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RESERVE BANK OF INDIA
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The Chairman and Managing Directors/
Chief Executive Officers of
All Scheduled Commercial Banks
(excluding RRBs and LABs)

Dear Sir,

Management of Intra-Group Transactions and Exposures – Draft Guidelines

As a prudential measure aimed at avoiding concentration of credit risk, the Reserve Bank of India has prescribed regulatory limits on banks' exposure to individual and Group borrowers which are laid down in the Master Circular on Exposure Norms. The instructions in this guideline are exclusively meant for banks' transactions and exposures to the entities belonging to the bank's own Group (Group entities). The draft guidelines contain both quantitative limits for the financial Intra-Group Transactions and Exposures (ITEs)[1] and prudential measures for the non-financial ITEs[2] to ensure that the banks engage in the ITEs in safe and sound manner in order to contain the concentration and contagion risk arising out of ITEs. These measures are aimed at ensuring that banks, at all times, maintain arms length relationship in their dealings with the Group entities, meet minimum requirements with respect to Group risk management and group-wide oversight, and adhere to prudential limits on intra-group exposures.

2. The draft guidelines on Management of Intra-Group Transactions and Exposures for safe conduct of ITEs and management of risk concentrations have been prepared in the light of experience gained in monitoring of identified financial conglomerates during last few years. The same are furnished in Annex.

[1] *Financial ITEs are those whose outcomes can be associated with financial flows manifesting in the form of assets, liabilities and/ or revenue transactions. Examples of Financial ITEs are fund-based and non-fund based transactions.*
[2] *Non-financial ITEs refer to operations arising out of 'matrix' management facilitating control/ effective risk management over a business segment or a line of activity across a number of legally independent entities. Examples of Non-financial ITEs are back-office arrangements, cross-selling of products, etc.*

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3. Comments/feedback on the draft guidelines may please be sent before September 14, 2012 to the Chief General Manager-in-Charge, Department of Banking Operations and Development, Reserve Bank of India or by email.

Yours faithfully,

(Deepak Singhal)
Chief General Manager-in-Charge

Annex

Management of Intra-Group Transactions and Exposures

1. Objective

1.1 The possibility that large losses could arise due to Intra-Group Transactions and Exposures (ITEs) and threaten the ongoing business operations of a Banking Group motivates supervisory concern that risk concentrations within the Group be identified, monitored and subject to an adequate management strategy. The concentrations arising at the Group level, whether from concentrations in the individual legal entities, from risks cutting across sectors or from the interaction of risk concentrations within the Group, could affect the efficacy of sectoral supervision. In addition, when there are different approaches to setting limits or defining concentrations in entities within a Group or where there are unregulated entities, the differences in requirements can produce an incentive to indulge in regulatory arbitrage.

1.2 It becomes a supervisory concern when ITEs disadvantage a regulated entity that is part of a financial Group. ITEs can be used to migrate/transfer ‘losses’, indulge in regulatory/ supervisory arbitrage, assume higher/unacceptable risks in variance with usual prudence or camouflage other unintended outcomes of a regulated entity parking the ‘losses’ with an unregulated entity and thereby escaping the public, auditor’s and supervisor’s scrutiny. In large diverse Groups, there could be situations leading to excessive concentrations in the same counterparty, a Group of related counterparties, a set of counterparties whose financial performance is dependent on the same activity/ market, same type of collaterals obtained for risk mitigation purpose, economic sector or geographical area.

1.3 It therefore becomes essential that these ITEs be monitored to identify cases of supervisory/regulatory arbitrage, detect cases of inappropriate transfer of capital/income, ensure compliance with prudential/regulatory guidelines, statutory requirements and arms' length principle, attempt to distort markets, and identify systemic issues for immediate, concerted actions by the regulators and the government in order to maintain stability of the financial system. With these issues in the backdrop, it was announced in the Second Quarter Review of the Monetary Policy 2010-11 to put in place an appropriate limit on bank's Intra-Group Transactions and Exposures, both for a single entity and on an aggregate basis for all other Group entities in order to limit the interconnectedness between the bank and other Group entities and issue detailed guidelines in this regard.

2. Applicability

2.1 This guideline is applicable to all scheduled commercial banks, including foreign banks operating in India, belonging to a financial Group irrespective of whether the bank is parent or where the bank's parent is a regulated financial entity or a non-operating holding company. For the purpose of this guideline, a 'Group' may be defined as an arrangement involving two or more entities related to each other through any of the following relationships[3] and a 'Group entity' as any entity involved in this arrangement:

i. Subsidiary – Parent
ii. Associate
iii. Joint Venture
iv. A Related Party[4]
v. Direct or indirect ownership of 20 percent[5] or more interest in the voting power of the enterprise
vi. Common brand name
vii. Holding Company of the bank
viii. An entity which has any of the first six relations, as above, with the promoter/holding company of the bank

2.2 The list of entities forming part of the Group should be prepared by the banks and finalized in consultation with the Department of Banking Supervision, Central Office (DBS, CO) of RBI. The exclusion and inclusion of Group entities, if any, should be intimated to DBS with reasons thereof.

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[3] *Subsidiary, Associate, Joint venture and related party as defined in relevant Indian Accounting Standards notified by the Central Government under Section 211(3c) of the Companies Act, 1956.*
[4] *Related party will include structures such as SPV/ SIV/ conduits based upon the actual ownership/ control/ significant influence/ beneficial interest.*
[5] *If exercise of voting power is restricted by statutory/ regulatory provisions or other arrangements, then the actual ownership will be the determining factor.*

3. Prudential Limits on Exposure to the Group and its Entities

3.1 The banks should adhere to the exposure limits as prescribed below:

a. Single Group Entity Exposure

- 5% of Paid-up Capital and Reserves in case of non-financial services companies and unregulated financial services companies
- 10% of Paid-up Capital and Reserves in case of regulated financial services companies

b. Aggregate Group Exposure

- 10% of Paid-up Capital and Reserves in case of all non-financial services companies and unregulated financial services companies taken together
- 20% of Paid-up Capital and Reserves in the case of the Group i.e. all Group entities (financial and non-financial) taken together

Banks should operate within these limits, as above, on an ongoing basis and report their exposure, on a quarterly basis, to DBS, CO. The definition of exposure and other related aspects would continue to be governed by the respective Master Circulars issued by the RBI.

3.2 If exposures exceed the stipulated limits, the same should be reported without delay, with an acceptable rationale of the cause of the breach to DBS, CO. If satisfied, DBS, CO may allow the bank an appropriate timeline within which the bank should comply with the stipulated limits. Any excess over the limits should be deducted from the Common Equity Tier 1 capital until the limits are restored. Further, failure to comply within the given timeline time if provided, may also lead to imposition of penalties or prohibition on the bank to undertake further intra-group transaction and exposure with other Group entities or both.

4. Monitoring and Management of ITEs

4.1 Banks shall put in place a comprehensive policy on monitoring and management of ITEs, approved by its Board. The policy should lay down effective systems and processes to identify, assess and report risk concentrations and significant ITEs. While framing such policy, the Board must take into consideration the risks posed to the bank on a stand-alone basis as a result of such intra-group activities and be satisfied that any exposures to Group entities have been appropriately captured in measures of the bank's exposures to Group entities.

4.2 The policy should be reviewed periodically by the banks. The policy should, at a minimum, include:

a. System of regular review and reporting of 'material' ITEs to the Board for facilitating clear understanding of the ITEs undertaken and the risks, if any, emanating there-from;

b. A requirement that bank should address risks arising from ITEs as strictly as it would address its risk exposures to a third party/non-group entity;

c. Requirement that terms and conditions and credit standards of intra-group transactions are substantially the same, as those prevailing at the time for comparable transactions with or involving third party/non-group entities;

d. The policy must prescribe fair, clearly articulated and unambiguous methodology/ies for transfer pricing mechanism which could be applied to ensure the compliance of the arms length principle;

e. Internal prudential limits on aggregate amount of transactions taking place during a quarter at both an individual and aggregate level. In determining limits on acceptable levels of transactions to Group entities, the Board should also take into consideration

- The kind and amount of risk that the entity would bring to the books and to the reputation of the bank; and
- The impact on the bank's stand-alone capital and liquidity positions, as well as its ability to continue operating, in the event of a liquidity crunch/failure of a Group entity to which the bank is exposed.

f. Procedures for resolving any conflict of interest arising from intra-group transactions and exposures;

g. Requirements relating to the transparency of third-party dealings associated with Group entities. As a general rule, banks should not undertake any third-party dealings with the prime purpose of supporting the business of Group entities;

h. Banks should set an internal threshold above which all intra-group transactions (both fund-based and non-fund based) shall be examined by the banks' concurrent and statutory auditors to ascertain that intra-group transactions undertaken

- comply with arms length principle;
- are not detrimental to the bank's interests;
- are not meant for hiding or transferring the low quality assets; and
- are not a conduit for inappropriate transfer of capital / income to Group entities.

i. Mechanism to ensure that ITEs do not lead to violation/circumvention of any regulatory, statutory or taxation laws.

4.3 Where the terms and conditions applying to a bank's dealings with Group entities are inconsistent with the benchmarks set for the similarly rated third party/non-group entities as required under para 4.2(c), they must be put up to the Board by the sanctioning authority with justifications fully and clearly documented. The same may be made available to the RBI at the time of inspection or whenever required.

4.4 As a general rule, banks should not

a. Hold unlimited exposures to Group entities either in aggregate or at an individual entity level (e.g. a general guarantee of the obligations of a Group entity); or

b. Enter into cross-default clauses whereby a default by a Group entity on an obligation (whether financial or otherwise) is deemed to trigger a default of the bank in its obligations.

4.5 Banks should not purchase a low-quality asset[6] from Group entities. Further, a low-quality asset should not be accepted as collateral for a loan or extension of credit to, or guarantee, acceptance, or letter of credit issued on behalf of the Group entity. The banks must ensure that the transfer/sale of low-quality assets to Group entities, whether regulated or unregulated, is not done for the purpose of hiding losses or window dressing of balance sheets.

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[6] an asset overdue/out of order or classified as NPA by the bank or by RBI or a restructured asset whose terms have been renegotiated or compromised due to the deteriorating financial condition of the borrower

4.6 Banks should furnish the details of intra-group support arrangements/agreements (e.g. a specific guarantee of the obligations of an entity in the Group or a letter of comfort) to DBS, CO.

4.7 Banks should ensure that they have adequate systems and controls in place for identifying, reviewing, monitoring and managing exposures arising from ITEs. RBI may require banks to put in place additional internal controls, a more robust reporting mechanism and to maintain a higher Capital Adequacy Ratio if RBI is not satisfied with the adequacy of the bank's systems and controls.

5. Arrangements for Providing Support within the Group

5.1 Banks may provide support to Group entities (and vice-versa) provided such support is undertaken in accordance with the prudential requirements set out in above paragraphs in relation to the policies governing bank's dealings with Group entities. Further, banks should take abundant cautious measures to avoid giving any impression of its direct or indirect support to Group entities unless there are formal legal arrangements in place providing for such support.

5.2 While assessing funding needs (especially under stressed situations), banks should account for any funding or liquidity commitment provided to Group entities (e.g. in the form of explicit guarantees or funding lines to be drawn in times of need) and prepare for any withdrawal of funding provided by Group entities. Banks should also analyse how the liquidity positions of Group entities may affect their own liquidity, either through direct financial impact or through contagion when those entities are faced with liquidity crunch. Where there is reliance on funding support among Group entities, banks should take into account any legal, regulatory or other limitations that may restrict Group entities access to liquidity from banks and vice versa in case of need.

5.3 Banks should establish internal limits on intra-group liquidity risk to mitigate the risk of contagion from other Group entities when these entities are under liquidity stress. Banks may put in place group-wide contingency funding plans, liquidity cushions and diversified funding to help Group entities when liquidity problems in the Group arise.

6. Cross-selling of Products

6.1 Banks should deal transparently when it comes to cross-selling of products to customers of the Group entities and adhere to the norms as stipulated in the Master Circular on Para-Banking Activities in respect of their relationship with subsidiaries.

6.2 If banks engage in marketing/distributing the financial products of the Group entities to their own customers, banks should ensure that the identity of the seller of the product is prominently disclosed and displayed in the relevant marketing material, product documentation and the same is also explicitly conveyed while marketing the product by the bank's staff/agents through the branches, ATMs, telemarketing, emails or any other place/means such that:

- **a.** There is no confusion to the customers about the respective roles and responsibilities of the bank and the product seller;
- **b.** It does not give any impression that the product is guaranteed or otherwise supported by the bank, unless a legally enforceable formal agreement is in place to this effect; and
- **c.** Such products should not be bundled/clubbed with the bank's own products in any way that compel the customers to buy the marketed product.

6.3 Banks must also ensure that when the Group entities distribute its products in any capacity:

- **a.** Adequate transparency should be ensured in relation to the respective roles of the bank and the Group entity; and
- **b.** The Group entities do not, unless otherwise permitted by the RBI (and supported by appropriate contractual arrangements), assume any key decision-making function of the bank (e.g. in ascertaining creditworthiness) in distributing the bank's products.

7. Sharing of Services with Group Entities

7.1 In a typical Group structure, banks usually 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 services to other Group entities, etc. RBI has issued guidelines on 'Managing Risks and Code of Conduct in Outsourcing of Financial Services by Banks' vide circular dated November 3, 2006 which is also applicable to outsourcing to entities within the Group / Conglomerate. While entering into such arrangements with Group entities, banks should continue to adhere to the provisions of para 5 of the said circular and ensure that these arrangements:

- **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;
- **c.** do not impinge on the safety and soundness of the bank as a stand-alone entity;
- **d.** do not prevent the RBI from being able to obtain information required for the supervision of the bank or pertaining to the Group as a whole; and
- **e.** there is a clear obligation under the written agreements for any service provider to comply with directions given by the RBI in relation to the activities of the bank.

7.2 Banks should 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.

7.3 Banks should ensure that the dependency placed on premises, services, etc. provided by Group entities, or the provision of services to Group entities, does not compromise the banks' ability to identify and manage their risks on a stand-alone basis.

7.4 Banks shall not publish any advertisement or enter into any agreement stating or suggesting or giving tacit impression that the banks are in any way responsible for the obligations of its Group entities.

8. Disclosures in the Notes to Financial Statements

Banks should make the following disclosures with a view to ensure transparency in their dealings with the Group entities:

- Top-20 intra-group exposure
- Total amount of intra-group exposure
- Percentage of intra-group exposure to total exposure of the bank on borrowers/customers
- Details of breach of limits on intra-group exposures and regulatory action thereon, if any.