

November 17, 2006

**All Scheduled Commercial Banks
(excluding RRBs)**

Dear Sir,

Banks' exposure to Capital Markets – Rationalisation of Norms

As banks may be aware, 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 rationalise the exemptions in regard to the coverage.

Accordingly, it is proposed to modify the existing guidelines on banks' exposure to capital markets. A draft of the proposed guidelines is furnished at the Annex.

2. Banks are requested to forward their comments and feedback on the draft guidelines to the undersigned (Fax No: 022-22150663) by close of business on Friday, December 1, 2006. [Click here](#) to send the feedback through e-mail

Yours faithfully,

(P.Vijaya Bhaskar)
Chief General Manager

ANNEX

DRAFT CIRCULAR – FOR COMMENTS

DBOD.No.Dir.BC. /13.07.05/2006-2007

**All Scheduled Commercial Banks
(excluding RRBs)**

Dear Sir,

Banks' exposure to Capital Markets – Rationalisation 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:

- iv) restrict a bank's aggregate capital market exposure to 40 per cent of its net worth on a solo and consolidated basis,
- v) modify a consolidated bank's direct capital market exposure to 20 percent of its consolidated net worth, and

vi) simplify and rationalise 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 debts,
- 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 etc.,
- 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 or collateral security,
- vi) secured and unsecured advances to stockbrokers and guarantees issued on behalf of stockbrokers and market makers,
- v) 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,
- vi) bridge loans to companies against expected equity flows/issues,
- vii) 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,
- viii) financing to stockbrokers for margin trading,
- ix) all exposures to Venture Capital Funds(both registered and unregistered) as mentioned in paragraph 6 of this circular and
- x) intra-day exposures as mentioned in paragraph 7 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.

2.3 Definition of Net Worth

Net worth would comprise of Paid-up equity capital plus Free Reserves including Share Premium plus credit balance in Profit & Loss account less accumulated losses, debit balance in the Profit and Loss account, intangible assets and Revaluation Reserves. 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 aggregate exposure ceiling of 40 per cent of net worth would **exclude** the following:

i) Banks' investments in own subsidiaries, joint ventures, sponsored Regional Rural Banks (RRBs) and investments in shares and convertible debentures, convertible bonds issued by 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) and National Multi-Commodity Exchange of India Ltd. (NMCEIL). **On listing, all the above exposures would form part of the Capital Market Exposure.**

- ii) Tier 1 and Tier 2 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. Ceiling on loans/advances against shares & debentures etc.

Loans/advances to any single borrower 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. Advances other than for IPOs to any single borrower from the banking system against security of shares, convertible bonds, convertible debentures and units of equity oriented mutual funds held in physical and demat form

should not exceed Rs.10 lakh and Rs.20 lakh respectively. 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.

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. Hence, the Board of each bank should evolve a policy for fixing intra-day limits for brokers and put in place an appropriate system to monitor the limits provided to brokers, on an ongoing basis. Further, the maximum intra-day exposure, sanctioned limit or outstanding, whichever is higher, should form part of the banks' exposure to capital markets.

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 of their exposure and justification for such higher limit.

9. Effective date of circular

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

Yours faithfully,

(P.Vijaya Bhaskar)
Chief General Manager