
MODERNIZING BANKING REGULATIONS: A COMPREHENSIVE OVERVIEW OF THE RBI DRAFT (COMMERCIAL BANKS- CAPITAL MARKET EXPOSURE) DIRECTIONS, 2025

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ABSTRACT

The Reserve Bank of India (RBI) released the Draft Directions on Capital Market Exposure (CME) for on October 24, 2025, to consolidate a set of circulars into a framework. These guidelines, set to be implemented from April 1, 2026, apply to all commercial banks operating in India, including foreign bank branches. The intent is to enhance clarity in definitions, improve supervision, and adjust prudential limits, all while selectively relaxing specific rules to allow more flexibility in banks' market-related activities. This analysis examines how the draft significantly broadens the definition of CME to encompass both direct and indirect forms of exposure. The intent is to enhance clarity in definitions, improve supervision, and adjust prudential limits, all while selectively relaxing specific rules to allow more flexibility in banks' market-related activities. The central update is the structure of exposure limits. While the familiar caps of 40% for aggregate CME and 20% for direct CME are maintained, they will now be calculated based on Tier 1 capital instead of net worth. Also, 10% Tier 1 sub-limit is explicitly introduced for acquisition finance, along with mandatory intra-day sub-limits. The Directions draft is a clear indication of a complete shift away from the restrictive and fragmented regulatory environment toward a more flexible and strong safeguards-included environment. This change is innovation and growth in the capital markets without endangering financial stability.

Key Words:- *Capital Market Exposure (CME), Reserve Bank of India (RBI), Prudential Regulation, Tier 1 Capital Framework, Financial Stability*

I. INTRODUCTION

The Reserve Bank of India (RBI) has introduced the draft “Commercial Banks - Capital Market Exposure (CME) Directions, 2025” on October 24, 2025, for public comment. This aims to consolidate and supersede numerous existing circulars into a single, simplified framework. While retaining the prudential spirit of previous regulations, this new proposal introduces significant updates by both liberalizing the scope, explicitly permitting activities like acquisition financing and tightening risk controls through refined sub-limits, stricter collateral rules, and enhanced monitoring requirements. These Directions, proposed to be effective from April 1, 2026,¹ will apply to all commercial banks in India, including foreign bank branches, but will not cover small finance banks, regional rural banks, local area banks, or payments banks.²

II. SCOPE OF EXPOSURES AND DEFINITIONS

The 2025 Directions define “Capital Market Exposure (CME)” broadly to include both direct and indirect exposures, aligning closely with previous definitions, but incorporating updated terminology. Direct CME covers a bank’s own investments in equity and equity-like instruments (shares, equity MF units, convertible bonds, venture capital/AIF units, etc.), as well as acquisition finance exposures (a newly defined category of credit). Indirect CME includes any fund-based or non-fund credit extended to capital market participants or against capital market securities, such as loans against shares, guarantees to stock exchanges, financing to stockbrokers and margin lending facilities, etc. Essentially, if the value or purpose of an exposure is linked to securities markets, it falls under CME.

By consolidating definitions, the RBI aims to achieve clarity on what counts toward the limits, ensuring that banks capture all relevant exposures in their monitoring. New definitions have been introduced for terms like “acquisition finance”, “bridge finance”, “capital market intermediaries (CMIs)”, and “loan to value (LTV)” to remove ambiguity.³ For instance, “Acquisition finance” is

¹Reserve Bank of India, Draft Directions (Commercial Banks-Capital Market Exposure) - October 24, 2025, Ch. I, E - 7.

²Reserve Bank of India, Draft Directions (Commercial Banks-Capital Market Exposure) - October 24, 2025, Ch. I, D - 5.

³Reserve Bank of India, Draft Directions (Commercial Banks-Capital Market Exposure) - October 24, 2025, Ch. I, F.

explicitly defined as funding provided to a company (or its SPV) to acquire shares or control of another company. This definition now forms the basis of allowable takeover loans.

III. EXPOSURE CEILINGS

The cornerstone of the new framework is a set of exposure caps, analogous to the old 40%/20% limits, but now tied to Tier1 capital instead of net worth. The draft Directions stipulate the following key ceilings:

The Aggregate Capital Market Exposure of a bank (solo basis) shall not exceed 40% of its Tier1 Capital (as of the previous fiscal year-end). The same 40% applies on a consolidated basis for banking groups.⁴This is essentially the same percentage as before that is the pre-2025 regime, which was set at a maximum of 40% of the bank's Net Worth.⁵However, using Tier1 (core capital) aligns with Basel norms and possibly is slightly more conservative if Tier1 < net worth for some banks. The RBI explicitly notes that Tier1 includes equity capital, reserves, and other similar assets, being the highest quality capital that absorbs losses first. Tying limits to Tier1 thus keeps market activities proportionate to the actual financial capacity.

The Direct Capital Market Exposures (investments and acquisition loans) are capped at 20% of Tier1 (solo and consolidated).⁶This aligns with the prior 20% limit on net worth for direct exposures. However, importantly, "direct exposure" explicitly includes acquisition finance exposures. Within this 20%, RBI has further sub-capped acquisition finance at 10% of Tier1.⁷

The Intra-day Exposures must be fixed by banks at separate sub-limits for intra-day capital market exposures, both to individual counterparties and in aggregate.⁸This acknowledges that banks might have large intra-day positions (e.g. underwriting or trading inventory during the trading day) that are squared off by end of day. RBI wants banks to monitor those too, albeit

⁴Reserve Bank of India, Draft Directions (Commercial Banks-Capital Market Exposure) - October 24, 2025, Ch. II, G-11).

⁵Reserve Bank of India, Master Circular - Exposure Norms, July 1, 2014, A, 2.3.3.2& 2.3.4.

⁶Reserve Bank of India, Draft Directions (Commercial Banks-Capital Market Exposure) - October 24, 2025, Ch. II, G-11 (c).

⁷Reserve Bank of India, Draft Directions (Commercial Banks-Capital Market Exposure) - 2025, Ch. VI, N – 40.

⁸Reserve Bank of India, Draft Directions (Commercial Banks-Capital Market Exposure) - October 24, 2025, Ch. II, G-11 (d).

separately, to ensure temporary exposures do not balloon unchecked. The new framework formalizes intra-day risk control.

IV. KEY CHANGES IN LENDING RULES AND PERMISSIBLE ACTIVITIES

The 2025 Directions introduce several liberalizations regarding what banks can do, particularly in the financing of securities transactions. Below are the significant areas of change:

1. Acquisition Finance

Acquisition finance is defined as funding provided to an acquiring company or its special purpose vehicle (SPV) to purchase all or a controlling portion of another company's shares or assets and gain control.

i. Historical legal landscape of acquisition finance in India

The Banking Regulation Act, 1949 restricts banks from holding significant equity stakes in other companies. Section 19(2)⁹ prohibits a banking company from holding shares in any company, whether as pledgee, mortgagee or absolute owner, of more than 30 per cent of the target company's paid-up share capital or 30 per cent of the bank's own paid-up capital and reserves, whichever is lower. Shares held as collateral must also be counted towards this limit. The policy ensures banks do not assume excessive ownership risks and is a longstanding constraint on acquisition finance because banks cannot accumulate large shareholdings as security for loans.

ii. RBI master circular on loans and advances

RBI's 2015 master circular on Loans and Advances – Statutory and Other Restrictions strictly limited lending for share acquisition. Paragraph 2.3.1.9 prohibited banks from providing finance to any entity domestic or foreign for acquiring shares of Indian companies, and disallowed the use of target-company assets as collateral. The circular allowed banks to accept shares only as collateral for productive purposes (e.g., working capital), not as primary security for acquiring

⁹ Banking Regulation Act, 1949, (Act 10 of 1949), s.19.

sharesing.indiafilings.com. Promoters' contributions to equity had to come from their own resources, though banks could grant loans against shares of promoters in new companies subject to prudential limit. Exceptions existed for financing overseas joint ventures and subsidiaries as strategic investmentsing.indiafilings.com and for acquiring promoters' stakes in infrastructure companies (up to 50 per cent of required finance) if secured by project assets rather than shares.

These restrictions reflected concerns following the non-performing asset (NPA) crisis of 2015-2018. Indian banks preferred to avoid highly leveraged buyouts (LBOs); leveraged finance remained the domain of offshore lenders and non-bank financial companies (NBFCs). The RBI considered acquisition finance a capital-market exposure and capped such exposure at 40 per cent of banks' net worthing.indiafilings.com.

iii. Companies Act restrictions on financial assistance

Section 67 of the Companies Act, 2013¹⁰ prohibits a company limited by shares from buying its own shares except through a statutorily permitted reduction of capital. It also forbids public companies from providing financial assistance including loans, guarantees or security for the purchase or subscription of their own shares or shares of their holding companyregisterkaro.in. Violations attract fines and prison terms for defaulting officersregisterkaro.in. Limited exceptions include loans by banking companies in the ordinary course of business and employee share. The prohibition on financial assistance prevents target companies from funding their own acquisition, thereby curtailing typical LBO structures where acquisition debt is secured by the target's assets.

Proposed Acquisition Finance

The most headline-grabbing change is that banks are now allowed to finance corporate acquisitions under a well-defined framework. This marks a policy reversal from the earlier de facto prohibition. Under the new draft (Chapter VII, Section N), banks may extend acquisition finance to Indian companies acquiring equity stake or control in other companies (domestic or foreign).

¹⁰ The Companies Act, 2013, (Act No. 18 of 2013), s.67.

However, this comes with stringent conditions to ensure only sound, non-speculative deals are funded. The mandatory conditions for such loans include: Banks can extend acquisition finance only to Indian listed companies with satisfactory net worth and at least three years of profitability, and the target must also have at least three years of financial statements available. The acquirer and target cannot be related parties under the Companies Act, preventing group entities from using bank-funded “acquisitions” merely to shuffle assets internally. The acquisition price must be supported by two independent valuations in line with SEBI norms, so banks are not lending against artificially inflated deal values. Bank funding is capped at 70% of the acquisition cost, with at least 30% coming as the acquirer’s own equity, ensuring sufficient skin in the game.

Post-transaction, the combined entity’s debt-equity ratio must stay within prudential limits and generally should not exceed 3:1, so the capital structure does not become unsustainably leveraged. The acquisition loan must be primarily secured by a pledge of the target company’s shares, with other assets of the acquirer or target taken as additional collateral where necessary. Banks are also required to maintain strong monitoring mechanisms, including early warning systems and periodic stress tests of their acquisition finance exposures.

Given the event-risky nature of acquisitions, continuous oversight is mandated. These conditions together are designed to prevent excessive leverage and ensure only financially sound, synergistic acquisitions get bank funding. From a regulatory perspective, India’s previous outright bar on acquisition finance is replaced by a permissive but a guarded regime.

It’s worth noting that the RBI still excludes certain players from acquisition finance: the borrower cannot be an NBFC or financial fund/AIF. So, banks can’t indirectly finance a private equity fund’s buyout via an NBFC conduit. The spirit is to facilitate strategic corporate M&A, not pure leveraged buyouts by investment funds using bank money.

Moreover, the 10% Tier-1 sub-limit on acquisition exposure means even large banks will likely syndicate big deals among multiple lenders to stay within their caps. This new avenue addresses

a long-standing gap previously on foreign banks or credit funds financed Indian takeovers and may deepen the domestic credit market by introducing acquisition lending as a bank product¹¹

2. Lending Against Shares and Capital Market Instruments (to Individuals)

The draft Directions significantly ease the credit limits for individuals while also formalizing LTV requirements. Under Chapter IV, banks can lend to individuals against a broad set of “eligible securities” which include listed equity shares, bonds, units of mutual funds or ETFs, government securities, Sovereign Gold Bonds, commercial paper, etc. (essentially most liquid, dematerialized instruments).

The aggregate loan to any individual for such purposes is now capped at ₹1 crore,¹² a five-fold increase over the previous ₹10 lakh per individual (if collateral in physical form) or ₹20 lakh if securities in demat form.¹³ Within this ₹1 crore ceiling, there is a sub-limit: only up to ₹25 lakh can be borrowed for the purpose of purchasing securities in the secondary market.¹⁴

In effect, an individual can take a large loan against their securities (for say, personal or business needs), but the amount of that loan which can be used to buy more stocks or bonds is restricted to ₹25 lakh. This rule aims to prevent an overly leveraged spiral of using borrowed money to invest in more securities and it caps the fresh investment element at ₹25 lakh.

Initial Public Offer (IPO) financing for individuals has likewise been liberalized: banks may now lend up to ₹25 lakh per individual application in an IPO, FPO, or for employee stock option purchases (ESOP). The loan amount cannot exceed 75% of the IPO application amount (i.e. a minimum 25% margin is required).¹⁵ Previously the limit was a hard ₹10 lakh¹⁶ and effectively with 50% margin rule¹⁷ that meant only ₹5 lakh funding on a ₹10 lakh application.

¹¹Guest Contributor, NDTV PROFIT, <https://www.ndtvprofit.com/opinion/economy-reserve-bank-of-india-Reserve-Bank-of-India-acquisition-financing-reform-structural-shift-banking>.

¹²Reserve Bank of India, Draft Directions (Commercial Banks-Capital Market Exposure) - October 24, 2025, Ch. IV, J – 25.

¹³Reserve Bank of India, Master Circular - Exposure Norms, July 1, 2014, 2.4.1.

¹⁴Reserve Bank of India, Draft Directions (Commercial Banks-Capital Market Exposure) - October 24, 2025, Ch. IV, J – 26.

¹⁵Reserve Bank of India, Draft Directions (Commercial Banks-Capital Market Exposure) - October 24, 2025, Ch. IV, K – 27&28

The Loan to Value (LTV) ratio requirements for loans against various securities are explicitly laid out in the new rules (as seen earlier in Table 1). For example: up to 60% LTV on listed equity shares, 75% on equity mutual fund units/ETFs, and as high as 85% on rated corporate bonds or debt mutual funds (e.g. 85% for AAA-rated bonds).¹⁸ Lower LTV (more margin) is required for riskier collateral: e.g. 60% on shares vs 85% on AAA debt.

This risk-graded approach replaces the blanket 50% margin old rule, allowing banks to lend more against low-volatility assets while still being conservative on shares (40% haircut on shares). Banks are required to have robust systems to monitor collateral values daily and trigger margin calls; any LTV breach must be corrected within 7 working days.¹⁹ They must also ensure they only lend against permitted securities, e.g., not against bank-issued securities or IDRs, not against locked-in shares or any security if loan is used to circumvent other rules.

3. Financing Capital Market Intermediaries (CMIs)

The new Directions devote a chapter to loans to stockbrokers, market makers, and other intermediaries. While previously RBI guided banks to set broker exposure sub-limits within the 40% limit²⁰ and explicitly banned arbitrage lending,²¹ the new rules formalize what banks can do for these clients. Banks may extend need-based credit to regulated CMIs for business operations, e.g., overdrafts for settlement timing, funding clients' margin requirements (through brokers' margin trading facilities), or providing inventory finance for market-making.²²

However, there are strict caveats: (a) The borrower must be a registered intermediary in compliance with its own regulator's norms. (b) The collateral for such loans must belong to the borrower (no lending against a third-party's securities in these cases). (c) Banks cannot finance a broker's proprietary trading or investments – loans cannot be used by a broker to take positions

¹⁶Reserve Bank of India, Master Circular - Exposure Norms, July 1, 2014, 2.4.2.

¹⁷Reserve Bank of India, Master Circular - Exposure Norms, July 1, 2014, 2.4.11.

¹⁸Reserve Bank of India, Draft Directions (Commercial Banks-Capital Market Exposure) - October 24, 2025, Ch. IV, I – 22.

¹⁹Reserve Bank of India, Draft Directions (Commercial Banks-Capital Market Exposure) - October 24, 2025, Ch. IV, I – 23.

²⁰Reserve Bank of India, Master Circular - Exposure Norms, July 1, 2014, 2.4.4.1.

²¹Reserve Bank of India, Master Circular - Exposure Norms, July 1, 2014, 2.4.4.2.

²²Reserve Bank of India, (Commercial Banks-Capital Market Exposure) Directions Draft- October 24, 2025, Ch. V, 29.

for itself. (d) If a broker is a market-maker in certain securities, the bank cannot accept those same securities as collateral (to avoid correlation risk).²³

All loans to CMIs must be fully secured, and the collateral is subject to specific haircuts enumerated in the rules. For instance, if a brokerpledge shares as collateral, the bank must apply a 40% haircut (i.e. lend at most 60% of their market value).²⁴ For government securities, haircuts can be per bank's policy (since they are safer).

For cash collateral, no haircut (100% value). These haircuts are essentially the inverse of LTV ceilings for institutional borrowers and are aligned with prudent norms. Additionally, for banks issuing guarantees on behalf of brokers (e.g. a bank guarantee to an exchange in lieu of the broker providing a security deposit or margin), the broker must provide at least 50% collateral to the bank (with 25% in cash).²⁵

Further, if a bank funds a broker's margin trading facility (the product brokers offer to their clients to leverage stock purchases), the bank must have a legally enforceable arrangement to directly access the clients' securities that the broker holds, in case the broker's client defaults.²⁶ This essentially ties the end-borrower's collateral into the bank's rights, preventing a scenario where the broker fails and the bank cannot reach the underlying shares. It adds a layer of legal protection for banks extending wholesale credit to brokerage margin programs.

V. VALUATION AND RISK MANAGEMENT ENHANCEMENTS

The draft rules put a strong emphasis on valuation mechanisms and monitoring areas that have evolved since the older guidelines. For example, in determining loan amounts, banks must value listed shares and mutual fund units at the lower of the average closing price over the last 6

²³Reserve Bank of India, (Commercial Banks-Capital Market Exposure) Directions Draft- October 24, 2025, Ch. V, 30.

²⁴Reserve Bank of India, (Commercial Banks-Capital Market Exposure) Directions Draft- October 24, 2025, Ch. V, 31.

²⁵Reserve Bank of India, (Commercial Banks-Capital Market Exposure) Directions Draft- October 24, 2025, Ch. V, 33.

²⁶Reserve Bank of India, (Commercial Banks-Capital Market Exposure) Directions Draft- October 24, 2025, Ch. V, 32.

months or the latest market price.²⁷ This is a conservative measure to guard against lending on suddenly inflated stocks using, a six months average that smooths out short-term spikes.

VI. FINANCING OF GOVERNMENT DISINVESTMENTS

The new framework continues to allow banks to finance Public Sector Unit (PSU) share acquisitions during government disinvestment programs, a practice encouraged to support privatization. The draft states that banks may lend to successful bidders who buy government stakes in PSUs (including any mandatory open offer that follows). The conditions are that the borrowing entities (and their promoters) should have adequate net worth and an excellent track record in loan repayments, and that there be no constraints on the bank's ability to liquidate the pledged shares even during any lock-in period.²⁸

VII. CONCLUSION

Finally, the draft Directions include disclosure and repeal provisions: Banks will be required to disclose their total outstanding in all capital market financing (aggregate CME loans) in the notes to accounts of their financial statements, thereby increasing transparency. Moreover, upon the direction's effect, a list of around 50 previous circulars from 1986 onwards will repeal along with dozens of old notices on advances against shares, badla financing, IPO financing, etc., in favor of this single cohesive framework.

In summary, the draft 2025 Capital Market Exposure Directions maintain the overarching exposure limits (40%/20%), but modernize the rules in several ways: they explicitly permit acquisition financing under safeguards, expand banks' ability to lend against shares and to IPO investors (with higher limits and refined LTV rules), formalize lending to brokers and other intermediaries with appropriate collateral norms, and generally align definitions with current market practices. The new framework is intended to be risk-sensitive and unified, replacing fragmentary rules with a coherent approach.

²⁷Reserve Bank of India, (Commercial Banks-Capital Market Exposure) Directions Draft- October 24, 2025, Ch. III, 19 (b).

²⁸Reserve Bank of India, (Commercial Banks-Capital Market Exposure) Directions Draft- October 24, 2025, Ch. VI, O – 43.