Credit Information Review

262
May
2001

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Policy

Bank Financing of Equities : Revised Guidelines

The Reserve Bank of India announced the revised guidelines for bank finance and investments in equities on May 11. Under the revised guidelines, banks can acquire shares, debentures and units of mutual funds for three different purposes:

(a) for making direct investment in shares / debentures at bank's own risk;
(b) for making loans and advances to individuals and sharebroking entities for the purpose of making investment in capital markets on their own account; and
(c) for making loans and advances to individuals and corporates against collateral of shares / debentures for certain approved purposes which do not involve stock broking or investment in capital market.

While making loans to individuals and stock-broking entities, the investment risk would be that of the individual or stock-broking entities. Loans / advances by banks are normally fixed in value and carry the stipulated interest rate, and the risk to banks could arise on account of inadequacy of margins or the inability of borrowers to meet their repayment / interest obligations to banks because of volatility in share prices or other related reasons.

Ceiling

The ceiling of 5 per cent prescribed for investment in shares will now apply to total exposure including both fund based and non-fund based, to capital market by a bank in all forms. The ceiling will illustratively cover:

(i) Direct investment by a bank in equity shares, convertible bonds and debentures and units of equity oriented mutual funds;
(ii) Advances against shares to individuals for investment in equity shares (including IPOs), bonds and debentures, units of equity-oriented mutual funds etc;
(iii) Secured and unsecured advances to stockbrokers and guarantees issued on behalf of stockbrokers and market makers.

The 5 per cent ceiling will be computed in relation to the bank’s total outstanding advances (including commercial paper) as on March 31, of the previous year. Non-fund based facilities and investment by banks in non-convertible debentures and other similar instruments (excluding commercial paper), should not be included in computing the total outstanding advances of the bank. Further, for computing the ceiling on exposure to

capital market, direct investment in shares by banks will be calculated at cost price of the shares.

The ceiling of 5 per cent will not include collateral of equity shares / bonds and debentures offered to the bank by corporates other than NBFCs, for availing of secured loans for working capital or other productive purposes which do not involve stock broking or investment in capital markets. Advances made by banks to individuals for personal purposes like education, housing, consumption, etc., will also be outside the 5 per cent ceiling.

Direct investment in shares

Within the overall ceiling of 5 per cent for total exposure to capital market, the total investment in shares, convertible bonds and debentures and units of equity-oriented mutual funds by a bank should not exceed 20 per cent of its networth.

While making investment in equity shares, etc., whose prices are subject to volatility, the banks should keep in view the following guidelines:

(i) The ceiling for investment in shares, etc., i.e., 20 per cent of a bank's net worth, is the maximum permissible ceiling and a bank's board of directors is free to adopt a lower ceiling for the bank, keeping in view its overall risk profile and corporate strategy.

(ii) Banks may make investment in shares directly taking into account the in-house expertise available within the bank as per the investment policy approved by the board of directors subject to compliance with the risk management and internal control systems.

(iii) Banks may also make investment in units of UTI and SEBI - approved other diversified mutual funds with good track record as per the investment policy approved by the board of directors. Such investments should be in specific schemes of UTI / mutual funds and not by way of placement of funds with UTI / mutual funds for investment in the capital market on their behalf.

(iv) Underwriting commitments taken up by the banks in respect of primary issues through book building route would also be within the overall ceiling.

(v) Investment in equity shares and convertible bonds and debentures of corporate entities should be reckoned for the purpose of arriving at the prudential norm of single-borrower and borrower-group exposure ceilings.

Advances against shares and debentures

(a) *Advances to individuals*

The present maximum ceilings of advances to individuals against security of shares and debentures (i.e. Rs.10 lakh against physical shares and Rs.20 lakh against dematerialised shares) will continue. Such loans are meant for genuine individual investors and banks should not support collusive action by a large group of individuals, belonging to the same corporate or their inter-connected entities to take multiple loans in order to support particular scrips or stock-broking activities of the concerned firms.

(b) *Financing of IPOs*

The maximum amount of finance that can be granted to an individual for initial public offerings (IPOs) remains unchanged at Rs. 10 lakh. Corporates should not be extended finance for investment in other companies' IPOs and NBFCs should not be provided finance for further lending to individuals for IPOs. Finance extended by a bank for IPOs should be reckoned as an exposure to capital market.

(c) *Concentration to a few stock broking entities to be avoided*

The banks are free to provide credit facilities to stock brokers and market makers on the basis of their commercial judgment, within the policy framework approved by their boards. However, in order to avoid any nexus emerging between inter-connected stock broking entities and banks, the board of each bank should, within the overall ceiling of 5 per cent, fix a sub-ceiling for total advances to:

(i) all the stock brokers and market makers (both fund based and non-fund based, i.e. guarantees) and

(ii) to any single stock broking entity, including its associate/inter-connected companies.

(d) *Margins on advances*

A uniform margin of 40 per cent should be applied on all advances / financing of IPOs / issue of guarantees. A minimum cash margin of 20 per cent (within the margin of 40 per cent) should be maintained in respect of guarantees issued by banks. The margin of 40 per cent will apply to all fresh advances / guarantees issued. The existing advances / guarantees issued may continue at the earlier margins until they come up for renewal.

(e) *Financing of arbitrage operations*

Banks should not undertake arbitrage operations themselves or extend credit facilities directly or indirectly to stockbrokers for arbitrage operations in stock exchanges. While banks are permitted to acquire shares from the secondary market, they should ensure that no sale transaction is undertaken without actually holding the shares in its investment account.

The guidelines also include details of risk management, internal control, separation of functional responsibilities and norms for valuation and disclosures.

Transitional provisions

In respect of banks whose exposure to capital market by way of investment in shares and advances against shares is in excess of the prescribed ceiling, the following transitional provisions are provided in order to ensure smooth transition to the revised guidelines:

(a) Banks whose exposure to capital market is in excess of the prescribed ceiling, should formulate a time-bound plan for gradually reducing their exposure to stock market in line with the prudential ceiling now prescribed. In working out the time bound plan, the advances granted to individuals against shares for investment purposes, may not be recalled and in case of any difficulties arising on this account, the banks may approach RBI for suitable relaxation. This time-bound plan, along with data on exposures under investment and various categories of advances / guarantees, should be submitted to the RBI by June 15, 2001. Meanwhile, the banks should not make any fresh investment in equity shares / advances against shares and issue guarantees.

(b) The margin of 40 per cent will apply to all fresh advances / financing of IPOs / issue of guarantees. Earlier advances / guarantees may continue at the existing margins until they come up for renewal.

(c) CMDs / CEOs of all banks should review their present portfolio of investment in shares / advances against shares / guarantees. In case investment / advances / guarantees are beyond the limits prescribed by its board or are in violation of the guidelines of November 10, 2000, such investment / advances / guarantees should be reduced at the earliest. This review should also cover cases of excessive advances / guarantees in favour of any particular entities and their inter-connected companies.

Review of the Guidelines

A review of the amended Guidelines will again be undertaken by the RBI-SEBI Technical Committee after six months.

Bank Finance for Film Industry

In June 1998, the Indian Banks' Association (IBA) had constituted a Working Group, comprising representatives of banks and film industry to suggest a suitable methodology for financing film industry, which constitutes an important segment of the entertainment industry. The Working Group submitted its Report to IBA in May 1999 and the same was circulated by IBA among member banks for necessary action. Further, Government of India has also conferred industry status to the 'Entertainment Industry including Films'. However, despite the above developments, film financing has not made much headway so far.

Against this background, it is felt desirable to formulate, for the information of banks, guidelines on various aspects of lending to film industry so that banks may participate in financing this important economic activity.

The Reserve Bank of India has, after extensive consultations with banks, Indian Banks' Association and representatives of film industry, framed broad guidelines regarding bank finance for production of films.

The Reserve Bank has, however, reiterated that its stance of bestowing operational freedom to banks in the matter of credit dispensation remains unchanged and that banks are free to take lending decisions based on their own experience and other relevant information without reference to the Reserve Bank, keeping in view the spirit of the guidelines.

The guidelines will be reviewed after a year based on the feedback received from the banks.

Eligibility

Banks may provide finance to film producers (corporate as well as non-corporate entities) with good track record in the relative field. Banks may also provide finance to these entities for production of films in participation with the National Film Development Corporation.

Direct Finance for Film Production

Criteria for financing

Banks may obtain from the producers a detailed budget for each film, clearly indicating the entire cost estimates for the film and the means of financing it. Ordinarily producers are required to bring in at least 25 per cent of the project cost as promoters' contribution. Producers are also required to tie up the advances from the distributors in the usual course as per usual practice (sales advances) to cover 35 per cent to 40 per cent of the budget. Thus, bank advances could be for the balance requirement of 35 per cent to 40 per cent of the project cost. However, in deserving cases where the banks are quite comfortable with the project as well as the background of the producers, the financing could be increased up to 50 per cent of the project cost on merits.

Banks may provide finance to such of the projects where the total cost of production of a film does not exceed Rs.10 crore. The amount sanctioned should be within the overall ceiling of the prudential exposure norms prescribed by the Reserve Bank from time to

time. Banks may also internally prescribe a suitable limit for their overall exposure to the film industry.

The disbursement of bank loan should ordinarily start only after utilising the promoter's contribution and advance payments from the distributors. There may not, however, be any objection to bank loan being disbursed side by side along with payments by distributors on proportionate basis. The arrangement should be firmed up at the commencement of the project. However, in any case, banks may disburse loan only after the promoter has brought in his contribution to the project.

Period of Loan

The period of loan may be fixed based on the financing bank's assessment of cash generation of the project.

Security

Banks may obtain the laboratory letter conveying rights on the negatives in favour of the lenders.

The music audio/video rights, CD/DVD/internet rights, satellite rights, channel rights, export/international rights, etc. should also be assigned to the banks to serve as main security along with the negative rights in the form of lab letter, through appropriate documentation.

First hypothecation charge on all the tangible movable assets under the project.

All agreements and Intellectual Property Rights (IPRs) should be assigned in favour of the lenders. Lenders should have the right in negotiation of valuation of all IPRs.

Collaterals, if necessary, may be obtained at the discretion of banks.

Interest Rates on Export Credit in Foreign Currency effective from 19 April 2001

(per cent per annum)

Pre-shipment Credit	
Upto 180 days	Not exceeding one per cent over LIBOR/EURO LIBOR/EURIBOR
Beyond 180 days and upto 360 days	Rate for initial period of 180 days prevailing at the time of extension plus 2 percentage points
Post-shipment Credit	
On demand bills for transit period (as specified by FEDAI)	Not exceeding one per cent over LIBOR/EURO LIBOR/EURIBOR
Usance bills (for total period comprising usance period of export bills, transit period as specified by FEDAI and grace period wherever applicable)	
Upto 6 months from the date of shipment.	Not exceeding one per cent over LIBOR/EURO LIBOR/EURIBOR
Export bills (demand or usance) realised after due date but upto date of crystalisation	Rate for 2(b) above plus 2 percentage points

Export Credit Not Otherwise Specified (ECNOS)	
Pre-shipment credit	Free @
Post-shipment credit	Free @

@ Banks are free to decide the rate of interest being rupee credit rate keeping in view the PLR and spread guidelines.

A Trust and Retention Account (TRA) may be maintained for all capital as well as revenue inflows and outflows. Thus, receivables on sale of all IPRs may be credited to TRA. The modalities of TRA may be worked out on case-to-case basis to the satisfaction of the lenders. A No Objection Certificate (NOC) from all concerned parties for the TRA arrangement will be required. The lenders will have first charge on the TRA.

Banks may look into the legal aspects of the laboratory letter, assignment of music, audio/video rights, etc.

Insurance

The existing insurance products as acceptable to banks may be obtained from film producers.

Follow-up/ Monitoring

Banks should devise appropriate accounting and information/data submission formats for periodic flow of information from the producers. They should also obtain periodical progress reports, cash flow statements, audit reports and such other reports as are considered necessary. Banks may also consider appointing specialised agencies for monitoring the timely shooting/processing of the film and assessing the reasonableness of the expenditure.

Risk factors

Production completion risk is one of the major risks in any film production. To mitigate this risk, it would be necessary for banks to carefully appraise the projects having due regard to the track record of the producers as also the distributors. If necessary, banks may also engage industry specialists /consultants for evaluation of proposals. Insurance of risks, key personnel, etc. needs to be organised. Pending development of appropriate risk insurance products, the existing products such as equipment insurance, key personnel insurance, etc. could be availed of.

Finance through NFDC/to NFDC

Considering that appraisal of film projects requires special skills (which all banks may not be equipped with, at least in the initial years), banks may, at the request of the National Films Development Corporation (NFDC), also consider extending credit for production of films in participation with NFDC. This would be an additional channel for extending credit to the film industry. The detailed modalities in this regard (including security cover) may be worked out mutually by banks and NFDC.

Banks may also consider providing reasonable credit facility to NFDC taking into account usual safeguards observed while taking credit exposure.

Reserve Bank of India reduces CRR

The Reserve Bank of India effected on a reduction in the Cash Reserve Ratio (CRR) by half a percentage point. From the fortnight beginning May 19, 2001 banks will have to maintain CRR at 7.5 per cent. The reduction will release resources of scheduled commercial banks to the extent of about Rs.4,500 crore.

Interest Rates on Export Credit of Scheduled Commercial Banks

(Per cent per annum)

Categories of export credit	Interest Rates	
	Existing upto May 4, 2001	Revised @ (with effect from May 5, 2001)
1. **Pre-Shipment Credit**		
(a) i) Upto 180 days	10 per cent	Not exceeding PLR minus 1.5 percentage points
ii) Beyond 180 days and upto 270 days	13 per cent	Not exceeding PLR plus 1.5 percentage points
(b) Against incentives receivable from Government covered by ECGC guarantee upto 90 days	10 per cent	Not exceeding PLR minus 1.5 percentage points
2. **Post-Shipment Credit**		
(a) On demand bills for transit period (as specified by FEDAI)	Not exceeding 10 per cent	Not exceeding PLR minus 1.5 percentage points
(b) Usance Bills (for total period comprising usance period of export bills, transit period as specified by FEDAI and grace period wherever applicable)		
i) Upto 90 days	Not exceeding 10 per cent	Not exceeding PLR minus 1.5 percentage points
ii) Beyond 90 days and upto 6 months from the date of shipment	12 per cent	Not exceeding PLR minus 1.5 percentage points
(c) Against incentives receivable from Government covered by ECGC guarantee upto 90 days	Not exceeding 10 per cent	Not exceeding PLR plus 1.5 percentage points
(d) Against undrawn balances (upto 90 days)	Not exceeding 10 per cent	Not exceeding PLR minus 1.5 percentage points
(e) Against retention money (for supplies portion only) payable within one year from the date of shipment (upto 90	Not exceeding 10 per cent	Not exceeding PLR minus 1.5 percentage points

days)		
3. **Deferred Credit**		
For the period beyond 180 days	Free *	Free*
4. **Export Credit not otherwise Specified**		
(a) Pre-shipment credit	Free *	Free*
(b) Post-shipment credit	Free*	Free*

@ Since these are ceiling rates, banks would be free to charge any rate below the ceiling rates.

*Free: The banks are free to decide the rate of interest to be charged, keeping in view the PLR and spread guidelines.