RBI.No.2007-08/210
DBOD. Dir. BC. 57/13.03.00/2007-2008

December 14, 2007

All Scheduled Commercial Banks
(excluding RRBs)

Dear Sir

Banks' Exposure to Capital Market –
Loans extended by banks to Mutual Funds and
issue of Irrevocable Payment Commitments (IPCs)

As banks are aware, the extant instructions on banks' exposure to the Capital Market have been consolidated in RBI's Master Circular No. DBOD. Dir. BC. 11 / 13.03.00/ 2007-08 dated July 2, 2007 on Exposure Norms. In terms of paragraph 5.6 of the above Master Circular, banks may grant loans and advances to individuals against units of Mutual Funds. However, there are no explicit guidelines for grant of loans and advances to Mutual Funds.

2. The Annual Financial Inspection reports of certain banks and an analysis of the Consolidated Prudential Return (CPR) of some banks have revealed that these banks have extended large loans to various Mutual Funds and have also issued Irrevocable Payment Commitments (IPCs) to stock exchanges (BSE & NSE) on behalf of Mutual Funds/FIIs. These exposures have, however, not been included by the banks for computation of their Capital Market Exposure.

3. The matter has been examined by us and we advise as under:

i. Loans extended by banks to Mutual Funds

In terms of paragraph 44(2) of the SEBI (Mutual Funds) Regulations, 1996, a mutual fund shall not borrow except to meet temporary liquidity needs of the mutual funds for the purpose of repurchase, redemption of units or payment of interest or dividend to the unit holders and, further, the mutual fund shall not borrow more than 20% of the net asset of the scheme and for a duration not exceeding six months. The SEBI guidelines imply that Mutual Funds should normally meet their repurchase/redemption commitments from their own resources and resort to borrowing only to meet temporary liquidity needs. In view of the above, banks are advised to be judicious in extending finance to Mutual Funds and grant loans and advances to Mutual Funds only to meet their temporary liquidity needs for the purpose of repurchase/redemption of units within the ceiling of 20% of the net asset of the scheme and for a period not exceeding 6 months. Such finance, if extended to equity-oriented Mutual Funds, will form part of banks' capital market exposure.

(ii) Irrevocable Payment Commitments (IPCs) issued to various stock exchanges at the request of MFs for their secondary market purchases

Banks issue Irrevocable Payment Commitments (IPCs) in favour of stock exchanges on behalf of Mutual Funds to facilitate the transactions done by these clients. We advise that IPCs are in the nature of non-fund based credit facility for purchase of shares and are to be treated at par with guarantees issued for the purpose of capital market operations. Such exposure of banks will, therefore, form part of their Capital Market Exposure. Banks are also advised that entities such as FIIs are not permitted to avail of fund or non-fund based facilities such as IPCs from banks (cf. Schedule 2 of Notification No. FEMA.20/2000-RB dated May 3, 2000).

4. A transition period of 6 months from the date of this circular is being provided to enable banks to comply with the above requirements.

5. Please acknowledge receipt.

Yours faithfully

(P. Vijaya Bhaskar)
Chief General Manager