EXPOSURES NORMS

Exposure

■ Exposure includes credit exposure (funded and non-funded credit limits) and investment exposure (including underwriting and similar commitments). The sanctioned limits or outstanding, whichever are higher, shall be reckoned for arriving at the exposure limit.

■ Credit exposure comprises of all types of funded and non-funded credit limits and facilities extended by way of equipment leasing, hire purchase finance and factoring services. The Investment Exposure comprises of investments in shares and debentures of companies, PSU bonds, and Commercial Papers (CPs).

■ Banks are required to fix limits on their exposure as a prudential measure aimed at better risk management and avoidance of concentration of credit risks as also to observe certain statutory and regulatory exposure limits in respect advances against some securities.

Ceilings

■ The exposure ceiling limits in case of a single borrower and borrower group would be **15%** and **40%** of capital funds of the bank respectively.

■ The capital funds comprise of Tier I and Tier II capital as per the published accounts as on March 31 of the previous year. Infusion of capital under Tier I and Tier II either through domestic or overseas issue (in case of foreign banks' branches in India capital funds received from their H.O.) after the published balance sheet date will also be taken into account for determining the exposure ceiling. However, accretions by way of quarterly profits, etc. would not be eligible to be reckoned for determining the exposure ceiling.

■ The ceiling limit can be exceeded in respect of single and group borrowers by **5%** to **20%** and by **10%** to **50%** of the bank's capital funds respectively provided the additional credit exposure is on account of extension of credit to infrastructure projects.

■ In addition to the exposure permitted above, banks can, in exceptional circumstances, with the approval of their Boards, consider enhancement of the exposure to a borrower (single as well as group) up to a further **5%** of capital funds subject to the borrower consenting to the banks making appropriate disclosures in their Annual Reports.

■ The exposure limit in respect of single borrower is **25%** of the capital funds in respect of Oil Companies who have been issued Oil Bonds (which do not have SLR status) by GOI and the same can be increased, in exceptional circumstances, up to a further **5** percent of capital funds.

■ The exposure (both lending and investment, including off balance sheet exposures) of a bank to a single NBFC / NBFC-AFC (Asset Financing Companies) should not exceed **10% / 15%** of the bank's capital funds as per its last audited balance sheet which can be increased to **15%/20%** of their capital funds provided the excess exposure is on account of funds on-lent by the NBFC / NBFC-AFC to the infrastructure sector.

■ The exposure limits are applicable to lending under consortium arrangements also.

■ Bills purchased / discounted / negotiated under LC (where the payment to the beneficiary is **not** made **'under reserve'**) will be treated as an exposure on the LC issuing bank and not on the borrower. In the case of negotiations ' **under reserve'** the exposure should be treated as on the borrower. Now-a-days there is no provision for negotiating 'under reserve'.

Exemptions from Ceiling norms

Banks' exposure in the following category is exempted from compliance of the exposure norms:-

- Rehabilitation of Sick/Weak Industrial Units
- Food credit
- Guaranteed by the Government of India
- Loans against Own Term Deposits
- Exposure on NABARD

Measurement of Credit Exposure of Derivative Products

Credit exposures, arising on account of the interest rate & foreign exchange derivative transactions and gold, are computed using the 'Current Exposure Method', (dealt separately). While computing the credit exposure banks may exclude 'sold options', provided the entire premium / fee or any other form of income is received / realized.

Current Exposure Method

- The current exposure method is the sum of current credit exposure and potential future credit exposure. While computing the credit exposure banks may exclude 'sold options', provided the entire premium / fee or any other form of income is received / realized.
- Current credit exposure is defined as the sum of the positive mark-to-market value of these contracts. The Current Exposure Method requires periodical calculation of the current credit exposure by marking these contracts to market, thus capturing the current credit exposure.
- Potential future credit exposure is determined by multiplying the notional principal amount of each of these contracts irrespective of whether the contract has a zero, positive or negative mark-to-market value by the relevant add-on factor according to the nature and residual maturity of the instrument as detailed by the RBI in its Circular dt. 02.07.12

Group

The concept of 'Group' and the task of identification of the borrowers belonging to specific industrial group is left to the perception of the banks/financial institutions, the guiding principle being commonality of management and effective control. In the case of a split in the group, if the split is formalized the splinter groups will be regarded as separate groups. In so far as public sector undertakings are concerned, only single borrower exposure limit would be applicable.

Credit Exposure to Industry and certain Sectors

Internal Exposure Limits

■ Based on the performance and risk perception, Banks may fix internal exposure limits to specific sectors, e.g. textiles, jute, tea, etc., so that the exposures are evenly spread over various sectors. These limits would be required to be reviewed periodically.

■ In the case of clients who enjoy foreign currency loans above USD 10 million or other appropriate limits, banks are required to put in place a policy as to the acceptability of un-hedged foreign currency liability of their customers. Further, the policy for hedging, to be framed by their boards, may consider, excluding forex loans of exporters, provided such customers have uncovered receivables to cover the loan amount and the loans are extended for meeting forex expenditure.

■ The policy should also cover unhedged foreign exchange exposure of all their clients including Small and Medium Enterprises (SMEs) and taking into account exposure from all sources including foreign currency borrowings and External Commercial Borrowings.

■ Banks which have large exposures to clients are required to monitor and review on a monthly basis, through a suitable reporting system, the unhedged portion of the foreign currency exposures of those clients, whose total foreign currency exposure is relatively large (say, about US $ 25 million or its equivalent).

■ The review of unhedged exposure for SMEs is also being done on a monthly basis. In all other cases, banks are required to put in place a system to monitor and review such position on a quarterly basis.

Exposure to Real Estate

■ Banks should frame comprehensive prudential norms relating to the ceiling on the total amount of real estate loans, single/group exposure limits for such loans, margins, security, repayment schedule and availability of supplementary finance and the policy should be approved by the banks' Boards.

■ Banks exposure to entities for setting up Special Economic Zones (SEZs) or for acquisition of units in SEZs which includes real estate would be treated as exposure to commercial real estate sector for the purpose of **risk weight and capital adequacy** from a prudential perspective and accordingly provision has to be made besides assigning appropriate risk weights for such exposures. This may be treated as exposure to **Infrastructure sector** only for the purpose of Exposure norms which provide some relaxations for the Infrastructure sector.

Exposure to Leasing, Hire Purchase and Factoring Services

Banks exposure to leasing, hire purchase and factoring activities should not **exceed 10 percent** of total advances.

Exposure to Indian JVs/ Wholly owned Subsidiaries Abroad and Overseas Step-down Subsidiaries of Indian Corporate

Banks exposure by way of credit/non-credit (LC/Guarantees) as also buyer's credit/acceptance finance to overseas parties for facilitating export of goods & services from India **should not exceed 20 percent of banks' unimpaired capital funds (Tier I and Tier II capital),** subject to the conditions including the holding of Indian company is more than 51%, compliance of Sec. 25 of B.R. 1949, the resource base should be funds held in foreign currency accounts such as FCNR(B), EEFC, RFC, etc.

Banks' Exposure to Capital Markets – Rationalization of norms

The revised guidelines on banks' exposure to capital markets which came into effect from April 1, 2007. Banks' capital market exposure includes both direct and indirect exposures on the various components of capital market such as direct investment in equity shares, convertible debentures, advances against shares/bonds/debentures, etc. and secured and unsecured advances to stock brokers and guarantees issued on behalf of them, etc.

<u>Irrevocable Payment Commitments (IPCs)</u>

Banks issue Irrevocable Payment Commitments (IPCs) in favour of stock exchanges on behalf of domestic mutual funds/FIIs to facilitate the transactions done by these clients. In order to protect the banks from the adverse movements in the equity prices and the possibility of default by the clients, various risk mitigation measures have been prescribed. The IPC will be treated as a financial guarantee.

Limits on Banks' Exposure to Capital Markets

Statutory limit on shareholding

No banking company shall hold shares in any company, whether as pledgee, mortgagee or absolute owner, of an amount exceeding **30%** of the paid-up share capital of that company or **30%** of its own paid-up share capital and reserves, whichever is less (Section 19(2) of the B.R. Act, 1949)

Regulatory Limit (Solo/Consolidated Basis)

The aggregate exposure of a bank/consolidated 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/consolidated net worth** as on March 31 of the previous year. Within this overall ceiling, the bank's direct investment/aggregate direct exposure by way of consolidated 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/consolidated net worth.

Net Worth

Net worth would comprise 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.

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.

Items excluded from Capital Market Exposure

The following investments in capital markets are exempted from the reckoning of capital market exposure of banks looking to the nature of their activities viz.:-

■ 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 as listed out in the RBI Circular.

■ Tier I and Tier II debt instruments issued by other banks;

■ Investment in Certificate of Deposits (CDs) of other banks;
Preference Shares, Non-convertible debentures and non-convertible bonds;

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

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

■ 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).

■ Own underwriting commitments, as also the underwriting commitments of their subsidiaries, through the book running process.

■ Promoters' shares in the SPV of an infrastructure project pledged to the lending bank for infrastructure project lending.

Financing of equities and investments in shares

The capital market exposure of banks on solo/consolidated basis should not exceed **40% of its net worth/consolidated net worth** as on March 31st of the previous year. Besides this, the certain capital exposure is subject to other restrictions/norms as under:-

No.	Nature of capital market exposure	Other restrictions/norms
01.	Advances against shares to individuals (shares, convertible bonds, convertible debentures and units of equity oriented mutual funds)	Physical Form: Not to exceed Rs. 10 Lakh Demat Form : Not to exceed Rs. 20 Lakh
02.	Financing of Initial Public Offerings (IPOs) to individuals (shares, convertible bonds/ debentures, units of equity oriented mutual funds and PSU bonds	Not exceed : Rs.10 lakh (for subscribing to IPOs)
03.	Bank finance to assist employees to buy shares of their own companies under Employees Stock Option Plan (ESOP)/ reserved by way of employees' quota under IPO including Follow-on Public Offers (FPOs)	To the extent of 90% of the purchase price of the shares or Rs.20 lakh whichever is lower.
04.	Advances against shares to Stock Brokers & Market Makers	Banks are free to provide credit facilities based on their commercial judgment (within overall 40%). However, **banks do not extend** credit facilities directly or indirectly for arbitrage operations in Stock Exchanges**.**
05.	Bank financing to individuals against shares to joint holders or third party beneficiaries	Finance should not be to circumvent the limits placed on loans/advances against shares and other securities specified above.
06.	Advances against units of Mutual Funds	Subject to:- *units listed in the Stock Exchange *completed the minimum lock-in-period (relevant scheme) *linked to Net Asset Value (NAV)/repurchase price or the market value whichever is less; *attract the quantum and margin requirements; *purpose oriented
07.	Advances to other borrowers against shares/ debentures/ bonds	Can accept as collateral for secured loans granted as working capital or for other productive purposes or margin for new projects or

		expansion of existing business
08.	Bank Loans for financing promoters' contribution	Individual : 15% of capital funds Group : 40% of capital funds And subject to the Statutory limit on share holding in companies (Sec. 19(2) of B.R. Act 1949 and within 40% of net worth.
09.	Bridge Loans	Period not exceeding one year, but, within 40% of networth.
10.	Investments in Venture Capital Funds (VCFs)	It should not exceed 20% within the capital market exposure norm of 40% of the net worth as on March 31st of previous year.
11.	Margin on advances against shares / issue of guarantees on behalf of stockbrokers and market makers	Uniform margin of 50% of which minimum cash margin of 25% (within 50%) to be maintained for issuance of guarantees for capital market operations.
12.	Disinvestment Programme of GOI	Within the regulatory ceiling of 40% of net worth. Relaxation, on case to case basis, is permitted to banks in such a manner that the total capital exposure, net of exposure under the disinvestment programme, is within the regulatory/ prudential individual/ group exposure ceiling
13.	Financing for acquisition of equity in Overseas companies	Statutory limit on share holding in companies (Sec. 19(2) of B.R. Act)
14.	Refinance Scheme of Export Import Bank of India	Approval of the EXIM Bank for refinance.
15.	Arbitrage Operations	Banks prevented from undertaking arbitrage operations themselves and extending credit facilities for the purpose.
16.	Margin Trading	Minimum margin 50% and the shares should be in dematerialized mode.

Risk Management and Internal Control System

Banks desirous of making investment in equity shares/ debentures, financing of equities and issue of guarantees etc., within the above ceiling, are required to observe the following guidelines:

■ Banks must have a transparent policy duly approved by the Board and build up adequate expertise in equity research by establishing equity research department, etc.

■ An Investment Committee should be in place to take direct investment decisions and the committee should be accountable for all investments made by the bank.

■ Suitable Risk Management mechanism should be put in place so as to ensure that the exposure to stockbrokers is well diversified, etc.

■ Formation of a suitable Audit Committee to have surveillance and monitoring of investment in shares / advances against shares and appropriate reporting to the Board the overall exposure to capital market, compliance of guidelines, etc.

Valuation and Disclosure

Equity shares in a bank's portfolio - as primary security or as collateral for advances or for issue of guarantees and as an investment - are required to be marked to market preferably on a daily basis, but at least on weekly basis. Banks are required to disclose the total investments made in equity shares, convertible bonds and debentures and units of equity oriented mutual funds as also aggregate advances against shares in the "Notes on Account" to their balance sheets.

Cross holding of capital among banks / financial institutions

Banks' / FIs' investment in the following instruments, which are issued by other banks / FIs and are eligible for capital status for the investee bank / FI, should not exceed **10%** of the investing bank's capital funds (Tier I plus Tier II):

a. Equity shares;
b. Preference shares eligible for capital status;
c. Subordinated debt instruments;
d. Hybrid debt capital instruments; and
e. Any other instrument approved as in the nature of capital.

Banks / FIs should not acquire any fresh stake in a bank's equity shares, if by such acquisition, the investing bank's / FI's holding exceeds **5%** of the investee bank's equity capital.

Bank's/FI's equity holdings in another bank held under provisions of a **Statute** will be outside the purview of the ceiling prescribed above.

Margin Requirements

Banks' Exposure to Commodity Markets

Like in case of stock brokers, Banks issue guarantees on behalf of commodity brokers in favour of national level commodity exchanges viz. NCDEX , MCX, NMCEIL, in lieu of margin money at a minimum margin of 50% and minimum cash margin of 25% (within the above margin of 50%) as per the Commodity Exchange Regulations.

Banks' exposure in respect of Currency Derivatives segment

The exposure under the currency derivatives segment is treated outside capital market exposure norms including margin requirements as well as intra-day monitoring are not applicable to banks' exposure to brokers.

Limits on exposure to unsecured guarantees and unsecured advances

The banks are required to formulate their own policies on the extent of unsecured exposures Unsecured exposure' is defined as an exposure where the realizable value of the security, as assessed by the bank /approved valuers / Reserve Bank's inspecting officers, is not more than 10 percent, ab-initio, of the outstanding exposure.

The rights, licenses, authorizations, etc., charged to the banks as collateral in respect of projects (including infrastructure projects) financed by them, should not be reckoned as tangible security for the purpose of determining the amount of unsecured advances.

Annuities under build-operate-transfer (BOT) model in respect of road/highway projects and toll collection rights where there are provisions to compensate the project sponsor if a certain level of traffic is not achieved, as tangible securities, subject to the condition that banks' right to receive annuities and toll collection rights is legally enforceable and irrevocable.

Buy back of securities

At the request of the issuers, additional facilities granted to small investors subscribing to new issues should not exceed 20% of the owned funds of the banks/their subsidiaries and the exposure should be within the overall exposure limits which have been or may be prescribed from time to time.

(Source: RBI M. Circular dt. 1.7.13)

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