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Overview of the Reserve Bank of India's draft directions governing acquisition finance by commercial banks

The Reserve Bank of India ("RBI"), on October 24, 2025, has published the draft RBI (Commercial Banks – Capital Market Exposure) Directions, 2025 ("CME Directions"), inviting comments and feedback. The CME Directions are applicable to all Commercial Banks (excluding Small Finance Banks, Regional Rural Banks, Local Area Banks, and Payment Banks) (the "Banks"). The CME Directions are proposed to come into force on (a) April 1, 2026; or (b) such other earlier date when the CME Directions are adopted by a Bank in entirety.

The CME Directions intend to consolidate the regulatory framework for governing capital market exposures ("CME") by Banks. CME is classified as being either direct ("Investment Exposure") or indirect ("Credit Exposure"):

1. **Investment Exposures:** Investment Exposures include direct investment by Banks in equity and preferences shares, convertible bonds and debentures, units of equity mutual fund schemes, and units of Alternative Investment Funds ("AIFs"); or
2. **Credit Exposures:** Credit Exposures include, *inter alia*:
 - a) acquisition finance;
 - b) advances by Banks to individuals or corporates, which are secured by collateral of shares, convertible bonds and debentures, units of all mutual fund schemes except debt schemes;
 - c) loans sanctioned to corporates against the security of shares/bonds/debentures or other securities, or on clean basis, for meeting promoter's contribution to the equity of new companies in anticipation of raising resources or for acquisition of other companies in part or full; and
 - d) bridge loans to companies against expected equity flows/issues of equity or preference shares or convertible bonds and debentures.

Salient features of the CME Directions

Below is a summary of the key features of the CME Directions, with a particular focus on the provisions applicable to Bank financing of acquisitions, of both Indian and overseas companies, and the prudential framework prescribed by RBI in this context.

1. Acquisition finance:

'Acquisition finance' is defined to mean providing finance either:

- a) directly to an Indian company (the "acquiring company"); or

- b) to a Special Purpose Vehicle (“**SPV**”) set up as a company by such acquiring company (the acquiring company and the SPV are collectively referred to as the “**Acquirer**”);

for purchase of all or a controlling portion of another domestic or foreign company’s (the “**target company**”) shares or assets to gain control over the target company and its operations.

For the purposes of this definition, ‘control’ includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

2. **Eligible borrowers:**

- a) The Acquirer is required to be an Indian body corporate (other than financial intermediaries such as Non – Banking Financial Companies (“**NBFCs**”), AIFs); and
- b) The acquiring company is required to be a listed entity with a satisfactory net worth and which has made profits for the preceding 3 (three) years.

3. **Eligible target companies:** The target company should:

- a) have audited annual returns for at least the last 3 (three) financial years; and
- b) not be a ‘related party’ (as defined in Section 2(76) of Companies Act, 2013) of the acquiring company.

4. **Nature of acquisition:** Post acquisition, the acquiring company should gain ‘control’ of the target. The acquisition should be driven by the core objective of long-term value creation and not mere financial restructuring for short term gains.

5. **Security:**

- a) The financing is required to be secured by shares of the target company as primary security. However, the limits under Section 19(2) and 19(3) of Banking Regulation Act, 1949 would apply to such pledge.
- b) Other assets of the Acquirer and/or the target company may be taken as additional security, as per the Bank’s internal policy.

The residual maturity of the securities (in case of securities with fixed maturity) taken as collateral should be equal to or longer than the tenor of the loan.

6. **Eligible Securities:**

- a) Listed Group 1 equity shares and preference shares.
- b) Government securities including treasury bills and Sovereign Gold Bonds (“**SGBs**”).
- c) Commercial paper and non-convertible debentures of original or initial maturity of upto 1 (one) year.
- d) Listed debt securities, including convertible debt securities, rated BBB or higher.
- e) Units of mutual fund schemes which are listed or where repurchase/redemption facility is available for such units through the asset management company.
- f) Units of Exchange Traded Funds (“**ETFs**”) (excluding commodity ETFs)
- g) Units of Real Estate Investment Trust (“**REITs**”) and Infrastructure Investment Trusts (“**InvITs**”), (collectively, the “**Eligible Securities**”).

7. **Prohibited lending:**

The CME Directions explicitly prohibit Banks from extending loans:

- a) against their own securities;

- b) against partly paid shares;
- c) against bonds or money market instruments issued by other banks, NBFCs, or All India Financial Institutions (AIFIs);
- d) against securities under lock-in;
- e) against Indian Depository Receipts (IDRs);
- f) against securities issued by entities to which they are not permitted to grant loans under RBI regulations; or
- g) to companies for buy-back of their own shares/securities.

8. Loans for general business purposes:

In addition to acquisition finance, Banks may also extend loans for general business purposes:

- a) to commercial entities (not in the nature of financial entities) against Eligible Securities for working capital or other productive purposes. Such financing is also subject to the Bank's internal policies; and
- b) as bridge finance to corporates, against Eligible Securities already held by them for financing promoters' stake in new companies. In such cases, the acquiring company must have a firm plan and capability to raise financial resources to repay the loan within 1 (one) year from the date of first disbursement of the bridge finance.

Lending by Banks for general business purposes will be subject to the following Loan to Value ("**LTV**") ceilings:

Eligible Security	LTV ceiling
Government securities including T-Bills	As per the Bank's policy
SGBs	As applicable in case of loans against gold and silver collateral in accordance with RBI guidelines
Listed shares and listed convertible debt securities	60%
Mutual Funds (excluding debt mutual funds), units of ETF (excluding commodity ETFs) and units of REITs/InvITs	75%
Debt mutual funds	85%
Listed debt securities	Rated AAA: 85% Rated AAA- / BBB: 75%
Commercial papers	Rated A1: 85% Rated A2-A3: 75%

Banks should monitor the end use of funds in such cases and ensure that the funds are not used for speculative purposes.

9. Prudential requirements in relation to acquisition finance:

- a) Limit on aggregate exposure towards acquisition finance: The limits should not exceed 10% of the Bank's Tier 1 capital as on March 31 of the previous financial year. This ceiling is to be complied with on an ongoing basis.
- b) Board-approved policy on acquisition finance: The Banks are required to put in place a policy on acquisition finance. This policy should include, at the minimum, the overall limit, terms and conditions in relation to eligibility of borrowers, security, margin, and applicable risk management and monitoring norms.
- c) Valuation: Acquisition value of the target company to be determined by 2 (two) independent valuations in accordance with the relevant regulations prescribed by the Securities and Exchange Board of India.
- d) Funding threshold: Banks are only permitted to fund up to 70% of the acquisition value of the target company. The balance 30% is required to be funded by the acquiring company in the form of equity and using its own funds.

- e) **Debt-to-equity ratio (“DE Ratio”)**: Post-acquisition, the DE Ratio should be within the prudential limits specified in the Bank’s internal policies but should not exceed 3:1. The credit assessment should be based on the combined balance sheet of the acquiring company and the target company.
- f) **Other considerations**: (i) End use of funds should be monitored; (ii) suitable risk limits should be specified by the Banks by taking into account *inter alia* the liquidity, volatility, and potential stress period corrections in the price of securities; and (iii) systems to be implemented for continuous monitoring of the financing provided, with early warning systems and regular stress testing.

10. CME ceilings:

Aggregate CME, on a solo basis	Should not exceed 40% of the Bank’s Tier 1 capital as on March 31 of the previous financial year
Aggregate CME, on a consolidated basis	Should not exceed 40% of the consolidated Tier 1 capital as on March 31 of the previous financial year
Aggregate of the Bank’s Investment Exposure and acquisition finance exposure	Should not exceed 20% of the solo and consolidated Tier 1 capital of the Bank, as applicable

The aforesaid limits are required to be maintained by the Banks on an ongoing basis. Banks are permitted to have lower prudential ceilings under their respective board-approved policies. Prudential ceilings applicable to specific Credit Exposures have been set out under the CME Directions and should be complied with when undertaking such Credit Exposure.

Any breach of the prudential ceilings due to acquisition of equity shares by Banks pursuant to the process of restructuring of their loans and advances would not result in a breach of the CME Directions, subject to other statutory restrictions, necessary reporting to the RBI and disclosure in the financial statements of the Banks.

Conclusion

The proposed regulations are a timely and strategic move to strengthen mergers and acquisitions and capital market activity in India. While Indian banks have long been permitted to finance overseas acquisitions, domestic acquisition financing (except in the infrastructure sector) has historically been restricted. These changes mark a significant shift in enabling broader participation by banks in financing domestic acquisitions. A few observations are set out below:

1. under the CME Directions, security structures for acquisition financings need to be further analysed. While security over shares of the target company is to be provided as primary security, pledge over shares of the target company can be created by the Acquirer only as a condition subsequent to the disbursement of the loan. Further, in case the target company is a public company, its ability to offer additional security or guarantees for the loan may be impacted on account of the financial assistance restrictions set out in the Companies Act, 2013;
2. it appears that financing is permitted to be extended only to a listed company or an SPV set up by such listed company. This could exclude subsidiaries of a listed company with existing operations. This could also raise potential issues whereby the SPV may have to be classified as a core investment company (CIC), triggering additional regulatory compliances and structuring complications for the SPV; and
3. the CME Directions prescribe that the acquisition should be made for the purpose of gaining control of the target company. However, the scope of ‘controlling portion’ requires further clarification. Although ‘control’ is defined to include the right to appoint a majority of directors or to influence management or policy decisions through management rights or shareholder agreements, it remains unclear whether this necessarily implies acquisition of majority shareholding or if control acquired through contractual arrangements would also qualify.

This is a welcome regulatory move by RBI. It is essential that all stakeholders actively engage during this consultation period to share their concerns and suggestions, enabling the RBI to shape guidelines that are both effective and facilitative.

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