

Guarantees and Co-acceptances

IECD.No. 17 /08.12.01/2002-03

April 5, 2003

Chief Executives of all Scheduled Commercial Banks
(excluding LABs and RRBs)

Dear Sir,

Guarantees and Co-acceptances

We invite a reference to circular IECD.No.37/08.12.01/94-95 dated February 23, 1995 whereby banks are precluded from issuing guarantees favouring financial institutions, other banks and other lending agencies. In tune with liberalisation and deregulation of the banking sector and in view of the adoption of risk management systems in banks, the above instructions were reviewed and it has been decided that banks may henceforth, be allowed to issue guarantees favouring other banks/FIs/ other lending agencies for the loans extended by the latter.

Guaranteeing banks

2. Banks may henceforth, be allowed to issue guarantees favouring other banks/FIs/other lending agencies for the loans extended by the latter, subject to strict compliance with the following conditions.

- i) The Board of Directors should reckon the integrity/ robustness of the bank's risk management systems and accordingly put in place a well-laid out policy in this regard.

The Board approved policy should, among others, address the following issues:

- (a) Prudential limits, linked to bank's Tier I capital, up to which guarantees favouring other banks/FIs/other lending agencies may be issued.
 - (b) Nature and extent of security and margins
 - (c) Delegation of powers
 - (d) Reporting system
 - (e) Periodical reviews
- ii) The guarantee shall be extended only in respect of borrower constituents and to enable them to avail of additional credit facility from other banks/FIs/lending agencies.
 - iii) The guaranteeing bank shall assume a funded exposure of at least 10% of the exposure guaranteed.
 - iv) Banks should not extend guarantees or letters of comfort in favour of overseas lenders including those assignable to overseas lenders, except for the relaxations permitted under FEMA.

- v) The guarantee issued by the bank will be an exposure on the borrowing entity on whose behalf the guarantee has been issued and will attract appropriate risk weight as per the extant guidelines.
- vi) Banks should ensure compliance with the recommendations of the Ghosh Committee and other internal requirements relating to issue of guarantees to obviate the possibility of frauds in this area.

Lending banks

3. Banks extending credit facilities against the guarantees issued by other banks/FIs should ensure strict compliance with the following conditions:

- i) The exposure assumed by the bank against the guarantee of another bank/FI will be deemed as an exposure on the guaranteeing bank/FI and will attract appropriate risk weight as per the extant guidelines.
- ii) Exposures assumed by way of credit facilities extended against the guarantees issued by other banks should be reckoned within the inter bank exposure limits prescribed by the Board of Directors. Since the exposure assumed by the bank against the guarantee of another bank/FI will be for a fairly longer term than those assumed on account of inter bank dealings in the money market, foreign exchange market and securities market, Board of Directors should fix an appropriate sub-limit for the longer term exposures since these exposures attract greater risk.
- iii) Banks should monitor the exposure assumed on the guaranteeing bank/FI, on a continuous basis and ensure strict compliance with the prudential limits/sub limits prescribed by the Board for banks and the prudential single borrower limits prescribed by RBI for FIs.
- iv) Banks should comply with the recommendations of the Ghosh Committee and other internal requirements relating to acceptance of guarantees of other banks to obviate the possibility of frauds in this area.

4. The related instructions contained in various circulars issued by IECD till date as also in the para 4.2.3 of the Master circular DBOD.No.BC.07/13.03.00/2002-03 dated 26th July 2002 stand superceded by this circular.

5. Please acknowledge receipt.

Yours faithfully,

(Smt. R.K. Makhija)
Chief General Manager