RBI/2006-07/ 144
DBOD No. Dir. BC. 33/ 13.03.00/ 2006-07

October 10, 2006
Ashwina 18, 1928

All Scheduled Commercial Banks
(Excluding RRBs)

Dear Sir,

Master Circular – Exposure Norms

Please refer to the Master Circular DBOD No. Dir. BC. 25/13.03.00/2005-06 dated August 3, 2005 consolidating the instructions / guidelines issued to banks till June 30, 2005 relating to Exposure Norms. The Master Circular has been suitably updated by incorporating the instructions issued till date 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,

(P. Vijaya Bhaskar)
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 limits would be 15 percent of capital funds in case of single borrower and 40 percent of capital funds in the case of a borrower group. The capital funds for the purpose will comprise of Tier I and Tier II capital as defined under capital adequacy standards (please also refer to para 2.3.5 of this Master Circular).

2.1.2 Credit exposure to borrowers belonging to a group may exceed the exposure norm of 40 percent of the bank's capital funds by an additional 10 percent (i.e up to 50 percent), 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 percent of the bank's capital funds by an additional 5 percent (i.e. up to 20 percent) 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 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 percent 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 Lending under Consortium Arrangements

The exposure limits will also be applicable to lending under consortium arrangements,.

2.1. 6 Bills discounted under Letter of Credit (LC)

Bills purchased / discounted / negotiated under LC (where the payment to the beneficiary is not made 'under reserve') will be treated as an exposure on the LC issuing bank and not on the borrower. In the case of negotiations ' under reserve' the exposure should be treated as on the borrower.

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 (both funded and non-funded facilities) granted against the security of a bank's own term deposits may not be reckoned for computing the exposure to the extent that the bank has a specific lien on such deposits.

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). The sanctioned limits or outstandings, whichever are higher, shall be reckoned for arriving at the exposure limit. However, in the case of fully drawn term loans, where there is no scope for re-drawal of any portion of the sanctioned limit, banks may reckon the outstanding as the exposure.

2.3.2 Measurement of Credit Exposure of Derivative Products

Derivative products such as Forward Rate Agreements and Interest Rate Swaps are also captured for computing exposure by applying the conversion factors to notional principal amounts. 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, either of the two methods viz. (i) Original Exposure Method, and (ii) Current Exposure Method, consistently, for all derivative products such as Forward Rate Agreements (FRAs) and Interest Rate Swaps (IRSs), forward contracts in foreign exchange and other derivative products like currency swaps, options, etc., 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 conversion factors according to the residual maturity:

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%

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 the 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.

2.3.4 Investment Exposure

Investment exposure comprises of the following elements:

(a) investments in shares and debentures of companies.

(b) investment in PSU bonds

(c) investments in Commercial Papers (CPs)..

(d) 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. In view of the extraordinary nature of the event, banks / FIs will be allowed, in the initial years, to exceed the 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[1] (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 and as per the published accounts as on March 31 of the previous year. The infusion of capital under Tier I and Tier II, either through domestic or overseas issue, after the published balance sheet date will also be taken into account for determining the exposure ceiling. Other accretion to capital funds by way of quarterly profits etc. would not be eligible to be reckoned for determining the exposure ceiling. Banks are also prohibited from taking exposure in excess of the ceiling in anticipation of infusion of capital at a future date.

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

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[1] 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.

[1] With the merger of IDBI Ltd. with IDBI Bank Ltd., effective April 2, 2005, the entire liabilities of IDBI Ltd. have been taken over by IDBI Bank Ltd. Therefore, for the purpose of exposure norms, investments made by banks in the bonds and debentures of corporate guaranteed by the erstwhile IDBI Ltd. would continue to be treated as an exposure of the banks on IDBI Bank Ltd. and not on the corporates, till redemption. Similarly, investments made in the erstwhile IDBI Ltd. by banks would be treated as outside the capital market exposure ceiling of 5%, till redemption.

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.

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 an individual or a Group of borrowers, as indicated above, banks may also consider fixing internal limits 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 Exposure to Real Estate

(i) 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 banks' Boards.

(ii) While appraising loan proposals involving real estate, banks should ensure that the borrowers have obtained prior permission from government / local governments / other statutory authorities for the project, wherever required. In order that the loan approval process is not hampered on account of this, while the proposals could be sanctioned in the normal course, the disbursements should be made only after the borrower has obtained requisite clearances from the government authorities. Banks' Boards may also consider incorporation of aspects relating to adherence to National Building Code (NBC) in their policies on exposure to real estate. The information regarding the NBC can be accessed from the website of Bureau of Indian Standards (www.bis.org.in).

(iii) The exposure of banks to entities for setting up Special Economic Zones (SEZs) or for acquisition of units in SEZs which includes real estate would be treated as exposure to commercial real estate sector and banks would have to make provisions as also assign appropriate risk weights for such exposures as per the existing guidelines.

(iv) 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 any 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 percent 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 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 Capital Market

The salient features of the guidelines on banks' financing against shares, debentures, etc. are given below:

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

Banks' aggregate exposure to the capital market covering direct investment in equity shares, convertible bonds and debentures, units of equity oriented mutual funds; and all exposures to Venture Capital Funds (VCFs) [both registered and unregistered], 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 percent of their total outstanding advances (including Commercial Paper) as on March 31 of the previous year. This ceiling of 5 percent prescribed for investment in shares would apply to total exposure including both fund based and non-fund based exposure to capital market in all forms. Within this overall ceiling, banks' investment in shares, convertible bonds and debentures, units of equity-oriented mutual funds and all exposures to Venture Capital Funds (VCFs) [both registered and unregistered] should not exceed 20 percent of their networth. The banks are required to adhere to this ceiling on an ongoing basis.

The ceiling on exposure to capital market should be computed with reference to sanctioned limits or outstandings, whichever is higher. Further, direct investment in shares by banks should be calculated at cost price of the shares.

3.4.3 Advances against Shares to Individuals

Loans against the security of shares, debentures and PSU bonds to individuals should not exceed the limit of Rs. 10 lakh per individual borrower if the securities are held in physical form and Rs 20 lakhs per individual borrower, if the securities are held in demat form. The banks can grant advances to employees for purchasing shares of their own companies under Employees Stock Option Plan(ESOP) to the extent of 90% of the purchase price of shares or Rs. 20 lakh, whichever is lower. Further, banks can extend loans upto Rs.10 lakh to individuals for subscribing to Initial Public Offerings (IPOs). Finance extended by a bank for IPOs/ESOPs will be reckoned as an exposure to capital market and included within the 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 are applicable to advances against shares and debentures. However, the quantum and margin requirement for loans/ advances to individuals against units of exclusively debt-oriented mutual funds may be decided by individual banks themselves in accordance with their loan policy.

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 for such advances.

3.4.5 Advances against Shares to Stockbrokers 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 percent 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 stockbrokers 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 50 percent shall be applied on all advances / financing of IPOs/issue of guarantees. A minimum cash margin of 25 percent (within the margin of 50%) 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 Promoters' Contributions

3.5.1 Loans sanctioned to corporates against the security of shares (as far as possible, demat shares) for meeting promoters' contribution to the equity of new companies in anticipation of raising resources, should be treated as a bank’s investments in shares which would thus come under the ceiling of 5 percent of the bank's total outstanding advances (including Commercial Paper) as on March 31 of the previous year prescribed for the 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, as 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 percent 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 percent. 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), 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. Further, banks may extend financial assistance to Indian companies for acquisition of equity in overseas joint ventures/wholly-owned subsidiaries or in other overseas companies, new or existing, as strategic investment, in terms of a Board approved policy, duly incorporated in the loan policy of the bank. Such policy should include overall limit on such financing, terms and conditions of eligibility of borrowers, security, margin, etc.

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, 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 turnover period of stocks and shares, the extent to which the 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 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 a 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 percent 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 exposure 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

Banks may provide finance to assist employees to buy shares of their own companies under Employee Stock Option Plans (ESOPs) to the extent of 90% of the purchase price of the shares or Rs. 20 lakh, whichever is lower. However, all such financing should be treated as

part of the banks' exposure to capital market within the overall ceiling of 5 percent 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 ESOPs/ IPOs. Banks therefore should not extend advances, including advances to their employees / Employee Trusts set up by them, for the purpose of purchasing their (banks') own shares under ESOP / IPO or from the secondary market. This prohibition will apply irrespective of whether the advances are unsecured or secured.

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 percent 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 percent of their 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 promoters' contribution towards equity capital of new companies.

iii. bridge loans to companies.

4.1.2 The investment ceiling excludes 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 the corpus is invested exclusively in debt instruments, and

vii. 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 banks in bonds and debentures of corporates, which are guaranteed by a PFI[2], as per the list given in Annexure 2, will be treated as an exposure by the banks 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 percent 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

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 percent 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 percent risk weight for credit risk for capital adequacy purposes.

4.1.7 Banks' Investment in Venture Capital Funds (VCFs)

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[2] 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.

[2] With the merger of IDBI Ltd. with IDBI Bank Ltd., effective April 2, 2005, the entire liabilities of IDBI Ltd. have been taken over by IDBI Bank Ltd. Therefore, for the purpose of exposure norms, investments made by banks in the bonds and debentures of corporate guaranteed by the erstwhile IDBI Ltd. would continue to be treated as an exposure of the banks on IDBI Bank Ltd. and not o the corporates, till redemption. Similarly, investments made in the erstwhile IDBI Ltd. by banks would be treated as outside the capital market exposure ceiling of 5%, till redemption.

All exposures of banks to VCFs (both registered and unregistered) will be deemed to be on par with equity and hence will be reckoned for compliance with the capital market exposure ceilings (ceiling for direct investment in equity and equity linked instruments as well as ceiling for overall capital market exposure).

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 provisions 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. 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 the 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 the 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 up to 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 level / on consolidated position

In terms of the guidelines for consolidated accounting and other quantitative methods to facilitate consolidated supervision, banks have, inter-alia, been advised that as a 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 percent 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 exposure, 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 the 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.

Annexure 1

The definition of infrastructure lending and the list of the items included under infrastructure sector [vide paragraph 2.1.2]

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.

Annexure 2

List of All-India Financial Institutions
(Counter party exposure - List of institutions guaranteeing bonds of corporates)
[vide paragraphs 2.3.4 & 4.1.4]

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

Annexure 3

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

Appendix

Master Circular - Exposure Norms

List of circulars consolidated by the Master Circular

1.	DBOD.No.BP.BC.	30/21.01.002/2006-07	dated 20.09.2006
2.	DBOD.No.BP.BC.	27/21.01.002/2006-07	dated 23.08.2006
3.	DBOD.No.BP.BC.	1711/08.12.14/2005-06	dated 12.06.2006
4.	DBOD.No.BP.BC.	84/21.01.002/2005-06	dated 25.05.2006
5.	DBOD.No.BP.BC.	73/21.03.054/2005-06	dated 24.03.2006
6.	DBOD No.BP.BC.	65/08.12..01/2005-06	dated 01.03.2006
7.	DBOD.No.Dir.BC.	51/13.07.05/2005-06	dated 27.12.2005
8.	DBOD.No.BP.BC.	47/21.03.054/2001-02	dated 22.11.2001