Appendix 2

Illustrative examples of Economic Interdependence Criteria

Requirement: Both A and B are customers of the bank and the exposure of the bank to each of them is more than 5% of its eligible capital base (i.e. Tier-1 capital).

- Where 50% or more of one counterparty's gross receipts or gross expenditures (on an annual basis) is derived from transactions with the other counterparty

  Illustrative Example:
  Company A is a commercial space provider and company B utilises a major portion of this space and accounts for more than 50% of gross receipts for Counterparty A.

- Where one counterparty has fully or partly guaranteed the exposure of the other counterparty, or is liable by other means, and the exposure is so significant that the guarantor is likely to default if a claim occurs;

  Illustrative Example:
  Company A fully or partly guarantees the loans undertaken by company B and the guarantee is so large that it could result in default in payments for A if it is invoked. Banks may consider parameters like networth, EBITDA, liquid assets, etc to assess whether the guarantor will be in a position to honour the claim on an on-going basis.

- Where a significant part of one counterparty's production/output is sold to another counterparty, which cannot easily be replaced by other customers;

  Illustrative Example:
  When a significant part of product/output/services of Company A is sold to Company B and there are no alternate buyers who can be approached if B fails to buy, in such a case goods may remain unsold and could lead to default in loan repayment by A. An auto part supplier and auto manufacturing firm could be part of the same economically dependent group based on this criteria. For deciding if the criteria would be applicable to the counterparties

under consideration, banks may use financial criteria like unsold inventory leading to operating loss/default in repayment as well as subjective criteria like ability of the seller to find alternate buyer/ market, R&D capability of the seller, etc.

- When the expected source of funds to repay the loans of both counterparties is the same and neither counterparty has another independent source of income from which the loan may be serviced and fully repaid;

  Illustrative Example:
  Two auto component manufacturers i.e. company A and company B are suppliers to a commercial vehicle manufacturer i.e. company C. Source of funds for repayment of loans taken by A and B is dependent on sales to C. In this case, A and B are connected to each other based on the criteria of economic interdependence. Important factors to consider would be extent of dependence of A and B on C, ability of A and B to find another buyer, etc.

- Where it is likely that the financial problems of one counterparty would cause difficulties for the other counterparties in terms of full and timely repayment of liabilities;

  Illustrative Example: Company A supplies intermediate goods to Company C. Company C processes these goods and then sells it to company B. In such cases, difficulties at A could lead to difficulties for B. In such cases A and B are economically dependent. Banks may consider factors like financial strength of counterparty B to withstand the shock, its ability to find alternate supplier in place of C, etc. to decide on applicability of the criteria.

- Where the insolvency or default of one counterparty is likely to be associated with the insolvency or default of the other(s);

  Illustrative Example:
  Examples would include all such cases where insolvency or default of one company may lead to the insolvency or default of the other companies. Banks may use criteria such as intercorporate liabilities, significant trade receivables, etc. to decide on applicability of the criteria.

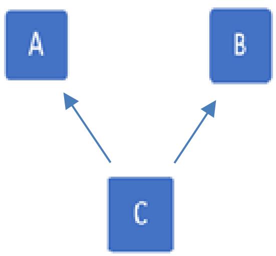
- When two or more counterparties rely on the same source for the majority of their funding and, in the event of the common provider's default, an alternative provider cannot be found - in this case, the funding problems of one counterparty are likely to spread to another due to a one-way or two-way dependence on the same main funding source.

  Illustrative Example:

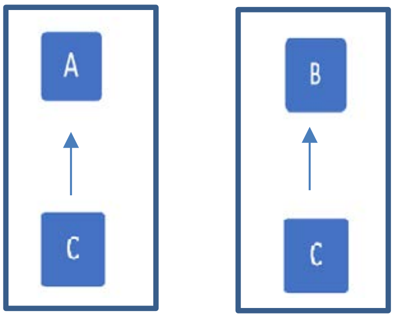
  Company A and Company B rely on the same non-bank source for their funding requirements and may not have access to alternative sources of funds. In such cases, difficulties at common source could lead to difficulties at both the companies and thus these companies are interconnected based on economic interdependence. Important factors to consider would be strength of A and B to decide alternate source of funds, likelihood of failure of the non-bank source, etc.

Economic interdependence with two different entities

If an entity (C) is economically dependent on two (or more) other entities (A and B) then payment difficulty of any one of the entities (A or B) may cause payment difficulties to dependent entity (C). Thus, C needs to be added in two different groups (A and C; B and C).



Grouping requirement



Since exposure to C is considered as single risk for two separate groups, it does not amount to double counting of exposure of C.