Exposure Norms for the Financial Institutions

REF. DBS.FID No. C- 7 /01.02.00/2003-04

August 7, 2003

The CEOs of the all-India Term Lending and Refinancing Institutions

Dear Sir,

Master Circular- Exposure Norms for the Financial Institutions

As you are aware, the Reserve Bank of India has from time to time, issued a number of circulars to the FIs containing instructions on matters relating to exposure norms . In order to enable the FIs to have all the current instructions on the subject at one place, this master circular has been prepared.

2. It may be noted that the instructions contained in circulars listed in Part A, as well as the relevant paragraphs indicated in column 5 of Part B of the Appendix have been consolidated in this master circular.

Yours faithfully,

Sd/-
(Rajesh Verma)
General Manager-in-Charge

MASTER CIRCULAR – EXPOSURE NORMS FOR THE FINANCIAL INSTITUTIONS

1 INTRODUCTION

On a review of the credit exposures of the term lending institutions in 1997, it was considered advisable to prescribe credit exposure limits for them in respect of their lending to individual / group borrowers. Accordingly, as a prudential measure, aimed at better risk management and avoidance of concentration of credit risks, it was decided in June 1997 by Reserve Bank of India to limit a term lending institution's exposures to an individual borrower and group borrowers and credit exposure norms were prescribed for them. These norms are to be considered as a part of prudent credit management system and not as a substitute for efficient credit appraisal, monitoring and other safeguards. In respect of existing credit facilities to borrowers which were in excess of the ceilings initially prescribed, term lending institutions were required to take necessary steps to rectify the excess and comply with the stipulations, within a period of one year from June 28, 1997, the date of the first circular, and to bring such cases to the notice of their Board of Directors.

2 SCOPE AND APPLICABILITY

2.1 The exposure norms are also applicable to the refinancing institutions (viz., NABARD, NHB and SIDBI) but in view of the refinance operations being the core function of these institutions, their refinance portfolio is not subject to these exposure norms. However, from the prudential perspective, the refinancing institutions are well advised to evolve their own credit exposure limits, with the approval of their Board of Directors, even in respect of their refinancing portfolio. Such limits could, *inter alia*, be related to the capital funds / regulatory capital of the institution. Any relaxation / deviation from such limits, if permitted, should be only with the prior approval of the Board.

2.2 These norms deal with only the individual borrower and group borrower exposures but not with the sector / industry exposures. The FIs may, therefore, consider fixing internal limits for aggregate commitments to specific sectors e.g., textiles, chemicals, engineering, etc., so that the exposures are evenly spread. These limits should be fixed having regard to the performance of different sectors and the perceived risks. The limits so fixed may be reviewed periodically and revised, if necessary.

2.3 These stipulations shall apply to all borrowers. However, in so far as public sector undertakings are concerned only single borrower exposure limit would be applicable.

2.4 The norms have evolved over the years and various aspects of the credit exposure norms applicable to FIs are detailed in the following paragraphs.

3. DEFINITIONS

3.1 '**Capital Funds**' : The total regulatory capital (i.e., Tier 1 + Tier 2 capital) of the FI, determined as per the capital adequacy norms of RBI applicable to the FIs, as on March 31 (June 30 in case of NHB) of the previous year, would constitute the 'capital funds' for the purpose of exposure norms.

(The aforesaid definition of 'capital funds' came into force from April 1, 2002. From this date, the exposure ceilings were to be monitored with reference to the revised definition of capital funds as obtaining on March 31, 2002. Prior to that date, the 'capital funds' were defined as (paid up capital + free reserves) as per the published accounts but the reserves created by way of revaluation of fixed assets, etc., were to be excluded.)

3.2 **'Infrastructure Projects' / 'Infrastructure Lending'**: Any credit facility in whatever form extended by the FIs to an infrastructure facility as specified below falls within the definition of "infrastructure lending". In other words, it is a credit facility provided to a borrower company engaged in:

- developing or
- operating and maintaining, or
- developing, operating and maintaining

any infrastructure facility that is a project in any of the following sectors:

i) a road, including toll road, a bridge or a rail system;

ii) a highway project including other activities being an integral part of the highway project;

iii) a port, airport, inland waterway or inland port;

iv) a water supply project, irrigation project, water treatment system, sanitation and sewerage system or solid waste management system;

v) telecommunication services whether basic or cellular, including radio paging, domestic satellite service (i.e., a satellite owned and operated by an Indian company for providing telecommunication service), network of trunking, broadband network and internet services;

vi) an industrial park or special economic zone ;

vii) generation or generation and distribution of power

viii) transmission or distribution of power by laying a network of new transmission or distribution lines.

ix) Any other infrastructure facility of similar nature

3.3 ‘**<u>Group’ Borrowers</u>** : The concept of "Group" and the task of identification of the borrowers belonging to specific industrial groups is to be based on the perception of the FIs. FIs are, it is observed, generally aware of the basic constitution of their clientele for the purpose of regulating their exposure to risk assets. The group to which a particular borrowing unit belongs may, therefore, be decided by them on the basis of the relevant information available with them, the guiding principle in this regard being commonality of management and effective control.

3.4 **<u>Net Owned Funds in respect of NBFCs</u> :** Net owned Fund will consist of paid up equity capital, free reserves, balance in share premium account and capital reserves representing surplus arising out of sale proceeds of assets but not reserves created by revaluation of assets. From the aggregate of items will be deducted accumulated loss balance and book value of intangible assets, if any, to arrive at owned funds. Investments in shares of other NBFCs and in shares, debentures of subsidiaries and group companies in excess of ten percent of the owned fund mentioned above will be deducted to arrive at the Net Owned Fund. The NOF should be computed on the basis of last audited Balance Sheet and any capital raised after the Balance Sheet date should not be accounted for while computing NOF.

4. <u>PRUDENTIAL NORMS</u>

4.1 <u>Exposure Ceilings</u>

4.1.1 For single / individual borrowers:

The credit exposure to single borrowers shall not exceed 15 per cent of capital funds of the FI. However, the exposure may exceed by additional five percentage points (i.e., up to 20 per cent) provided the additional credit exposure is on account of infrastructure projects.

4.1.2 For group borrowers

The credit exposure to the borrowers belonging to a group shall not exceed 40 per cent of capital funds of the FI. However, the exposure may exceed by additional ten percentage points (i.e., up to 50 per cent) provided the additional credit exposure is on account of infrastructure projects.

[The exposure ceilings stipulated initially in 1997 were 25 per cent and 50 per cent of the capital funds of the FIs for the individual and group borrowers, respectively. In September 1997, an additional exposure of up to 10 percentage points for the group borrowers (i.e., up to 60 per cent) was permitted provided the additional credit exposure was on account of infrastructure projects (which at that time were narrowly defined as only power, telecommunication, roads and ports). In November 1999, with a view to moving closer to the international standard of 15 per cent exposure ceiling, the individual borrower exposure ceiling was reduced, with effect from April 1, 2000, from 25 per cent to 20 per cent of capital funds. The FIs which had, as on October 31, 1999, exposures in excess of the reduced limit of 20 per cent, were permitted to reduce their exposures to the level of 20 per cent latest by October 31, 2001. In June 2001, the exposure ceilings for the individual and group borrowers were reduced from 20 per cent and 50 per cent to 15 per cent and 40 per cent, respectively, with effect from April1, 2002 , but the additional exposure in respect of group borrowers, of up to 10 percentage points on account of infrastructure projects was continued. In February 2003, an additional exposure of up to five percentage points (i.e., up to 20 per cent) on account of infrastructure projects was permitted in respect of individual borrowers also.]

4.1.3 For bridge loans / Interim finance

With effect from January 23, 1998, the restriction on grant of bridge loans by the FIs against expected equity flows / issues has been lifted. Accordingly FIs may henceforth grant bridge loan / interim finance to companies other than NBFCs against public issue of equity whether in India or abroad, for which appropriate guidelines should be laid down by the Board of the Financial Institution, as prescribed by RBI. However, FIs should not grant any advance against Rights issue irrespective of the source of repayment of such advance.

FIs may sanction bridge loans to companies for commencing work on projects pending completion of formalities only against their own commitment and not against loan commitment of any other FIs/ Banks. However, FIs may consider sanction of bridge loan / interim finance against commitment made by a financial institution and / or another bank only in cases where the lending institution faces temporary liquidity constraint, subject to certain conditions prescribed by RBI.

These restrictions are also applicable to the subsidiaries of FIs for which FIs are required to issue suitable instructions to their subsidiaries.

4.1.4 Working capital finance

There is no objection to FIs extending working capital finance on a very selective basis to borrowers enjoying credit limits with banks, whether under a consortium or under a multiple banking arrangement, when the banks are not in a position to meet the credit requirements of the borrowers concerned on account of temporary liquidity constraints. The FIs should take into account these guidelines while granting short term loans to borrowers enjoying credit limits with banks on a consortium basis. In case of borrowers whose working capital is financed under a multiple banking arrangement, the FI should obtain an auditor's certificate indicating the extent of funds already borrowed, before considering the borrower for further working capital finance.

4.1.5 Revolving underwriting facility

FIs should not extend Revolving Underwriting Facility to Short Term Floating Rate Notes/ Bonds or Debentures issued by corporate entities.

4.1.6 Lending to Non Banking Financial Companies (NBFCs)

With effect from May 21, 1997 the quantitative limits in the form of multiples of Net Owned Funds have been removed in respect of aggregate lending by all FIs taken together for Equipment Leasing & Hire Purchase Companies and Loan & Investment Companies which have complied with Reserve Bank's requirement of registration, credit rating and prudential norms and have been so certified by the Reserve Bank. The overall ceiling for borrowing (upto ten times of NOF) has also been removed for equipment and hire purchase NBFCs which meet the aforesaid three criteria and are also certified by the RBI. However such lending would be subject to compliance with single and group borrower exposure norms.

For NBFCs which have not complied with the above requirements and the Residuary Non Banking Companies (RNBCs), overall limit of aggregate credit from all FIs taken together is furnished below:

Sr No.	Category of Financial Companies	Over all Ceiling on Borrowings from all the FIs taken together
A	***Equipment Leasing (EL) and Hire Purchase (HP) Finance Companies***	
	a) Registered EL/HP Companies complying with Credit Rating requirement and prudential norms	No ceiling except in respect of Inter Corporate Deposits (ICDs) subscribed to by FIs which should not be more than 2 times the NOF
	b) Registered EL/HP companies complying with either credit rating requirement or the prudential norms	Ten times the NOF with a sub-ceiling of 2 times of NOF for ICDs
	c)Registered EL/HP companies complying with neither the credit rating nor the prudential norms	Seven times the NOF with a sub-ceiling of 2 times of NOF for ICDs
	d) All other EL/HP Companies	Five times the NOF with a sub-ceiling of 1 times of NOF for ICDs
B	***Loan and Investment Companies***	
	a) Registered Loan and investment Companies complying with Credit Rating requirement and prudential norms	Two times the NOF with a separate ceiling of 2 times the NOF for ICDs
	b) Registered Loan and investment Companies complying with either Credit Rating requirement or prudential norms	Equal to NOF with a separate ceiling of 2 times the NOF for ICDs
	c) Registered Loan and investment Companies complying with neither Credit Rating requirement nor prudential norms	40 % of NOF with a separate ceiling of 2 times the NOF for ICDs
	d)All other Loan and Investment Companies	40 % of NOF with a separate ceiling of equal to NOF for ICDs
C	***Residuary Non Banking Companies***	Equal to NOF

FIs are also advised that finance by them shall not be provided to NBFCs for the following activities:

a) Bills discounted/rediscounted by NBFCs except those arising from sale of commercial vehicles including light commercial vehicles subject to normal lending safeguards.

b) Investments made by NBFCs in shares, debentures, etc., of a current nature (i.e. stock-in-trade);

c) Investments of NBFCs in and advances to subsidiaries, group companies or other entities, and

d) Investments of NBFCs in, and inter-corporate loans/deposits to/ in other companies.

Further, it is advised that Fls should not sanction bridge loans and loans of a bridging nature in any form to any category of NBFCs (Including RNBCs) including against capital/ debenture issues.

4.2 Level of Exposure

4.2.1 The sanctioned limits or outstandings whichever is higher shall be reckoned, in respect of the funded as well as non-funded facilities, for arriving at the level of exposure. The "credit exposure" shall include funded and non-funded credit limits, underwriting and other similar commitments. The exposure on account of derivative products should also be reckoned for the purpose.

4.2.2 In case of term loans, however the level of exposure may be reckoned on the basis of actual outstandings plus undisbursed or undrawn commitments. However, in cases where disbursements are yet to commence, the level of exposure should be reckoned on the basis of the sanctioned limit or the extent up to which the FI has entered into commitments with the borrowing companies in terms of the agreement.

(Since the inception of the exposure norms, only 50 per cent of the non-funded limits were required to be reckoned for arriving at the level of exposure. However, with effect from April 1, 2003, in tune with the international practice, the funded as well as non-funded exposures are required to be reckoned at 100 per cent value.)

4.2.3 For the purpose of determining the level of exposure, the following instruments should also be reckoned:

(i) **Bonds and Debentures in the nature of advance** : The bonds and debentures should be treated in the nature of advance when :

- The debenture / bond is issued as part of the proposal for project finance and the tenor of the bond / debenture is for three years and above.

and

- The FI has a significant stake (i.e. 10% or more) in the issue

and

- The issue is a part of private placement i.e. the borrower has approached the FI, and not part of a public issue where the FI has subscribed in response to an invitation.

(ii) **Preference Shares in the nature of advance** : The preference shares, other than convertible preference shares , acquired as part of project financing and meeting the criteria as at (i) above.

(iii) **Deposits :** The deposits placed by the FIs with the corporate sector .

4.2.4 For computing the level of exposure in respect of the NBFCs, the FI's investment in the privately placed debentures should be included while those acquired in the secondary market should be excluded.

4.2.5 **Measurement of exposure in derivative products**: With effect from April 1, 2003, the FIs are required to include in the non-funded credit limit, the forward contracts in foreign exchange and other derivative products like currency swaps, options, etc at their **replacement cost** in determining the individual / group borrower exposures, as per the following guidelines.

4.2.5.1 Methodology for calculation of replacement cost

There are two methods for measuring the credit risk exposure inherent in derivatives, as described below.

A. **The original exposure method**

Under this method, which is a simpler alternative, the credit risk exposure of a derivative product is calculated at the beginning of the derivative transaction by multiplying the notional principal amount with the prescribed credit conversion factors. The method, however, does not take account of the ongoing market value of a derivative contract, which may vary over time. In order to arrive at the credit equivalent amount under this method, an FI should apply the following credit conversion factors to the notional principal amounts of each instrument according to the nature of the instrument and its **original** maturity:

Original Maturity	**Credit Conversion Factor to be applied to Notional Principal Amount**	
	Interest Rate Contract	**Exchange Rate Contract**
Less than one year	**0.5 %**	**2.0%**
One year and less than two years	**1.0%**	**5.0 % (2 % + 3 %)**
For each additional year	**1.0%**	**3.0 %**

B. **The current exposure method**

Under this method, the credit risk exposure / credit equivalent amount of the derivative products is computed periodically on the basis of the market value of the product to arrive at its current replacement cost. Thus, the credit equivalent of the off-balance sheet interest rate and exchange rate instruments would be the sum of the following two components:

(a) the total **'replacement cost'** - obtained by "marking-to-market" of all the contracts with positive value (i.e. when the FI has to receive money from the counterparty); and

(b) an amount for **'potential future exposure'** - calculated by multiplying the total notional principal amount of the contract by the following credit conversion factors according to the residual maturity of the contract:

Residual Maturity	Conversion Factor to be applied on Notional Principal Amount	
	Interest Rate Contract	Exchange Rate Contract
Less than one year	Nil	1.0 %
One year and over	0.5%	5.0 %

Under the current exposure method, the FIs should mark to market the derivative products **at least on a monthly basis** and they may follow their internal methods for determining the marked-to-market value of the derivative products. However, the FIs would **not** be required to calculate potential credit exposure for **single currency floating / floating interest rate swaps**. The credit exposure on these contracts would be evaluated solely on the basis of their mark-to-market value.

4.2.5.2 The FIs are encouraged to follow, with effect from April 1, 2003, the **Current Exposure Method**, which is an accurate method of measuring credit exposure in a derivative product, for determining individual / group borrower exposures. In case an FI is not in a position to adopt the Current Exposure Method, it may follow the Original Exposure Method. However, its endeavour should be to move over to Current Exposure Method in course of time.

> **Note:** Under the extant capital adequacy norms, the credit exposure of the FIs in derivative products also gets reflected in the risk-weighted value of the off-balance sheet items in the CRAR computation, for which the 'original exposure method' has been prescribed under the capital adequacy norms. The FIs are, however, encouraged to adopt, with effect from April 1, 2003, the Current Exposure Method for computation of CRAR also.

5. EXPOSURE IN RESPECT OF BONDS GUARANTEED BY PUBLIC FINANCIAL INSTITUTIONS (PFIS)

The investments made by the banks in the bonds and debentures of corporates which are guaranteed by a PFI listed in the Annexure, will be treated as an exposure of the bank on the PFI and not on the corporate. Guarantees issued by a PFI to the bonds of the corporates will be treated as an exposure of the PFI to the corporate whereas the exposure of the bank on the PFI guaranteeing the corporate bond will be to the extent of 100 per cent of the bank's investment. Initially, such exposures of the PFI to the corporate were required to be reckoned to the extent of 50 per cent of the value of such guarantees, being non-funded exposure, but with effect from April 1, 2003, such exposure are also required to be reckoned at 100 per cent of the value of such guarantees.

The PFIs are also required to take into account the overall exposure of the guaranteed unit to the financial system before guaranteeing the bonds / debentures.

6. TREATMENT OF LOANS GRANTED BY THE FIS AGAINST THE GUARANTEE OF BANKS

In terms of RBI instructions vide Circular IECD.No./08.12.01/ 2001-02 dated February 20, 2002, banks have 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. For the purpose of exposure norms, 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 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.

7 REPORTING SYSTEM

An annual review of the implementation of exposure management measures may be placed before the Board of Directors before the end of June every year. A copy of the review may be furnished for information to the Chief General Manager, Financial Institutions Division, department of banking Supervision, Reserve Bank of India, Central Office, "The Arcade", World Trade Centre, Cuffe Parade, Colaba, MUMBAI – 400 005.

ANNEXURE
(Cf. Para 5)

List of All-India Financial Institutions whose bonds/debentures would qualify for 20 per cent weight for Capital Adequacy Ratio

1. Industrial Credit and Investment Corporation of India Ltd. (Since merged with the ICICI Bank limited)

2. Industrial Finance Corporation of India Ltd.
3. Industrial Development Bank of India
4. Industrial Investment Bank of India Ltd.
5. Tourism Finance Corporation of India Ltd.
6. Risk Capital and Technology Finance Corporation Ltd.
7. Technology Development and Information Company of India Ltd.
8. Power Finance Corporation Ltd.
9. National Housing Bank.
10. Small Industries Development Bank of India
11. Rural Electrification Corporation Ltd.
12. Indian Railways Finance Corporation Ltd.
13. National Bank for Agriculture and Rural Development.
14. Export import Bank of India.
15. Infrastructure Development Finance Company Ltd.
16. Housing and Urban Development Corporation Ltd.

APPENDIX

Part A: List of circulars consolidated by the Master Circular

No.	Circular No.	Date	Subject	Para No.
1.	FIC No. 187/ 01.02.00 / 94-95	September 26, 1994	Bridge loan / Interim Finance	Entire Circular
2.	FIC No. 191/ 01.02.00 / 94-95	September 28, 1994	Lending to Non- Banking Financial Companies.	Entire Circular
3.	FIC. No. 685 /	April 21,	Lending to Non Banking Financial	Entire

	01.02.00/ 94-95	1995	Companies	Circular
4.	FIC. No. 684 / 01.02.00/ 94-95	April 21, 1995	Lending by Financial Institutions- Bridge Loan / Interim Finance	Entire Circular
5.	FIC. No. 183 / 01.02.01/ 95-96	August 18, 1995	Lending by Financial Institutions- Bridge Loan / Interim Finance	Entire Circular
6.	FIC. No. 235 / 01.02.00/ 95-96	September 13, 1995	Commitments in respect of Underwriting etc. Obligations	Entire Circular
7.	FIC. No. 432 / 01.02.00/ 95-96	December 2, 1995	Lending by Financial Institutions- Bridge Loan / Interim Finance- Subsidiaries of FIs	Entire Circular
8.	FIC. No. 851 / 01.02.00/ 95-96	June 26, 1996	Sanction of Working Capital Credit Facility by Financial Institutions.	Entire Circular
9.	FIC. No. 11 / 01.02.00/ 96-97	April 4, 1997	Lending by Financial Institutions- Bridge Loan / Interim Finance	Entire Circular
10.	FIC No. 13 /02.01.01/ 96-97	May 21, 1997	Lending to Non Banking Financial Companies	Entire Circular
11.	DOS FID No. 17/ 01.02.00 /96-97	June 28, 1997	Limits on Credit Exposures of Term Lending Institutions to Individual / Group borrowers	Entire Circular
12.	DOS FID No. 18/ 01.02.00 /97-98	September 11, 1997	Limits on Credit Exposures of Term Lending Institutions to Individual / Group borrowers	Entire Circular
13.	DOS FID No. 20/ 01.02.00 /97-98	December 4, 1997	Limits on Credit Exposures of Term Lending Institutions to Individual / Group borrowers	Entire Circular
14.	DBS.FID No. 37/ 02.01.01/98-99	January 11, 1999	Lending to Non Banking Financial Companies	Entire Circular
15.	DBS FID No. C-7/ 01.02.00 /99-2000	November 13, 1999	Credit Exposure Norms for Individual Borrowers	Entire Circular
16.	DBS FID No. C-26/ 01.02.00 /2000-2001	June 20, 2001	Monetary and Credit Policy Measures 2001-2002 - Credit Exposure Norms	Entire Circular
17.	DBS FID No. C-3/ 01.02.00 /2001-2002	August 27, 2001	Credit Exposure Norms - Applicability to Refinancing Institutions	Entire Circular
18.	DBS FID No. C-12 / 01.02.00 / 2002-03	January 20, 2003	Credit Exposure Norms - Measurement of Credit Exposure of Derivative Products - Methodology for Measurement	Entire Circular

Part B: List of other circulars containing instructions related / relevant to Exposure Norms incorporated in the Master Circular

No.	Circular No.	Date	Subject	Para No.
1.	IECD.No.7/CMD.GA/ Gen/ 91-92	July 29, 1991	Group Accounts	Para 3
2.	FIC. No. 337 / 01.02.00/ 95-96	November 3, 1995	Lending by Financial Institutions- Bridge Loan / Interim Finance	Para 2

3.	DBS.FID No. 24 / 02.01.00/ 97-98	January 23, 1998	Lending by Financial Institutions- Bridge Loan / Interim Loan	Para 2
4.	DBS FID No. 35/ 01.02.00 /98-99	December 3, 1998	Strengthening of Prudential Norms	Para 6
5.	DBS. FID. No. 507/ 01.02.00 /98-99	January 2, 1999	Strengthening of Prudential Norms - Risk Weight on Banks' Investments in Bonds / Securities Issued by Financial Institutions.	Para 2
6.	DBS FID No. C-6/ 01.02.00 /2001-2002	October 16, 2001	Guidelines for Classification and Valuation of Investments	Annexure Para 2 and 3
7.	DBS.FID. No. C-5/ 01.02.00 / 2002-03	August 8, 2002	Capital Adequacy and Credit Exposure Norms - Treatment of Loans Granted by FIs Against the Guarantee of Banks	Para 2(b)
8.	DBOD.No.BP.BC.67/ 21.04.048/2002-03	February 4, 2003	Guidelines on Infrastructure Financing	Para 1 of the Annexure