

NHB(ND)/DRS/Pol-No-23/2008
April 24, 2008



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राष्ट्रीय
आवास बैंक
NATIONAL
HOUSING BANK

ALL REGISTERED HOUSING FINANCE COMPANIES (HFCs)

Dear Sir,

**TERMS AND CONDITIONS APPLICABLE TO DEBT CAPITAL INSTRUMENTS TO
QUALIFY FOR INCLUSION AS UPPER TIER II CAPITAL**

With a view to provide the housing finance companies with additional options for raising capital funds to meet their increasing business requirements as well as to further shore up their capital funds to meet market risk, housing finance companies can augment their capital funds by issue of debt capital instruments eligible for inclusion as Upper Tier -II capital.

2. It has been decided to stipulate terms and conditions for debt capital instruments to qualify for inclusion as upper Tier-II Capital. The Housing Finance Companies (NHB) Directions, 2001 have, accordingly, been modified in terms of Direction No. NHB. HFC. DIR. 23/CMD/2008 dated April 11, 2008. The guidelines governing the instruments indicating the minimum regulatory requirements are furnished in Annexure.. Housing finance companies should ensure that the instruments that may be issued by them are in strict conformity with these guidelines.

3. Please acknowledge receipt.

Yours faithfully,

(R. Bhalla)

General Manager
Department of Regulation & Supervision

Encl: a/a

**TERMS AND CONDITIONS APPLICABLE TO DEBT CAPITAL INSTRUMENTS TO
QUALIFY FOR INCLUSION AS UPPER TIER II CAPITAL**

<p>Currency of issue- HFCs shall issue Upper Tier II instruments in Indian Rupees. HFCs shall obtain prior approval of the RBI/NHB, on a case-by-case basis, for issue of Upper Tier II instruments in foreign currency.</p>
<p>Amount- The amount of Upper Tier II instruments to be raised may be decided by the Board of Directors of HFCs.</p>
<p>Limits- Upper Tier II instruments along with other components of Tier II capital shall not exceed 100% of Tier I capital. This eligible amount will be computed with reference to the amount of Tier 1 capital as on March 31 of the previous financial year, after deduction of goodwill and other intangible assets but before the deduction of investments.</p>
<p>Maturity period- The Upper Tier II instruments should have a minimum maturity of 15 years.</p>
<p>Rate of interest- The interest payable to the investors may be either at a fixed rate or at a floating rate referenced to a market determined rupee interest benchmark rate.</p>
<p>Options- Upper Tier II instruments shall not be issued with a 'put option'. However HFCs may issue the instruments with a call option subject to strict compliance with each of the following conditions:</p> <p>a) Call option may be exercised only if the instrument has run for at least ten years;</p> <p>Call option shall be exercised only with the prior approval of NHB. While considering the proposals received from HFCs for exercising the call option the NHB would, among other things, take into consideration the HFC's CRAR position both at the time of exercise of the call option and after exercise of the call option.</p>
<p>Step Up- The issuing housing finance company may have a step-up option which may be exercised only once during the whole life of the instrument, in conjunction with the call option, after the lapse of ten years from the date of issue. The step-up shall not be more than 100 bps. The limits on step-up apply to the all-in cost of the debt to the issuing HFCs.</p>
<p>Lock-in clause</p> <p>a) Upper Tier II instruments shall be subjected to a lock-in clause in terms of which the issuing HFC shall not be liable to pay either interest or principal, even at maturity, if</p> <p>(i) the HFC's CRAR is below the minimum regulatory requirement prescribed by NHB OR</p> <p>(ii) the impact of such payment results in HFC's capital to risk assets ratio (CRAR) falling below or remaining below the minimum regulatory requirement prescribed by NHB.</p> <p>b) However, HFCs may pay interest with the prior approval of NHB when the impact of such payment may result in net loss or increase the net loss provided CRAR remains above the regulatory norm.</p> <p>c) The interest amount due and remaining unpaid may be allowed to be paid in the later years in cash/ cheque subject to the housing finance company complying with the above regulatory requirement.</p> <p>d) All instances of invocation of the lock-in clause should be notified by the issuing HFCs to the General Manager of Department of Regulation and Supervision of the NHB, Delhi.</p>
<p>Seniority of claim- The claims of the investors in Upper Tier II instruments shall be</p> <p>a) Superior to the claims of investors in instruments eligible for inclusion in Tier I capital; and</p> <p>b) Subordinate to the claims of all other creditors.</p>



Discounting- The Upper Tier II instruments shall be subjected to a progressive discount for capital adequacy purposes as in the case of long term subordinated debt over the last five years of their tenor. As they approach maturity these instruments should be subjected to progressive discount as indicated in the table below for being eligible for inclusion in Tier II capital.

Remaining Maturity of Instruments	Rate of Discount (%)
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

Redemption- Upper Tier 2 instruments shall not be redeemable at the initiative of the holder. All redemptions shall be made only with the prior approval of the National Housing Bank (Department of Regulation and Supervision).

Reserve Requirements- Not required.

Investments by FIIs & NRIs- Investment in Upper Tier II instruments by FIIs shall be within the limits as laid down in the ECB Policy for investment in debt instruments. In addition, NRIs shall also be eligible to invest in these instruments as per existing policy.

Issue of Upper Tier II instruments in foreign currency- HFCs may augment their capital funds through the issue of Upper Tier II Instruments in foreign currency after seeking prior approval of the Reserve Bank of India and subject to compliance with the undermentioned requirements:

- i) The total amount of Upper Tier II Instruments issued in foreign currency shall not exceed 25% of the unimpaired Tier I capital. This eligible amount will be computed with reference to the amount of Tier 1 capital as on March 31 of the previous financial year, after deduction of goodwill and other intangible assets but before the deduction of investments.
- ii) Investment by FIIs in Upper Tier II Instruments raised in Indian Rupees shall be outside the limit for investment in corporate debt instruments. However, investment by FIIs in these instruments will be subject to a separate ceiling of USD 500 million.
- iii) HFCs should not enter into such swap transactions in respect of their Upper Tier II Instruments.

Other conditions

- a) Upper Tier II instruments should be fully paid-up, unsecured, and free of any restrictive clauses.
- b) HFCs should comply with the terms and conditions, if any, stipulated by SEBI/other regulatory authorities in regard to issue of the instruments.

Reporting Requirements- HFCs issuing innovative instruments shall submit a report to the General Manager, Department Regulation and Supervision, National Housing Bank, New Delhi giving details of the debt raised, including the terms of issue together with a copy of the offer document soon after the issue is completed.

Investment in innovative instruments issued by other HFCs /banks/ FIs- An HFC's investments in innovative instruments issued by other HFCs/banks/ financial institutions will attract a 100% risk weight for capital adequacy purposes.

Grant of advances against Upper Tier 2 instruments- HFCs should not grant advances against the security of the Upper Tier 2 instruments issued by them.

