Guidelines for bank finance for PSU disinvestments of Government of India

Reserve Bank of India
Central Office
Department of Banking Operations and Development
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All Scheduled Commercial Banks
(excluding RRBs & LABs)

Dear Sir,

Guidelines for bank finance for PSU
<u>disinvestments of Government of India</u>

As you are aware, the Government of India is pursuing the programme of disinvestment of its holdings in some public sector undertakings (PSUs). In this connection, it may be mentioned that RBI had issued instructions to the banks vide our circular DBOD.No.Dir.BC.90/13.07.05/98 dated August 28, 1998 that the promoters' contribution towards the equity capital of a company should come from their own resources and the bank should not normally grant advances to take up shares of other companies. Banks were also advised to ensure that advances against shares were not used to enable the borrower to acquire or retain a controlling interest in the company/companies or to facilitate or retain inter-corporate investment. In view of the above circular, banks have sought clarification from Reserve Bank of India (RBI) whether they can extend finance to the successful bidders for acquisition of shares of these PSUs under the Government of India's disinvestment programme.

2. It is clarified that the aforesaid instructions of the 1998 circular would not apply in the case of bank finance to the successful bidders under the PSU disinvestment programme of the Government, subject to the following :

i) Banks' proposals for financing the successful bidders in the PSU disinvestment programme should be approved by their Board of Directors.

ii) Bank finance should be for acquisition of shares of PSU under a disinvestment programme approved by Government of India, including the secondary stage mandatory open offer, wherever applicable and not for subsequent acquisition of the PSU shares. Bank finance should be made available only for prospective disinvestments by Government of India.

iii) The companies, including the promoters, to which bank finance is to be extended should have adequate net worth and an excellent track record of servicing loans availed from the banking system.

iv) The amount of bank finance thus provided should be reasonable with reference to banks' size, its net worth and business and risk profile.

3. In case the advances against the PSU disinvestment is secured by the shares of the disinvested PSUs or any other shares, banks should follow our extant guidelines on capital market exposures on margin, ceiling on overall exposure to the capital market, risk management and internal control systems, surveillance and monitoring by the Audit Committee of the Board, valuation and disclosure, etc. (cf. our circular No.DBOD.BP.BC.119/21.04.137/2000-01 dated May 11, 2001). If the PSU disinvestment shares against which bank finance is proposed to be extended are illiquid due to lock-in period / restrictive clauses, the successful bidder, to whom the bank proposes to extend finance, should obtain necessary approval from Government of India and other regulatory agencies exempting such equity holdings from these restrictions before bank finance can be extended. In other words shares pledged to the bank should be marketable without a lock-in period. Further, banks should ensure compliance with the requirements of Section 19(2) of the B.R. Act, 1949 in this regard.

4. On account of banks' financing acquisition of PSU shares under the Government of India disinvestment programmes, if any bank is likely to exceed the regulatory ceiling of 5% on capital market exposure in relation to its total outstanding advances as on March 31 of the previous year, it has been decided that RBI will consider requests from these banks for relaxation of the ceiling on a case by case basis, subject to adequate safeguards regarding margin, bank's exposure to capital market, internal control and risk management systems, etc. The relaxation of ceiling will be considered in such a manner that the bank's exposure to capital market in all forms, net of its advances for financing of acquisition of PSU shares shall be within the regulatory ceiling of 5%.

5. RBI will also consider relaxation on specific requests from banks in the individual / group credit exposure norms on a case by case basis (in the format prescribed in terms of our circular DBOD No.BP. 2724/21.03.054/ 2000-01 dated May 28, 2001), provided that the bank's total exposure to the borrower, net of its exposure due to acquisition of PSU shares under the Government of India disinvestment programme, should be within the prudential individual/group borrower exposure ceiling prescribed by RBI.

6. In this context, it may be mentioned that Government of India, Ministry of Finance (DEA), Investment Division, vide its Press Note dated July 8, 2002 on guidelines for Euro issues, has permitted an Indian company utilizing ADR/GDR/ECB proceeds for financing disinvestment programme of the Government of India, including the subsequent open offer. Banks may, therefore, take into account proceeds from such ADR/GDR/ECB issues, for extending bank finance to successful bidders of PSU disinvestment programme.

7. Please acknowledge receipt.

Yours faithfully,
sd/-
(M. R. Srinivasan)
Chief General Manager-in-Charge