

Investments Avenues for the Urban Cooperative Banks



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The investment avenues for the urban cooperative banks (UCBs) are governed by the regulatory prescriptions of the Reserve Bank of India (RBI), which comes out with relevant instructions from time to time. The Master Circular dated July 02, 2007 issued by the Reserve Bank of India is the most updated instructions on the investment guidelines issued by the Central Bank to the UCBs.

Existing Stipulations

a. SLR Investments

Typically, the investment of the UCBs may be broadly classified as statutory investment viz. SLR investments and the non-SLR investments. In terms of provisions of section 24 of the Banking Regulation (BR) Act 1949, (as applicable to co-operative societies), every UCB is required to maintain liquid assets which at the close of business on any day should not be less than 25 percent of its demand and time liabilities in India. The banks may hold such liquid assets in the form of cash, gold or unencumbered approved securities. The 'approved securities' are defined under section 5(a) (i) & (ii) of the BR Act, 1949 (AACS) and means any securities in which a trustee may invest money under clause (a), (b), (bb), (c) or (d) of Section 20 of the Indian Trust Act, 1882 and such securities authorised by the Central Government under clause (f) of Section 20 of the Indian Trust Act, 1882 as may be prescribed.

All UCBs are required to achieve certain minimum level of their SLR holdings in the form of government and other approved securities as percentage of their Net Demand and Time Liabilities (NDTL) as indicated below:

- a. Scheduled UCBs should have 25 per cent of their SLR holdings in government and approved securities
- b. Non scheduled UCBs with NDTL more than Rs. 25 crore should have 15 per cent of their SLR holdings in government and approved securities
- c. Non scheduled UCBs with NDTL less than Rs. 25 crore should have 10 per cent of their SLR holdings in government and approved securities

Further, the non-scheduled UCBs, having single branch-cum-head-office or having multiple branches within a single district and having a deposit base of Rs.100 crore or less are exempted from maintaining SLR in prescribed assets up to 15% of their DTL if they maintain an equivalent amount in interest bearing deposits, with State Bank of India and its subsidiary banks and the public sector banks including Industrial Development Bank of India Ltd. Such exemption is available to the UCBs up to March 31, 2008.

The Securities may be held in any of the three forms viz:

- a. Physical Scrip form
- b. Subsidiary General Ledger (SGL) Account and

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- c. In a dematerialised account with depositories (NSDL/CDSL, NSCCL).

In respect of securities with SGL facility, the SGL account can be maintained in the bank's own name directly with the Reserve Bank of India, or in a Constituent SGL (CSGL) Account opened with any scheduled commercial bank/state co-operative bank / primary dealer (PD) or Stock Holding Corporation of India Ltd. (SHCIL). Further, UCBs are not permitted to open and maintain CSGL A/cs of other PCBs / other entities like charitable institutions, trusts etc. Non-scheduled UCBs with DTL of Rs.25 crore & above and all scheduled primary (urban) co-operative banks are required to maintain investments in government securities only in SGL Accounts with the Reserve Bank of India or in Constituent SGL Accounts with PDs/scheduled commercial banks/state co-operative banks/depositories SHCIL.

Only scheduled UCBs, not classified as Grade III/IV, are at present permitted to become members of NDS and participate in DVP III mode for settlement of Government securities transactions. As per the present instructions issued by RBI, UCBs should seek a scheduled commercial bank, a primary dealer, a financial institution, another UCB, insurance company, mutual fund or provident fund, as counter-party for their transactions. Preference should be given for direct deals with such counter parties. Scheduled UCBs may undertake retailing of Government securities with non-bank clients, such as, provident funds, non-banking financial companies, high net worth individuals. UCBs may take advantage of the non-competitive bidding facility in the auction of Government of India dated securities provided by RBI. Under this scheme, *banks may bid upto Rs. two crore (face value) in any auction of Government of India dated securities, either directly, through a bank or through a primary dealer.* CSGL Accounts should be used for holding the securities and such accounts should be maintained in the same bank with which the cash account is maintained. For availing of this facility, no bidding skill is required, as allotment up to Rs. two crore (face value) is made at the weighted average cut-off rate which emerges in the auction. UCBs may also participate directly or through a bank or a primary dealer in the auctions of state development loans, where coupon is mostly fixed in advance and notified by RBI. An advertisement in leading newspapers is issued 4-5 days in advance of the date of auction. Half yearly auction calendar of Government of India securities is also issued by RBI. No transactions in Government securities by a primary (urban)

co-operative bank should be undertaken in physical form with any broker. All Government securities transactions (both Outright and Repo) are being settled compulsorily through Clearing Corporation of India Ltd. (CCIL) only. Any transactions in Government securities for settlement by the banks outside the NDS-CCIL system are not being entertained by Reserve Bank of India. UCBs, which are not a member of NDS-CCIL system, should undertake their transactions in Government securities through gilt account/de-mat account maintained with a Negotiated Dealing System (NDS) member. UCBs have the option to undertake transactions in dated Government of India (GOI) securities in dematerialized form on automated order driven system of the National Stock Exchange (NSE), The Stock Exchange, Mumbai (BSE) and Over the Counter Exchange of India (OTCEI) in addition to the existing mode of dealing through SGL accounts with Reserve Bank of India or Constituent SGL accounts with the designated entities such as Scheduled Commercial Bank/ Primary Dealer/State Cooperative Bank etc. trading members of the stock exchanges shall not be involved in the settlement process for any RBI regulated entity. All stock exchange trades of banks have to be settled either directly with CCIL/clearing house (in case they are clearing members) or else through a clearing member custodian.

b. Non-SLR Investments

As per the RBI instructions, the UCBs are not permitted to subscribe to the initial or subsequent issue of shares / debentures of private sector companies or bodies or organisations other than in co-operative sector. Further, non-scheduled UCBs can place deposits with scheduled UCBs provided they are complying with the prescribed level of CRAR, NPA below 7 per cent, no default in CRR / SLR maintenance in the previous two years and the bank has declared profit for the last three consecutive years. The scheduled UCBs accepting deposits from these banks should not have such deposits for more than 10 per cent of their deposit liabilities as on March 31 of the previous year and the deposit made by the non-scheduled UCB should not be more than 15 per cent of the capital fund of the former.

UCBs are not permitted to invest in unrated debt securities except bonds of nationalised banks, unlisted securities, unlisted shares of all India Financial Institutions and privately placed debt securities. The securities should necessarily be of investment grade and it should be ensured that all fresh non-SLR debt investments are made only in listed debt securities

of public sector. The total non-SLR investment should not exceed 10 per cent of the total deposits as on March 31 of the previous year and with a sub-ceiling of 5 per cent of incremental deposits of the previous year for investments in CDs issued by scheduled commercial banks and other FIs as approved by RBI. UCBs can invest in the debt securities of the following:

- a. Bonds of public sector undertakings,
- b. Bonds /equity of All India Financial Institutions
- c. Infrastructure bonds floated by All India Financial Institutions,
- d. Unsecured redeemable bonds floated by nationalised banks,
- e. Units of UTI and
- f. Certificates of deposit issued by scheduled commercial banks and other financial institutions approved by RBI.

Membership of CCIL

The membership of CCIL is available to those applicants fulfilling the following criteria (for Security Segment):

- Bank / Financial Institution / Primary Dealer / Mutual Fund or a Statutory Corporation or a body corporate including a Company as defined in the Companies Act, 1956 or any entity as may be permitted from time to time by Reserve Bank of India to open SGL and Current Accounts with it
- Entities which have opened SGL Account and Current Account with the Reserve Bank of India. However, Clearing Corporation may relax the requirement of the maintenance of Current and SGL Accounts in respect of the Members
- Not have any record of repeated failure in complying with the regulatory requirements
- Not have been subject to an order of statutory disqualification or an order of similar effect issued by a regulatory authority
- Have adequate risk management systems in place and shall have qualified personnel in its employment
- Fulfilled Capital Adequacy norms / Minimum Net Worth requirements as laid down by their respective regulators; if no such norm is prescribed or if the applicant is exempted from fulfilling the same, then the

applicant shall have adequate Net Worth to support the scale of operations undertaken or proposed to be undertaken

- Be a profitable organization (must have reported operating profits in at least two out of three financial years immediately preceding the date of application)
- Provided that Clearing Corporation may exempt public sector undertakings/ banks that is to say entity in which a majority of the shares are held by the Government of India / State Governments / Reserve Bank of India), Financial Institutions/body corporate formed under any special statute or Act of the Parliament, from the requirement of above sub-rules

Eligibility

Membership (including Associate Membership) of CBLO segment is extended to banks, financial institutions, insurance companies, mutual funds, primary dealers, NBFCs, non-Government Provident Funds, Corporates, etc. The members are required to open Constituent SGL Account with CCIL for depositing securities which are offered as collateral / margin for borrowing and lending of funds. Besides, associate members are required to open a current account with a Settlement Bank designated by CCIL for settlement of funds. Further, the Boards of UCBs can decide in regard to using the stock exchange platform for making investments in government securities in addition to the existing NDS-CCIL market and the direct bidding facility. As regulations of SEBI will also apply insofar as trading of government securities is concerned, the Board should frame and implement a suitable policy to ensure that operations are conducted in accordance with the norms laid down by RBI/SEBI and the respective stock exchange. For the limited purpose of dealing through the screen based trading system of the stock exchanges the condition that an UCB should seek a scheduled commercial bank, a primary dealer, a financial institution, another UCB, insurance company, mutual fund or provident fund as a counterparty, while undertaking transactions in Government securities, will not apply.

UCBs can enter into ready forward contracts (including reverse ready forward contracts), only in (i) Dated securities and Treasury Bills issued by Government of India and (ii) Dated securities issued by State Governments.

All ready forward contracts should be reported on the Negotiated Dealing System (NDS). In respect of ready

forward contracts involving gilt account holders, the custodian (i.e., the CSDL account holder) with whom the gilt accounts are maintained will be responsible for reporting the deals on the NDS on behalf of the constituents (i.e. the gilt account holders).

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

UCBs can undertake ready forward transactions only in securities held in excess of the prescribed Statutory Liquidity Ratio (SLR) requirements. At present, repo transactions are permitted in Central Government securities including Treasury Bills and dated State Government securities.

UCBs should make investments in non-SLR securities in dematerialised form only. In addition to one SGL / CSDL A/c, banks may open a demat account with a bank depository participant of NSDL/CDSL or with SHCIL for holding PSU Bonds.

CBLO Eligibility

“Collateralised Borrowing and Lending Obligation (CBLO)”, a money market instrument as approved by RBI, is a product developed by CCIL for the benefit of the entities who have either been phased out from inter bank call money market or have been given restricted participation in terms of ceiling on call borrowing and lending transactions and who do not have access to the call money market. CBLO is a discounted instrument available in electronic book entry form for the maturity period ranging from one day to ninety days (can be made available up to one year as per RBI guidelines). In order to enable the market participants to borrow and lend funds, CCIL provides the Dealing System through Indian Financial Network (INFINET), a closed user group to the members of the Negotiated Dealing System (NDS) who maintain current account with RBI and through internet for other entities who do not maintain current account with RBI. As per Section 9 (ii) of RTGS Regulations, 2004, no institution shall be admitted as a member of the RTGS system unless it fulfills all the following criteria -

- a. It is a member of the Indian Financial Network (INFINET)
- b. It is member of the Negotiated Dealing System (NDS)

The UCBs, which are members of NDS (as per the information at www.nds.rbi.org.in) are

Sr. No.	Name of the UCB
1	Abhyudaya Co Operative Bank Ltd.
2	Bassein Catholic Cooperative Bank Ltd.
3	Citizen Credit Cooperative Bank Ltd
4	Dombivli Nagari Sahakari Bank Ltd.
5	Janakalyan Sahakari Bank Ltd
6	Mandvi Co Operative Bank Ltd.
7	New India Co Operative Bank Ltd
8	Punjab and Maharashtra Co Operative Bank Ltd.
9	Thane Bharat Sahakari Bank Ltd.
10	The Bharat Cooperative Bank Mumbai Ltd.
11	The Cosmos Cooperative Bank Ltd.
12	The Greater Bombay Cooperative Bank Ltd.
13	The Kalupur Commercial Cooperative Bank Ltd.
14	The Kalyan Janata Sahakari Bank Ltd.
15	The Kapol Cooperative Bank Ltd.
16	The North Kanara G.S.B Co Operative Bank Ltd.
17	The Saraswat Cooperative Bank Ltd
18	The Shamrao Vithal Co Operative Bank Ltd.
19	The Thane Janata Sahakari Bank Ltd.

Members trade on RBI's Negotiated Dealing System (NDS) and NDS-Order Matching (NDS-OM) via the INFINET network, a secure Closed-User Group (CUG) hybrid network consisting of VSATs and leased lines.

All the details of such trades on NDS and NDS-OM are forwarded in batches to the CCIL system via INFINET for exposure check and computing the settlement obligations. Both the funds as well as the securities leg get settled through members' current and SGL/CSDL accounts maintained at RBI. Trades passing the exposure check are novated in which CCIL becomes the Central Counter Party. DVP-III is a method of settlement in which ISIN-wise securities are netted

separately for SGL and CSGL transactions and funds netting is done on a multilateral basis. As a Central Counter Party, CCIL guarantees settlement of all such trades on the settlement date and ensures efficiency of the settlement system.

Investment in Government Securities

UCBs generally invest in government securities (G sec) which are inherent part of the debt market in India. The most important features of G sec in India are:

Dated Government Securities

- Issued through auction and private placement by the RBI on behalf of the Government of India
- Payment of interest at regular intervals (mostly six monthly)
- Repayment of maturity and payment of interest by the RBI on behalf of the Government of India
- Public Debt Office (PDO) of the RBI takes care of issue, interest payment and maturity repayment

Typically a bond has four essential parts - coupon, name of issuer, maturity and face value. For example 7.49% GOI 2017 would comprise:

Coupon	:	7.49% paid on face value
Coupon payment dates	:	Half-yearly (October 16 and April 16) every year
Date of Issue	:	April 16, 2007
Date of Maturity	:	April 16, 2017
Face Value	:	Rs. 100/-

Treasury Bills (T-bill)

These are short term debt instruments issued by Government of India to meet its expenditure and issued for 91 day, 182 day and 364 day maturities. These are issued at discount to face value and redeemed at par. Only 364 day T-Bill forms part of the borrowing programme. 91 day and 182 day T-Bills are issued through the auction process every Wednesday and on the Wednesday of the week other than the reporting Friday (i.e. every alternate week) respectively. 364 day T-Bills are issued through the auction process on the Wednesday preceding reporting Friday (i.e. every alternate week).

G-sec is issued by RBI on behalf of Government of India. This is known as issuance in Primary market and can be done by

any of following manners:

- Auction
- Private placement with the RBI
- On tap Issues
- Market Stabilisation Scheme

RBI issues an auction calendar half yearly which contains information about amount of scheduled borrowing and period in which auctions will take place. When government decides to borrow, RBI issues an auction notification on its website and in news papers, which contains information on type of security, amount and date of auction.

Types of Auctions

i. Yield Based Auction is used for Government securities issued for the first time. Bids are submitted for deciding the coupon rate which is the cut off yield decided in auction based on the tenure. Successful bidders are those who have bid at the cut-off yield or lower, bids above the cut-off yield are rejected.

ii. Price Based Auction is used when RBI re-issues G secs already existing in the market. Bidders quote the price per Rs 100 face value of the G-sec. Successful bidders are those who have bid at the cut-off price or higher, bids below the cut-off price are rejected.

Auction Bidding

i. Competitive Bidding Preferred by banks, financial institutions, primary dealers, mutual funds and insurance companies. Minimum amount is Rs 10,000 and its multiples thereafter. Normally bids are of above Rs 2 crore. Multiple bidding is also allowed.

ii. Non Competitive Bidding Process of competitive bidding requires certain amount of technical knowledge and only large and well-informed investors participate in that manner. With an intention of introducing small and medium investors to the primary market, the RBI introduced scheme of non-competitive bidding from December 7, 2001. This is open to individuals, HUFs, RRBs, Co-operative banks, firms, companies, corporate bodies, institutions, provident funds, trusts. This form of bidding is only allowed for CSGL/Demat account holders, exceptions being RRBs and Cooperative Banks which hold SGL and current account with RBI. In case of non competitive bidding, RBI notifies, in advance, whether auction will have non-competitive bidding. A

maximum of 5% of the issue is reserved for non-competitive bids. Only one bid has to be submitted either through a bank or Primary Dealer. For participating in Non-Competitive Bids the participant has to fill up an undertaking form and send it to the Primary Dealer or Bank. Maximum amount for bidding is Rs 2 crore. Allotment will be at weighted average price/yield plus up to 6 paise. There will be partial allotment in case of over subscription. This is a preferred method for Co-operative banks as allotment is at weighted average cut off.

Scheme for Non-competitive Bidding Facility

With a view to encouraging wider participation and retail holding of Government securities, participation on 'non-competitive' basis is allowed in *select* auctions of dated Government of India (GoI) securities. Accordingly, non-competitive bids up to 5 percent of the notified amount are accepted in the auctions of dated securities. The reserved amount will be within the notified amount. Participation on a non-competitive basis in the auctions of dated GOI securities will be open to investors who satisfy the following:

- They do not maintain current account (CA) or Subsidiary General Ledger (SGL) account with the Reserve Bank of India.
- They make a single bid for an amount not more than Rs. two crore (face value) per auction
- They submit their bid *indirectly* through any *one* bank or PD offering this scheme.

Exceptions:

- Regional Rural Banks (RRBs) and cooperative banks shall be covered under this Scheme in view of their statutory obligations.
- Regional Rural Banks (RRBs) and cooperative banks that maintain SGL account and current account with the Reserve Bank of India shall be eligible to submit their non-competitive bids directly.

State Development Loans

- Issued by the respective State Governments in co-ordination with the RBI
- Qualify for SLR and recently allowed for LAF*
- Payment of interest at regular six-monthly intervals
- Issued through on-tap or auction

The Securities may be held in any of the three forms viz:

(a) Physical scrip form, (b) Subsidiary General Ledger (SGL) Account and (c) in a dematerialized account with depositories (NSDL/CDSL, NSCCL). In respect of securities with SGL facility, the SGL account can be maintained in the bank's own name directly with the Reserve Bank of India, or in a Constituent SGL Account opened with any scheduled commercial bank/state co-operative bank/primary dealer (PD) or Stock Holding Corporation of India Ltd. (SHCIL)

UCBs should not undertake any purchase/sale transactions with broking firms or other intermediaries on principal to principal basis. Banks should seek a scheduled commercial bank, a primary dealer, a financial institution, another primary (urban) co-operative bank, insurance company, mutual fund or provident fund, as a counter-party for their transactions. Preference should be given for direct deals with such counter parties. It will be desirable to check prices from the other banks or PDs with whom the primary (urban) co-operative bank may be maintaining constituent SGL Account (CSGL). The prices of all trades done in government securities, including those traded through Negotiated Dealing System are also available at RBI website (www.rbi.org.in).

Banks may take advantage of the non-competitive bidding facility in the auction of Government of India dated securities, provided by RBI. For availing this facility, no bidding skill is required, as allotment upto Rs. two crore (face value) is made at the weighted average cut-off rate which emerges in the auction. UCBs may also participate directly or through a bank or a primary dealer in the auctions of state development loans, where coupon is mostly fixed in advance and notified by RBI. An advertisement in leading newspapers is issued 4-5 days in advance of the date of auction. Half yearly auction calendar of Government of India securities is also issued by RBI. No transactions in Government securities by a primary (urban) co-operative bank should be undertaken in physical form with any broker.

Conclusion

In order to avoid concentration of risk, the banks should have a fairly diversified investment portfolio. Smaller investment portfolios should preferably be restricted to securities with high safety and liquidity such as Government securities. The UCBs may seek the guidance of Primary Dealers' Association of India / Fixed Income and Money Market Dealers' Association (FIMMDA) on investment in Government securities. Further, keeping in view the risk in investments and the various regulatory / statutory and the bank's own

internal requirements, UCBs should lay down a policy, with the approval of their Board of Directors and the policy should be reviewed each year.

The bank's investment policy should clearly define the authority to put through deals, procedure to be followed for obtaining sanction of the appropriate authority, putting through deals, fixing various prudential exposure limits, and reporting system. The investment policy of the bank should include guidelines on the quantity (ceiling) and quality of each type of security to be held on its own investment account. Bank should clearly indicate the authority to put through investment deals and the reporting system to be adopted. It should be prepared strictly observing the instructions issued by the Registrar of Co-operative Societies and the Reserve Bank of India from time to time and clearly spell out the internal control mechanism, accounting standards, audit and review and reporting system to be evolved. All the transactions should be clearly recorded indicating full details. The top management should undertake a periodic review of investment transactions in a critical manner and put up large transactions to the Board, and a copy of the internal

investment policy guidelines framed by the bank with the approval of its Board should be forwarded to the Regional Office of the RBI concerned certifying that the policy is in accordance with the prescribed guidelines and the same has been put in place. Subsequent changes, if any, in the policy should also be advised to the Regional Office of the RBI.

As for the trading and settlement in debt securities, SEBI guidelines should be followed which specifies that all trades with the exception of the spot transactions in a listed debt security, shall be executed only on the trading platform of a Stock Exchange. In addition to complying with the SEBI guidelines, banks should ensure that all spot transactions in listed securities are reported on the NDS and settled through the CCIL from a date to be notified by RBI. These non-SLR investments may be made by the banks subject to the prescribed conditions / safety measures viz. a provision should exist for such investments in respective State Co-operative Societies Act / Multi State Co-operative Societies Act, and a general or specific permission should be obtained from the Registrar of Co-operative Societies of the State concerned .

List of Select Abbreviations

AFS	Available For Sale	INFINET	Indian Financial Network
CBLO	Collateralised Borrowing and Lending Obligation	ITGGSM	Internal Technical Group on Government Securities Market
CCIL	Clearing Corporation of India Ltd.	LAF	Liquidity Adjustment Facility
CCP	Central Counter Party	MSS	Market Stabilisation Scheme
CSGL	Constituent Subsidiary General Ledger	NDS	Negotiated Dealing System
DvP	Delivery versus Payments	NDS-OM	NDS Order Matching
DFI	Development Financial Institution	NDTL	Net Demand and Time Liability
FIMMDA	Fixed Income Money Market and Derivatives Association of India	PD	Primary Dealer
FRB	Floating Rate Bonds	RTGS	Real Time Gross Settlement System
HFT	Held for Trading	PTC	Pass Through Certificate
HTM	Held To Maturity	SGL	Subsidiary General Ledger
		SFG	Settlement Guarantee Fund