RBI/2006-2007/210
DBOD. No. Dir. BC. 47/13.07.05/2006-2007

December 15, 2006
Agrahayana 24, 1928 (Saka)

All Scheduled Commercial Banks
(excluding RRBs)

Dear Sir,

Banks' exposure to Capital Markets – Rationalization of Norms

It was announced in the Mid-Term Review of Annual Policy Statement for the year 2005-2006 that the prudential capital market exposure norms prescribed for banks would be rationalized in terms of base and coverage so as to:

i) restrict a bank's aggregate capital market exposure to 40 per cent of its net worth on a solo and consolidated basis,

ii) modify a consolidated bank's direct capital market exposure to 20 per cent of its consolidated net worth, and

iii) simplify and rationalize the exemptions in regard to the coverage.

Accordingly, our existing guidelines on banks' exposure to capital markets have been modified and the revised guidelines are given below.

2. Revised instructions/norms

2.1 Components of Capital Market Exposure (CME)

As stated in our circular DBOD.BP.BC.119/21.04.137/2000-2001 dated May 11, 2001, banks' capital market exposures would include both their direct exposures and indirect exposures. The aggregate exposure (both fund and non-fund based) of banks to capital markets in all forms would **include** the following:

i) direct investment in equity shares, convertible bonds, convertible debentures and units of equity-oriented mutual funds the corpus of which is not exclusively invested in corporate debt;

ii) advances against shares/bonds/debentures or other securities or on clean basis to individuals for investment in shares (including IPOs/ESOPs), convertible bonds, convertible debentures, and units of equity-oriented mutual funds;

iii) advances for any other purposes where shares or convertible bonds or convertible debentures or units of equity oriented mutual funds are taken as primary security***;***

iv) advances for any other purposes to the extent secured by the collateral security of shares or convertible bonds or convertible debentures or units of equity oriented mutual funds i.e. where the primary security other than shares/convertible bonds/convertible debentures/units of equity oriented mutual funds `does not fully cover the advances;

v) secured and unsecured advances to stockbrokers and guarantees issued on behalf of stockbrokers and market makers;

vi) loans sanctioned to corporates against the security of shares / bonds/ debentures or other securities or on clean basis for meeting promoter's contribution to the equity of new companies in anticipation of raising resources;

vii) bridge loans to companies against expected equity flows/issues;

viii) underwriting commitments taken up by the banks in respect of primary issue of shares or convertible bonds or convertible debentures or units of equity oriented mutual funds;

ix) financing to stockbrokers for margin trading;

x) all exposures to Venture Capital Funds (both registered and unregistered) as mentioned in paragraph 6 of this circular.

2.2 Limits on banks' exposure to Capital Markets

2.2.1 Solo Basis

The aggregate exposure of a bank to the capital markets in all forms (both fund based and non-fund based) should not exceed 40 per cent of its net worth (as defined in para 2.3), as on March 31 of the previous year. Within this overall ceiling, the bank's direct investment in shares, convertible bonds / debentures, units of equity-oriented mutual funds and all exposures to Venture Capital Funds (VCFs) [both registered and unregistered] should not exceed 20 per cent of its net worth.

2.2.2. Consolidated Basis

The aggregate exposure of a consolidated bank to capital markets (both fund based and non-fund based) should not exceed 40 per cent of its consolidated net worth as on March 31 of the previous year. Within this overall ceiling, the aggregate direct exposure by way of the consolidated bank's investment in shares, convertible bonds / debentures, units of equity-oriented mutual funds and all exposures to Venture Capital Funds (VCFs) [both registered and unregistered] should not exceed 20 per cent of its consolidated net worth.

2.2.3 The above-mentioned ceilings (para 2.2.1 and 2.2.2) are the maximum permissible and a bank's Board of Directors is free to adopt a lower ceiling for the bank, keeping in view its overall risk profile and corporate strategy.

2.3 Definition of Net Worth

Net worth would comprise of Paid-up capital plus Free Reserves including Share Premium but excluding Revaluation Reserves, plus Investment Fluctuation Reserve and credit balance in Profit & Loss account, less debit balance in Profit and Loss account, Accumulated Losses and Intangible Assets. No general or specific provisions should be included in computation of net worth. Infusion of capital through equity shares, either through domestic issues or overseas floats after the published balance sheet date, may also be taken into account for determining the ceiling on exposure to capital market. Banks should obtain an external auditor's certificate on completion of the augmentation of capital and submit the same to the Reserve Bank of India (Department of Banking Supervision) before reckoning the additions, as stated above.

2.4 Items excluded from Capital Market Exposure

The following items would be excluded from the aggregate exposure ceiling of 40 per cent of networth and direct investment exposure ceiling of 20 per cent of networth (wherever applicable) **:**

i) Banks' investments in own subsidiaries, joint ventures, sponsored Regional Rural Banks (RRBs) and investments in shares and convertible debentures, convertible bonds issued by institutions forming crucial financial infrastructure such as National Securities Depository Ltd. (NSDL), Central Depository Services (India) Ltd. (CDSL), National Securities Clearing Corporation Ltd. (NSCCL), National Stock Exchange (NSE), Clearing Corporation of India Ltd., (CCIL), Credit Information Bureau of India Ltd. (CIBIL), Multi Commodity Exchange Ltd. (MCX), National Commodity and Derivatives Exchange Ltd. (NCDEX), National Multi-Commodity Exchange of India Ltd. (NMCEIL), National Collateral Management Services Ltd. (NCMSL) and other All India Financial Institutions as given in the Annex. After listing, the exposures in excess of the original investment (i.e. prior to listing) would form part of the Capital Market Exposure.

ii) Tier I and Tier II debt instruments issued by other banks;

iii) Investment in Certificate of Deposits (CDs) of other banks;

iv) Preference Shares;

v) Non-convertible debentures and non-convertible bonds;

vi)Units of Mutual Funds under schemes where the corpus is invested exclusively in debt instruments;

vii) Shares acquired by banks as a result of conversion of debt/overdue interest into equity under Corporate Debt Restructuring (CDR) mechanism;

viii) Term loans sanctioned to Indian promoters for acquisition of equity in overseas joint ventures / wholly owned subsidiaries under the refinance scheme of Export Import Bank of India (EXIM Bank).

2.5 Computation of exposure

For computing the exposure to the capital markets, loans/advances sanctioned and guarantees issued for capital market operations would be reckoned with reference to sanctioned limits or outstanding, whichever is higher. 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. Further, banks' direct investment in shares, convertible bonds, convertible debentures and units of equity oriented mutual funds would be calculated at their cost price.

3. Loans and advances against shares

(i) Ceiling on loans/advances against shares & debentures etc. to individuals

Loans against security of shares, convertible bonds, convertible debentures and units of equity oriented mutual funds to individuals from the banking system should not exceed the limit of Rs.10 lakh per individual if the securities are held in physical form and Rs. 20 lakhs per individual if the securities are held in demat form. Loans/advances to any individual from the banking system against security of shares, convertible bonds, convertible debentures, units of equity oriented mutual funds and PSU bonds should not exceed the limit of Rs.10 lakh for subscribing to IPOs. Banks may extend finance to employees for purchasing shares of their own companies under ESOP to the extent of 90% of the purchase price of the shares or Rs. 20 lakh, whichever is lower. These instructions, however, will not be applicable to banks' extending financial assistance to their own employees for acquisition of shares under ESOPs/ IPOs. Banks should, therefore, not extend advances including 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.

Banks should obtain a declaration from the borrower indicating the details of the loans / advances availed against shares and other securities specified above, from any other bank/s in order to ensure compliance with the ceilings prescribed for the purpose.

(ii) 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 40 percent of their net worth 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.

Further, banks should not extend credit facilities directly or indirectly to stockbrokers for arbitrage operations in Stock Exchanges.

4. Bank financing to individuals against shares to joint holders or third party beneficiaries

While granting advances against shares held in joint names to joint holders or third party beneficiaries, banks should be circumspect and ensure that the objective of the regulation is not defeated by granting advances to other joint holders or third party beneficiaries to circumvent the above limits placed on loans/advances against shares and other securities specified above.

5. Margins on advances against shares/issue of guarantees

A uniform margin of 50 per cent shall be applied on all advances/financing of IPOs/issue of guarantees for capital market operations. A minimum cash margin of 25 per cent (within the margin of 50%) shall have to be maintained in respect of guarantees issued by banks for capital market operations.

6. Investments in Venture Capital Funds (VCFs)

As announced in the Annual Policy Statement for the year 2006-2007 and advised in our circulars DBOD.BP.BC.84 & 27/21.01.002/2005-2006 dated May 25 and August 23, 2006 respectively, banks' exposures 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 (both direct and indirect).

7. Intra-day Exposures

At present, there are no explicit guidelines for monitoring banks' intra-day exposure to the capital markets, which are inherently risky. It has been decided that the Board of each bank should evolve a policy for fixing intra-day limits and put in place an appropriate system to monitor such limits, on an ongoing basis. The position will be reviewed after an year.

8. Enhancement in limits

Banks having sound internal controls and robust risk management systems can approach the Reserve Bank for higher limits together with details thereof.

9. Transitional provisions

Such banks whose exposure to capital market on solo and/or consolidated basis is in excess of the ceilings prescribed in paragraphs 2.2.1 and 2.2.2 should approach RBI with a plan for adhering to the exposure ceilings prescribed.

10. Effective date of circular

With a view to ensuring smooth transition the revised guidelines will come into effect from **April 1, 2007.**

Yours faithfully,

(P.Vijaya Bhaskar)
Chief General Manager

Annex

List of All-India Financial Institutions
[Investment in equity/convertible bonds/ convertible debentures by banks - List of FIs whose instruments are exempted from capital market exposure ceiling - vide paragraph 2.4 (i)]

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)