaction into a credit equivalent amount by applying the current exposure method and
- (b) The resulting credit equivalent amount is multiplied by the risk weight

applicable to the counterparty or the type of asset, whichever is higher.

### 3.2 Current Exposure Method

(i) The credit equivalent amount of interest rate derivative contracts calculated using the current exposure method is the sum of current credit exposure and potential future credit exposure of these contracts.

(ii) Current credit exposure is defined as the sum of the positive mark-to-market value of these contracts. The Current Exposure Method requires periodical calculation of the current credit exposure by marking these contracts to market, thus capturing the current credit exposure.

(iii) Potential future credit exposure is determined by multiplying the notional principal amount of each of these contracts, irrespective of whether the contract has a zero, positive or negative mark-to-market value, by the relevant add-on factor indicated below according to the nature and residual maturity of the instrument.

**Table 1: Credit Conversion Factor (CCF) for Interest Rate Derivative Contracts**

Residual Maturity	CCF (%)
	Interest Rate Derivative Contracts
One year or less	0.50
Over one year to five years	1.00
Over five years	3.00

(iv) For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be set equal to the time until the next reset date. However, in the case of interest rate contracts which have residual maturities of more than one year and meet the above criteria, the CCF or add-on factor is subject to a floor of 1.0 per cent.

(v) No potential future credit exposure would be calculated for single currency floating / floating interest rate swaps; the credit exposure on these contracts would be evaluated solely on the basis of their mark-to-market value.

(vi) Potential future exposures should be based on 'effective' rather than 'apparent notional amounts'. In the event that the 'stated notional amount' is

leveraged or enhanced by the structure of the transaction, PDs must use the 'effective notional amount' when determining potential future exposure. For example, a stated notional amount of ₹ 5 crore with payments based on an internal rate of two times the applicable rate would have an effective notional amount of ₹ 10 crore.

(vii) Bilateral netting of mark-to-market (MTM) values arising on account of such derivative contracts is not permitted. Accordingly, PDs should count their gross positive MTM value of such contracts for the purpose of capital adequacy.

#### **4. Capital charge for repo/reverse repo transactions:**

**4.1** The repo-style transactions should attract capital charge for Counterparty credit risk (CCR), in addition to the credit risk and market risk. The CCR is defined as the risk of default by the counterparty in a repo-style transaction, resulting in non-delivery of the security lent/pledged/sold or non-repayment of the cash.

##### **A. Treatment in the books of the borrower of funds:**

(i) Where a PD has borrowed funds by selling / lending or posting, as collateral, of securities, the 'Exposure' will be an off-balance sheet exposure equal to the 'market value' of the securities sold/lent as scaled up after applying appropriate haircut as detailed in **paragraph 4.2 below**. The 'off-balance sheet exposure' will be converted into 'on-balance sheet' equivalent by applying a credit conversion factor of 100 per cent.

(ii) The amount of money received will be treated as collateral for the securities lent/sold/pledged. Since the collateral is cash, the haircut for it would be zero.

(iii) The credit equivalent amount arrived at (i) above, net of amount of cash collateral, will attract a risk weight as applicable to the counterparty.

(iv) As the securities will come back to the books of the borrowing PD after the repo period, it will continue to maintain the capital for the credit risk in the securities in the cases where the securities involved in repo are held under HTM category, and capital for market risk in cases where the securities are held under HFT category. The capital charge for credit risk / specific risk would be determined according to the credit rating of the issuer of the security. In the case of Government securities, the capital charge for credit / specific risk will be 'zero'.



## **B. Treatment in the books of the lender of funds:**

- (i) The amount lent will be treated as on-balance sheet/funded exposure on the counter party, collateralised by the securities accepted under the repo.
- (ii) The exposure, being cash, will receive a zero haircut.
- (iii) The collateral will be adjusted downwards/marked down as per applicable haircut.
- (iv) The amount of exposure reduced by the adjusted amount of collateral, will receive a risk weight as applicable to the counterparty, as it is an on- balance sheet exposure.
- (v) The lending PD will not maintain any capital charge for the security received by it as collateral during the repo period, since such collateral does not enter its balance sheet but is only held as a bailee.

### **4.2 Haircuts**

- (i) PDs should use only the standard supervisory haircuts for both the exposure as well as the collateral.
- (ii) The standard supervisory haircuts (assuming daily mark-to-market, daily re-margining and minimum holding period of five business-days), expressed as percentages, would be as furnished in Table below.
- (iii) The ratings indicated in Table 2 represent the ratings assigned by the domestic rating agencies. In the case of exposures toward debt securities issued by foreign central Governments and foreign corporates (if permitted), the haircut shall be based on ratings of the International rating agencies as indicated in Table 3.
- (iv) Sovereign will include the Bank and DICGC which are eligible for zero per cent risk weight.

**Table 2: Standard Supervisory Haircuts for Sovereign and other securities which constitute Exposure and Collateral**

<b>Sl. No.</b>	<b>Issue Rating for Debt securities</b>	<b>Residual Maturity (in years)</b>	<b>Haircut (in percentage)</b>
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<b>A</b>	<b>Securities issued / guaranteed by the Government of India and issued by the State Governments (Sovereign securities)</b>			
	i	Rating not applicable – as Government securities are not currently rated in India	≤ 1 year	0.5
			>1 year and ≤ 5 years	2
			>5 years	4
<b>Domestic debt securities other than those indicated at Item No. A above including the securities guaranteed by Indian State Governments</b>				
ii	AAA TO AA A1	≤ 1 year	1	
		> 1 year and ≤ 5 years	4	
		>5 years	8	
iii	A to BBB A2 and A3	≤ 1 year	2	
		> 1 year and ≤ 5 years	6	
		>5 years	12	
<b>B</b>	<b>Cash in the same currency</b>		0	

**Table 3: Standard Supervisory Haircut for Exposures and Collaterals which are obligations of foreign central sovereigns / foreign corporates**

<b>Issue rating for debt securities as assigned by international rating agencies</b>	<b>Residual Maturity</b>	<b>Sovereigns (%)</b>	<b>Other Issues (%)</b>
AAA to AA / A1	≤ 1 year	0.5	1
	>1 year and < or = 5 years	2	4
	>5 years	4	8
A to BBB / A2 / A3 and Unrated Bank Securities	≤ 1 year	1	2
	>1 year and < or = 5 years	3	6
	>5 years	6	12

(v) Where the collateral is a basket of assets, the haircut on the basket will be,

$$H = \sum a_i H_i$$

where  $a_i$  is the weight of the asset (as measured by the amount/value of the asset in units of currency) in the basket and  $H_i$ , the haircut applicable to that asset.

(vi) Adjustment for non-daily mark-to-market or remargining:

- a. For repo style transactions, standalone PDs should use minimum holding period of five business days with daily remargining.
- b. In case a transaction has different minimum holding period or margining frequency different from daily margining assumed, the applicable haircut for the transaction will also need to be adjusted by scaling up/down the haircut for 10-business days with daily margining indicated in Table 2 and 3 using the formula given in **paragraph 4.2 (vii)** below.

(vii) Formula for adjustment for different holding periods and / or non-daily mark-to-market or remargining:

Adjustment for the variation in holding period and margining / mark-to-market, as indicated in paragraph (vi) above will be done as per the following formula:

$$H = H_{10} \sqrt{\frac{N_r + (T_M - 1)}{10}}$$

Where:

H = haircut

$H_{10}$  = 10-business-day standard supervisory haircut for instrument

$N_R$  = actual number of business days between remargining for capital market transactions or revaluation for secured transactions

$T_M$  = minimum holding period for the type of transaction

## **5 Capital requirements for exposures to Central Counterparties (CCPs)**

### **5.1 Definitions**

**5.1.1 Counterparty Credit Risk (CCR)** is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. An economic loss would occur if the transactions or portfolio of transactions with the counterparty has a positive economic value at the time of default. CCR creates a bilateral risk of loss: the market value of the transaction can be positive or negative to either counterparty to the transaction. The market value is uncertain and can vary over time with the movement of underlying market factors.

**5.1.2 Securities Financing Transactions (SFTs)** are transactions such as repurchase agreements, reverse repurchase agreements, security lending and borrowing and, collateralised borrowing and lending (CBLO), where the value of the transactions depends on market valuations and the transactions are often subject to margin agreements.

**5.1.3 Hedging Set** is a group of risk positions from the transactions within a single netting set for which only their balance is relevant for determining the exposure amount or exposure at default under the CCR standardised method.

**5.1.4 Current Exposure** is the larger of zero, or the market value of a transaction or portfolio of transactions within a netting set with a counterparty that would be lost upon the default of the counterparty, assuming no recovery on the value of those transactions in bankruptcy. Current exposure is often also called Replacement Cost.

**5.1.5 A central counterparty (CCP)** is a clearing house that interposes itself between counterparties to contracts traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer and thereby ensuring the future performance of open contracts. A CCP becomes counterparty to trades with market participants through novation, an open offer system, or another legally binding arrangement. For the purposes of the capital framework, a CCP is a financial institution.

**5.1.6 A qualifying central counterparty (QCCP)** is an entity that is licensed to operate as a CCP (including a license granted by way of confirming an exemption), and is permitted by the appropriate regulator / overseer with respect to the products offered. This is subject to the provision that the CCP is based and prudentially supervised in a jurisdiction where the relevant regulator/overseer has established, and publicly indicated that it applies to the CCP on an ongoing basis, domestic rules and regulations that are consistent with the CPSS-IOSCO Principles for Financial Market Infrastructures.

**5.1.7 A clearing member** is a member of, or a direct participant in, a CCP that is entitled to enter into a transaction with the CCP, regardless of whether it enters into trades with a CCP for its own hedging, investment or speculative purposes or

whether it also enters into trades as a financial intermediary between the CCP and other market participants<sup>3</sup>.

**5.1.8 A client** is a party to a transaction with a CCP through either a clearing member acting as a financial intermediary, or a clearing member guaranteeing the performance of the client to the CCP.

**5.1.9 Initial margin** means a clearing member's or client's funded collateral posted to the CCP to mitigate the potential future exposure of the CCP to the clearing member arising from the possible future change in the value of their transactions. For the purposes of these guidelines, initial margin does not include contributions to a CCP for mutualised loss sharing arrangements (i.e. in case a CCP uses initial margin to mutualise losses among the clearing members, it will be treated as a default fund exposure).

**5.1.10 Variation margin** means a clearing member's or client's funded collateral posted on a daily or intraday basis to a CCP based upon price movements of their transactions.

**5.1.11 Trade exposures** include the current<sup>4</sup> and potential future exposure of a clearing member or a client to a CCP arising from OTC derivatives, exchange traded derivatives transactions or SFTs, as well as initial margin. It also include cash transactions routed through a CCP.

**5.1.12 Default funds**, also known as clearing deposits or guarantee fund contributions (or any other names), are clearing members' funded or unfunded contributions towards, or underwriting of, a CCP's mutualised loss sharing arrangements. The description given by a CCP to its mutualised loss sharing arrangements is not determinative of their status as a default fund; rather, the substance of such arrangements will govern their status.

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<sup>3</sup> For the purposes of these guidelines, where a CCP has a link to a second CCP, that second CCP is to be treated as a clearing member of the first CCP. Whether the second CCP's collateral contribution to the first CCP is treated as initial margin or a default fund contribution will depend upon the legal arrangement between the CCPs. In such cases, if any, RBI should be consulted for determining the treatment of this initial margin and default fund contributions.

<sup>4</sup> For the purposes of this definition, the current exposure of a clearing member includes the variation margin due to the clearing member but not yet received.

**5.1.13 Offsetting transaction** means the transaction leg between the clearing member and the CCP when the clearing member acts on behalf of a client (e.g. when a clearing member clears or novates a client's trade).

## **5.2 Scope of Application**

- (i) Exposures to central counterparties arising from OTC derivatives transactions, exchange traded derivatives transactions, securities financing transactions (SFTs) and the settlement of cash transactions, will be subject to the counterparty credit risk treatment as indicted in this paragraph below.
- (ii) When the clearing member-to-client leg of a transaction is conducted under a bilateral agreement, both the client PD and the clearing member are to capitalise that transaction.
- (iii) For the purpose of capital adequacy framework, CCPs will be considered as financial institution and a standalone PD's investments in the capital of CCPs should not exceed 10% of its capital funds, but after all applicable deductions or any other limit as may be prescribed from time to time.
- (iv) Capital requirements will be dependent on the nature of CCPs viz. Qualifying CCPs (QCCPs) and non-Qualifying CCPs.
  - (a) Regardless of whether a CCP is classified as a QCCP or not, a standalone PD should have the responsibility to ensure that it maintains adequate capital for its exposures. A standalone PD should consider whether it might need to hold capital in excess of the minimum capital requirements if, for example, (i) its dealings with a CCP give rise to more risky exposures or (ii) where, given the context of that PD's dealings, it is unclear that the CCP meets the definition of a QCCP.
  - (b) Standalone PDs may be required to hold additional capital against their exposures to QCCPs, if in the opinion of RBI, it is necessary to do so.
  - (c) Where the standalone PD is acting as a clearing member, the PD should assess through appropriate scenario analysis and stress testing whether the level of capital held against exposures to a CCP adequately addresses the inherent risks of those transactions. This assessment will include potential future or contingent exposures resulting from future drawings on default fund commitments, and/or from secondary commitments, if permitted, to take over or replace offsetting transactions from clients of

another clearing member in case of this clearing member defaulting or becoming insolvent.

- (d) A standalone PD must monitor and report to senior management and the appropriate committee of the Board (e.g. Risk Management Committee) on a regular basis (quarterly or at more frequent intervals) all of its exposures to CCPs, including exposures arising from trading through a CCP and exposures arising from CCP membership obligations such as default fund contributions.
- (e) Unless the Bank requires otherwise, the trades with a former QCCP shall continue to be capitalised as though they are with a QCCP for a period not exceeding three months from the date it ceases to qualify as a QCCP. After that time, the PD's exposures with such a central counterparty must be capitalised according to rules applicable for non-QCCP.

### **5.3 Exposures to Qualifying CCPs (QCCPs)**

#### **(i) Trade exposures**

##### ***Clearing member exposures to QCCPs***

- a. Where a standalone PD acts as a clearing member of a QCCP for its own purposes, a risk weight of 2% must be applied to the standalone PD's trade exposure to the QCCP.
- b. The exposure amount for trade exposure in respect of OTC derivatives transactions, exchange traded derivatives transactions and SFTs should be calculated in accordance with the Current Exposure Method (CEM) for derivatives as detailed in **paragraph 3.2** above and rules for capital adequacy for Repo / Reverse Repo-style transactions prescribed in **paragraph 4** above.
- c. Where settlement is legally enforceable on a net basis in an event of default and regardless of whether the counterparty is insolvent or bankrupt, the total replacement cost of all contracts relevant to the trade exposure determination can be calculated as a net replacement cost if the applicable close-out netting sets meet the requirements given below in **paragraph 5.5** of these guidelines.
- d. Standalone PDs should have to demonstrate that the conditions mentioned in **paragraph 5.5** of the guidelines are fulfilled on a regular basis by obtaining independent and reasoned legal opinion as regards legal certainty of netting of exposures to QCCPs. Standalone PDs shall also obtain from such QCCPs, the legal opinion taken by the QCCPs on the legal certainty of their major

activities such as settlement finality, netting, collateral arrangements (including margin arrangements); default procedures etc.

### ***Clearing member exposures to clients***

The clearing member will always capitalise its exposure to clients as bilateral trades, irrespective of whether the clearing member guarantees the trade or acts as an intermediary between the client and the QCCP. However, to recognize the shorter close-out period for cleared transactions, clearing members can capitalize the exposure to their clients by multiplying the exposure at default by a scalar which is not less than 0.71.

### ***Client PD exposures to clearing member***

I. Where a PD is a client of the clearing member, and enters into a transaction with the clearing member acting as a financial intermediary (i.e. the clearing member completes an offsetting transaction with a QCCP), the client's exposures to the clearing member will receive the treatment applicable to the paragraph "clearing member exposure to QCCPs" of this section (mentioned above), if following conditions are met:

(a) The offsetting transactions are identified by the QCCP as client transactions and collateral to support them is held by the QCCP and / or the clearing member, as applicable, under arrangements that prevent any losses to the client due to:

- i. the default or insolvency of the clearing member;
- ii. the default or insolvency of the clearing member's other clients; and
- iii. the joint default or insolvency of the clearing member and any of its other clients.

The client PD must obtain an independent, written and reasoned legal opinion that concludes that, in the event of legal challenge, the relevant courts and administrative authorities would find that the client would bear no losses on account of the insolvency of an intermediary under the relevant law, including:

- the law(s) applicable to client PD, clearing member and QCCP;
- the law of the jurisdiction(s) of the foreign countries in which the client PD, clearing member or QCCP are located
- the law that governs the individual transactions and collateral; and
- the law that governs any contract or agreement necessary to meet this condition (a).

(b) Relevant laws, regulations, rules, contractual, or administrative arrangements provide that the offsetting transactions with the defaulted or insolvent clearing



member are highly likely to continue to be indirectly transacted through the QCCP, or by the QCCP, should the clearing member default or become insolvent. In such circumstances, the client positions and collateral with the QCCP will be transferred at the market value unless the client requests to close out the position at the market value. In this context, it is clarified that if relevant laws, regulations, rules, contractual or administrative agreements provide that trades are highly likely to be ported, this condition can be considered to be met. If there is a clear precedent for transactions being ported at a QCCP and intention of the participants is to continue this practice, then these factors should be considered while assessing if trades are highly likely to be ported. The fact that QCCP documentation does not prohibit client trades from being ported is not sufficient to conclude that they are highly likely to be ported. Other evidence such as the criteria mentioned in this paragraph is necessary to make this claim.

II. Where a client is not protected from losses in the case that the clearing member and another client of the clearing member jointly default or become jointly insolvent, but all other conditions mentioned above are met and the concerned CCP is a QCCP, a risk weight of 4% will apply to the client's exposure to the clearing member.

III. Where the client PD does not meet the requirements in the above paragraphs, the PD should be required to capitalize its exposure to the clearing member as a bilateral trade.

IV. In case a standalone PD as a client enters into a transaction with the QCCP with a clearing member guaranteeing its performance, the capital requirements for client PD should be calculated as if client PD has entered into a bilateral contract with the clearing member.

#### ***Treatment of posted collateral***

- (a) In all cases, any assets or collateral posted must, from the perspective of the PD posting such collateral, receive the risk weights that otherwise applies to such assets or collateral under the capital adequacy framework, regardless of the fact that such assets have been posted as collateral. Where assets or collateral of a clearing member or client are posted with a QCCP or a clearing member and are not held in a bankruptcy remote manner, the PD posting such assets or collateral must also recognise credit risk based upon the

assets or collateral being exposed to risk of loss based on the creditworthiness of the entity<sup>5</sup> holding such assets or collateral.

- (b) Collateral posted by the clearing member (including cash, securities, other pledged assets, and excess initial or variation margin, also called over-collateralisation), that is held by a custodian<sup>6</sup>, and is bankruptcy remote from the QCCP, is not subject to a capital requirement for counterparty credit risk exposure to such bankruptcy remote custodian.
- (c) Collateral posted by a client, that is held by a custodian, and is bankruptcy remote from the QCCP, the clearing member and other clients, is not subject to a capital requirement for counterparty credit risk. If the collateral is held at the QCCP on a client's behalf and is not held on a bankruptcy remote basis, a 2% risk weight will be applied to the collateral if the conditions established in paragraph on "client PD exposures to clearing members" of this section are met (mentioned above). A risk weight of 4% will be made applicable if a client is not protected from losses in the case that the clearing member and another client of the clearing member jointly default or become jointly insolvent, but all other conditions mentioned in paragraph on "client PD exposures to clearing members" of this section are met.
- (d) If a clearing member collects collateral from a client for client cleared trades and this collateral is passed on to the QCCP, the clearing member may recognize this collateral for both the QCCP - clearing member leg and the clearing member - client leg of the client cleared trade. Therefore, initial margins (IMs) as posted by clients to clearing members mitigate the exposure the clearing member has against these clients.

## **(ii) Default Fund Exposures to QCCPs**

- (a) Where a default fund is shared between products or types of business with settlement risk only (e.g. equities and bonds) and products or types of business which give rise to counterparty credit risk i.e., OTC derivatives, exchange traded derivatives or SFTs, all of the default fund contributions will receive the risk weight determined according to the formulae and

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<sup>5</sup> Where the entity holding such assets or collateral is the QCCP, a risk-weight of 2% applies to collateral included in the definition of trade exposures. The relevant risk-weight of the QCCP will apply to assets or collateral posted for other purposes.

<sup>6</sup> In this paragraph, the word "custodian" may include a trustee, agent, pledgee, secured creditor or any other person that holds property in a way that does not give such person a beneficial interest in such property and will not result in such property being subject to legally-enforceable claims by such persons, creditors, or to a court-ordered stay of the return of such property, should such person become insolvent or bankrupt.

methodology set forth below, without apportioning to different classes or types of business or products.

- (b) However, where the default fund contributions from clearing members are segregated by product types and only accessible for specific product types, the capital requirements for those default fund exposures determined according to the formulae and methodology set forth below must be calculated for each specific product giving rise to counterparty credit risk. In case the QCCP's prefunded own resources are shared among product types, the QCCP will have to allocate those funds to each of the calculations, in proportion to the respective product specific exposure i.e. exposure at default.
- (c) Clearing member PDs are required to capitalise their exposures arising from default fund contributions to a qualifying CCP by applying the following formula:

Clearing member PDs are required to apply a risk-weight of 1111% to their default fund exposures to the qualifying CCP, subject to an overall cap on the risk-weighted assets from all its exposures to the QCCP (i.e. including trade exposures) equal to 20% of the trade exposures to the QCCP. More specifically, the Risk Weighted Assets (RWA) for both PD *i*'s trade and default fund exposures to each QCCP are equal to<sup>7</sup>:

$$\text{Min} \{(2\% * TE_i + 1111\% * DF_i); (20\% * TE_i)\}$$

Where;

-TE<sub>*i*</sub> is PD *i*'s trade exposure to the QCCP; and

-DF<sub>*i*</sub> is PD *i*'s pre-funded contribution to the QCCP's default fund.

#### **5.4 Exposures to Non-qualifying CCPs**

(a) PDs must apply the Standardised Approach for credit risk according to the category of the counterparty, to their trade exposure to a non-qualifying CCP<sup>8</sup>.

(b) PDs must apply a risk weight of 1111% to their default fund contributions to a non-qualifying CCP.

(c) For the purposes of this paragraph, the default fund contributions of such PDs will include both the funded and the unfunded contributions which are liable to be paid should the CCP so require. Where there is a liability for unfunded contributions (i.e. unlimited binding commitments) the Bank will determine the amount of unfunded commitments to which an 1111% risk weight should apply.

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<sup>7</sup> The 2% risk weight on trade exposures does not apply additionally, as it is included in the equation.

## **5.5 Requirements for Recognition of Net Replacement Cost in Close-out Netting Sets**

### **A. For repo-style transactions**

The effects of bilateral netting agreements covering repo-style transactions will be recognised on a counterparty-by-counterparty basis if the agreements are legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of whether the counterparty is insolvent or bankrupt. In addition, netting agreements must:

(a) provide the non-defaulting party the right to terminate and close-out in a timely manner all transactions under the agreement upon an event of default, including in the event of insolvency or bankruptcy of the counterparty;

(b) provide for the netting of gains and losses on transactions (including the value of any collateral) terminated and closed out under it so that a single net amount is owed by one party to the other;

(c) allow for the prompt liquidation or setoff of collateral upon the event of default; and

(d) be, together with the rights arising from the provisions required in (a) to (c) above, legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of the counterparty's insolvency or bankruptcy.

### **B. For Derivatives transactions**

(a) PDs shall net transactions subject to novation under which any obligation between a PD and its counterparty to deliver a given currency on a given value date is automatically amalgamated with all other obligations for the same currency and value date, legally substituting one single amount for the previous gross obligations.

(b) PDs may also net transactions subject to any legally valid form of bilateral netting not covered in (a), including other forms of novation.

(c) In both cases (a) and (b), a PD will need to satisfy that it has:

(i) A netting contract or agreement with the counterparty which creates a single legal obligation, covering all included transactions, such that the PD would have either a claim to receive or obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions in the event a counterparty fails to perform due to any of the following: default, bankruptcy, liquidation or similar circumstances;

(ii) Written and reasoned legal opinions that, in the event of a legal challenge, the relevant courts and administrative authorities would find the PD's exposure to be such a net amount under:

- The law of the jurisdiction in which the counterparty is chartered and, if the foreign branch of a counterparty is involved, then also under the law of the jurisdiction in which the branch is located;
- The law that governs the individual transactions; and
- The law that governs any contract or agreement necessary to effect the netting.

(iii) Procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in the light of possible changes in relevant law.

(d) Contracts containing walkaway clauses will not be eligible for netting for the purpose of calculating capital requirements under these guidelines. A walkaway clause is a provision which permits a non-defaulting counterparty to make only limited payments or no payment at all, to the estate of a defaulter, even if the defaulter is a net creditor.

## 6. Foreign Exchange (FE) Contracts

Like the interest rate contracts, the outstanding contracts should be first multiplied by a conversion factor as shown below:

<b>CCF for Market-Related Off-Balance Sheet Items</b>	<b>CCF (%)</b>
<b>Residual Maturity</b>	
<b>Exchange Rate Contracts</b>	
One year or less	2.00
Over one year to five years	10.00
Over five years	15.00

This will then have to be again multiplied by the weights attributable to the relevant counter-party as specified above. Foreign exchange contracts with an original maturity of 14 calendar days or less, irrespective of the counterparty, shall be assigned "zero" risk weight as per international practice.

## 7. Single Name Credit Default Swaps (CDS) on Corporate Bonds

For CDS related transactions, standalone PDs shall follow the capital adequacy guidelines issued vide [circular IDMD. PCD.No.2301/14.03.04/2011-12 dated November 30, 2011](#) and as updated from time to time.

### Measurement of Market Risk

Market risk is defined as the risk of loss arising from movements in market prices or rates away from the rates or prices set out in a transaction or agreement. The objective in introducing the capital adequacy for market risk is to provide an explicit capital cushion for the price risk to which the PDs are exposed to in their portfolio.

2. The capital charge for market risks should be worked out by the standardised approach and the internal risk management framework based Value at Risk (VaR) model. The capital charge for market risk to be provided by PDs would be higher of the two requirements. However, where price data is not available for specific category of assets, PDs shall follow the standardised approach for computation of market risk. In such a situation, PDs should disclose to RBI, details of such assets and ensure that consistency of approach is followed. PDs should obtain RBI's permission before excluding any category of asset for calculations of market risk. PDs would normally consider the instruments of the nature of fixed deposits, commercial bills etc., for this purpose. Such items will be held in the books till maturity and any diminution in the value will have to be provided for in the books.

Note: In case of underwriting commitments, following points should be adhered to:

- a. In case of devolvement of underwriting commitment for G-Sec, 100% of the devolved amount would qualify for the measurement of market risk.
- b. In case of underwriting under merchant banking issues (other than G-Sec), where price has been committed/frozen at the time of underwriting, the commitment is to be treated as a contingent liability and 50% of the commitment should be included in the position for market risk. However, 100% of devolved position should be subjected to market risk measurement.

3. The methodology for working out the capital charges for market risk on the portfolio is as below:

## **A. Standardized Approach**

Capital charge will be the measure of risk arrived at in terms of paras A1 – A3 below, summed arithmetically.

### **A1. For Fixed Income Instruments**

Duration method shall continue to apply as hitherto. Under this, the price sensitivity of all interest rate positions viz., Dated securities, Treasury bills, Commercial papers, PSU/FI/Corporate Bonds, Special Bonds, Mutual Fund units and derivative instruments like IRS, FRA, IRF etc., including underwriting commitments/devolvement and other contingent liabilities having interest rate/equity risk will be captured.

In duration method, the capital charge is the sum of four components namely:

- a) the net short or long position in the whole trading book;
- b) a small proportion of the matched positions in each time-band (the “*vertical disallowance*”);
- c) a larger proportion of the matched positions across different time-bands (the “*horizontal disallowance*”); and
- d) a net charge for positions in options, where appropriate.

**Note 1:** *Since short position in India is allowed only in derivatives and G-Sec, netting as indicated at (a) and the system of ‘disallowances’ as at (b) and (c) above are applicable currently only to the PDs entering into FRAs / IRSs / exchange traded derivatives and G-Sec.*

However, under the duration method, PDs with the necessary capability may, with RBI’s permission use a more accurate method of measuring all of their general market risks by calculating the price sensitivity of each position separately. PDs must select and use the method on a consistent basis and the system adopted will be subjected to monitoring by the RBI. The mechanics of this method are as follow:

- (i) first calculate the price sensitivity of all instruments in terms of a change in interest rates between 0.6 and 1.0 percentage points depending on the duration of the instrument (as per Table 1 given below);

- (ii) slot the resulting sensitivity measures into a duration-based ladder with the thirteen time-bands set out in Table 1;
- (iii) subject the lower of the long and short positions in each time-band to a 5% capital charge towards vertical disallowance designed to capture basis risk;
- (iv) carry forward the net positions in each time-band for horizontal offsetting across the zones subject to the disallowances set out in Table 2.

**Note 2:** Points (iii) and (iv) above are applicable only where opposite positions exist as explained at Note 1 above.

<b>Table 1</b>	
<b>Duration time-bands and assumed changes in yield (%)</b>	
<b>Zone 1</b>	
0 to 1 month	1.00
1 to 3 months	1.00
3 to 6 months	1.00
6 to 12 months	1.00
<b>Zone 2</b>	
1 to 2 years	0.95
2 to 3 years	0.90
3 to 4 years	0.85
<b>Zone 3</b>	
4 to 5 years	0.85
5 to 7 years	0.80
7 to 10 years	0.75
10 to 15 years	0.70
15 to 20 years	0.65
Over 20 years	0.60



Table 2				
Horizontal disallowances				
Zones	Time-band	Within the zone	Between adjacent zones	Between zones 1 and 3
Zone 1	0 – month	40%	40%	100%
	1 – 3 months			
	3 – 6 months			
	6 – 12 months			
Zone 2	1 – 2 years	30%		
	2 – 3 years			
	3 – 4 years			
Zone 3	4 – 5 years	30%		
	5 – 7 years			
	7 – 10 years			
	10 – 15 years			
	15 – 20 years			
	Over 20 years			

The gross positions in each time-band will be subject to risk weighting as per the assumed change in yield set out in Table 1, with no further offsets.

#### **A1.1 Capital charge for interest rate derivatives**

The measurement system shall include all interest rate derivatives and off balance-sheet instruments in the trading book which react to changes in interest rates, (e.g. FRAs, other forward contracts, bond futures, interest rate positions).

#### **A1.2 Calculation of positions**

Derivatives shall be converted into positions in the relevant underlying and subjected to market risk charges as described above. In order to calculate the market risk as per the standardized approach described above, the amounts reported should be the market value of the principal amount of the underlying or of the notional underlying.

### **A1.3 Futures and Forward Contracts (including FRAs)**

These instruments are treated as a combination of a long and a short position in a notional government security. The maturity of a future contract or an FRA will be the period until delivery or exercise of the contract, plus - where applicable - the life of the underlying instrument. For example, a long position in a June three-month IRF taken in April is to be reported as a long position in a government security with a maturity of five months and a short position in a government security with a maturity of two months. Where a range of deliverable instruments may be delivered to fulfill the contract, the PD has flexibility to elect which deliverable security goes into the maturity or duration ladder but should take account of any conversion factor defined by the exchange. In the case of a future on a corporate bond index, positions will be included at the market value of the notional underlying portfolio of securities.

### **A1.4 Swaps**

Swaps will be treated as two notional positions in G-Sec with relevant maturities. For example, an IRS under which a PD is receiving floating rate interest and paying fixed will be treated as a long position in a floating rate instrument of maturity equivalent to the period until the next interest fixing and a short position in a fixed-rate instrument of maturity equivalent to the residual life of the swap. For swaps that pay or receive a fixed or floating interest rate against some other reference price, e.g. a stock index, the interest rate component should be slotted into the appropriate re-pricing maturity category, with the equity component being included in the equity framework.

### **A1.5 Calculation of capital charges**

Allowable offsetting of matched positions - PDs may exclude from the interest rate maturity framework altogether (long and short positions, both actual and notional) in identical instruments with exactly the same issuer, coupon and maturity. A matched position in a future or forward and its corresponding underlying may also be fully offset, and thus excluded from the calculation. When the future or the forward comprises a range of deliverable instruments, offsetting of positions in the future or forward contract and its underlying is only permissible in cases where there is a readily identifiable underlying security which is most profitable for the trader with a short position to deliver.

The leg representing the time to expiry of the future should, however, be taken into account. The price of this security, sometimes called the "cheapest-to-deliver", and the price of the future or forward contract should in such cases move in close alignment.

In addition, opposite positions in the same category of instruments can in certain circumstances be regarded as matched and allowed to offset fully. To qualify for this treatment the positions must relate to the same underlying instruments and be of the same nominal value. In addition:

- (i) **For futures:** offsetting positions in the notional or underlying instruments to which the futures contract relates must be for identical products and mature within seven days of each other;
- (ii) **For swaps and FRAs:** the reference rate (for floating rate positions) must be identical and the coupon closely matched (i.e. within 15 basis points); and
- (iii) **For swaps, FRAs and forwards:** the next interest fixing date or, for fixed coupon positions or forwards, the residual maturity must correspond within the following limits:
  - less than one month hence: same day;
  - between one month and one year hence: within seven days;
  - over one year hence: within thirty days.

PDs with large swap books may use alternative formulae for these swaps to calculate the positions to be included in the duration ladder. One method would be to first convert the payments required by the swap into their present values. For that purpose, each payment shall be discounted using zero coupon yields, and a single net figure for the present value of the cash flows entered into the appropriate time-band using procedures that apply to zero (or low) coupon bonds; these figures should be slotted into the general market risk framework as set out earlier. An alternative method would be to calculate the sensitivity of the net present value implied by the change in yield used in the duration method and allocate these sensitivities into the time-bands set out in Table 1. Other methods which produce similar results could also be used. Such alternative treatments will, however, only be allowed if:

- the supervisory authority is fully satisfied with the accuracy of the systems being used;
- the positions calculated fully reflect the sensitivity of the cash flows to interest rate changes and are entered into the appropriate time-bands;

General market risk applies to positions in all derivative products in the same manner as for cash positions, subject only to an exemption for fully or very closely-matched positions in identical instruments as defined in above paragraphs. The various categories of instruments shall be slotted into the maturity ladder and treated according to the rules identified earlier.

## **A2 Capital charge for equity positions<sup>8</sup>**

### **A2.1 Equity positions**

This section sets out a minimum capital standard to cover the risk of holding or taking positions in equities by the PDs. It applies to long and short positions in all instruments that exhibit market behavior similar to equities, but not to non-convertible preference shares (which will be covered by the interest rate risk requirements). Long and short positions in the same issue shall be reported on a net basis. The instruments covered include equity shares, convertible securities that behave like equities, i.e., units of Mutual Funds and commitments to buy or sell equities. The equity or equity like positions including those arrived at in relation to equity /index derivatives as described in following sections shall be included in the duration ladder below one month.

### **A2.2 Equity derivatives**

Equity derivatives and off balance-sheet positions which are affected by changes in equity prices should be included in the measurement system. This includes futures and swaps on both individual equities and on stock indices. The derivatives are to be converted into positions in the relevant underlying.

### **A2.3 Calculation of positions**

In order to calculate the market risk as per the standardized approach for credit and market risk, positions in derivatives should be converted into notional equity positions:

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<sup>8</sup> As per the [circular IDMD.PDRS.26/03.64.00/2006-07 dated July 4, 2006](#) on "Diversification of PD Activities", PDs have been allowed to calculate the capital charge for market risk on equity and equity derivatives using the Internal Models approach only.

- futures and forward contracts relating to individual equities should in principle be reported at current market prices;
- futures relating to stock indices should be reported as the marked-to-market value of the notional underlying equity portfolio;
- equity swaps are to be treated as two notional positions

### **A3 Capital Charge for Foreign Exchange (FE) Position:**

PDs normally would not be dealing in FE transactions. However, as they have been permitted to raise resources under FCNR (B) loan route, subject to prescribed guidelines, they may end up holding open FE positions. Such open positions in equivalent rupees arrived at by marking to market at FEDAI rates will be subject to a flat market risk charge of 15 per cent.

### **B. Internal risk management framework based method**

The PDs should calculate the capital requirement based on their internal risk management framework based VaR model for market risk, as per the following minimum parameters:

- (a) **VaR** must be computed on a daily basis at a 99<sup>th</sup> percentile, one-tailed confidence interval.
- (b) An instantaneous price shock equivalent to a 15-day movement in prices is to be used, i.e. the minimum "holding period" will be fifteen trading days.
- (c) Interest rate sensitivity of the entire portfolio should be captured on an integrated basis by including all fixed income securities like G-Sec, Corporate/PSU bonds, CPs and derivatives like IRS, FRAs, IRFs, etc., based on the mapping of the cash flows to work out the portfolio VaR. Wherever data for calculating volatilities is not available, PDs shall calculate the volatilities of such instruments using the G-Sec yield curve with appropriate spread. However, the details of such instruments and the spreads applied have to be reported and consistency of methodology should be ensured.
- (d) Instruments which are part of trading book, but found difficult to be subjected to measurement of market risk shall be applied a flat market risk measure of 15 per cent. These include units of Mutual Funds,

unquoted equity, etc., and should be added arithmetically to the measure obtained under VaR in respect of other instruments.

- (e) Underwriting commitments as explained at the beginning of the Annex should also be mapped into the VaR framework for risk measurement purposes.
- (f) The unhedged FE position arising out of the foreign currency borrowings under FCNR (B) loans scheme would carry a market risk of 15 per cent as hitherto and the measure obtained will be added arithmetically to the VaR measure obtained for other instruments.
- (g) The choice of *historical observation period* (sample period) for calculating VaR will be constrained to a minimum length of one year and not less than **250** trading days. For PDs who use a weighting scheme or other methods for the historical observation period, the "effective" observation period must be at least one year (that is, the weighted average time lag of the individual observations cannot be less than 6 months).
- (h) The capital requirement will be the higher of:
  - a) the previous day's VaR number measured according to the above parameters specified in this section; and
  - b) the average of the daily VaR measures on each of the preceding **sixty** business days, multiplied by a multiplication factor prescribed by the RBI (**3.3** presently).
- (i) No particular type of model is prescribed. So long as the model used captures all the material risks run by the PDs, they will be free to use models, based for example, on variance-covariance matrices, historical simulations, Monte Carlo simulations or Extreme Value Theory (EVT), etc.
- (j) The criteria for use of internal model to measure market risk capital charge are given by Internal Debt Management Department of the Bank.

## Illustration

### Statement of Capital Adequacy - Quarter ended -

Name of the Primary Dealer :

Statement - 1 (Summary)

(Amount in Rs.)

- (i) Total of Risk Weighted Assets(RWA) for Credit Risk (Appendix I)
  
- (ii) (a) Tier-I Capital funds (after deductions)  
 (b) Tier-II Capital funds eligible  
 (c) Total of available Tier-I & II capital funds
  
- (iii) Minimum credit risk capital required  
 i.e. (i) x 15 per cent
  
- (iv) Excess of Tier-I & II capital funds available  
 for market risk capital charge i.e. (ii) (c) – (iii)
  
- (v) The Market Risk capital charge worked  
 out as the higher of the amounts under the  
 Standardised method and the one as per  
 internal risk management framework based VaR model  
 (Appendices II and III)
  
- (vi) Capital funds available to meet (v)  
 i.e: excess of Tier-I and Tier-II as at (iv) above,
- (vii) **Over all Capital Adequacy**
  - (a) Total RWA for credit risk i.e. (i)
  - (b) Capital charge for market risk i.e. (v)
  - (c) Numerical Link for (b) = 6.67  
 i.e.(reciprocal of credit risk capital ratio of 15%)
  - (d) Risk Weighted Assets relating to  
 Market Risk i.e. (b) x (c)
  - (e) Total Risk Weighted Assets i.e. (a) + (d)
  - (f) Minimum capital required i.e. (e) x 15%
  - (g) Total Capital funds available i.e. (ii) + (vi)
  - (h) **less** : Capital funds prescribed by other regulators/  
 licensors e.g. SEBI/ NSE/ BSE/OTCEI

(i) Net capital funds available  $(g - h)$   
for PD business

(viii) Capital to Risk-Weighted Assets Ratio (CRAR) %  $(i / e) * 100$



**Guidelines for Entry of NBFCs into Insurance**

1. NBFCs registered with the Bank are permitted to undertake insurance agency business on fee basis and without risk participation, without the approval of the Bank subject to the following conditions:

(i) The NBFCs shall obtain requisite permission from IRDA and comply with the IRDA regulations for acting as 'composite corporate agent' with insurance companies.

(ii) The NBFCs shall not adopt any restrictive practice of forcing its customers to go in only for a particular insurance company in respect of assets financed by the NBFC. The customers shall be allowed to exercise their own choice.

(iii) As the participation by a NBFC's customer in insurance products is purely on a voluntary basis, it shall be stated in all publicity material distributed by the NBFC in a prominent way. There shall be no 'linkage' either direct or indirect between the provision of financial services offered by the NBFC to its customers and use of the insurance products.

(iv) The premium shall be paid by the insured directly to the insurance company without routing through the NBFC.

(v) The risks, if any, involved in insurance agency shall not get transferred to the business of the NBFC.

2. No NBFC would be allowed to conduct such business departmentally. A subsidiary or company in the same group of an NBFC or of another NBFC engaged in the business of a non-banking financial institution or banking business will not normally be allowed to join the insurance company on risk participation basis.

3. All NBFCs registered with RBI which satisfy the eligibility criteria given below will be permitted to set up a joint venture company for undertaking insurance business with risk participation subject to safeguards. The maximum equity contribution such an NBFC can hold in the joint venture company will normally be 50 per cent of the paid-up capital of the insurance company. On a selective basis, the Bank may permit a higher equity contribution by a promoter NBFC initially, pending divestment of equity within the prescribed period [see Note (1) below].

In case more than one company (irrespective of doing financial activity or not) in the same group of the NBFC wishes to take a stake in the insurance company, the contribution by all companies in the same group shall be counted for the limit of 50 percent prescribed for the NBFC in an insurance JV.

In cases where IRDA issues calls for capital infusion into the Insurance JV company, the Bank may, on a case to case basis, consider need based relaxation of the 50% group limit as specified. The relaxation, if permitted, will be subject to compliance by the NBFC with all regulatory conditions as prescribed for in these Directions and such other conditions as may be necessary in the specific case. Application for such relaxation along with supporting documents is to be submitted by the NBFC to the Regional Office of the Bank under whose jurisdiction its registered office is situated.

The eligibility criteria for joint venture participant will be as stated below:

- (i) The owned fund of the NBFC shall not be less than ₹ 500 crore,
- (ii) The level of net non-performing assets shall be not more than 5% of the total outstanding leased/hire purchase assets and advances taken together,
- (iii) The NBFC shall have net profit for the last three continuous years,
- (iv) The track record of the performance of the subsidiaries, if any, of the concerned NBFC shall be satisfactory,
- (v) Regulatory compliance and servicing public deposits, if held.

The provisions of RBI Act shall be applicable for such investments while computing the net owned funds of the NBFC.

4. In case where a foreign partner contributes 26 per cent of the equity with the approval of insurance Regulatory and Development Authority/Foreign Investment Promotion Board, more than one NBFC may be allowed to participate in the equity of the insurance joint venture. As such participants will also assume insurance risk, only those NBFCs which satisfy the criteria given in paragraph 2 above, would be eligible.

5. NBFCs registered with RBI which are not eligible as joint venture participant, as above can make investments up to 10 per cent of the owned fund of the NBFC or ₹

50 crore, whichever is lower, in the insurance company. Such participation shall be treated as an investment and should be without any contingent liability for the NBFC. The eligibility criteria for these NBFCs will be as under:

- (i) The level of net NPA shall be not more than 5 per cent of total outstanding leased/hire purchase assets and advances;
- (ii) The NBFC shall have net profit for the last three continuous years.

**Notes :**

(1) Holding of equity by a promoter NBFC in an insurance company or participation in any form in insurance business will be subject to compliance with any rules and regulations laid down by the IRDA/Central Government. This will include compliance with Section 6AA of the Insurance Act as amended by the IRDA Act, 1999, for divestment of equity in excess of 26 per cent of the paid up capital within a prescribed period of time.

(2) The eligibility criteria shall be reckoned with reference to the latest available audited balance sheet for the previous year.

## **Guidelines on Distribution of Mutual Fund Products by NBFCs**

1. NBFCs, which desire to distribute mutual funds, shall be required to adhere to the following stipulations:

### **(i) Operational Aspects**

(a) The NBFC is required to comply with the SEBI guidelines / regulations, including its code of conduct, for distribution of mutual fund products;

(b) the NBFC shall not adopt any restrictive practice of forcing its customers to go in for a particular mutual fund product sponsored by it. Its customers must be allowed to exercise their own choice;

(c) the participation by the NBFCs customers in mutual fund products is purely on a voluntary basis and this information shall be stated in all publicity material distributed by it in a prominent way. There shall be no 'linkage' either direct or indirect between the provisions of financial services offered by the NBFC to its customers and distribution of the mutual fund products;

(d) the NBFC shall only act as an agent of its customers, forwarding their applications for purchase / sale of MF units together with the payment instruments, to the Mutual Fund / the Registrars / the transfer agents. The purchase of units should be at the customers' risk and without the NBFC guaranteeing any assured return;

(e) the NBFC shall neither acquire units of mutual funds from the secondary market for sale to its customers, nor shall it buy back units of mutual funds from its customers;

(f) in case the NBFC is holding custody of MF units on behalf of its customers, it shall ensure that its own investments and the investments belonging to its customers are kept distinct from each other.

### **(ii) Other Aspects**

(a) The NBFC shall have put in place a comprehensive Board approved policy regarding undertaking mutual funds distribution. The services relating to the same should be offered to its customers in accordance with this policy. The policy will also

encompass issues of customer appropriateness and suitability as well as grievance redressal mechanism. The code of conduct prescribed by SEBI, as amended from time to time and as applicable, must be complied with by NBFCs undertaking these activities;

(b) the NBFC shall be adhering to Know Your Customer (KYC) Guidelines and provisions of prevention of Money Laundering Act.

2. NBFCs shall comply with other terms and conditions as the Bank may specify in this regard from time to time.

**Publication of Financial Results**

**Name of Primary Dealer**

Audited Financial Results for the year ended March 31, .....

**Sources of Funds**

- Capital
- Reserves and Surplus
- Loans
  - Secured
  - Unsecured
  - (of which call money borrowings)

**Application of Funds**

- Fixed Assets
- Investments
  - Government Securities (inclusive of T-Bills & CMBs)
  - Commercial Papers
  - Corporate Bonds
- Loans and Advances
  - (of which call money lendings)
- Non Current Assets
- Others

**Profits and Loss account**

- Income (business segment wise)
  - Interest
  - Discount
  - Trading Profit
- Expenses
  - Interest
  - Administrative Costs
- Profit before tax
- Net Profit

**Regulatory Capital required (as per Capital Adequacy Guidelines)**

**Actual Capital**

**Return on Net Worth**

Notes on Accounts:

**'Fit and Proper' Criteria for directors of NBFCs**

Reserve Bank had issued a Directive in June 2004 to banks on undertaking due diligence on the persons before appointing them on the Boards of banks based on the 'Report of the Consultative Group of directors of Banks / Financial Institutions'. Specific 'fit and proper' criteria to be fulfilled by the directors were also advised.

2. The importance of due diligence of directors to ascertain suitability for the post by way of qualifications, technical expertise, track record, integrity, etc. needs no emphasis for any financial institution. It is proposed to follow the same guidelines *mutatis mutandis* in case of NBFCs also. While the Bank does carry out due diligence on directors before issuing Certificate of Registration to an NBFC, it is necessary that NBFCs put in place an internal supervisory process on a continuing basis. Further, in order to streamline and bring in uniformity in the process of due diligence, while appointing directors, NBFCs are advised to ensure that the procedures mentioned below are followed and minimum criteria fulfilled by the persons before they are appointed on the Boards:

(a) NBFCs shall undertake a process of due diligence to determine the suitability of the person for appointment / continuing to hold appointment as a director on the Board, based upon qualification, expertise, track record, integrity and other 'fit and proper' criteria. NBFCs shall obtain necessary information and declaration from the proposed / existing directors for the purpose in the format given at Annex IX.

(b) The process of due diligence shall be undertaken by the NBFCs at the time of appointment / renewal of appointment.

(c) The boards of the NBFCs shall constitute Nomination Committees to scrutinize the declarations.

(d) Based on the information provided in the signed declaration, Nomination Committees shall decide on the acceptance or otherwise of the directors, where considered necessary.

(e) NBFCs shall obtain annually as on 31st March a simple declaration from the directors that the information already provided has not undergone change and where there is any change, requisite details are furnished by them forthwith.

(f) The Board of the NBFC must ensure in public interest that the nominated/ elected directors execute the deeds of covenants in the format given in Annex X.

Name of NBFC: \_\_\_\_\_

<b>Declaration and Undertaking by Director (<u>with enclosures as appropriate as on _____</u>)</b>		
<b>I.</b>	<b>Personal details of director</b>	
a.	Full name	
b.	Date of Birth	
c.	Educational Qualifications	
d.	Relevant Background and Experience	
e.	Permanent Address	
f.	Present Address	
g.	E-mail Address / Telephone Number	
h.	Permanent Account Number under the Income Tax Act and name and address of Income Tax Circle	
i.	Relevant knowledge and experience	
j.	Any other information relevant to Directorship of the NBFC	
<b>II</b>	<b>Relevant Relationships of director</b>	
a.	List of Relatives if any who are connected with the NBFC (Refer Section 6 and Schedule 1A of the Companies Act, 1956 and corresponding provisions of New Companies Act, 2013)	
b.	List of entities if any in which he/she is considered as being interested (Refer Section 299(3)(a) and Section 300 of the Companies Act, 1956 and corresponding provisions of New Companies Act, 2013)	
c.	List of entities in which he/she is considered as holding substantial interest within the meaning of prudential norms as prescribed in these Directions.	
d.	Name of NBFC in which he/she is or has been a member of the board (giving details of period during which such office was held)	
e.	Fund and non-fund facilities, if any, presently availed of	



		by him/her and/or by entities listed in II (b) and (c) above from the NBFC	
	f.	Cases, if any, where the director or entities listed in II (b) and (c) above are in default or have been in default in the past in respect of credit facilities obtained from the NBFC or any other NBFC / bank.	
III	<b>Records of professional achievements</b>		
	a.	Relevant professional achievements	
IV.	<b>Proceedings, if any, against the director</b>		
	a.	If the director is a member of a professional association/body, details of disciplinary action, if any, pending or commenced or resulting in conviction in the past against him/her or whether he/she has been banned from entry into any profession/ occupation at any time.	
	b.	Details of prosecution, if any, pending or commenced or resulting in conviction in the past against the director and/or against any of the entities listed in II (b) and (c) above for violation of economic laws and regulations	
	c.	Details of criminal prosecution, if any, pending or commenced or resulting in conviction in the last five years against the director	
	d.	Whether the director attracts any of the disqualifications envisaged under Section 274 of the Companies Act 1956 and corresponding provisions of New Companies Act, 2013?	
	e.	Has the director or any of the entities at II (b) and (c) above been subject to any investigation at the instance of Government department or agency?	
	f.	Has the director at any time been found guilty of violation of rules/regulations/ legislative requirements by customs/ excise /income tax/foreign exchange /other revenue authorities, if so give particulars	
	g.	Whether the director has at any time come to the adverse notice of a regulator such as SEBI, IRDA, MCA.	

	(Though it shall not be necessary for a candidate to mention in the column about orders and findings made by the regulators which have been later on reversed/set aside in toto, it would be necessary to make a mention of the same, in case the reversal/setting aside is on technical reasons like limitation or lack of jurisdiction, etc and not on merit, If the order of the regulator is temporarily stayed and the appellate/ court proceedings are pending, the same also should be mentioned.)	
V.	<b>Any other explanation / information in regard to items I to III and other information considered relevant for judging fit and proper</b>	
	<b>Undertaking</b>	
	I confirm that the above information is to the best of my knowledge and belief true and complete. I undertake to keep the NBFC fully informed, as soon as possible, of all events which take place subsequent to my appointment which are relevant to the information provided above.	
	I also undertake to execute the deed of covenant required to be executed by all directors of the NBFC.	
	Place :	Signature
	Date :	
VI.	<b>Remarks of Chairman of Nomination Committee/Board of Directors of NBFC</b>	
	Place :	Signature
	Date:	

**Form of Deed of Covenants with a Director of an NBFC**

**THIS DEED OF COVENANTS** is made this \_\_\_\_\_ day of \_\_\_\_\_ Two thousand \_\_\_\_\_ **BETWEEN** \_\_\_\_\_, having its registered office at \_\_\_\_\_ (hereinafter a deposit taking NBFC and a non-deposit taking NBFC with asset size of ₹ 500 crore and above being called the "NBFC") of the one part and Mr / Ms \_\_\_\_\_ of \_\_\_\_\_ (hereinafter called the "Director") of the other part.

**WHEREAS**

A. The director has been appointed as a director on the Board of Directors of the NBFC (hereinafter called "the Board") and is required as a term of his / her appointment to enter into a Deed of Covenants with the NBFC.

B. The director has agreed to enter into this Deed of Covenants, which has been approved by the Board, pursuant to his said terms of appointment.

**NOW IT IS HEREBY AGREED AND THIS DEED OF COVENANTS WITNESSETH AS FOLLOWS :**

1. The director acknowledges that his / her appointment as director on the Board of the NBFC is subject to applicable laws and regulations including the Memorandum and Articles of Association of the NBFC and the provisions of this Deed of Covenants.

2. The director covenants with the NBFC that :

(i) The director shall disclose to the Board the nature of his / her interest, direct or indirect, if he / she has any interest in or is concerned with a contract or arrangement or any proposed contract or arrangement entered into or to be entered into between the NBFC and any other person, immediately upon becoming aware of the same or at meeting of the Board at which the question of entering into such contract or arrangement is taken into consideration or if the director was not at the date of that meeting concerned or interested in such proposed contract or arrangement, then at the first meeting of the Board held after he / she becomes so concerned or interested and in case of any other contract or arrangement, the required disclosure shall be made at the first meeting of the Board held after the director becomes concerned or interested in the contract or arrangement.

(ii) The director shall disclose by general notice to the Board his / her other directorships, his / her memberships of bodies corporate, his / her interest in other

entities and his / her interest as a partner or proprietor of firms and shall keep the Board apprised of all changes therein.

(iii) The director shall provide to the NBFC a list of his / her relatives as defined in the Companies Act, 1956 or 2013 and to the extent the director is aware of directorships and interests of such relatives in other bodies corporate, firms and other entities.

(iv) The director shall in carrying on his / her duties as director of the NBFC:

- a. use such degree of skill as may be reasonable to expect from a person with his / her knowledge or experience;
- b. in the performance of his / her duties take such care as he / she might be reasonably expected to take on his / her own behalf and exercise any power vested in him / her in good faith and in the interests of the NBFC;
- c. shall keep himself / herself informed about the business, activities and financial status of the NBFC to the extent disclosed to him / her;
- d. attend meetings of the Board and Committees thereof (collectively for the sake of brevity hereinafter referred to as "Board") with fair regularity and conscientiously fulfil his / her obligations as director of the NBFC;
- e. shall not seek to influence any decision of the Board for any consideration other than in the interests of the NBFC;
- f. shall bring independent judgment to bear on all matters affecting the NBFC brought before the Board including but not limited to statutory compliances, performance reviews, compliances with internal control systems and procedures, key executive appointments and standards of conduct;
- g. shall in exercise of his / her judgement in matters brought before the Board or entrusted to him / her by the Board be free from any business or other relationship which could materially interfere with the exercise of his / her independent judgement; and
- h. shall express his / her views and opinions at Board meetings without any fear or favour and without any influence on exercise of his / her independent judgement;

(v) The director shall have :

- a. fiduciary duty to act in good faith and in the interests of the NBFC and not for any collateral purpose;
- b. duty to act only within the powers as laid down by the NBFC's Memorandum and Articles of Association and by applicable laws and regulations; and
- c. duty to acquire proper understanding of the business of the NBFC.

(vi) The director shall :

- a. not evade responsibility in regard to matters entrusted to him / her by the Board;
- b. not interfere in the performance of their duties by the whole-time directors and other officers of the NBFC and wherever the director has reasons to believe otherwise, he / she shall forthwith disclose his / her concerns to the Board; and
- c. not make improper use of information disclosed to him / her as a member of the Board for his / her or someone else's advantage or benefit and shall use the information disclosed to him / her by the NBFC in his / her capacity as director of the NBFC only for the purposes of performance of his / her duties as a director and not for any other purpose.

3. The NBFC covenants with the director that:

(i) the NBFC shall apprise the director about:

- a. Board procedures including identification of legal and other duties of Director and required compliances with statutory obligations;
- b. control systems and procedures;
- c. voting rights at Board meetings including matters in which Director should not participate because of his / her interest, direct or indirect therein;
- d. qualification requirements and provide copies of Memorandum and Articles of Association;
- e. corporate policies and procedures;
- f. insider dealing restrictions;
- g. constitution of, delegation of authority to and terms of reference of various committees constituted by the Board;
- h. appointments of Senior Executives and their authority;
- i. remuneration policy,
- j. deliberations of committees of the Board, and
- k. communicate any changes in policies, procedures, control systems, applicable regulations including Memorandum and Articles of Association of the NBFC, delegation of authority, Senior Executives, etc. and appoint the compliance officer who shall be responsible for all statutory and legal compliance.

(ii) the NBFC shall disclose and provide to the Board including the director all information which is reasonably required for them to carry out their functions and duties as a director of the NBFC and to take informed decisions in respect of matters brought before the Board for its consideration or entrusted to the director by the Board or any committee thereof;

(iii) the disclosures to be made by the NBFC to the directors shall include but not be limited to the following :

- a. all relevant information for taking informed decisions in respect of matters brought before the Board;
- b. NBFC's strategic and business plans and forecasts;
- c. organisational structure of the NBFC and delegation of authority;
- d. corporate and management controls and systems including procedures;
- e. economic features and marketing environment;
- f. information and updates as appropriate on NBFC's products;
- g. information and updates on major expenditure;
- h. periodic reviews of performance of the NBFC; and
- i. report periodically about implementation of strategic initiatives and plans;

(iv) the NBFC shall communicate outcome of Board deliberations to directors and concerned personnel and prepare and circulate minutes of the meeting of Board to directors in a timely manner and to the extent possible within two business days of the date of conclusion of the Board meeting; and

(v) advise the director about the levels of authority delegated in matters placed before the Board.

4. The NBFC shall provide to the director periodic reports on the functioning of internal control system including effectiveness thereof.

5. The NBFC shall appoint a compliance officer who shall be a Senior executive reporting to the Board and be responsible for setting forth policies and procedures and shall monitor adherence to the applicable laws and regulations and policies and procedures including but not limited to directions of the Bank and other concerned statutory and governmental authorities.

6. The director shall not assign, transfer, sublet or encumber his / her office and his / her rights and obligations as director of the NBFC to any third party provided that nothing herein contained shall be construed to prohibit delegation of any authority, power, function or delegation by the Board or any committee thereof subject to applicable laws and regulations including Memorandum and Articles of Association of the NBFC.

7. The failure on the part of either party hereto to perform, discharge, observe or comply with any obligation or duty shall not be deemed to be a waiver thereof nor shall it operate as a bar to the performance, observance, discharge or compliance thereof at any time or times thereafter.

8. Any and all amendments and / or supplements and / or alterations to this Deed of Covenants shall be valid and effectual only if in writing and signed by the director and the duly authorised representative of the NBFC.

9. This Deed of Covenants has been executed in duplicate and both the copies shall be deemed to be originals.

**IN WITNESS WHEREOF THE PARTIES HAVE DULY EXECUTED THIS AGREEMENT ON THE DAY, MONTH AND YEAR FIRST ABOVE WRITTEN.**

For the NBFC	Director	
By .....		
Name:	Name:	
Title:		
In the presence of:		
1.		2. ....

---

**Indicative List of Balance Sheet Disclosure for non-deposit taking NBFCs with Asset Size ₹ 500 Crore and Above and Deposit Taking NBFCs (hereinafter called as Applicable NBFCs)**

**1. Minimum Disclosures**

At a minimum, the items listed in this Annex shall be disclosed in the NTA by all applicable NBFCs. The disclosures listed are intended only to supplement, and not to replace, other disclosure requirements as applicable.

**2. Summary of Significant Accounting Policies**

Applicable NBFCs shall disclose the accounting policies regarding key areas of operations at one place along with NTA in their financial statements. A suggestive list includes - Basis of Accounting, Transactions involving Foreign Exchange, Investments - Classification, Valuation, etc, Advances and Provisions thereon, Fixed Assets and Depreciation, Revenue Recognition, Employee Benefits, Provision for Taxation, Net Profit, etc.

**3.1 Capital**

(Amount in ₹ crore)			
Particulars		Current Year	Previous Year
i)	CRAR (%)		
ii)	CRAR - Tier I Capital (%)		
iii)	CRAR - Tier II Capital (%)		
iv)	Amount of subordinated debt raised as Tier-II capital		
v)	Amount raised by issue of Perpetual Debt Instruments		



### 3.2 Investments

			(Amount in ₹ crore)	
Particulars			Current Year	Previous Year
(1)	Value of Investments			
	(i)	Gross Value of Investments		
		(a) In India		
		(b) Outside India,		
	(ii)	Provisions for Depreciation		
		(a) In India		
		(b) Outside India,		
	(iii)	Net Value of Investments		
		(a) In India		
		(b) Outside India.		
(2)	Movement of provisions held towards depreciation on investments.			
	(i)	Opening balance		
	(ii)	Add : Provisions made during the year		
	(iii)	Less : Write-off / write-back of excess provisions during the year		
	(iv)	Closing balance		

### 3.3 Derivatives

#### 3.3.1 Forward Rate Agreement / Interest Rate Swap

(Amount in Rs crore)			
Particulars		Current Year	Previous Year
(i)	The notional principal of swap agreements		
(ii)	Losses which would be incurred if counterparties failed to fulfill their obligations under the agreements		
(iii)	Collateral required by the applicable NBFC upon entering into swaps		
(iv)	Concentration of credit risk arising from the swaps \$		
(v)	The fair value of the swap book @		
<p>Note: Nature and terms of the swaps including information on credit and market risk and the accounting policies adopted for recording the swaps should also be disclosed.</p>			
<p>\$ Examples of concentration could be exposures to particular industries or swaps with highly geared companies.</p>			
<p>@ If the swaps are linked to specific assets, liabilities, or commitments, the fair value would be the estimated amount that the applicable NBFC would receive or pay to terminate the swap agreements as on the balance sheet date.</p>			

### 3.3.2 Exchange Traded Interest Rate (IR) Derivatives

(Amount in ₹ crore)		
S. No.	Particulars	Amount
(i)	Notional principal amount of exchange traded IR derivatives undertaken during the year (instrument-wise)	
	a)	
	b)	
	c)	
(ii)	Notional principal amount of exchange traded IR derivatives outstanding as on 31st March ..... (instrument-wise)	
	a)	
	b)	
	c)	
(iii)	Notional principal amount of exchange traded IR derivatives outstanding and not "highly effective" (instrument-wise)	
	a)	
	b)	
	c)	
(iv)	Mark-to-market value of exchange traded IR derivatives outstanding and not "highly effective" (instrument-wise)	
	a)	
	b)	
	c)	

### 3.3.3 Disclosures on Risk Exposure in Derivatives

#### Qualitative Disclosure

Applicable NBFCs shall describe their risk management policies pertaining to derivatives with particular reference to the extent to which derivatives are used, the associated risks and business purposes served. The discussion shall also include:

- a) the structure and organization for management of risk in derivatives trading,
- b) the scope and nature of risk measurement, risk reporting and risk monitoring systems,
- c) policies for hedging and / or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges / mitigants, and
- d) accounting policy for recording hedge and non-hedge transactions; recognition of income, premiums and discounts; valuation of outstanding contracts; provisioning, collateral and credit risk mitigation.

#### Quantitative Disclosures

(Amount in ₹ crore)			
Sl. No.	Particular	Currency Derivatives	Interest Rate Derivatives
(i)	Derivatives (Notional Principal Amount)		
	For hedging		
(ii)	Marked to Market Positions [1]		
	a) Asset (+)		
	b) Liability (-)		
(iii)	Credit Exposure [2]		
(iv)	Unhedged Exposures		

### 3.4 Disclosures relating to Securitisation

**3.4.1** The NTA of the originating applicable NBFCs shall indicate the outstanding amount of securitised assets as per books of the SPVs sponsored by the applicable NBFC and total amount of exposures retained by the NBFC as on the date of balance sheet to comply with the Minimum Retention Requirements (MRR). These figures shall be based on the information duly certified by the SPV's auditors obtained by the originating applicable NBFC from the SPV. These disclosures shall be made in the format given below.

Sr. No.	Particulars	No./Amount in ₹ crore
1.	No of SPVs sponsored by the applicable NBFC for securitisation transactions*	
2.	Total amount of securitised assets as per books of the SPVs sponsored	
3.	Total amount of exposures retained by the applicable NBFC to comply with MRR as on the date of balance sheet	
	a) Off-balance sheet exposures	
	First loss	
	Others	
	b) On-balance sheet exposures	
	First loss	
4.	Amount of exposures to securitisation transactions other than MRR	
	a) Off-balance sheet exposures	
	i) Exposure to own securitizations	
	First loss	
	Loss	
	ii) Exposure to third party securitisations	
	First loss	
	Others	
	b) On-balance sheet exposures	
	i) Exposure to own securitisations	

			First loss	
			Others	
		ii)	Exposure to third party securitisations	
			First loss	
			Others	
*Only the SPVs relating to outstanding securitisation transactions shall be reported here				

### 3.4.2 Details of Financial Assets sold to Securitisation / Reconstruction Company for Asset Reconstruction

(Amount in ₹ crore)			
Particulars		Current year	Previous Year
(i)	No. of accounts		
(ii)	Aggregate value (net of provisions) of accounts sold to SC / RC		
(iii)	Aggregate consideration		
(iv)	Additional consideration realized in respect of accounts transferred in earlier years		
(v)	Aggregate gain / loss over net book value		

### 3.4.3 Details of Assignment transactions undertaken by applicable NBFCs

			(Amount in ₹ crore)	
Particulars			Current year	Previous Year
(i)	No. of accounts			
(ii)	Aggregate value (net of provisions) of accounts sold			
(iii)	Aggregate consideration			
(iv)	Additional consideration realized in respect of accounts transferred in earlier years			
(v)	Aggregate gain / loss over net book value			

### 3.4.4 Details of non-performing financial assets purchased / sold

Applicable NBFCs which purchase non-performing financial assets from other NBFCs shall be required to make the following disclosures in the NTA to their Balance sheets:

#### A. Details of non-performing financial assets purchased :

			(Amount in ₹ crore)	
Particulars			Current year	Previous Year
1.	(a)	No. of accounts purchased during the year		
	(b)	Aggregate outstanding		
2.	(a)	Of these, number of accounts restructured during the year		
	(b)	Aggregate outstanding		

**B. Details of Non-performing Financial Assets sold :**

(Amount in ₹ crore)			
Particulars		Current year	Previous Year
1.	No. of accounts sold		
2.	Aggregate outstanding		
3.	Aggregate consideration received		

**3.5 Asset Liability Management Maturity pattern of certain items of Assets and Liabilities**

	Up to 30/31 days	Over 1 month upto 2 Month	Over 2 months upto 3 months	Over 3 month & up to 6 month	Over 6 Month & up to 1 year	Over 1 year & up to 3 years	Over 3 years & up to 5 years	Over 5 years	Total
Deposits									
Advances									
Investments									
Borrowings									
Foreign Currency assets									
Foreign Currency liabilities									



### 3.6 Exposures

#### 3.6.1 Exposure to Real Estate Sector

		(Amount in ₹ crore)	
Category		Current Year	Previous Year
a)	<b>Direct Exposure</b>		
(i)	<b>Residential Mortgages -</b>		
	Lending fully secured by mortgages on residential property that is or will be occupied by the borrower or that is rented		
(ii)	<b>Commercial Real Estate -</b>		
	Lending secured by mortgages on commercial real estates (office buildings, retail space, multi-purpose commercial premises, multi-family residential buildings, multi-tenanted commercial premises, industrial or warehouse space, hotels, land acquisition, development and construction, etc.). Exposure would also include non-fund based limits		
(iii)	<b>Investments in Mortgage Backed Securities (MBS) and other securitised exposures -</b>		
a.	Residential		
b.	Commercial Real Estate		
<b>Total Exposure to Real Estate Sector</b>			

### 3.6.2 Exposure to Capital Market

(Amount in ₹ crore)			
<b>Particulars</b>		<b>Current Year</b>	<b>Previous Year</b>
(i)	direct investment in equity shares, convertible bonds, convertible debentures and units of equity-oriented mutual funds the corpus of which is not exclusively invested in corporate debt;		
(ii)	advances against shares / bonds / debentures or other securities or on clean basis to individuals for investment in shares (including IPOs / ESOPs), convertible bonds, convertible debentures, and units of equity-oriented mutual funds;		
(iii)	advances for any other purposes where shares or convertible bonds or convertible debentures or units of equity oriented mutual funds are taken as primary security;		
(iv)	advances for any other purposes to the extent secured by the collateral security of shares or convertible bonds or convertible debentures or units of equity oriented mutual funds i.e. where the primary security other than shares / convertible bonds / convertible debentures / units of equity oriented mutual funds 'does not fully cover the advances;		
(v)	secured and unsecured advances to stockbrokers and guarantees issued on behalf of stockbrokers and market makers;		
(vi)	loans sanctioned to corporates against the security of shares / bonds / debentures or other securities or on clean basis for meeting promoter's contribution to the		

	equity of new companies in anticipation of raising resources;		
(vii)	bridge loans to companies against expected equity flows / issues;		
(viii)	all exposures to Venture Capital Funds (both registered and unregistered)		
<b>Total Exposure to Capital Market</b>			

### **3.6.3 Details of financing of parent company products**

### **3.6.4 Details of Single Borrower Limit (SGL) / Group Borrower Limit (GBL) exceeded by the applicable NBFC**

The applicable NBFC shall make appropriate disclosure in the NTA to the annual financial statements in respect of the exposures where the applicable NBFC had exceeded the prudential exposure limits during the year. The sanctioned limit or entire outstanding, whichever is high, shall be reckoned for exposure limit.

### **3.6.5 Unsecured Advances**

a) For determining the amount of unsecured advances the rights, licenses, authorisations, etc., charged to the applicable NBFCs as collateral in respect of projects (including infrastructure projects) financed by them, shall not be reckoned as tangible security. Hence such advances shall be reckoned as unsecured.

b) Applicable NBFCs shall also disclose the total amount of advances for which intangible securities such as charge over the rights, licenses, authority, etc. has been taken as also the estimated value of such intangible collateral. The disclosure shall be made under a separate head in NTA. This would differentiate such loans from other entirely unsecured loans.

## **4. Miscellaneous**

### **4.1 Registration obtained from other financial sector regulators**

### **4.2 Disclosure of Penalties imposed by RBI and other regulators**

Consistent with the international best practices in disclosure of penalties imposed by the regulators, placing the details of the levy of penalty on the applicable NBFC in public domain will be in the interests of the investors and depositors. Further, strictures or directions on the basis of inspection reports or other adverse findings

should also be placed in the public domain. The penalties shall also be disclosed in the NTA.

#### **4.3 Related Party Transactions**

- a. Details of all material transactions with related parties shall be disclosed in the annual report
- b. The company shall disclose the policy on dealing with Related Party Transactions on its website and also in the Annual Report.

#### **4.4 Ratings assigned by credit rating agencies and migration of ratings during the year**

#### **4.5 Remuneration of Directors**

All pecuniary relationship or transactions of the non-executive directors vis-à-vis the company shall be disclosed in the Annual Report.

#### **4.6 Management**

As part of the directors' report or as an addition thereto, a Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This Management Discussion & Analysis shall include discussion on the following matters within the limits set by the company's competitive position:

- a. Industry structure and developments.
- b. Opportunities and Threats.
- c. Segment-wise or product-wise performance.
- d. Outlook
- e. Risks and concerns.
- f. Internal control systems and their adequacy.
- g. Discussion on financial performance with respect to operational performance.
- h. Material developments in Human Resources / Industrial Relations front, including number of people employed.

#### **4.7 Net Profit or Loss for the period, prior period items and changes in accounting policies**

Since the format of the profit and loss account of applicable NBFCs does not specifically provide for disclosure of the impact of prior period items on the current year's profit and loss, such disclosures, wherever warranted, shall be made in the NTA.

#### **4.8 Revenue Recognition**

An enterprise shall also disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.

#### **4.9 Accounting Standard 21 -Consolidated Financial Statements (CFS)**

Applicable NBFCs shall be guided by general clarifications issued by ICAI from time to time.

A parent company, presenting the CFS, should consolidate the financial statements of all subsidiaries - domestic as well as foreign. The reasons for not consolidating a subsidiary shall be disclosed in the CFS. The responsibility of determining whether a particular entity shall be included or not for consolidation would be that of the Management of the parent entity. In case, its Statutory Auditors are of the opinion that an entity, which ought to have been consolidated, has been omitted, they should incorporate their comments in this regard in the "Auditors Report".

### **5. Additional Disclosures**

#### **5.1 Provisions and Contingencies**

To facilitate easy reading of the financial statements and to make the information on all Provisions and Contingencies available at one place, applicable NBFCs are required to disclose in the NTA the following information:

(Amount in ₹ crore)		
Break up of 'Provisions and Contingencies' shown under the head Expenditure in Profit and Loss Account	Current Year	Previous Year
Provisions for depreciation on Investment		
Provision towards NPA		
Provision made towards Income tax		
Other Provision and Contingencies (with details)		
Provision for Standard Assets		

#### **5.2 Draw Down from Reserves**

Suitable disclosures shall be made regarding any draw down of reserves in the NTA.

### 5.3 Concentration of Deposits, Advances, Exposures and NPAs

#### 5.3.1 Concentration of Deposits (for deposit taking NBFCs)

(Amount in ₹ crore)	
Total Deposits of twenty largest depositors	
Percentage of Deposits of twenty largest depositors to Total Deposits of the deposit taking NBFC.	

#### 5.3.2 Concentration of Advances

(Amount in ₹ crore)	
Total Advances to twenty largest borrowers	
Percentage of Advances to twenty largest borrowers to Total Advances of the applicable NBFC	

#### 5.3.3 Concentration of Exposures

(Amount in ₹ crore)	
Total Exposure to twenty largest borrowers / customers	
Percentage of Exposures to twenty largest borrowers / customers to Total Exposure of the applicable NBFC on borrowers / customers	

#### 5.3.4 Concentration of NPAs

(Amount in ₹ crore)	
Total Exposure to top four NPA accounts	

### 5.3.5 Sector-wise NPAs

Sl. No.	Sector	Percentage of NPAs to Total Advances in that sector
1.	Agriculture & allied activities	
2.	MSME	
3.	Corporate borrowers	
4.	Services	
2.	Unsecured personal loans	
3.	Auto loans	
4.	Other personal loans	

### 5.4 Movement of NPAs

(Amount in ₹ crore)			
Particulars		Current Year	Previous Year
(i)	Net NPAs to Net Advances (%)		
(ii)	Movement of NPAs (Gross)		
	(a) Opening balance		
	(b) Additions during the year		
	(c) Reductions during the year		
	(d) Closing balance		
(iii)	Movement of Net NPAs		
	(a) Opening balance		
	(b) Additions during the year		
	(c) Reductions during the year		
	(d) Closing balance		
(iv)	Movement of provisions for NPAs (excluding provisions on standard assets)		
	(a) Opening balance		
	(b) Provisions made during the year		
	(c) Write-off / write-back of excess		

		provisions		
	(d)	Closing balance		

### 5.5 Overseas Assets (for those with Joint Ventures and Subsidiaries abroad)

Name of the Joint Venture/ Subsidiary	Other Partner in the JV	Country	Total Assets
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### 5.6 Off-balance Sheet SPVs sponsored

(which are required to be consolidated as per accounting norms)

Name of the SPV sponsored	
Domestic	Overseas

## 6. Disclosure of Complaints

### 6.1 Customer Complaints

(a)	No. of complaints pending at the beginning of the year	
(b)	No. of complaints received during the year	
(c)	No. of complaints redressed during the year	
(d)	No. of complaints pending at the end of the year	



**Capital Charge for Foreign Exchange (FE) Position:**

Market Risk: As prescribed in the existing capital adequacy guidelines, the capital charge for market risk in foreign exchange shall be worked out by the standardised approach and the internal risk management framework based Value at Risk (VaR) model. The capital charge for market risk would be higher of the two requirements.

Under standardised approach, PD's net open positions in each currency shall be calculated and the same shall be risk weighted as 100 per cent. These open positions shall be subject to a flat market risk charge of 15 per cent.

Credit Risk: Since currency futures contracts would be subject to CCP clearing of the authorised stock exchanges, capital charge for credit risk would be calculated as per methodology prescribed for calculation of capital charge for exposure towards CCP issued vide circular IDMD.PCD.11/14.03.05/2013-14 dated March 27, 2014. The Credit Conversion Factor (CCF) to be used for exchange rate contracts would be as under:

<b>CCF for Market-Related Off-Balance Sheet Items Residual Maturity</b>	<b>CCF (%)</b>
<b>Exchange Rate Contracts</b>	
One year or less	2.00
Over one year to five years	10.00
Over five years	15.00

<b>Reporting Format for Primary Dealers declaring Dividend</b>				
Details of dividend declared during the financial year beginning on .....				
Name of the Primary Dealer _____				
Accounting Period*	Net Profit for the Accounting Period (Cumulative)	Rate of Dividend (Cumulative)	Amount of Dividend (excluding Dividend Tax) (Cumulative)	Payout Ratio (Cumulative)
	₹ in crore	Per cent	₹ in crore	Per cent
* - quarter or half year or year ended, as the case may be.				
<b>Note :</b> While submitting the statement for the final dividend declared, details of the interim dividends declared, if any, shall also be included in the statement.				
I / We confirm that the guidelines issued by the Bank for declaration of dividend have been complied with while declaring the abovementioned dividend.				
Authorised Signatories				
Name :				
Designation :				
Date :				

**Directions on Managing Risks and Code of Conduct in Outsourcing of Financial Services by SPDs**

**1. Introduction**

1.1 'Outsourcing' is defined as the NBFC's use of a third party (either an affiliated entity within a corporate group or an entity that is external to the corporate group) to perform activities on a continuing basis that would normally be undertaken by the NBFC itself, now or in the future.

'Continuing basis' includes agreements for a limited period.

1.2 NBFCs have been outsourcing various activities and are hence exposed to various risks as detailed in para 5.3. Further, the outsourced activities are to be brought within regulatory purview to a) protect the interest of the customers of NBFCs and b) to ensure that the NBFC concerned and the Reserve Bank of India have access to all relevant books, records and information available with service provider. Typically outsourced financial services include applications processing (loan origination, credit card), document processing, marketing and research, supervision of loans, data processing and back office related activities, besides others.

1.3 Some key risks in outsourcing are Strategic Risk, Reputation Risk, Compliance Risk, Operational Risk, Legal Risk, Exit Strategy Risk, Counterparty Risk, Country Risk, Contractual Risk, Access Risk, Concentration and Systemic Risk. The failure of a service provider in providing a specified service, a breach in security/ confidentiality, or non-compliance with legal and regulatory requirements by the service provider can lead to financial losses or loss of reputation for the NBFC and could also lead to systemic risks.

1.4 It is therefore imperative for the NBFC outsourcing its activities to ensure sound and responsive risk management practices for effective oversight, due diligence and management of risks arising from such outsourced activities. The directions are applicable to material outsourcing arrangements as explained in para 3 which may be entered into by an NBFC with a service provider located in India or elsewhere. The service provider may either be a member of the group/ conglomerate to which the NBFC belongs, or an unrelated party.

1.5 The underlying principles behind these directions are that the regulated entity shall ensure that outsourcing arrangements neither diminish its ability to fulfil its obligations to customers and RBI nor impede effective supervision by RBI. NBFCs, therefore, have to take steps to ensure that the service provider employs the same high standard of care in performing the services as is expected to be employed by the NBFCs, if the activities were

conducted within the NBFCs and not outsourced. Accordingly, NBFCs shall not engage in outsourcing that would result in their internal control, business conduct or reputation being compromised or weakened.

1.6 (i) These directions are concerned with managing risks in outsourcing of financial services and are not applicable to technology-related issues and activities not related to financial services, such as usage of courier, catering of staff, housekeeping and janitorial services, security of the premises, movement and archiving of records, etc. NBFCs which desire to outsource financial services would not require prior approval from RBI. However, such arrangements would be subject to on-site/ off- site monitoring and inspection/ scrutiny by RBI.

(ii) In regard to outsourced services relating to credit cards, RBI's detailed instructions contained in its circular on credit card activities vide [DBOD.FSD.BC.49/24.01.011/2005-06 dated November 21, 2005](#) would be applicable.

## **2. Activities that shall not be outsourced**

NBFCs which choose to outsource financial services shall, however, not outsource core management functions including Internal Audit, Strategic and Compliance functions and decision-making functions such as determining compliance with KYC norms for opening deposit accounts, according sanction for loans (including retail loans) and management of investment portfolio. However, for NBFCs in a group/conglomerate, these functions may be outsourced within the group subject to compliance with instructions in Para 6. Further, while internal audit function itself is a management process, the internal auditors can be on contract.

## **3. Material Outsourcing**

For the purpose of these directions, material outsourcing arrangements are those which, if disrupted, have the potential to significantly impact the business operations, reputation, profitability or customer service. Materiality of outsourcing would be based on:

- the level of importance to the NBFC of the activity being outsourced as well as the significance of the risk posed by the same;
- the potential impact of the outsourcing on the NBFC on various parameters such as earnings, solvency, liquidity, funding capital and risk profile;
- the likely impact on the NBFC's reputation and brand value, and ability to achieve its business objectives, strategy and plans, should the service provider fail to perform the service;

- the cost of the outsourcing as a proportion of total operating costs of the NBFC;
- the aggregate exposure to that particular service provider, in cases where the NBFC outsources various functions to the same service provider and
- the significance of activities outsourced in context of customer service and protection.

#### **4. NBFC's role and Regulatory and Supervisory Requirements**

4.1 The outsourcing of any activity by NBFC does not diminish its obligations, and those of its Board and senior management, who have the ultimate responsibility for the outsourced activity. NBFCs would therefore be responsible for the actions of their service provider including Direct Sales Agents/ Direct Marketing Agents and recovery agents and the confidentiality of information pertaining to the customers that is available with the service provider. NBFCs shall retain ultimate control of the outsourced activity.

4.2 It is imperative for the NBFC, when performing its due diligence in relation to outsourcing, to consider all relevant laws, regulations, guidelines and conditions of approval, licensing or registration.

4.3 Outsourcing arrangements shall not affect the rights of a customer against the NBFC, including the ability of the customer to obtain redress as applicable under relevant laws. In cases where the customers are required to deal with the service providers in the process of dealing with the NBFC, NBFCs shall incorporate a clause in the relative product literature/ brochures, etc., stating that they may use the services of agents in sales/ marketing etc. of the products. The role of agents may be indicated in broad terms.

4.4 The service provider shall not impede or interfere with the ability of the NBFC to effectively oversee and manage its activities nor shall it impede the Reserve Bank of India in carrying out its supervisory functions and objectives.

4.5 NBFCs need to have a robust grievance redress mechanism, which in no way shall be compromised on account of outsourcing.

4.6 The service provider, if not a group company of the NBFC, shall not be owned or controlled by any director of the NBFC or their relatives; these terms have the same meaning as assigned under Companies Act, 2013.

## **5. Risk Management practices for Outsourced Financial Services**

### **5.1 Outsourcing Policy**

An NBFC intending to outsource any of its financial activities shall put in place a comprehensive outsourcing policy, approved by its Board, which incorporates, *inter alia*, criteria for selection of such activities as well as service providers, delegation of authority depending on risks and materiality and systems to monitor and review the operations of these activities.

### **5.2 Role of the Board and Senior Management**

#### **5.2.1 Role of the Board**

The Board of the NBFC, or a Committee of the Board to which powers have been delegated shall be responsible *inter alia* for the following:

- i. approving a framework to evaluate the risks and materiality of all existing and prospective outsourcing and the policies that apply to such arrangements;
- ii. laying down appropriate approval authorities for outsourcing depending on risks and materiality;
- iii. setting up suitable administrative framework of senior management for the purpose of these directions;
- iv. undertaking regular review of outsourcing strategies and arrangements for their continued relevance, and safety and soundness and
- v. deciding on business activities of a material nature to be outsourced, and approving such arrangements.

#### **5.2.2 Responsibilities of the Senior Management**

- i. Evaluating the risks and materiality of all existing and prospective outsourcing, based on the framework approved by the Board;
- ii. developing and implementing sound and prudent outsourcing policies and procedures commensurate with the nature, scope and complexity of the outsourcing activity;
- iii. reviewing periodically the effectiveness of policies and procedures;
- iv. communicating information pertaining to material outsourcing risks to the Board in a timely manner;

- v. ensuring that contingency plans, based on realistic and probable disruptive scenarios, are in place and tested;
- vi. ensuring that there is independent review and audit for compliance with set policies and
- vii. undertaking periodic review of outsourcing arrangements to identify new material outsourcing risks as they arise.

### **5.3 Evaluation of the Risks**

The NBFCs shall evaluate and guard against the following risks in outsourcing:

- i. Strategic Risk – Where the service provider conducts business on its own behalf, inconsistent with the overall strategic goals of the NBFC.
- ii. Reputation Risk – Where the service provided is poor and customer interaction is not consistent with the overall standards expected of the NBFC.
- iii. Compliance Risk – Where privacy, consumer and prudential laws are not adequately complied with by the service provider.
- iv. Operational Risk- Arising out of technology failure, fraud, error, inadequate financial capacity to fulfil obligations and/ or to provide remedies.
- v. Legal Risk – Where the NBFC is subjected to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements due to omissions and commissions of the service provider.
- vi. Exit Strategy Risk – Where the NBFC is over-reliant on one firm, the loss of relevant skills in the NBFC itself preventing it from bringing the activity back in-house and where NBFC has entered into contracts that make speedy exits prohibitively expensive.
- vii. Counter party Risk – Where there is inappropriate underwriting or credit assessments.
- viii. Contractual Risk – Where the NBFC may not have the ability to enforce the contract.
- ix. Concentration and Systemic Risk – Where the overall industry has considerable exposure to one service provider and hence the NBFC may lack control over the service provider.
- x. Country Risk – Due to the political, social or legal climate creating added risk.

## **5.4 Evaluating the Capability of the Service Provider**

5.4.1 In considering or renewing an outsourcing arrangement, appropriate due diligence shall be performed to assess the capability of the service provider to comply with obligations in the outsourcing agreement. Due diligence shall take into consideration qualitative and quantitative, financial, operational and reputational factors. NBFCs shall consider whether the service providers' systems are compatible with their own and also whether their standards of performance including in the area of customer service are acceptable to it. NBFCs shall also consider, while evaluating the capability of the service provider, issues relating to undue concentration of outsourcing arrangements with a single service provider. Where possible, the NBFC shall obtain independent reviews and market feedback on the service provider to supplement its own findings.

5.4.2 Due diligence shall involve an evaluation of all available information about the service provider, including but not limited to the following:

- i. past experience and competence to implement and support the proposed activity over the contracted period;
- ii. financial soundness and ability to service commitments even under adverse conditions;
- iii. business reputation and culture, compliance, complaints and outstanding or potential litigation;
- iv. security and internal control, audit coverage, reporting and monitoring environment, business continuity management and
- v. ensuring due diligence by service provider of its employees.

## **5.5 The Outsourcing Agreement**

The terms and conditions governing the contract between the NBFC and the service provider shall be carefully defined in written agreements and vetted by NBFC's legal counsel on their legal effect and enforceability. Every such agreement shall address the risks and risk mitigation strategies. The agreement shall be sufficiently flexible to allow the NBFC to retain an appropriate level of control over the outsourcing and the right to intervene with appropriate measures to meet legal and regulatory obligations. The agreement shall also bring out the nature of legal relationship between the parties - i.e. whether agent, principal or otherwise. Some of the key provisions of the contract shall be the following:

- i. the contract shall clearly define what activities are going to be outsourced including appropriate service and performance standards;



- ii. the NBFC must ensure it has the ability to access all books, records and information relevant to the outsourced activity available with the service provider;
- iii. the contract shall provide for continuous monitoring and assessment by the NBFC of the service provider so that any necessary corrective measure can be taken immediately;
- iv. a termination clause and minimum period to execute a termination provision, if deemed necessary, shall be included;
- v. controls to ensure customer data confidentiality and service providers' liability in case of breach of security and leakage of confidential customer related information shall be incorporated;
- vi. there must be contingency plans to ensure business continuity;
- vii. the contract shall provide for the prior approval/ consent by the NBFC of the use of subcontractors by the service provider for all or part of an outsourced activity;
- viii. it shall provide the NBFC with the right to conduct audits on the service provider whether by its internal or external auditors, or by agents appointed to act on its behalf and to obtain copies of any audit or review reports and findings made on the service provider in conjunction with the services performed for the NBFC;
- ix. outsourcing agreements shall include clauses to allow the Reserve Bank of India or persons authorised by it to access the NBFC's documents, records of transactions, and other necessary information given to, stored or processed by the service provider within a reasonable time;
- x. outsourcing agreement shall also include a clause to recognise the right of the Reserve Bank to cause an inspection to be made of a service provider of an NBFC and its books and account by one or more of its officers or employees or other persons;
- xi. the outsourcing agreement shall also provide that confidentiality of customer's information shall be maintained even after the contract expires or gets terminated and
- xii. the NBFC shall have necessary provisions to ensure that the service provider preserves documents as required by law and take suitable steps to ensure that its interests are protected in this regard even post termination of the services.

## **5.6 Confidentiality and Security**

5.6.1 Public confidence and customer trust in the NBFC is a prerequisite for the stability and reputation of the NBFC. Hence the NBFC shall seek to ensure the preservation and

protection of the security and confidentiality of customer information in the custody or possession of the service provider.

5.6.2 Access to customer information by staff of the service provider shall be on 'need to know' basis i.e., limited to those areas where the information is required in order to perform the outsourced function.

5.6.3 The NBFC shall ensure that the service provider is able to isolate and clearly identify the NBFC's customer information, documents, records and assets to protect the confidentiality of the information. In instances, where service provider acts as an outsourcing agent for multiple NBFCs, care shall be taken to build strong safeguards so that there is no comingling of information / documents, records and assets.

5.6.4 The NBFC shall review and monitor the security practices and control processes of the service provider on a regular basis and require the service provider to disclose security breaches.

5.6.5 The NBFC shall immediately notify RBI in the event of any breach of security and leakage of confidential customer related information. In these eventualities, the NBFC would be liable to its customers for any damages.

## **5.7 Responsibilities of Direct Sales Agents (DSA)/ Direct Marketing Agents (DMA)/ Recovery Agents**

5.7.1 NBFCs shall ensure that the DSA/ DMA/ Recovery Agents are properly trained to handle their responsibilities with care and sensitivity, particularly aspects such as soliciting customers, hours of calling, privacy of customer information and conveying the correct terms and conditions of the products on offer, etc.

5.7.2 NBFCs shall put in place a board approved Code of conduct for DSA/ DMA/ Recovery Agents, and obtain their undertaking to abide by the code. In addition, Recovery Agents shall adhere to extant instructions on Fair Practices Code for NBFCs as also their own code for collection of dues and repossession of security. It is essential that the Recovery Agents refrain from action that could damage the integrity and reputation of the NBFC and that they observe strict customer confidentiality.

5.7.3 The NBFC and their agents shall not resort to intimidation or harassment of any kind, either verbal or physical, against any person in their debt collection efforts, including acts intended to humiliate publicly or intrude the privacy of the debtors' family members, referees and friends, making threatening and anonymous calls or making false and misleading representations.

## **5.8 Business Continuity and Management of Disaster Recovery Plan**

5.8.1 An NBFC shall require its service providers to develop and establish a robust framework for documenting, maintaining and testing business continuity and recovery procedures. NBFCs need to ensure that the service provider periodically tests the Business Continuity and Recovery Plan and may also consider occasional joint testing and recovery exercises with its service provider.

5.8.2 In order to mitigate the risk of unexpected termination of the outsourcing agreement or liquidation of the service provider, NBFCs shall retain an appropriate level of control over their outsourcing and the right to intervene with appropriate measures to continue its business operations in such cases without incurring prohibitive expenses and without any break in the operations of the NBFC and its services to the customers.

5.8.3 In establishing a viable contingency plan, NBFCs shall consider the availability of alternative service providers or the possibility of bringing the outsourced activity back in-house in an emergency and the costs, time and resources that would be involved.

5.8.4 Outsourcing often leads to the sharing of facilities operated by the service provider. The NBFC shall ensure that service providers are able to isolate the NBFC's information, documents and records, and other assets. This is to ensure that in appropriate situations, all documents, records of transactions and information given to the service provider, and assets of the NBFC, can be removed from the possession of the service provider in order to continue its business operations, or deleted, destroyed or rendered unusable.

## **5.9 Monitoring and Control of Outsourced Activities**

5.9.1 The NBFC shall have in place a management structure to monitor and control its outsourcing activities. It shall ensure that outsourcing agreements with the service provider contain provisions to address their monitoring and control of outsourced activities.

5.9.2 A central record of all material outsourcing that is readily accessible for review by the Board and senior management of the NBFC shall be maintained. The records shall be updated promptly and half yearly reviews shall be placed before the Board or Risk Management Committee.

5.9.3 Regular audits by either the internal auditors or external auditors of the NBFC shall assess the adequacy of the risk management practices adopted in overseeing and managing the outsourcing arrangement, the NBFC's compliance with its risk management framework and the requirements of these directions.

5.9.4 NBFCs shall at least on an annual basis, review the financial and operational condition of the service provider to assess its ability to continue to meet its outsourcing obligations. Such due diligence reviews, which can be based on all available information about the service provider shall highlight any deterioration or breach in performance standards, confidentiality and security, and in business continuity preparedness.

5.9.5 In the event of termination of the outsourcing agreement for any reason in cases where the service provider deals with the customers, the same shall be publicized by displaying at a prominent place in the branch, posting it on the web-site, and informing the customers so as to ensure that the customers do not continue to deal with the service provider.

5.9.6 Certain cases, like outsourcing of cash management, might involve reconciliation of transactions between the NBFC, the service provider and its sub-contractors. In such cases, NBFCs shall ensure that reconciliation of transactions between the NBFC and the service provider (and/ or its sub-contractor), are carried out in a timely manner. An ageing analysis of entries pending reconciliation with outsourced vendors shall be placed before the Audit Committee of the Board (ACB) and NBFCs shall make efforts to reduce the old outstanding items therein at the earliest.

5.9.7 A robust system of internal audit of all outsourced activities shall also be put in place and monitored by the ACB of the NBFC.

#### **5.10 Redress of Grievances related to Outsourced Services**

i. NBFCs shall constitute Grievance Redressal Machinery as contained in RBI's circular on Grievance Redressal Mechanism vide [DNBS. CC. PD. No. 320/03.10. 01/2012-13 dated February 18, 2013](#). At the operational level, all NBFCs shall display the name and contact details (Telephone/ Mobile nos. as also email address) of the Grievance Redressal Officer prominently at their branches/ places where business is transacted. The designated officer shall ensure that genuine grievances of customers are redressed promptly without involving delay. It shall be clearly indicated that NBFCs' Grievance Redressal Machinery will also deal with the issue relating to services provided by the outsourced agency.

ii. Generally, a time limit of 30 days may be given to the customers for preferring their complaints/ grievances. The grievance redressal procedure of the NBFC and the time frame fixed for responding to the complaints shall be placed on the NBFC's website.

### **5.11 Reporting of transactions to FIU or other competent authorities**

NBFCs would be responsible for making Currency Transactions Reports and Suspicious Transactions Reports to FIU or any other competent authority in respect of the NBFCs' customer related activities carried out by the service providers.

## **6. Outsourcing within a Group/ Conglomerate**

6.1 In a group structure, NBFCs may have back-office and service arrangements/ agreements with group entities e.g. sharing of premises, legal and other professional services, hardware and software applications, centralize back-office functions, outsourcing certain financial services to other group entities, etc. Before entering into such arrangements with group entities, NBFCs shall have a Board approved policy and also service level agreements/arrangements with their group entities, which shall also cover demarcation of sharing resources i.e. premises, personnel, etc. Moreover the customers shall be informed specifically about the company which is actually offering the product/service, wherever there are multiple group entities involved or any cross selling observed.

6.2 While entering into such arrangements, NBFCs shall ensure that these:

- a. are appropriately documented in written agreements with details like scope of services, charges for the services and maintaining confidentiality of the customer's data;
- b. do not lead to any confusion to the customers on whose products/services they are availing by clear physical demarcation of the space where the activities of the NBFC and those of its other group entities are undertaken;
- c. do not compromise the ability to identify and manage risk of the NBFC on a stand-alone basis;
- d. do not prevent the RBI from being able to obtain information required for the supervision of the NBFC or pertaining to the group as a whole; and
- e. incorporate a clause under the written agreements that there is a clear obligation for any service provider to comply with directions given by the RBI in relation to the activities of the NBFC.

6.3 NBFCs shall ensure that their ability to carry out their operations in a sound fashion would not be affected if premises or other services (such as IT systems, support staff) provided by the group entities become unavailable.

6.4 If the premises of the NBFC are shared with the group entities for the purpose of cross-selling, NBFCs shall take measures to ensure that the entity's identification is distinctly visible and clear to the customers. The marketing brochure used by the group entity and verbal communication by its staff / agent in the NBFCs premises shall mention nature of arrangement of the entity with the NBFC so that the customers are clear on the seller of the product.

6.5 NBFCs shall not publish any advertisement or enter into any agreement stating or suggesting or giving tacit impression that they are in any way responsible for the obligations of its group entities.

6.6 The risk management practices expected to be adopted by an NBFC while outsourcing to a related party (i.e. party within the Group / Conglomerate) would be identical to those specified in Para 5 of this directions.

## **7. Off-shore outsourcing of Financial Services**

7.1 The engagement of service providers in a foreign country exposes an NBFC to country risk -economic, social and political conditions and events in a foreign country that may adversely affect the NBFC. Such conditions and events could prevent the service provider from carrying out the terms of its agreement with the NBFC. To manage the country risk involved in such outsourcing activities, the NBFC shall take into account and closely monitor government policies and political, social, economic and legal conditions in countries where the service provider is based, both during the risk assessment process and on a continuous basis, and establish sound procedures for dealing with country risk problems. This includes having appropriate contingency and exit strategies. In principle, arrangements shall only be entered into with parties operating in jurisdictions generally upholding confidentiality clauses and agreements. The governing law of the arrangement shall also be clearly specified.

7.2 The activities outsourced outside India shall be conducted in a manner so as not to hinder efforts to supervise or reconstruct the India activities of the NBFC in a timely manner.

7.3 As regards the off-shore outsourcing of financial services relating to Indian Operations, NBFCs shall additionally ensure that

- a) Where the off-shore service provider is a regulated entity, the relevant off-shore regulator will neither obstruct the arrangement nor object to RBI inspection visits/ visits of NBFCs internal and external auditors.

- b) The availability of records to management and the RBI will withstand the liquidation of either the offshore custodian or the NBFC in India.
- c) The regulatory authority of the offshore location does not have access to the data relating to Indian operations of the NBFC simply on the ground that the processing is being undertaken there (not applicable if off shore processing is done in the home country of the NBFC).
- d) The jurisdiction of the courts in the off shore location where data is maintained does not extend to the operations of the NBFC in India on the strength of the fact that the data is being processed there even though the actual transactions are undertaken in India and
- e) All original records continue to be maintained in India.

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