RBI /2006-2007/113
DBOD. No. BP. BC. 27/21.01.002/ 2006- 2007

August 23, 2006

The Chairman & Managing Directors
Chief Executive Officers of Commercial Banks
(excluding RRBs)

Dear Sirs,

Prudential Guidelines -
Bank's Investment in Venture Capital Funds (VCFs)

It is observed that the exposure of banks to Venture Capital Funds (VCFs) has been steadily increasing over the last few years. While significance of venture capital activities and need for banks' involvement in financing of venture capital funds is well recognized, it is also considered important to address the relatively higher risks inherent in such exposures. In view of this, we have reviewed the entire issue of financing of VCFs and revised the prudential framework governing banks' exposure to VCFs. Banks are advised to comply with the prudential requirements relating to financing of VCFs set out in the Annex.

2. Please acknowledge receipt.

Yours faithfully,

(Prashant Saran)
Chief General Manager-in-Charge

Annex

Prudential Guidelines on Bank's Investment in Venture Capital Funds (VCF)

1. Prudential exposure limits

1.1 All exposures to VCFs (both registered and unregistered) will be deemed to be on par with equity and hence will be reckoned for compliance with the capital market exposure ceilings (ceiling for direct investment in equity and equity linked instruments as well as ceiling for overall capital market exposure).

1.2 The investment in VCFs set up in the form of companies will be subject to compliance with the provisions of Section 19(2) of Banking Regulation Act 1949 i.e the bank will not hold more than 30% of the paid up capital of the investee company or 30% of its own paid up share capital and reserves, whichever is lower.

1.3. Besides, investments in VCFs in the form of equity/units etc. will also be subjected to the limits stipulated vide para 3 of Master circular on Para Banking Activities DBOD.FSD.No.10/24.01.001/2005-06 dated July 1, 2005 in terms of which the investment by a bank in a subsidiary company, financial services company, financial institution, stock and other exchanges should not exceed 10 per cent of the bank's paid-up capital and reserves and the investments in all such companies, financial institutions, stock and other exchanges put together should not exceed 20 per cent of the bank's paid-up capital and reserves.

2. Valuation and classification of banks' investment in VCFs

2.1 The quoted equity shares / bonds/ units of VCFs in the bank's portfolio should be held under Available for Sale (AFS) category and marked to market preferably on a daily basis, but at least on a weekly basis in line with valuation norms for other equity shares as per existing instructions.

2.2 Banks' investments in unquoted shares/bonds/units of VCFs made after issuance of these guidelines will be classified under Held to Maturity (HTM) category for initial period of three years and will be valued at cost during this period. For the investments made before issuance of these guidelines, the classification would be done as per the existing norms.

2.3 For this purpose, the period of three years will be reckoned separately for each disbursement made by the bank to VCF as and when the committed capital is called up. However, to ensure conformity with the existing norms for transferring securities from HTM category, transfer of all securities which have completed three years as mentioned above will be effected at the beginning of the next accounting year in one lot to coincide with the annual transfer of investments from HTM category.

2.4. After three years, the unquoted units/shares/bonds should be transferred to AFS category and valued as under:

i) Units:

In the case of investments in the form of units, the valuation will be done at the Net Asset Value (NAV) shown by the VCF in its financial statements. Depreciation, if any, on the units based on NAV has to be provided at the time of shifting the investments to AFS category from HTM category as also on subsequent valuations which should be done at quarterly or more frequent intervals based on the financial statements received from the VCF. At least once in a year, the units should be valued based on the audited results. However, if the audited balance sheet/ financial statements showing NAV figures are not available continuously for more than 18 months as on the date of valuation, the investments are to be valued at Rupee 1.00 per VCF.

ii) Equity:

In the case of investments in the form of shares, the valuation can be done at the required frequency based on the break-up value (without considering 'revaluation reserves', if any) which is to be ascertained from the company's (VCF's) latest balance sheet (which should not be more than 18 months prior to the date of valuation). Depreciation, if any on the shares has to be provided at the time of shifting the investments to AFS category as also on subsequent valuations which should be done at quarterly or more frequent intervals. If the latest balance sheet available is more than 18 months old, the shares are to be valued at Rupee.1.00 per company.

(iii) Bonds:

The investment in the bonds of VCFs, if any, should be valued as per prudential norms for classification, valuation and operation of investment port- folio by banks issued by RBI from time to time.

3. Risk Weight and capital charge for market risk for exposures in VCFs

3.1 Shares and units of VCFs

Investments in shares /units of VCFs may be assigned 150% risk weight for measuring the credit risk during first three years when these are held under HTM category. When these are held under or transferred to AFS, the capital charge for specific risk component of the market risk as required in terms of the present guidelines on computation of capital charge for market risk, may be fixed at 13.5% to reflect the risk weight of 150%. The charge for general market risk component would be at 9% as in the case of other equities.

3.2 Bonds of VCFs

Investments in bonds of VCFs will attract risk weight of 150% for measuring the credit risk during first three years when these are held under HTM category. When the bonds are held under or transferred to AFS category, these would attract specific risk capital charge of 13.5%. The charge for general market risk may be computed as in the case of investment in any other kind of bonds as per existing guidelines.

3.3 Exposures to VCFs other than investments

The exposures to VCFs other than investments may also be assigned a risk weight of 150%.

4. Exemption under guidelines relating to non-SLR securities

As per extant guidelines relating to non-SLR securities, a bank's investment in unlisted non-SLR securities should not exceed 10 per cent of its total investment in non-SLR securities as on March 31, of the previous year. Further, banks must not invest in unrated non-SLR securities. The investments in unlisted and unrated bonds of VCFs will be exempted from these guidelines.

5. RBI approval for strategic investments in VCFs by banks

Banks should obtain prior approval of RBI for making strategic investment in VCFs i.e. investments equivalent to more than 10% of the equity/unit capital of a VCF.