

May 25, 2006

All Commercial Banks
(excluding RRBs)

Dear Sir,

Annual Policy Statement for the Year 2006-07- Risk Weight on Exposures to Commercial Real Estate and Venture Capital Funds

Please refer to our Circular No. DBOD. BP.BC. 20 / 21.01.002/ 2005-06 July 26, 2005 wherein, the risk weight on banks' exposure to the commercial real estate was increased from 100 per cent to 125 per cent and was applicable on an on-going basis. In this connection, a reference may be made to paragraph 186 of the Annual Policy Statement for the Year 2006-07 (extract enclosed). As mentioned therein, it has been decided to increase the risk weight on banks' exposure to the commercial real estate to 150 per cent.

2. Further, as indicated in para 187 of the Statement (extract enclosed) a bank's total exposure to venture capital funds will form a part of its capital market exposure and, henceforth, a higher risk weight of 150 per cent will be assigned to these exposures.

Yours faithfully,

(Prashant Saran)
Chief General Manager-in-Charge

Extract of Annual Policy Statement for the year 2006-07

Risk Weight on Exposures to Commercial Real Estate

186. In July 2005, the Reserve Bank had increased the risk weight on exposures to commercial real estate from 100 per cent to 125 per cent. Given the continued rapid expansion in credit to this sensitive sector, it is proposed:

- to increase the risk weight to 150 per cent.

Exposure to Venture Capital Funds Included for Capital Market

187. Venture capital funds (VCFs) play an important role in encouraging entrepreneurship. In the absence of adequate public disclosures with regard to performance/asset quality of VCFs, prudence would demand treatment of exposures to VCFs as 'high risk'. Therefore, in terms of risk, all exposures to VCFs would have to be deemed to be on par with 'equity'. While significance of venture capital activities and need for banks' involvement in financing venture capital funds is well recognised, there is also a need to address the relatively higher risks inherent in such exposures. Accordingly, it is proposed that:

- a bank's total exposure to venture capital funds will form a part of its capital market exposure and banks should, henceforth, assign a higher risk weight of 150 per cent to these exposures.

Operational guidelines in this regard would be issued separately.