

## **Connected Lending by the select all-India Financial Institutions (FIs)**

Ref. DBS.FID No.C-10/ 01.02.00 / 2002- 03

December 21, 2002

### **The CEOs of all-India Term Lending and Refinancing Institutions**

Dear Sir,

#### **Connected Lending by the select all-India Financial Institutions (FIs)**

The matter of "connected lending" by the Financial Institutions (FIs) had been under our consideration. In consultation with the Government of India, it has now been decided to issue the following guidelines to the FIs in regard to the connected lending.

#### **Credit facilities to the Directors**

2. In order to obviate the possibility of conflict of interest in the lending operations of the FIs, it has been decided in consultation with the Government of India that, with immediate effect, the FIs should not:

- a) grant any loan or advance on the security of its own shares; or
- b) enter into any commitment for granting any loan or advance to or on behalf of:
  - (i) any of its Directors, or
  - (ii) any firm in which any of its Directors is interested as Partner, Manager, Employee or Guarantor, or
  - (iii) any company (not being a subsidiary of the FI or a company registered under Section 25 of the Companies Act, 1956, or a Government Company) of which, or the subsidiary or the holding company of which, any of the Directors of the FI is a Director, Managing Agent, Manager, Employee or Guarantor or in which he holds substantial interests, or
  - (iv) any individual in respect of whom any of its Directors is a Partner or a Guarantor.

For the purpose of these instructions, the term "loans and advances" shall not include the transactions listed in **Annexure I**. However, purchase or discount of bills from Directors and their concerns which is in the nature of clean accommodation would be reckoned as 'loans and advances' for the purpose of these instructions. For seeking the approval of Reserve Bank, as envisaged at items (c) and (d) of Annexure I, the FI should make an application to the this Division.

#### **Non-fund facilities on behalf of the Directors**

3. As regards extending guarantees and establishing Letters of Credit (L/Cs) on behalf of the FI's own Directors, it is pertinent to note that in the event of default by the principal debtor in discharging his liability and consequently, the FI being called upon to honour its obligations under the guarantee or L/C, the relationship between the FI and the Director could

become one of a creditor and a debtor. Further, it is possible that the Directors could borrow from a third party against the guarantee given by the FI. Such transactions may defeat the very purpose of the restrictions imposed on 'connected lending', if the FI does not take appropriate steps to ensure that the liabilities thereunder do not devolve upon them.

**3.1** The FIs should, therefore, ensure while extending non-fund based facilities, such as guarantees, L/Cs, acceptances, etc., on behalf of Directors and the companies / firms in which the Directors are interested, that:

- (a) adequate and effective arrangements have been made to the satisfaction of the FI that the commitments would be met by the applicants for guarantees, openers of L/Cs or acceptors, out of their own resources;
- (b) the FI will not be called upon to grant any loan or advance to meet the liability consequent upon the invocation of guarantee or devolvement of L/Cs; and
- (c) no liability would devolve on the FI on account of LCs / acceptances.

In case, the contingencies as at (b) & (c) above arise, the FI will be deemed to be a party to the violation of the provisions of this Circular.

**Loans and advances to relatives of the FI's Directors or to the Directors of other FIs / banks and their relatives**

**4.** Without prior approval of the Board or without the knowledge of the Board, no loans or advances should be granted, except to the extent permitted in the guidelines in the following paragraphs, to the undernoted categories of counterparties:

- (a) relatives of the FI's Chairman / Managing Director or other Directors;
- (b) Directors (including Chairman/Managing Director) of other FIs and banks and their relatives;
- (c) Directors of Scheduled Co-operative Banks and their relatives;
- (d) Directors of subsidiaries / trustees of mutual funds/ trustees of venture capital funds set up by the financing FIs or other FIs and banks, and their relatives.

**4.1** In order to obviate the possibility of development of **reciprocal arrangements** amongst the FIs / banks for extending credit and non-funded facilities, as also for awarding contracts, to each other's Directors, their relatives, etc., the following guidelines should be adopted:

**4.1.1** Unless sanctioned by the Board of Directors / Management Committee, the FIs should not grant loans and advances, aggregating **Rs. 25 lakhs and above**, to:-

- (a) Directors (including the Chairman/Managing Director) of other FIs and banks (including Directors of Scheduled Co-operative Banks, Directors of subsidiaries / trustees of mutual funds / trustees of venture capital funds);

- (b) any firm in which any of the Directors of other FIs and banks (including Directors of Scheduled Co-operative Banks, Directors of subsidiaries / trustees of mutual funds / trustees of venture capital funds) is interested as a partner or guarantor; and
- (c) any company in which any of the Directors of other FIs and banks (including Directors of Scheduled Co-operative Banks, Directors of subsidiaries / trustees of mutual funds / trustees of venture capital funds) holds 'substantial interest' or is interested as a Director or as a guarantor.

**4.1.2** Unless sanctioned by the Board of Directors / Management Committee, the FIs should also not grant loans and advances aggregating **Rs. 25 lakhs and above** to -

- (a) any relatives of the FI's Chairman /Managing Director or other Directors;
- (b) any relatives of the Chairman / Managing Director or other Directors of other FIs and banks (including Directors of Scheduled Co-operative Banks, Directors of subsidiaries / trustees of mutual funds / trustees of venture capital funds);
- (c) any firm in which any of the relatives as mentioned at (a) & (b) above is interested as a partner or guarantor; and
- (d) any company in which any of the relatives as mentioned at (a) & (b) above holds 'substantial interest' or is interested as a Director or as a guarantor.

The scope of the term "relative" shall be as defined in **Annexure II** while the term "other FIs" would mean any Public Financial Institution specified by the Government of India in terms of Section 4-A of the Companies Ac, 1956.

**4.2** The term "**substantial interest**" for the purpose of these instructions:

- (i) in relation to a company, means the holding of a beneficial interest by an individual or his spouse or minor child, whether singly or taken together, in the shares thereof, the amount paid-up on which exceeds five lakhs of rupees or ten per cent of the paid-up capital of the company, whichever is less;
- (ii) in relation to a firm, means the beneficial interest held therein by an individual or his spouse or minor child, whether singly or taken together, which represents more than ten per cent of the total capital subscribed by all the partners of the said firm;

**4.3** The proposals for credit facilities of an amount **less than Rs.25 lakh** to these borrowers may be sanctioned by the appropriate authority in the financing FI under the powers vested in such authority, but the matter should be **reported to the Board**.

#### **Loans and advances to Officers of FIs or to their relatives**

**5.** The following guidelines should be followed by the FIs with reference to the extension of credit facilities to the officers and their relatives:

**5.1** No officer or any Committee comprising, *inter alia*, an officer as member, shall, while exercising powers of sanction of any credit facility, sanction any credit facility to

himself or his relative. Such a facility shall ordinarily be sanctioned only by the next higher sanctioning authority. Credit facilities sanctioned to the Senior Officers of the financing FI should be reported to the Board.

**5.2** Proposals for credit facilities to the relatives of Senior Officers of the FI sanctioned by the appropriate authority should be reported to the Board. Further, when a credit facility is sanctioned by an authority, other than the Board to -

- (i) any firm in which any of the relatives of any Senior Officer of the financing FI holds substantial interest, or is interested as a partner or guarantor; or
- (ii) any company in which any of the relatives of any Senior Officer of the financing FI holds substantial interest, or is interested as a director or as a guarantor,

such transactions should also be reported to the Board.

**5.3** The scope of the term "**relative**" shall be as defined in Annexure II. The term '**substantial interest**' for the purpose of these instructions shall have the same meaning as contained in para 4.2 above. The term '**Senior Officer**' will refer to any officer of the FI in senior management level in a grade equivalent to Grade IV and above in a nationalised bank. **Credit facility** will not include loans and advances such as housing loans, car advances, consumption loans, etc. granted to an officer of the FI under any scheme applicable generally to officers.

**5.4** In the case of **consortium arrangements**, the above norms relating to grant of credit facilities to relatives of Senior Officers of the FI will apply to the relatives of Senior Officers of all the participating banks and other FIs.

#### **Timeframe for recovery of loans**

**6.** In cases where the FIs have already entered into transactions covered within the prohibitions stipulated above, immediate steps should be initiated to recover the amounts due to the FI on account of the loan or advance together with interest, if any, due thereon within the period stipulated at the time of grant of the loan or advance, or where no such period has been stipulated, **before the expiry of one year** from the date of this Circular.

**7.** In case of any difficulty in complying with the foregoing provisions, RBI may, on application made to it by the FI concerned in this behalf, extend the period for the recovery of the loan or advance until such date, not being a date beyond the period of three years from the date of issue of this circular, and subject to such terms and conditions, as the Reserve Bank may deem fit. However, the foregoing restrictions shall not apply, if and when the Director concerned vacates the office of the Director of the FI / other FIs / bank / subsidiary or of the trustee of the mutual fund / venture capital fund concerned, whether by death, retirement or resignation or otherwise.

#### **Effect of non-recovery within the stipulated time**

**8.** Where any loan or advance referred to in the foregoing paragraphs, payable by any person has not been repaid to the FI, within the period specified at paragraph 5 or 6 (as the

case may be) above, such person shall, if he is a Director of such an FI on the date of expiry of the aforesaid period, be **deemed to have vacated his office** as such on the said date. For the purpose of the provisions of this paragraph, a Director would include a **member of any Board or a Committee in India** constituted by an FI for the purpose of managing or for the purpose of advising it in regard to the management of, all or any of its affairs. Furthermore, the term 'loan or advance' shall not include any transaction which the Reserve Bank may, having regard to the nature of the transaction and the circumstances of the case, specify as not being a loan or advance for the purpose of the stipulations contained in this paragraph.

### **Remission of the liabilities of the borrowers**

9. No loan or advance referred to at paragraph 2 above, or any part thereof or any liability of the aforesaid categories of borrowers on account of the non-funded facilities availed of by him from the FIs, shall be remitted without the prior approval of Reserve Bank and any remission without such approval shall be void and of no effect.

### **Interpretation**

10. If any question arises whether any transaction constitutes a 'loan or advance' for the purpose of these instructions, it shall be referred to the Reserve Bank, whose decision thereon shall be final.

### **Non-participation of the interested Directors in the proceedings**

11. The Chairman /Managing Director or other Director who is directly or indirectly concerned or interested in any proposal should disclose the nature of his interest to the Board or the Committee (as the case may be) when any such proposal is discussed. He should **not be present** in the meeting unless his presence is required by the other Directors for the purpose of eliciting information in which case the Director, so required to be present, **shall not vote** on any such proposal.

### **Award of contracts by the FIs**

12. The above norms relating to grant of loans and advances will equally apply to **awarding of contracts**.

13. The FIs are advised to evolve appropriate operating procedures and information system for ascertaining the interest of their own Directors as also the interest of the Directors of other FIs and banks for the purpose of implementing these instructions and for monitoring ongoing compliance therewith.

14. These Directions are being issued in exercise of the powers vested in the Reserve Bank under Section 45L of the Reserve Bank of India Act, 1934. This Circular should be placed before the Board of Directors of the FI at its ensuing meeting and its contents also duly brought to the notice of all the Directors.

15. Please acknowledge receipt.

Yours faithfully,

(Rajesh Verma)  
General Manager-in-Charge

**Annexure I**

**List of transactions that shall not be included in the term "loans and advances"**

- (a) loans or advances to the Agriculture Finance Corporation Limited;
- (b) such loans or advances as can be made by a FI to any of its directors (who immediately prior to becoming a director, was an employee of the FI) in his capacity as an employee of that FI and on the same terms and conditions as would have been applicable to him as an employee of that FI, if he had not become a director of the FI.
- (c) such loans or advances as are granted by a FI to its Chairman and Chief Executive Officer, who was not an employee of the FI immediately prior to his appointment as Chairman / Managing Director / CEO, for the purpose of purchasing a car, personal computer, furniture or constructing / acquiring a house for his personal use and Festival Advance, **with the prior approval of RBI** and on such terms and conditions as may be stipulated by it.
- (d) such loans or advances as are granted by a FI to its whole time director, for the purpose of purchasing a car, personal computer, furniture or constructing / acquiring a house for his personal use and Festival Advance, **with the prior approval of RBI** and on such terms and conditions as may be stipulated by it.
- (e) Facilities like bills purchased / discounted (whether documentary or clean and sight or usance and whether on D/A basis or D/P basis), purchase of cheques, other non-fund based facilities like acceptance / co-acceptance of bills, opening of L/Cs and issue of guarantees, purchase of debentures from third parties, etc.

**The scope of the term "relative"**

The scope of the term 'relative' will be as under:

- (a) Spouse
- (b) Father
- (c) Mother (including step-mother)
- (d) Son (including step-son)
- (e) Son's Wife
- (f) Daughter (including step-daughter)
- (g) Daughter's Husband
- (h) Brother (including step-brother)
- (i) Brother's wife
- (j) Sister (including step-sister)
- (k) Sister's husband
- (l) Brother (including step-brother) of the spouse
- (m) Sister (including step-sister) of the spouse