RBI/2011-12/ 322

DBOD.Dir.BC. 68 /13.03.00/2011-12 December 27, 2011

All Scheduled Commercial Banks
(excluding RRBs)

Dear Sir / Madam

Banks' Exposure to Capital Market -
Issue of Irrevocable Payment Commitments (IPCs)

Please refer to our circulars No.DBOD.Dir.BC.46/13.03.00/2010-11 dated September 30, 2010, DBOD.Dir.BC.52/13.03.00/2010-11dated October 28, 2010 and DBOD.Dir.BC.43/13.03.00/2011-12 dated October 31, 2011 wherein banks issuing Irrevocable Payment Commitments (IPCs) to various Stock Exchanges on behalf of Mutual Funds and FIIs had been advised to adopt the following risk mitigation measures:

i. Only those custodian banks, who have a clause in the Agreement with their clients which gives them an inalienable right over the securities to be received as pay out in any settlement, would be permitted to issue IPCs. However, in cases where transactions are pre-funded i.e. there are clear INR funds in the customer's account and, in case of FX deals, the bank's nostro account has been credited before the issuance of the IPC by custodian banks, the requirement of the clause of inalienable right over the security to be received as pay out in the agreement with the clients will not be insisted upon.

ii. The maximum risk to the custodian banks issuing IPCs would be reckoned at 50%, on the assumption of downward price movement of the equities bought by FIIs/ Mutual Funds on the two successive days from the trade date (T) i.e., on T+1 and T+2, of 20% each with an additional margin of 10% for further downward movement.

iii. Accordingly the potential risk on T+1 would be reckoned at 50% of the settlement amount and this amount would be reckoned as CME at the end of T+1 if margin payment / early pay in does not come in.

iv. In case there is early pay in on T+1, there will be no Capital Market exposure. By T+1, we mean 'end of day' (EOD) as per Indian Time. Thus, funds received after EOD as per Indian Time, **will not be** reckoned as early pay-in on T+1. CME will have to be computed accordingly.

v. In case margin is paid in cash on T+1, the CME would be reckoned at 50% of settlement price minus the margin paid. In case margin is paid on T+1 by way of permitted securities to FIIs / Mutual Funds, the CME would be reckoned at 50% of settlement price minus the margin paid plus haircut prescribed by the Exchange on the securities tendered towards margin payment.

vi. The IPC will be treated as a financial guarantee with a Credit Conversion Factor (CCF) of 100. However, capital will have to be maintained only on exposure which is reckoned as CME and the risk weight would be 125% thereon.

2. It has now been decided that the above mentioned arrangements will continue to be in force until further review.

Yours faithfully,

(P. R. Ravi Mohan)
Chief General Manager