28 Aug 1998

Bank Finance against shares and debentures

DBOD No. Dir.BC.90/13.07.05/98
28 August 1998
6 Bhadra 1920 (Saka)

All commercial banks

Dear Sir,

Bank Finance against shares and debentures - Master Circular

As you are aware the Reserve Bank of India has, from time to time, issued a number of guidelines/instructions/directives to banks in regard to advances against shares. To enable banks to have the current instructions at one place, a Master Circular containing all existing guidelines on the subject has been prepared and is enclosed. We advise that this Master Circular supersedes all the previous instructions contained in the Circulars issued by the RBI so far.

Please acknowledge receipt.

Yours faithfully,
Sd/-
(Radhe Shyam)
Additional Chief General Manager

Advances against Shares, Units, Debentures and Public Sector Undertaking (PSU) Bonds

1. General Guidelines:
The Annexure lays down the general guidelines to be followed by banks in all cases of grant of advances against shares and debentures/bonds.

2. Advances against security of shares/debentures/bonds may be given to

individuals, share and stock brokers and market makers, as per guidelines detailed in paragraphs 3 to 6 below. In regard to loans to other borrowers, banks may please refer to paragraphs 7 and 8 below. Paragraph 9 relates to advances against units of mutual funds.

3. Advances to individuals
Banks may grant advances against the security of shares, debentures or bonds to individuals subject to the following conditions:

i. ***Purpose of the Loan:*** **Loans against shares, debentures and bonds of public sector undertakings (PSUs) may be granted to individuals to meet contingencies and personal needs or for subscribing to rights or new issues of shares/debentures/bonds or for purchase in the secondary market, against the security of shares/debentures/bonds held by the individual.**
ii. ***Amount of advance:*** **Loans against the security of shares, debentures and PSU bonds if held in physical form should not exceed the limit of Rs. 10 lakhs per borrower. The limit of Rs. 10 lakhs has been enhanced to Rs. 20 lakhs if the securities are held in dematerialised form.**
iii. ***Margin*** **: Banks should maintain a minimum margin of 50 percent of the market value of equity shares/convertible debentures held in physical form. In the case of shares/convertible debentures held in dematerialised form, a minimum margin of 25 percent should be maintained. These are minimum margin stipulations and banks may stipulate higher margins for shares whether held in physical form or dematerialised form. The margin requirements for advances against preference shares/non-convertible debentures and bonds may be determined by the banks themselves.**
iv. ***Lending policy :*** **Each bank should formulate with the approval of the Board a Lending Policy for grant of advances to individuals against shares/debentures/bonds keeping in view the general guidelines given in the Annexure as applicable to such advances. Banks should obtain a declaration from the borrower indicating the extent of loans availed of by him from other banks as input for credit evaluation. It would also be necessary to ensure that such accommodation from different banks is not obtained against shares of a single company or a group of companies. As a prudential measure, each bank may also consider laying down an aggregate limit of such advances.**

4. Advances to share and stock brokers

i. **Banks and their subsidiaries should not undertake financing of**

`Badla' transactions.

ii. **Share and stock brokers may be provided need based overdraft facilities/line of credit against shares and debentures held by them as stock-in-trade. A careful assessment of need based requirements for such finance should be made taking into account the financial position of the borrower, operations on his own account and on behalf of clients, income earned, the average turnover period of stocks and shares and the extent to which the broker's funds are required to be involved in his business operations. Large scale investment in shares and debentures on own account by stock and share brokers with bank finance, should not be encouraged. The securities lodged as collateral should be easily marketable.**

iii. **The ceiling of Rs.10 lakhs/Rs.20 lakhs for advances against shares/debentures to individuals will not be applicable in the case of share and stock brokers and the advances would be need based.**

iv. **Banks may grant working capital facilities to stock brokers registered with SEBI and who have complied with capital adequacy norms prescribed by SEBI/Stock exchanges to meet the cash flow gap between delivery and payment for DVP transactions undertaken on behalf of institutional clients viz. Fis, FIIs, mutual funds and banks. The duration of such a facility will be short and would be based on an assessment of the financing requirements keeping in view the cash flow gaps, the broker's funds required to be deployed for the transaction and the overall financial position of the broker. The utilisation will be monitored on the basis of individual transactions. Margins may be determined by the banks themselves and banks may institute adequate safeguards and monitoring mechanisms.**

v. **Banks may issue guarantees on behalf of share and stock brokers in favour of stock exchanges in lieu of security deposit to the extent it is acceptable in the form of bank guarantee as laid down by stock exchanges. Banks may also issue guarantees in lieu of margin requirements as per stock exchange regulations. The bank should assess the requirement of each applicant borrower, observe usual and necessary safeguards including the exposure ceilings.**

vi. **The requirement relating to transfer of shares in bank's name in respect of shares held in physical form mentioned in paragraph (vii) in the Annexure shall not apply in respect of advances granted to share and stock brokers provided such shares are held as security for a period not exceeding nine months. In the case of dematerialised shares, the depository system provides a facility for pledging and banks may avail themselves of this facility and in such cases there will not be need to transfer the**

shares in the name of the bank irrespective of the period of holding. The share and stock brokers are free to substitute the shares pledged by them as and when necessary. In case of a default in the account, the bank should exercise the option to get the shares transferred in its name.

vii. **Banks shall grant advances only to share and stock brokers registered with SEBI and who comply with capital adequacy norms prescribed by SEBI/Stock Exchanges.**

5. Bank Finance for Market Makers

Banks may provide need based finance to meet the genuine credit requirements of approved Market Makers. For this purpose, they should lay down appropriate norms for financing them including exposure limits, method of valuation, etc. They should also follow the guidelines given below:

a. **Market Makers approved by stock exchange would be eligible for grant of advances by scheduled commercial banks.**
b. **Market Making may not only be for equity but also for debt securities including State and Central Government securities.**
c. **Banks should exercise their commercial judgement in determining the need based working capital requirements of Market Makers by taking into account the Market Making operations.**
d. **Banks may prescribe normal prudential margin based on their commercial judgement while extending advances to Market Makers.**
e. **Banks may accept, as collateral for the advances to the Market Makers, scrips other than the scrips in which the market making operations are undertaken.**
f. **Securities offered as collateral may include shares/debentures/bonds/units of mutual funds including UTI as well as securities of Central and State Governments.**
g. **Banks should ensure that advances provided for Market Making are not diverted for investment in shares other than the scrip earmarked for Market Making purpose. For this purpose, a suitable follow-up and monitoring mechanism must be evolved.**
h. **The ceiling of Rs.10 lakhs/Rs.20 lakhs for advances against shares/debentures to individuals will not be applicable in the case of Market Makers.**

6. Each bank should lay down a detailed loan policy for granting advances to Stock Brokers and Market Makers and also a policy for grant of guarantees on behalf of brokers which should keep in view the

general guidelines given in the Annexure and include inter alia, the following:

- **purpose and use of such advances/guarantees**
- **pricing of such advances**
- **control features that specifically recognise the unique characteristics and risks of such financing**
- **margins to be maintained**
- **method of valuation of collateral**
- **frequency of valuation of shares and other securities taken as collateral. Frequency of valuation of shares may at least be once in a quarter.**
- **guidelines for transfer of shares in bank's name**
- **maximum exposure for individual credits (within the RBI prescribed prudential Single Borrower Limit). The Board may also consider laying down a limit on the aggregate exposure of the bank to this sector.**
- **the aggregate portfolio, its quality and performance should be reviewed**
  and put up at least on a half-yearly basis to the Board.

7. Advances to other borrowers against shares/debentures/bonds
The question of granting advances against primary security of shares and debentures including promoters shares to industrial, corporate or other borrowers should not normally arise. However, such securities can be accepted as collateral for secured loans granted as working capital or for other productive purposes from borrowers other than NBFCs. In such cases banks may increasingly accept shares in dematerialised form. Banks may accept shares of promoters only in dematerialised form wherever demat facility is available.
In the course of setting up of new projects or expansion of existing business or for the purpose of raising additional working capital required by units other than NBFCs, there may be situations where such borrowers are not able to find the required funds towards margin, pending mobilisation of long term resources. In such cases, there would be no objection to the banks obtaining collateral security of shares and debentures by way of margin. Such arrangements would be of a temporary nature and may not be continued beyond a period of one year. Banks have to satisfy themselves regarding the capacity of the borrower to raise the required funds and to repay the advance within the stipulated period.

8. Bank Loans for Financing Promoters contribution
The promoters' contribution towards the equity capital of a company should come from their own resources and the bank should not

normally grant advances to take up shares of other companies. However, banks are permitted to extend loans to corporates against the security of shares (as far as possible in dematerialised form) held by them to meet the promoters' contribution to the equity of new companies in anticipation of raising resources subject to the following terms and conditions, in addition to the general guidelines given in the Annexure:

i. **The margin and period of repayment of the loans may be determined by the banks.**
ii. **Loans sanctioned to corporates for meeting promoters' contribution should be treated as banks' investments in shares and would thus come under the ceiling of 5 per cent of the incremental deposits of the previous year prescribed for investments in shares/convertible debentures of PSUs, corporate bodies, units of mutual fund schemes and in equity of dedicated venture capital funds meant for information technology.**
iii. **With the approval of the Boards of Directors, the banks should formulate internal guidelines with appropriate safeguards for this purpose.**
iv. **Under the refinance scheme of Export-Import Bank of India, the banks may sanction term loans on merits to 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.**

9. Advances against Units of mutual funds

While granting advances against Units of mutual funds including Units of UNIT 64 Scheme of UTI, the banks should follow the guidelines given below.

i. **The Units should be listed in the Stock Exchanges or repurchase facility for the Units of mutual fund should be available at the time of lending.**
ii. **The Units should have completed the minimum lock-in-period stipulated in the relevant scheme.**
iii. **The amount of advances should be linked to the Net Asset Value (NAV) /repurchase price or the market value, whichever is less and not to the face value.**
iv. **The advance would attract the quantum and margin requirements as applicable to advance against shares and debentures wherever stipulated. The margin should be calculated on the NAV/repurchase price or market value, whichever is less.**
v. **The advances should be purpose-oriented, taking into account the credit requirement of the investor. Advances should not be**

granted for subscribing to or boosting up the sales of another scheme of the mutual funds or for the purchase of shares/debentures/bonds.

10. Reporting of advances against shares/debentures/bonds
Banks should submit in the enclosed Format details of advances granted by them against shares and debentures as on the last Reporting Friday of each Quarter viz. March, June, September and December. The Returns should reach the Reserve Bank of India (DBOD, Central Office) not later than the 15th of the succeeding month of the Quarter to which it relates.

Annexure

General guidelines applicable to advances against shares/debentures/bonds

i. **Statutory provisions regarding the grant of advances against shares contained in Sections 19 (2) and (3) and 20 (1) (a) of the Banking Regulation Act 1949 should be strictly observed. Shares held in dematerialised form should also be included for the purpose of determining the limits under Section 19 (2) and 19 (3) ibid.**

ii. **Banks should be concerned with what the advances are for, rather than what the advances are against. While considering grant of advances against shares/debentures banks must follow the normal procedures for the sanction, appraisal and post sanction follow-up.**

iii. **Advances against the primary security of shares/debentures/bonds should be kept distinct and separate and not combined with any other advance.**

iv. **Banks should satisfy themselves about the marketability of the shares/debentures and the networth and working of the company whose shares/debentures/bonds are offered as security.**

v. **Shares/debentures/bonds should be valued at prevailing market prices when they are lodged as security for advances.**

vi. **Banks should exercise particular care when advances are sought against large blocks of shares by a borrower or a group of borrowers. It should be ensured that advances against shares are not used to enable the borrower to acquire or retain a controlling interest in the company/companies or to facilitate or retain inter-corporate investments.**

vii. **No advance against partly paid shares shall be granted. Whenever the limit/limits of advances granted to a borrower exceeds Rs. 10 lakhs, it should be ensured that the said shares/debentures/bonds are transferred in the bank's name and that the bank has exclusive and unconditional voting rights in respect of such shares. For this purpose the aggregate of limits against shares/debentures/bonds granted by a bank at all its offices to a single borrower should be taken into account. Where securities are held in dematerialised form, the requirement relating to transfer of shares in bank's name will not apply and banks may take their own decision in this regard. Banks should however avail of the facility provided in the depository system for pledging securities held in dematerialised form under which the securities pledged by the borrower get blocked in favour of the lending bank. In case of default by the borrower and on the bank exercising the option of invocation of pledge, the shares and debentures get transferred in the bank's name immediately.**

viii. **Banks may take their own decision in regard to exercise of voting rights and may prescribe procedures for this purpose.**

ix. **Banks should ensure that the scrips lodged with them as security are not stolen/duplicate/fake/benami. Any irregularities coming to their notice should be immediately reported to RBI.**

x. **The Boards of Directors may decide the appropriate level of authority for sanction of advances against shares/debentures. They may also frame internal guidelines and safeguards for grant of such advances.**

xi. **Banks operating in India should not be a party to transactions such as making advances or issuing back-up guarantees favouring other banks for extending credit to clients of Indian nationality/origin by some of their overseas branches, to enable the borrowers to make investments in shares and debentures/bonds of Indian companies.**

Explanatory notes

(i) "Shares" mean and include shares and stocks of every description.

(ii) "Debenture" means the same as defined in the Companies Act,1956.

(iii) "Share broker" means a share broker who is registered with SEBI and is a member of a recognised stock exchange.

(iv) "Advances" include cash credit, overdraft, loans and advances of every description.

(v) "Advances against security of shares/debentures, include all types of advances against shares/debentures whether by way of principal security or collateral security.

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Format (vide Para 10)

Statement of Aggregate Credit Limits of Rs.1 lakh and above against the security/collateral of shares, debentures and public sector bonds and outstandings thereagainst as on the last Reporting Friday of March/June/September/December

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Name of the Bank:

(Amount in lakhs of rupees)

A	*B*		*C*		D		*E*	
Category of borrowers	Aggregate limits sanctioned		Total outstandings		Of `C' Advances extended for further investments in shares,debentures and public sector bonds		Other purposes	
	No.of parties	Amt.	No.of parties	Amt.	No.of parties	Amount	No.of parties	Amount

a) Individuals

b) Investment firms/ companies

c) Share and stock brokers

d) Trusts and endowments

e) Industrial and trading concerns

f) Others

Total:

Note:

1. Only outstandings in respect of limits of Rs.1 lakh and above need be furnished.
2. The limits may be by way of loan, overdraft, cash credit etc.
3. Figures should relate to the last Friday of the month.
4. Total of columns (D) and (E) should tally with (C)
5. 'Individual' will include advances to more than one person in their own names.
6. 'Industrial and Trading concerns' will include proprietorship/partnership firms andprivate/public limited companies engaged in trade or industry.