RBI Press Release

Liquidity Facilities to Co-operative Banks
(April 4, 2001)

In the wake of the recent events that have affected a few urban co-operative banks in Gujarat, it had been reported that some co-operative banks may face liquidity problems in their day-to-day operations. To obviate any such difficulty, the Reserve Bank had already advised all concerned that these banks may approach public sector banks and also primary dealers for repos facilities against eligible government securities held by them.

In case the co-operative banks are unable to meet their liquidity needs from the money market, including through repos with other banks and primary dealers, such banks have further been advised to approach the Reserve Bank of India, Central Office through the Reserve Bank Regional Director in Ahmedabad. On the advice of Regional Director, the Reserve Bank will provide special liquidity support to such banks against their eligible holdings of appropriate assets for temporary periods upto 90 days.

Proposed amendments to the Guidelines on Bank Financing of Equities and Investments in Shares (April 23, 2001)

In November 10, 2000, the Reserve Bank had issued guidelines in respect of banks' investments and advances in capital markets. As announced at that time, the working of these guidelines has been reviewed by the RBI-SEBI Technical Committee. The Report of the Committee was submitted to the Reserve Bank on April 12, 2001 and was released on the same day for comments / suggestions by experts, market participants and others. (The Report is available on RBI Website also).

2. In the light of the recommendations of the Technical Commitee, and comments received, the Reserve Bank proposes to make the following amendments in the guidelines issued in November 2000.

(i) Ceiling on Overall Exposure to Capital Market

3. The ceiling of 5 per cent, prescribed in the November 2000 guidelines, will henceforth apply to **total** exposure of a bank to stock markets in all forms.

The ceiling will cover :

(a) direct investment by banks in equity shares, convertible debentures and units of equity oriented mutual funds;

(b) advances against shares and debentures; and

(c) guarantees issued on behalf of brokers.

4. The 5 per cent ceiling will be computed in relation to the total advances (including commercial paper) as on March 31, of the previous year as against total outstanding domestic credit as on March 31 of the previous year under the earlier guidelines. It is clarified that 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 credit portfolio of a bank. Further, for computing the 5 per cent norm, direct investment in shares by banks will be calculated at the price paid by banks at the time of acquisition of shares.

(ii) Avoidance of concentration of bank investments / advances to a few Stock Broking Entities

5. An important finding of the Technical Committee was that, while the overall exposure of banks in the capital market continue to be modest at 1.76 per cent of the total advances, some relatively small banks (in terms of their share in total bank credit) did not observe appropriate risk management guidelines, particularly in respect of advances against shares and issues of guarantees to a few stock broking entities (including their associates and inter-connected companies). In order to avoid such unwarranted 'nexus' emerging between some inter-connected stock broking entities and promoters /managers of some banks, the Technical Committee had recommended that -

(a) Each bank should fix, within the overall ceiling of 5 per cent, a subceiling for total advances to all the stock brokers and market-makers (both fund-based and non-fund based, i.e., guarantees).

(b) The total fund based and non-fund based facilities sanctioned by a bank to a single stock-broking entity, including its associates/interconnected companies, should not exceed the prudential norm of 10 per cent of the sub-ceiling at (a) above for total advances to all the stock brokers.

6. It is proposed to leave to the discretion to fix both the sub-ceilings at (a) and (b) above for total advances to all stock brokers as well as a single stock broker (and connected unertakings), to the Boards of banks who should, however, keep in view the above recommendations of the Technical Committee.

7. As a further safeguard to prevent any 'nexus' from emerging, it is proposed that there should be a clear separation of responsibilities for making decisions with regard to actual advances against shares / investments in shares on the one hand and surveillance and monitoring of actual advances / investments in shares by a bank in the light of prudential guidelines approved by its Board on the other. It will be desirable if the CMD / CEO of the bank is entrusted with the latter responsibility and is not a member of the Investment Committee. Under this arrangement, recommendations on investments in shares should be made by the Investment Committee, to be chaired by Executive Director or Whole time Director or the next Senior Officer and would not involve the CMD / CEO. The CMD / CEO should review the investments through weekly / fortnightly reports from the Investment Committee and ensure that actual investments and advances against shares are in accordance with the prudential norms prescribed by the RBI / bank's Board. The CMD should have the management responsibility for

surveillance and monitoring and reporting the actual investments made / advances against shares, to the Board.

(c) Margins

8. Under the November 2000 guidelines, banks are required to obtain a minimum cash margin of 25 per cent for issue of guarantees, 25 per cent margin for advances against demat shares, and a margin of 50 per cent for advances against shares in physical form. The SEBI-RBI Committee has recommended a uniform margin of 50 per cent on all advances/guarantees including a minimum cash margin of 25 per cent for issue of guarantees on behalf of any stock broking entity. In the amended guidelines, it is proposed to prescribe a uniform margin of 40 per cent on all advances/guarantees with minimum cash margin of 20 per cent in respect of guarantees issued by banks to take care of volatility in stock valuations.

(d) Advances to individuals

9. The RBI-SEBI Committee had recommended that the maximum amount of advance that can be granted to an individual against security of shares and debentures, either in de-materialised or in physical form, should not exceed Rs. 10 lakh.

10. It is, however, proposed to retain the existing guidelines on the maximum ceiling of Rs. 10 lakh against physical shares and Rs. 20 Lakh against de-materialised shares for individuals with the proviso that banks should not extend loans to the multiple members of the same family or a group of employees of the same corporate or their interconnected entities. Such loans are meant for genuine individual investors and collusive action by a group of individuals to take multiple loans should not be supported.

(e) Transitional provisions

11. As mentioned above, advances/investments in most cases in stock market are well below the overall ceiling of 5 per cent. The above proposals should provide adequate head-room for growth of banks’ support to capital market, while minimizing the possibility of an unwarranted nexus emerging between some broking entities and promoters/ managers of a bank.

In respect of few banks whose present exposure to the capital market is above the overall ceiling of 5 per cent, the following transitional provisions are proposed:

(a) These banks should formulate a time-bound plan for gradually reducing their exposure to stock markets in line with the amended guidelines. This time-bound plan, along with data on exposures under various categories of advances/guarantees, should be submitted to the Reserve Bank by May 31, 2001. Meanwhile, they should not make fresh advances and guarantees.

(b) The proposed 40 per cent margin will apply to all advances/guarantees made after April 23, 2001. Advances made before that date may continue at the existing margins until they come up for renewal.

(c) CMDs/CEOs of all banks should review their present portfolio of advances/guarantees and in case any advances/guarantees were beyond the limits prescribed by its Board (or they were in violation of November 2000 guidelines), such advaces/guarantees should be reduced as early as possible. This review should also cover excessive advances/guarantees in favour of particular entities and their inter-connected companies.

Review of the amended Guidelines

12. As proposed by the Technical Committee, a review of the amended guidelines will again be undertaken after six months. For this purpose banks may submit data in the prescribed form by October 2001, to the Reserve Bank.

These draft guidelines along with the Report of the RBI-SEBI Technical Committee are again being released for comments / suggestions by market participants, experts and others. These comments should reach the Reserve Bank at the address given below by May 3, 2001.

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It is proposed to issue the final amended guidelines in early May 2001.