Capital adequacy and credit exposure norms - Treatment of loans granted by Financial Institutions (FIs) against the guarantee of banks

REF. DBS.FID No. C-5/01.02.00/2002-03

August 8, 2002

The CEOs of all-India Term Lending and Refinancing Institutions

Dear Sir,

Capital adequacy and credit exposure norms - Treatment of loans granted by Financial Institutions (FIs) against the guarantee of banks

As you might be aware, the banks till recently were not permitted to furnish a guarantee in favour of another lending institution for a loan extended by the latter to a third party. However, in terms of RBI instructions vide Circular IECD.No./08.12.01/ 2001-02 dated February 20, 2002, banks have now been permitted to extend guarantees in respect of **infrastructure projects** in favour of other lending institutions provided the bank issuing the guarantee takes a funded share in the infrastructure project at least to the extent of five per cent of the project cost and undertakes normal credit appraisal, monitoring and follow up of the project.

2. In this context, a query has been received regarding the applicable risk weight for the loan extended by an FI against the guarantee of a bank in the CRAR computation of the FI and the treatment of the loan for the purpose of exposure norms. The issue has been examined and we advise as follows:

a) In the transactions of the type referred to at para 1 above, the loan extended by an FI against the guarantee of a bank would attract a risk weight of 20% in computation of CRAR of the lending FI. The risk weight of 20 per cent would apply to only that part of the loan which is covered by the bank's guarantee and the remaining amount of loan, if any, would normally attract 100 per cent risk weight.

b) For the purpose of exposure norms, however, the entire loan transaction should be reckoned as an exposure on the borrowing entity and **not** on the bank guaranteeing the loan, so as to correctly reflect the degree of credit concentration. In case the funded facility is by way of a term loan, the level of exposure should be reckoned, as per our Circular DBS.FID.No.20/02.01.00/97-98 dated December 4, 1998, as indicated below:

? Before commencement of disbursement, the exposure would be the sanctioned limit or the extent up to which the FI has entered into commitment with the borrowing entity in terms of the agreement, as the case may be;

- After commencement of disbursement, the exposure would be the aggregate of the outstanding amount plus the undisbursed or undrawn commitment.

3. Please acknowledge receipt.

Yours faithfully,

Sd/-

(K. C. Bandyopadhyay)
Chief General Manager