

Bank financing of equities and investments in shares

RefNo. DBOD. Dir.BC. 63/13.07.05/2002-03

January 29, 2003

All scheduled commercial banks
(excluding RRBs and LABs)

Dear Sir,

Bank financing of equities and investments in shares

As you are aware, revised guidelines on bank financing of equities and investments in shares were issued vide circular DBOD.No.BP.BC.119/ 21.04.137/ 2000-2001 dated 11th May 2001. These guidelines were issued to address the risks to banks that could arise on account of inadequacy of margins or the inability of borrowers to meet their repayment/ interest obligations because of volatility in share prices or other related reasons. These guidelines prescribed, among others, the ceiling on overall exposure to capital market, the ceiling on direct investment in shares etc, prudential limits on advances to individuals, financing of initial public offerings, margins on advances against shares/ issue of guarantees. Though banks are free to provide credit facilities to stockbrokers and market makers on the basis of their commercial judgment within the policy framework approved by the Boards, banks were advised to put in place appropriate sub-ceilings, within the overall ceiling prescribed for capital market exposures, on exposure to all stockbrokers and market makers, and also to any single stock broking entity including its associates / interconnected companies. The CMDs / CEOs of banks were advised vide the above circular to bestow their personal attention while implementing the revised guidelines particularly with reference to the putting in place of appropriate risk management and internal control systems as enunciated in the revised guidelines.

2. In view of the increasing importance of efficiency of the risk management systems, banks are advised to more specifically review their risk management systems pertaining to capital market exposures and exposures to stock broking entities / market makers. The review, which should be placed before the Board of Directors, should, *inter alia*, assess the efficiency of the risk management systems in place in the bank, assess the extent of compliance with the guidelines issued vide circular dated 11th May 2001 referred to above, and identify the gaps in compliance with the above guidelines for initiating appropriate steps immediately.

3. Please acknowledge receipt.

Yours faithfully,

(**C. R. Muralidharan**)
Chief General Manager