Large Exposures and Exposure Norms

exposure ≥ 10%

1. Introduction to the Large Exposures Framework (LEF) 🏦⚖️

The LEF, issued by the RBI, **caps** how much a bank can lend to one borrower or a group—so a single failure can't sink the bank!

- **Why It Matters**
  - **Single Counterparty Cap**: 20% of Tier-1 capital (+ up to 5% more per Board policy)
  - **Group Cap**: 25% of Tier-1 capital
  - **Avoids concentration risk** 🛡️ —limits on sectoral exposures (real estate, infrastructure, NBFCs) and **capital market** lending prevent systemic shocks.

20%

NBFC

IFSC

25%

- **Who It Applies To**
  - **All on- & off-balance sheet** exposures, including derivatives and off-BS commitments.
  - **Subsidiaries & branches** (domestic or in IFSCs) under the parent bank's umbrella.

🔑 **Highlight:**

A bank's **solvency** must **not** hinge on a single borrower or industry!

2. Key Terms You Should Know 📚

Term	Meaning
#1 **Exposure**	Total of **Credit** (funded & non-funded) + **Investment** (shares, bonds, underwriting) limits—use the **higher** of sanctioned or outstanding.
#2 **Credit Exposure**	All funded & non-funded credit (loans, LC, BG, leasing, HP, factoring).
#3 **Investment Exposure**	Investments in **equity**, **debentures**, PSU bonds, CPs, ARC securities (SRs/PTCs).
#4 **Large Exposure**	Sum of exposures to a **single** counterparty (or group) ≥ **10%** of the bank's Tier-1 capital.
#5 **Connected Counterparties**	Group of entities so linked that one's failure likely triggers others' failures (e.g., parent-subsidiary, common management).
Exposure Value Types	1. **On-BS assets** at accounting value 2. **OTC derivatives** at EAD per RBI rules 3. **SFTs** per risk-based capital methods 4. **Off-BS** commitments converted via CCFs

3. Large Exposures Framework (LEF)

Aspect	Key Points
Scope	• **Solo** (bank alone) & **Consolidated** (group) levels• Includes **all** on- & off-BS exposures, derivatives, and connected groups
Limits	• **Single Counterparty**: ≤ **20%** of Tier-1 capital (plus up to 5% per Board)• **Connected Group**: ≤ **25%** of Tier-1 capital
Breaches	• **Exceptional cases only**• **Report** to DBS-RBI immediately• **Rectify** breach within **30 days**
Modulation	RBI can **adjust** limits for specific entities (e.g., CCPs, G-SIBs, D-SIBs, NBFCs).
Exclusions	Certain exposures (e.g., exposures to other banks under settlement, exposures guaranteed by sovereigns) are **carved out**—check RBI details.

Other Key Provisions

- **CRM Techniques**: Eligible collateral, netting, guarantees can **reduce** exposure.

MTM

- **Trading Book**: Special rules for **long/short offsets** and derivatives.
- **Reporting**: **Monthly** returns to DBS-RBI in **prescribed** templates.

Example:

If Bank X's Tier-1 capital is ₹1 000 cr, the max exposure to Mr. Y is ₹200 cr (20%). If Mr. Y's group includes 3 firms, total to all ≤ ₹250 cr (25%).

---

4. Exposure Norms for Urban Co-operative Banks (UCBs) 🏘️

Aspect	Key Points
Individual Borrower Cap	• Board sets cap (as % of Tier-1) • **Regulatory** max: **15%** of Tier-1 capital
Group Borrower Cap	**≤ 25%** of Tier-1 capital
Excluded Exposures	Certain govt. guaranteed, inter-bank settlement exposures—refer RBI list.
Cap Review	• **Annually** post-audit • Update Tier-1 changes **half-yearly**
Loan Thresholds ~~2crore~~	• **Top 50%** of aggregate advances: min **₹25 lakh** or **0.2%** of Tier-1, whichever higher • **Max** ₹1 cr per party
Real Estate Exposure	• Board-approved norms • Ceiling: **10%** of total assets + **5%** of individual housing loans (under PSL)
Other Provisions	• **Inter-bank** exposure limits • **Unsecured** advance ceiling • **Credit card** limit margins

1000 × 0.2%

🔑 **Highlight:**

UCBs must balance community-level focus with **sound risk limits**—no local "too-big-to-fail"!

5. Credit Exposure to Industry and Certain Sectors 🏭📊

Banks must **spread** their lending across industries and set **caps** to avoid too much risk in one area.

Main Aspect	Sub-Aspect	Key Points
Internal Exposure Limits	a) **Spread exposures** evenly across sectors (textiles, jute, tea, etc.) 🌾 b) **Fixed limits** for each sector, based on past performance & perceived risk ⚖️ c) **Board approval** needed for all sectoral limits ✔️ d) **Review periodically** to adjust for market changes 🔄 e) **NBFC sector** to have its own cap f) **Separate limits** for unsecured advances and guarantees 🚫	
#2 **Unhedged Foreign Currency Exposure**	a) **Include** any foreign-currency risk your borrowers carry (UFCE) 🌐 b) **Exclude** transactions naturally hedged (e.g., export receipts against import payables) 🛡️ c)	USD/INR 83 → 86

	Quarterly reporting of UFCE by borrowers 📆d) Applies to **overseas branches** & subsidiaries 🌍	
#3 **Exposure to Real Estate**	a) **Board-approved policy** on real-estate lending 🏢b) **RBI rules**: building permits, environmental clearances **before** disbursement 🏗️c) **SEZ units** get special treatment—treated partly as infrastructure, easing caps 🚧	
#4 **Leasing, Hire-Purchase & Factoring**	a) Keep a **balanced mix**—don't let one line exceed **10%** of total advances 📦b) Monitor monthly to ensure ceilings are respected 📈	
#5 **Indian JVs / WOS Abroad & SDS**	a) **Max 20%** of unimpaired capital to any JV/WOS/Special Subsidiary abroad ✈️b) **No SBLC/LOC** solely for raising loans—only in normal trade use 🔗	

📘 **Example:**

If your bank has ₹1 000 cr in Tier-1 capital and sets a **10% limit** for the textile sector, the **maximum** textile exposure is **₹100 cr**.

6. Exposure to Capital Markets 📈💹

Banking Compliance Crash Course By Ashish Sir

Banks' **capital-market** exposures include **direct investments**, **advances** against securities, and **underwriting** commitments. RBI caps keep speculative risk in check.

Component	Details
Direct Investments	Equity shares, convertible bonds/debentures, units of equity-oriented mutual funds (MFs) 💼
Advances against Securities	Loans with primary security = shares, convertible bonds, MF units 🏦If primary value falls, banks must top up collateral or reduce loan. ⚠️
Secured & Unsecured Advances	• Secured: to stockbrokers, guaranteed by exchanges or market-makers 📜• Unsecured: limited to small margins, tightly monitored
Loans to Corporates	For **promoter's contribution** to new equity issues—must check subscription commitments 🆗
Bridge Loans	Short-term cash for pending equity issues—max **1 year**, with clear repayment source (e.g., upcoming IPO) ⏳
Underwriting Commitments	Banks underwrite share/bond/MF issuances—must hold adequate capital & limits 🔒

Margin Trading Finance	Lending to brokers for customer margin trading—subject to strict **haircuts** on security value 📉
VCF Exposure	Investments in **registered** or **unregistered** Venture Capital Funds—careful due diligence needed 🚀
Payment Commitments	Irrevocable instructions by custodian banks to exchanges—treated as exposure until settled 🖊

Regulatory Caps

- **Shareholding Cap** (Sec 19(2) BR Act): Bank's **direct** equity ≤ 30% of its **paid-up capital or reserves**, whichever lower 🤝
- **Aggregate CME** (solo or consolidated) ≤ 40% of **net worth**; within that, **direct equity + VCF** ≤ 20% 🚦
- **Exclusions**: Govt-guaranteed exposures, intra-day trading limits, SME bonds under PSL
- **Relaxations**: For PSU disinvestment financing or under restructuring programmes 🔄

max. 40%

CME

📘 **Example:**

A bank with ₹500 cr net worth can have up to **₹200 cr** total capital-market exposure (40%), and within that up to **₹100 cr** in direct equities & VCFs (20%).

7. Prudential Limits on Intra-Group Exposure 🤝🏦

Banks often belong to **groups** with NBFCs, insurers, asset managers, etc. To stop trouble in one arm spilling over, RBI caps how much a bank can lend or invest within its own group.

Aspect	Key Points
Objective 🎯	Contain **concentration** & **contagion** risk—so one sister company's trouble can't sink the whole family.
What Counts as Exposure 📊	1. **Credit Exposure**: Loans, guarantees, inter-company lines 2. **Investment Exposure**: Equity stakes, bonds, mutual-fund units 3. **Exclusions**: E.g., govt-guaranteed debt
Exposure Limits 📏	• **Single Group Entity**: ≤ X% of bank's paid-up capital + reserves • **Aggregate Group**: ≤ Y% • **Ceilings** vary by type (NBFC, insurer, asset manager, etc.)
Exemptions 🚫	Certain exposures (e.g., regulatory capital, exposures to RBI or multilateral bodies) **don't** count towards these caps.
Prohibited ❌	1. Banks under a **NOFHC** structure can't lend to their own holding co. 2. No credit/investments to promoters or related individuals under NOFHC.

🔑 **Highlight:**

"Keep lending and investments to sister companies well below risk thresholds!"

Example 👩‍💼

If Bank A has ₹1 000 cr of capital+reserves and the aggregate group cap is 20%, its total exposure to all group entities must stay under **₹200 cr**.

---

8. Financing of Equities & Investments in Shares 📈💸

Banks can help **genuine** investors buy shares, debentures, or MF units—but only up to safe limits, with proper margins.

I. Loans to Individuals Against Shares & Securities 👤🔒

Feature	Details
System Limit	50% 25% • **Physical shares**: up to **₹10 lakh** • **Demat form**: up to **₹20 lakh**
Allowed Purposes 🎯	• Real investors—not speculators • Personal emergencies • New/rights issue subscriptions • Secondary-market buys
Strict Restrictions 🚫	• **No collusion** (e.g., pooling loans to push a stock price) • **One loan per scrip** per borrower
Minimum Margin 📊	• **Physical**: 50% of value • **Demat**: 25% of value

🔍 **Caution:**

Loans against shares **must not** be split among joint-holders or third-party nominees to dodge these **limits**.

II. IPO/FPO Financing 🚀

Feature	Details
Who?	**Individuals** only—banks **cannot** lend to NBFCs just for them to on-lend for IPOs/FPOs.
System Limit	Maximum **₹10 lakh** per investor. 90%
Security	Pledged shares, CDs/Bonds, equity-oriented MF units, PSU bonds.

🔑 **Highlight:**

"Banks can help retail investors subscribe to IPOs—but keep exposures small and margins high!"

Example 💡

Ms. Roy wants a ₹15 lakh loan to buy demat shares. Bank gives **₹11.25 lakh** (75% LTV) since demat margin = 25%, but system cap is ₹20 lakh—so it's OK.

9. Specialized Equity-&-Securities Finance Facilities 📈💼

Banking Compliance Crash Course By Ashish Sir

Banks offer a range of loans against shares, MF units, and related instruments—but each comes with **tight guardrails** to curb speculation and conflicts of interest.

A. Employee Share Purchase Loans 👩‍💼🪙

Feature	Details
Purpose	Employees buying via **ESOPs** or employees' IPO quotas.
Loan Amount	Up to **90%** of purchase price, **max ₹20 lakh**.
Exclusions	**Not** for the bank's own staff trust or employees.
Why It Matters	Empowers staff ownership, aligns incentives—without letting insider lending run wild.

Example: An engineer buys ESOPs worth ₹15 lakh—bank can lend her up to ₹13.5 lakh (90%), with the shares as collateral.

B. Borrower Declaration 📝✔️

Before disbursal, all borrowers must **declare**:

1. **Existing loans** for share/IPO financing from other banks.
2. **Compliance** with system-wide ceilings (₹10/20 lakh caps).

This keeps the bank from unwittingly breaking the rules when customers juggle multiple loans.

C. Advances Against Mutual-Fund Units 🏦🔄

- **Eligible Units:** Listed, redeemable (post lock-in), open-ended debt & equity MFs.
- **Purpose:** Meet **investor's credit** needs—never to buy more securities.
- **Loan Size:** Lesser of NAV, market price, or fair value.
- **Margin & Norms:** Follow **same margins** (50%/25%) as share loans; debt-fund units subject to bank's discretion.

Tip: A ₹10 lakh equity-MF pledged at NAV ₹200 gets up to ₹5 lakh loan (50% margin).

D. Brokers' Working-Capital & DVP Facilities 🎯📊

1. **Stock/Commodity Brokers**
   - **Board-approved policy** on margins, haircuts & exposure.
   - **Need-based WC**—against inventory (stocks, commodities).
   - **Prohibitions:** No funding of "Badla" (carry-forward) trades, broker's own large investments, arbitrage deals.
2. **Delivery-vs-Payment (DVP)**
   - Short-term loans (1–3 days) to **institutional clients** (FIs, FIIs, MFs) to bridge **trade settlement** gaps.

E. Market-Maker Finance 📈🔧

- **Who:** Registered market makers in equity, debt & government securities.
- **What:** WC loans against their **non-market-making** inventory.
- **Monitor:** Ensure funds aren't diverted into non-eligible securities.

F. Other Borrower Categories 🏭💰

- **Industrial & Corporate:** WC or capex finance, **not** secured by shares/debentures. Tenor ≤ 1 year.
- **Promoter's Equity:** Loans to meet **promoter contribution** in new companies. Bank sets **margin** & **tenor**; pledged shares treated as bank investments.
- **Overseas Equity:** Loans to Indian firms acquiring equity in JVs/WOS abroad (incl. **EXIM** refinance schemes).

Exim ← XYZ — A

---

10. Other Securities-Related Facilities & Limits 🌐

Scheme	Key Points
EXIM Refinance	Term loans via Exim Bank for equity in **overseas JVs/WOS**—EXIM approval mandatory.
Bridge Loans vs. Expected Flows	Up to 1 year: funded against NCDs, ECBs, GDRs pipelines (treated **outside** CME).

Margin Trading	• Under CME ceilings. • **Min 50%** margin on funds lent. • Spread exposures across multiple brokers. • Must disclose in "Notes on Accounts."
Cross-Holdings	Banks/FIs investing in each other's capital instruments: ≤ 10% of own **capital funds**; no fresh stake if it exceeds **5%** of the investee's equity.

---

11. General Guidelines for Share/Debenture/Bond Advances ⚖️

P.C / PC+I

Aspect	Rule
Legal Sections	Adhere to **Sec 19(2)/(3)** & **20(1)(a)** of the BR Act—no shortcuts!
Purpose Over Security	Loans must be for **genuine needs**, not just to leverage shares.
Segregation	Keep **separate** books for share-backed advances vs. other loans.
Prohibited Deals	1. Big blocks to single/group borrowers. 2. Loans to **gain/retain control** in companies. 3. Financing inter-corporate investments. 4. Partly-paid shares.
Bank's Name Transfer	If loan > ₹10 lakh, bank can take shares into its books—subject to single-borrower limits.

Voting Rights	Bank decides if/when to vote pledged shares—must have **clear procedures**.
Margins	• **50%** on shares/IPOs/ guarantees / DVP. • **Min 25%** cash margin for capital-market guarantees (within the 50% frame).

---

12. Other Restrictions for Securities Loans 🚫

No "Safety-Net" facilities (guaranteed buy-back) on public issues by banks/subsidiaries.

Buy-Back Commitments: Can't promise fixed prices; use **prevailing market rates**; total ≤ 25% of bank's owned funds.

---

13. Global Applicability 🌍

All the above **exposure norms** and **LEF caps** apply equally to:

- **Overseas branches** & **subsidiaries** of Indian banks.
- Units in **IFSCs** (e.g., GIFT City)—no regulatory arbitrage!