



भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA
www.rbi.org.in

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DBOD.FSD.BC. / /2011-12

July 6, 2011

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

Dear Sir,

**Section 19 of the Banking Regulation Act, 1949-
Equity Investments in subsidiaries and other companies– Draft Guidelines**

Please refer to the instructions contained in paragraphs 2 and 3 of our Master Circular [DBOD. No. FSD.BC.15 / 24.01 .001/ 2011-12 dated July 1, 2011](#) on Para-Banking Activities which deal with the guidelines for setting up of subsidiaries by banks as also banks' investments in companies which are not subsidiaries and are financial services companies. These require Reserve Bank's prior approval and are permitted within certain prescribed limits. Banks' investments in companies which are not subsidiaries are governed by the limits prescribed under Section 19(2) of B.R. Act and there is no requirement, at present, for obtaining prior approval of RBI for such investments except in cases where the investee companies are financial services companies. It is, therefore, possible that banks could through their holdings in other entities, exercise control on such companies or have significant influence over such companies and thus, engage indirectly in activities not permitted to banks [Section 6(1) of the B. R. Act deals with the activities permitted to banks]. This would be against the spirit of the provisions of the Act and is not considered appropriate from prudential perspective.

2. It has, therefore, been decided to lay down prudential guidelines for banks' investments in companies which are not subsidiaries and are not 'financial services companies' (as defined in the Annex 1).

3. In the following paragraphs, first the regulations governing banks' setting up subsidiaries and banks' investments in companies (not being subsidiaries) engaged in financial services are reviewed to provide a perspective and then prudential regulations for governing banks' investments in companies (not being subsidiaries) which are non-financial services companies are set out.

4. Investments in subsidiaries

In terms of Sub-section (1) of Section 19 of the Banking Regulation Act, 1949, a banking company shall not form any subsidiary company except (i) for undertaking any business specified in clause (a) to (o) of the Sub-section(1) of Section 6, i.e. functions which banks can undertake or (ii) for carrying on the business of banking exclusively outside India with the previous permission of the Reserve Bank of India or (iii) for undertaking such other business, which the Reserve Bank may, with the prior approval of the Central Government, consider to be conducive to the spread of banking in India or to be otherwise useful or necessary in the public interest (for example, banks setting up IT subsidiaries catering to banking sectors' IT requirement may fall in this category).

5. Investments other than in subsidiary

Sub-section (2) of the Section 19 of the Banking Regulation Act, 1949 provides that no banking company shall hold shares in any company, whether as pledgee, mortgagee or absolute owner, of any amount exceeding 30 per cent of the paid –up share capital of that company or 30 per cent of its own paid-up share capital and reserves. It may be noted that there are no statutory restrictions, unlike in the case of subsidiaries, on the activities of companies in which banks can hold equity within the ceiling laid down under Section 19(2) of the B.R. Act. In other words, these companies could be both financial services companies as well as companies not engaged in financial services.

6. Prudential regulations for investments in subsidiaries and Financial Services Companies.

Banks are required to obtain prior approval of the Reserve Bank of India for setting up subsidiary companies and for any equity investment in financial services companies.

As per prudential regulation, equity investments by a bank in a subsidiary company, or a financial services company including financial institution, stock and other exchanges, depositories, etc, which is not a subsidiary should not exceed 10 percent of the bank's paid-up share capital and reserves[subject to the limit prescribed under Section 19(2)of the B. R. Act in respect of the holdings in non-subsidiary investee companies] and the total investments made in all subsidiaries and all non-subsidiary financial services companies should not exceed 20 percent of the bank's paid-up share capital and reserves. However, the cap of 20 percent neither applies, nor prior approval of RBI is required, if investments in financial services companies are held under 'Held for Trading' category, and are not held beyond 90 days.

7. Prudential regulation for banks' investments in non-financial services companies which are not subsidiaries

As stated in paragraph 1 above, banks could through their holdings in such companies exercise control or have significant influence over them and thus, engage indirectly in activities not permitted to banks. It is, therefore, necessary to limit such investments so as to ensure that banks do not indirectly undertake activities not permitted to them. With this objective, the following guidelines are laid down.

- i) Equity investments in companies engaged in non-financial services activities would be subject to a limit of 10 per cent of the investee company's paid up capital or 10 percent of the bank's paid up capital and reserves, whichever is lower. For the purpose of this limit, equity investments held under 'Held for Trading' category would also be reckoned. Such investments within the above mentioned limits would not require prior approval of the Reserve Bank.

- ii) Bank's request for investments in excess of 10 percent of such investee company's paid up capital would be considered by RBI if the investee company is engaged in activities permitted to banks in terms of Section 6(1) of B. R. Act. It is reiterated that banks are permitted to set up subsidiaries for undertaking activities which are conducive to the spread of banking in India or useful or necessary in public interest in accordance with the provisions of Section 19(1) (c) of the B.R. Act.

- iii) A bank's equity investments in subsidiaries and other entities that are engaged in financial services together with equity investments in entities engaged in non-financial services activities should not exceed 20 percent of the bank's paid-up share capital and reserves. The cap of 20 percent would not apply for investments classified under 'Held for Trading' category and are not held beyond 90 days.

- iv) Equity holding in excess of 10 percent of investee company's paid up capital would be permissible without RBI's prior approval if the additional acquisition is through restructuring/CDR. The equity investment in excess of 10 percent of investee company's paid up capital in such cases would be exempted from the 20 percent limit referred to above.

- v) While the above measures will limit the investments of banks in non subsidiary companies engaged in non-financial services activities, it is possible that even with limited investment, banks may exercise control or significant influence in companies through other arrangements like having more than half of the voting rights indirectly through subsidiaries/joint ventures/associates or having control over the composition of the board of directors. These companies would under such circumstances be actually subsidiaries or associates or joint ventures of banks. Such arrangements may result in banks' indirectly undertaking activities not permitted to them under the B. R. Act. Banks should, therefore, desist from exercising control or significant influence over such companies.

In determining whether an entity is a subsidiary, associate or joint venture of a bank, the definitions given in the Accounting Standards(Annex 2) may be used, which use two tests: (a) Ownership, and (b) Control. While applying the ownership test, the holdings of the bank, its subsidiary/ies and associates and joint ventures (not the proportionate holding) may be aggregated since ownership by the bank and its subsidiaries, associates and joint ventures denies that level of ownership to others. As regards control, the holdings of the bank and its subsidiaries only may be aggregated since the bank does not control the associates and joint ventures.

8. Banks should strictly observe these guidelines while investing in companies undertaking non-financial services activities. Banks should also carry out a review of their subsidiaries, associates, joint ventures (i.e. entities in which they have control or significant influence) by applying the test of ownership and control parameters as stated above, within a period of three months. Wherever investments do not conform to the above mentioned policy parameters, banks may ensure that (a) their investments are brought down to 10 percent of the paid-up share capital of the investee company and/or give up control or exercising significant influence as the case may be or (b) they seek RBI's approval in terms of para 7(ii) above.

9. The review as referred to at paragraph 8 above together with the proposed course of action to comply with the regulatory requirement, where the existing investments are not as per the above guidelines may be forwarded to the Reserve Bank of India within one month from the date of the review.

Yours faithfully,

(A.K. Khound)
Chief General Manager
Encl: As above

Financial Services Companies

For the purpose of prudential guidelines on investments in subsidiaries and other companies, 'financial services companies' are companies engaged in the 'business of financial services'. The 'business of financial services' means –

(i) the forms of business enumerated in clauses (a), (c), (d), (e) of sub-section (1) of section 6 of the Banking Regulation Act, 1949 and notified under clause (o) of sub-section (1) of section 6 of the Banking Regulation Act, 1949;

(ii) the forms of business enumerated in clause (c) and item (ii) of clause (f) of section 45I of the Reserve Bank of India Act, 1934;

(iii) business of credit information as provided under the Credit Information Companies (Regulation) Act, 2005;

(iv) operation of a payment system as defined under the Payment and Settlement Systems Act, 2007;

(v) operation of a stock exchange, commodity exchange, derivatives exchange or other exchange of similar nature;

(vi) operation of a depository as provided under the Depositories Act, 1996;

(vii) business of a securitization or reconstruction company as provided under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(viii) business of a merchant banker, portfolio manager, stock broker, sub-broker, share transfer agent, trustee of trust deeds, registrar to an issue, merchant banker, underwriter, debenture trustee, investment adviser and such other intermediary as provided in the Securities and Exchange Board of India Act, 1992 and the regulations made thereunder;

(ix) business of a credit rating agency as defined in Securities and Exchange Board of India (Credit rating Agencies) Regulations, 1999;

(x) business of a collective investment scheme as defined under the Securities and Exchange Board of India Act, 1992;

(xi) business of managing a pension fund;

(xii) business of an authorized person as defined under the Foreign Exchange Management Act, 1999;and

(xiii) such other business as may be specified by the Reserve Bank from time to time.

Definition of Subsidiary, Associates, Joint Ventures, 'Control and Significant Influence' in terms of Indian Accounting Standards

Accounting Standards 18, 21, 23 and 27 define the above mentioned terms.

Subsidiary is an enterprise that is controlled by another enterprise (known as the parent).

An Associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a Joint venture of the investor, and

Joint Venture is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.

Significant Influence is the power to participate in the financial and/or operating policy decisions of the investee but not control over their policies.

Control –

- (a) The ownership, directly or indirectly, through subsidiary (ies), of more than one-half of the voting power of an enterprise; or
 - (b) Control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from its activities.
- Control exists when the parent owns, directly or indirectly through subsidiary (ies), more than one-half of the voting power of an enterprise. Control also exists when an enterprise controls the composition of the board of directors (in the case of a company) or of the corresponding governing body (in case of an enterprise not being a company) so as to obtain economic benefits from its activities.

An enterprise is considered to control the composition of:

- (i) The board of directors of a company, if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of directors of that company. An enterprise is deemed to have the power to appoint a director, if any, if the following conditions are satisfied.
- A person cannot be appointed as director without the exercise in his favour by that enterprise of such a power as aforesaid; or
 - A person's appointment as director follows necessarily from his appointment to a position held by him in that enterprise; or
 - The director is nominated by that enterprise or a subsidiary thereof.

For the purpose of AS 23, significant influence does not extend to power to govern the financial and/or operating policies of an enterprise. Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investor holds, directly or indirectly through subsidiary (ies), 20% or more of the voting power of the investee, it is presumed that the investor has significant influence, **unless it can be clearly demonstrated that this is not the case.** Conversely, if the investor holds, directly or indirectly through subsidiary (ies), less than 20% of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated. A substantial or major ownership by another investor does not necessarily preclude an investor from having significant influence. The existence of significant influence by an investor is usually evidenced in one or more of the following ways:

- representation on the board of directors or corresponding governing body of the investee;
- participation in policy making processes;
- material transactions between the investor and the investee;
- interchange of managerial personnel; and
- provision of essential technical information.