

RBI/2004-05/60

DBOD No. Dir. BC. 14 /13.03.00/2004-05

July 21, 2004

Chief Executives of all Scheduled Commercial Banks
(Excluding RRBs)

Dear Sir,

Master Circular – Exposure Norms

Please refer to the Master Circular DBOD. No. Dir .BC. 17/13.03.00/2003-04 dated August 22, 2003 consolidating the instructions/guidelines issued to banks till June 30, 2003 relating to Exposure Norms. The Master Circular has been suitably updated by incorporating the instructions issued up to June 30, 2004 and has been placed on the RBI website (<http://www.rbi.org.in>).

2. This Master Circular is a compilation of the instructions contained in the circulars issued by RBI on the above subject, which are operational as on the date of this circular.

Yours faithfully,

(Prashant Saran)
Chief General Manager

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Master Circular on Exposure Norms

1. General

As a prudential measure aimed at better risk management and avoidance of concentration of credit risks, the Reserve Bank of India has advised the banks to fix limits on their exposure to specific industry or sectors and has prescribed regulatory limits on banks' exposure to individual and group borrowers in India. In addition, banks are also required to observe certain statutory and regulatory exposure limits in respect of advances against / investments in shares, debentures and bonds.

2. Credit Exposures to Individual/Group Borrowers

2.1 Ceilings

- 2.1.1 The exposure ceiling should be fixed in relation to bank's capital funds. Internationally, exposure ceilings are computed in relation to total capital as defined under capital adequacy standards (Tier I and Tier II Capital). Taking into account the best international practices, it has been decided to adopt the concept of capital funds as defined under capital adequacy standards for determining exposure ceiling uniformly both by domestic and foreign banks, effective from 31 March 2002. The exposure ceiling limits applicable from April 1, 2002, which is based on the capital funds in India as computed above would be 15 per cent of capital funds in case of single borrower and 40 percent in the case of a borrower group.
- 2.1.2 Credit exposure to borrowers belonging to a group may exceed the exposure norm of 40 per cent of the bank's capital funds by an additional 10 per cent (i.e up to 50 per cent), provided the additional credit exposure is on account of extension of credit to infrastructure projects. Credit exposure to single borrower may exceed the exposure norm of 15 per cent of the bank's capital funds by an additional 5 per cent (i.e. up to 20 per cent) provided the additional credit exposure is on account of infrastructure. The definition of infrastructure lending and the list of the items included under infrastructure sector are furnished in the Annexure 1.
- 2.1.3. In addition to the exposure permitted under paragraphs 2.1.1 and 2.1.2 above, banks may, in exceptional circumstances, with the approval of their Boards, consider enhancement of the exposure to a borrower up to a further 5 per cent of capital funds.

2.1.4 The bank should make appropriate disclosures in the 'Notes on account' to the annual financial statements in respect of the exposures where the bank had exceeded the prudential exposure limits during the year.

2.1.5 Banks should phase out by March 31, 2005 exposures in excess of single/group borrower limits not in conformity with above, either by increasing capital funds or reducing exposures.

2.1.6 **Lending under Consortium Arrangements**

The exposure limits will be applicable even in case of lending under consortium arrangements, wherever formalised.

2.2 **EXEMPTIONS**

2.2.1 **Rehabilitation of Sick/Weak Industrial Units**

The ceilings on single/group exposure limits would not be applicable to existing/additional credit facilities (including funding of interest and irregularities) granted to weak/sick industrial units under rehabilitation packages.

2.2.2 **Food credit**

Borrowers to whom limits are allocated directly by the Reserve Bank, for food credit, will be exempt from the ceiling.

2.2.3 **Guarantee by the Government of India**

The ceilings on single /group exposure limit would not be applicable where principal and interest are fully guaranteed by the Government of India.

2.2.4 **Loans against own Term Deposits**

Loans and advances granted against the security of bank's own term deposits may be excluded from the purview of the exposure ceiling.

2.3 **DEFINITIONS.**

2.3.1 **Exposure**

Exposure shall include credit exposure (**funded** and **non-funded** credit limits) and investment exposure (including **underwriting** and **similar commitments**) as well as certain types of investments in companies. The sanctioned limits or outstandings, whichever are higher, shall be reckoned for arriving at exposure limit. In line with international best practices, it has been decided that effective from April 1, 2003, non-fund based exposures should also be reckoned at 100 per cent of the limit or outstandings, whichever is higher.

2.3.2 Measurement of Credit Exposure of Derivative Products

At present, derivative products such as Forward Rate Agreements (FRAs) and Interest Rate Swaps (IRSs) are also captured for computing exposure by applying the conversion factors to notional principal amounts as per the original exposure method prescribed in Annexures 1 and 2 of our circular MPD.BC. 187/07.01/279/1999-2000 dated July 7, 1999. It has been decided that, effective from April 1, 2003, banks should also include forward contracts in foreign exchange and other derivative products like currency swaps, options, etc. at their replacement cost value in determining individual/group borrower exposure. The methodology to be adopted by banks for arriving at the replacement cost value is given below.

Banks may adopt, effective from April 1, 2003, either of the two methods viz. (i) Original Exposure Method, and (ii) Current Exposure Method consistently for all derivative products, in determining individual / group borrower exposure.

Under the Original Exposure Method, credit exposure is calculated at the beginning of the derivative transaction by multiplying the notional principal amount with a conversion factor. In order to arrive at the credit equivalent amount using the Original Exposure Method, a bank would 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 | Conversion factor to be applied on 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% |

The other method (Current Exposure Method) to assess the exposure on account of credit risk on interest rate and exchange rate derivative contracts is to calculate periodically the current replacement cost by

marking these contracts to market, thus capturing the current exposure without any need for estimation and then adding a factor (“add-on”) to reflect the potential future exposure over the remaining life of the contract. Therefore, in order to calculate the credit exposure equivalent of off-balance sheet interest rate and exchange rate instruments under Current Exposure Method, a bank would sum:

- (i) the total of replacement cost (obtained by “marking to market”) of all its contracts with positive value (i.e. when the bank has to receive money from the counter party), and
- (ii) an amount for potential future changes in credit exposure calculated on the basis of the total notional principal amount of the contract multiplied by the following credit of conversion factors according to the residual maturity:

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

Banks should mark to market the derivative products at least on a monthly basis and they may follow their internal methods of determining the marked to market value of the derivative products.

Banks 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.

Banks are encouraged to follow the Current Exposure Method, which is an accurate method of measuring credit exposure in a derivative product. In case a bank 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.

2.3.3 Credit exposure

Credit exposure comprises of the following elements:

- (a) all types of funded and non-funded credit limits.
- (b) facilities extended by way of equipment leasing, hire purchase finance and factoring services.
- (c) advances against shares, debentures, bonds, units of mutual funds, etc. to stock brokers, market makers.
- (d) bank loan for financing promoters contributions.
- (e) bridge loans against equity flows/issues.
- (f) financing of Initial Public Offerings (IPOs)/Employee Stock Options(ESOPs).

2.3.4 Investment exposure

Investment exposure comprises of the following elements:

- (a) investments in shares and debentures of companies acquired through direct subscription, devolvement arising out of underwriting obligations or purchased from secondary markets or on conversion of debt into equity.
- (b) investment in PSU bonds through direct subscription, devolvement arising out of underwriting obligations or purchase made in the secondary market.
- (c) investments in Commercial Papers (CPs) issued by Corporate Bodies/PSUs.
- (d) the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, provides, among others, sale of financial assets by banks / FIs to Securitisation Company (SC)/ Reconstruction Company(RC). Banks' / FIs' investments in debentures/ bonds / security receipts / pass-through certificates (PTCs) issued by a SC / RC as compensation consequent upon sale of financial assets will constitute exposure on the SC / RC. As only a few SC/RC are being set up now, banks' / FIs' exposure on SC / RC through their investments in debentures / bonds / security receipts / (PTCs) issued by the SC / RC may go beyond their prudential exposure ceiling. In view of the extra ordinary nature of event, banks / FIs will be allowed, in the initial years, to exceed prudential exposure ceiling on a case-to-case basis.

The investment made by the banks in bonds and debentures of corporates which are guaranteed by a PFI^Å (as per list given in Annexure 2) will be treated as an exposure by the bank on the PFI and not on the corporate.

2.3.5 Capital Funds

Capital funds for the purpose will comprise of Tier I and Tier II capital as defined under capital adequacy standards.

2.3.6 Group

The concept of 'Group' and the task of identification of the borrowers belonging to specific industrial groups is left to the perception of the banks/financial institutions. Banks/financial institutions are 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 being commonality of management and effective control.

2.3.7 In the case of a split in the group, if the split is formalised, the splinter groups will be regarded as separate groups. If banks and financial institutions have doubts about the *bona fides* of the split, a reference may be made to RBI for its final view in the matter to preclude the possibility of a split being engineered in order to prevent coverage under the Group Approach.

2.4 Review

An annual review of the implementation of exposure management measures may be placed before the Board of Directors before the end of June and a copy each of such review may be furnished for information to the Chief General Manager-in-Charge, Department of Banking Operations and Development, Central Office, Reserve Bank of India, World Trade Centre, Mumbai and to the concerned Regional Offices of the Department of Banking Supervision.

3. Credit Exposure to Industry and Certain Sectors

3.1 Internal Exposure Limits

3.1.1 Fixing of sectoral limits

Apart from limiting the exposures to individual or Group of borrowers, as indicated above, the banks may also consider fixing internal limits

^ÅWith the merger of ICICI Ltd. with ICICI Bank Ltd. effective from 30.03.2002, the entire liabilities of ICICI Ltd. have been taken over by ICICI Bank Ltd. As per the scheme of merger all loans and guarantee facilities to ICICI Ltd. provided by Government would be transferred to the merged entity. Similarly, the investments made in erstwhile ICICI Ltd. by banks would be treated outside the ceiling of 5% till redemption.

for aggregate commitments to specific sectors e.g. textiles, jute, tea, etc. so that the exposures are evenly spread over various sectors. These limits could be fixed by the banks having regard to the performance of different sectors and the risks perceived. The limits so fixed may be reviewed periodically and revised, as necessary.

3.1.2 Unhedged Foreign Currency Exposure of Corporates

To ensure a policy by each bank that explicitly recognizes and takes account of risks arising out of foreign exchange exposure of their clients, foreign currency loans above US \$ 10 million, or such lower limits as may be deemed appropriate vis-à-vis the banks' portfolios of such exposures, should be extended by banks only on the basis of a well laid out policy of their Boards with regard to hedging of such foreign currency loans. Further, the policy for hedging, to be framed by their boards, may consider, as appropriate for convenience, excluding the following :

- Where forex loans are extended to finance exports, banks may not insist on hedging but assure themselves that such customers have uncovered receivables to cover the loan amount.
- Where the forex loans are extended for meeting forex expenditure

3.1.3 Exposure to Real Estate

Banks should frame comprehensive prudential norms relating to the ceiling on the total amount of real estate loans, single/group exposure limits for such loans, margins, security, repayment schedule and availability of supplementary finance and the policy should be approved by the bank's Board.

- 3.1.4** While framing the bank's policy, the guidelines issued by the Reserve Bank should be taken into account. Banks should ensure that the bank credit is used for productive construction activity and not for activity connected with speculation in real estate.

3.2 Exposure to Leasing, Hire Purchase and Factoring Services

- 3.2.1** Banks should maintain a balanced portfolio of equipment leasing, hire purchase and factoring services vis-à-vis the aggregate credit. Their exposure to each of these activities should not exceed 10 percent of total advances.

3.3 Exposure to Indian Joint Ventures/Wholly-owned Subsidiaries Abroad

- 3.3.1** Banks are allowed to extend credit/non-credit facilities (viz. letters of credit and guarantees) to Indian Joint Ventures/Wholly-owned Subsidiaries abroad. Banks are also permitted to provide at their discretion, buyer's credit/acceptance finance to overseas parties for facilitating export of goods & services from India.

3.3.2 The above exposure will, however, be subject to a limit of 10 per cent of banks' unimpaired capital funds (Tier I and Tier II capital), subject to the following conditions:-

i. Loan will be granted only to those joint ventures where the holding by the Indian company is more than 51%.

ii. Proper systems for management of credit and interest rate risks arising out of such cross border lending are in place.

iii. while extending such facilities, banks will have to comply with Section 25 of the Banking Regulation Act, 1949, in terms of which the assets in India of every banking company at the close of business on the last Friday of every quarter shall not be less than 75 percent of its demand and time liabilities in India. In other words, aggregate assets outside India should not exceed 25 percent of the bank's demand and time liabilities in India.

iv. The resource base for such lending should be funds held in foreign currency accounts such as FCNR (B), EEFC, RFC etc. in respect of which banks have to manage exchange risk.

vi. Maturity mismatches arising out of such transactions are within the overall gap limits approved by RBI.

vii. All existing safeguards / prudential guidelines relating to capital adequacy, exposure norms etc. applicable to domestic credit / non-credit exposures are adhered to.

Further, the loan policy for such credit / non-credit facility should be, inter alia, in keeping with the following;

(a) Grant of such loans is based on proper appraisal and commercial viability of the projects and not merely on the reputation of the promoters backing the project. Non-fund based facilities should be subjected to the same rigorous scrutiny as fund based limits.

(b) The countries where the joint ventures / wholly owned subsidiaries are located should have no restrictions applicable to these companies in regard to obtaining foreign currency loans or for repatriation etc. and should permit non-resident banks to have legal charge on securities / assets abroad and the right of disposal in case of need.

3.3.3 The banks should also comply with all existing safeguards/prudential guidelines relating to capital adequacy, and exposure norms indicated in paragraph 2.1, *ibid*.

3.4 Banks' exposure to the Capital Markets

The detailed instructions on Bank Finance against Shares and Debentures are given separately in the circular DBOD. No. DIR. BC. 90/13.07.05/98 dated 28 August 1998 on Bank Finance against shares

and debentures -- Master Circular read with Circular DBOD. No. BP. BC. 119/21.04.037/2000-01 dated 11 May 2001. The salient features are given below for ready reference.

3.4.1 Statutory Limit on Shareholding in Companies

In terms of Section 19(2) of the Banking Regulation Act, 1949, no banking company shall hold shares in any company, whether as pledgee, mortgagee or absolute owner, of an amount exceeding 30 percent of the paid-up share capital of that company or 30 percent of its own paid-up share capital and reserves, whichever is less, except as provided in sub-section (1) of Section 19 of the Act. Shares held in demat form should also be included for the purpose of determining the exposure limit. This is an aggregate holding limit for each company. While granting any advance against shares, underwriting an issue of shares, or acquiring any shares on investment account or even in lieu of debt of any company, these statutory provisions should be strictly observed.

3.4.2 Regulatory Limits

The bank's aggregate exposure to the capital markets covering direct investment by a bank in equity shares, convertible bonds and debentures and units of equity oriented mutual funds; advances against shares to individuals for investment in equity shares (including IPOs/ESOPs), bonds and debentures, units of equity-oriented mutual funds etc and secured and unsecured advances to stockbrokers and guarantees issued on behalf of stockbrokers and market makers; should not exceed 5 per cent of their total outstanding advances (including Commercial Paper) as on March 31 of the previous year. This ceiling of 5 per cent prescribed for investment in shares would apply to total exposure including both fund based and non-fund based to capital market in all forms. Within this overall ceiling, banks investment in shares, convertible bonds and debentures and units of equity oriented mutual funds should not exceed 20 percent of its networth. The banks are required to adhere to this ceiling on an ongoing basis.

3.4.3 Advances against Shares to Individuals

Loans at all the offices of a bank, against the security of shares, debentures and PSU bonds to individuals, if held in physical form should not exceed the limit of Rs. 10 lakh per individual borrower (Rs 20 lakhs per individual borrower, if the securities are held in demat form). The maximum amount of finance that can be granted to an individual for financing his subscription to an Initial Public Offering (IPO)/Employee Stock Options (ESOPs) is Rs. 10 lakh. Finance extended by a bank for IPOs/ESOPs is also reckoned as an exposure to capital market and reckoned within 5% ceiling indicated in para 3.4.2 above. Advances against units of mutual funds including units of Unit-64 scheme would attract the quantum and margin requirements as

applicable to advances against shares and debentures wherever stipulated.

- 3.4.4** Banks should formulate with the approval of their Boards the Lending Policy for grant of advances to individuals against shares, debentures, bonds keeping in view RBI guidelines. As a prudential measure, the banks may also consider laying down appropriate aggregate sub limits of such advances.

3.4.5 Advances against Shares to Stock Brokers and Market Makers

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 their Boards. However, in order to avoid any nexus emerging between inter-connected stock broking entities and banks, the Board of each bank should fix, within the overall ceiling of 5 per cent of their total outstanding advances (including Commercial Paper) as on March 31 of the previous year a sub-ceiling for total advances to –

- i all the stock brokers and market makers (both fund based and non-fund based, i.e. guarantees); and
- ii. to any single stock broking entity, including its associates/ inter-connected companies.

3.4.6 Margins on advances against shares / issue of guarantees

A uniform margin of 40 per cent shall be applied on all advances / financing of IPOs/ESOPs/issue of guarantees. A minimum cash margin of 20 per cent (within the margin of 40%) shall be maintained in respect of guarantees issued by banks for capital market operations.

3.4.7 Arbitrage operations

Banks should **not** undertake arbitrage operations themselves or extend credit facilities directly or indirectly to stockbrokers for arbitrage operations in Stock Exchanges. While banks are permitted to acquire shares from the secondary market, they should ensure that no sale transaction is undertaken without actually holding the shares in its investment account.

3.4.8 Margin Trading

Banks may extend finance to stockbrokers for margin trading in actively traded scrips forming part of the NSE Nifty and the BSE Sensex, within the overall ceiling of 5% prescribed for exposure of banks to capital market.

3.5 Bank Loans for Financing Promoter's Contributions

- 3.5.1** Loans sanctioned to corporates against the security of shares (as far as possible demat shares) for meeting promoter's contribution to the equity of new companies in anticipation of raising resources, should be

treated as bank's investments in shares which would thus come under the ceiling of 5 per cent of the bank's total outstanding advances (including Commercial Paper) as on March 31 of the previous year prescribed for bank's total exposure including both fund based and non-fund based to capital market in all forms.

3.5.2 These loans will also be subject to individual/group of borrowers **exposure norms** as well as the **statutory limit** on shareholding in companies detailed above.

3.5.3 In the context of Government of India's programme of disinvestments of its holdings in some public sector undertakings (PSUs), it has been clarified to banks that they can extend finance to the successful bidders for acquisition of shares of these PSUs, subject to certain conditions. If on account of banks' financing acquisition of PSU shares under the Government of India's disinvestment programmes, any bank is likely to exceed the regulatory ceiling of 5 per cent on capital market exposure in relation to its total outstanding advances as on March 31 of the previous year, such requests for relaxation of the ceiling would be considered by RBI 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 would 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 per cent.

RBI would 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 circular DBOD No. BP. 2724/21.03.054/2000-01 dated 28 May 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 disinvestments programme, should be within the prudential individual / group borrower exposure ceiling prescribed by RBI.

3.5.4 Under the refinance scheme of Export Import Bank of India, (EXIM Bank) the banks may sanction term loans on merits for eligible Indian promoters for acquisition of equity in overseas joint ventures/ wholly owned subsidiaries, provided the term loans have been approved by the EXIM Bank for refinance.

3.6. Risk Management and Internal Control System

Banks desirous of making investment in equity shares / debentures, financing of equities and issue of guarantees within the above ceiling, should observe the following guidelines:

a) **Investment policy**

- (i) Formulate a transparent policy and procedure for investment in shares, etc., with the approval of the Board.
- (ii) The banks should build up adequate expertise in equity research by establishing a dedicated equity research department, wherever warranted by their scale of operations.

b) **Investment Committee**

The decision in regard to direct investment in shares, convertible bonds and debentures should be taken by an Investment Committee set up by the bank's Board. The Investment Committee should be held accountable for the investments made by the bank.

c) **Risk Management**

- (i) Banks should ensure that their exposure to stockbrokers is well diversified in terms of number of broker clients, individual inter-connected broking entities;
- (ii) While sanctioning advances to stockbrokers, the banks should take into account the track record and credit worthiness of the broker, financial position of the broker, operations on his own account and on behalf of clients, average turn over period of stocks and shares, the extent to which broker's funds are required to be involved in his business operations, etc;
- (iii) While processing proposals for loans to stockbrokers, banks are also advised to obtain details of facilities enjoyed by the broker and all his connected companies from other banks;
- (iv) While granting advances against shares and debentures to other borrowers, banks should obtain details of credit facilities availed by them or their associates/inter-connected companies from other banks for the same purpose (i.e. investment in shares etc.) in order to ensure that high leverage is not built up by the borrower or his associate or inter-connected companies with bank finance.

3.6.1 Audit committee

- (i) The surveillance and monitoring of investment in shares / advances against shares shall be done by the Audit Committee of the Board, which shall review in each of its meetings, the total exposure of the bank to capital market both fund based and non-fund based, in different forms and ensure that the guidelines issued by RBI are complied with and adequate risk management and internal control systems are in place;
- (ii) The Audit Committee shall keep the Board informed about the overall exposure to capital market, the compliance with the RBI and Board guidelines, adequacy of risk management and internal control systems;
- (iii) In order to avoid any possible conflict of interest, it should be ensured that the stockbrokers as directors on the Boards of banks or in any other capacity, do not involve themselves in any manner with the Investment Committee or in the decisions in regard to making investments in shares, etc., or advances against shares.

3.6.2 Valuation and Disclosure

Equity shares in a bank's portfolio - as primary security or as collateral for advances or for issue of guarantees and as an investment- should be marked to market preferably on a daily basis, but at least on weekly basis. Banks should disclose the total investments made in equity shares, convertible bonds and debentures and units of equity oriented mutual funds as also aggregate advances against shares in the 'Notes on Account' to their balance sheets.

3.7 Bridge Loans

- 3.7.1** Banks have been permitted to sanction bridge loans to companies for a period not exceeding one year against expected equity flows/issues. Such loans should be included within the ceiling of 5 per cent of the banks' total outstanding advances (including Commercial Paper) as on March 31 of the previous year prescribed for total exposure including both fund based and non-fund based to capital market in all forms.
- 3.7.2** Banks should formulate their own internal guidelines with the approval of their Board of Directors for grant of such loans, exercising due caution and attention to security for such loans.
- 3.7.3** Banks may also extend bridge loans against the expected proceeds of Non-Convertible Debentures, External Commercial Borrowings, Global Depository Receipts and/or funds in the nature of Foreign Direct Investments, provided the banks are satisfied that the borrowing company has already made firm arrangements for raising the aforesaid resources/funds.

3.8 Bank finance to employees to buy shares of their own companies

The restriction that banks could provide finance up to Rs.50,000/- or six months' salary, whichever is less, to assist employees to buy shares of their own companies has been reviewed in view of more companies offering Employee Stock Options (ESOPs) and employee quota in their IPOs as also introduction of robust system of assessing risks in many banks. Banks have been advised that while extending finance to employees for purchasing shares of their own companies either under ESOP or IPO, they may take their own decision subject to extant regulations including margin requirement on IPO financing. However, all such financing should be treated as part of the banks' exposure to capital market within the overall ceiling of 5 per cent of banks' total outstanding advances, as on March 31 of the previous year. These instructions, however, will not be applicable to banks' extending financial assistance to their own employees for acquisition of shares under ESOP/ IPO.

4. Exposure norms for investments

4.1 Ceiling on overall exposure to capital market

Banks exposure to capital market as detailed in paragraph 3.4.2 above should be within the overall ceiling of 5 per cent of the banks total outstanding advances (including Commercial Paper) as on March 31 of the previous year. Within this overall ceiling, banks investment in shares, convertible bonds and debentures and units of equity-oriented mutual funds should not exceed 20 per cent of its net worth. The banks are required to adhere to the ceiling on an ongoing basis and should exercise care to see that the limit is not exceeded.

4.1.1 For the purpose of reckoning compliance with the ceiling for investments prescribed above, the following items are to be included –

- i.** direct investment by a bank in equity shares, convertible bonds and debentures and units of equity oriented mutual funds the corpus of which is not exclusively invested in corporate debt.
- ii.** bank finance for financing promoter's contribution towards equity capital of new companies.
- iii.** bridge loans to companies.

4.1.2 The investment ceiling exclude investment in -

- i.** the subordinated debts of other banks.
- ii.** preference shares,
- iii.** non-convertible debentures/bonds of private corporate bodies,
- iv.** equities/bonds of All-India Financial Institutions
(as per list given in *Annexure 3*),

- v. bonds issued by Public Sector Undertakings,
- vi. units of Mutual Funds under schemes where corpus is invested exclusively in debt instruments,
- vii. venture capital including units of dedicated venture capital funds meant for Information Technology, and
- viii. investments in Certificate of Deposits (CDs) of other banks/ financial institutions.

4.1.3 However, all these categories of investments are to be taken into consideration for the purpose of arriving at the prudential norm of credit exposure for single borrower and group of borrowers as stipulated in paragraph 2.1 above.

4.1.4 Banks Investment in the Bonds of a Corporate

For the purpose of calculation of exposure norm, investments made by the banks in bonds and debentures of corporates, which are guaranteed by a PFI^A, as per list given in *Annexure 2*, will be treated as an exposure by the bank on the PFI and not on the corporate.

4.1.5 Guarantees issued by the PFI to the bonds of corporates will be treated as an exposure by the PFI to the corporates to the extent of 50 percent being a non-fund facility, whereas the exposure of the bank on the PFI guaranteeing the corporate bond will be 100 percent. The PFI before guaranteeing the bonds/debentures should, however, take into account the overall exposure of the guaranteed unit to the financial system.

4.1.6 Cross holding of capital among banks / financial institutions

- i. Banks' / FIs' investment in the following instruments, which are issued by other banks / FIs and are eligible for capital status for the investee bank / FI, should not exceed 10 per cent of the investing bank's capital funds (Tier I plus Tier II)
 - a. Equity shares;
 - b. Preference shares eligible for capital status;
 - c. Subordinated debt instruments;
 - d. Hybrid debt capital instruments; and

[⊗] With the merger of ICICI Ltd. with ICICI Bank Ltd. effective from 30.03.2002, the entire liabilities of ICICI Ltd. have been taken over by ICICI Bank Ltd. As per the scheme of merger all loans and guarantee facilities to ICICI Ltd. provided by Government would be transferred to the merged entity. Similarly, the investments made in erstwhile ICICI Ltd. by banks would be treated outside the ceiling of 5% till redemption.

- e. Any other instrument approved as in the nature of capital.
 - ii. Banks / FIs should not acquire any fresh stake in a bank's equity shares, if by such acquisition, the investing bank's / FI's holding exceeds 5 per cent of the investee bank's equity capital.
2. Banks' / FIs' investments in the equity capital of subsidiaries are at present deducted from their Tier I capital for capital adequacy purposes. Investments in the instruments issued by banks / FIs which are listed at paragraph 4.1.6 (i) above, which are not deducted from Tier I capital of the investing bank/ FI, will attract 100 per cent risk weight for credit risk for capital adequacy purposes.
3. Banks/ FIs which currently exceed the limits specified at (i) and (ii) of paragraph 4.1.6 above, may apply to the Reserve Bank upto August 20, 2004 along with a definite roadmap for reduction of the exposure within prudential limits.

4.1.7 Banks' Investment in Venture Capital

In order to encourage the flow of finance for venture capital, the banks investment in venture capital (including units of dedicated Venture Capital Funds meant for Information Technology) would be over and above the ceiling of 5 per cent of the banks total outstanding advances (including Commercial Paper) as on March 31 of the previous year. This would, however, be subject to the condition that the venture capital funds/ companies are registered with SEBI.

4.2 Underwriting of Corporate Shares and Debentures

Generally, there are demands on the banks for underwriting the issues of shares and debentures. In order to ensure that there is no over exposure to underwriting commitments to earn fees, the guidelines detailed below should be strictly adhered to:

- i. The statutory provision contained in Section 19(2) & (3) of the Banking Regulation Act, 1949 regarding holding of shares in any company as pledgee / mortgagee or absolute owner, should be strictly adhered to;
- ii. The banks have to ensure that the shares/debentures including PSU equities and shares of other banks, Mutual Funds (the corpus of which is not exclusively invested in corporate debt instruments), the units of UTI subscribed and/or devolving on them as a part of their underwriting obligations in any particular year comply with the ceiling prescribed for the banks' exposure to the capital markets.
- iii. It may be noted that the limit placed is on the shares and debentures, that may be held in the banks own portfolio as a result of devolvement and not on the amount of underwriting that the banks may engage in. Normally, the amount of underwriting is a multiple of the amount which devolves finally.
- iv. The underwriting exposure will be a part of the overall exposure and subject to limit laid down in paragraphs 2.1 above. While taking up underwriting commitments, banks or their subsidiaries, should ensure

that the aggregate of such commitments are included in the exposure limits fixed by the Reserve Bank.

v. In the case of underwriting, the commitments under a single obligation should be fixed taking into account the owned funds of banks and the capacity to meet the commitments that may devolve and should not in any case exceed 15 percent of an issue.

4.3 Other matters on Underwriting Operations

Regarding all other matters concerning underwriting, banks may be guided by our Master Circular on Para Banking Activities.

4.4 'Safety Net' Schemes for Public Issues of Shares, Debentures, etc.

4.4.1 'Safety Net' Schemes

Reserve Bank had observed that some banks/their subsidiaries were providing buy-back facilities under the name of 'Safety Net' Schemes in respect of certain public issues as part of their merchant banking activities. Under such schemes, large exposures are assumed by way of commitments to buy the relative securities from the original investors at any time during a stipulated period at a price determined at the time of issue, irrespective of the prevailing market price. In some cases, such schemes were offered *suo motto* without any request from the company whose issues are supported under the schemes. Apparently, there was no undertaking in such cases from the issuers to buy the securities. There is also no income commensurate with the risk of loss built into these schemes, as the investor will take recourse to the facilities offered under the schemes only when the market value of the securities falls below the pre-determined price.

Banks/their subsidiaries have therefore been advised that they should refrain from offering such 'Safety Net' facilities by whatever name called.

4.4.2 Provision of buy back facilities

In some cases, the issuers provide buy-back facilities to original investors upto Rs. 40,000/- in respect of non-convertible debentures after a lock-in-period of one year to provide liquidity to debentures issued by them. If, at the request of the issuers, the banks or their subsidiaries find it necessary to provide additional facilities to small investors subscribing to new issues, such buy-back arrangements should not entail commitments to buy the securities at pre-determined prices. Prices should be determined from time to time, keeping in view the prevailing stock market prices for the securities. Commitments should also be limited to a moderate proportion of the total issue in terms of the amount and should not exceed 20 percent of the owned funds of the banks/their subsidiaries. These commitments will also be subject to the overall exposure limits which have been or may be prescribed from time to time.

5. **Limits on exposure to unsecured guarantees and unsecured advances**

The instruction that banks have to limit their commitment by way of unsecured guarantees in such a manner that 20 percent of the bank's outstanding unsecured guarantees plus the total of outstanding unsecured advances do not exceed 15 percent of total outstanding advances has been withdrawn to enable banks' Boards to formulate their own policies on unsecured exposures. Simultaneously, all exemptions allowed for computation of unsecured exposures also stand withdrawn.

With a view to ensuring uniformity in approach and implementation, 'unsecured exposure' is defined as an exposure where the realisable value of the security, as assessed by the bank /approved valuers / Reserve Bank's inspecting officers, is not more than 10 percent, *ab-initio*, of the outstanding exposure. 'Exposure' shall include all funded and non-funded exposures (including underwriting and similar commitments). 'Security' will mean tangible security properly charged to the bank and will not include intangible securities like guarantees, comfort letters etc.

6. **Application of prudential norms at group / on consolidated position**

In terms of guidelines for consolidated accounting and other quantitative methods to facilitate consolidated supervision, banks have inter-alia been advised that as prudential measure aimed at better risk management and avoidance of concentration of credit risks, in addition to adherence to prudential limits on exposures assumed by banks, consolidated banks should also adhere to the following prudential limits on:

- i) **Single and Group borrower exposures:** as indicated in paragraph 2.1 above.
- ii) **Capital market exposures :** The consolidated bank's aggregate exposure to capital markets should not exceed 2 per cent of its total on-balance-sheet assets (excluding intangible assets and accumulated losses) as on March 31 of the previous year. This ceiling will apply to the consolidated bank's exposure to capital market in all forms, including both fund based and non-fund based, similar to the computation for the parent bank. Within the total limit, investment in shares, convertible bonds and debentures and units of equity-oriented mutual funds should not exceed 10 percent of consolidated bank's net worth.
- iii) **Exposures by way of unsecured guarantees and unsecured advances :** The norms relating to unsecured guarantees and unsecured funded exposures as formulated by the Board of the bank should also be extended to the consolidated bank.

Note : For the purpose of application of prudential norms on a group wise basis, a 'consolidated bank' is defined as a group of entities, which include a licensed bank, which may or may not have subsidiaries.

The definition of infrastructure lending and the list of the items included under infrastructure sector

Any credit facility in whatever form extended by lenders (i.e. banks, FIs or NBFCs) to an infrastructure facility as specified below falls within the definition of "infrastructure lending". In other words, 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, or any infrastructure facility of a similar nature :
 - 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. *construction relating to projects involving agro-processing and supply of inputs to agriculture;*
- x. *construction for preservation and storage of processed agro-products, perishable goods such as fruits, vegetables and flowers including testing facilities for quality;*
- xi. *construction of educational institutions and hospitals.*

- xii. *any other infrastructure facility of similar nature*

List of All-India Financial Institutions

(Counter party exposure - List of institutions guaranteeing bonds of corporates) [Vide paragraph 2.3.4 & 4.1.4]

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

List of All-India Financial Institutions

(Investment in equity/bonds by banks- List of FIs whose instruments are exempted from the 5 % ceiling)

(Vide paragraph 4.1.2)

1. Industrial Finance Corporation of India Ltd. (IFCI)
2. Industrial Development Bank of India (IDBI)
3. Tourism Finance Corporation of India Ltd. (TFCI)
4. Risk Capital and Technology Finance Corporation Ltd. (RCTC)
5. Technology Development and Information Company of India Ltd. (TDICI)
6. National Housing Bank (NHB)
7. Small Industries Development Bank of India (SIDBI)
8. National Bank for Agriculture and Rural Development (NABARD)
9. Export Import Bank of India (EXIM Bank)
10. Industrial Investment Bank of India (IIBI)
11. Discount and Finance House of India Ltd. (DFHI)
12. Unit Trust of India (UTI)
13. Life Insurance Corporation of India (LIC)
14. General Insurance Corporation of India (GIC)
15. Securities Trading Corporation of India Ltd. (STCI)
16. Infrastructure Development Finance Company Ltd. (IDFC)

Master Circular
Exposure Norms

List of Circulars consolidated by the Master Circular

| | | | |
|----|-------------------|-----------------------|------------------|
| 1. | DBOD No. Dir. BC. | 17/13.03.00/2003-04 | dated 22.08.2003 |
| 2. | DBOD. BP. BC. | 51/21.04.103/2003-04 | dated 5.12.2003 |
| 3. | DBOD No. Dir. BC. | 61/13.07.05/2003-04 | dated 03.01.2004 |
| 4. | DBOD No. Dir. BC. | 67/13.07.05/2003-04 | dated 06.02.2004 |
| 5. | DBOD No. Dir. BC. | 86/13.07.05/2003-04 | dated 18.05.2004 |
| 6. | DBOD No. BP.BC. | 92/21.04.048/2003-04 | dated 16.06.2004 |
| 7. | DBOD No. BP.BC. | 97/21.04.141/2003-04 | dated 17.06.2004 |
| 8. | DBOD No. BP.BC. | 100/21.03.054/2003-04 | dated 21.06.2004 |
| 9. | DBOD No. BP.BC. | 3/21..01..002/2004-05 | dated 06.07.2004 |