RBI Press Release

Streamlining Banks' Investments in Capital Market

(September 2, 2000)

Ceiling for Bank's Investment in Capital Market to be linked with Bank's Total Outstanding Advances
Banks with no Expertise to Invest Two-thirds of Eligible Amount in Units of Mutual Funds
Guidelines for IPO Financing by Banks

The banks' exposure to capital market by way of investments in shares, convertible debentures and units of mutual funds may now be linked with their total outstanding advances and may be limited to 5 per cent of such advances. This has been recommended by the Committee comprising senior executives of the Reserve Bank of India and the Securities and Exchange Board of India. The Committee was set up in pursuance of the Monetary and Credit Policy for the year 2000-2001 with the objective of evolving operative guidelines for a transparent and stable system of banks' investment and financing of equities. The Committee has, while finalising its report, had the benefit of discussions with the Chief Executives of select banks which have exposure to capital market. The Committee has also obtained feedback from other participants, including brokers. It submitted its report to the Reserve Bank on August 30, 2000.

Explaining the rationale behind its recommendation of linking banks' advances to shares, debentures etc., with total outstanding advances, the Committee has stated that the present norm of banks investing up to 5 per cent of their incremental deposits of the previous year in shares, debentures, etc., did not reflect the shift in the asset portfolio of banks from credit to investment. It has, therefore, recommended that the ceiling prescribed for banks' investments in shares, debentures, and units of mutual funds should be related to outstanding advances and not to incremental deposits of the previous year.

While suggesting the operative guidelines for banks' investments in the capital market, the Committee's approach has been to optimise the opportunities for banks to take advantage of the returns available from the capital market without exposing them to undue risks that arise due to volatility in the capital market. In view of the Committee, such a system of bank's investment and financing of equities would also contribute to a healthy development of financial markets.

The Committee has also suggested that banks which do not have in-house expertise in research in capital market may invest not less than 2/3 of their eligible amount in units of UTI and SEBI approved mutual funds. In an attempt to streamline the guidelines for banks' investment in the capital market, the Committee has, for the first time, also recommended guidelines for banks' financing of Initial Public Offerings (IPOs).

The following are the main recommendations of the Committee.

(i) ***Policy :*** Since the capital market is exposed to constant price fluctuation, the banks' policy with regard to financing against shares should be one of risk minimisation. The Committee has, therefore, recommended that the banks' policy in financing against shares should be such that they are not exposed to undue risks emanating out of volatility in capital market. The Committee has also made recommendations on margin prudential limits on exposure, etc., to minimise the risks due to price fluctuations.

(ii) ***Ceiling for Bank's Investment in Capital Market:*** The Committee has recommended that the ceiling prescribed for banks' investments in shares, convertible debentures and units of mutual funds (other than debt funds) should be related to outstanding advances and not to incremental deposits of the previous year. The Committee has, therefore, recommended that within the overall exposure to sensitive sectors, a bank's exposure to capital market by way of investments in shares, convertible debentures and units of mutual funds (other than debt funds), may be limited to 5 per cent of their total outstanding advances. The recommendation follows the Committee's view that the existing norm of 5 per cent of the incremental deposits of the previous year for investments in shares, etc., did not reflect the shift in the asset portfolio of banks from credit to investment.

(iii) ***Flexibility to Invest in Units of Mutual Funds :*** The Committee has recommended that banks which do not have in-house expertise in capital market, may invest, not less than two-third of the eligible amount, in units of UTI or SEBI approved mutual funds. The balance one-third of the eligible amount may be deployed directly by the banks in listed equity shares.

(iv) ***Financing IPOs :*** According to the Committee, the terms and conditions for financing of Initial Public Offerings (IPOs) should be the same as those applicable to advances against shares to individuals. The ceiling on the amount of advances as also margin as applicable to advances against shares to individuals, should apply *mutatis mutandis* to financing of IPOs. The maximum amount of finance extended to an individual against IPOs should, however, be Rs. 10 lakh, as applicable to advances against physical shares. Corporates should not be given advances for IPOs. Banks should also not extend finance to NBFCs in any form for on-lending to individuals for IPOs. Finance extended by a bank for IPOs should be reckoned as an exposure to the capital market.

(v) ***Margins :*** Considering the fact that the minimum margin taken by banks depends upon the scrip and that margins higher than the minimum stipulated by the Resere Bank are usually obtained keeping in view the price movements for the past six months, the Committee felt that the margins stipulated on advances against shares to individuals needed no review.

(vi) ***Bank Guarantee :*** The Committee has recommended that the minimum margin of 25 per cent, inclusive of cash margin, should be stipulated for issue of guarantees on behalf of brokers. The maximum amount of margin to be obtained is, however, left to the boards of banks. The recommendation is made considering it is prudent for the banks to maintain adequate margin which will ensure that the brokers do not build up substantially leveraged position and at the same time, the banks minimize their risks.

(vii) The Committee has recommended that the following may be excluded for reckoning the bank's aggregate exposure to capital market:

a) Advances against collateral security of shares,

b) Advances granted to individuals for personal purposes like education, housing, consumption, etc., against the security of shares,

c) Credit substitutes like commercial paper, etc., may not be considered as part of credit portfolio,

(viii) The Committee has recommended that the board of each bank should lay down a prudential ceiling on the bank's total exposure to capital market, keeping in view its overall risk profile.

The recommendations made by the Committee are now being examined by the Reserve Bank of India. The Reserve Bank would welcome comments on the recommendations from banks, financial institutions and other market participants. For this purpose, it has placed the Report of the Committee on the RBI website **(www.rbi.org.in)**. Comments may be sent by September 15, 2000 to : Shri Amalendu Ghosh, Chief General Manager-in-Charge, Department of Banking Operations and Development, Reserve Bank of India, Centre I, World Trade Centre, Cuffe Parade, Mumbai - 400 005. Fax : 2183785

Corporates to Approach the RBI for Hedging of Crude Oil/Petro Products (September 2, 2000)

Corporates desiring to avail of the facility of hedging their underlying exposures in crude oil/petroleum products may approach the Reserve Bank of India, Exchange Control Department, Forex Markets Division, Amar Building, Mumbai for one-time approval subject only to monthly reporting of transactions through the concerned authorised dealers. No approval is required for individual transactions. Under the simplified procedure, the Reserve Bank's decision would be given within three days. The Reseve Bank of India is issuing instructions to authorised dealers permitting hedging crude oil and petroleum products. The same guidelines that were issued earlier would also apply for crude oil and petroleum products.

The Government of India had, in September 1998, permitted Indian Corporates that had underlying exposures to hedge the commodity price risks on offshore exchanges through the authorised dealers. The Reserve Bank of India had, in turn, issued detailed guidelines for accessing international commodity exchanges for hedging commodity price exposure on September 28, 1998. Crude oil and petroleum products were, however, not eligible for such hedging.

The Government has now allowed corporates that have underlying exposures in crude oil/petroleum products to hedge the commodity price risks. The hedging facility would be available for both, purchases and sales of crude oil/petroleum products. Corporates can access OTC hedging products in addition to exchange traded products.

Draft Guidelines on Bank Financing of Equities and Investment in Shares, etc. (September 21, 2000)

In pursuance of the announcement made in the Monetary and Credit Policy for the year 2000-2001, Standing Technical Committee on Bank Financing of Equities, comprising officials of the RBI and SEBI, was set up to develop operative guidelines for a transparent and stable system of bank financing of equities and investment in shares. The Report of the Committee submitted on August 2, 2000 was placed on the RBI website soliciting comments on the proposals made by the Committee from banks, financial institutions and other market participants. A meeting with Chief Executives of major banks was also taken by the Deputy Governor, Shri S.P. Talwar, on September 19, 2000 to elicit the views of the banks on the recommendations made by the Committee. Keeping in view the views expressed by the bankers in the meeting as also by other market participants, the following draft guidelines on bank financing of equities and investment in shares, based on the report of the RBI-SEBI Committee are being issued, for comments from banks, financial institutions and other interested participants.

(i) ***Financing of Initial Public Offerings (IPOs)***

(a) The financing of IPOs should be treated as advances against shares to individuals. Accordingly, as recommended by the RBI-SEBI Committee, the terms and conditions for financing of IPOs should be the same as those applicable to advances against shares to individuals. The maximum amount of finance that can be extended to an individual against IPOs should, however, be Rs. 10 lakh, as applicable to advances against physical shares. The corporates should not be extended credit by banks for investment in other companies' IPOs. Similarly, banks should not provide finance to NBFCs for further lending to individuals for IPOs.

(b) Finance extended by a bank for IPOs should be reckoned as an exposure to capital market.

(ii) ***Issue of Guarantees on behalf of Brokers***

Banks should obtain a minimum margin of 25 per cent inclusive of cash margin, for issue of guarantees on behalf of share brokers. Banks may, at their discretion, obtain margin higher than 25 per cent as per the policy approved by their Board of Directors.

(iii) ***Total Exposure***

The Board of Directors of banks may lay down a prudential ceiling on the bank's aggregate exposure to capital market, keeping in view the overall risk profile. The following may be excluded for reckoning the bank's aggregate exposure to capital market :

(a) Advances against collateral security of shares,

(b) Advances to individuals for personal purposes like education, housing, consumption, etc. against the security of shares,

(c) Credit substitutes like Commercial Paper, non convertible debenture, etc. may not be reckoned as part of credit portfolio for arriving at the bank's exposure to capital market.

(iv) ***Banks' Investments in Shares and Debentures***

(a) In terms of circular DBOD. No. Dir.

BC. 61/13.07.05/94 dated May 18, 1994, banks are free to acquire shares and/or convertible debentures of corporates subject to a ceiling of 5 per cent of the incremental deposits of the previous year. This is an **annual** ceiling and no cumulative ceiling has been prescribed for banks' aggregate investments in shares and convertible debentures. As recommended by the RBI-SEBI Committee, it is proposed that the ceiling prescribed for banks' investments in shares, convertible debentures, etc. should be related to outstanding advances and not to incremental deposits of the previous year and that within the overall exposure to sensitive sectors, the exposure to capital market by way of investments in shares, convertible debentures and units of mutual funds should not exceed 5 per cent of the banks' total outstanding credit as on 31st March of the previous year. It is clarified that this ceiling for investment in shares is **not mandatory**.

Consequently, it is not obligatory on the part of banks to invest in equity shares, convertible debentures and units of equity oriented mutual funds upto their eligible limit. Keeping in view the volatility of capital market and the bank's overall risk profile, the Boards of Directors of each bank shall formulate its policy on exposure to capital market.

(b) The extent upto which banks may make investment in shares directly or through UTI and SEBI approved other diversified mutual funds with good track records, will be as per the investment policy approved by the Board of Directors keeping in view the in-house expertise available within the bank. The operational aspects including the decision on investments shall be taken by the Investment Committee set up by the bank.

(c) Under the extant instructions, banks are required to mark to market their investment portfolio in equities like other investments on quarterly basis. Further, banks may disclose their investment in shares in their balance sheets on the same lines as advances against shares.

(d) The Standing Technical Committee of the RBI-SEBI will review these guidelines after six months based on the feed back received from banks and other market participants.

The draft guidelines are being put on the RBI website, **www.rbi.org.in,** and are also being forwarded to select banks and other market participants for comments on the above proposals by September 30, 2000 whereafter the Reserve Bank of India will finalise the guidelines. The comments on the proposals may be forwarded to : Shri A. Ghosh, Chief General Manager-in-Charge, Department of Banking Operations and Development, Reserve Bank of India, Central Office, World Trade Centre, Cuffe Parade, Mumbai - 400 005.

RBI Working Group on Discounting of Bills Submits Report (September 28, 2000)

Making bill finance available at interest rates lower than loan or cash credit, freedom to individual banks to lay down norms, abolition of stamp duty on bills of usance up to 182 days and exemption from stamp duty to financial institutions and registered non-banking finance companies are some of the recommendations of the Working Group on Discounting of Bills by Banks. The Working Group has also recommended allowing borrowers to discount bills drawn under letters of credit with any bank of their choice outside the existing consortium/ multiple banking arrangements and creation of new alternatives to bill financing as well as introduction of a credit insurance scheme to ensure that domestic receivables are on lines similar to those prevailing abroad.

The Working Group was set up by the Reserve Bank of India in December 1999 to examine the possibility of extending bills discounting facility to services sector especially industries such as information technology, software services, travel and tourism, etc. The Working Group submitted its report to the Reserve Bank of India on September 7, 2000. The Working Group was constitued under the Chairmanship of Shri K. Ramamoorty, Chairman, Vysya Bank Ltd. and comprised members drawn from commercial banks and different central office departments of the Reserve Bank of India. The Group co-opted representatives from trade, industry and services sector as additional members to have the benefit of their views and to ensure that the findings of the Group are relevant to the trade, industry and services sector.

In view of services sector transforming the economic profile of the country and being poised to register tremendous growth and contribute significantly to overall strength of the economy, the Group undertook a detailed scrutiny of the key issues involved in bill financing and examined the possibility of strengthening the existing bill discounting mechanism and extend its scope to services sector.

The Group has made several recommendations duly taking into account the Indian context in respect of bill financing, Bankers' Acceptance, and the scope for extending Bill financing to services sector. The important recommendations in brief are :

- Bill finance being the preferred style of credit from the bankers' point of view should carry interest lower than loan or cash credit, which is in line with international practice.
- In respect of bill transactions, individual bank should be given the fredom to lay down norms for satisfying themselves about the genuineness of underlying commercial transactions and/or the movement of goods.
- Banks should evolve the system of "value-dating" of clients account.
- Stamp duty for all bills of usance upto 182 days may be abolished.
- The exemption from stamp duty should be made available to bills discounted by Financial Institutions and Registered Non-Bank Finance Companies.
- All corporate and other commercial entities who have a turnover above a threshold level may be mandated to disclose the "aging schedule" of their overdue payables in their annual reports as well as in their periodical reports to their banks.
- Borrowers may be permitted to discount bills drawn under Letters of Credit with any bank of their choice, outside the existing consortium/multiple banking arrangements.
- New alternatives to bill financing like Invoice Financing and Secured Fixed Rate
- Note on the lines of asset - backed Commercial Paper, prevalent in developed markets may be introduced. Factoring services could also be revitalized.
- A Credit Insurance Scheme for ensuring domestic receivables on lines similar to the ones prevailing abroad may be introduced.
- Bankers' Accceptance (BA) may be introduceed in the Indian market to finance import, export and domestic trade transactions. However, care has to be taken to ensure that BAs are issued to cover only genuine trade transactions.

- Borrowing clients who enjoyed working capital limits of Rs. 10 crore and above and whose rating with the bank has been consistently satisfactory may be allowed drawal against the Working Capital Demand Loan (WCDL) component on the basis of the tradable promissory note in favour of the lending bank called "Bank Paper".
- Banks may be permitted to entertain purchase/discount of bills drawn by service providers on their debtors, subject to the satisfaction of the banker that the service has been rendered.

The Group has also considered it appropriate to briefly advert to one of the key emerging trends in the world of business, *viz*, the use of internet as a potent cost effective tool for electronic commerce (e-commerce). Looking at the wave of optimism being shared in the developed markets on the future potential of e-commerce and their preparedness to meet them, the Group has recommended that an expert group drawn from the fields of technology, banking and corporate finance may be constitued to prepare the blue-print for meeting the e-commerce challenges that may be thrown up in the financial sector of the country.

The full text of the report of the Working Group on Bills Discounting by Banks has been placed on the RBI website **(www.rbi.org.in).**

Suggestions/comments may be sent to The Chief General Manager, Industrial and Export Credit Department, Reserve Bank of India, Central Office Building, 12th floor, Shahid Bhagat Singh Road, Mumbai - 400 001 or through Fax at 2660407, 2661256 or e-mail - rbibiecd@giasbm01.vsnl.net.in.