RBI/2007- 2008/255

DBOD No. BP. BC.65 / 21.04.009/ 2007-08

March 4, 2008

All Commercial Banks (Excluding RRBs)

Dear Sir,

Prudential Norms for Issuance of Letters of
<u>Comfort by Banks regarding their Subsidiaries</u>

It has been observed that the banks in India have been issuing Letters of Comfort (LoCs) to meet the requirements of the overseas regulators while seeking their approval for establishing subsidiaries / opening branches in their countries as also to support certain activities of their subsidiaries in India. Such LoCs are intended to provide the comfort to: (i) the overseas and domestic regulators that the parent bank would support its foreign / domestic subsidiaries in case they face any financial problems in future; and (ii) the rating agencies in India, which might be rating the issuances / products of the bank's Indian subsidiaries, in regard to availability of the parental support to the subsidiary. Such LoCs could entail an element of contingent liability on the part of the issuing banks which, at present, is not adequately captured under the extant regulatory dispensation.

2. The matter of issuance of LoCs by the banks was, therefore, examined by the RBI recently in view of the possible liabilities / obligations that may have to be met by the issuing banks in future and it has been decided to lay down the following prudential norms in this regard:

i) Every issuance of an LoC should be subject to the prior approval by the Board of Directors of the bank. The bank should lay down a well defined policy for issuance of LoCs, including the indicative cumulative ceilings up to which LoCs could be issued by the banks for various purposes. The policy must, *inter alia*, provide that the banks will obtain and keep on record a legal opinion in regard to the legally binding nature of the LoC issued. An appropriate system for keeping record of all the LoCs issued should also be put in place.

ii) The bank should make an assessment, at least one a year, of the likely financial impact that might arise from the LoCs issued by it and outstanding, in case it is called upon to support its subsidiary in India or abroad, as per the obligations assumed under the LoCs issued. Such an assessment should be made qualitatively on judgmental basis and the amount so assessed should be reported to the Board, at least once a year. As a first time exercise, such an assessment should be undertaken in respect of all the outstanding LoCs issued and outstanding as on March 31, 2008 and the results placed before the Board in the ensuing meeting. Such an assessment should form a part of the bank's liquidity planning exercise as well.

iii) Any LoC that is assessed to be a contingent liability of the bank by a rating agency / internal or external auditors/ internal inspectors or the RBI inspection team, shall be treated, <u>for all prudential regulatory purposes</u>, on the same footing as a financial guarantee issued by the bank.

iv) The banks should disclose full particulars of all the LoCs issued by them during the year, including their assessed financial impact, as also their assessed cumulative financial obligations under the LoCs issued by them in the past and outstanding, in its published financial statements, as part of the ‘Notes to Accounts”.

Yours faithfully,

(Prashant Saran)
Chief General Manager-In-Charge