

Turning point: Acquisition Financing permitted by RBI for Indian banks for the first time – game changing or over cautious?

6 November 2025

Background

Historically and till date, the current regulatory regime of RBI has barred Indian banks from funding domestic acquisitions. The Reserve Bank of India (RBI) has however comprehensively, reviewed the current regulatory regime on bank finance for acquisition of shares in India and with an aim to rationalize the extant guidelines and broadening the scope for capital market exposures and lending by banks, the RBI has released and invited public comments on the draft Reserve Bank of India (Commercial Banks - Capital Market Exposure) Directions, 2025 on 24 October 2025 (Draft Directions). The Draft Directions consolidate and repeal / replace over 50 circulars dating back to 1986, as well as RBI's current regime on capital market exposures in general.

The Draft Directions represent a comprehensive overhaul of, *inter alia*, the existing framework on financing by banks against shares and now specifically acquisition financing in the following respects:

- (a) prescribing prudential limits on the capital market exposure of the banks towards acquisition finance;
- (b) introducing conditions to be met by banks for providing acquisition financing;
- (c) permitting banks to extend acquisition financing of up to 70% of the acquisition value of the target company; and
- (d) unveiling policy requirements to be met by banks for providing acquisition financing, bridge financing and other kinds of financing against shares as collateral.

Erstwhile Regime

As per the current regulatory position, acquisition financing by banks in India is largely restricted pursuant to the provisions of the Banking Regulation Act, 1949 (Banking Regulation Act), and the directives issued by the RBI through its Master Circular on Loans and Advances – Statutory and Other Restrictions dated 1 July 2015 (RBI Master Circular on Loans and Advances). These stipulate that banks are prohibited from granting loans or advances for the purpose of acquiring shares of other companies, including financing corporate takeovers or management buyouts except to the extent of infrastructure sector. The rationale behind this restriction is to ensure that banking funds, which are primarily public deposits, are not exposed to the inherent risks associated with equity and speculative investments.

About the Draft Directions and its Applicability and Effective Date

The RBI now, pursuant to the Draft Directions, is proposing to liberalize the share backed financing domain to align with evolving market practices and the depth of the Indian economy.

Applicability: The Draft Directions are applicable to all commercial banks excluding small finance banks, regional rural banks, local area banks and payment banks.

Effective Date: The directions will come into effect from 1 April 2026 or on such earlier date when adopted by a bank in entirety (**Effective Date**).

The directions will only apply to fresh loans/guarantees made available after the Effective Date and not apply with respect to any outstanding loan/ guarantee up to the Effective Date and such outstanding loans/guarantees are permitted to continue until their respective maturity.

RBI's renewed proposition on acquisition financing by banks

The salient features of these Draft Directions with respect to acquisition financing by banks are as follows:

1. Acquisition finance may now be extended by banks to Indian corporates for acquiring equity stakes in domestic or foreign companies for strategic investments rather than mere financial restructuring for short term gains, particularly those investments which are driven by the core objective of creation of long-term value for the acquirer through potential synergies;
2. Such acquisition finance can be extended directly to the acquiring company, or even to a step-down special purpose vehicle (SPV) set up by the acquiring company specifically for acquiring all or a controlling portion of the target company's shares, or assets to gain control over it and its operations.
3. Banks proposing to undertake such acquisition financing transactions are required to put in place a comprehensive lending policy for acquisition financings setting out the banks policy on exposure limits, eligibility criteria for borrowers, security, margin, risk management, monitoring, etc.

While the RBI has given the liberty to the banks to adopt their own policies with respect to acquisition finance based on their business prospects and risk appetite, the RBI has set out the mandatory policy provisions which are required to be covered in the bank's acquisition finance policy such as:

Consideration point	Conditions
Eligibility criteria for borrower (acquiring company)	• Acquiring company and/or the SPV set up by it is required to be a body corporate (i.e. excluding LLPs, trusts, funds, foreign owned and controlled companies from its purview); • Acquiring company does not include financial intermediaries such as NBFC, Alternate Investment Fund (AIF) etc.; • Acquiring company is required to be a listed entity; and • Acquiring company is required to have a satisfactory net worth and be profit making for last 3 years
Eligibility criteria for target company	• Target company cannot be a related party of the acquiring company; and • The annual returns of the target company should be available for at least the previous three financial years
Acquisition finance permitted only for control deals	• Financing to an acquirer for acquisition of all or a controlling portion of the target company's shares, or assets to gain control over the target company and its operations. • Refinancing of acquisition finance is not specifically mentioned
Debt to Equity Ratio in Target Company	• Credit assessment to be based on the combined balance sheet of the acquirer company and the target company. Post-acquisition debt to equity ratio at the level of acquiring company or the SPV or the target company shall not exceed 3:1
Collateral	• Such acquisition finance is to be fully secured by shares of the target company as primary security • Assets of the acquirer and/or target company, or other securities held by the acquiring company, may be taken as collateral security as per the bank's policy

Consideration point	Conditions
Prudential Exposure limits	The banks are mandated to fix limits for their aggregate exposures towards acquisition finance provided that: - the aggregate capital market exposure of the bank, on a consolidated and solo basis, is mandated to not exceed 40% of its consolidated and individual Tier 1 capital respectively as on March 31 of the previous financial year; - the direct capital market exposure of the bank (i.e., investment exposures) and acquisition finance exposures, shall not exceed 20 % of solo and consolidated Tier 1 Capital; and - the aggregate exposure of the bank towards acquisition financing is capped at 10% of its Tier 1 capital
Funding criteria	- Two independent valuations as prescribed in the SEBI regulations are to be referred to for determining the acquisition value of the target company. - The bank may finance at a maximum of up to 70% of the acquisition value of the target and remaining 30% of the acquisition value to be funded by the acquiring company in the form of equity using own funds

Few other notable changes

Other than the acquisition financing related provisions set out above, the RBI has also set out few key and notable revisions such as:

- Banks may provide finance for acquisition of shares of public sector undertakings (PSU) under a disinvestment programme approved by Government of India, including the secondary stage mandatory open offer wherever applicable, subject to the following:
 - the companies, including the promoters, to which bank finance is to be extended, should have adequate net worth and an excellent track record of servicing loans availed from the banking system;
 - there are no constraints for the pledgee to liquidate the shares, even during lock-in period that may be prescribed in respect of such disinvestments, in case of shortfall in margin requirements or default by the borrower; and
 - such exposures secured by the shares of the disinvested PSUs or any other shares, shall be reckoned as direct capital market exposure.
- Limits on lending by banks to individuals against shares have also been enhanced from INR 20 lakh (equivalent to approximately USD 22,500) to INR 1 crore (equivalent to approximately USD 112,500) per individual. Loan up to INR 25 lakh (equivalent to approximately USD 28,000) per individual may be granted by the bank for the purpose of acquisition of securities in secondary markets.
- The RBI has also removed the regulatory ceiling on lending against listed debt securities which was earlier at an amount of INR 20 lakh (equivalent to approximately USD 22,500). Now, the banks may fix their own prudential limits in terms of their policy for loans to individuals against listed debt securities.
- Loan to value (LTV) ratio for loans against shares is proposed to be increased to 60% from 50%, while LTV for debt mutual funds is proposed to be increased to 75% from the existing limit of 50%.
- The following revisions have also been prescribed with respect to initial public offering (IPO) / follow-on public offering (FPO) / employee stock option plan (ESOP) financing:
 - Banks have been allowed to grant loans to individuals for subscribing to shares under initial public offerings, follow-on public offers, or in an employee stock option plan. Under the Draft Directions, the RBI is proposing to increase the current limit of INR 10 lakh per individual to INR 25 lakh per individual.

- b. the loan amount shall not exceed 75% of the subscription value and borrowers will be required to contribute minimum cash margin of 25%.
- c. no loan, whether secured or unsecured, shall be granted by the bank to its own employees or employees' trust set up by the bank for purchasing its own securities under ESOPs / IPOs / FPOs or from the secondary market.
- d. lien shall be created on the shares to be allotted under the IPO / FPO / ESOP, and such shares shall be pledged to the bank upon allotment.

Conclusion

The Draft Directions signal a mindful shift and transformative leap in India's acquisition financing ecosystem. The proposed liberalisation increases funding options available to eligible acquirers who currently rely primarily on NBFCs, foreign portfolio investors, private credit funds and alternative investment funds funding for such acquisitions. The inclusion of banks as potential financing sources not only expands the avenues available to acquirers for securing acquisition funding but also fosters competitive pricing and enables borrowers to access capital at more cost-effective rates.

While the RBI has permitted acquisition financing, it has simultaneously adopted a cautious approach and to mitigate the high risks associated with capital market exposures, the RBI has proposed a set of safeguards and regulatory guardrails including prudential guidelines.

It appears from the Draft Directions that (i) the acquiring entity and target company should be in existence for at least 3 years prior to availing the acquisition financing from the banks; (ii) acquiring company is required to be a listed company and shall be profit making for last 3 years; (iii) the acquirer is required to be a company incorporated in India and seems to exclude LLPs, trusts, REITs and INVITs from its scope; (iv) the financing is only for acquisition of all or a controlling stake in the target company; (v) the acquiring entity cannot be related party of the target company and hence real estate investment trusts and infrastructure investment trusts seem to be excluded; (vi) capital market exposure prudential limits are still restrictive; (vii) acquisition by financial intermediaries such as mutual funds, AIFs and NBFCs cannot be funded by banks; (viii) such acquisition finance is to be fully secured by shares of the target company as primary security, thus significantly reducing the amount of relaxation and making the entire amendment too prescriptive and available only for select type of acquisitions.

To ensure consistent interpretation and effective implementation of the Draft Directions, the following clarifications and amendments will be required in other laws simultaneously to effectively use the provisions such as: (a) restriction on holding not more than 30% of the paid-up share capital of a company should be disappplied in case of enforcement of pledge by the bank or its trustee to recover the outstanding amounts under the acquisition finance loan provided by the bank and necessary amendments to be made in the Banking Regulation Act and RBI Master Circular on Loans and Advances in this regard; (b) it appears from the Draft Directions that assets of the target company can be provided as the collateral for acquisition financing, therefore necessary amendments will have to be made to the Companies Act, 2013 to allow such creation of collateral for securing such acquisition finance; and (c) it also appears that foreign owned and controlled companies (FOCCs) are currently not permitted to avail acquisition financing and an amendment will be required to be made under the extant Foreign Exchange Management regulations to permit such transactions.

It is important to note that with the easing of acquisition financing norms, the RBI has struck a thoughtful balance between liberalisation and prudential oversight. If implemented effectively, the proposed reforms could significantly reshape India's acquisition finance landscape—reflecting a forward-looking regulatory approach that not only aligns with current market dynamics but also anticipates the evolving needs of borrowers and lenders in a rapidly changing global financial environment. However, one may also argue that the RBI may have been overly cautious with its approach and there is scope for a less prescriptive approach and further liberalization.

We invite you to share your insights and comments on the Draft Directions. Please use the following link to submit your comments: <https://kcoit.filecloudonline.com/url/msezs4arvuq2ytmg>.

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