

KNOWLEDGEWARE

DECEMBER 2016

REGULATORY

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Editorial:

Dear Esteemed Readers,

Wishing our readers, a very Happy 2017.

It is our pleasure to share with you the December 2016 Newsletter with key regulatory updates in India.

While India is still grappling (though the situation is better now) with Demonetisation, this month, among the key circulars/notifications, Reserve Bank of India (RBI) has:

- issued a circular to permit all Regulated entities to defer the down grade of any business loan that was standard as on November 1, 2016, but, for any reason, would have become NPA during the period November 1, 2016 to December 31, 2016
- issued a guideline on technical audit of prepaid payment instrument to facilitate adoption of digital payments in a big way under a safe environment with security and risk mitigation measures for Prepaid Payment Instrument issuers
- released a Large Exposure Framework which will help in limiting and managing the bank's exposure to a single counterparty or a group of connected counterparties. In a way, the Large Exposure framework will act as a security and risk mitigation measure for lending to various companies or group of connected companies

Securities & Exchange Board of India (SEBI) has also issued following key circulars viz.

- review of guidelines for Co-location / proximity hosting facility offered by stock exchanges which will benefit small & medium co-brokers who are desirous to avail such connectivity, in a fair and equitable manner
- circular for streamlining the process for acquisition of shares pursuant to tender-offers made for takeovers, buy back and delisting of securities

Ministry of Corporate Affairs (MCA) issued new rules in the form of National Company Law Tribunal (Procedure for reduction of share capital of Company) Rules, 2016.

MCA has also made operative, effective from 15 December 2016, certain sections of the Companies Act 2013, dealing with merger, amalgamation, winding-up etc.. These specified sections are a comprehensive code in itself providing for the manner in which compromises, arrangements, amalgamations and winding ups are to take place.

Though the government has made lot of efforts to convince the people of India about a long-term positive from demonetization, signs of short-term pain are visible through economic slow-down, reduced consumption (and therefore no circulation of money), shortage of currency notes etc. How far the same will go can only be told in retrospect!

We hope to continue to contribute effectively through our knowledge initiatives/newsletters and help our readers to remain updated and ahead of the curve!

Thank you.

Happy reading!

Yours Sincerely,

Knowledgeware Team

B. K. Khare & Co.

Reserve Bank of India (RBI)

Technical Audit of Prepaid Payment Instrument issuers

With the withdrawal of legal tender characteristics of existing ` 500/- and ` 1000/- Bank Notes (Specified Bank Notes – SBN), use of alternate modes of payment, specifically e-wallets has gained momentum. RBI has also notified special measures for Prepaid Payment Instruments (PPIs) to facilitate adoption of digital payments in a big way. While all efforts should continue to be made by entities for on-boarding new customers and merchants, it needs to be borne in mind that any kind of cyber security incident affecting the digital channels/products, particularly at this juncture, may have significant system-wide ramifications and may act as a dampener for the adoption of digital products by public at large

As the rapid escalation in e-payments may put significant pressure on the existing digital infrastructure, it is imperative that the integrity of the digital ecosystem is maintained by ensuring that they remain robust and fully secure.

The extant guidelines require authorized entities to submit system audit reports from a CISA/DISA qualified auditor on an annual basis. The scope of the System Audit includes evaluation of the hardware structure, operating systems and critical applications, security and controls in place, including access controls on key applications, disaster recovery plans, training of personnel managing the systems and applications, documentation.

All authorized entities/banks issuing PPIs in the country are advised to:-

1. Carry out, on a priority basis, a special audit by the empanelled auditors of Indian Computer Emergency Response Team (CERT-In) and take immediate steps thereafter to comply with the findings of the audit report. The audit should cover compliance as per security best practices, specifically the application security lifecycle and patch/vulnerability and change management aspects for the system authorized and adherence to the process flow approved by RBI.
2. Take appropriate measures on mitigating phishing attacks considering that the new customers are likely to be first time users of the digital channels. Safety and security best practices may be disseminated to the customers periodically.
3. Implement additional measures dynamically depending upon the risk perception or threats as they emerge

A confirmation giving the details of action plan, including the name and date of appointment of the auditor needs to be conveyed to the Department of Payment and Settlement System DPSS, CO via email by December 21, 2016. Also, a senior functionary may be designated to monitor the position on an ongoing basis and report the updates periodically (1st compliance within 15 days and subsequent compliance on a monthly basis). Banks may forward the compliance to the respective Senior Supervisory Manager (SSM) and non- bank entities may forward to the respective regional offices of DPSS

These guidelines will help in smoother on-boarding of customers and merchants. Also, the technical audit will act as security and risk mitigation measure for Prepaid Payment Instrument issuers.

RBI/2016-17/178 DPSS.CO.OSD.No.1485/06.08.005/2016-17 dated December 9, 2016

Large Exposure Framework

In order to align the exposure norms for Indian banks with the Basel Committee on Banking Supervision (BCBS) standards, and based on comments and feedback received on the Discussion Paper on the Large Exposures Framework, a Draft Large Exposures (LE) Framework was issued on August 25, 2016 for public comments. The comments/feedback received from stakeholders on the draft proposals have been examined and the final guidelines have been issued for full implementation by March 31, 2019.

The salient features of Large Exposure framework (LEF) guidelines are as under: -

- 1) Applicability - Banks must apply LEF at the same level as the risk-based capital requirements are applied, that is, a bank shall comply with the LEF norms at two levels: (a) consolidated (group) level and (b) Solo (individual) level
- 2) It lays down the scope of counterparties to be included and exemptions to be excluded while computing exposure limits.
- 3) It defines a "Large Exposure" and also specifies the format in which the large exposures are to be reported to RBI.
- 4) It lays down the large exposure limits
 - a. Single Counterparty – The sum of all the exposure values of a bank to a single counterparty must not be higher than 20 percent of the bank's available eligible capital base at all times. In exceptional cases, Board of banks may allow an additional 5 percent exposure of the bank's available eligible capital base. Banks shall lay down a Board approved policy in this regard
 - b. Groups of connected counterparties - The sum of all the exposure values of a bank to a group of connected counterparties must not be higher than 25 percent of the bank's available eligible capital base at all times.
- 5) It defines what is a group of connected counterparties and specifies control criteria to determine / arrive at existence of relationship among counterparties
- 6) Values of Exposure - Under the proposed LE Framework, an exposure to a counterparty will constitute both on and off-balance sheet exposures included in either the banking or trading book and instruments with counterparty credit risk. Definitions and measurements of such exposures are also covered in detail in guidelines.
- 7) It also covers exposures for which a specific treatment is deemed necessary such as
 - a. Interbank Exposures
 - b. Collective Investment Undertakings (CIUs), securitisation vehicles and other structures - adoption of "Look Through Approach" (LTA)
- 8) Identification of additional risks - While taking exposures to structures, banks should identify such third parties which may constitute an additional risk factor and which are inherent in the structure itself rather than in the underlying assets. Such a third party could be a risk

factor for more than one structure that a bank invests in. Examples of third party include originator, fund manager, liquidity provider.

- 9) Exposures to and among certain specific counterparties such as-
 - a. Exposures to Central Counterparties
 - b. Exposures to NBFCs
 - c. Large exposures rules for global systemically important banks (G-SIBs) and domestic systemically important banks (D-SIBs)

These guidelines will help in reducing the bank's exposure to single counterparty or group of connected counterparties. The Large Exposure framework will act as security and risk mitigation measure for lending to various companies or group of connected companies.

RBI/2016-17/167 DBR.No.BP.BC.43/21.01.003/2016-17 dated December 1, 2016

[Demonetization effect: Further relaxation provided by RBI Circular on prudential norms applicable for select loan assets](#)

As represented to RBI, upon the withdrawal of the legal tender status of the existing Rs. 500 and Rs. 1,000 notes, small borrowers needed some more time to repay their loan dues. RBI, on 21 November 2016 issued a circular to provide an additional 60 days, beyond what is applicable for the concerned regulated entity (RE), for recognition of a loan account as substandard for select cases, subject to certain conditions.

An important clarification which the current circular has provided is to permit all REs, in the following categories of accounts, to defer the down grade of an account, that was standard as on November 1, 2016, but would have become NPA for any reason during the period November 1, 2016 to December 31, 2016, by 90 days from the date of such downgrade:

- (a) Running working capital accounts (OD/CC)/crop loans, with any bank, the sanctioned limit whereof is ₹ 1 crore or less;
- (b) Term loans for business purposes, secured or otherwise, the original sanctioned amount whereof is ₹ 1 crore or less, on the books of any bank or any NBFC, including NBFC (MFI). This shall include agriculture loans.

The additional time so given shall only apply to defer the classification of an existing standard asset as substandard and not for delaying the migration of an account across sub-categories of NPA.

In its earlier circular dated 21 November 2016, the dispensation of 60 days was available to loans whether business or personal in nature. However, in the circular dated 28 December 2016, RBI while extending the dispensation to 90 days has removed 'personal' loans from this dispensation.

Considering the profiles of the borrowers and a continual impact in the cash-dependent economy like ours, the additional benefit will provide some respite to the RBI regulated entities. However, what remains to be seen is whether this would result into (mere) postponement of stress or the real money flow would start in the next calendar year.

RBI circular: RBI/2016-17/198 DBR.No.BP.BC.49/21.04.048/2016-17

Demonetisation effect: Amendment to Master Circular of RBI on PPIs to include other entities for onward issuance to their employees.

Pre-paid payment instruments help purchase of goods and services, including funds transfer, against the value stored in it.

As per para 7.9 of the Master Circular on Issuance and Operations of Prepaid Payments Instruments dated July 01, 2016 Banks were permitted to issue PPIs to corporates for onward issuance to their employees, subject to the conditions as mentioned in the circular.

Companies were required to be listed on any stock exchange in India to be eligible to get prepaid instruments issued by banks.

To deepen the digital transaction system and facilitate greater adoption of digital payments, instructions contained in paragraph 7.9 of the said circular have been partially modified as under:

- Banks may include other entities such as unlisted corporates / partnership firms / sole proprietorship / public organizations like municipal corporations, urban local bodies, etc.
- Banks shall extend this facility only to those entities / 'employers' that have a bank account with them and after obtaining an undertaking that they are not availing of this facility from any other bank.
- Verification of the identity of the staff / employees / contract workers, etc. shall be the responsibility of the concerned 'employer'. The bank should put in place proper systems to capture and maintain details of the employees to whom the cards are issued by the 'employer' along with copies of photograph and identity proof of such employees. The 'employer' is also required to make available details of bank accounts (if any) of the employees to the bank.
- Banks shall load/reload PPIs after obtaining necessary authorisation and above mentioned details of the employees/staff/contract workers, etc. from the 'employers'.
- Existing instructions of paragraph 7.9 (d), (e), (f) and (g) would continue to be applicable.

In the light of the above amendments it can be noted that RBI has eased the rules for PPIs to bring it in line with the Government's vision of Cashless Economy. This would in turn reduce the cash crunch faced by the public.

RBI Circular No.: DPSS.CO.PD.No.1610/02.14.006/2016-17

RBI Circular No.: DPSS.PD.CO.PPI.No.01/02.14.006/2016-17

Securities and Exchange Board of India (SEBI)

SEBI issues circular regarding Spread Margin Benefit

- i. SEBI had prescribed vide circular SEBI/HO/CDMRD/DRMP/CIR/P/2016/77 dated September 01, 2016 that margin benefit on spread positions shall be entirely withdrawn within the time limits prescribed by the circular.
- ii. Based on the representations received, SEBI has decided that margin benefit on spread positions shall be entirely withdrawn latest by the start of tender period or the start of the expiry day, whichever is earlier.

SEBI Circular no: SEBI/HO/CDMRD/DRMP/CIR/P/2016/130 dated December 2, 2016.

SEBI – Streamlining the process for Acquisition of Shares pursuant to Tender-Offers made for Takeovers, Buy Back and Delisting of Securities.

SEBI has issued a circular for streamlining the process for acquisition of shares pursuant to tender-offers made for takeovers, buy back and delisting of securities, amending the original circular CIR/CFD/POLICYCELL/1/2015 dated April 13, 2015.

In the current mechanism, the shareholders submit their bids through stock brokers and subsequently, the brokers transfer the shares to the special account of the clearing corporation. Likewise, the consideration payable to shareholders for the shares accepted in the offer is routed through stock brokers. Also, the shares not accepted in the offer are returned to shareholders through the stock brokers.

It has now been decided in consultation with the stock exchanges and depositories that transfer of shares of shareholders under the tender offers would be made directly to the account maintained by the clearing corporation. After such transfer of securities, the clearing corporation will be allowed to utilize the securities towards the settlement obligations under such offers. Further, consideration for the accepted shares in the tender offer and shares tendered but not accepted under such offer would be credited directly to shareholders' bank and demat accounts respectively.

Following are the changes which shall be applicable to all offers for which Public Announcement is made on or after January 02, 2017:

- Clause (h) shall be substituted as below:

Old Clause (h): “Such shares would be transferred to a special account of the Clearing Corporation specifically created for this purpose prior to placing the bid. The stock brokers shall also forward to the Clearing Corporation such details regarding the shares tendered as may be required by the Merchant Banker.”

New Clause (h): “The securities pay-in shall be as per the early pay-in mechanism currently available in the secondary market.”

- Clause (i) shall be substituted as below:

Old Clause (i): “The cumulative quantity tendered shall be made available online to the market throughout the trading session at specific intervals by each of the Stock Exchanges during the tendering period on the basis of shares transferred to the special account of the clearing corporation.”

New Clause (i) and further new sub-clauses: “The shares tendered by the shareholder under the offer shall be transferred directly to Clearing Corporation of the stock exchange providing Acquisition Window (CC) using early pay-in mechanism prior to placing the bid by the seller broker.”

ia. “Depositories shall provide information to CC about the shareholder on whose behalf the member has placed sell order. This information shall include investor PAN, beneficiary account details and bank details including IFSC code.”

ib. “The cumulative quantity tendered shall be made available online to the market throughout the trading session at specific intervals by Stock Exchange providing acquisition window during the tendering period on the basis of shares transferred to CC using early pay-in mechanism.”

- Clause (l) shall be substituted as below:

Old Clause (l): “Once the basis of acceptance is finalized, the clearing corporation would facilitate execution and settlement of trades by transferring the required number of shares from the special account to the escrow account of the acquirer/ company.”

New Clause (l): “Once the basis of acceptance is finalized, CC would transfer unaccepted shares directly to the shareholders account. If the securities transfer instruction is rejected in the depository system, due to any issue then such securities will be transferred to the seller broker’s depository pool account for onward transfer to the shareholder.”

- Clause (m) shall be substituted as below:

Old Clause (m): “The trades shall be carried out in the manner similar to settlement of trades in the secondary market process including providing an option for direct payout to the shareholders. This would include settlement of trades of physical shares as well.”

New Clause (m): “Acquirer will transfer the funds pertaining to the offer to CC's bank account. CC will then settle the trades by making direct funds payout to shareholders. If shareholders bank account details are not available or if the funds transfer instruction is rejected by RBI/bank, due to any issue then such funds will be transferred to the seller broker’s settlement account for onward transfer to shareholder.”

- Clause (n) shall be deleted

- Clause (o) shall be substituted as below:

Old Clause (o): “The seller broker would then issue contract note for the shares accepted and also return the balance to their respective clients.”

New Clause (o): “The seller broker would then issue contract note for the shares accepted in the offer.”

- Sub Clause (iv) of clause (p) shall be substituted as below:

Old Sub clause (iv) of (p): “Details of the special account opened with Clearing Corporation.”

New Sub clause (iv) of (p): “Details of Early Pay-in account of CC.”

SEBI circular No. CFD/DCR2/CIR/P/2016/131 dated December 09, 2016

Ministry of Corporate Affairs (MCA)

Provisions related to merger, amalgamation and winding up etc. are notified under the Companies Act 2013

Central Government has issued a notification on 7th December 2016, wherein certain provisions of the Companies Act, 2013 shall become effective from 15th December 2016. These sections relate to variation of shareholder's rights, reduction of share capital, compromises, arrangements, amalgamations and certain winding up sections.

Highlights:

- **Variation of Shareholders' Rights (Section 48):**
 - If the variation of rights of one class of shareholders affects the rights of any other class of shareholders, consent of 3/4th of such other class of shareholders shall also be obtained and provisions of the section shall apply to such variation.
 - Where the holders of not less than 10% of the issued shares of a class did not consent to such variation or vote in favor of the special resolution for the variation, they may apply to the Income Tax Appellate Tribunal (Tribunal) to have the variation cancelled.
- **Reduction of share capital of company (Section 66):**
 - Tribunal shall have the jurisdiction in relation to capital reduction.
 - No reduction of capital if the company is in arrears in the repayment of any deposits accepted by it or of the interest payable thereon.
 - Tribunal shall give notice of every capital reduction application to the Central Government (CG), Registrar of Companies (ROC), Securities and Exchange Board of India (SEBI) and to the creditors, who may make representations within three months and if no representation has been received within the said period, it will be presumed that they have no objection to reduction of capital.
 - Company shall file a certificate from its auditor to the effect that the accounting treatment for such reduction is in conformity with the accounting standards.
 - Tribunal's order shall be published by the company in prescribed manner and deliver its certified copy to ROC within 30 days of its receipt.
- **Compromises, Arrangements and Amalgamations (Section 230 [except sub-section (11) and (12)], Sections 231 to 233, 235 to 240):**
 - Tribunal shall have the jurisdiction in relation to compromises, arrangements and amalgamations.
 - Disclosure in affidavit to be made to the Tribunal of all material facts such as the latest financial position of the company, latest auditor's report on the accounts of the company, pendency of any investigation or proceedings against the company, reduction of share capital of company if any, etc.
 - At a meeting called by the Tribunal, objection to scheme of compromise or arrangement can be made only by persons holding not less than 10% of the shareholding or having an outstanding debt amounting to not less than 5% of the total outstanding debt as per latest audited financial statement.

- Scheme of compromise or arrangement shall be approved by majority of 3/4th in value of creditors or members or class of members or creditors present in person or proxy or postal ballot.
 - Tribunal may dispense with creditors meeting if creditors having 90% in value agree to the scheme and confirm it by way of an affidavit.
 - No scheme of compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by company's auditor has been filed to the effect that the accounting treatment proposed in the scheme is in conformity with the accounting standards.
 - The scheme shall clearly indicate an appointed date from which it shall be effective.
 - Purchase of minority shareholding by majority shareholders holding 90% or more of the issued equity share capital of the company by virtue of an amalgamation, share exchange, conversion of securities or any other reason.
- **Winding up by the Tribunal (Section 270 to 288, 290 to 303), Provisions applicable to winding up (Section 324, 326 to 358) and Official Liquidators (359 to 365):**
- Procedure for winding up to be monitored by the Tribunal.
 - Company liquidator to file certified copy of Tribunal's order of dissolution with ROC. Non-compliance attracts penalty.
- **Sections on Action to be taken in pursuance of inspector's report (Section 224(2)), Voluntary winding up of a company not to stop investigation proceedings (Section 226), Winding up of unregistered companies (Section 375 to 378), Closure of place of business of a foreign company in India (Section 391(2)), Transfer of pending proceedings to the Tribunal (Section 434(1)(c)) will also be effective from 15th December 2016.**

The specified sections are a comprehensive code in itself providing for the manner in which compromises, arrangements, amalgamations and winding ups are to take place.

Notification No- S.O. 3677(E) dated 7th December 2016

National Company Law Tribunal (Procedure for reduction of share capital of Company) Rules, 2016.

Until recently, the Share Capital Reduction provisions were governed by Section 100 of the Companies Act 1956. As per the old Act, **subject to the confirmation of the Court**, a company limited by shares or company limited by guarantee and having share capital may, if authorized by its articles, by Special Resolution, reduce its share capital. Vide s 66 of the 2013 Act, **the said powers of Court have been transferred to National Company Law Tribunal (NCLT) which section has been now been notified.**

Immediately thereafter, MCA has further, notified the **National Company Law Tribunal (Procedure for Reduction of Share Capital of Company) Rules, 2016** on 15th December, 2016.

PROCEDURE FOR REDUCTION OF SHARE CAPITAL UNDER SECTION 66 READ WITH NCLT (PROCEDURE FOR REDUCTION OF SHARE CAPITAL) RULES, 2016

In view of the aforesaid provisions of the Act, a company proposing to reduce its share capital is required to take the following steps:

1. Convene a Board Meeting to approve the reduction of share capital and fixing the date of general meeting of the company.
2. Hold the general meeting and have the **Special Resolution** passed.
3. File **MGT-14** with ROC within 30 days of passing of Special Resolution.
4. Apply to NCLT by filing an application in **Form RSC-1** along with prescribed fee of Rs.5,000/-to confirm reduction.
5. The application shall be accompanied with:
 - List of creditors
 - Certificates of auditor to the effect that:
 - list of creditors is correct;
 - company is not in arrears of repayment of deposit and interest thereon; and
 - Accounting Treatment proposed by the company for reduction of share capital is in conformity with the Accounting standards.
6. The NCLT shall within 15 days of submission of the application give a notice to ROC and SEBI in **Form RSC-2** and to every creditors of the company in **Form RSC-3**.
7. The NCLT shall also give direction for the notice to be published in a leading English and vernacular language newspaper in **Form RSC-4** within 7 days of such direction and also for uploading on the website of the company.
8. The company shall file an affidavit in **Form RSC-5** confirming the dispatch and publication of the notice within 7 days from the date of issue of such notice.
9. The NCLT may dispense with the requirement of giving notice to the creditors or publication of notice, if every creditor has been discharged or secured or given his consent.
10. Representation by ROC, SEBI and creditors shall be sent to NCLT within 3 months of receipt of notice and copy of which shall also be sent to the company. If no such representation has been received by NCLT within the said period, it shall be presumed that they have no objection.
11. Company shall send the representation or objections so received along with responses of the company thereto within 7 days of expiry of period up to which objections were sought.
12. NCLT may hold any enquiry on adjudication of claim and/or give direction for securing the debts of the creditors.
13. The order confirming the reduction of share capital shall be in **Form RSC-6**.
14. The company shall deliver a certified copy of the order of the NCLT under sub-section (3) and of minute approved by the Tribunal to the ROC and file **E-form INC-28** within 30 days of the receipt of order.

15. The ROC shall issue a certificate to that effect in **Form RSC-7**.

MCA Circular dated December 15, 2016

Insurance Regulatory and Development Authority of India (IRDAI)

IRDA allows investment in “Additional Tier 1 (Basel III Compliant) Perpetual Bonds” [AT1 Bonds] by Insurance Companies

Insurer can invest in AT1 Bonds if following conditions are fulfilled:

- Rating not less than “AA” at the time of investment
- Provision of listing in at least one of the exchanges in Offer document in case of IPO
- Investment not more than 10% of AT1 Bonds offered through IPO. Further, aggregate value of AT1 Bonds held in any particular bank, at any point of time, shall not exceed 10% of total outstanding AT1 Bonds
- The Common Equity Tier I Capital (CET) including Capital Conservation buffer of issuer bank shall be more than 1% the minimum CET prescribed by RBI, at the time of investment
- Issuer banks have declared dividend for proceeding 2 years
- Shall be disclosed under “Equity” in compliance with IRDA (Investment) Regulations, and Master Circular issued there under
- Issuer bank should not be under the Promoter Group of Insurer or Corporate Agent of the Insurer.

Valuation should be as per FIMMDA or applicable Market Yield Rates published by any Rating Agency registered with “SEBI”.

Category Code for AT1 Bonds is also mentioned for “Approved Investments” and “Other Investment” basis PSU Banks and Private Banks.

Concurrent auditor should confirm in his quarterly report to Audit Committee / Board regarding compliance with the norms and disclosures.

Insurers to participate in Joint Lenders Forum (JLF) formed under RBI Guidelines

IRDA permits insurers to participate in JLF for loan accounts which could turn into potential NPAs. Excess exposure above the permitted level under IRDA (Investment) Regulation is also allowed with the prior approval of the Insurers Board.

Apart from making necessary disclosure in Notes to Accounts of Financial Statement Insurer shall file Quarterly Return to IRDA in the format mentioned in the circular.

Amendment to Provision on “Exposure to Credit Default Swap”

Following provisions shall be substituted for Provision of 1.8.a.2.c of Master Circular – Investment, 2016

On the Purchase of Protection, the exposure with respect to reference entity shall shift to “Protection Seller” to the extent of “Protection Purchases” within Regulation 9 of the IRDA (Investment) Regulation, 2016 and such exposure shall form part of BFSI Sector, under Industry Sector Exposure.

IRDA/CIR/F&I/INV/239/11/2016-17